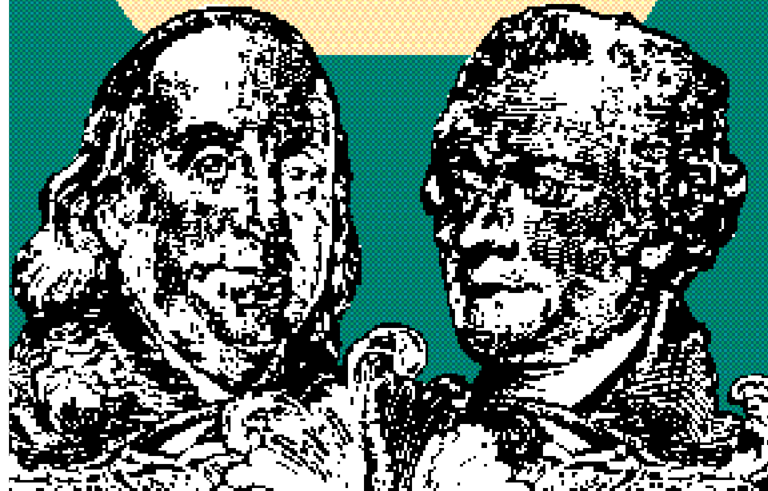
SIMPLE STEPS TO RAISING A MONEY-SMART CHILD

From Toddlers to Teens

NATIONAL ENDOWMENT FOR FINANCIAL EDUCATION



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So Much to Teach! Where Do I begin?

We all want the best for our children. We want them to have good values and an education that will help them become successful. And, of course, part of that education includes learning how to manage money. That's a complex subject. There is so much to learn—how to earn money, how to save and invest it, how to stay out of debt—and more.

To add to the complexity, kids of all ages are targeted by mass marketers pushing a single message—buy everything and anything you want *now*. Plus, money is much more abstract than it used to be. Seeing mom and dad use credit cards, debit cards, ATM machines, and the Internet—instead of cash—can be confusing, especially for young children.

So how do you impart the wisdom your parents and life experiences have taught you about financial matters? How do you get the attention of children who live in a high-speed, high-tech, insatiable consumer society? How can they learn and practice habits based on healthy financial values?

The Big Ideas

When you get down to it, there are six major areas of personal finance. Almost every financial skill your child needs will fit under one of these topics:

- Setting goals
- Earning money
- Spending money wisely (budgeting)
- Understanding the time value of money (saving and investing)

- Using credit responsibly
- Protecting assets

You can teach your child about these areas progressively. In other words, begin when he or she is just a toddler and build on each idea as your child is ready to absorb more complex information. It's important not to wait. Habits form early!

Some parents may be saying, "I haven't saved enough." "I'm in debt." "I don't know much about investing." If you are among the many who feel less than secure about their money skills, don't despair. You can teach your child, even if your own habits aren't yet perfect. After all, there's no better way to learn than by teaching. On the other hand, if you're among those who know a good deal about investing and other money matters, try to be patient while your child learns.

In this booklet, the National Endowment for Financial Education® (NEFE®) suggests various ways to introduce children to financial concepts based on a child's age. However, there is nothing magical about the age brackets. As you undoubtedly recognize, children are different, even within the same family. You know your child best, and you will know when he or she is ready to progress.

Ages 2-4
What Can a Toddler or Young Child Understand?

The answer to the question is…quite a lot. At this age children are like sponges, absorbing a great deal more information than we imagine. They are beginning to develop habits and skills that will last a lifetime. This is the time to lay the foundation for a sound financial future. Here are some basics:

Money is a medium of exchange. Your child can learn that money has value because she can begin by exchanging it for things she needs and wants. Let your child play “store,” setting up things that can easily be counted, such as apples or oranges, and exchanging those items with you for coins. The next time you visit the grocery, let your child hand the clerk the money for a small purchase. (Be sure that you have bills and coins on hand. Your child is not yet ready to deal with credit cards.) Count the change and

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explain that you are checking to see if you received the right amount of money back. At this age your child may not yet be able to count change, but you are demonstrating a respect for the value of money that she will remember.

