Chapter 8
Retirement: 401k, Roth IRAs, College Funds, and More

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Introduction

THE CASE TO BE MADE: Transitioning away from a surgical practice to retirement requires advanced planning and discussion with family, friends, peers, and professional advisors. It is well recognized that many general surgeons continue to practice beyond the customary retirement age of 65. The most common reason for a surgeon to continue practicing is a personal fulfillment in one's career. However, while

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some surgeons do not fully retire at age 65, many that remain in their practice will reduce their operative volume after age 60 [1]. Approximately 17% of practicing surgeons continue to operate after 70 years of age according to a 1994 survey. It is also important to remember that the average surgeon does not begin his or her career until the age of 31. This is 10 years after the average college graduate begins their career and an important consideration in planning for future retirement. Another consideration in continuing to practice may be the need or desire to continue one's income. In the following discussion, financial retirement preparation issues are addressed so that a surgeon is financially prepared for retirement whether or not he or she chooses to leave or reduce their operative volumes at or near retirement age.

ASSEMBLE AN ADVISORY TEAM: Albert Einstein, the German-born twentieth century theoretical physicist is quoted as saying "Out of clutter, find simplicity." Financial retirement preparation needs to be made simple, out of what may appear cluttered. We would add that to find simplicity in the clutter, a surgeon needs to be deliberate in his or her retirement preparation. The surgeon is best served if the deliberate preparation for retirement is best addressed and implemented early in a surgeon's career to provide flexibility in approaches and efficiency in asset accumulation. The preparation process can be referred to as "Financial Planning." Financial Planning requires analysis and implementation coordinating several areas of expertise, including legal, tax, insurance, retirement plan design, and investment advice. Because Financial Planning is a multifaceted approach, surgeons may want to develop a team of experts to guide him or her through one's clinical career. To coordinate these specialists, a primary advisor having a broad understanding of a surgeon's financial objectives is important. Primary advisors may be found with a plethora of backgrounds including, legal, accounting, tax, and financial planning. While an individual advisor's area of expertise has some bearing on the selection decision, of paramount importance is the individual's experience, coordinating capabilities, personality, and communication skills.

DETERMINE THE FINANCIAL TARGET: When fully or partially leaving the workforce, income replacement may come from one or more of four primary sources: (1) savings, including retirement accounts; (2) annuities; (3) permanent insurance policies; and, (4) social security benefits. While each of these sources has benefits and risk, a surgeon must initially estimate future financial goals. One obvious goal is an estimate of income needs of the surgeon when he or she retires. Additionally, future goals may include gifts and bequests to family and charity. To determine this amount, a practical way to describe these desires is to state the amounts in today's dollars, i.e., the present value of the goal. With the goal stated in today's dollars, the surgeon's Financial Planning team will need to address how many dollars it will take to accomplish the goal(s) at the future retirement date, taking into account inflation, taxes, and investment return estimates. The resulting analysis will be probabilistic rather than definitive. Therefore, the planning process needs to be updated periodically to assure the surgeon that the asset accumulation is on plan to meet the goal(s).

For the typical American, many financial analysts recommend a total savings sufficient for a 4% withdrawal rate of saving assets to produce 70% of one's annual salary. This withdrawal rate historically preserves asset value over time, assuming investments allocated in approximately 50% in stocks and 50% bonds. Using this calculation, a surgeon with a $200,000 annual salary should anticipate having a total savings of $5,000,000 at the start of retirement, which may be significantly more than what is needed. While analysts assume that a retiree will require 70% of preretirement income, the actual number may be considerably lower for high-income earners because expenses in retirement may be significantly reduced, i.e., mortgages paid off, life insurance premiums fully funded and children's education costs funded. The United States Department of Labor Lifetime Income Calculator (http://www.askebsa.dol.gov/lia/home) may be a useful tool, in addition to a surgeon's Financial Planning Team, to estimate monthly lifetime income based on the

individual's current account balance and projected value of that account balance at age 65, factoring in investment returns of 7% and inflation rates of 3% annually [2].

