



Impact of Award Displacement on Students and their Families: Recommendations for Colleges, Universities, Policymakers and Scholarship Providers

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Objective

The purpose of this paper is to inform federal, state, institutional¹ and scholarship provider policymakers and scholarship professionals about the negative impacts that award displacement can have on students and their families, college access, college completion and college affordability. This paper also recommends changes to federal, state, institutional and scholarship provider policies and practices so that students may gain the full monetary value of private scholarships² when they are combined with federal, state and institutional financial aid to pay for their higher education. Improving awareness and cooperation between scholarship providers, colleges and universities, and federal and state governments will help increase student access to, and completion of, higher education.

What is Award Displacement?

Award displacement³ occurs when receipt of one form of financial aid, such as a private scholarship, leads to a reduction in other forms of student financial aid. Throughout this paper, the term “award displacement” is used to refer to the reduction of grants and scholarships, or gift aid, when a student receives a private scholarship; however, award displacement describes any situation in which one type of aid supplants another, as opposed to supplementing it.

Reductions in institutional grants, other scholarships, student loans, and/or student employment that are prompted by a student’s receipt of a private scholarship are all forms of award displacement; but the impact on the student depends on which type(s) of aid the scholarship displaces. Some forms of award displacement are more or less beneficial than others. For instance, federal and state statutes and regulations and institutional policies and practices may require financial aid officers to

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- 1 This paper uses the term institution to refer to institutions of higher education, such as four-year colleges and universities serving traditional aged students. However, many of the displacement scenarios may apply more broadly.
 - 2 This paper uses the term private scholarships to refer to scholarships awarded by independent providers as opposed to scholarships and grants awarded by colleges and universities. Such scholarships are sometimes referred to as independent scholarships, outside scholarships or external scholarships. However, some institutions have foundations or other supporting organizations that may practice award displacement in the same manner as the institution for which they are raising the scholarship funds.
 - 3 Students who do not receive need-based aid, such as wealthy students, are generally not affected by award displacement. When a high-income student receives a merit-based scholarship, no award displacement occurs. When a low-income student receives a merit-based scholarship, the private scholarship may be fully or partially displaced. This is a significant source of inequity implicit in the financial aid policies of most colleges.

make revisions to students' need-based financial aid packages when the student receives a private scholarship(s). When revisions are made that reduce the student's loan debt the net price⁴ of higher education decreases, a positive result. On the other hand, when a private scholarship(s) merely replaces previously awarded institutional or state grants, there is no change in the net price and thus no improvement in access to or completion of a student's higher education goals.

Award displacement can occur even when there is a reduction in the net price of higher education. For example, the following scenario describes how the value of the private scholarship is effectively cut in half for the student, and does not yield the positive impact that the donor intended. A student at Institution A receives a \$2,500 private scholarship and the institution uses 50% of the scholarship to replace institutional grants and 50% to replace loans in the financial aid package. The net price to attend the institution decreases by \$1,250 because part of the private scholarship replaces loans (that must ultimately need to be repaid), but since the other \$1,250 of the scholarship supplants the \$1,250 in institutional grants the overall decrease to the net price of education is only 50% as much as it could have been, a form of partial displacement.

Implementation of Award Displacement

The implementation of award displacement may depend on when the institution learns about a student's private scholarship(s). Institutions often have some flexibility in how they reduce the financial aid package when a student is overawarded. They can choose whether to reduce loans first or grants first. Some will reduce a combination of loans and grants. They can increase the student's cost of attendance (COA) or decrease the student's estimated family contribution (EFC) to increase financial need, thereby eliminating the overaward. However, this type of change, called professional judgment, is subject to the discretion of the institution's financial aid administrators and must be based on a student's documented unusual circumstances. Although federal overaward regulations and institutional financial aid policies can contribute to award displacement, institutional financial aid policies usually control how displacement occurs. Some institutions will reduce their grant aid before reducing government student aid funds, while others will reduce loans and student employment before reducing institutional grants.