Equivalency. As soon as your child can count to five, let him collect coins in a see-through jar. (Use a clear jar, not a piggy bank, as a young child may feel that the money is “gone” if he cannot see it.) Let him count the coins. When you sense that your child is ready to learn more, explain that five pennies make a nickel, five nickels make a quarter, and four quarters make a dollar. Let the child give you coins for an even exchange. Very young children may have a hard time understanding the fine points of equivalency. After all, your child may see the quantity of four quarters and assume they are worth more than one dollar, or get confused because a dime is smaller than a nickel. That’s okay. For now, you’re just playing a game.

Saving gets us what we need and want. At early ages, attention spans are short, so saving should be for something immediate. “Let’s save for a box of crayons” is a recipe for success. “Let’s save for a puppy or a bicycle” will only make the child feel that saving is a hopeless endeavor. To make the savings goal seem real, tape a picture of the crayons to the savings jar, and give your toddler a few coins each day to reach the goal. Once she makes her purchase, praise her for reaching her savings goal.

Ages 5-7
Starting to Make Choices

The Allowance

Why give an allowance? At about age five, most children are ready to begin receiving an allowance—one of the most important tools for learning money management. With guidance, managing an allowance can prepare your child for having an adult income and set him on the path to financial well-being. Many experts believe that it is most effective to use the allowance only as a means of teaching money management—not as a source of reward and punishment, or as a means of control.

The importance of choice. Most children will make mistakes. Spending the entire allowance the first day is typical. Let your child do it. But don't bail him out. Instead, discuss how he may want to treat *next* week's allowance.

How much allowance? Some parents base the allowance on age. For example, a five year-old receives $5 per week, a six year-old $6, and so on. However, this method is somewhat mechanical and may be either too much or too little. Another method might be to decide what you expect your child to pay for and then adjust the allowance to his expected expenditures. Look at the current costs of the things children typically buy:

• collector's cards	$1.00
• comic book	$3.00
• kid's movie ticket	$5.25
• action figures	$10.00
• compact discs	$15.00
• video game cartridges	$30.00

Of course, your child does not have to have all of these things. This list is included just to remind you that being a kid is expensive these days. As your child grows older, gradually adjust the amount he or she receives by reviewing and revising the list of items to be covered by the allowance.

When establishing an allowance, start a discussion about needs and wants. Help your child to begin distinguishing between needs—things we must have to live—and wants—things we would like to have. Learning this money management skill can save her from impulse buying and compulsive spending later in life. As she grows, it will allow her to develop judgment about how to control her spending.

When and how often should you give an allowance? For 5-7 year-olds, give the allowance at short intervals—once a week is typical. Give it out on the same day of the week and at a set time of day, say after dinner on Fridays. Have bills and coins in the right denomination. Be consistent. To ensure that no one forgets when the allowance is given out, make a note on the calendar.

Should a child earn an allowance? Parents think differently on this subject. Many reach a compromise, giving the child a base allowance whether he has earned it or not, continuing to expect the child to do basic household jobs as part of the family, and paying extra money for "big" chores. There are several advantages to this method. You avoid family clashes, in which the child says, "No, I'm not going to make up my bed for that price," or "I don't care about the allowance. I don't want to pick up my toys." At the same time, the child learns that he can earn extra money and even negotiate the price for tasks like weeding the garden or dusting the furniture. Be realistic about how much the child can accomplish and how well he can do it. Match the job to the child's ability and then give adequate compensation when the job is completed.

Saving

Goal setting. Talk to your child about saving for something he truly wants and can save for in about a month—perhaps a Junior Monopoly® set for about $10.00, or a remote control car for about $20.00. Show him how much he needs to save each week to meet his goal. Continue to attach a picture of the item to the savings jar to make the goal seem less abstract.