ATTAINING THE FINANCIAL TARGET: Albert Einstein is quoted as saying that, "Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't … pays it." In other words, a dollar efficiently saved today allows for compounded growth toward the financial resources to support financial retirement needs. For example, saving 10% of pre-tax income of $250,000 for 25 years compared to 20 years with a starting $0 account balance will yield a $315,661 greater total account balance, and a $1638 higher income per month (Fig. 8.1). When planning for retirement, establishing a plan to accumulate retirement assets is important to begin early in the surgeon's career. If not established early in a career, establishing a financial plan for retirement becomes even more critical if retirement goals are to be met.

The following accumulation methods have been organized into income benefits and asset accumulation benefits. While neither exhaustive nor detailed, it should provide a framework for a surgeon's understanding and communication with his or her Financial Planning Team.

	Scenario 1	Scenario 2	Difference
Retirement Age (years)	65	65	0
Current Account Balance ($)	0	0	0
Current Annual Contribution ($)	25,000	25,000	0
Age at Start of Savings (years)	45	40	**5**
Projected Account Balance ($)	815,262	1,130,923	**315,661**
Lifetime Income Per Month ($)	4,231	5,869	**1,638**

*Source- United States Department of Labor Lifetime Income Calculator

Fig. 8.1 Lifetime income calculations (asterisk)—a comparison of 5 years difference of savings

Income Benefits, Social Security: Social Security is the US national pension program for Americans who pay into the program while employed [3]. It will not cover all expenses while retired; rather, it should be used as a supplement. The calculation for an individual's benefit is complex and is based on the number of years worked and paid into Social Security and average national wage. Formulas are applied so that high-income earners will receive disproportionately less than low-income earners. The earliest age of eligibility is 62 years, at which time the individual will receive 70% of the full benefit amount. Full retirement age is 67 years in order to receive 100% of benefits. Each year of delaying benefits provides an 8% increase in income up to age 70 (124% of primary insurance amount). In addition, Social Security is taxable based on the benefit amount. A physician with a $250,000 annual salary may expect to receive $20,000–$40,000 in benefits annually. The Social Security Administration provides several online calculators that may assist with your financial planning, including the Retirement Calculator that estimates your monthly benefits based on your actual Social Security earnings record (https://www.ssa.gov/planners/benefitcalculators.html).

Income Benefits, Pension Plans: Pension plans are retirement accounts that are arranged and managed by the employer. While pension plans are "sister" retirement programs to contributory plans including 401 k, profit sharing plans, and simplified employee plans, pension plans are designed to provide retirement income whereas defined contribution plans are designed to provide a pre-tax savings vehicle providing an asset for retirement that will generate an unspecified and nonguaranteed amount of income However, a *defined-benefit*, including a cash balance pension plan, guarantees a certain payout amount at retirement according to a fixed formula, usually considering salary and the number of years of membership in the plan. It is important to recognize career opportunities that may have a lower pre-tax compensation with favorable pension plans, including state and federal retirement systems, as this may have a greater contribution to one's retirement income.

Income Benefits, Annuities: Annuities are another tax-deferred investment option which allows one to invest money and then select for payments to be withdrawn at a future date. The income can be distributed monthly, quarterly, annually, or in the form of a lump sum. A fixed annuity is one managed by an investment company and provides a guaranteed payout; whereas a variable annuity has a payout determined by the performance of the underlying investment and is managed by the individual. In addition, one can opt for a deferred annuity, in which money is invested for a period of time until one is ready for withdrawals (typically in retirement) or an immediate annuity, which allows for withdrawals shortly after making the initial investment. Annuities are purchased with after-tax dollars and have no contribution limits. They have commission and other fees which, in the aggregate, are higher than many other retirement investments.

