New Physician's Guide to Personal Finance

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To the consternation of young physicians, the general public perception is that all medical practitioners are wealthy, which may be the reason why we hear so much grumbling over the cost of health care. What is largely lost on the public is that the vast majority of physicians begin their careers deep in a hole both in terms of money and time. It is difficult for the average person to fully gauge, let alone appreciate the monetary and time commitment that goes into preparing for the profession. Even before they confront the lifelong challenge of building wealth from a medical practice, new physicians are lined up well behind the starting line:

- As a result of their extended educations, they enter the workforce much later leaving them with fewer productive years.
- Entering practice with an average school-related debt of $170,000, they must commit a higher portion of their income from their least productive years to debt.
- This often leads to delaying the start of families which pushes the need for college savings into a critical period for accumulating retirement capital.
- The focus on debt-repayment often results in restricting career opportunities to safer but lower paying jobs.
- The ongoing demands of continuing education and practice development precludes many practitioners from being able to allocate sufficient time to acquire the most essential knowledge and skills for managing both their personal and business finances.

Certainly, new physicians have much better prospects for earning a high income than most people; however the initial delay and expense of launching their careers puts them at a distinct disadvantage in their efforts to build wealth. So, unless they quickly grasp the financial implications of these early challenges, even high-earning physicians can run into financial difficulties.

Young medical professionals are particularly disadvantaged when it comes to acquiring the essential financial knowledge they need to plan and manage their finances. Most are so deeply engrossed in the advancing their careers and pursuing the expanding body of knowledge required to keep on top of their professions they have little time to even think about their financial future, let alone plan for it.

This report was developed especially for new or soon-to-be medical practitioners to help them navigate the early stages of their personal financial life. With the proper foundation and focus on personal finance issues, new practitioners stand a much better chance of overcoming the obstacles that have prevented many physicians from achieving true financial independence.

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Section I:
Managing Your Personal Finances

Medical residents are universally lauded for their mastery of “delayed gratification,” and no one can fault them for wanting to play catch-up once the money starts rolling in. But, the transition from medical student to MD is laden with some unique financial challenges that, without the tools to confront them, could postpone life’s ultimate gratification (retirement) well into the future. Beginning a career ten or twelve years late with six figures of debt can place an enormous burden on new physicians who aren’t prepared to manage their finances with their future in mind.

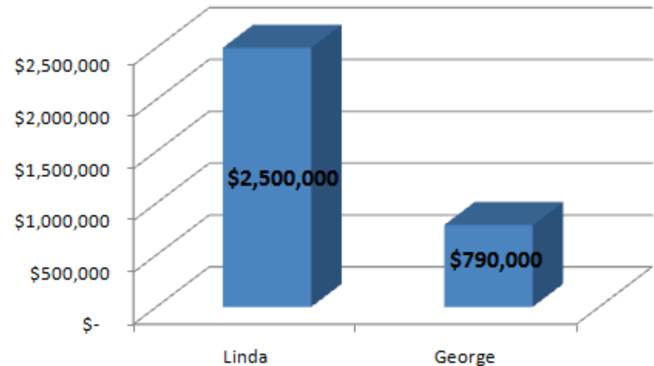
Caught between the temptations to step up their lifestyles and to quickly pay down their debt, new physicians can find themselves running out of paycheck without any consideration for savings. But then, they’re only at the beginning of their income potential and there will always be time for savings, right? Wrong. The most powerful resource we all have for building wealth is time. You really don’t have control over how much money you will make, but you do have control over how much time you have to save what you do make. The more time you have, the more opportunity you have to build wealth.

The “cost of waiting” is best illustrated with an example of two young physicians who choose two different timeframes for their savings program.

Linda invests $20,000 per year from age 25 to 45, and then stops contributing to her investments.

George doesn’t invest from age 25 to 45, but then invests $20,000 per year from age 45 to 65.

Assuming an investment return of 6%, by age 65, Linda would have $2,500,000, whereas George would only have $790,000!



To accumulate the same amount of capital as Linda, George would have to invest $60,000 a year. His cost of waiting is the extra $800,000 he will have to invest to make up for lost time, and that doesn’t factor in the added cost of inflation and taxation over that period of time.

The takeaway from this is that new physicians already have to make up for lost time, so there is much less time to waste. It is, therefore, vitally important to save early and save often.

