Wealth Transfer Planning with Qualified Plans

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Qualified retirement plans are tax favored retirement vehicles that have no peer when it comes to wealth accumulation. They are the most efficient means of generating retirement income. They are also the most valuable asset that can be passed to heirs at death, since they retain their tax favored status at death. On the other hand, qualified retirement plans are the most heavily taxed asset at death. Wealth transfer planning with qualified plans therefore is focused on preservation of the qualified plan balance at death. Qualified retirement plans take many forms. The most widely utilized are pension plans, profit sharing plans, 401(k) plans, and individual retirement accounts. In this Article, I will focus on profit sharing plans, 401(k) plans, and Individual Retirement Accounts. I will refer to profit sharing plans, 401(k) plans and Individual Retirement Accounts collectively as "RPs" and Individual Retirement Accounts specifically as "IRAs." Although many of the rules that govern RPs apply to pension plans and other types of qualified plans, different considerations apply to pension plans and other types of qualified plans, unless, of course, one converts them to an RP.

Over the past decade we have seen an enormous growth in the value of assets held in RPs. It is not unusual to see cases where RPs constitute 30% - 40% or more of an individual's (or couple's) total net worth. Many individuals have accumulated enough other wealth so that they no longer need the retirement income from the RP, others do not need all the income that will be generated, and still others will die with a significant RP balance, since in most cases the RP balance will, even with the distributions that are required under current tax law, grow through age 84. This is because, in general, the portion of the RP account balance that must be distributed (after age 70 1/2) will not exceed 10% until age 84. If the account earns 10%, the RP plan balance will grow each year until, under the minimum distribution rules, the required annual distribution equals or exceeds 10%.

There are two major reasons why RPs function so well as wealth accumulators. The first is that contributions to RPs are tax deductible. The second, and most important, reason is that assets invested inside RPs grow tax free. The longer funds remain in the RPs (the "Wealth Accumulation Period") the greater the after tax income that the RPs will generate.

EXAMPLE 1

Assume a husband and wife (both age 60) with an RP account balance of $800,000 to which no further contributions are made. The RP investments grow at a pre-tax rate of 10% per year. If the couple waits 10 years and then withdraws all the money, and pays the tax (assume 40%), they will have $1,244,996 of after tax income. If they invest the amount withdrawn for another 10 years (on a taxable basis) they will have $2,229,599 at the end of the 20th year. If they leave the money in the IRA for 20 years, and then take out the money at the end of the 20th year, they will have $3,229,200 or 45% more, after tax money based upon identical investment returns. The RP money available to the couple, on an after tax basis, will be almost twice as much if the couple waits 20 years to withdraw the funds. If they wait 30 years to withdraw the money they will have $8,375,713, after tax, in the 30th year. This is more than double the $3,992,872 they would have if they withdrew the funds in the 10th year and invested the amount withdrawn (on a taxable basis) for another 20 years. Deferring the tax generates more after tax income. The excess will be greater at higher tax brackets, and less at lower tax brackets, but it is always greater.

There are, however, four factors that limit the Wealth Accumulation Period. First, the RP account owner may have need for the funds at retirement. Second, tax laws require that minimum distributions ("MDs") must be made annually beginning no later than April 15 of the year following the year in which the account owner reaches age 70 1/2 (the "Required Beginning Date" or "RBD") or within one year of the account owners death if he or she dies prior to the RBD. Third, the MD amount is based upon the age of the account owner and his or her designated beneficiary ("DB") on the RBD, or the age of the DB if the account owner dies before his or her RBD. The MD amount is the minimum amount that must withdraw each year. Distributions can always exceed this amount, but distributions can never be less than the MD amount. The MD amount is always less if an individual (or properly drafted trust) is named as the DB. Selection of the proper DB is essential to overall planning since the selection of the proper DB can maximize the Wealth Accumulation Period, however that process involves many considerations that are beyond the scope of this article. Since RPs are more valuable if the Wealth Accumulation Period can be extended, most planning involves planning to maximize the Wealth Accumulation Period by deferring the RBD and minimizing the MD by proper selection of the DB and the payout method selected once the account owner attains age 70 1/2. Fourth, RP accounts cannot be given away during the account owner's lifetime, and the value of the account is included in the account owner's estate at death. If the RP is included in the estate tax base at death, unless there are other assets with which to pay any estate tax attributable to the account balance, withdrawals must be made from the RP to make the estate tax payment within nine months of death. Since all withdrawals or distributions from qualified plans are subject to income tax, the withdrawals or distributions from the IRA to meet the estate tax liability are subject to income tax. Thus, when there are no other assets with which to pay the estate tax, the withdrawal amount must be sufficient to pay the estate tax and the income tax on the withdrawal. Assuming a 50% estate tax rate and a 40% income tax rate, you would have to withdraw between 63% (IRD deduction allocated to first distributions) and 83% (IRD deduction allocated to principal distributions only, which is the IRS position) of the account balance within 9 months of death just to pay the estate tax and income tax unless you have other assets with which to pay the 50% estate tax.

