HOW TO MAKE PERSONAL FINANCE "CONNECT" WITH YOUNG ADULTS

By Paula Hogan

Parents feel uncomfortable as they see their children's slow progress toward financial independence, while young adults are deciding that remaining financially dependent is, if not comfortable, at least rational and adaptive. The challenge is to develop steps that will make the world of personal finance visible, credible, and appealing to young adults as they work their way through adolescence.

We live in the largest and most enduring free economy in the history of the world. And yet, we have no standard rituals to mark the entry of our youth into the economy as fully responsible adults.

What an odd omission.

In the spiritual realm, many young people go through a confirmation ritual; in the education realm, young people graduate from high school and leave for college; and in the political realm, upon turning age 18, citizens in our country assume voting responsibility.

But we do nothing for young people to mark their entry as an adult into the financial realm.

Of course, the obvious question is: Why is there a need to have financial-coming-of-age rituals?

Rituals usually are the culmination of a process that prepares young people for independence as they move to adulthood. This preparation process is key, and is now missing in many young people's lives. Why?

For one thing, the reality is that it is taking longer to become an adult in the financial realm. Adolescence, at least with respect to financial matters, has been lengthening. In 1950, children moved relatively quickly from adolescence into adult responsibilities. The average age of marriage was 20 and jobs were readily available for high school graduates at relatively good wage levels.

In contrast, high school graduates today generally have access only to minimum wage jobs with little chance for advancement. Further, for most young adults it takes four to five years of college plus often several years of graduate education to be able to enter a professional field and earn wages sufficient to support a family. It is not surprising then, given this context, that the average age of marriage has risen with the average age of being able to support a family, to about age 28.

A further complicating factor is that young people often have ambitious expectations about what standard of living to expect as new wage earners. Many have been socialized to expect to enjoy at least their childhood lifestyle during and immediately after school, even though the reality is that for most students today it takes longer to achieve their parent's standard of living than it did in the previous generation.

As a result, parents, recollecting their own experiences feel uncomfortable and confused as they see their children's slow progress toward financial independence. Meanwhile, young adults are deciding that remaining financially dependent and even living at home for a long period is, if not comfortable, at least rational and adaptive. In fact, the percentage of young adults age 18 to 24 living at home rose from 43% in 1960 to 53% in 1990, and for young adults ages 25 to 34 from 9% to 12%.

In this context, the challenge is to develop a series of cumulative steps that will make the world of personal finance visible, credible, and appealing to young adults as they work their way through this prolonged adolescence.

What follows is a collection of various steps to consider for creating financial coming-of-age traditions tailored to your family's values and circum-

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stances.

They are offered as a way to jumpstart brainstorming. Specific traditions will obviously vary for each family according to family values and family wealth. But each area is worthy of thoughtful consideration if we want young people well prepared to participate as adults in our free economy.

CREDIT CARDS

Credit card companies market hard to college students because they know that consumers tend to stick with the first credit card they are ever issued. Colleges facilitate these marketing efforts because many colleges have rebate arrangements with credit card companies so that the more students charge, the more the college receives.

With these powerful forces in place, it's no wonder that by sophomore year, over 90% of college students have credit cards. The dangerous part of this trend is that students are ill-prepared for the marketing onslaught, as illustrated by the fact that "credit card debt" is now a recognized factor contributing to college drop-out rates. In fact, the average credit card debt for graduating seniors is a bit over $2,000, a debt that if paid via 2% minimum monthly payments with a 16% interest rate means a total of $3,329 paid over the subsequent 24 years. (See www.bankrate.com.)

Students need to be made aware of not only these dangers, but also the positive aspect of credit card debt. College is actually a terrific opportunity to establish a good credit history, which will be very helpful after graduation. Graduates with a poor credit history—or no credit history—are at a disadvantage. Credit history checks are routine for many potential landlords, car insurance companies, individual health insurance companies, and even employers. Consequently, savvy college students will have a credit card, make small charges regularly, and pay the charges in full each month.

To get this process off on the right foot, talk about these issues with the high school and college students in your family. Once a child turns 16, consider getting a credit card in the child's name, with the parent as the guarantor. Once the child turns 18, consider a low-limit card for which the child is responsible, in addition to a card in the parents' name to use in case of emergency and/or for purchases that in your family are paid for by the parent. Help your older college student to order a credit report from one of the national reporting agencies.

