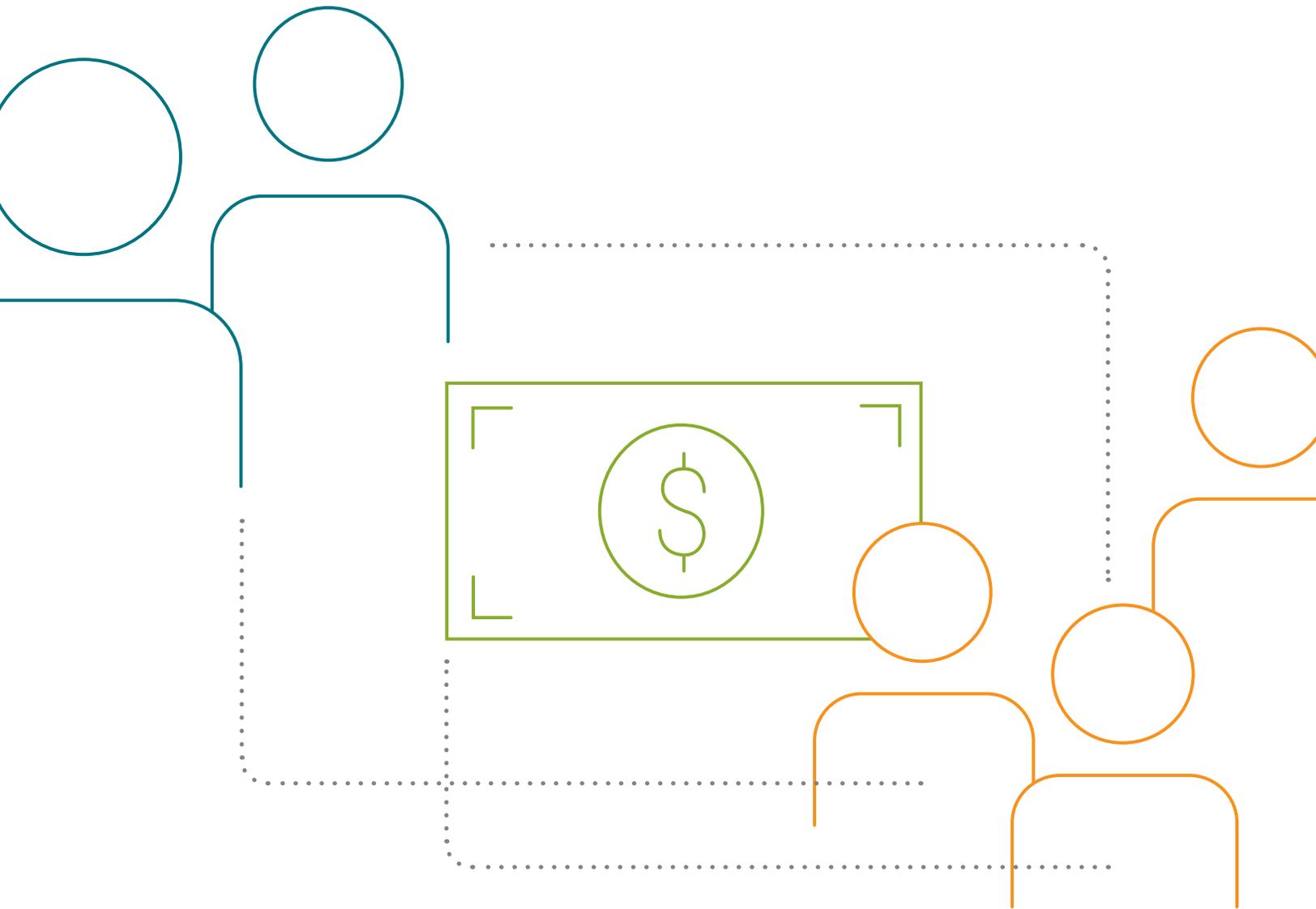


Financial Turning Points The Parent's Dilemma



Depending on the situation, people talk very differently about money. While Morningstar behavioral economist Sarah Newcomb, Ph.D., was doing research for her recent book, *Loaded: Money, Psychology, and How to Get Ahead without Leaving Your Values Behind*, she found that this was especially true when kids entered the equation.



