Financial Planning for Your Children

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Children. One child. Five children. Grandchildren. Young children. Adult children.

In the world of financial planning for your family, most of us want to also take care of our children financially when they are young and dependent, guide them as young adults and transfer our wealth to them when we die in old age and they often have children of their own.

The bigger your family and the more complex your net worth, the more financial planning issues you have. Let's examine some of the most important planning issues in Canada related to your family.

Section A: Financial Planning for Children Ages Five to Thirty-Five

Children Under Ten Years Old

At these formative young years, it is a good time to introduce the concept of money and the role it plays in society. Up to this point, kids may think that everything is free and easy – there are several steps you can take to start to teach about our financial system:

- The traditional allowance – don't just give the child money every week or month. Trade off the money for completion of a task like making a bed, picking up clothes or setting a table. Explain that this aspect of barter (work for money) is the fundamental element of our society.
- Keep a proverbial piggy bank on their dresser in the bedroom. Have them count what is inside on a regular basis and the impact of using money to buy something – have them count again to teach that there is a limited aspect to money. If the piggy bank is empty, teach them that they cannot afford to buy anything. Use the bank as a central focal point

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for accumulating their money and tell them how our financial institutions serve the same purpose for parents' money.

- Let children stand in front of you at the Instant Teller machine at your financial institution. Let them push the buttons, pull out the cash, get the receipt and at the same time discuss what is happening.
- When your child was born, you may have opened an RESP (Registered Educational Savings Plan) which is a government sponsored savings program where you get a 20% grant for every dollar you deposit up to defined limits. As your child gets close to ten years old, they are old enough for a discussion about what an RESP is, what post secondary education is, how the money should grow and why you make more contributions. At this age they are at the very early stages of learning that there can be school after high school, and a talk about RESPs helps to introduce the idea that some school has a cost and that cost should be saved for in advance.

Children Ten to Eighteen Years Old

Children this age are starting to have a mind of their own, may be earning money from babysitting or paper delivery, like to buy music, clothes, games and more. They are now young consumers and their financial education should take on a greater level of sophistication:

- Set up a child's savings account at a local financial institution, obtain a debit card for the child if you can and set up to receive a paper statement (at least for awhile). Take your fourteen-year-old to the institution to deposit earnings and to make withdrawals, taking the opportunity to explain the purpose of a financial institution.
- A teenager with earned income from a job also means you can file a tax return for them. They will not pay any income tax unless they earn more than $10,000 a year but filing a tax return anyway starts them earning RRSP contribution room. An RRSP can be opened at age 18 and a lumpsum contribution made at that point. The filing of a tax return presents a new opportunity to discuss the concept of taxes with your teenager and how a tax return is a once a year summary of how a portion of your earnings are sent away to provide a variety of services for society (I'm sure you will find your own personal way to say this!).

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- At this age, often kids in school also start to do projects on business topics. Reading the newspaper or watching the news together with children presents ample opportunity for you to start talking to them about governments, business, currency, trade, corporations, economics and a host of other topics related to understanding basic finances. Do this and you are providing a solid base of learning on finances that will go beyond what many schools offer.
- For children growing up with affluent lifestyles, these are formative years for understanding the value of money. Often children get anything they want in an affluent household, grow up with the nicest of everything and can have little appreciation for hard work or for the challenges of getting money if you don't have it. I have had to assist many children in their 20s and 30s to re-align their financial goals now that they are out on their own and without their parent's money at their fingertips. Finding out that mega vacations, expensive foreign cars and big houses are now a thing of the past as they struggle to live on their own "normal-level" Canadian incomes. Often the kids are in shock. You can avoid this – when they are ten to fifteen years old incorporate some hard life lessons with money and your kids – don't hand them everything they want every day, rethink lavish and endless gifts and designer clothes. Encourage them to get part time jobs and remove all allowances at this age. Giving them this balanced experience will set them well for their 20s and 30s.
- Absolutely no credit card exposure for kids up to this point. I see no value in teaching children about using other people's money and spending beyond your means. Give them a debit card instead and teach them how spending their own money will reduce their account balance until there is no money left.
- This is also the age where I encourage parents to bring their children to meetings with me, the financial advisor. First, they can learn that sometimes individuals and families look to an advisory partner to help them with their finances – whether it be for expertise, objectivity, integrated planning or to simplify their own lives –all for a fee. This is often a person's first introduction to professional service providers (e.g. lawyers, accountants, etc.). Second, for a teenager with some money, we will often open an in-trust for account and start a little investment account that we can manage and monitor with them. We will buy a share or two in a company they can relate to – Apple, Sony, Disney, Royal Bank or others. We will also encourage buying a bond, a GIC, a mutual fund and other securities

where they can learn about different products and how they interact with the market place. The child will get a paper statement mailed to their home and they are encouraged to interact with us by email or other means to ask questions about their account, the products and how it all works. Often, because we are neutral from mom and dad, the relationship flourishes and a lot of financial knowledge is absorbed quickly by the young kids.