Interest. Start teaching your child about interest. For every dollar she saves, you can add a dime at the end of the month. (This, of course, is more interest than a savings account pays, but at this point you are simply getting across the idea that saving money can earn money.) Keep the dimes in a separate jar so the growth is visible.

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Spending

Learning to shop. If your child has money and saves money, he is ready to learn how to get the most value for that money. In the grocery store, show your children how to select produce such as apples (not bruised), oranges (firm and heavy), and bananas (not too green.) This can be fun, if he or she makes the selection.

When you buy clothing, explain the importance of waiting for sales and selecting quality merchandise. Suggest that he do the same with toys. Ask him to compare the price and the quality of two toys, rather than just forking over his allowance.

More about Money. When we were kids, our parents cautioned us, “Money doesn’t grow on trees.” Today, some children may be as unaware as we were about sources of money. For instance, some may believe that $20 bills just come out of machines, or that plastic cards are all you need to make purchases. How can you offer your child a more realistic picture? Before you go to the ATM machine, take your child with you to the bank to make a deposit. Then explain at the ATM that you are simply using the money you’ve already put in the bank.

When you pay with a credit card, explain that giving the clerk the card is permission to charge your credit card account the amount of the purchase. Be sure your child understands that you will have to pay the credit card bill at the end of the month. When you are paying bills, show your child the credit card statement, saying something like, “Remember the T-shirt we bought for $10? Here it is on the list of things I have to pay for now.”

Ages 8-10
Strengthening the Financial Foundation

Discuss the family budget. Children quickly learn that mom and dad spend a good deal of time working and paying bills. When your child shows an interest, tell her about the big spending categories—food, shelter, clothing, and transportation and how much the family spends on each of these categories. To provide hands-on experience, you may want to let your child help you write out the checks for one month, or if you bank on-line, let her fill in the blanks and click to send the money.

Continue the discussion of needs and wants. You can deepen the discussion about needs and wants by pointing out that the central budget items are needs To help make the distinction, one mother had her kids inventory the family room, listing each item as either a want or a need. It didn't take long for her son to see that the Nintendo® was a want, and the telephone a need.

Learning to wait. You may also want to talk about delayed gratification—not in those words, of course. You can point out that if you don't actually need something, you can wait to purchase it until you have cash in hand. To the inevitable question of "why?" give a simple answer. Just say, "We don't want to owe too much money. We have to earn the money before we can spend it." Anticipating a purchase and finally being able to afford it can instill a great sense of pride.

More about choices. This may be a good time to introduce the idea of trade-offs. Tell your child that even very rich people can't have everything. This is a tough concept and may lead to a discussion about value. Point out that you have to know what you value most before making a choice. For example, if your child begs for an expensive software game, you might ask if he is willing to trade off Saturday movies for a while.

Starting a savings account. Now is the right time to set up a savings account for your child. Some banks and credit unions have child-friendly accounts that do not require a minimum balance and charge low or no fees. Shop for one of these so your child's savings will not be eroded. Savings rates continue to be low, averaging around one percent. Explain to your child that once she saves a certain amount, she can open a Money Market account or a Certificate of Deposit (CD) with a higher interest rate. This can become a savings goal.

Few financial institutions offer passbooks anymore, so you will probably need to find other ways to make the growth of savings visible. One way is to have your child write down all deposits in a notebook. Also, go over the savings statement with her to see how much interest her account has earned. Keep the savings statements in a three-ring binder, by date, for easy reference.

Should your child have to save? Iron-clad rules seldom motivate, but you may want to strongly suggest that at least 10 percent go into savings. Financial planners recommend the "70-20-10 Rule"—that is, 70 percent of income should be earmarked for spending on immediate needs, 20 percent should be set aside for the purchase of big-ticket items, and 10 percent should be saved or invested for long-term goals. The point is to establish the savings habit.

