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# Why financial literacy is important

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This article presents a tremendous investment opportunity, available to parents only, that will continue to pay tax-free dividends on a guaranteed basis, long into your family's future.

I love being a parent. I think it's one of the best jobs in the world. But for many people, it's also one of the toughest. And now, along with instilling confidence and a sense of responsibility, the modern world has added another parental duty for all of us: helping our kids become financially literate.

The inability of people (too many) – young and old – to understand basic and fundamental principles of financial literacy has far-reaching implications.

A recent publication by the Canadian Institute of Actuaries noted that those who can't make simple calculations of interest and don't understand how inflation and diversification fit into their investment portfolios are far less likely to correctly estimate their retirement savings needs. On the flip side, those who do understand these concepts have higher rates of saving.

We can already see how this is unfolding. Canadians have record debt levels. And a poll by the Bank of Nova Scotia reported that only three in 10 people surveyed plan to put away money this year in their savings plans, including registered and non-registered accounts.

Financial literacy has been defined as having the knowledge, skills and confidence to make responsible financial decisions. Some schools are now teaching kids the basics about earning, saving, spending, investing, budgeting, credit and borrowing. As a financial planner, I applaud this move, and so too should every Investor's Digest reader.

Accumulating money is all well and good. But as parents we should also instill in our children the importance of charitable giving; that is, donating 10 per cent of what we earn to those less fortunate. It's the best investment.

As a long-term plan, children should be encouraged to become involved in charitable organizations – contributing not just their money, but also their time. Having a strong set of values and leaving a legacy will trickle down from one generation to another.

Whenever I talk to young people about saving, I explain there are basically two kinds of people. The first are the ones who spend their money and then save whatever they have left over – this makes up about 96 per cent of Canadian households.

These people usually have "more month than money" and get themselves into credit trouble. The second group pays themselves first, and then spends the remainder to their hearts' delight.

Unfortunately, the second group constitutes roughly four per cent of Canadian households. That group has money available to buy a house, take a vacation each year, pay for their children's education and perhaps even buy some recreational property. The first group usually ends up working for the second group most of their lives.

Of course, we all hope people have enough money to make themselves and their families happy, and to contribute to the economy. People of all ages must ask themselves: do I want to be a spender or a saver? And as our children become adults, we need to ensure that they know about the four basic financial necessities of life:

**Set up an emergency fund:**

People need to have at least three to six months of their income in cash, liquid assets or lines of credit. They need to put aside, at minimum, 10 per cent of their income each month to accomplish this.

This is the first thing I would want for any young person, because if something unexpected happens and they need to take a "time out" – they are downsized, or they need a new vehicle they will use for work – they have readily available money that won't put them into debt.

**Spend only what you have:**

Debt management is a crucial topic. It is too easy these days for young people to rack up debt (unfortunately mimicking the ways of many parents).

University students are often offered free credit cards and tempted with other kinds of credit, potentially putting themselves into a financial bind that can impact their entire lifetime, unfortunately mimicking the ways of many parents. As our children become adults, we need to ensure they know about the four basic financial necessities of life.

My suggestion to them when it comes to credit: only spend what you have, limit yourself to just one credit card and even then, use that card only for emergencies. It will help also to build up a good credit report for the future when you need to buy a home or other investment. Using a debit card instead is a great way for young people (or anyone) hold down their level of debt.

**Make investments:**

Young people who learn the magic of compounding interest start saving early and can put away enough while living at home to begin making investments. This can be anything from RRSPs, a company pension plan, their first home or perhaps some stocks and bonds.

How to accomplish this? Treat the savings like it was going into a tight-fitting jar: you put the money in and close it up.

Before you know it, you have a self-enforced savings program that enables you to put aside funds to purchase investments for the long term.

Best is to set up a monthly pre-authorized withdrawal plan straight from a bank account to the specific investment.

**Manage risk:**

There is a time in life when everyone asks: What will I do if I can't work any longer? If I remember correctly, being young means feeling immortal. But what would happen, heaven forbid, to a young person who is a sole proprietor, entrepreneur, a lawyer or doctor in a new practice who can't work due to a sickness or injury?

They should consider long-term disability and critical illness insurance while they are young and healthy. As well, once people start working and begin saving, they also need to consider life insurance, wills and powers of attorney.

It's not a surprise that the key to saving for things like an emergency, a long-term investment or a house is to pay yourself first. Young people may not be able to put aside $1,000 a month, but they could do $100 a month at first. This is money that goes directly into a high- interest savings account for their emergency fund or an RRSP.

When people get a bit older, they realize they can use this money for a down payment on a house, help to pay for a new baby, buy life and disability insurance and, yes, even take a vacation. It's a matter of making priorities and keeping to a schedule of forced savings.

The basic premise behind this personal financial planning is for young people to begin to look after themselves and their loved ones.

Baby boomers already know that governments are increasingly taking an arm's-length view of their responsibilities to look after their citizens. It is up to each of us to take the proper steps to look after ourselves, so we are protected in the following situations:

1. When will I be able to stop working if I no longer want to? Remember how we used to talk about the elusive dream of Freedom 55? Young people today are more inclined to think about Freedom 45 or even Freedom 40, while baby boomers are beginning to realize that Freedom 55 refers to when their kids turn 55.

It's important to remember, however, that more people are living longer than ever before, and someone has to pay for that. We all hear about a massive transfer of intergenerational wealth, but the older generation will need much of that money themselves for long-term health care and taxes.

2. If I get sick or die prematurely, will my family be in financial trouble?

3. When I die, will I leave a tax and financial headache for my family to take care of?

The first question is about retirement, while the second deals with risk management and the third is all about estate planning.

Parents can teach their young children about the importance of saving, bank accounts, retirement plans and insurance. As they get older, parents should also share information about their own financial arrangements – things like where their estate-planning toolkit and directory are kept, digital passwords, where the key to the safety deposit box is located and who they have chosen for powers of attorney. (Visit our website to get an Estate Planning Toolkit.)

Teaching financial literacy to your children now will help them and you many times over. It's a great investment - not only will your children feel the satisfaction that comes from looking after themselves, don't forget that you will also be able to rely on them to help you in your later years.

There is a saying that a wise person has eyes on the top of their head, looking above everyone else and into the future.

The future is where your children will be – financially confident and guided by all the knowledge you instilled in them from a young age. It's never too late. Start now.

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*Mark Halpern is one of Canada's top life insurance advisors, a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and CEO of WEALTHinsurance.com®. He guides busy clients, who are already challenged for time, through the complex process of ensuring the people and organizations they care about are taken care of. If you are like his other successful clients, you are looking to reduce your tax obligations, preserve your wealth and leave a legacy. Incompletions rob us of energy. Mark collaborates with your professional advisory team to achieve your desired outcomes. His approach is simple. He makes sure what is important to you gets done. He gets you organized, provides a big picture view of your financial affairs, determines your strategy and helps you take action. He will simplify the complicated, so you and your family can rest easy. He can be reached at 416-364-2929, toll-free at 1-866-566-2001 or Mark@WEALTHinsurance.com.*