EXAMPLE 2

Assume the couple in the first example both die at age 70 (prior to age 70 1/2). Assume the account owner is the second to die and the estate of the second to die is the beneficiary of the IRA account. Assume further the couple has one child, age 35, the estate of the second to die is in the 50% estate tax bracket, and there is no liquidity with which to pay the estate tax. In this case, the child inherits the IRA from the estate of the second to die. The value of the IRA at the death of the second to die is $2,282,493. The estate tax that must be paid within 9 months of death is $1,141,247. The estate must withdraw $1,521,663 from the IRA account. $380,416 of the withdrawal amount is necessary to pay the income tax on the withdrawal, leaving $1,141,247 to pay the estate tax. The child inherits an IRA with a balance of $760,830. Under the MD rules, since the estate is the DB the child must withdraw this amount within one year of the account owners death, and pay an income tax on the withdrawal of $304,332, leaving the child with an inheritance of $456,498 that the child can invest only on a taxable basis. The child receives only 20% of the account value (80% is lost to taxes), and even as to that amount the child has lost the benefit of tax deferral.

EXAMPLE 3

Assume the same facts as in Example 2, except the child, rather than the estate, is properly designated as the recipient of the IRA account. The withdrawal that must be made within 9 months to satisfy the estate tax obligation (and the related income tax on the withdrawal) is the same ($1,521,622). However, since the child (and not the estate) is the DB, the child now inherits an IRA with an account balance of $760,831 (33% of the account balance at death). The $760,831 will continue to grow tax deferred, with annual MDs based upon the child's life expectancy. The child has inherited the power of deferral as to 33% of the account balance at the death of the account owner. We have already seen what the power of deferral can do for the original account owner, it can do the same for the child who inherits the IRA.

EXAMPLE 4

Assume the same facts as in Example 3, except that the couple is insured under a joint and survivor insurance policy for $1,141,247 that is owned by an irrevocable trust. The trust is structured so that the death benefit is not subject to estate or income tax at death. In this case the estate taxes are paid with the insurance proceeds. There is no need to withdraw any amount from the IRA to meet the estate tax obligation. As a result the child now inherits an IRA with an account balance of $2,282,493 (100% of the account balance at death). The entire account balance will continue to grow tax deferred, with annual

MDs based upon the child's life expectancy. The child has inherited the power of deferral as to 100% of the account balance.

Would you rather have $459,499 to invest on a taxable basis, $760,831 to invest on a tax deferred basis, or $2,282,493 to invest on a tax deferred basis? In the second example the $459,499 would grow to $3,743,654 at the time the child attained age 70. In the third example the $760,831 IRA account balance would grow to $4,849,078, and the value of the side fund in which the child's MDs are invested would be worth $6,680,008 at age 70. The total after tax amount available to the child at age 70 would be $9,580,455. In the fourth example, the $2,282,493 IRA account balance would grow to a $14,547,235, and the value of the side fund in which the child's MDs are invested would be worth $20,040,004, at age 70. The total after tax amount available to the child at age 70 would be $28,768,345 .