Throughout the college years, and especially early on, keep the communication about credit card use ongoing. (For more details, please see www.equifax.com, www.experian.com, and/or www.transunion.com.)

LEGAL & TAX MATTERS

Once a child turns 18, in the eyes of the law that child becomes an adult—which, among other implications, means that parents lose their authority to make medical or legal decisions for the child without the child's consent. How alarming to think that if your 18 year or older child is in a car crash, that you would have no legal right to go to the hospital and make medical or financial decisions for that child—unless you go to court and ask to be formally declared as the child's guardian. The remedy is to pay a nominal legal fee to have Durable Powers of Attorney drawn up for your child for both medical and financial affairs, through which the child specifies his or her preferred agents.

While having these papers in place is prudent, you also should consider how you might make the process of drawing up the papers a powerful coming-of-age ritual in your family. A formal visit to the attorney's office can be a symbolically important event, especially if, as a young adult, you go to the attorney's office on your own, without a parent, and after much family discussion and anticipation.

Similarly, preparing one's own income tax return, or meeting with the family accountant, is a potentially educational and maturing experience.

In families where inheritances in the form of trust funds are part of the picture, consider working with your attorney to develop a series of steps designed to draw your child gradually into trust management. For example, trust documents can specify that young adult heirs become co-trustees with limited responsibility and authority before assuming full responsibility at a later age.

DAILY CASH ACCOUNTS

Families differ greatly in the amount of cash children are allowed to have and in the amount of cash that children earn, save, and spend. Consequently, family traditions in this area will vary widely. But here are some key ingredients to keep in mind for the young adults in your family.

At age 18 a child can open his or her own checking and savings account. Consider making a parent/child visit to the bank to open these accounts an honored coming-of-age ritual in your family. During the visit with the bank officer, review how to track deposits and withdrawals, arrange for an ATM debit card and a first PIN number. Review safe ATM machine habits. Help your child think through what percentage of earned income, and of gifted monies, will go to checking versus to savings. Use this opportunity to promote the notion that "in our family"—or at least in smart circles—people save 10% to 20% of every dollar they earn, starting with the first dollar.

ROTH IRA ACCOUNTS

Once a child has earned income—income reported on a W2 form at

year-end—consider opening a Roth IRA account, which has an IRS limit of the smaller of earned income or the annual dollar limit ($3,000 in 2003).

Once the child turns 18, an IRA account, like a bank checking or savings account, can be opened directly by the child. Explain that Roth IRAs are one of the most powerful savings vehicles available, and a potentially important source of long-term wealth for the child. Contributions are made with after-tax dollars, but then grow tax-sheltered and (with reasonable planning and under current law) also escape taxation at withdrawal.

To fund a Roth IRA for a young adult, it is necessary for that young adult to have earned income. However, there is no IRS prohibition preventing parents or grandparents from funding all or a part of the contribution, if they choose to do so. Some families offer a parental (or grandparental) matching contribution, some families fund the entire contribution, while other families make up the difference between an agreed upon child's contribution and the IRS maximum allowed contribution—or between an agreed upon child's contribution and the minimum amount required by the IRA company to open an IRA.

Some families offer funding each year, while others just provide a first-year "jumpstart" contribution, and some provide no funding at all. Regardless of how much is contributed and regardless of whomever it is contributed by, make the opening of a Roth IRA account an honored family tradition. As part of the tradition, focus everyone's attention on the power of saving, and in particular on the power of saving early and regularly.

FAMILY INFORMATION

Children grow up with an intuitive notion of their family's standard of living—but no dollar amount to associate with that standard of living unless parents share that information with them.

At some point it becomes appropriate and helpful for parents to share information about their income and wealth with their children, a process that is perhaps the most profound financial coming-of-age ritual of all. There are few higher honors for a child than when a parent trusts the child with family financial information. For this reason, coming to know one's own family net worth and income level, as well as the financial history and philosophy of one's parents, can be a fruitfully maturing experience in itself.

Again, parents differ widely as they consider when, how much, or even whether to ever share personal financial information with their children. Children also differ in their ability to appropriately handle such information.

But think how much better prepared young adults would be if they had more factual knowledge to match against their intuitive, but not always accurate, financial impressions. ❖