Help your child establish a savings program with short-term, intermediate, and long-term goals. Show your child that some savings goals are short-term (money for snacks at the movie), others are mid-term (a baseball glove), and still others are long-term (such as saving enough to open a higher-paying savings account, or buy a computer).

It helps greatly to break total amounts needed to meet each goal into the amounts your child will need to save each “pay day” to meet the goal. For example, let’s say your son decides he wants a baseball glove. The glove costs $40. How much must he save each week to buy the glove? If he can save $4 per week—or $8 every two weeks—it’ll take 10 weeks.

To keep children interested, some parents set up matching programs. For every dollar the child saves, the parent puts in a dollar—much like some employer savings and retirement plans. This can be especially helpful in keeping a child focused on long-term savings goals.

Encourage entrepreneurial effort and earning extra money. One great source of extra money is a garage sale. Your children can sell their old toys, books, and clothing. They can polish, wash, and mend things so that the sale items will be more attractive to prospective buyers. You may have to help set realistic prices. The depreciation in what was originally paid for the item and what it can be sold for can be instructive.

Ages 11-13

Dealing with Peer Pressure and Learning to Plan

Keeping up with “everyone else.” During the middle-school years, and even before, “what’s hot, and what’s not” is an enormous force, enticing your child to spend. You really can’t control peer pressure. However, by the time your child has reached age 11, she should know about ways to make money (allowance, extra jobs) and how to spend it wisely (savings, planned expenses.) If you have been paying her interest on savings, she has a rudimentary grasp of the time value of money concept. With this background, you may have noticed that your child is beginning to have the independence and self-confidence to make her own judgments. Continue to allow her to make decisions on her own, even if it means she sometimes spends money on the latest fad.

Sometimes, as parents, we are hesitant about teaching budgeting, investing, and other essential money skills, because we don’t do these things perfectly ourselves. The best thing to do? Wade in and open a dialogue about money. Talk to your kids about what they earn, what they save, and what they spend. Let them know how important you think it is to learn more about saving and investing. If you’re not already savvy about these subjects, think of learning more as a joint project. You may also want to talk to other parents about how they are handling their childrens’ financial education.

A good time to introduce the “magic of compound-interest.” You could make a game of this by looking at a compound-interest rate chart with your child. To illustrate the power of compounding, show your child how a dollar grows over various periods of time at various interest rates. Then show what happens if you increase the amount to $100. Kids get excited when they see how well they can do.

Pacing spending. Review your child’s allowance with him to see that his “income” covers what you expect him to pay, adding items when necessary. Again, lengthen the time between giving out the allowance—say to once every two weeks—so that he can learn to pace himself. If your child runs out of money before the end of that time, you might lend him some, but insist he pay it back from his next allowance. Keep careful records and continue to be consistent about his allowance day. Otherwise, he’ll get used to you bailing him out, and the opportunity for him to learn more about money management will be lost. If he continually runs out of money, don’t rescue him. This is a good time to introduce your child to the concept of a spending plan, or a budget.

Budget Talk. Talk to your child about budgets and ways to live within one. Show her how the family budget works. Keeping track of expenses and living within a spending plan is hard for most people, so don’t expect immediate comprehension from your pre-teen. What you’re working on now is laying a foundation for understanding.

Look for teachable moments. Be observant and notice what your child truly wants. When the time is right, talk about how she can achieve what she desires. It would be helpful to have her determine how much she needs to save each week in order to reach her goal in a given amount of time. As she learns to plan and prioritize, she is learning the skills needed for a more formal approach to budgeting.

Introduce your pre-teen to market concepts—or explore these concepts together. It's easy to get basic investment information. There are many quality Web sites and books on investing, some written specifically for young people. Talk to your kids to see what they already know. Also, go over basic investment principles such as setting investment goals and diversifying investments to reduce risk. Buy them a small amount of stock in companies they recognize and help them track it—or do this using fictitious "money," just for the fun of it.

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Ages 14-18
Getting Ready for the Adult World

Some tips for your teen-ager.