The same thought process applies even if the couple survives past the RBD. The matter is complicated somewhat by the fact that the account owner must choose an MD method at age 70 1/2, and the method chosen will have an impact on the Wealth Accumulation Period unless the spouse survives the account owner, inherits the IRA, elects to treat it as his or her own and names a new designated beneficiary. Nevertheless, in general, the RP account balance will continue to grow at least to the account owners age 84 assuming a 10% growth rate for plan assets at the estate tax and income tax issues must be planned for at the surviving spouse death. Planning to pass an RP account balance, intact, to heirs at the death of the survivor of a husband and wife (or a single individual) is by far the most advantageous planning that can be done.

IRAs are by far the most flexible of all RPs for estate planning purposes. Other RPs can be rolled over tax free to an IRA. A single IRA can be divided into two or more smaller IRAs, each with a different account balance and/or DB. The entire MD can be taken from one of the IRAs or from different IRAs in different amounts.

In summary, when it comes to estate planning for the account owners, there are a four general rules that one must follow to pass the RP account, and the related power of deferral, to heirs:

First: Plan for the period before and after age 70 1/2;

Second: Be certain that there is, at all times, an individual DB (or properly drafted trust) that is named on the account as the owner at the account owner's death and be sure that you understand why you have selected this particular DB.

Third: At age 70 1/2 select the MD method (there are five possible methods, the single life, recalculated single life, joint lives, joint lives - recalculated participant only, and joint lives - recalculated participant and spouse) that maximizes the Wealth Accumulation Period. Most often, for married couples and single individuals the method of choice is joint lives- recalculated participant only.

Fourth: Be certain that there are sufficient liquid assets (exclusive of the RP) to pay the estate tax liability at death of the owner (or at the death of the surviving spouse if the surviving spouse is the DB). Purchasing life insurance for this purpose is critical for any period where liquid assets (exclusive of the RP) are insufficient to pay the estate tax liability.

THE BABY BOOMERS' GREATEST RISKS

by: Marty Kawadler

Much has been written about marketing opportunities and the baby boomer generation. Changing demographics indicate much of the investment and insurance world will increasingly focus on baby boomers. To clearly understand the type of insurance products that will be needed by baby boomers, we must understand the greatest risks that they will face. The older baby boomers, with their children's college tuitions ending, will have significantly more discretionary income. A significant part of this discretionary income will be used to maximize 401K plans and to invest in other vehicles designed to supplement retirement investing, such as variable annuities, mutual funds and stocks. While many baby boomers have not adequately planned for retirement, many are counting on the extra dollars that will be available after having paid for the expense of college and the care of aging parents, both of which can significantly limit resources available for retirement savings.

For those boomers in their early 50's with the next ten to fifteen years being critical in building assets, their ability to work, maximize their 401K plans and other investments, become critically important in accumulating sufficient assets for retirement. The greatest threat to accumulating these assets is a disability.

The 1985 Disability Determination Study by the Society of Actuaries was the last major comprehensive study from which today's insurance agents and brokers get their information. From that study we have found that a professional or business owner (white collar) age 50 has more than a 39% chance of suffering a disability that will last at least 90 days before their 65th birthday. Furthermore, there is a 1 in 5 chance that the disability will last at least 5 years.

There are a significant number of Americans who suffer from a disability. From the U.S. Census Bureau's Survey of Income and Program Participation (SIPP) from 1994 - 1995, it is revealed that of people 15 years old and over, 23.5% have a disability that prevents them from working part or full time with more than half (12.1%) considered to be a severe disability. The Census Bureau defines severe as those disabilities that include significant functional or emotional limitations.

The most damaging impact of a disability is to experience loss of income. However, since most families today are dual income, most disabilities will not result in complete loss of income but rather in the inability to continually save for retirement. Accordingly, most long-term disabilities will prevent today's baby boomer from taking full advantage of the increased discretionary income and the opportunity to save adequately for retirement. For example, a person age 50 with $150,000 in retirement funds, investing $833 per month in their 401K, with all assets growing at 10%, will have over $1,000,000 at age 65. Should disability strike at age 50, and 401K contributions terminated, the same person will have about $668,000 at age 65 - a loss of over $345,000.