Sarah Newcomb, Ph.D.
Behavioral Economist
Morningstar

“I asked about their emotional relationship with money, and they wrote narratives for me, these epic stories, heart-wrenching experiences of struggle. All them had very rich, detailed, emotionally charged relationships with money,” Newcomb said. “Then I asked the same people how would they explain money to a child, and all of a sudden the emotion was gone. They started saying things like, ‘Money is a useful medium of exchange.’ I saw a huge disconnect between the way that they experienced money and the way they wanted to explain it to the next generation. No wonder we’re all so confused and unprepared—we try to remove emotions and our actual life experiences from our discussions with kids about money.

“Dealing with money is complex,” Newcomb said. “It affects our social lives as well as our material lives, and if your clients don’t discuss that with their children, and let them see how money really affects their clients’ lives, then the children will find out the hard way.”

By helping your clients raise financially fit kids, everyone wins: Your clients get peace of mind that their children will be better equipped for life on their own, the children get a financial head start to prepare them for financial independence, and your practice benefits from stronger client relationships and, potentially, a new generation of clients.

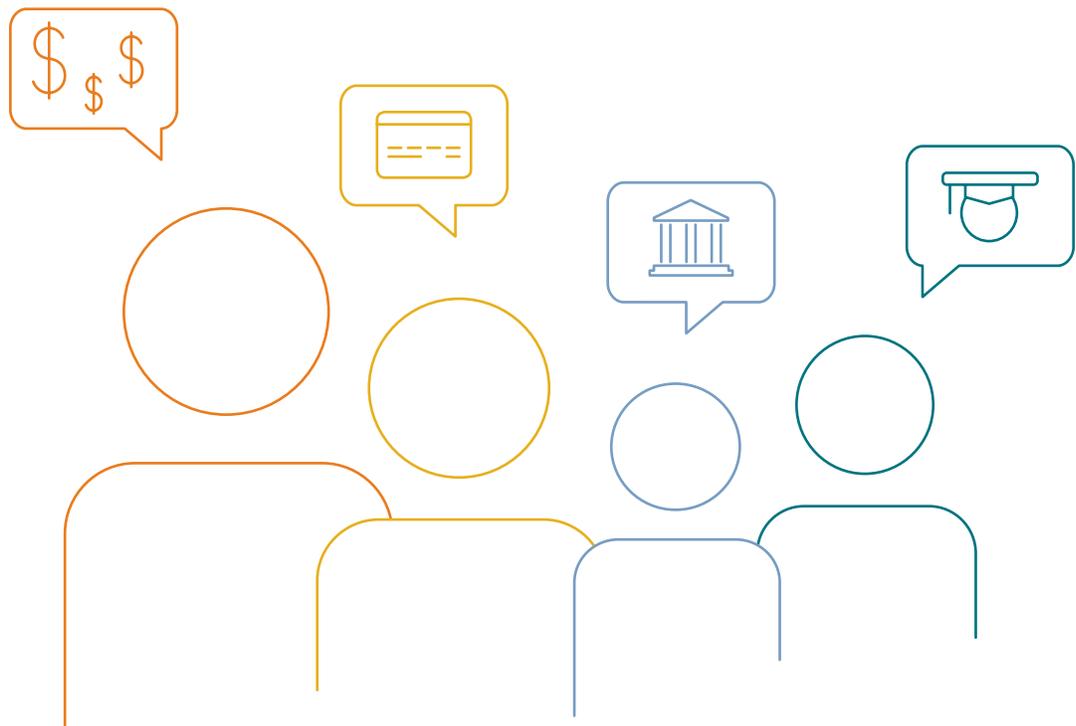
Learning by Example Isn't Enough

"There's a huge problem with financial education: Kids are just not getting enough. A lot of it is simply that parents don't involve children in financial decisions," Newcomb said. "Kids are left to try to learn by watching their parents' financial behaviors, but we often keep our finances so tightly held that even our own children aren't able to learn good financial skills that way.

Only 17% of wealthy parents said that they have told or would tell their children about their income or net worth by the time they reach 18 years old.