Defining Your Ambition for a Good Life

A common mistake that many new physicians make when their earnings increase is, instead of increasing their savings by the amount of increase, or at least a proportionate amount, they add their pay increase to their lifestyle. Typically, people who don’t have a “purpose” for the next dollars they earn will likely give into the cultural tendency towards “more is better” with the expectation that it will make them happier to make relative improvements to their lifestyle. The reality is that the happiness of consumption is fleeting and does little to improve a person’s sense of overall well-being.

A good-life narrative is not built from having more money; rather, it’s from knowing how much money

is needed to produce the situations that result in a good life. That requires having clarity in your beliefs and values, but more importantly, it needs to be placed in a context that clearly addresses the question, "but for the sake of what?" What is it that you believe, value and care for – these are the primary elements at the heart of a good life that differentiate it from a philosophy of "more." If you don't understand what it is you're after, you can't put any kind of math to the plan. For a good life today, money can produce certain situations. But a good life today isn't enough as you need to be able to develop a strategy for living a good life for the rest of your life.

The Late Reality Check

After years of endless study and enduring 15-hour shifts, the transition from intern to full-time MD seemed like a blur to newly-minted obstetrician, Dr. Kyle Wilson, whose income more than tripled to $225,000 almost overnight. After relocating to Orlando, Florida to join a private practice, Dr. Wilson immediately engaged one of the top realtors in the area to find him a house to buy. He had saved up $30,000 for a down payment and he set his parameters based on what he thought he could comfortably afford – a $300,000 mortgage with monthly payments of $2,000.

The realtor, who typically works with affluent home buyers in the million dollar market, convinced the young doctor to go upscale because it would be a better investment. He would "live among other professionals and enjoy the country club lifestyle that he richly deserves." He rationalized the bigger mortgage and $4,500 monthly payment with his expectation of higher earnings in the near future. With 25 percent of his income going towards housing, Dr. Wilson had little available for savings.

While his income did increase over the years, so did his lifestyle, and so did his tax bite. Now at the age of 47, with a family of 4, he is still contributing far less than 5 percent of his income to his retirement plan. Realizing that he will have to continue working until at least until age 65, and that he will need to contribute at least 30 percent of his income towards retirement going forward, Dr. Wilson is forced to make some difficult lifestyle choices.

As a new physician, the time for a reality check is now, before you become enslaved to debt or lifestyle. It is, therefore, important to envision your professional life cycle in stages, and plan for each one. By planning around your professional life cycle, you can avoid the issues and pitfalls faced by those who simply react to the evolving circumstances.

Personal Finances through the Professional Life Cycle

Early Stage

Typically, a new medical practice is marked by high expectations, high debt and marginal cash flow. The challenge for new practitioners is to build their cash flow sufficiently in order to pay down their debt quickly or risk impeding the growth of their practice.

Physicians in the early stage of their practice are usually in the early stage of their family life as well. Marriage, kids, and a new home become priorities that compete for the cash flow generated from the practice, leaving other, long-term goals, such as retirement, on the back burner. What many physicians eventually realize, albeit much too late, is the missed opportunity for early contributions to their

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qualified retirement plan, which costs them tens of thousands of dollars over the course of their retirement fund accumulation phase. (See the example of Linda and George above).

Mid-Stage

After five to ten years, the physician is steadily rising up the income ladder. While student loan debt may be getting under control, it is at this stage that a fledgling practitioner begins to take on personal debt in the form of a mortgage or new car loans. At this point, their cash flow is sufficient to be able to make maximum contributions to their qualified retirement plan; however, they are playing catch up, and even maximum contributions won't be enough to fund a timely retirement.

Still mired in a long work week, most mid-stage physicians have neither the time nor inclination to properly study their personal financial situation to know the predicament they are creating for themselves. Meanwhile, the retirement time horizon continues to grow shorter.

Late Stage

In the late stage of their practices, physicians are generating maximum cash flow and their debt is well under control if not eliminated all together. They have educated their children and are living in an empty nest of a large home in a desirable area. They have been making maximum contributions to their retirement plan for some time, and they have built up other assets, such as investment property and securities portfolios. The issue at this stage is whether they are achieving the maximum tax efficiency in their overall retirement plan. Their retirement plan won't be sufficient to generate an adequate income, so they scramble to pull together other investment assets to augment their retirement plan. Up against a shrinking time horizon, they sometimes find themselves taking more risk than they care to tolerate.

