

Planning for Retirement

Advance preparation can make the transition smoother for physicians.

BY MICHAEL P. HATCH, CFP, JD

Over the course of their careers, physicians have differing thoughts about retirement, ranging from “I’ll never retire. I want to expire in my office” to “I can’t wait to hang it up, so I can spend my time (fill in the blank).” This disparity reflects a variety of personal circumstances, including the organization of their practices, their level of interest in activities outside their professional life, and the decade or more of education and training they completed to achieve competence and expertise in eye care.

The financial market’s recent volatility and the decline in real estate values can discourage almost anyone from attempting to achieve the financial security they desire. Actually, now is an especially important time for you to focus on four primary issues in order to build your financial independence, including practice/business organization, asset protection, realistic retirement projections, and, of course, investment planning.

PRACTICE STRUCTURE

Essential to building your financial independence is having an adequate structure in place to continue, sell, or otherwise plan for the disposition of your practice down the road. If set up properly, the value of your business could become a significant portion of the asset base needed to achieve financial security. In his seminal work on entrepreneurship, the *E-Myth Revisited*, Michael Gerber noted that most small business founders (including many physicians) are frequently so busy working in their business that they forget to spend adequate time and attention working on their business.

If you work for a larger organization with well-established procedures in place for leaving the practice, then simply ensuring that you have a good grasp of the details may be all that is required. If, however, you work solo or in a group practice that does not have formal plans in place for exit/retirement from the business, then setting up the appropriate structure is critical to your financial independence. For solo practitioners, will

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the practice support bringing on a junior physician to train/mentor so that, eventually, you can sell the business to someone who knows it well? If not, are there other physicians in your vicinity to whom you could talk about establishing reciprocal purchase/sale agreements? Without such plans, you may have to close your practice, sell its assets, and achieve little real value. If you have partners, have you talked through the timing of when/how you would like to retire and set up definite means to achieve those objectives? Are your partners all the same age, and will they likely want to step down at the same time as you? In the event you are disabled long term or die prematurely, you want to have a plan for the take-over of your practice, the provision of services/continuity to your patients, and the extraction of the value of your practice for your family. Of course, this presupposes that you have a transferable practice that someone would want to take over.

A lack of clarity in the business model and related financial measurements can limit a practice’s value to another physician. Many doctors see only one source of income from their practice: their personal income derived from their work in the business. This is earned income from labor. There should also be a reward, however, for ownership, which encompasses the time, money, risk, and aggravation of renting space, hiring employees, and tying up capital. An attractive and potentially salable practice needs a clearly delineated business model that includes rewards for both labor and ownership.

A BRIEF SUMMARY OF THE TYPES OF QUALIFIED RETIREMENT PLANS AVAILABLE

Defined Benefit Plan

The purpose is to provide a specified retirement benefit. Employers bear the investment risk.

Defined Contribution Plan

The purpose is to set aside funds to the individual accounts of participants based on an established contribution formula. Employers are generally committed only to making annual contributions.

Money Purchase Pension Plan

A defined contribution plan under which the employer's contributions are made annually and based on a set percentage of the employee's compensation.

Profit Sharing Plan

A defined contribution plan under which the employer's contributions are based on profits or income. The employer is not necessarily obligated to fund each year, but contributions must be recurring and substantial.

Target Benefit Plan

A cross between a defined benefit and a money purchase pension plan. The employer's contributions are based on a target benefit formula established at the plan's inception, and employees bear all investment risk.

Section 412(e)(3) Plan. Fully Insured Plan

This type of defined benefit pension plan is funded entirely by annuity or insurance contracts.

Section 401(k) Plan

A defined contribution plan that allows employees or self-employed individuals to make elective deferrals to the plan. Employers may make matching contributions.

Individual 401(k) Plan

An individual 401(k) plan permits a business owner without eligible employees to create and operate a 401(k) plan solely for his or her own benefit (or for a spouse's).

Keogh Plan

Any qualified retirement plan maintained by a self-employed person or partnership. Keogh plans may be defined benefit or defined contribution plans.

Note: Two types of plans technically are not qualified retirement plans but are alternatives to formal qualified retirement plans. They include a simplified employee pension (SEP) plan and a SIMPLE retirement plan. These plans generally do not have the same asset protection benefits as the other plans mentioned herein.

