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The money talk: Have it with kids by age 10

NOREEN RASBACH
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We all have heard the stories: Young adults who come into tremendous wealth too early and unprepared – and proceed to squander their fortunes.

It's a thorny problem that financial institutions and advisers involved with wealth management are confronting at the request of their affluent clients. How do you teach children to be rich? How do you know when the next generation is ready to properly handle wealth?

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It's an issue that is growing as the number of affluent Canadians increases. The number of high-net-worth individuals here – those with investable wealth of $1-million or more – grew 6.5 per cent over the year before to a record 298,000 in 2012, according to the 2013 World Wealth Report by Royal Bank of Canada's RBC Wealth Management and Capgemini. The number of ultra-rich individuals – with wealth of $30-million or more – increased 11 per cent to 4,500 people.

And that means more wealthy Canadians who are looking to pass on those assets to their children. According to a study released this week by the Bank of Montreal's wealth management arm, BMO Harris Private Banking, affluent Canadians plan on leaving, on average, 30 per cent of their wealth to their children. The online survey of 305 Canadians with at least $1-million in investable assets also found that parents are taking the time to educate their children about finances – 65 per cent said they do.

"There has been a lot of focus on that kind of education in the last five or 10 years," says Yannick Archambault, vice-president and chief operating officer at BMO Harris Private Banking. "The larger the dollars, the more complexity there tends to be. … High-net-worth parents or clients want to make sure that the second or third generation is well-equipped to handle it.”

Mr. Archambault is referring to programs such as BMO Harris’s Financial Fluency, aimed at children of clients who are in their late teens or early 20s that teach the principles of debt, credit, investing and risk tolerance. Financial Fluency was introduced in 2008, and has been bolstered regularly since.

Programs like these help, but Mr. Archambault and others have seen financial advisers tackle more and more of the educational role – bringing in the adult children of clients and explaining to them aspects of their parents’ finances.

That’s certainly the case with Phil Tippetts-Aylmer, a Vancouver-based financial adviser with Nicola Wealth Management, who says a large number of clients he works with have introduced their children to the firm or have brought the children in for extensive discussions about the family’s financial situation.

“There is the understanding that the children are going to inherit a sizable amount of money and there is a desire to have them be financially literate by the time that event occurs,” he says.

One way to help is to give children control gradually. For example, university students might be given responsibility for the money the parents have saved for their education, with a financial planner to help. Some parents bring their children to sit in on regular review meetings that deal with their assets.

“If the parents are happy with that and the child is keen, we’re happy to do that,” Mr. Tippetts-Aylmer says.

In the case of estate planning, parents might restrict when children get the assets – or set up a trust in which there is a co-trustee for a certain length of time.

But Mr. Tippetts-Aylmer says that for most children in affluent families, understanding finances comes in the same way that it does for most people – when they come up against major financial decisions for the first time, such as when getting married, landing their first job, buying a house or having children. How they tackle those events is a great indicator of whether they can handle the legacies their parents will eventually leave.

Other indicators of whether they can handle finances are if they save and if they undertake financial planning on their own. Warning signs include carrying a lot of debt.

Mr. Tippetts-Aylmer says that most of the children who meet with him are 20 or older. Participants in the BMO Harris Financial Fluency program are between the ages of 15 and 30, Mr. Archambault says, with the average age about 22 or 23.

But many personal finance experts believe that there is work to be done before that – that teaching children to manage money should start before the age of 10, says New Jersey-based personal finance author Jonathan Clements, echoing many others who advise people on finances.

“The stakes are higher for parents with lots of money who plan to bequeath substantial sums to their kids, but I think the issues facing wealthy parents are the same that face all parents,” says Mr. Clements, who was director of financial education for Citi Personal Wealth Management and just left to write a column for the Wall Street Journal.

The one lesson that parents need to teach their children early, he says, is how to delay gratification.

Most children, he says, grow up spending their parents’ money so they have absolutely no incentive to curb their desires. It’s like going out to dinner when you know someone else is going to pay: “Of course you’re going to order dessert.”

Parents need to set up a system where kids feel like they’re spending their own money – and making some financial decisions of their own, Mr. Clements says. When his children were small and the family went to restaurants, he would offer the kids $1 if they drank water with meals instead of pop. It was their choice: Take the money or the drink.

When his daughter Hannah was 13 and his son Henry was 10, he started bank accounts for them and got them ATM cards. He then deposited their pocket money into the accounts four times a year. This had two benefits, he says: The kids stopped asking him all the time for money and they learned to budget.

Mr. Clements says it’s also important to instill values in your children, and those are best passed down “in the stories we tell.”

Parents can talk about the financial struggles they had when they first started out, for example. Describe the first apartment you lived in as a student – with cockroaches or mice.

Children will take these stories to heart. “A great family story is far more powerful than any lecture on financial prudence you could ever deliver,” he says.

The family story he heard growing up definitely set him and his three siblings on the right path. It’s a doozy.

His maternal grandfather inherited millions and blew it all. “We grew up hearing about how the great family fortune was squandered.” All four children ended up being responsible with money, he says. “Let me tell you, it was a very powerful story to hear.”

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