Financial Planning
The View From Lowry Hill

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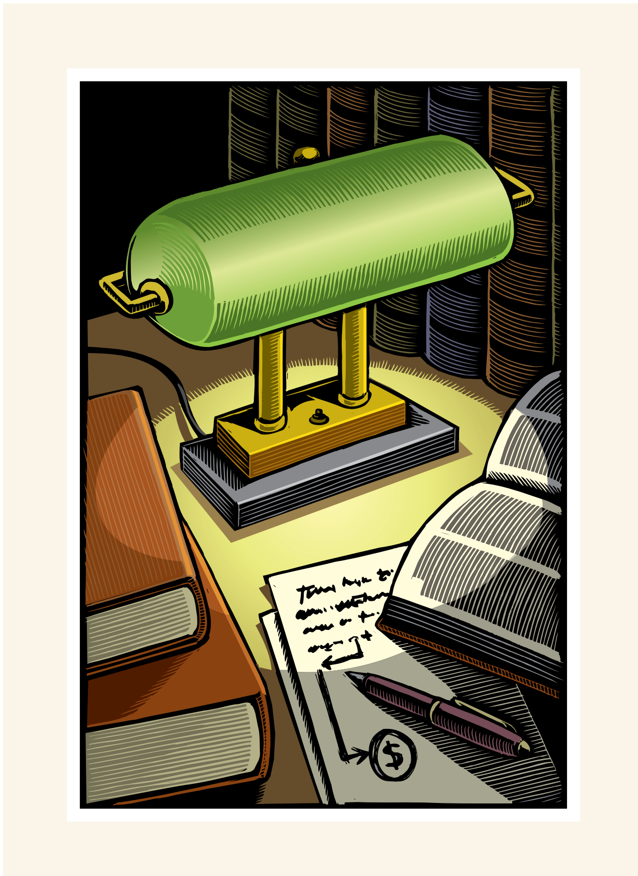

The Transition to Adulthood: Readying Children for the Real World

There are a plethora of books, magazines, guides and tips to help prospective parents better understand what to expect when a new little one arrives. Unfortunately, the sequels to these start-of-life resources seem to dwindle at every subsequent stage in a child's life. With statistics indicating that an additional two million youth will turn 18 years of age during every year for the next five years, it seems books devoted to a child's transition to adulthood would be frequent best sellers.

In this issue of *Financial Planning: The View From Lowry Hill*, we will explore some of the key issues facing both children and parents (or other adults in a child's life who help provide guidance and support) during this period, as well as identify measures that can be taken to facilitate a smoother transition into adulthood.

Becoming of "Legal" Age

Although some people still appear quite young at the age of 18, they officially shed their minor status—attaining the "age of majority"—and become adults in the eyes of the law. In addition to encouraging your child to register to vote, following are a few issues for you to consider when your child reaches that magic age of 18.

Signing over Minors' Accounts

If a child has an UTMA (Uniform Transfer to Minors Act) or UGMA (Uniform Gifts to Minors Act) account, documents will need to be signed and submitted to the financial institution where the account is held in order to transfer such funds into the young adult's name when he or she attains the age of 18, 21 or sometimes 25 (depending on the state in which the account is established). Translation: Parents and custodians will no longer have control over those funds unless the young adult owner signs applicable documents permitting the parent to have access to information about, or assist with the management of, the account.

Legal Documents

Upon reaching the milestone 18th birthday, a new adult will be in the driver's seat regarding his or her own financial, medical and educational information—even if he or she is still in high school. As such, it is important that you discuss and have the following legal documents prepared and signed. (Note: Actual legal terminology may vary from state to state.)

