Financial Planning When "Going Bare" – Friday Q&A Series

Q.

I come from a lower middle class family that made a total of less than 30k/year (combined income) and I am the first and only physician in my family. I'm currently finishing up fellowship in a surgical specialty and joining a group in Florida that has no malpractice insurance. I'm single without dependents, planning to rent, and will start as an employee. I accumulated ~250k in debt over my education, but have also been very lucky in the past year as I inherited my grandmother's house and sold it for $600k – I immediately paid off 150k of my high interest loans leaving me with 500k while finishing up fellowship. I'm emailing you now because I know I will be entering a high malpractice liability state with a significant net worth. I'm working with a financial advisor and lawyer, but would like your perspective. The going "bare" without malpractice insurance is somewhat freaking me out. I have never had anything, and all of a sudden I now have this stuff – and in the flip of a switch I feel like it could be taken away by a greedy lawyer.

So far, I've created a Limited Partnership (LP), a Limited Liability Company (LLC), and a wage account to help protect my assets. I've started getting wages put directly into the wage account. I'm in the process of transferring my cash into the LP bank account. I'm in the process of transferring my real estate investment into the LP name and my taxable investments into the LP. My understanding is that this will help protect my investments. Does this sound correct? Also, my financial adviser is pushing me into whole life insurance, which raised some red flags for me. Should that form a component of my plan?

A.

This email was three times this long, asking three times as many questions, but I've pared it down some to facilitate a discussion about the financial planning that should be done when "going bare." Going bare is a common practice in Florida, where the physician literally carries no liability insurance. He is required to have $100K per person/$300K total (for surgeons practicing in an outpatient surgical center it's $250K per person/$750K per year) in personal assets available to pay any malpractice liabilities. He can then place his other assets into asset protected vehicles so he can declare bankruptcy if the judgement is for more than $100K. The theory behind going bare is that you'll be sued less often because the possibility of a huge payout just doesn't exist, since it is theoretically limited to $100-250K. You're basically self-insuring that first $100K (along with the costs of the defense.) Since it costs an attorney about $100K to do a full malpractice suit, that's a huge disincentive to suing you. This post is not going to discuss whether going bare is a good idea or not, it is merely going to give you some things to think about from a financial planning and investing perspective once you've decided you wish to go bare.

Going bare would freak me out too. I'm not sure that it is a wise thing to do right out of training, if for no other reason than it's uncommon for a new residency graduate to have $100K-$750K in assets with which to pay a judgment(s) (although a line of credit probably isn't that hard to get). Given your inheritance, it might be a little easier for you. But I would be an expert in exactly what the plan is for when (not if) you are successfully sued.

Meet With An Asset Protection Attorney

My first stop would be to meet with a Florida asset protection attorney, and it sounds like you're already doing this. You're going to need to keep a certain amount of assets "exposed" (although a line of credit may suffice) to creditors to comply with Florida laws regarding going bare. It would be nice to be able to get a decent investment return off this huge sum of money. A reasonable portfolio of stock index funds and municipal bond funds would likely serve you well. You may also wish to take a look at this inexpensive book- The Asset Protection Guide For Florida Physicians. I haven't read it, but I've been told by a reader that's it's very useful.

Asset Protection Vehicles

Next, I would consider all the ways you can protect money from creditors in Florida. Florida is great in this respect. Their homestead exemption is essentially unlimited, meaning all the equity in your home is protected from creditors. Unlike in my state, where only $20K is protected, it makes more sense for a Florida doc (especially one going bare) to buy a little bit bigger home and pay down the mortgage instead of investing in a taxable account. Retirement accounts like 401Ks and IRAs are also completely protected from creditors in Florida. I would be maxing those out every year, including a backdoor Roth IRA. HSA law is a little less clear, but I suspect it would also be protected. Annuities and cash value life insurance are also protected from creditors in Florida. I certainly wouldn't invest in those instead of a more traditional retirement account (or paying down a mortgage), but I can understand why a physician going bare in Florida might choose the lower returns and higher costs of an insurance-based investing product over a taxable investing account, even inside an LP, in order to have better asset protection for the money.

LLCs, LPs, and Trusts

Other asset protection techniques should also be explored.

Residential real estate should definitely be inside of an LLC (one for each property.) I am less familiar with using a limited partnership to protect otherwise exposed assets, but I understand that in Florida the only remedy for a creditor to access funds in a limited partnership is a charging order. That means that while you don't have to give the assets to your creditor, you can't use them, since pulling them out of the partnership would subject them to the charging order. Some Florida asset protection attorneys also consider an asset protection trust (either foreign or "portable") to be a good option. Putting other assets (cars, boats, ATVs etc) into the name of a trusted spouse might also be a good idea.

A Wage Account

Wage accounts are another option used in Florida. "Florida Statutes Section 222.11 exempts from attachment or garnishment by a creditor 100% of the "earnings" of an individual who is "head of family" unless a person has agreed otherwise in writing. An additional requirement in order for the earnings to gain this exempt status is that the earnings must be "credited or deposited in any financial institution." If these requirements are met, the earnings will be "exempt from attachment or garnishment for 6 months after the earnings are received by the financial institution if the funds can be traced and properly identified as earnings." I don't believe you, as a single individual without dependents, actually qualify as a "head of family" under Florida Statute, so I doubt a wage account is doing you any good. I could be wrong; ask your attorney. Perhaps if you're supporting your parents or other family members you could qualify.

The other issue is the definition of earnings. If you own the business (not an issue for you while you're an employee) a court may feel that what you're calling earnings is really business profit, and thus not protected. Finally, this is really just a delay, since in 6 months the money is then subject to garnishment. You would then have to transfer it elsewhere, such as into a tenancy by the entireties account or a trust account, which brings in the whole "fraudulent transfers" question. Doing so after finding out you're being sued could be an issue.

Paying Off Loans A Great Option

Paying down a mortgage can be a great idea for a Florida doc going bare, but so can paying down his student loans. Student loans don't disappear in bankruptcy, so paying them down is just like paying into an asset-protected bank account. Paying down consumer debt like credit cards and car loans, of course, may not be as wise since those loans can disappear in bankruptcy. In fact, a case could probably be made for a low interest auto loan for a doc going bare. [Update prior to publication: It looks like the automobile you commute in is generally protected from creditors in Florida. So you should probably still pay cash for that, but I suppose you could make a case that maybe you could drive a little nicer car!]

You Need To Be Willing To Go Bankrupt

Bankruptcy isn't exactly fun, but when you decide to go bare you're agreeing to go bankrupt if the amount you're sued for is more than you're willing to pay. Bankruptcy affects your ability to get credit to buy a home, a car, or even a credit card. It also adds an additional "psychological failure" on to an already large malpractice "psychological failure." Remember that bankruptcy is part of the plan of going bare. If you don't like that, go buy some malpractice insurance.

Whole Life Is Not The Solution To All Of The World's Financial Problems

Cash value life insurance does have advantages, especially for a physician going bare. But many of its proponents feel it is a solution to all of the world's financial problems. It isn't, and I would be very wary of any financial adviser who brought it up at a first meeting, was overly enthusiastic about it, or was "pushing it." Get your asset protection advice from an attorney, and your financial advice from an unbiased fee-only adviser, not a whole life insurance salesman.

Going bare can be a good option (especially in a state with great asset protection possibilities like Florida) for physicians faced with high malpractice premiums. But careful financial, and especially asset protection, planning needs to be done early on.

What do you think? Have you gone bare? What steps did you take to protect assets? Any other techniques that are useful for Florida docs going bare? Comment below!