"This is true for people who are rich or poor. In fact, there was a study in *The New York Times* a year ago. Ron Lieber reported the results of a survey of wealthy parents in which only 17% said that they have told or would tell their children about their income or net worth by the time they reach 18 years old. When they were asked why, nearly a third of them said it was none of their business. This is not a culture of open financial communication, and that perpetuates our issues with money and makes them generational. We need to start talking with our kids about money and involving them in our financial decisions.

"Your clients should think about their kids and their financial needs this way: By the time the kids leave home, most of them are going to be at least partially on their own, financially. Some of them will be completely on their own," Newcomb said. "Advisors should get their clients financially healthy first, and then get their clients thinking about the basic skills that their children need and how they can help them practice those skills."



Simple Steps: The Rule of 72 and 'Just-in-Time' Moments

"The simpler your clients can get with basic financial concepts, the better, because kids can take those fundamental building blocks of economics into their lives. They'll learn the details later, but the foundational concepts, the big-picture concepts, are most important to understand," Newcomb said.¹ "One of these key concepts is time perception, which really hurts our financial decisions. Because our brains are not wired to understand and accurately calculate compound interest, teaching kids the rule of 72 at a young age is a great start. Divide 72 by the interest rate, and that tells you how many years it will take for your money to either double if it's invested or get cut in half if you're talking about paying interest or inflation.

Getting kids to understand the time value of money from a young age can help them plan their careers, to understand why they need to continuously get raises and increase the value of their labor over time.

"People can't just teach kids something once. It has to be reiterated. Teach the rule of 72 when they're 8, and then do it again at 10, and again at 15, and again when they get a credit card. Teach the rule of 72, because it's so simple a kid can understand," Newcomb said. "Getting kids to understand the time value of money from a young age can help them plan their careers, to understand why they need to continuously get raises and increase the value of their labor over time. It can help them understand why investing a small amount of money in their 20s is so much more practical and valuable than a much larger amount in their 40s. That simple concept of how long it takes for this money to double is easier for our minds to wrap around than compound interest.

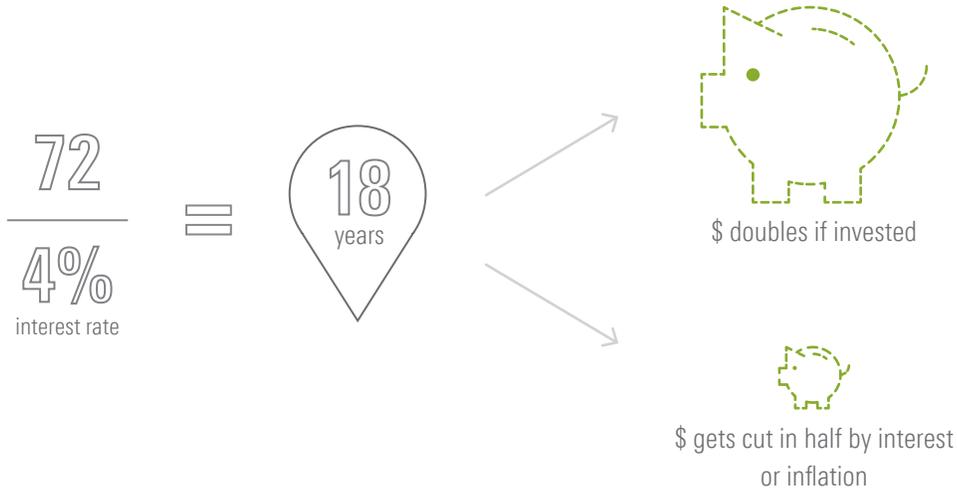
Newcomb also recommends what she calls "just-in-time" financial education.²

"People seek information about financial transactions when they need it. When they're buying a home, that's when they learn about mortgages. That's when they'll pay the most attention, be the most receptive, and retain that information the longest, because it's personally relevant," she said.

"Your clients can take family moments, like when the family is buying a new car, and use them this way. They can easily bring the kids into the purchase and help them see everything involved in it. It's the same with buying the home, or figuring out the family budget for vacation. Those types of things can be just-in-time moments. If your clients keep their eyes out for when their kids are having just-in-time moments, it can be really effective."