Children Eighteen to Twenty-Five Years Old

For children at this age, they are typically in post-secondary education (university, college, trade school or other) or went directly into the work force after high school. Children have very different goals depending on their paths at this stage and we advise them as such. While they may still look to dad or mom for advice on money matters, they may also rebel against parental guidance which can be viewed as "bossy" or "I know better". At this stage more than most, as they gain their independence, having their own advisor starts to feel like their own person. We treat these young adults as individual clients (not the son or daughter of our client) and make them feel important. For the parent, losing this control can be uncomfortable. At the same time, you know we are their new advisory partner, and we are guiding your children the way we guide you – they are in good hands.

- For the student, we start to talk about their financial goals later in life – do you think you will want to own a home, have a family, travel and so on. We help them to put prices on these goals and have literally affected their career directions from this analysis.
- We continue the investing relationship with the student that we started a few years back – routinely talking about investment results in their account. After age 18 their parent's name often comes off the in trust for account but we still encourage the child to continue to let their parents get a statement cc'd copy in the mail each quarter. We routinely do investment update conference calls with kids in their dorm rooms on campus.
- This is often the first stage where children get credit cards, so we start to talk about cash flow budgeting, how a credit card works and the importance of not carrying balances month to month. We find if we get involved early enough we can teach fundamentals that

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avoid bad credit habits later on – we have already had to help a few 20 somethings go through bankruptcy and credit counseling due to credit card bills they could not pay off. We can avoid this if the parents teach proper financial accountability, spending control and money management at a young enough age.

- If the parent doesn't do it, we will absolutely start the lessons as soon as we are introduced to the children.
- For the child working just out of high school, we will also start with goals but clearly, they are different – perhaps buy a home in the next five years, get a vehicle, enjoy life with regular vacations, and spend money on nice things. At this young age, often long-term goals are far from their minds. We try to instill balanced thinking with their pay cheque. Knowing these kids may spend every dollar they make, we encourage opening several investment accounts with us and setting up automatic transfers from their pay cheque account to these accounts for various amounts. One account may be savings for a car. Another account may be for a home purchase deposit. Another account as an emergency fund. And so on. We get them thinking about how to compartmentalize their money, and how to allocate some of it towards a variety of goals. Without this coaching, a child will end up getting it backwards – spending most of their pay cheque on lifestyle and then struggling to find money for RRSP, disability insurance, an emergency fund and other important financial goals.
- Also, now that they have a pay cheque they are paying taxes and they are accruing RRSP contribution room. We encourage them to open two investment accounts: a Tax-Free savings account to save $5000 over a few years for emergencies. We hold this money in a high interest savings product for easy access. And we encourage them to open a basic RRSP account and may automate monthly contributions from their chequing account. With forty years of compounding time inside an RRSP portfolio, they have a greater likelihood of achieving their retirement goals by starting early.

Children 25 to 35 Years Old

By this age, most children in Canada live away from their parents, have careers and perhaps steady relationships. Children still living at home may be saving money, but they are not being

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taught about financial independence. This age is one of the most complicated and important stages of their finances in their entire lives. Within a ten-year period starting around age 25, most children will finalize a career that they hope lasts forty years, buy a home (often the most expensive assets a person will ever buy) agree to a mortgage (the largest debt they will ever hold) get married to a stranger and hope it lasts half a century, and lastly, have children of their own with a financial cost that could easily exceed a million dollars per child over their lifetime.

Financial decisions at this stage can make or break their financial future.

Sadly, most twenty somethings do not seek out financial guidance or get turned off by financial advisors that brush them aside because of little or no portfolio wealth yet.

Specifically for people in this phase, here are some planning areas they may need guidance on:

- Starting a new career – helping them to decide on choices in their group benefits package and their pension plan; understanding what company stock and stock options are; financial plans for bonuses and how taxes work with company cars and other perks.
- This is the phase where we like to see kids get serious about cash flow management and following goals. It is time for the child (and their spouse) to assess if they are spenders or savers – it's dangerous if you have one of both. They may also need cash flow templates to follow with respect to preparing annual budgets – less about day to day cash flow needs and more about strategic purchases like homes, cars, vacations, renovations, debt elimination and more. Often at this age a financial planner will monitor progress towards these goals more than may be necessary with older people – after all, the child is new at this, maybe new to managing finances with a new partner / spouse, and we want to see if good habits or bad habits take root in their finances. By staying involved a financial planner can coach them along the way to become good financial stewards.

- Getting a vehicle – it is important to examine the three methods to purchase a vehicle: car leases, car loans and buying a car outright. It is also necessary to evaluate if a family can afford two vehicles and what kind.