Asset Accumulation, Savings Accounts: Investment portfolios should comprise both short-term and long-term investments. Short-term investments include savings, certificates of deposit, and short-term bonds; while long-term investments include longer term bonds, variable annuities, and stocks. Income during retirement may be divided in three main categories: taxable, tax-free, and tax-deferred. *Taxable income* includes those accounts outside of structured retirement savings plans, such as traditional savings accounts, stocks, mutual funds, and real estate. Taxable income does not offer a tax-benefit at any time to the individual. *Tax-free income* refers to funds that were invested with after-tax money and may be withdrawn at retirement age free of any additional taxation. Examples of tax-free investments include Roth Individual Retirement Accounts (IRAs), life insurance, and bonds. *Tax-deferred income* uses pre-tax funds, which may be withdrawn at retirement. However, all money withdrawn is taxed at the standard income tax rates. Examples of tax-deferred income include traditional IRAs, 401(k) and 403(b), 457 deferred compensation plans, and annuities. This offers the advantage of pre-tax payroll deduction, company

matching, and choices for investment. Experts recommend maximizing contributions into tax-free and tax-deferred accounts and then use taxable income accounts as a supplement to those investments. There are specific rules set out by the Internal Revenue Service regarding the distribution of retirement plans. If money is withdrawn from a retirement plan before the age of 59.5 years, there are considerable penalties. However, there are harsher penalties if the required amount is not withdrawn before 70.5 years as well. In addition, a beneficiary should be named to reduce tax implications at the time of one's death.

401(k), 403(b), and 457 Company Plans

The 401(k) plan, named for its respective section of the Internal Revenue Code, allows employees to invest a portion of their paycheck before taxes are taken out through payroll deductions [4]. In this example of tax-deferred income, the savings can multiply tax-free until retirement, at which point the entire withdrawal will be taxed as income. One of the major benefits of this plan is tax deduction; funds are pre-tax and are therefore tax deductible. This offers an attractive benefit for high-income earners to reduce annual taxes and potentially decrease their tax bracket. Although limits are set by the Internal Revenue Code, IRS regulations and the Department of Labor, the annual contribution limit at this writing is $17,500 in 2014, increasing to $18,000 in 2015 (with an additional $5500 in 2014 and $6000 in 2015 if the employee is age 50 or older). The funds contributed to the 401(k) are then invested with the 401(k) provider. Many employers will then match an employee's contribution. Employer contributions do not count against the individual contribution limits, but do count against the total 401(k) contribution limit-currently $52,000 in 2014. In using a 401(k) plan, it is important to identify one's savings goal; if the employer contributes 3%, the individual may need to increase his or her contribution to 12% to match a 15% goal.

Most financial analysts recommend increasing the individual's contribution to the employer match. A 403(b) plan is similar to a 401(k) plan except that 403(b) plan is only available to employees of tax-exempt organizations. A 457 plan is available to state and local public employees as well as some nonprofit organizations. It is also similar to the 401(k) and 403(b) plans but without a penalty for early withdrawals though one would still owe the income tax on the money withdrawn early [5].

Traditional IRA: A Traditional IRA is tax-deferred retirement savings account that comes in either a tax-deductible or tax-nondeductible form. A deductible IRA allows the investor to deduct the contributions on annual taxes, whereas a nondeductible IRA is funded with after-tax dollars. However, only those without an employer retirement plan or with an income less than $89,000 for a married couple or $56,000 for an individual can qualify for a deductible IRA. Amounts in your traditional IRA including earnings and gains are taxed at the time of distribution.

Roth IRAs

A Roth IRA is a popular example of tax-free income. Roth IRAs use after-tax funds to be placed in favorable retirement savings accounts, which can be withdrawn without tax after 5 years beginning at age 59½. For years 2013–2016, the maximum amount that can be contributed to a Roth IRA is $5500 for those age 49 and below, and $6500 for those age 50 and above. *However high-income earners may not be eligible*. For 2016, single filers earning up to $117,000 can qualify for a full contribution or up to $132,000 for a partial contribution. Married filers earning up to $184,000 qualify for a full contribution, or up to $194,000 for a partial contribution. Those who are married and filing separately can only contribute if the investing spouse's income is less than $10,000.