If the institution learns about a private scholarship after the student has received the financial aid award letter but before financial aid is disbursed, it might issue a revised financial aid package. If some financial aid has already been disbursed, the institution may address the overaward by reducing or eliminating subsequent loan disbursements or unearned Federal Work Study eligibility. If the institution is unable to make adjustments to undisbursed financial aid to eliminate the overaward, the student may be required to refund the overpayment. Failure to repay this money may cause the student to lose eligibility for further federal student aid.

⁴ The net price is the difference between the cost of attendance and gift aid. The cost of attendance includes tuition, fees, room and board, books and supplies, transportation and miscellaneous/personal expenses associated with attending a college or university. The net price is the amount of money the student and his or her family must pay from savings, income and loans to cover college costs.

Institutions may withhold official academic transcripts and diplomas from students who fail to repay a grant or loan overpayment or otherwise owe a debt to the institution.

Key Findings about Award Displacement at Surveyed Colleges and Universities

In September 2011, the NSPA circulated an 11-question “Scholarship Award Displacement” survey to 100 financial aid offices derived from a stratified sample of four-year institutions.⁵ The survey concerned institutional policies pertaining to private scholarships and the displacement of other forms of financial aid when a student receives a private scholarship. The responses (61) to this survey constitute the foundation for the white paper’s key findings. While the number of responses did not allow for statistically significant results, the stratification of the sample demonstrates the range of institutions and the typical award displacement experiences of students. The key findings provide a context for the award displacement issue and are as follows:⁶

- ◆ When a private scholarship results in a student receiving more money for his/her college bills than the federal financial aid formula says s/he needs (an overaward^{7,8}), four fifths of the institutions surveyed reduce the loans and work requirements in a student’s financial aid package (self-help aid),⁹ and half reduced their own institutional grants or scholarships (gift aid). In addition, half contacted the scholarship donor and/or the student to discuss options for dealing with the overaward situation. Almost one third increase the student’s overall cost of college, the COA, for education-related expenses and indirect costs. One sixth of the institutions reduced state gift aid, mainly because many states require institutions to treat state grants as last dollar, which requires the state grant to be reduced ahead of all other forms of financial aid in a student’s financial aid package.
- ◆ Public institutions, institutions with a high percentage¹⁰ of Federal Pell Grant recipients, institutions with high overall enrollment and institutions with low tuition and fees were much more likely to report eliminating an overaward by increasing the COA.

5 The characteristics that were used to define the institutional sample are included in Appendix I of this paper. Also, responding institutions, defined by characteristics, are grouped by their answers to each survey question in Appendix I. Questions fell into the following categories: Publication of Outside Scholarship Policies; Methods of Responding to an Overaward; Prioritization of Reductions in Different Types of Aid; Packaging and Disbursement of Financial Aid.

6 Mark Kantrowitz, NSPA Scholarship Displacement Survey, September 16, 2013: <http://www.edvisors.com/student-aid-policy/scholarship-displacement-survey.php>.

7 An overaward occurs when a student’s total financial assistance exceeds that student’s eligibility for need-based financial aid. Federal regulations and institutional policies require institutions to reduce the need-based financial aid package to compensate. Certain types of federal aid, such as the Federal Pell Grant, are not subject to the overaward regulations and are never reduced. Other types of federal aid, such as campus-based aid and student loans, are subject to the overaward regulations and must be reduced if the overaward is not otherwise eliminated. Campus-based aid includes the Federal Perkins Loan, Federal Supplemental Educational Opportunity Grant (SEOG) and Federal Work-Study (FWS). Federal Subsidized Stafford loans, which are awarded based on demonstrated financial need, may also need to be reduced if the student is overawarded.

8 The federal overaward regulations relating to campus-based aid appear in 34 CFR 673.5(b), (c) and (d), based on the requirements that appear in sections 428(a)(2)(C), 428H(d), 471 and 480(j) of the Higher Education Act of 1965. The requirement to reduce subsidized Stafford loan disbursements appears in the regulations at 34 CFR 685.303(e) and 34 CFR 682.604(h) and in section 443(b)(4) of the Higher Education Act of 1965. See also www.finaid.org/scholarships/overawardregs.phtml.

