Raising Financially Responsible Kids

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KLINGENSTEIN FIELDS
WEALTH ADVISORS

Introduction

"Any fool can make a fortune; It takes a man of brains to hold onto it after it is made."
– attributed to Cornelius Vanderbilt

Few people amass significant wealth with the thought that it will all be gone within two generations. Yet, in the majority of cases, that is exactly what happens.

Wealth creators are great at building businesses and family wealth. Unfortunately, the traits that drive their personal success don't always translate well into another daunting task – preparing a family to preserve and manage that wealth across generations. And, without preparation, the values that helped build a family's wealth may quickly be lost and forgotten.

But there are steps that can be taken to develop a responsible approach to family wealth and build financial acumen. Families that gain the tools to make sound spending, investment and philanthropy decisions can sustain and build a family's assets for generations to come.

Here Today, Gone Tomorrow

In the 19th century, Cornelius Vanderbilt amassed a fortune from the railroad and shipping industries that would be worth $100 to $200 billion today in inflation-adjusted dollars. Fast forward two to three generations to the mid-20th century, and most of the Vanderbilt fortune was squandered, given away or otherwise lost. The Vanderbilts can perhaps take some comfort in knowing they are not alone. According to Roy O. Williams in *For Love & Money, A Comprehensive Guide to the Successful Generational Transfer of Wealth*, most of the time, family wealth is not sustained past even the next generation and 90% of the time it's gone by the end of the third generation.

Despite the Best of Intentions

The loss of wealth is in direct contradiction to the wishes of the majority of wealthy individuals and families. Most would like to see their assets last through at least the next generation, and over 40% would like to see wealth make a significant difference in their grandchildren's lives.

	DESIRE TO HAVE IT LAST	HOW MANY MAKE IT
Next generation	69%	<33%
Grandchildren's generation	43%	10%

Source: Merrill Lynch

The Kids Aren't Alright

The key way families lose their wealth is pretty simple. It's spending. Most wealthy families significantly underestimate their annual use of cash without understanding the impact on the long-term sustainability of assets. Many observers believe this is a far greater contributor to the dissolution of family wealth than investment performance, and one which families can control. Planning can make a huge difference. Families that sustain their wealth across generations typically run their family finances differently. They embrace:

- Clear discussion of the family's wealth with children that is repeated and reinforced at different ages
- Involvement at an early age in gaining an understanding and then contributing to the family's view of their own wealth, its purpose and family goals
- Limits on spending for all family members to control asset evaporation and ensure that money is there for emergencies without tapping excessively into family capital

- Education about responsibility and budgeting so that each family member is prepared and understands what is expected of them
- Well-defined family rules, with consequences to members that do not follow family financial guidelines
- Use of fiduciary instruments to control wealth dissipation and make sure funds are available for family members with special needs and for philanthropy
- Setting family parameters for investment decisions, risk management, distribution of financial reports, and providing the education needed to understand the family's fiscal health

Reviewing the Situation

While many parents say they should discuss their financial situation with their children earlier rather later, it rarely happens. This reluctance often comes from wealth creators or parents thinking that, frankly, it's not their children's business. Perhaps there is a fear of fostering a sense of entitlement and/or lack of ambition. But, children are rarely fools. They know their family has money and often end up believing that their parents are unnecessarily shielding them from both the comfort of their assets and the responsibilities of learning how to manage their wealth.

Fortunately, there are a number of things families can do to prepare their children for inheriting substantial wealth:

- **Clearly communicate the family's views, values and goals** for their wealth, as well as the effort involved in building that wealth – it didn't just magically appear but required time and hard work. As children get older, increase their involvement in family investments, philanthropy and spending decisions so they will be prepared as they gain additional responsibility
- **Make sure your estate plan, will and other legal documents** are in place and up to date and structured to achieve your family's objectives. Leaving an estate in disarray leaves it open to interpretation regarding the distribution of your assets, and different family members may have very disparate views. The results may be devastating to a family's harmony resulting in litigation and further dissolution of assets
- **Set clear expectations with your children** about your intended disposition of your wealth, business, or other assets. While this can be an uncomfortable conversation, especially if your intentions are different from their wishes, putting the conversation off can be damaging emotionally and financially

Encourage your children to take and embrace basic financial education so they clearly understand the terminology of finance and investing.

Keeping Your Family in the Loop

Several of the wealthiest individuals and families in the world have announced their intentions to give away almost all their wealth. Notable examples include Warren Buffett, Michael Bloomberg and Bill and Melinda Gates, all of whom have already given billions away to support causes that they support. Not to worry, the next generation will still be quite comfortable, as even a small portion of $70 billion plus is a substantial amount.

Buffett once stated in a Fortune article in 1986 that, the appropriate amount to leave your children is "enough money so that they feel they could do anything, but not so much that they could do nothing." Other wealthy families feel differently; it's a very personal decision depending on many variables. **The important takeaway; whatever your plans are let your children know how you feel about your wealth, what your plans are for it and why.**

- **Provide formal and informal education** on the opportunities and challenges that accompany wealth. Your advisors may offer family workshops, and mentoring sessions covering fiscal responsibility, setting family financial plans, investment management, and budgeting
- **Provide opportunities for your family to directly access** wealth advisors, accountants, attorneys and other experts so they become a resource they are comfortable approaching in a confidential, objective and nonjudgmental environment
- **Take steps to improve your children's financial knowledge**, literacy and responsibility. As the Vanderbilt example and research shows, it is not that difficult to go from "shirtsleeves to shirtsleeves" within the space of a few generations, even when the wealth seems so vast that it could never be exhausted. Encourage your children to take and embrace basic financial education so they clearly understand the terminology of finance and investing as well as know how to translate their goals into instructions for your family's advisors

General Lack of Financial Knowledge

Most children are unprepared to handle even their basic financial matters. Yet, financial knowledge can be a powerful indicator of future financial well-being for college students (Norvilitis & MacLean, *The role of parents in college students' financial behaviors and attitudes)*. A survey published in 2015 by Higher One, a financial technology company providing payment solutions for educational institutions, and EverFi, an education technology company focused on providing life skills, asked college students six questions to assess their financial knowledge. While there is some disparity among different types of respondents, on average the financial literacy rate was 2.3 questions correct.