Retirement Stage

For most physicians, their peak earning years are those just prior to retirement. This significant cash flow, combined with lower debt obligations and family expenses, means they can retire comfortably. The real question becomes whether that retirement comes earlier or later than anticipated.

For a physician, retirement (or semi-retirement) is more about having the option to work or not. With active minds, physicians sometimes choose to work part-time in practice or education, or to be involved in charitable work. At this stage, physicians are also spending more time with their families and enjoying their grand-children. With an increasing awareness of their own mortality, the retired physician starts to consider his or legacy to family and society at large.

We all know that change is inevitable, so we are left with two choices: react to change while it is happening to us, or plan for change and capitalize on the opportunities. The difference lies in the planning you do now.

What's Your Vision of Your Professional Life Cycle?

Take moment to visualize your professional life cycle. Where will you be in terms of your debt, your cash flow, your retirement plan contributions, your family life and obligations, and your lifestyle. Understanding the demands and requirements at each stage will help you to make wiser choices from the very beginning.

Early Stage

Lifestyle:
Rent or own; car – new or used; leisure activities, etc.? ______________________

Financial situation:
budget; debt payment; savings goal? ______________________

Retirement plan:
max contributions? ______________________

Family obligations? ______________________

Professional goals? ______________________

Mid Stage

Lifestyle:
Rent or own; car – new or used; leisure activities, etc.? ______________________

Financial situation:
budget; debt payment; savings goal? ______________________

Retirement plan:
max contributions? ______________________

Family obligations? ______________________

Professional goals? ______________________

Late Stage

Lifestyle:
Rent or own; car – new or used; leisure activities, etc.? ______________________

Financial situation:
budget; debt payment; savings goal? ______________________

Retirement plan:
max contributions? ______________________

Family obligations? ______________________

Professional goals? ______________________

Retirement Stage

Lifestyle:
Rent or own; car – new or used; leisure activities, etc.? ______________________

Financial situation:
budget; debt payment; savings goal? ______________________

Retirement plan:
max contributions? ______________________

Family obligations? ______________________

Professional goals? ______________________

Budgeting for Prosperity

Once you understand your own ambition for a good life, now and in the future, you can begin mapping out a course to get there and then apply the math that will help you make the right decisions today. And it begins with prioritizing your spending and adhering to a strict budget. And, don't let the "budget" word put you off. Most people think of a budget as a constraint and an annoyance, but the real purpose of a budget is to enhance your financial freedom, both now and in the future. To that end, a budget is your most important financial planning tool.

The big mistake most people make is to prioritize their spending around their expenses – first their essential expenses (rent/mortgage, debt, food, transportation, insurance and utilities), and then their variable expenses (entertainment, clothing, dining out, household items, misc). If anything is leftover, they might apply to savings.

Generally, when savings is treated as an afterthought or a leftover, it usually doesn't materialize. Instead, establish a savings goal first, be it 10 percent or 20 percent of your income, and lop that off the top of your budget. That will happen automatically when you enroll in your employer's

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401k plan. But, if you don't have access to a 401k plan or the contribution limit is below your monthly savings goal, you need to account for the difference at the top of your budget.

But you have other savings goals besides retirement. Your most immediate savings goal should be to accumulate an emergency fund equivalent to six months worth of living expenses. Beyond that, your savings can be applied to longer term goals, such as a car or home purchase. Whatever the goal or the timeline, by paying yourself first, you will then be forced to prioritize your spending based on your remaining income.

Next, you should create some spending guidelines for the rest of your budget. The guidelines are meant to keep you on track, so they should be reasonable for your desired lifestyle while allowing you to adhere to your savings plan. Spending guidelines will vary from one person to the next based on their needs as well as the actual cost of living in the city or region they reside.

As an example, the spending guidelines for an attending physician who earns $150,000 and who lives in an east coast city might look something like the scenario that is laid out on the right column of this page of the report.

