MONEY 101 EDUCATION

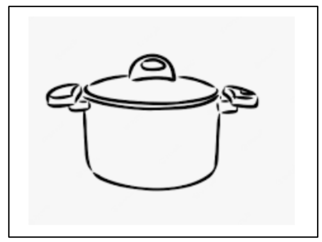
10.32 How do couples set up their finances? – one pot, two pots, or three pots

When couples form a household together, a common issue to resolve is "how will finances be handled?" It is advantageous to discuss this issue BEFORE moving in together. The key is to approach to topic with openness and transparency.

An advisable first step would be for each person to prepare a budget, listing their current sources and uses of cash. Additionally, each person should prepare a Personal Financial Statement showing their existing assets and liabilities. Hiding anything from a partner, especially if they are to become a future spouse, is a sign of trouble and will invalidate a pre-nuptial agreement should the couple proceed to write one.

Once the couple has prepared their current budget, they should work on what will change when they live together. A new budget should be drawn up, and a method agreed upon IN ADVANCE as to how bills will be paid and finances maintained.

Methods include:



ONE POT

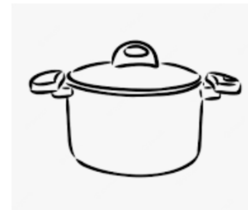
In the "olden days," it was common for couples to open up a joint checking and savings account, have all of their income deposited into the account, and pay all their bills from the account. One person usually took on the role of bookkeeper and wrote the checks to pay the bills. Provided there was enough incoming cash to cover expenditures, and there was no disagreement on how each partner was spending money, this worked.

However, if there were not enough funds to cover needs, or one partner resented the other's spending, it was easy for problems to arise. It was common that the "bookkeeping" partner was the higher wage earner, and then would set limits on the other partner's expenses – calling it an "allowance." Problems could easily escalate when one partner felt their expenditures were being limited and the other was not making a similar sacrifice.

Furthermore, in this scenario, the non-bookkeeping partner often did not have accurate information regarding household finances. Unless a partner sees the monthly inflow and outflow over at least a year, it is easy to have the information become fuzzy. Whether it was because one partner wanted to keep control or the other partner was lazy is up to discussion – but over the years, the lack of knowledge can create an imbalance that is not healthy.

The one-pot setup does make sense if only one partner is working; however, in those circumstances, it is critical that a mutual budget be agreed upon in advance including discretionary spending by both parties and the bookkeeping function should rotate between the partners annually so that both partners have complete knowledge of the finances.

TWO-POTS



A more modern approach is for both parties to keep separate checking and savings accounts and NOT commingle their funds. However, they do prepare a budget and divide the routine bills so that one person pays for certain items, and the other partner pays for other items.

However, agreeing in advance on the items that will be shared is important. While it is common to agree to share expenses related to housing, insurance, basic transportation, and child care, couples may have different attitudes towards sharing discretionary expenses such as luxury cars, vacations, clothing, club memberships, entertainment and eating out, gifts to others, retirement savings, paying past debts and tax liabilities.

Often couples may differ on how much to allocate towards their children's expenses – for example is private school or summer camp a necessity? Or a discretionary expense? How about saving for their children's future educational needs?

Additionally, even when the items to be shared are agreed upon, couples should decide on the method for allocating the total cost. In most cases, couples make the division based on their gross income ratio, thus if one person earned twice as much, that person might pay 2/3 and the other partner 1/3. Normally this works, but it can become challenging if one partner is an entrepreneur and lowers their own income by reinvesting funds in the business.

The key is to discuss the shared expense division methodology upfront because one thing is certain, life will bring changes.

THREE POTS

A hybrid of the one or two-pot method – is the three-pot approach.

The partners maintain separate accounts for their discretionary expenses but also have a joint account. Each person deposits money into the joint account at the beginning of the month, and the agreed-upon bills are paid out of this account.

Again, it is critical to agree in advance on

- what will be paid out of the account.
- how much will each partner contribute monthly
- who will perform the job of "bookkeeper" and how often should the job rotate

Alternating the role of the household bookkeeper is important, so that both parties "stay knowledgeable" and in touch with the finances.