WELLS FARGO ADVISORS

Helping children build sound financial skills

Practical tips and suggestions for raising financially literate kids

For some children, money skills seem to come naturally. But it doesn't happen often. In fact, the JumpStart Coalition for Personal Financial Literacy found that only a fraction of 12th graders could satisfactorily answer questions about personal finance. To raise financially literate children, there's normally no substitute for good, old-fashioned parenting and hands-on teaching.

Whether your family has already begun the process of instilling sound money management or you're searching for ways to begin, you may find the following tips, suggestions, and concepts helpful.

Lead by example

If you're a parent embarking on the task of educating your children regarding money management, take a look in the mirror. If, for instance, you budget effectively, invest wisely, pay down debt, and donate to charity, your children will learn by example.

Once you have your own financial house in order, begin early with children. In younger children, be receptive to expressions of curiosity regarding money. Children may begin asking questions about coins, dollar bills, checks you write, and utility bills — sometimes as early as age three.

Even with preschoolers, it's not too early

At this stage, keep things simple, and don't expect too much. Take advantage of "teachable moments" that happen during the typical day, such as letting the child put coins into a parking meter or vending machine. You can begin talking to young children about the value of setting aside money they receive during the holidays or for a birthday for future wants and needs. Piggy banks make great gifts for this age group. As a child's savings grow, you can decide together when to spend money.

In today's consumer society, perhaps the two most difficult lessons to learn are that money doesn't grow on trees and that "no" is sometimes the best answer. Children are bombarded with advertising targeted at kids, and they need to understand that it takes hard-earned money to buy the latest toy or game advertised on TV and that the family has a limited amount to spend. Take the opportunity to explain that advertising is a sales pitch, and children don't need everything they see on TV. In addition, begin to define the boundaries between what we *want* and what we *need* to thrive.

For school-age children, try the "three jars" approach

The elementary-school years are a good time to help children understand how far a dollar goes. At about age seven, children can probably handle a small allowance. But instead of giving your child his or her allowance to spend as he or she sees fit, introduce the concept of three jars: one for money the child can spend, a second for money to go into a savings account, and a third for giving to charity. Have the child divide his or her allowance into the three jars. To help encourage larger allocations to the charity jar, offer to match the child's money with your own.

Discuss the significance of the three jars. The spending jar can motivate kids to become wise shoppers. Talk to them about ways to compare quality and prices of similar items. A trip to the grocery store can easily lead to one of those teachable moments. You can show children the differences among generic and name brands and the variations among price and quality. You can begin to discuss concepts at both ends of the spectrum. On the one hand, it's possible to save money by purchasing a brand-name item on sale or by selecting a generic brand. On the other hand, you'll want to analyze an item's quality and how long you want it to last, and perhaps have a conversation around the concept of "getting what you pay for."

Of course, learning is always more fun if you can make a game of it. When there's a rainy day, spend some quality time playing money games such as Monopoly, The Game of Life, Easy Money, or Pay Day.

As children mature, let them have increasing freedom regarding how they use the contents of their "spending" jar. For example, as their interest in clothes blossoms, point out why one purchase may be better than another in regard to quality, appropriateness, and price.

Focus on the savings jar

This is also the time to begin focusing on the "savings" jar. As the value of the savings jar increases, consider opening a savings account at a nearby bank. (To avoid bank fees, you may have to "prime" the account with some of your own money, although some banks offer accounts targeted especially to students or teens.)

Together, decide on something the child wants to save for, such as a bicycle, doll, baseball glove, or video game. Let's say the item costs $50 and your child typically saves $3 per week. It will take a little longer than 16 weeks (four months) to have enough to purchase the item. Explain to the child that if he or she can save an extra dollar a week ($4 per week), there will be enough money to purchase the item in just over 12 weeks (three months). Of course, it makes for a better teaching experience if the extra dollar per week isn't saved at the expense of the "giving" jar but rather earned through some additional activity or behavior.

Allowing a child to use his or her savings to purchase items is only part of the learning experience, however. Letting your child make decisions about what to purchase is also important. Children who save and spend their own money tend to become savvier consumers. They're also more likely to take better care of their possessions because they understand the sacrifice they made to purchase them.

As the child gets older, introduce the idea that you expect him or her to pay for certain expenses out of the allowance you provide. See more about this on the following page.

Allowance as a teaching tool

One of the most effective money-management teaching tools for parents is one everyone is familiar with: allowance. There's really no better method for teaching children how to deal with money than by giving them their own to spend, save, and give as they wish. Although this may seem simple enough, deciding to give an allowance actually raises a few issues.