Essential Expenses	Annual Expense	% of income
Taxes	$ 35,000	23%
401k /Savings	$ 30,000	20%
Housing	$ 20,000	13%
Debt payments	$ 16,000	11%
Food	$ 9,000	6%
Transportation	$ 6,000	4%
Utilities	$ 5,000	3%
Insurance	$ 7,000	5%
Professional Development	$ 3,000	2%
Total Essential Expenses	$ 131,000	87%
Non-Essential Expenses	Annual Expense	% of income
Entertainment	$ 4,500	3%
Dining out	$ 2,500	2%
Clothing	$ 2,500	2%
Household needs	$ 2,500	2%
Misc	$ 7,000	5%
Total Non-Essential Expenses	$ 19,000	13%
Total Expenses	**$150,000**	**100%**

** Percentages are rounded*

This physician has set up her spending guidelines to meet her savings goals while paying down her debt. She has managed to create a surplus of $32,000 ($17,000 into 403(b) / $10,000 into savings accounts / $2,000 applied to additional spend-down of student loan principal balance) that can be applied to debt payments, savings, or both, with enough left over for an occasional splurge. If additional essential expenses arise, such as child care, she would have to adjust non-essential spending first and then essential spending to cover the expense. She should do everything she can to avoid using any part of her savings allocation.

Now it's your turn. Using the example as a framework, try establishing spending guidelines around a savings goal and see how much surplus you can create that can be used to further your goals.

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Estimated Income: $____________________

Essential Expenses	Annual Expense	% of income
Taxes		
401k /Savings		
Housing		
Debt payments		
Food		
Transportation		
Utilities		
Insurance		
Total Essential Expenses		

Non-Essential Expenses		
Entertainment		
Dining out		
Clothing		
Household needs		
Misc		
Total Non-Essential Expenses		
Total Expenses		

**Divide the amount of expense by total income*

Your next step is to plan your budget over a 12 month period carrying your surpluses forward to see how much progress you can make in adding to your savings or paying down your debt. Once established, tracking your spending takes only a matter of minutes. Software programs such as Quicken or Mint.com, can automate much of your tracking by linking with your bank and credit card accounts. They can also automatically categorize your spending and project future cash flow.

Taking the time now to prioritize your spending and building the habit of prudent and diligent financial management will not only enable you to meet your goals on your time horizon, it will form the foundation for serious wealth accumulation as you enter your peak earning years.

Section II: Managing Your Benefits

For new physicians, their benefits program is a large component of their personal financial management. Even before they receive their first paycheck, they're provided with a booklet or package that outlines the various benefits offered through their employer. While the explanation of benefits may seem straightforward, the devil is in the details; and often times the decisions made at the outset can have long-term implications for future planning. So, for new physicians who quickly become absorbed in their profession, having a clear understanding of how the various benefits work in the context of their personal financial situation is essential from the very start.

Your Health Benefits

Medical employers understand better than most the importance of a comprehensive health benefits program. Most benefit programs are all-inclusive, meaning they contain the key coverages that concern your health, including health insurance, dental and vision care, disability income insurance and life insurance. All of these are provided on a group basis which means they are generally less expensive than individual coverage, and there is typically automatic acceptance into the plan. In many cases, you are given some choices within each of the plans that affect both the cost and the type of coverage you will have.

Health Insurance Plans

Most people participate in a managed health care plan offered through employers that come in the form of a Health Maintenance Organization (HMO),

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or a Preferred Provider Organization (PPO) both of which provide complete coverage for medical care. The advantage of managed care organizations is that they offer a high level of service at a low cost to the insured.

Health Maintenance Organizations (HMO): Through an HMO, a network of medical services is formed from which covered individuals can choose for specific medical needs. First, a primary care physician (PCP) is selected. In addition to providing regular medical services, the PCP is the point person for coordinating any specialized medical care. Visits to an urologist or an orthopedist have to be arranged through a referral from your PCP. Any care provided by a specialist who is not in the HMO network will most likely result in charges not covered by the plan. This does not include visits to the emergency room which must be covered by the HMO.

Due to the fact that an HMO is able to dictate the list of providers, it can better control its costs through negotiated rates for medical services. These cost savings are passed on to the insured in the form of lower premiums. Typically HMO plans cover most types of medical care, including preventive and they require minimal deductibles with higher annual caps.

Preferred Provider Organizations (PPO): PPOs offer the insured much more in the way of selection than an HMO. While there still may be prescribed network of doctors and hospitals, it tends to include a much wider selection and there are less restrictions on using out-of-network providers. PPO premiums tend to be higher than HMOs primarily because the PPO doesn't negotiate rates with all of the listed providers. So, the co-payments tend to be higher, especially if a provider is used that is not within the network. One of the key differences between the HMO and the PPO is in the flexibility of arranging visits with specialists as PPOs do not require that a PCP referral be given.

