Financial Focus for Young Physicians

First, build your foundation.

BY DAVID B. MANDELL, JD, MBA, AND H. MICHAEL LEWELLEN, CFP

As advisors to young physicians across the country, we are often asked what is the most important financial action to take in the first years of practice. Our answer is simple: build a solid foundation. The application of this concept is different for each physician and depends on where he or she is in his or her personal life (single, married, children). Ideally, the physician begins "building" before completing training. Establishing the right habits early in one's career is the key to securing a financial foundation.

Most young physicians' income will increase significantly when they begin to practice. Up to that point, they have typically lived paycheck to paycheck, and a jump in income by fivefold or more can make them a bit euphoric. Those with a "spend now and plan later" attitude will indulge and make large purchases. If they take this too far, these professionals will find themselves once again living paycheck to paycheck. Their attitude then becomes: "I'll address my financial plan once I make partner in a few years." Although some splurging is fine, we encourage our young clients to practice the right financial habits to shield what they have already built.

GREATEST ASSET: FUTURE VALUE OF INCOME

Many young doctors have little savings and large student loan debts. As such, it seems impossible that they have actually begun to build a financial foundation. In reality, however, they have a significant asset that needs protecting—the value of their future income.

Given the significant investment made to become a practicing physician, it should not be surprising that the value of one's future income is also significant. For example, let us say an ophthalmologist is offered a starting salary of $300,000, including benefits. Assuming this physician plans on practicing for 30 years (with 3.5% inflation), the present value of this annual income is $5,517,613, even if that physician never makes more than $300,000 per year, including inflation. Ultimately, new physicians must protect their ability to earn this income in the future.

PROTECTING FUTURE INCOME

For Physicians

Disability income insurance is necessary for new physicians, because they have not yet accumulated the savings to support themselves and their families in case they cannot work as a doctor in the future. When purchasing individual disability income insurance, physicians need to determine what their true need is, not how much insurance they can get. If monthly expenses are $3,000, but the doctor agrees to an insurance salesman's pitch to get $5,000 per month, the physician is overinsuring him- or herself. Although having more coverage than needed is not always wrong, controlling expenses in order to build a proper foundation is more important.

That said, physicians must make sure they are purchasing adequate coverage. The definition of *disability* should be occupation specific so that a physician cannot be forced to go back to work in another field. A residual or partial disability rider protects physicians' ability to work part time in their occupation if they suffer a partial disability Typically, there has to be an income loss of 20% or greater to qualify. Also, in the event of a long-term disability, having a cost-of-living rider as an inflationary protector is important.

Young doctors should beware what is available through their employer. More often than not, a hospital will provide group disability income insurance at no or minimum cost to the physician. The problem is that group insurance covers the masses, meaning the coverage is not occupation specific, has short benefit periods, does not have a partial or inflation protection rider, and can be cancelled at any time. While this is not the case with all hospitals, group insurance is generally inadequate for young physicians. Discounts connected to hospitals are often available and allow new physicians to purchase individual disability income insurance at a discount or with unisex rates. The unisex rate option is ideal and has the greatest benefit for female physicians.

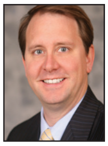
For Dependents

Young doctors with financial dependents (typically, children or spouses but sometimes other family members) need to protect their future income value not only against disability but also against death. As with disability income insurance, physicians need to determine their need from a death benefit perspective to be cost efficient. Their need includes expenses to be covered such as a mortgage, education funding for children, car loans, and other debts as well as income support for a spouse.

We recommend term insurance for young physicians, because it is inexpensive and provides a death benefit for a period of time (10, 20, 30 years). We are not suggesting that term insurance is the only or best type of insurance, but it is generally ideal for young physicians who have a specific need. If structured properly, permanent life insurance can be a tax-efficient savings vehicle that provides tax-free growth and distributions and can provide great asset protection, depending on the state of residence. For these reasons, young physicians often select permanent (cash value) insurance as a vehicle for wealth accumulation and protection.

CONCLUSION

At the outset of their medical careers, physicians in training are told, "First, do no harm." As advisors to young physicians nationwide who are at the outset of their financial careers, we recommend, "First, build your foundation." Purchasing disability income insurance and life insurance are the two key steps to establishing a sturdy base. ■



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