Should receiving an allowance be tied to completing assigned chores?

One of the goals of an allowance is to put cash into the child's hands so he or she can figure out how to manage it. If the allowance is tied to chores that perpetually are neglected, and thus the allowance is forfeited, you fail to give your child the experience of managing money. Many experts believe you are better served to give an allowance regularly. Tie the loss of other privileges or the burden of additional duties to failure to accomplish household expectations. This arrangement fosters money-management skills while instilling a sense of responsibility as a family member.

If you want to tie money to work, consider giving the child the opportunity to earn additional cash for taking on tasks that go beyond everyday responsibilities. This may also help him or her realize the additional work needed to reach savings goals faster.

How much allowance should be paid?

A child's age is a primary factor in determining an appropriate amount. A rule of thumb is to give an allowance equal to half the child's age. It's a simple calculation, and the amount automatically increases as the child ages.

Another factor to consider is expenses you want the child to cover using his or her allowance. If, for example, you expect the child to buy his or her own clothes, a larger allowance will likely be needed.

How much freedom should the child have with his or her allowance?

Since the allowance is designed to help the child learn about money, it's best to provide as much flexibility as possible. If you use the three-jar approach, you'll want to give the child the latitude to allocate the allowance as he or she sees fit – within reason, of course.

But remember that it's not a bad thing to let your child make mistakes. We all learn by doing, and sometimes the most important lessons are learned when we fail to reach our goals. Generally, the stakes are lower at this stage in a child's life. Let the child learn from missteps today before the consequences become much greater tomorrow.

You can also use the allowance to encourage a savings habit, demonstrating the long-term value of setting aside money. You may want to offer a "matching contribution" to your child's savings. That is, if the child saves $X over a certain time period, you will match that savings; for example if the child saves $20 over a 3-month period, you'll add $20 to the savings jar or bank account. This step sets the stage for helping the child understand the benefit of an employer's matching contribution once he or she starts the first job (see page 6).

Depending on the child's money skills and interest, you may want to begin discussing investing in stocks. Describe how purchasing stock makes the child a part-owner in a company, which means he or she can share in the company's profitability. Encourage the child to research various companies. Typical candidates include a high-profile local company or a company that creates products or services the child uses. You might want to purchase a few shares of the selected company on behalf of the child and let him or her track the stock's progress over time. If the company has a nearby location or is headquartered in your community, inquire about taking a tour with your child.

Don't neglect the "giving" jar

Let the child determine where the cash in the charity jar should go. The selected organization should reflect the child's interests and age level. For example, if he or she loves animals, an animal-welfare organization may be a good choice. If there are multiple children in your household, help each one decide on a charity of choice.

Stepping it up a notch during the teenage years

Accustomed to instant gratification and relatively carefree lives, many modern teenagers have a hard time understanding "no." But your teenager's desire for a new video game, phone, computer, or car can work to your advantage.

At this stage, you can begin to plan periodic family financial discussions. This doesn't necessarily mean that your teenager needs to know your total income or the amount of your home mortgage. But you can certainly begin to familiarize your teenager with the family budget, financial challenges you may be facing, some of the family's longer-term goals and priorities, and perhaps how he or she can help you make progress toward these goals.

At this stage your teen may be itching to get a job to earn extra cash. You'll want to emphasize the wisdom in balancing work during the school year with school performance. Studies have shown that teens who work 20 hours or more per week achieve grades that are half a letter lower, on average, than those who work fewer than 10 hours.

If your teen is earning a paycheck, he or she may find it easier to access his or her savings account with an ATM card, a move you may or may not decide to support. If your older teen (or college-bound student) wants a credit card, you might take the opportunity to have a serious talk or two about spending. In general, teens with credit cards are less price-conscious, more likely to spend more and to overestimate their savings than those who pay cash.

Start by explaining the importance of a credit score. A credit score is a snapshot of a person's credit risk at a particular point in his or her credit history. The score helps a lender determine how likely you are to repay your debt on time. For teens with no credit history, no score can be computed.

You can help your teenager understand that one of the keys to qualifying for the loan he or she will want someday at a competitive rate is a strong credit score. Even beyond being a key indicator of whether or not an applicant can qualify for a mortgage or line of credit, credit scores are used in other ways that affect people's lives. A 2012 survey conducted by the Society of Human Resource Management found that 60% of employers conduct credit background checks for some or all job candidates.

When your child comes knocking...