- *Health Care Power of Attorney.* This document is important because it designates an agent to make medical decisions if an adult child becomes unable to do so on his or her own (e.g., after severe injury in a car accident). Without a Health Care Power of Attorney, parents may end up spending time in emergency court hearings trying to obtain legal authority to make time-sensitive medical decisions for their child.
- *Living Will.* The young adult should also consider whether he or she wants to execute a "Living Will," which would allow for the removal or discontinuance of food and water if the person is in an irreversible coma. This may be uncomfortable to discuss, but keep in mind that Terry Schiavo (who became well known during the late 1990s and early 2000s when her parents and husband engaged in bitter court battles because she didn't have a Living Will) was only in her 20s when she entered into a persistent vegetative state. (Note: In some states, living will provisions may be included in, and combined with, a Health Care Power of Attorney document which is then referred to as a "Health Care Directive.")
- *Durable General Power of Attorney.* This document will appoint an agent to make financial decisions for the young adult if he or she becomes unable to do so (even in a temporary capacity). Without this legal instrument, someone would have to apply to the court to become the legal "conservator" or "guardian of the estate" in order to handle the young adult's financial matters during incapacity.

Obtaining Credit and Establishing a Credit History

The Credit Card Accountability, Responsibility and Disclosure ("CARD") Act of 2009 now prohibits credit card issuers from lending to anyone under the age of 21 unless he or she has a co-signer (or has proof of his or her ability to make payments).

So how can college students establish and build their credit history? Parents can authorize their child to become a user of their existing credit cards. Even better, parents can obtain a new credit card with a substantially lower credit limit and allow their child to be a user of that new card. This "trial period" of usage can be a win-win for both parents and child. It is beneficial to the child because the usage will be reported to the credit card bureaus under the child's own name which will build his or her credit history. Co-owning a credit card also allows time for parents to teach their child how to use it for purchases while tracking their child's spending (as well as to counsel the child to avoid late fees and finance charges by paying off the entire balance prior to the bill's due date).

Leaving the Nest

When the time comes for children to leave the family nest (whether they are going to college, going abroad for a gap-year program or otherwise), consideration should be paid to the following issues:

College Planning and Funding

It is important to explore the many options made available by third parties for funding higher education expenses, including grants (which do not have to be paid back), loans or scholarships (which may be merit-based instead of solely financially need-based). When discussing college funding, it is also important for the parents and child to talk about expectations concerning the college plan (including how many years of higher education the parents are willing to finance).

- *Using 529 Plans.* When it is time to tap into 529 plans, it is important to understand, as well as explain to the child, the withdrawal and payment processes required by the particular plan. Establishing a strategy and "tracking" mechanism for determining which educational costs will be paid by the 529 plan (or in some cases one of several 529 plans) can facilitate the child's and family's budgeting processes.

- *Direct Tuition Payments.* Good news: Payments made by anyone (the payer does not need to be related to the child) for tuition *directly* to the child's education institution are *not* subject to a gift tax (even if the amount paid exceeds $13,000 per year and even if the child already will be receiving a $13,000 gift). As noted, it is critical that payments are not made to an individual; they must be made only to the college or university.

Insurance Coverage

Because individuals under the age of 18 are unable to legally enter into contracts, insurance (particularly vehicle insurance) is usually covered and paid for under a parent's policy. In order to limit the parent's liability once the child turns 18, it may be worthwhile to evaluate with the insurance carrier whether he or she should take title for the vehicle in his or her own name and obtain a separate policy. A lack of driving history and the teen's age, as well as the lack of multi-vehicle discounts which previously may have been applicable, could weigh against this option. However, it still may be worth evaluating with the child and your insurance professional. An umbrella policy to insure over-limits on the vehicle should also be considered. Lastly, the young adult should consider purchasing renter's insurance if he or she will be living in a dorm or apartment.

Accessing a Student's Educational Information

The Family Educational Rights and Privacy Act of 1974, as amended (called "FERPA" or the "Buckley Amendment"), prohibits the release of student information from education records to anyone other than the student. Accordingly, information such as a student's grades, health services or disciplinary action will not be disclosed to anyone—even to the people who are paying the tuition bills—in any oral or written communication. That said, many educational institutions have procedures that allow students to grant their parents access to certain parts of their student records (including permitting the students to establish "shadow" access to portions of their Web-based accounts for others to view). Having a discussion regarding a mutually respectful method of communication concerning a student's records is advisable before the child leaves for college.