Teaching Kids About Time and Money

Teaching kids the rule of 72 is a great way to help them wrap their heads around the concept of compound interest. By dividing 72 by the interest rate, kids can see how many years it will take for money to either double if it's invested or get cut in half by interest or inflation.



Small rate changes can mean big differences in the time scale.



$72 \div 2\% = 36 \text{ years}$
 $72 \div 4\% = 18 \text{ years}$
 $72 \div 6\% = 12 \text{ years}$

Getting kids to understand the time value of money from a young age can help them plan their careers, to understand why they need to continuously get raises and increase the value of their labor over time. It can help them understand why investing a small amount of money in their 20s is so much more practical and valuable than a much larger amount in their 40s.



Begins investing at 38 years old



Invests **\$10K** at 38 years old



Doubles to **\$20K** at 56 years old



Doubles to **\$40K** at 74 years old



Begins investing at 20 years old



Invests **\$10K** at 20 years old



Doubles to **\$20K** at 38 years old



Doubles to **\$40K** at 56 years old



Doubles to **\$80K** at 74 years old

Those simple concepts can set the stage for your clients to get their children more involved in the family finances, but deeper involvement requires a degree of financial transparency that parents will be much more comfortable with once they themselves get financially fit. As an advisor, you can help your clients get into a position where they're ready to be financially transparent and then give them the confidence in their financial expertise to discuss finances with their children.

That's the biggest thing in money management that kids need to pick up: Every financial decision is a trade-off.

"After your clients get themselves financially healthy, you should tell them to involve their kids in financial decisions," Newcomb said. "The obvious example is grocery shopping. People will involve their kids even at a young age. They can say, 'Here's our grocery budget, here's the calculator. You hold the calculator, and every time we get an item, I'll tell you how much to add on.' The children start to associate the shopping cart full of groceries with the budget, and the associated trade-offs. That's the biggest thing in money management that kids need to pick up: Every financial decision is a trade-off."

By the time they leave the nest, your clients' children need to be ready to balance major financial decisions for meeting their physical and emotional needs with limited financial resources.

"Kids can be taught about rent, earning, expenses, and budgeting, but if they've never had any experience with those things, they're going to have a rough transition," Newcomb said. "Your clients should start bringing kids in and give them a say in the family budget, or give them the reins and let them handle the budget for a little while. There's no teacher like experience, and it will give kids a lot of financial confidence. They can say, 'I ran my family's budget before I left the house. I know how this works. I paid the bills.' We can be so shy about allowing our kids to see how much we earn, how much we spend, how financially insecure we may be, but it doesn't help them to hide behind our own fears. Teach them to drive the finances, let them watch you, and then let them drive."

There's one big gap in this education that's more difficult to teach: banking.

"The banking system has not caught up to the fact that kids need to learn about money early," Newcomb said. "I learned this firsthand when I took my daughter to open an account and experience the real world of banking today, which really means having a little piece of plastic that represents your finances. Most banks will not allow a child to have an ATM card until they're 16. That means kids only have two years in which to learn about managing money in an age of ATMs and online shopping before most of them become financially independent."

"Crucial skills—learning how to mentally keep track of finances, how to have access to money 24/7 without spending it all—need to be developed at a younger age," she said. "We can't just expect that kids will learn by watching."

Careers: It's More Than One Question

Our society has a difficult relationship with careers and money. There's tension between what we may be passionate about and what we can get paid for, and Newcomb said that while there's no right answer to this dilemma, there's a better way your clients can prepare their children to make tough career choices that could impact their financial stability later in life.

"We need to have a different kind of career conversation," Newcomb said. "Right now, we say, 'What do you want to do when you grow up?' What we're really getting at is, 'How are you going to make a living?' You can love something, and that can make you a great fan. There are also things that we love and are passionate about that we're very good at doing, and those can be great hobbies. Then there are things that we're passionate about, that we're very good at doing, and that other people find value in and will pay us to do. That's a career," Newcomb said.³ "This doesn't mean that the things that we're passionate about and don't get paid for aren't a wonderful use of our time and that we shouldn't be investing ourselves in them, but a career is about making money. It's at least about getting to a place of financial stability so that we have the time and energy and health and stability to be able to do the things that we're passionate about.

