Raising Kids to be Financially Responsible at Every Stage of Life

The vocabulary of money and wealth, like any foreign language, is most easily acquired at an early age. But, thanks in large part to technology, today's children are anything but immersed in that language. It's a challenge. Parents often pay with credit cards, electronic funds transfer (EFT) or Apple Pay— kids don't actually see money changing hands.

The obstacles to promoting financial literacy are present at every age. Parents who do the best job of encouraging financial literacy work hard at it. Look for every opportunity to share advice with the expectation that children will one day be fiscally responsible young adults planning for their future and ultimately retirement. Adult children may be resistant to take advice from parents, but that doesn't mean you should overlook opportunities to share financial insight.

First lessons in budgeting for children

Whenever a child receives money, be it a gift, allowance or earned money, a suggestion to parents would be to encourage them to engage in a budgeting exercise in which they allocate their pay or the funds across three buckets:

- The SPEND Bucket contains a portion they can spend freely on whatever they want.
- The SAVE Bucket stores funds for a major purchase such as a new computer, a class trip or a downpayment on a car. This can be an excellent tool for teaching financial goal-setting and discipline for a responsible mindset well into adulthood.
- The PREPARE Bucket contains reserves for a long-term/emergency fund to cover unexpected costs that arise. This category is designed to prepare for "teenage emergencies" like a cracked iPhone screen or a trip to the auto shop after a fender-bender. Few Americans have enough set aside for even minor emergencies, and instilling this value early in life could prevent debt or a retirement cut short by lack of funds.

It can be difficult saying "no" to children or forcing them to use their own money for expenditures. This is especially true for affluent parents who can afford to be more generous. But being smart with money is a valuable lesson best learned early, regardless of present and future circumstances. These skills can help prepare a child for financial setbacks they may encounter later in life.

First lessons in "plastic": debit cards

Let's use an example of Kristi, a mother of four teenage children. She explains:

When each of my children turned 13 years old, I took them to the bank, opened joint checking accounts and got them a debit card. I've seen firsthand how paying with a debit card helps children begin to understand that when you pay for something with plastic, there has to be funds backing up the purchase. Each of my kids has learned to check their statements and online transaction records on a regular basis, which keeps them on top of their purchases and is also an important fraud-prevention practice to learn early. With four children 19 and under—and no overdrafts— I'm a firm believer in the benefits of kids taking responsibility early on.

Learning to navigate larger purchases

Kristi, the mother of four, has also seen firsthand how experience managing accounts helps children gain the perspective to deal with larger expenses. She relates a recent situation in which her oldest daughter, 19, needed to purchase a car after her 2002 car was rear-ended. The insurance company wrote off the damaged car as totaled, but unfortunately, the $2,300 check from the insurance company wouldn't cover the purchase of another car with similar features. Kristi notes that her daughter had learned early on to always "pay herself first" with earnings from her jobs. Therefore, she had savings to fall back on and was able to purchase a replacement car—on her own—with funds drawn from her savings in combination with the insurance company's payment. She even evaluated whether to take a small loan to help with the purchase, but she realized her savings account wasn't paying as much interest as the loan would charge and decided to simply apply her savings. She was thankful she'd made the provision to deal with exactly this type of situation.

The dangers—and importance—of credit cards

Once basic financial skills are acquired, credit cards are a convenient and effective way to teach financial discipline to teenage and college-age children. This may seem counterintuitive, as credit cards remove the tangible quality of money even more so than debit cards.

Parents should emphasize that credit cards offer convenience and not an unlimited source of funds to purchase items they can't afford. But they are also important learning tools, because managing credit wisely is essential as children reach adulthood. Establishing a positive credit history can serve well down the road.

Conversely, foolish purchases when young can mean difficulty securing a loan someday. A low credit score may delay the purchase of a home, new car or further education as an adult. Digging a credit "ditch" as a teen or young adult won't always eliminate the possibility of taking out a loan, but it will affect interest rates and may strain a young person's cash flows.

WHEN PLASTIC GETS PERILOUS

If a child isn't successfully internalizing lessons about credit cards and managing them well, here are some ways to tighten the focus.

» Discuss and agree on a monthly credit card limit, ideally maintaining a balance far lower than the card's maximum.

» Explain the consequences of exceeding the agreed upon limit and missing payments. Review interest rates, APR and how many months it would take to pay off different balance totals. You can find many user-friendly credit card interest calculators online.

» Share and review the statements together, even if you aren't paying the bill – this may help limit unnecessary purchases. Break down purchase categories to highlight spending habits.

Build on lessons learned with checking accounts and debit cards to ensure your child practices diligent account oversight in monitoring available funds and preventing fraud. Also, encourage children to check their credit scores periodically, and clarify for them what that number means and how it may affect their financial options in the future.

What about young adults?

After your children reach adulthood and are navigating their finances on their own, continue to seek out opportunities to model values. According to a Charles Schwab financial literacy study[1], 69% of young adults believe their parents are good financial role models and more than a third of respondents say their parents are their most trusted source for money advice. With this in mind, don't avoid educational conversations that might seem awkward.

The Schwab study also identified that the next generation is more optimistic about their financial future than past generations have been. On average, they expect to retire earlier than their parents did by learning to manage their money, budget and save enough for later stages of life. Seek opportunities to share from your own experiences as you find ways to share wisdom with adult children. Concepts you introduced years ago—from the SPEND / SAVE / PREPARE buckets onward—can continue to pay dividends.

Also, you may find hands-on ways to include adult children in family finances. For example, involving children in charitable giving as an ideal way to continue to foster financial awareness and family values. Donor Advised Funds (DAFs) offer a unique way to do that. Encourage your children to do research on different charity organizations and make suggestions for grants from the family's DAF. This helps pass on both philanthropic values and important financial lessons on stewarding and maintaining wealth.

"Stewarding" may be a big word for an eight-year-old just learning to budget, but it's the right attitude to take from childhood right on through adulthood. Throughout each phase, think about modeling values in addition to teaching skills. With that solid foundation, children can reap the benefits of a strong financial start throughout their entire lives.

[1]Young Adult Financial Literacy Study, Survey of 2,000 individuals aged 16-25, conducted by Logica Research, Published by Charles Schwab, 2018.

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