Lesson 1 – Introduction to Classification

1. Objective

This lesson explains the purpose of the classification system and how it impacts the premium of workers compensation insurance.

2. Introduction to Classification

The first step in determining the proper premium for a business is to identify the correct NCCI classification for the business. Each classification is represented by a four digit number and groups businesses together that share common exposures to hazards.

Each classification is assigned a rate (or loss cost) that is used to develop policy premium. The classification rate reflects the exposure to workplace injury common to similar employers. For example,

- Dairy Farms are grouped together using Code 0036 – Farm: Dairy
- Plumbers are grouped together using Code 5183 – Plumbing NOC

The rate is different for these two classes as the exposure to workplace injury is different.

Through the NCCI classification system, the cost of workers compensation premium is distributed fairly among similar businesses.

3. Introduction to Classification

In establishing a classification, the following criteria is considered:

- There must be a large enough group of employers so that a statistically credible rate can be produced.
- The businesses must be readily identifiable.
- Businesses within the group must have similar operations from one business to the next, resulting in similar exposures to hazards. The businesses must be “homogeneous.”
4. **Introduction to Classification**

If a classification system did not exist, and a single rate was used to determine the premium for all businesses, the premium charged to:

- High hazard businesses would be insufficient
- Low hazard businesses would be excessive

Insurance providers would be reluctant to write high hazard operations if the rate was not specifically developed to cover the cost of the risk.

5. **Introduction to Classification**

There are approximately 600 workers compensation classifications. The experience reported by insurance providers for each classification, in each state, is used in calculating the “manual rate” for that classification in that state.

6. **Introduction to Classification**

A classification applies to the business of the insured within the state of operation. A basic classification applies to all of the various job duties, occupations and operations performed by the business. There are exceptions to the all inclusiveness of a classification that are discussed later in this tutorial.

Why is the business classified rather than classifying individual job duties, occupations or operations within the business?

- While the benefits of workers compensation are paid to the injured worker, the coverage is for the protection of the insured (business).
- Workers compensation coverage also provides employers liability coverage, a coverage provided for the insured's liability.

7. **Introduction to Classification**

- By grouping employers by the nature of the business, each industry has the opportunity to control its own workers compensation costs through industrywide safety and loss prevention programs.
- Classification by individual occupation would require additional recordkeeping and auditing of payroll, causing an increase in administrative costs.
8. **Introduction to Classification**

Summary:

A classification system based upon the business of the employer recognizes that it is the employer that purchases and is provided the insurance protection.

This system also encourages industries to promote loss prevention. Effective loss prevention can impact the rate for the overall industry.

9. **Explanation of Classifications**

Classifications:

- Describe the business of the employer
- Are identified by a four-digit code number

**EXAMPLES:**

<table>
<thead>
<tr>
<th>Business</th>
<th>Classification</th>
<th>Code Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacture of a Product</td>
<td>Furniture Mfg. – Wood NOC*</td>
<td>2883</td>
</tr>
<tr>
<td>Construction or Erection</td>
<td>Carpentry NOC*</td>
<td>5403</td>
</tr>
<tr>
<td>A General Type or Character of Business</td>
<td>Hardware Store</td>
<td>8010</td>
</tr>
<tr>
<td>A Service</td>
<td>Beauty Parlor</td>
<td>9529</td>
</tr>
</tbody>
</table>

*NOC = Not Otherwise Classified*
10. Explanation of Classifications

Manuals for Classification:

The Basic Manual for Workers Compensation and Employers Liability Insurance lists all classifications alphabetically by title.

The Scopes Manual of Basic Manual Classifications provides a detailed narrative of each classification in numerical order. The Scopes Manual also includes:

- an alphabetical index
- a numerical index
- an industrial index

The industrial index groups classifications having similar characteristics into 132 main industrial groups called “schedules.”

11. Explanation of Classifications

What are “Standard Exceptions”?

- “Standard Exceptions” refer to special classifications established for those occupations common to many businesses.

- Employees within the definition of a standard exception classification are not included in a basic classification — unless the basic classification specifically includes those employees.

12. Explanation of Classifications

These occupations are common to so many businesses that special classifications have been established for them.

These "standard exceptions" cover:

<table>
<thead>
<tr>
<th>Classification</th>
<th>Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clerical or Drafting</td>
<td></td>
</tr>
<tr>
<td>• Office Employees</td>
<td>8810</td>
</tr>
<tr>
<td>• Telecommuter Employees</td>
<td>8871</td>
</tr>
<tr>
<td>Drivers, Chauffeurs and their Helpers</td>
<td>7380</td>
</tr>
<tr>
<td>Outside Salespersons, Collectors &amp; Messengers</td>
<td></td>
</tr>
<tr>
<td>• Automobile Salespersons</td>
<td>8742</td>
</tr>
<tr>
<td></td>
<td>8748</td>
</tr>
</tbody>
</table>
13. Explanation of Classifications

What are “General Inclusions”? General inclusions are certain operations performed by a business that would be eligible for their own classification, if the operations were conducted as a separate business.

