

12 Ways to Make Your Kids Financially Savvy

Ten years after I am dead and gone, I suspect only two people will give much thought to me, and their names are Henry and Hannah.

They're my legacy, so I hope they thrive -- and I sure hope they remember me fondly.

Henry and Hannah are, of course, my children, now ages 15 and 19, respectively. Like any parent, I spend a lot of time thinking about my kids, including how I can best help them financially.

This isn't simply about coughing up dollars and cents, though the sums involved have been frighteningly large. Rather, what it's really about is passing along values.

Yes, I want my kids to be financially successful. But mostly, I want them to be competent, contented managers of their own money, so they don't spend their lives agonizing over their finances and dogged by foolish mistakes.

I am not claiming to have the road map for every parent. We all have different values, different incomes and strong ideas about how best to raise children -- and you will likely scoff at some of the things I've done. With that caveat, here are a dozen ways I have endeavored to help my kids financially.

1. WAITING UNTIL LATER

If children are to grow up to be successful savers and investors, they need to learn two key skills: How to delay gratification and how to take risks prudently. The first is easily the most important.

Indeed, the self-control needed to delay gratification is associated not only with good saving habits, but also with things like succeeding in school and coping better with frustration and stress.

Yet this isn't an easy skill to teach. Henry and Hannah grew up spending their parents' cash, so they didn't have much incentive to curb their desires. My response? Make them feel like they're spending their own money.

One of my early tricks was the soda game, which I learned about from a reader. When my children were young and we went to restaurants, I would give them a choice: They could have a soda or they could have \$1.

Henry and Hannah ended up drinking a lot of water.

2. ASKING THEMSELVES

Emboldened by the soda game's success, I looked for other ways to apply the same notion. The breakthrough came when Hannah was 14 and Henry was 10. That was when I opened a savings account for each of them. The accounts came with a cash-machine card.

Every three months since then, I have deposited pocket money for them in their savings accounts and, as they have grown older, their clothing allowance as well. That way, they've had to learn to budget for a three-month period. More important, they no longer ask me for money.

Instead, if they want to buy something, they have to ask themselves. The effect has been startling. Henry and Hannah almost immediately became more careful spenders.

Sound manipulative? You'd better believe it. But I also think of it as financial self-defense. Suppose Henry and Hannah don't learn good money skills and grow up to be financial deadbeats. If they ended up deeply in debt, I can't imagine not helping -- at which point their financial problems would be mine.

3. TALKING THE TALK

I haven't just molded Henry and Hannah with financial incentives. I have also used family stories.

Values are passed down to our children in the stories we tell. My children may live in an affluent household in an affluent town. But I want them to know that their mother and I struggled financially, and that they will likely have their own struggles.

So I talk about the mouse- and cockroach-infested Brooklyn apartment where we all lived while their mother worked on her Ph.D. and we squeaked by on a junior reporter's salary. I tell them about the beaten-up '76 Camaro that used to stall if the traffic light stayed red too long. I recount taking them as toddlers to the "toy museum," otherwise known as FAO Schwarz, where we would play with the dolls and the trains but never buy.

Instead of regaling my children with these tales, I could simply lecture them about the virtues of thrift. But the stories pack far more punch.

4. SCOFFING AT WEALTH

I have also encouraged my kids to be suspicious of displays of opulence, whether it's the big house, the fancy car or the designer clothes. The fact is, this sort of spending doesn't lead to lasting happiness, but it can create a heap of financial stress.

In belittling conspicuous consumption, I may be a little too strident, but there's a reason. Henry and Hannah may have grown up hearing about the dilapidated Brooklyn apartment. But I grew up hearing a far more powerful story, about my maternal grandfather and his four

siblings, who in the 1940s each inherited what today would be millions of dollars. My grandfather's siblings quickly blew the money on fast cars and high living. My grandfather blew his money more slowly, on horses and cattle farming. Either way, the great family fortune was gone, and reckless spending was largely to blame.

5. COMPOUNDING FOR DECADES

When my children were young, I opened a variable annuity for each of them. This isn't a product I particularly like, because many have outrageously high annual expenses and charge back-end sales commissions if you sell within, say, the first seven years.

Still, there are a few no-load variable annuities with low annual expenses, notably the offerings from Fidelity Investments and Vanguard Group. Moreover, unlike with an individual retirement account, you don't need earned income to fund a variable annuity, so you can open an account for a toddler. Today, my kids' low-cost variable annuities are each worth some \$37,000.

I have long been captivated by the idea of starting Henry and Hannah on the road to retirement. Think about it: The dollars I invested when they were youngsters might enjoy six decades of tax-deferred compounding. That's enough to turn \$1 into over \$100, assuming an 8% annual return. And thanks to the tax penalty on early withdrawals, my children will be discouraged from touching the money before they are 59½.

6. GROWING FREE

There are far better investment vehicles than a variable annuity, and my chance came a few years ago. Hannah got a job at a local restaurant, which meant she had earned income. That allowed me to open a Roth individual retirement account for her, which will give Hannah tax-free growth.