Health Savings Accounts (HSA): HSAs are a health plan alternative that provides individuals with a much more "consumer- oriented" approach to dictating how much they spend on health care thus lowering their overall health care expenditures. An HSA is an account, much like an IRA, which allows for tax deductible contributions. The funds are also allowed to accumulate on a tax deferred basis. Annual contributions of up to $2,600 may be made by individuals ($5,150 for families). The funds from an HSA can be used to pay for all eligible medical expenses including health insurance premiums. Unused HSA funds can be rolled over into the next year.

In order to qualify as an HSA under the tax code, it must be combined with a high deductible health insurance plan (HDHP) which, typically, carries a high deductible upwards of $5,000. Because of the high deductible, HDHP premiums are usually very low. The deductible expense can be paid from HSA funds as well.

HSAs established through employers are eligible to receive employer contributions. If an employee leaves an employer, the HSA can follow and be used to cover medical expenses with or without an HDHP. If the funds are used for anything other than medical expenses, the withdrawals may be subject to a 10% IRS penalty.

Group Disability Plans

Most medical organizations and employers offer group disability plans which can be less expensive than individual policies, but with more limitations than individual disability plans. For new physicians, group disability plans are a good, low cost solution for protecting their income potential; however they should be aware of the limitations especially as their income increases.

- Group disability plans offered through medical groups and associations include an "own occupation" definition of disability which means that benefits become payable when you can't are unable to perform the duties of your own occupation in the event of a disability. However, the language is sometimes ambiguous, allowing for a more restrictive interpretation of the definition that requires a "total" disability in order to receive benefits. It is important to carefully review the definition of disability offered in a group plan to know precisely how you are protected.

- Group disability plans premiums are much lower than individual disability insurance plans and are typically paid for or subsidized by the medical group.

- The maximum monthly benefit amount that can be purchased is typically capped at $5,000 or $6,000, and will not exceed 60 percent of your income at the time of disability. Benefits received are fully taxable.

- Group plans are generally not portable, meaning that, if you leave your employer, your coverage doesn't follow you.

- Most group plans are not guaranteed renewable, or non-cancellable, which means the premium or coverage can change at any time.

Unquestionably, group disability plans are a great option for new physicians on a tight budget; but as your earnings grow or the opportunity to move on arises, it would be important to consider making an individually designed, non-cancellable, guaranteed renewable disability insurance plan the foundation of your income protection. The best time to purchase an individual disability plan is when you're young and healthy in order to lock in the lowest possible premium.

Group Term Life Insurance

For many people group term life insurance forms the foundation of their insurance protection. Most employer plans offer basic term life coverage, typically $50,000, paid for by the employer with the opportunity to add supplemental coverage at intervals equal to your salary. So, if is available, you can purchase additional term life coverage at 1X, 2X or 3X your salary. Unless your employer offers portable term life supplemental coverage, you will not be able to take your group life insurance coverage with you should you leave your employer. As with disability income protection, new physicians should consider purchasing individual life insurance coverage when they are young and healthy in order to lock in the lowest possible premiums. Group life insurance can still be a valuable supplement for an individual life insurance plan.

Group Dental Plans

Group dental plans generally come in one of three flavors - PPO-style, HMO-style and Preventative-style – each providing varying levels of coverage at varying levels of out-of-pocket costs.

Dental Preferred Provider Organization (DPPO): These plans generally offer a broader list of participating dentists with lower out-of-pocket expenses for in-network services. All preventative, basic and major services are covered with no deductibles and claims are submitted by your dentist so there is little or no paperwork on your part.

Dental Managed Care (DHMO): These plans are similar to DPPO plans except that you choose from a list of participating network dentists and specialists. DHMO plans cover all preventative care and most basic and major care services, but they

usually require a co-payment in order to keep premium costs lower.

Preventative Plans: These plans allow you to visit any dentist of your choosing; however the claims process differs in that the dentist files a claim with the insurer for reimbursement and then submits a bill to you for uncovered charges. All preventative services are covered 100 percent, while most basic services are covered at 50 percent.

401(k) Retirement Plans

Most private practices and medical groups offer 401k retirement plans. These are defined contribution plans which allow employees to contribute pre-tax earnings into a tax deferred savings account. The 2013 contribution limit is $17,500. Most employers will match your contribution up to a certain amount. A typical employer match might be 100 percent of your contribution up to 3 percent of your earnings. For example, an employee earning $100,000 who contributes $10,000 to his 401k would earn a $3,000 employer match. That's equivalent to an automatic 30 percent return on your investment!