General inclusion operations are not separately classified but are included within each basic classification. General inclusions are listed below:

- Restaurants, cafeterias and commissaries operated by the business for use by the business’ employees (exception – restaurants, cafeterias and commissaries operated by construction, erection, lumbering or mining operations are separately classified from the basic classification of the business)
- Manufacturing of containers such as boxes, bags, cans, cartons or packing cases by the employer for use in the employer’s operation
- Hospitals or medical facilities operated by the employer for use by its employees
- Maintenance or repair of the employer’s building, equipment, vehicles, etc., by the insured’s employees
- Printing or lithographing by the insured on its own products

14. Explanation of Classifications

What are “General Exclusions”? General exclusions are certain operations that involve hazards that are not included in a basic classification. Unlike General Inclusions, General Exclusions are separately classified unless the basic classification states the operation is specifically included.

General Exclusions include:

- aircraft operation—all operations of the flying and ground crews
- new construction or alterations
- stevedoring—including tallying and checking incidental to stevedoring
- sawmill operations
- employer-operated day care service
15. Steps to Determine the Proper Classification

To determine the classification for an employer that manufactures bathroom vanity tops made of cultured marble:

First - review classification pages of the Basic Manual. There are no entries for:

- “cultured marble”
- “bathroom vanity” or
- “vanity top”

Second - turn to the alphabetical index in the Scopes Manual. There are no references.

16. Steps to Determine the Proper Classification

Third - turn to the industrial index in the Scopes Manual. In searching through this index, possible industrial groups are selected.

Industrial Groups:

- BRICK, TILE AND MISCELLANEOUS EARTHENWARE
- CEMENT AND PLASTER
- CEMENT, PLASTER, AND CONCRETE PRODUCTS
- MASONRY AND PLASTERING
- STONE PRODUCTS—MISCELLANEOUS

Fourth—review the phraseologies under each possible industrial group. After searching, you find that “CEMENT, PLASTER, AND CONCRETE PRODUCTS” offers the best selection.
17. Steps to Determine the Proper Classification

Your search has been narrowed to:

Cement, Plaster and Concrete Products

<table>
<thead>
<tr>
<th>Code</th>
<th>Phraseology</th>
</tr>
</thead>
<tbody>
<tr>
<td>4038</td>
<td>Plaster form mfg.</td>
</tr>
<tr>
<td>4038</td>
<td>Plaster novelties mfg.</td>
</tr>
<tr>
<td>4036</td>
<td>Plaster or staff mixing &amp; drivers</td>
</tr>
<tr>
<td>4038</td>
<td>Plaster statuary or ornament mfg.</td>
</tr>
<tr>
<td>4036</td>
<td>Plasterboard or Plaster Block Mfg. &amp; drivers</td>
</tr>
<tr>
<td>4036</td>
<td>Staff or plaster mixing &amp; drivers</td>
</tr>
</tbody>
</table>

After reading the scope (detailed narrative) of Code 4036 – “Plasterboard or Plaster Block Mfg.”, you find the code refers to the manufacture of cultured marble such as bathroom vanity tops. The classification search is done.

18. Assignment of More than One Classification

Additional classifications are assigned to the policy of the insured under the following instances:

- The insured operates commonly-owned businesses and insures the businesses under a single policy. Each legal entity is classified based on the nature of the business
- The insured’s principal business is described by a basic classification that requires certain operations or employees to be separately rated
- The insured conducts one or more of the following operations:
  - construction or erection
  - farming
  - employee leasing
  - labor contracting
  - temporary labor services
  - mercantile business
19. Assignment of More than One Classification

Secondary Business Operations (not considered General Inclusions or General Exclusions)

An additional classification may apply to secondary operations not considered by the basic classification. To qualify for a secondary classification:

- The operation must be able to exist on its own should the principal business cease operations
- The operation must be physically separated from the principal operation so that employees are not exposed to the hazards of the secondary operation
- Proper payroll records for each operation must be maintained

20. Assignment of More than One Classification

Building or construction contractors often use various construction trades to complete a project.

Each distinct type of construction at a job site, such as plumbing, electrical, masonry, carpentry, may be classified separately if proper payroll records are maintained.

21. Classification Dynamics

Two important processes continuously update the classification process:

1. A classification rate is dynamic, changing as the losses and payrolls in the state change. Rates are generally developed using five years of state experience. Each year, a new year of experience data is blended into the five-year period and the oldest year is removed.

2. NCCI continually reviews the classification system to assure it accurately represents the changing environment of industries. New classifications are established to apply to emerging industries. Classifications representing dying industries are discontinued.
22. Classification Administration

NCCI administers an inspection program to confirm the correct classification for a business.

Most inspections involve an on-site visit to obtain first-hand information on the nature of the business. An Inspection Report is prepared, which lists:

- a description of the business operations, processes used, products made, etc
- a departmental breakdown listing which classifications apply to which employees

The insurance carrier or the business may request inspections. In addition, NCCI conducts inspections on a random basis to assure the proper application of its classification system.

23. Classification Summary

The classification system groups businesses with similar operations into the same classification. Grouping businesses with common exposures to hazards allows for the development of an appropriate rate for the classification.

The classification system is based on sound insurance principles. It recognizes the need for an adequate rate for the exposure insured.

The classification system:

- is easily administered
- is non-discriminatory
- is cost efficient
- promotes safety and loss prevention