Identity Theft, E-reputation and Personal Safeguards

Young adults spend significant time on the Internet and social media sites. Through their various profiles, they expose tremendous amounts of information about themselves. Identity theft has become rampant across the country—particularly for people in this age group. Young adults should exercise caution when determining what information to put into profiles and social media messages (e.g., not broadcasting when the person will be out of town or not including personal identification information such as date of birth). Moreover, in a society where potential employers and others frequently conduct Internet searches to learn more about people, it becomes even more critical that young adults learn to monitor and manage their "e-reputations." Finally, in situations where a student is living with a roommate or roommates, particular attention should be paid, and precautions taken, by the student to ensure that his or her valuables, passwords and information are kept in a secure area. This is especially true if the student does not know the roommate (or the roommate's friends and acquaintances that may come to visit) well.

Communicating When They're Not at Home

For a free alternative to paying for long-distance—or even international—telephone calls, try using www.skype.com (where people can talk or make video calls for free using an Internet connection).

Not all cell phones work overseas. If the young adult is participating in a study-abroad program or traveling internationally, be sure to check whether his or her cell phone will have appropriate coverage at the destination. Calling plans and pre-paid calling cards that are inserted into international-capable cell phones differ from country to country.

More "Big Firsts"

Young children have lots of "big firsts"—first tooth, first step, first words. Children moving further into adulthood have plenty of big firsts as well—first career job, first house, etc. During this period, young adults often are faced with competing goals: Should they start paying off a greater portion of their student loans or use the money to save for a down payment on a new house? Or should they use money to fund a retirement account or buy the latest electronic gadget? Start by having your child re-evaluate his or her budget and set certain financial goals and priorities. Establishing a well thought out plan before your child encounters these "firsts" can help build confidence with respect to his or her financial path.

Funding Retirement with First Job

When young adults start their first jobs, they should consider automatically and *immediately* funding their retirements from their paychecks (even if it is only with a modest amount of money to start). The power of compounding is significant. The younger a person is, the more time the account will have to grow during his or her lifetime. The temptation often exists to put off funding a retirement account until after a home is purchased, student loans are paid off or a new car is purchased, etc. Therefore, suggest that money automatically go to the retirement account before the person puts it in his or her pocket. There is better chance they will "miss" it less that way.

Obtaining Credit or a Mortgage

Because obtaining credit is much more difficult today than in past years, getting a loan can be tricky for someone who is just starting out. Before attempting to obtain a loan, suggest that the young adult request a copy of his or her credit score so that he or she understands how outside sources view his or her credit worthiness. If any information in the report is inaccurate, he or she also can report the error to the credit reporting agency and contact the information reporting company. In the event that the young adult's credit score is too low (such that third-party financing is not likely), intra-family loans may be a viable option. The IRS dictates that a minimum amount of interest (i.e., the Applicable Federal Rate) must be charged on intra-family loans in order to avoid the loan being characterized as a gift (which could lead to the imposition of the gift tax). Typically the interest rate is much lower than a person could obtain in the lending market. It is important to note that in order for intra-family loans to "work" (from an IRS perspective, as well as to assist a child in becoming financially stable rather than simply enabling financial dependence on the parents), all formalities (including repayment terms) must be observed as if the lender was not related to the borrower.

Revisit Insurance Coverage

Once people attain certain ages or have multiple insured assets (e.g., home, car), they may be eligible for decreased premiums or discounts on property and casualty insurance. Consideration of an umbrella liability policy may also be prudent. Furthermore, purchasing life insurance (whether term or whole life) at a younger age is typically less expensive than waiting until later in life. It may be worthwhile for your child to go through an insurance analysis to assess his or her insurance needs.

Long-term Relationships or Marriage

If your child is in a long-term relationship or heading down the marriage aisle, encourage him or her to openly discuss financial goals with his or her fiancé or partner. Because financial issues are one of the leading causes of marital and relationship discord, suggest that the couple establish a joint financial plan and communicate regularly about whether they are on-track with their plan and goals. Because children of affluent parents might have family wealth to protect, consideration of a pre-nuptial agreement (or domestic partner agreement) or even separate accounts may also be in order.

Children will continue to have new financial experiences with varying complexity as they transition into adulthood. At each phase, parents and other adults involved in their lives have many opportunities to provide proactive guidance. Discussing issues ahead of these milestones may prove invaluable to children in securing eventual financial competence and independence.

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