The insurance industry has responded with new policies designed to fully replace, dollar for dollar, retirement contributions. These policies will pay in the event of total disability and will be paid directly into a disabled worker's 401K plan or a trust vehicle. These policies are in addition to group insurance and/or personal supplemental disability policies. Some are non-cancelable and others guaranteed and/or conditionally renewable.

As the boomer approaches retirement, he or she will also approach the "gray area"; the diminished need for disability insurance to replace income or retirement contributions and the increased need to cover the financial impact of disability associated with (custodial) health care costs. At this stage, the function of disability coverage will evolve into providing funds for the costs associated with long-term health care.

Some boomers may decide for a limited time to maintain their personal (income protection) disability insurance and also purchase long term care coverage. However, in most cases, it would be advisable to purchase long term care coverage replacing the personal disability coverage when it is no longer needed. Why long term care coverage? The New England Journal of Medicine reported that of people turning age 65 in 1990, 43% will enter a nursing home at some point before they die. The Health Insurance Association of America in their guide to long term care insurance (1996) revealed that people aged 65 face a 40% lifetime risk of entering a nursing home and about 10% will stay there 5 years or longer.

Financial Planning News, in March, 1994 reported the following nursing home confinement periods and associated costs:

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Leading Causes	Length of Care	Total Cost if in a Private Room @ $158/day:	Semi-Private Room @ $112/day:
Alzheimer's	96 months	$455,040	$322,560
Cancer	36 months	$170,640	$120,960
Cardiac	16 months	$ 75,840	$ 53,760
Diabetes	48 months	$227,520	$161,280
Pulmonary	36 months	$170,640	$120,960
Stroke	21 months	$ 99,540	$ 70,560

Ten years from now, assuming a 4% inflation rate, the cost for Alzheimer's care will be $673,570!

Clearly, with the significant limitations of Medicaid requiring impoverishment and Medicare limiting coverage to partial benefits for 100 days (at best), the logical alternative for most people is to purchase long term care coverage.

The greatest threat to the aged baby boomer in retirement becomes paying for long term health care costs, out of pocket. The greatest risks facing the boomer are the impact of disability in the working years that will prevent sufficient accumulation of assets to fund the retirement years, and the disability associated with aging which can deplete needed retirement assets. The impact of disability both in the working years and in retirement can be equally as devastating and today's boomer needs to adequately plan for both contingencies.

Welcome New Members

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Have an i/ssue or comment?

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The Adviser

Massachusetts Society of Licensed Insurance Advisers

Editor - John Paul Sutrich Fall 1998

Upcoming Events

Wednesday, November 18, 1998
Speaker: Thomas L. Atkins JD,CPCU,ARM,CML
Topic: The Future of Risk Management

Wednesday, January, 1999
Speaker: To Be Determined
Location: Downtown Harvard Club

Note: Registration is at 11:30 a.m. Cost is $25.00 in advance and $30.00 at the door. For additional information and reservations, call the Insurance Library of Boston, 617-227-2087.

Intellectual Patent Infringement
What do you recommend to your clients?

by: John Paul Sutrich

Did you hear the story about the organization who's intellectual patent was being infringed upon? It's actually quite sad.

As the story goes, after years of hard work and the desire to arise above industry standards, a select group is granted authority to market their unique product. However, unbeknown to the organization, both individuals and companies were marketing and selling products containing the organizations exclusive authorized product. What makes the story even more discerning is the fact that the licensed product is being further diluted by the lesser quality of the unauthorized marketers.

As licensed advisors what course of action would you recommend to the infringed? Do they purchase insurance for this exposure? Is it even available? Do they try to prosecute each and every violator? Do they seek government invention? What other avenues would you recommend they pursue?

Well, whatever course of action you would recommend to this organization should be taken to heart. That's because the fact is that each and every member of MSLIA are the ones being infringed upon. That's right! The license you worked to obtain grants you the authority to provide insurance consulting for a fee. The Commonwealth recognizes the unique skills of Insurance Advisors and as such Massachusetts General Law (chapter 175 section 177) requires any person or firm who, in or on advertisements, cards, signs, circulars, letterhead, or elsewhere, or in any other manner by which public announcements are made, uses the title insurance adviser, insurance specialist, insurance counselor, insurance analyst, policyholders' counselor, or any similar title, word or combination of words to be licensed as an insurance adviser by the Commissioner of Insurance.