- If your child has already learned about goal setting, saving, credit, and basic budgeting, good! If not, start the teen years by communicating these skills as outlined in previous sections.
- Encourage your child to take any personal finance instruction offered in school.
- Have fun with your teen-ager by searching and visiting quality personal finance Web sites.
- Keep the dialogue about money open. And let it be a discussion rather than a lecture.

Earning a paycheck. Especially in the early teen years, your child needs guidance about employment. You may want to discuss values, with school being the top priority. (Some parents set a limit on work outside the home—as does the law.) If your teen does take a job, it's important to go over codes of conduct and dress at work, the importance of being on time, and other employer expectations.

Your teen-ager can learn a lot from having a job. One of the most important things is the concept of "pay yourself first." If he begins to set something aside from every paycheck, his savings will grow. More important, he will establish a lifelong habit that can result in financial security in the long run.

In addition, by looking at his pay stub, he can see how taxes affect his take-home pay and how many hours of work it takes to buy a pizza or a favorite CD. Work with your teen to figure out how the items he buys equate to hours spent earning money for them. Understanding this relationship may counter the temptation for him to spend every cent he earns "because there's more where it came from."

Managing a checking account. Shop around for an account with the smallest balance requirements and the lowest service charge. Talk about fees for bounced checks and how to report a lost checkbook.

Many accounts now offer ATM debit cards that can be used for purchases instead of writing checks. Make sure your child understands that using the card takes money directly out of her account and that she must write down the amount of purchase in her check register, just as she would record a check. Work with her to balance the checkbook for the first few months.

High school students can learn a lot about how to manage a credit card by first using a debit card.

Learning how to use "plastic." When teenagers go to college, they are often bombarded with credit card offers. High school students can learn a lot about how to manage a credit card by first using a debit card. Because money comes out of a bank account, this type of card reinforces the need to pace and limit spending.

A debit card can be attached to either a checking account or a special savings account designated for "personal expenses." Attaching a debit card to a savings account is economical because no checking account fees are incurred. And using a debit card has the added benefit of helping teens establish a working relationship with a financial institution.

When your teen does graduate to using a credit card, look for one that lets you establish a ceiling—$500, for example. Communicate that:

1. Credit card purchases are loans. The price for the loan is called "interest." It can be very high, especially if the borrower pays only the minimum each month.
2. There's one way to avoid paying interest, and that is to pay off the balance each month. Always do this, except in true emergencies.
3. It's important to shop for the best deal. Compare interest rates, annual fees, late fees, and grace periods.
4. One credit card is plenty.

Investing. Did you know that a 15 year-old with earned income who invests $2,000 a year in a Roth IRA for just five years (until she reaches age 19) will have almost one-million dollars tax-free at age 65, if the account earns a little over 10 percent? This is the magic of compounding! And it should impress most teen-agers. Some mutual fund companies will allow your teen to start a Roth IRA account with the initial $2,000 deposit and low monthly deposit amounts thereafter.

In addition to the Roth IRA, you can also open a custodial or guardian account for your teen-ager's investments. Keep in mind, however, that if your teen is college-bound, the financial aid office will expect a large percentage of your child's custodial account to cover college expenses. (It's often better to save for college in the parent's name.)

More about the market. Some teens are truly sophisticated about stocks, bonds, and mutual funds. Others are not, but they may be interested in learning. Talk about the best way to start investing, the risks and rewards, terminology, different types of investments, and the value of long-term investing. All of the basics are covered in detail on a number of quality Web sites, which you and your teen can explore together. Discuss how to monitor investments and the advantages of dollar-cost-averaging. (Or how about asking your teen-ager to teach *you* these concepts.) Know that neither you nor your teen-ager needs to be a stock market genius to do well financially.

Talk with teens about the best way to start investing, the risks and rewards, terminology, different types of investments, and the value of long-term investing.