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- Buying a home – proper financial analysis is necessary to determine what they can afford to spend on a home, types of mortgages, payment size, interest rate decisions and even set up the mortgages for them. In Canada today, too many young people have rushed headfirst into big mortgages and find themselves with little cash flow for other things – beware – know what you can afford!
- Setting up an RRSP and building an investment plan – whether through an employer's group plan or through an individual RRSP or Tax-Free account, setting up a monthly savings plan is an effective way to start investing for the long term. There are many different types of products to buy. To learn about investing, consider purchasing a variety of securities in the form of a balanced portfolio of fixed income and risky assets that matches the new investor's risk profile. Considering different securities in their accounts allows them to learn about different investing styles, fees, risk, returns, diversification, products, fees and more.
- One area of estate planning important for young people to address is a Power of Attorney form – this important form ensures the family can manage their affairs if they become incapable of doing so.
- Similarly, with personal insurance, evaluate what they get in their group benefits plan at work and consider a top up enhancer plan for disability insurance to give them a better safety net should they be unable to work for an extended period of time. If the person has a mortgage and a family at this stage, disability insurance which protects a life of income generation is essential.
- Lastly, a child who marries or takes a life partner in this phase can often be stressed about how the finances will fit together. Children come with questions like merging our bank accounts, who will pay bills, should one person only be in charge of the finances, do we need a will, RRSP and life insurance beneficiary designations and who's name to save in. As a neutral third party with ample advisory experience with couples, we can tell them what works best in combining a new couple's finances.

And then your children have children of their own – providing you with grandchildren now as well as children. In Canada today people are having kids later in life – often after age 30 once careers

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are established. There are three major financial planning areas to address when a baby is on the way:

- **Life insurance** – completing a proper needs analysis takes about two hours with the individual and couple and should be completed at least six months before the baby is born. Review the types of life insurance (term and permanent), how much one needs to have (up to 20x your annual income in some cases), how long to carry the insurance (20 years or more), how employer group insurance fits in (it doesn't), why you never should buy bank life insurance on your mortgage and much more. Review how much life insurance you need on a stay at home spouse, how your life, disability and critical illness insurance needs should evolve over your lifetime and which insurance companies to avoid.
- **Wills and an estate plan** – when a baby is on the way, now is the time to get serious about estate planning. Protecting a new dependent child is critical to ensure they don't end up in foster care managed by the government. Everyone needs at least two estate documents (will and Power of Attorney for finances) and perhaps a third document (Power of Attorney for healthcare) depending on your beliefs. In this estate planning discussion before you head to the lawyer, a financial planner will discuss the right choices for Executors, Guardians and Trustees of your estate – it may not be your brothers and sisters. We look at when a family trust makes sense for legal protection against divorce. We talk about the ages that are appropriate to release money to children after your death and what to do with big ticket assets like cottages. We cover estate planning for second marriages and much more as you get an earful of good planning well before you should visit the lawyer.
- **Registered educational savings plan (RESP**) – once the baby is born new parents can complete the social insurance number application to file for a SIN. Once they have a SIN for their child, they can open a RESP with a financial services institution. They can open a self-directed RESPs building an investment plan for children from birth to age 30. A financial planner can help to calculate how much the parents should save towards future educational goals after age 18 and build an investment plan that matches the child's timing

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of need, the parent's risk tolerances and preferences for investment products. They will need to examine whether a family plan should be used for multiple children, why grandparents should never own the RESP, why you never, ever use a pooled scholarship RESP and what amount of money is ideal for your annual contribution.

After Age 35

Your children are not children anymore and have now reached adulthood and are immersed in the real life issues of day to day and year by year financial management of their goals. Now with a full life of assets, income, liabilities and expenses ahead of them, the focus shifts to a "financial plan" and proper management of this plan. While up to now we were tackling age-specific issues suitable to the child's stage of life, now we switch to management of the person or family's full financial plan and the evolution of this plan through their adulthood. A full financial plan starts with defining long term financial goals (short term (under 5 years), medium term (5-15 years) and long term (15 years+)), looks at cash flow
management of pay cheques (budgeting) and explores strategies and solutions in the planning areas of retirement, estate, insurance, real estate, debt, career, children, taxes, legal, investing and more.

From this point on with the family, it is wise to monitor progress of results over time (e.g. achieving net worth growth of 10%+ a year during your working years, debt free date, retirement capital needs, etc.) and adapt the financial plan as the people age, as goals changes and as financial results occur.

Conclusion

We have only scratched the surface on the discussion of a variety of financial planning issues related to children at all ages. As always, we are ready to assist you with questions and real situations that you need advice on.

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How We Can Help:

Our whole team is passionate about helping your children learn about personal finance. In Canada, very little is taught in high school about personal finance so we have stepped in to fill the gap for our clients! A few years ago we launched ("Money Skills Training") and we offer a financial topic curriculum for children aged sixteen to age thirty or so. Contact the office to get a copy of our Money Skills Training brochure to see what topics we teach about and to learn about next steps if you are interested.

Kurt Rosentreter, CPA, CA, CFP, CLU, TEP, FMA CIMA, FCSI is a national best-selling author seven books on personal finance in Canada and the past co-founder of the national wealth management practice at one of Canada's "Big Four" public accounting firms. For the last fifteen years Kurt has been a core financial course instructor for the Ontario Chartered Public Accountant Association and also appears regularly in the national press as an expert on matters of money. Kurt is the owner of a national wealth management practice in Toronto working with professionals and business owners on all topics of personal finance. Learn more about Kurt at www.kurtismycfo.com.

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