Creating Your Asset Allocation

With most 401k plans you have the choice of several different investment funds, ranging from stock accounts of varying types to bond accounts to fixed interest accounts. When allocating funds among the different accounts, it's important to maintain a long-term perspective and invest for growth. Over 30 years of investing you will have to contend with inflation and then, eventually taxes, so it is important to earn rates of return that can at least compensate for both.

There is a general rule for allocating among stocks and bonds that may be a good place to start for novice investors and that is to subtract your age from 100 and make that your stock allocation. So, if you are 30 years old your stock allocation would be 70 percent and your bond allocation 30 percent. Then, depending on your comfort level, investment experience and your investment objective, you can adjust the allocation accordingly.

To mitigate your risk and reduce market volatility, you should diversify more broadly among different types of stock and bond funds. For instance, apportioning funds among an international fund, a blue chip stock fund and a more aggressive stock fund can generate positive returns over time with less volatility than if you invest in just a single fund.

The most important thing is to start contributing early (at least up to the employer match) and then increase your contribution level as your income allows.

Should You Roll Your 403b Plan into Your 401k Plan?

This question often comes up for new physicians who left a non-profit hospital or medical organization after contributing to a 403b retirement plan. A 403b plan is similar to a 401k plan except that is offered through 501(c)3 organizations. The tax code does allow for rolling a 403b plan into a 401k plan, however, there is no one correct answer as to whether you should. Your biggest consideration should be the plan's performance and fees. If the 403b plan is performing well for you and the plan fees are less expensive than your 401k plan, then you might as well keep it in place. Conversely, if your 401k plan has better investment choices and is performing better, it would make sense to combine your retirement funds into one plan.

Benefits and Insurance Coverage through the Professional Life Cycle

Understanding your benefits is a critical part of managing your personal finances, especially as your

earnings and family obligations increase. At some point, between the early and mid stages of your professional life cycle, the benefits provided through your employer may no longer be adequate to meet your increasing needs. This is especially true with group disability and life insurance plans which aren't portable (in the event you leave your employer) and are limited in their coverage. You'll also reach a point early on when you reach your maximum contribution level for your retirement plan, and will need to explore ways to augment your retirement savings through an investment strategy.

Just as you need to map out a vision for your personal finances through your professional life cycle, now is the ideal time to do the same with your benefits and insurance coverage.

You Don't Have to Go it Alone

The biggest mistake new physicians make is to try to go it alone in managing their personal finances. The body of knowledge and competencies required to develop and implement a comprehensive financial plan integrating multiple disciplines that address both personal and business needs is as extensive as any that any physician must be able to acquire in his or her own field. In fact, it is far beyond the capacity of any one professional advisor, which is why the most qualified and client-centric advisors insist on a "team approach" to developing and implementing a comprehensive financial plan for physicians. Nothing short of a well-coordinated, collaborative effort by a team of professionals from the legal, insurance, investment, estate, business and tax will provide the scale of planning and advice successful physicians need.

You Need a Coach

Anyone who is attempting to achieve a level of performance beyond their current experience needs a coach. The most successful business people and athletes recognize that there is huge chasm that separates theory from practice, a plan from action, and activity from results. And, as is the wont of human nature, it often takes an external source of energy to compel us beyond our comfort level, and that's what a coach does.

A good financial advisor is also a "life coach" helping you to navigate all aspects of your financial life and put all of the pieces of your financial puzzle together. They have access to the expertise and resources to help you manage your finances holistically taking into account your needs and objectives in the areas of taxes, insurance, debt management, estate planning and lifestyle planning. If you are going to take the important step of working with a financial advisor, you shouldn't settle for an investment sales person. Find yourself and authentic, objective and independent financial advisor who places your interests first.

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Joe Capone is a dedicated advisor who works with individuals, families and business owners to help them build and protect their wealth. Joe utilizes a process which integrates a wide range of financial strategies that organizes his clients' financial world, integrating individual strategies into a consolidated, comprehensive plan. This process ensures that planning is completed with the goal of maximizing wealth and with the ultimate purpose of helping clients realize their goals, hopes and dreams.

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Jonathan Rogg has no conflicts of interest or financial disclosures to report.

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