Instead, I could have funded a regular IRA, where withdrawals are taxable but you get an initial tax deduction. That tax deduction, however, wouldn't have been worth much, given Hannah's low tax rate, so the Roth seemed like a better bet.

The money I've stashed in my kids' variable annuities and in Hannah's Roth IRA won't be nearly enough to pay for their retirement, especially once you figure in inflation. But fully funding their retirement was never my aim. Rather, the accounts are intended to be a powerful example, showing my children how money will grow if they are willing to sit quietly with a diverse collection of low-cost funds.

7. HEADING HOME

When I bought my first home, my parents helped me financially, and I want to do the same for my kids. To that end, I have invested \$15,000 for each of them.

Even with a decade or more of growth, that \$15,000 probably won't be nearly enough for a 20% down payment. But it will give them something to build on.

I stashed Hannah's \$15,000 in a target-date mutual fund that's geared toward 2010, while Henry's money is in a 2015 fund. I bought those funds knowing my kids probably won't buy homes until five or 10 years after those dates.

My thinking: Target-date funds typically have around half their money in stocks as of their target date, and then they continue to become more conservative in the years that follow. By the time my kids need their down-payment money, their target-date funds should be largely invested in bonds.

8. KEEPING SCORE

When my kids buy a house, they won't just need a down payment. They will also want to have a good credit score.

With that in mind, I listed Hannah as a joint account holder on my Visa card earlier this year. That meant the card's credit history was added to her previously blank credit report.

Suddenly, she looked like a model financial citizen. That allowed her, a few months later, to apply for a Discover card on her own. I now have her on a strict regimen, where she charges a small sum each month and dutifully pays it off, thus slowly building up a good credit score.

When Henry reaches college age, I will go through the same nonsense with him. This, alas, is necessary nonsense. The reality is, a good credit score will help my kids get a lower mortgage rate, lower insurance premiums and a host of other financial benefits.

9. VOWING TO HELP

Full disclosure: I am divorced. But even before my marriage broke up, I was horrified by the way many families blow \$20,000 or \$30,000 on a single day of celebration for a wedding.

To put such spending in context, consider this: According to the Federal Reserve's 2004 Survey of Consumer Finances, more than 96% of households headed by someone 65 to 74 had some savings -- but the median value of these financial assets, including things like checking accounts, stocks and mutual funds, was just \$36,100.

Spending \$30,000 on a party is not one of my values, and I've made sure my kids know it. I have told them I will give them \$5,000 toward a wedding or at age 30, whichever comes first. What if they want the \$30,000 wedding? They can ask their mother.

10. LENDING A HAND

While an expensive wedding is low on my list of priorities, a good education ranks near the top. My ex-wife and I long ago agreed that we would pay the full cost of our children's

undergraduate education. Again, this was something my parents did for me, and we all tend to be heavily influenced by our parents' behavior.

There is, however, a limit to my generosity. I have told Henry and Hannah that, if they want to go on to graduate school, they will have to take out loans. I may relent somewhat when the time comes. But I think that there should be some cost to staying in school, so I am not inclined to continue footing the full tab.

11. SETTING EXPECTATIONS

As you might gather, I have talked to my kids a fair amount about money. They know they will graduate college debt-free, they will get some help toward a house down payment and they will receive just \$5,000 toward a wedding. They know about the retirement accounts. I have also promised them \$5,000 upon graduating college, to get them started in the world.

No doubt some folks will think I'm overly generous, while others might consider me cheap. Many will question my priorities. For instance, folks have told me that they would have skipped the retirement accounts and allocated more toward a house down payment.

But, frankly, the precise sums aren't that important. Instead, what I am striving to do is set expectations. By detailing everything to Henry and Hannah, I have made it clear where I think my financial responsibility ends and where theirs will begin.

12. GETTING EDUCATED

Along the way, I have also endeavored to teach my kids about sensible investing. It's been a slow process.

For instance, earlier this decade, I tried a family investment contest. We all picked a mutual fund, I invested \$50 a month in each and then we tracked who fared best. I thought the competition would grab their interest, but it wasn't a great success. Maybe Henry and Hannah were too young.

Indeed, I have continued to show them their mutual-fund statements as they arrive in the mail, and my kids have grown more interested as they have grown older. They have also become more curious about the financial markets, and I can now chat about investing for at least 30 seconds before they reach for their iPods.

I hope enough of this will stick, and they will grow up to be prudent managers of their own money. The potential savings are huge. A financial adviser might charge 1% of a portfolio's value each year, and then recommend mutual funds that cost another 1%. What if my children learn to build their own index-fund portfolios that cost a mere 0.2% a year? When their portfolios hit \$1 million, they will pay just \$2,000 a year in investment costs, instead of the \$20,000 they would be paying if they used an adviser. And, with any luck, they will remember whom to thank.