In an effort to qualify our position, the board is looking into offering our membership an MSLIA "approved" contract for the unique services of our profession. It's our hope that this will set a standard for the industry as well as for the insurance department.

The insurance industry's image is soiled enough. Let's keep our pond clean by regulating ourselves and enforcing the law. Otherwise, your fate maybe in the hands of some appointed government official.

As the saying goes, the fish rots from the head down.

Year, 2000 Endorsements Approved in Massachusetts

by: Irene Morrill, CPCU, CIC, ARM, LIA, CPIW

What does the future hold?
As the millennium approaches the insurance industry is gearing up to make a "manageable" transition. No one knows exactly how computers or computer chips that are date-sensitive will react to the change in century. If your client has equipment containing date-sensitive computer chips, will the equipment fail to work; will the malfunctioning equipment damage itself or other property; or, will there be resulting business income loss due to the failure of the equipment to work or due to the equipment being damaged? Will the environmental control systems work if run by computer or computer chip? Will injury to others or property damage result from failed equipment? There are a million questions as to what will happen, and no one knows the answer.

Is there currently coverage?
Is there any property coverage or business income coverage for equipment that fails to work or damages itself or other property as it fails? What about the people or property of others injured by failed or failing equipment, will there be liability protection? Will the liability exclusion of "expected or intended injury" or the fact that this is a "known event" preclude coverage under the CGL? A named peril property form does not recognize "Y2K - failure to recognize a date" as a named peril. Many believe that a Special Form policy will not provide coverage due to various property exclusions such as latent defect and mechanical breakdown. Insurance policies are generally written to cover "fortuitous" (accidental) losses. Some believe that the failure of the computer, chip or software to recognize a date is NOT an accidental situation and therefore no property or liability losses flowing from this "non-fortuitous" event should be addressed by insurance coverage. Others feel some losses resulting from the "computer failure" should be covered under the property and liability policies. Who is right???? How lucky do you feel today?

Indecision breeds fear . . . so let's "resolve" the issue!
Whenever there is indecision, there is ONE thing that we know will arise.., litigation. In an attempt to forestall millions of dollars of unanticipated claim payments and defense costs, ISO has filed a myriad of Y2K "computer failure" endorsements to attach to just about every policy currently written. There are Y2K endorsements designed for 1) Commercial Auto, 2) Garage, 3) Commercial Property, 4) Business Income, 5) Extra Expense, 6) Inland Marine forms, 7) Crime coverage forms, 8) Boiler and Machinery, 9) Farm, 10) Commercial General Liability, 11) Professional Liability, 12) and even HO policies that have business endorsements currently attached!

This article attempts to provide you with a short description of the possible endorsements created for the CGL and CP Coverage Parts. Should you have questions on any of the others, please call.

The Division of Insurance requests caution in attaching endorsements

The Massachusetts Insurance Department has issued an advisory notice stating that they will not allow any Y2K exclusionary endorsements for Personal Lines Coverage (including HO or DP policies with business endorsements); Commercial Auto; and Workers' Compensation.

The insurance department will allow other lines of insurance to be endorsed with Y2K exclusionary endorsements. The carrier must specify the lines of insurance to be addressed AND the specific types of insureds to which the carrier intends to attach the endorsement. The insurance department does NOT want to see blanket use of the Y2K exclusionary endorsements. The department wants to see some justification for usage of the Y2K endorsements.

The Property Y2K endorsements
IL 09 35 (8/98) Exclusion of Certain Computer-related losses
This endorsement is designed to be added to the Commercial Property Coverage Part, the Boiler and Machinery Coverage Part, the Commercial Crime Coverage Part, the Commercial Inland Marine Coverage Part and the Standard Property Policy.

This endorsement creates a new "peril/cause of loss" to be addressed and EXCLUDED. Some have considered a computer's or computer chip's failure to recognize a date such as the year 2000 to be a latent defect, mechanical breakdown, inherent vice or some other "known" — and excluded — cause of loss. This endorsement addresses this failure, malfunction or inadequacy of computers, software, networks, computer chips, etc., due to the inability to correctly recognize, process, distinguish, interpret or accept one or more dates or times.