Perhaps your adult child has had problems finding a job. Or he or she has gone through a divorce and is looking to you for food, shelter, and comfort. What should you do? Parental instinct often says, "Of course, we'll help." But before you loosen your purse strings too much, ask yourself: Will my actions enable my grown child to continue to flounder financially, or can I structure my assistance to empower my child to build (or rebuild) his or her financial independence?

Before you open your door, establish some guidelines and expectations. What room and board will the adult child pay? What additional expenses will the child pay, and how much of his or her budget will be left for entertainment? What is the plan to eventually get the child on his or her feet financially and on the way to independence? Negotiating expectations, behaviors, and financial arrangements upfront helps avoid family friction and conflicts down the road.

Be sure to impress upon your teen that responsible use of credit cards is a common way to help establish a good credit history and that paying off the balance each month in a timely manner is an important safeguard against becoming a credit risk. Problem behaviors to watch for in your teenager include:

- Paying bills late
- Not paying off credit cards in full
- Incurring late payments and fees
- Bouncing checks

Remind your teen how stressful debt can be, and reinforce the point that the credit history he or she establishes now will increase in importance as he or she applies in coming years for large loans, such as a mortgage. Make it clear that once someone has created a bad credit history, it can take a long time to recover.

Continuing education for young-adult children

College graduation day has finally arrived. Your child is one of the lucky ones to land a job with a regular paycheck. The urge to splurge may be tempting for both you and your adult child as you celebrate his or her success. A college degree and a blossoming career are great accomplishments. As in his or her earlier years, however, finding a balance between spending and investing may be crucial during this period in establishing long-term financial security. Some of the topics you may want to discuss include budgeting, "paying yourself first," and the value of investing early.

Balancing inflow and outflow

Budgeting may sound intimidating to the uninitiated, but it's easier than it sounds and pays off for years to come. Boil it down to the basics for your adult child, and don't hesitate to return to the concept of three jars or "buckets": one for spending, one for savings, and one for giving. In some instances, you may want to add a fourth bucket for "luxuries."

Your Financial Advisor can provide you and your adult child with helpful budget worksheets, or you can access any number of templates on the Internet. Your adult child will be asked to list income sources, such as wages, investment income, bonuses, etc. After that, he or she will list expenses, such as mortgage or rent payments, utilities, groceries, gasoline or transportation costs, insurance costs, etc. Those expenses go into the "spending" jar.

Taking control of expenses

If expenses exceed income by a narrow margin, your child may be able to fix the problem by cutting some variable items listed in the expense column and transferring them to the "luxuries" category. For instance, a monthly clothing expense or cash set aside for restaurants or entertainment could be adjusted. If the margin separating income and expenses is greater, he or she might find it necessary to look for ways to reduce housing costs, such as rent, mortgage, or service expenses.

Listed below are spending figures from the 2012 Department of Labor Consumer Expenditure Survey that show where consumers spend their money. These figures are not necessarily guidelines for you and your adult child. But you may want to compare the expenses listed on his or her budget worksheet with these national figures:

Housing	32.8%
Food	12.8
Transportation	17.5
Clothing and services	3.4
Health care	6.9
Entertainment	5.1

Also consider the following common guidelines for spending:

Mortgage payments	Not to exceed 28% of gross (pretax) income
Discretionary expenses (clothing, entertainment, restaurants, etc.)	Not to exceed 20% of after-tax income
Auto loans and credit-card debt	Not to exceed 20% of total after-tax income
Combined monthly debt	Not to exceed 36% of monthly gross (pretax) income