Financial education and experience can improve financial knowledge, but currently only 20 states require a high school course in financial literacy and only 16 states require standardized financial literacy testing. Clearly, significant improvement can be made preparing our children for independence and financial responsibility, but wealthy families cannot rely upon the educational system to do the job. So, what can we do?

College Students Financial Literacy

	OVERALL	FOUR YEAR PUBLIC	FOUR YEAR PRIVATE	FOUR YEAR RELIGIOUS	TWO YEAR
Percent taking financial literacy course in high school	34%	35%	30%	35%	24%
Overall financial knowledge	2.26	2.25	2.34	2.22	2.44
State required financial literacy course in high school	2.29	2.28	2.44	2.21	N/A
State required financial literacy testing in high school	2.36	2.38	2.45	2.27	N/A

Source: Higher One and EverFi, Money Matters on Campus, How College Students Behave Financially and Plan for the Future, 2015

Start Early

Starting early is key to raising financially responsible children. The number of steps that can be taken to instill financial fitness, even at a young age, may be surprising.

Earning learning – Giving your children an allowance is a great way to communicate the value of money, particularly if it comes with age-appropriate financial responsibility. For example, for younger children, you may give them a weekly allowance, from which they pay for smaller toys. Older children could be responsible for covering entertainment (movies, etc.) with their allowance.

Saving savvy – It's never too early to teach your children the joy of accumulating savings. Have your children save a portion of their allowance each week, in a separate place (or set up a bank savings account) from where they keep the rest of their allowance. Apply this principle to gifts of money received for birthdays and holidays. Make sure they understand the responsibility that comes with savings and resist the temptation to "bail them out" if they make bad spending decisions.

Gracious giving – Engendering a sense of community, responsibility to others and an understanding that there are many others that are not as fortunate as they are will help your children better appreciate the wealth they will one day inherit. Have them participate in a cause in which they feel a sense of connection through both active involvement and monetary contributions. Encouraging them to allocate a portion of their savings to giving can make their commitments personally meaningful.

As children get older, the level of financial responsibility should expand accordingly:

Giving credit – Many children don't really understand the difference between a credit and debit card. Helping them understand that, as well as the importance of paying off their debts promptly and establishing a good credit history, can avoid costly mistakes later.

Budget boundaries – The allowance concept should extend to college. Rather than an unlimited open wallet, providing a fixed amount of money each month teaches your children how to live on a budget and prioritize their spending. For college age children, be very clear about what you expect them to buy from their allowance and what acceptable parental expenses are.

Be invested – Many high schools have an investment club. Encourage your children to participate, so they can learn about the stock market and how investing works. If your children's school doesn't offer an investment club, you can give them a grounding and, for a fun and educational activity, give them a (small) real or hypothetical amount to invest in companies of their choosing. Let them feel the responsibility of their own investment decisions and resist your well-meaning, but perhaps misplaced, desire to "bail them out" for decisions they make that don't work out.

Working life – Even if your wealth means that your children never have to work for financial reasons, having a job imparts invaluable lessons about money, prioritizing and managing time and responsibility to others. It is important, once your child finds a job, whether part time when younger or full time as an adult, to be very clear what the boundaries are between what expenses they are expected to fund versus looking to the family for largesse.

Safe and secure – While you might think your children are much more aware of the dangers of identity theft and online fraud, they also tend to be more trusting. Teach your children the basics (and that they can always check with you before acting):

- Establish "strong" passwords
- Use security check software on their computers
- Don't click on links in email, even if (especially if) they purport to be from a known company such as PayPal or a credit card company or retailer at which they may shop
- Make sure they know financial institutions and payment companies will not ask for confidential information (social security number, credit card information, security information, etc.) in an email or text
- Similarly, such companies will not tell you they need information or funds sent to them or authorization immediately "or else"

Be on Your Own Best (Financial) Behavior

Remember, your children will look to you as an example of how to behave financially. If you are fiscally prudent in your saving and spending, that sets the tone for their behavior. Conversely, if you never budget, spend freely whenever you want something, don't participate in philanthropic activities and act as if you have an unlimited wallet at all times, they will adapt that as acceptable financial conduct.

Here to Help

Klingenstein Fields Wealth Advisors has been helping our clients and their families understand and address the complexities of significant wealth for multiple generations. Our planning and advisory resources have the expertise and experience to help you navigate the challenging issues involved in wealth planning and transfer for families. Lacey Johnson, Director, Wealth Advisor, at Klingenstein Fields Wealth Advisors, explains "Usually, when I meet with families, there is a strong desire to improve communications and family dynamics, but a frustration regarding where to start. As a neutral party with deep experience, we help our families through what can be an emotional process. This can range from suggesting financial educational programs for the younger generation to informal meetings with multiple generations to facilitating peer conversations on common topics and issues among wealthy families." We welcome the opportunity to meet with you and your family to help you sustain your wealth for generations to come.

For more information, please contact us at **212.492.7000** or email us at **info@klingenstein.com**. We look forward to hearing from you.

IMPORTANT DISCLOSURES

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