Life Insurance Retirement Plan

A Life Insurance Retirement Plan (LIRP) mimics many of the characteristics of a Roth IRA, without the income limitations, allowing high-income individuals to participate. The investor purchases a cash-value life insurance policy that is overfunded for at least 10 years. There are no contribution caps, but contributions into the policy are not tax deductible. Once the value of the deposits approaches the cash value of the policy, usually after approximately 15 years, tax-free loans or withdrawals can then be made from the policy to supplement retirement income. Death benefits paid to beneficiaries are also income tax-free. However, if the life insurance policy lapses, all distributions become immediately taxable. In addition, policies must be carefully structured, and the LIRP offers the greatest advantage to investors who have already maximized other tax-advantage retirement savings plans.

Investment Allocation, Long-term returns, short-term volatility, and implementation vehicles: To reach a surgeon's retirement goals, the Financial Planning Team should among other things, establish an investment allocation based on qualitative and quantitative measures. Qualitative considerations should include the surgeon's risk tolerance, i.e., acceptance of short-term depreciation for long-term appreciation. Quantitative measures analyze various investment assets for their risk, return, and correlation of these variables to one another.

Investment asset classes are groupings of various investments that have similarity in structure, volatility, and returns. Two of the asset classes typically utilized by surgeons are stocks and bonds. For this discussion, more specialized asset classes such as precious metals, private equity, real estate, and hedge funds are not summarized.

Stocks: A stock is an ownership share of a company. Money is made off of stocks when a stock goes up in value as more people are interested in purchasing it. The owner of the stock only makes money when the stock is then sold at a higher price than it was purchased. Companies may also issue

dividends, which are payouts to the stockholders reflecting the company's earnings. Historically, stocks have produced larger long-term gains than other asset classes, at an average of 9.8% per year since 1926, but they carry more short-term risk due to variability in the market. Stocks that are purchased outside of tax-free or tax-deferred retirement accounts are taxed annually. Dividends and any profits made on a sale of stock are taxed up to a rate of 15%.

Bonds: Investing in bonds is another method of securing income in retirement. In purchasing a bond, the investor is loaning out money to the issuer for a certain period of time. In return, the investor gets the loan back in addition to a fixed interest rate on the loan at the specified maturity date. Bonds provide some advantages in that they are generally more stable than stocks, they pay interest regularly, allowing for a predictable amount of income, and the income is tax-free on many lower-yield government bonds. However, bonds are subject to income loss should the issuer be unable to make its payment, and the fixed interest rate may not keep up with inflation across the time of maturation.

Mutual funds: Mutual funds are not, in themselves, an asset class. Rather, mutual funds are a pooling method of many thousands of investors with a common investment strategy. Mutual funds can invest in stocks, bonds, and other asset classes. The decision of what to buy or sell is determined by professional fund managers based on strategy outlined in the prospectus of the fund. The advantage of these funds is that they provide broader diversification for risk reduction in investing, with a lower management fee.

Exchange Traded Funds: While most mutual funds are actively managed, i.e., an investment manager selects the securities, a passive pooling fund that generally invests in indexes rather than selecting specific securities, is known as an exchange traded fund.

Conclusion: Retirement presents new and often underappreciated emotional, psychological, and financial hurdles.

Preparation by developing new interests and fulfilling hobbies is essential in retirement planning. But in addition to that, retirement requires careful financial planning to maintain an acceptable quality of life. An individual must consider their postretirement expenses and the use of multiple retirement savings plans to prepare. In addition to personal career fulfillment, prolonging the length of time until withdrawing retirement funds can have significant financial benefits, so the earlier you start the better off you will be. We strongly recommend consulting with professional financial experts throughout one's clinical practice to plan accordingly for your retirement needs.

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