"So, when your clients talk to their kids about careers, first they should help them find their trifecta, that mix of passion, talent, and value. But not every passion and hobby is a career," she said.

"Economics works separately from the concept of personal fulfillment. For some people, their passion and their career don't overlap, because it's not a perfect world, and the things that light some people up are never going to be careers. These are financial choices and life choices. These are conversations that your clients can have with their kids from age 8 to 18 as they're trying to figure out what they're going to do with their time."



Inherited Credit

"There are other ways that parents can give kids a financial leg up when they leave the house," Newcomb said. "Specifically, if a parent has a good credit score, the kids can actually inherit that score.

"Advisors can tell their clients: Put them on one of your credit card accounts, and suddenly they have a credit history now, and it's your credit history. If you don't have a good credit score, you don't want to do this. If you

don't trust your children and you don't want to give them access to the account, there's nothing stopping a parent from putting their name on the account and not giving them the card," she said. "It's one way that parents who have worked hard to build a good credit score can help kids start off with the benefits of that score. Once they're flying on their own, parents can take them off of the account and then let them build their credit history on their own."

College Costs and Beyond

As student loan expenses get more headlines every day, along with stories about graduates being saddled with massive amounts of debt, Newcomb said advisors are in a great position to help parents see the long-term picture associated with helping out financially.

“A very common desire for parents is to fully pay for their child’s college education even at very expensive schools, and parents will often refinance and take out the equity in their homes to pay for their children’s college education,” Newcomb said. “This is a really dangerous move on the part of the parent to lower their own assets—and often find themselves deeply in debt rather than financially secure—so their children won’t have college loans when they come out of school.

It may be very tempting, but advisors can remind their clients that hurting themselves financially can raise the chances of them being a burden on their children in old age, and that may be more of a burden than those student loans.

“It doesn’t have to be all or nothing. Your clients can help their children with some financial support and the children can take out some student loans and work some hours, and through a combination of work and loans and financial support, they can get the training to have great skills that are useful in the marketplace and get a great career that pays them enough to pay back those student loans while building their own financial security. There are ways to do this without your clients sacrificing their financial future.

“It may be very tempting, but advisors can remind their clients that hurting themselves financially can raise the chances of them being a burden on their children in old age, and that may be more of a burden than those student loans.”

Even if parents have done everything right as their children grow up, there’s always the potential for their kids to get into financial trouble as a result of bad decisions or just bad fortune. As with careers, there’s no right or wrong way to respond to these situations—as long as the parents’ finances aren’t hurt by helping.

“In anything as parents, we have to figure out when the consequence is appropriate for them to deal with and learn from on their own, and when the consequences are too much,” Newcomb said.

“There isn’t a scientific answer to that, but the financial answer may be: If it threatens your clients’ financial security, they should not do it. The kids have more years to make up for the losses of bad decisions than your clients do. It may be a painful lesson for the children, and it may be even more painful for the parents to watch their children struggle, but your clients should not sacrifice their own financial security to bail out a child who’s made financial mistakes.

“Your clients don’t have as much time as the children do. If the parents bail the kids out and make themselves financially unstable in the process, then there’s a chance the children still won’t have the skills to support their parents if the parents need support,” she said.

Taking care of themselves financially is the first thing your clients have to do in order to take care of their children financially.

Money aside, being a parent is a lifelong commitment full of difficult choices, second-guessing, and doubt. But advisors can help their clients (and their children) by encouraging an early, open, and honest financial dialogue across generations.

“Taking care of themselves financially is the first thing your clients have to do in order to take care of their children financially. Then they can help their children understand how to learn and grow and take care of themselves financially,” Newcomb said. “Your clients should set an example of open communication, prioritizing, budgeting, tweaking, revisiting, being transparent, comparison shopping—all of these things. Then the children will really remember.”

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1. <https://www.moodys.com/microsites/miic2010/presentationfiles/Fischer.pdf>
 2. <https://www.treasury.gov/resource-center/financial-education/Documents/Lynch%20presentation.pdf>
 3. <https://profiles.stanford.edu/tina-seelig>

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