ASSET PROTECTION

Aspects of asset protection to help limit your financial or legal exposure should be incorporated into nearly every business decision you make, from your choice of business entity structure to how you hold title to assets, your estate plan, employee-related matters, your choice of retirement plans, and insurance protection. While this topic is broad, setting up a qualified retirement plan for your business can provide not only a method of saving money on a pretax basis (an attractive benefit for employees) but also powerful asset protection benefits. That is because most retirement plan assets are generally exempt from creditors' claims, thus ensuring those funds are not exposed. (For the purposes of comparison and review, see *A Brief Summary of the Types of Qualified Retirement Plans Available*.)

Choosing a plan that is right for your practice involves comparing costs, the amounts that can be saved, and your employee base that will need to be covered. A good place to start is to consider how much you personally are willing to save in these retirement plans as well as how much it will cost you to cover the required contributions for your employees. A standard comparison is to start with a 401(k) arrangement and to evaluate if the \$22,000 that you yourself can put away in such a plan (for 2009) as an employee salary deferral, plus your employer contribution, meets your needs. Note, this is considered the employee salary deferral contribution and is only \$22,000 for those over age 50. If under age 50, the maximum employee contribution amount is \$16,500. The employer's contribution will generally be at least 3% of all covered payroll to ensure that your plan is safe-harbored (ie, exempt from most governmental testing requirements by making a minimum contribution to all employees). Because this amount can be as high as 25% of covered payroll, you will likely be able to set aside at least \$30,000 to \$35,000 per year or more (\$49,000 is the maximum for 2009) in an account that is pretax and (nearly) exempt from the claims of potential creditors. Before choosing such a plan, consult your accountant, financial advisor, and pension actuary.

RETIREMENT PLANNING

If the idea of retiring is completely contrary to your thinking, recast the issue as one of financial independence or a point at which work is optional. To help define what your long-term retirement goals are, keep in mind your hopes, dreams, and fears associated with answering questions such as

- What would I do if I didn't come to work every day?
- How will I derive my monthly income?
- How can I ensure that my patients, employees, and firm reputation will be maintained in an appropriate manner?

After identifying your goals, put them in writing (either

TABLE. THE GREATER IMPORTANCE OF SAVINGS OF VERSUS RETURNS ON CAPITAL

Year	Annual Savings, \$	Interest Rate	Earnings, \$	Year-End Value, \$
1	25,000	5.00%	1,250	26,250
2	25,000	5.00%	1,313	52,563
3	25,000	5.00%	2,628	80,191
4	25,000	5.00%	4,010	109,200
5	25,000	5.00%	5,460	139,660
6	25,000	5.00%	6,983	171,643
7	25,000	5.00%	8,582	205,225
8	25,000	5.00%	10,261	240,487
9	25,000	5.00%	12,024	277,511
10	25,000	5.00%	13,876	316,386
Total Savings	250,000			

Note: A hypothetical investment earns 5% over a 10-year period. The amount saved (\$250,000) represents 79% of the total ending value. Saving capital is paramount to accumulating the most on your money in the short-to-medium term. Even with a 9% hypothetical return, the capital saved would still be 65% of the value after 10 years.

in a spreadsheet or using formal financial planning software) in order to establish a realistic time frame for meeting these objectives. Compare your expected sources of income (social security, pensions, investment income, etc.) against your need for income for the rest of your life. On the income side of the projection, be conservative on your assumed returns (use single-digit numbers!). On the expense side, include the rising cost of living due to inflation and the effects of costs that have a finite term (eg, a mortgage) or that may begin later in life (eg, medical costs). Rules of thumb are often inadequate for expressing a person's need for retirement income. Suggestions that you will only need 80% of your preretirement salary are simple averages and may not apply to your situation. Lastly, do not underestimate your longevity. When making projections, use a life expectancy of no less than age 90 (the author typically uses age 95); this is especially important if you are married.

INVESTMENT PLANNING

With all the doom and gloom in the investment markets today, it is easy to dismiss the idea of having a sound, diversified portfolio. If the financial market's gyrations worry you, by all means, put your savings in a fixed account such as a CD or treasuries. Do not let the market's current volatility, however, prevent you from saving. At the risk of stating the obvious, over the short-to-medium term, the

return on your money is much less important than having put away the actual capital in the first place (Table). This is not to say that earning an appropriate return on your money longer term is unimportant. Compound interest is wonderful, but remember that declining financial markets do not mean it is pointless to save capital.

CONCLUSION

With the myriad issues that you face in running your practice, it is easy not to conduct periodic assessments of your overall goals and to overlook your need for long-term financial independence. It is important, however, to make the time to plan for your future. Then, you can continue working as long as it is rewarding—and hang up your ophthalmoscope for good when you are ready to pursue other dreams. □

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