



Adult Children and Money: An Estate Planning Perspective

by Jon J. Gallo, J.D.

This month's Money and Soul column, written by my wife Eileen, discusses the need for financial advisors to be proactive and psychologically aware when working with clients whose adult children are exhibiting extended economic dependency. My column examines two areas—estate planning and credit cards—where the financial advisor's expertise can become a valuable tool in helping your clients avoid the problem of financially dependent adult children.

Far too few financial advisors think of themselves as resources who can be used to educate their clients' children in the appropriate management of family money. This is a shame, because doing so provides the clients with a capability they lack—both anecdotal experience and formal studies demonstrate that it is often easier for children to learn from outsiders than from parents—while enhancing the likelihood of long-term client retention.

All of us who work with affluent families can tell horror stories of millions of dollars in trust funds being dissipated by children as fast as they receive them. In almost all cases, these children never received training in money management. As Eileen and I point out in our book, *Silver Spoon Kids: How Successful Parents Raise Responsible Children* (McGraw-Hill, 2002), many children growing up in affluent homes have this notion that money grows on trees, that they have so much that they'll never run out of it, and if they do, they can magically grow some more. As a result, they are incapable of exercising restraint when they receive the money from a trust. In our opinion, the biggest error parents commit when creating trusts

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for children does not involve running afoul of the Internal Revenue Code; rather, it is failing to structure them in such a manner that they provide an opportunity for their children to learn money management. In this process, the financial advisor can play a major role.

Psychologically, trusts created for children are meaningful to them in ways that other money subjects aren't. After all, it's *their* money that's in trust, and a 15-year-old is likely to pay much more attention to a discussion of *his* trust than he is to an abstract discussion of family money and investments.

Trusts as a Learning Tool

Here are four ways to help your client turn a trust for his or her children into an educational money management vehicle long before the children actually start receiving trust distributions. To take advantage of this approach, a distinction should be made between a trustee's duties to manage assets (the administrative function of the trustee) and the trustee's discretion over distributions of income and principal (the distributive function of the trustee.) This distinction will permit the children to become administrative co-trustees who may participate in the management of trust assets,

without giving them authority over distributions of income and principal, which can be vested exclusively in a distributive trustee.

1. The trust agreement should provide that all children who have reached age 15 are to meet periodically (at least once a year) with the administrative trustee and the trust's financial advisor. At the meeting, you will have the opportunity to explain both how and why the assets of the trust are currently invested. This gives you the opportunity to introduce the children to concepts such as asset allocation and investing for growth or income.
2. Suggest to your client that at some point each child should become a co-administrative trustee of his or her trust. You could select an age for this purpose, such as when the child reaches age 18, 21 or 25. You might also want to tie it to an event, such as when the child completes two classes in investing or when he or she graduates from college. The child is now involved in day-to-day management of their own trust and getting a hands-on education in their co-administrative trustee capacity.
3. After several years of serving as a co-trustee, the child should “graduate” to sole administrative trustee and assume responsibility for trust management and

investment. A properly drafted trust agreement will allow the trustee to hire money managers to assist in investing trust assets. Again, this will serve as a post-graduate course in money management.

- Your client may want to structure the trust so that the child becomes the sole distributive trustee at some age. If you do so, the child is now able to exercise complete control over his or her trust. By doing so, the client has essentially communicated that the child is now sufficiently responsible to handle the trust without any help or limitations. By continuing to keep the property in trust rather than distributing it outright, you are providing the child with important protection from creditors, bankruptcy and divorce.

Credit Card Education

Like trusts, credit cards have significant potential for teaching adolescents and young adults about money management. Here again, the financial professional can be a significant asset.

In 2001, almost 150,000 young people between 18 and 25 declared bankruptcy. The single largest cause was credit card abuse.

According to the American Council On Education's National Postsecondary Student Aid Study, almost 80 percent of undergraduates in the 1999–2000 school year had at least one credit card with a median balance of \$1,600. Most colleges and universities contribute to the problem. A study of 12 public and private universities and colleges, published in June 2001 by the General Accounting Office, showed that 10 allowed soliciting of students for credit cards, 8 allowed credit card applications to be inserted in bookstore bags and 11 had alumni associations with affinity cards that carried the logo of the institution and paid rebates based on student spend-

ing. Four out of six credit card companies soliciting on campus had no income and employment requirements for college students.

The following four-step process is a road map to help your clients maximize the educational potential inherent in credit cards.

Explain the importance of a good credit history. Without good credit, young adults find it impossible to rent a car, lease an apartment or purchase anything over the phone or through the Internet. It is far worse to have a bad credit history than no credit history at all. Some parents with whom we have worked simply co-sign for a credit card in their child's name with a low (\$100–200) limit, use the card once a month to make a \$10–20 purchase and pay the statement in full each month. While this practice will ensure an excellent credit rating, it won't help the child learn anything.

Do a trial run. Start with either a debit card tied to a checking account or a prepaid credit card, such as Visa Buxx. In either case, the amount that can be charged is limited. This avoids the possibility of a spending spree when the child is first learning about credit cards.

Debunk the myth of easy credit. Once the child is sufficiently responsible to have a credit card, explain the real cost of credit. Determine the annual percentage rate and explain how interest accrues and increases the cost of what is being purchased if the entire balance is not paid every month. Whether the card can be paid off every month is a function of the child's income (allowance plus any income from discretionary chores or a part-time job) and the amount charged on the card. If the card will not be paid off every month, recommend that an appropriate dollar limit be set. Make sure the child understands the connection between charging one month and paying the bill the next month. Teach the child about late fees. The credit card issuer may charge \$25 for a late payment, even if the balance is only \$10! Stress the importance of keeping the card safe, and

help the child figure out what to do if the card is lost or stolen.

Monitor the child's use of the credit card and discuss purchases. This process needs to be carried out by the parents on a monthly basis. It serves two purposes.

First, the parents can observe whether the child is handling the card responsibly. Is the child paying the full amount each month? Incurring late charges? Using the card for inappropriate purchases, such as a \$5 charge for fast-food that could have been paid for with cash?

Second, it's an opportunity to observe and discuss the pattern of purchases. It's eye-opening for kids to realize that they're spending their entire allowance on gas for the car each month or that they are single-handedly keeping the local clothing store in business. Credit card statements can't be rationalized away or denied; they offer clear evidence of spending patterns. The parents should be cautioned not to use the discussion process as an opportunity to berate the child for poor judgment. Instead, they can employ it as a launching pad for a discussion of whether this is the best way for their children to use their purchasing power.



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