Specifically classifying and then excluding this inability of certain types of equipment or software to recognize dates as a distinct situation should reduce litigation. Leaving the policies "as is" permits much litigation and argument. The endorsement excludes loss or damage caused directly or indirectly by this "situation".

The endorsement DOES guarantee coverage for a Covered Cause of Loss as described in the Boiler and Machinery, Crime, or Inland Marine Coverage parts; or the Standard Property Policy. These coverage parts or policies will still continue to pay the EXACT same types of loss scenarios EVEN if the loss was instigated by the computer or computer chip's inability to recognize a date. The carrier should NOT argue that a Y2K failure caused this normally covered cause of loss and therefore we don't have to pay. The client has essentially the same coverage as before the endorsement is added on. However, if the client suffers a loss that these coverage parts would NOT normally cover, oh well, it will probably be attributed to failure to recognize a date and excluded.

The endorsement also addresses how the Commercial Property Coverage Part (Coverage for buildings, contents, business income, etc.,) will respond to loss resulting from failure to recognize a date, i.e., "computer failure". The Special Form Cause of Loss will ONLY provide coverage for resulting "Specified Causes of Loss" or elevator collision resulting from mechanical breakdown. The "Specified Causes of Loss" are essentially — but NOT exactly — your "broad form" named perils. The "specified causes of loss" are fire, lightning, explosion, windstorm or hail, smoke, aircraft, vehicles, riot, vandalism, leakage from fire extinguishing equipment, sinkhole collapse, volcanic action, falling objects, weight of ice or snow, water damage. Unfortunately, you best read the definition of water damage under "specified causes of loss" — it is NOT the same coverage as under the Broad Form named perils or under usual Special Form coverage.

Some good news
If a computer system running equipment or computer chip fails to work causing excessive heat and a fire or explosion results, the resulting fire or explosion would be covered. If the elevator system suffers a "mechanical breakdown" due to the computer error, the resulting elevator crash damage would be covered.

Some bad news
However, if a computer chip fails to work causing the heating system to shut off, the resulting frozen pipes would NOT be covered if the insured has the Special Form. The "specified causes of loss" are NOT exactly the broad form perils. The "specified causes of loss" define water damage as "accidental discharge or leakage of water or steam as the direct result of the breaking or cracking of any part of a system or appliance containing water or steam". This does NOT necessarily provide frozen pipe coverage. (Yet, if your insured had the Broad Form Perils the IL 0935 says that resulting Covered Causes of Loss under the Cause of Loss - Broad Form WOULD be covered.) The Broad Form definition of water damage is MUCH BROADER than that of the "specified causes of loss". (Isn't it a bummer when an insured buys an "open peril" policy and receives LESS coverage than an insured who purchased a named peril policy? Make sure your E&O policy is paid up... and there are NO Y2K exclusions on it!)

If the computer error causes the elevator to just "not work", your insured will pay the repair bill. If the computer chip ONLY causes mechanical breakdown of your equipment, there will be NO coverage!

How will this endorsement affect the premium?

It won't. ISO contends that the failure to recognize date issue is NOT currently covered in the property policy and, therefore, no reduction in premium is necessary. ISO also feels that most failure to recognize date situations will NOT result in physical loss, and they are probably correct.

The corresponding BOP endorsement is BP 10 04 designed for the BOP Property Coverage form.

There might not be physical loss, but there certainly can be INDIRECT nonphysical losses!

If the computers fail or the equipment with imbedded microchips fail, there will CERTAINLY be resulting loss of business income and huge extra expenses incurred by our clients. If a "specified cause of loss" damages equipment and then a suspension of operations results, the client will have business income and extra expense coverage also (providing you sold it to them in the first place!). But, if the equipment just fails and is not damaged or a loss other than a "specified cause of loss" results, there will be NO coverage for the loss of business income or extra expenses incurred.