Learning about insurance. Teen-agers need to understand that insurance is a way of managing risk. Discuss with them how much they think a major illness or car accident might cost. Once they have the idea, you can say that we have insurance to protect ourselves against financial loss resulting from occurrences beyond our control. Teens should know the basic facts about:

- **Health Insurance and Disability Insurance.** Check to see how long your family policies will cover your child and share the information with him. Colleges, universities, and private employers often provide this coverage, but young adults looking for a job may need to take out a temporary interim health policy and a disability policy. Young adults who are self-employed, or who work for an employer that does not offer such coverage, will have to search hard to find affordable quality policies.

- **Car Insurance.** Many parents ask their child to cover the increase in car insurance that comes when a teen-ager starts to drive. Your teen should know how to shop for car insurance, getting quotes from several companies before choosing a policy. If your teen owns an older used car, you may want to suggest that he take out just liability and uninsured motorist insurance, foregoing collision and comprehensive coverage.

- **Renter's Insurance.** If your teen-ager is leaving home or plans to live off campus, she should consider protecting her property with renter's insurance. If she has items such as a computer, stereo equipment, etc., the cost makes sense. Paying for renter's insurance can be good preparation for understanding homeowner's insurance in years to come.

A Closing Word about Teaching Your Kids Financial Skills

Now that you know where to start teaching your kids about money, you may be saying, “There’s still so much we both need to learn. Am I leaving out important things? Are my kids absorbing these ideas?”

It is essential to remember that your children may be mirroring your money habits. While you are teaching your kids the core concepts highlighted in this booklet, make sure that you are following your own advice. From your good example, they will begin to see how to apply these basic ideas practically. Your enthusiasm and creativity in passing along this information can instill in your children the habits and skills they need to put these ideas to work. Introduce them to additional personal finance information available in books, courses, and on the Internet. It makes sense to add to their knowledge and skills base because learning to manage money wisely and well is a lifelong endeavor.

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Resources

Books

Investing on a Shoestring by Barbara O'Neill (Chicago: Dearborn Financial Publishing, 1999).

Learn to Earn: A Beginner's Guide to the Basics of Investing and Business by Peter Lynch and John Rothchild (NY: John Wiley and Sons, 1997).

Making the Most of Your Money by Jane Bryant Quinn (NY: Simon & Schuster, 1997).

The Wall Street Journal Guide to Understanding Personal Finance by Kenneth Morris and Alan Siegel (NY: Fireside/Simon & Schuster, 2000).

The Wealthy Barber: Everyone's Commonsense Guide to Becoming Financially Independent by David Chilton (3rd ed., Rocklin, CA: Prima Publishing, 1998).

Web Sites

General Personal Finance

http://finance.yahoo.com

www.moneycentral.msn.com

http://money.cnn.com/pf/101

www.NTRBonline.org

www.usatoday.com/money/front.htm

Investing

www.bloomberg.com

www.invest-faq.com

www.investorwords.com

www.younginvestor.com

The National Endowment for Financial Education (NEFE) is an independent, nonprofit foundation dedicated to providing individual Americans with the knowledge and skills they need to make positive choices and informed decisions concerning their personal finances.

One of the foundation's key initiatives is to encourage in the nation's young people an understanding of personal financial planning and the acquisition of sound money management skills. It is NEFE's firm belief that competence in managing one's finances results from certain attitudes and behaviors toward money, and that these are more easily instilled if taught early in life. Providing basic financial planning education to young people today will help to create a population of more fiscally responsible and self-reliant adults tomorrow.

The National Endowment for Financial Education provides this brochure and other educational resource materials to consumers as a public service.

Free copies of the following personal finance materials are also available by writing to the National Endowment for Financial Education.

- The NEFE Wealth Care Kit—a consumer guide to establishing and maintaining a financial wellness program.
- Your Spending, Your Savings, Your Future—a guide on developing and nurturing fundamental money management skills needed for most financial circumstances.

To learn more about current and past NEFE projects, visit www.nefe.org.

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