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Teach your children the basics of money now

Financial ABCs

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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 – young and old – to understand certain fundamental principles of financial literacy has far-reaching implications.

In a recent publication put out by the Canadian Institute of Actuaries, the author notes that those who can't make simple calculations of interest and don't understand how inflation and diversification fit into their 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 Bank of Nova Scotia earlier this year showed 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 starting to teach kids the basics about earning, saving, spending, investing, budgeting, credit and borrowing. As a financial planner, I applaud this move.

Accumulating money is all well and good. But as parents we should also instill in our children the concept 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 – giving 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 tell them 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 only makes up about 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 maybe even buy some recreational property. The first group generally 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

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happy, and to contribute to the economy. So people of all ages have to 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 so 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 lured with other kinds of credit, potentially putting themselves into a financial bind that can impact their entire lifetime.

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My suggestion to them when it comes to credit: only spend what you have and 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) to hold down their level of debt.

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 and, 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.

Risk management. 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? Well, today, young people are more inclined to think about Freedom 45 or even Freedom 40.

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 take care of?

The first question is actually about retirement, while #2 deals with risk management; #3 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 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.

Teaching financial literacy to your children now will help them and you many times over. Not only will your children feel the satisfaction that comes with looking after themselves, 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. ❐