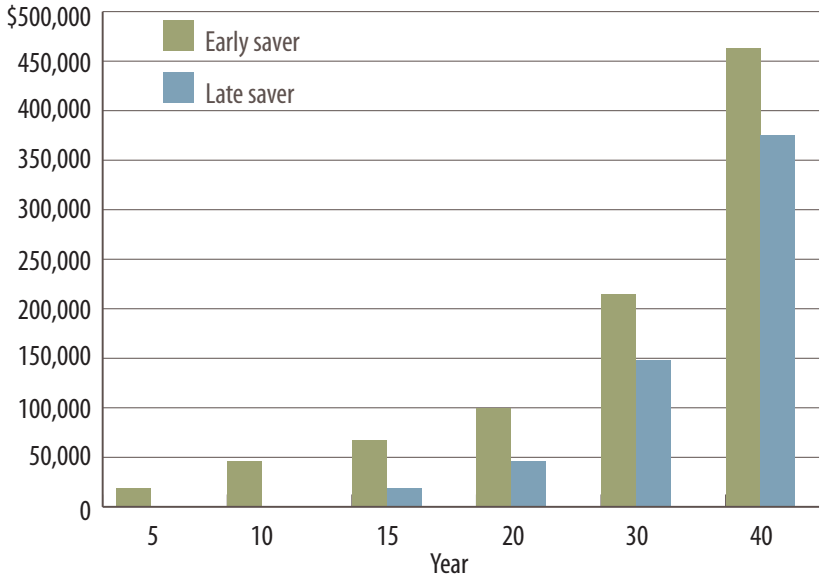
Building savings

One of the easiest and most practical ways to ensure that your adult child invests for the future is by encouraging the principle of "paying yourself first." Assuming the child has a job, recommend participating in the employer-sponsored retirement plan if one is available. If the plan offers an automatic payroll deduction feature [such as with a 401(k) or 403(b) plan], encourage the child to enroll. If the employer provides a matching contribution, encourage him or her to contribute at least the amount that will be matched as such contributions are essentially "free" money. Discuss with your child what he or she will do in the future with potential salary increases. Plant the seed of intention now to increase retirement-plan contributions as his or her salary grows, which will ease the path toward eventually reaching the maximum annual contribution amount.

More affluent families may also want to reward saving. If you or a grandparent expect to have a taxable estate someday, gifting to a child or grandchild may be beneficial. You may want to tie the gift to the saving behavior. Grandparents could make it clear that if children or grandchildren increase their savings amounts in a company-sponsored retirement plan or IRA, grandparents would be inclined to gift an equal amount to the child or grandchildren.

Source: BLS Reports, March 2014, Bureau of Labor Statistics

If your adult child's employer doesn't provide a retirement plan, encourage a systematic way to begin investing in a traditional or Roth IRA. Often financial institutions, such as Wells Fargo Advisors, provide an automatic way to transfer funds directly into an IRA. Regardless of the method used to begin investing systematically, here's the potential benefit of starting such a program early:



The early saver deposits $250 a month for 10 years. Total invested: $30,000.

The late saver waits 10 years, then begins to deposit $250 a month for 30 years. Total invested: $90,000. Assumes an 8% compounded interest rate.

For illustrative purposes only and not reflective of the performance of any particular investment.

For adult children whose adjusted gross income (AGI) falls below certain limits, remind them of the saver's credit. The credit is equal to a specific percentage of employee contributions made to a retirement plan or IRA. The specific percentage depends on the taxpayer's filing status and income. Ask your Financial Advisor and tax consultant about more information if you think the child may qualify.

You'll also want to educate your adult child on the value of dollar cost averaging, reinvesting dividends, and investing in other tax-deferred accounts. Ask your Financial Advisor for a copy of "Taking Control," a complimentary investment primer that discusses these and many other investment concepts.

Developing social responsibility

Now it's time to revisit the "giving" jar with your adult child. Along with a career and financially stable life comes a social responsibility to give back to the community. Just as with younger children, you may want to encourage your adult child to set aside a portion of his or her inflow for charitable purposes. Remember, your child's values may differ from your own; the goal here is not to raise funds for your favorite charity but rather for your adult child to support initiatives that are consistent with his or her ideals.

Preparing for marriage and children

As your adult child matures, marries, and begins a family of his or her own, you'll want to continue to encourage sound financial management. At this point it's important to review family protection programs including life, disability, and health insurance. Remind your adult child to check for child-care flexible spending accounts (FSAs) through his or her employer. And, of course, he or she will want to ensure that proper estate documents (at least a will and durable power of attorney) are in order in case of the unforeseen. For even more information and guidance at this stage of life, ask your Financial Advisor for a copy of our "Guide for a Growing Family."

Depending on your child's financial success, this may be the appropriate time to reintroduce him or her to your Financial Advisor. He or she can offer an array of financial services and programs to begin helping your adult child achieve the same financial success you enjoy.

Bibliography

This brief report has barely scratched the surface of techniques and concepts you may want to use to nurture your children toward financial literacy. In addition to resources you and your Financial Advisor may have already uncovered, consider these additional publications to expand your horizons in this area:

"Raising Financially Fit Kids"
by Joline Godfrey, published by Ten Speed Press

"Silver Spoon Kids"
by John and Eileen Gallo, published by Mc-Graw-Hill Companies

"Rich Dad, Poor Dad"
by Robert T. Kiyosaki, published by Business Plus/Hachette Book Group