Optional endorsement for some Business income and Extra Expense coverage

CP 15 57 (8/98) Business Income and/or Extra Expense Coverage for Year 2000 Computer-Related and Other Electronic Problems is an endorsement that your carriers might offer to your clients. It provides a $25,000 limit that can be used for loss of business income and/or extra expenses incurred due to "computer failure". "Computer failure" is the inability of the computer, microchip, software, etc., to recognize a date.

The good news of this Business Income/Extra Expense endorsement Physical damage to property is NOT REQUIRED!!!!! (Normally, direct physical damage to described premises is required before BII or EE is paid.) Suspension of operations is ALSO not required. We pay your loss of Business Income or Extra Expense due to "computer failure" at the premises DESCRIBED in the schedule or at ANOTHER location if the off-premises computer interfaces with a computer at the DESCRIBED location. (As you know, Extra Expense payments are determined by the type of Business Income form sold. Business Income provides broader Extra Expense options than the Business Income form without Extra Expense.)

The bad news of this Business Income Endorsement
There is NO coverage due to the failure of power or other utility service caused by "computer failure" whether your client purchased the Utility Services - Time Element endorsement or not! Coverage is provided for a MAXIMUM of 30 days. The endorsement limit is $25,000 with no ISO option for additional coverage.

The corresponding BOP form is BP 04 58 designed for the BOP Property Coverage Form.

The CGL Y2K options . . . Get ready, there are quite a few
The CG 21 60 (9/98) Exclusion - Year 2000 Computer Related and

C)ther Electronic Problems (this is referred to as Option #1 in the CGL manual Rule 54)

For those of you who generally assume that most losses occurring on the premises or during the course of operations are covered, think again! This endorsement EXCLUDES ALL "bodily injury "property damage" "personal injury" or "advertising injury" arising DIRECTLY or INDIRECTLY out of" computer failure" (the inability of the computer, chip or software to recognize a date). ALL of the ISO endorsements define the issue EXACTLY the same way. There is no premises, no operations, no products, no advice, NO NOTHING!!!! This is a TOTAL exclusion for all claims that arise from the "computer failure" issue. The fact that the endorsement not only excludes situations DIRECTLY resulting from the computer failure but INDIRECTLY resulting from the computer failure could preclude losses where employee error or management error is also concerned. Both the damage to property of others as well as the corresponding loss of use will be excluded.

This is NOT a user friendly endorsement. As agents we DON'T want to see our carriers utilizing this endorsement. The corresponding BOP endorsement is BP 10 05.

CG 21 62 (9/98) Exclusion -Year 2000 Computer-related and Other Electronic Problems - with Exception for Bodily Injury On Your Premises (this is referred to as Option #4 in the CGL manual Rule 54) This endorsement intended for the CGL is identical to CG 21 60 EXCEPT the last paragraph. This endorsement excludes ALL BI, PD, PI, Al arising from the computer error EXCEPT ... "this exclusion does NOT apply to "bodily injury" occurring on ANY premises owned by or rented to you." If the Y2K failure results in BI to others, the policy WILL respond. All of the OTHER exclusions still apply. I'd much rather have THIS endorsement attached to my client's policies than CG 21 60, wouldn't you???? The BOP equivalent is BP 10 07.

CG 21 61(4/98) Exclusion - Year 2000 Computer-Related And Other Electronic Problems - Products and Completed Operations. (this is referred to as Option #2 in the CGL manual Rule 54)
This endorsement identifies the "computer failure" issue but ONLY excludes "bodily injury" or "property damage" arising out of the "products-completed operations hazard". This means that all BI and PD arising out of the insured's operations or on the insured's premises will be covered (to the extent the normal policy exclusions such as pollution and PD to property in their care, custody and control, etc., do not apply). The client will ALSO have coverage for "personal injury" or "advertising injury" that might occur due to the "computer failure" issue. This endorsement is better than the other two, so far, don't you think? The BOP equivalent is BP 10 06.

CG 04 31(9/98) Year 2000 Computer-Related and Other Electronic Problems - Limited Coverage Options. (this is referred to as Option #3 in the CGL manual Rule 54)This endorsement is designed for risks other than traditional computer companies. This endorsement would be used INSTEAD of any of the above. It lets the carrier and client cover the "computer failure" exposure to mutual satisfaction (more or less!). It's a "design a coverage" endorsement. The endorsement identifies the "computer failure" issue and excludes any BI, PD, PI or AI arising directly or indirectly from it just as the first OVERALL exclusionary endorsement did (the CG 21 60).

This endorsement permits the insured to "schedule" (buyback) certain coverages that could give rise to claims due to the "computer failure" This overall exclusion does NOT apply to any of the types of injury or damages specified on the endorsement schedule. The endorsement allows the client to purchase coverage for BI, PD, PI and AI - or ANY combination of these coverages. The client must check off in Schedule A whether they want BI, PD, AI, PI

Then in Schedule B on the endorsement, the client must specify EXACT location(s), operation(s), product(s) or service(s) to be covered. Everything is EXCLUDED unless mentioned on this endorsement. If they forget to mention a location or an operation or a product or service ... oh well, no coverage due to "computer failure". The endorsement is "A" rated!

This will be a MAJOR can of E&O worms for the agent. I guess that I would want to say "any and all locations, products, services and operations" or something comprehensive like that! But, will the carrier allow that??? The agent had better be prepared to negotiate both price and coverage. The BOP counterpart is BP 04 64

CG 21 63 (9/9 8) Year 2000 Computer-Related And Other Electronic Problems - Exclusion of Specified Coverages for Designated Locations, Operations, Products or Services.(this is referred to as option 5 in the CGL manual Rule 54) This is the LAST "computer failure" option endorsement designed for the CGL ... thank goodness!!!!! Like the CG 0431 it is a "schedule" endorsement but this time EVERYTHING emanating from a "computer failure" is COVERED unless EXCLUDED. I like this option BETTER than the CG 0431. If NOT specifically mentioned, there is coverage. This endorsement has a Schedule A mentioning BI, PD, PI and AI. If NOTHING is checked off, then ALL normal policy coverages apply. This endorsement also has a Schedule B where the insured or carrier must list the location(s), operation(s), product(s) or service(s) to be excluded. If no items are listed than the policy applies to all locations, operations, products or services. This is a type of "laser-out" coverage endorsement. If you don't specifically mention something, then the policy applies as normal. This would be a SAFER endorsement for the agent AND for the client than the CG 04 31. The BOP equivalent is BP 10 08. This endorsement is "A" rated.

What if the insured only buys a Products and Completed Operations Coverage Part?

Yes, ISO has designed special exclusionary endorsements to meet the language of a "products" or "completed operations" only policy. If you refer to the CCL manual Rule 54, each of the options identify if there is a "special" endorsement designed just for the Products and Completed Operations Coverage Part.

I'm exhausted are you???

Be careful of your clients coverage and YOUR E&O. You SHOULD address the issue of Y2K with your clients. It is NOT just a computer problem. They must also consider the microcomputer chips in their equipment. Will the equipment just "fail to work" when the year 2000 comes due to the inability of the computer or computer chip to recognize the date? Will this failure to recognize the date cause damage to the equipment and other property — both owned and non-owned. Will people be injured? Will personal injury suits arise? Will the products your clients sell malfunction and cause injury to others? How will this "computer failure" affect their ability to conduct normal business operations? How much loss of income will they suffer? The Y2K is ONE BIG IF!

You should warn them to have their computers checked for Y2K compliance. You should also tell them to contact the manufacturers of any equipment that might contain a computer chip to find out if the chip is "date sensitive" and, if it is, is it Y2K compliant? They should address the issue BEFORE 12/31/99!!!

Then, once your carriers have decided how to implement the various Y2K endorsements, as an agent you MUST find out WHICH endorsements your carriers intend to utilize. Certain coverage buy back endorsements might not be offered to all your risks. For the good of your clients and your E&O carrier, you MUST find out what your carriers intend to do, and then notify your clients. If you think they don't understand Ordinance or Law coverage, explaining this will be a LOT of fun, I'm sure!!! (I'll be routing for you!)

I can't stand the thought of identifying another endorsement right now. Call if you have a question. We'll finish this monster at a later date!

We welcome your thoughts, comments and suggestions on this dynamic issue. Send them to the editor c/o the
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