9 Need-based student loans and student employment are collectively referred to as “self-help aid.”

10 Each institution’s percentage of Pell Grant recipients was categorized as low (10% or less), medium (between 10% and 20%) or high (21% or more).

- ◆ Private institutions and institutions with high tuition and fees¹¹ were twice as likely to reduce institutional gift aid in an overaward situation.
- ◆ Four fifths of institutions have private scholarship policies that are optimal from a scholarship provider perspective. These policies reduce unmet need, if any, before self-help, and reduce self-help before gift aid. Within self-help, loans are reduced before student employment.
 - ◆ Public institutions, institutions with a high percentage of Federal Pell Grant recipients, institutions with high enrollment and institutions with low tuition were more likely to reduce unmet need first.
- ◆ One sixth of institutions either reduce gift aid first or require students to maintain some amount of unmet need (e.g., summer work expectations or the amount students are expected to earn by working over the summer) above and beyond the calculated EFC.¹² The expected family contribution is the amount of money that a student and/or his/her family must contribute to his/her college bill if s/he qualify for federal financial aid.
- ◆ Two fifths of institutions said that they adjusted a student's financial aid package or offer for future academic years based on the expectation that a private scholarship will be renewed. These adjustments are not necessarily consistent with the institutions' private scholarship policies.
- ◆ Most institutions mail incoming students' financial aid award letters in February, March or April. Only about one in twelve institutions issue award letters after the National Candidates Reply Date of May 1.¹³ Most institutions disburse financial aid in August and September. One eighth of colleges disburse financial aid in July.

Award Displacement Scenarios

I. Award Displacement in Overaward Situations

Award displacement can occur in an overaward situation, where a student receives total need-based financial aid and private scholarships that together exceed the student's full demonstrated financial need.¹⁴ Federal regulations and institutional policies require institutions to reduce the need-based financial aid package to compensate.

Certain types of federal aid, such as the Federal Pell Grant, are not subject to the overaward regulations and are never reduced. Other types of federal aid, such as campus-based aid and

11 Each institution's tuition and fees was categorized as low (\$18,000 or less) or high (more than \$18,000).

12 Some institutions redefine financial need to exclude a summer work expectation. But these institutions still leave the student with unmet financial need based on the federal definition of financial need. See also, Section IV. Renewable Scholarships and Hidden Award Displacement.

13 The National Candidates Reply Date was established by the National Association for College Admission Counseling (NACAC). It appears in the NACAC Statement of Principles of Good Practice, which can be found at <http://www.nacacnet.org/about/Governance/Policies/Documents/SPGP.pdf>.

14 The full demonstrated financial need is the difference between the total cost of attendance (COA) and the expected family contribution (EFC). In other words, Financial Need = COA - EFC. Financial need increases with increases in the COA and with decreases in the EFC. The COA includes tuition and fees, room and board, books and supplies, transportation and miscellaneous expenses. The EFC is calculated by financial aid application forms like the Free Application for Federal Student Aid (FAFSA).

student loans, are subject to the overaward regulations and must be reduced if the overaward is not otherwise eliminated. Campus-based aid includes the Federal Perkins Loan, Federal Supplemental Educational Opportunity Grant (SEOG) and Federal Work-Study (FWS). Federal Subsidized Stafford loans, which are awarded based on demonstrated financial need, may also need to be reduced if the student is overawarded. All federal education loans are also capped at the COA, minus other aid received. Stafford and Perkins loans are subject to annual and cumulative limits.

Overaward situations can also occur when a student receives non-need-based loans that exceed the EFC. Such loans include the Federal Direct unsubsidized Stafford loan, the Federal Direct PLUS loan and private student loans. When the total of these loans exceeds the EFC, the excess is treated as a financial resource that reduces eligibility for need-based aid. If the student does not return the excess funds to the lender, the institution is forced to reduce the need-based financial aid package. If the institution is unable to reduce the need-based financial aid package due to timing or other issues, the student may be required to pay back some of the need-based financial aid.¹⁵

Certain forms of federal student aid, such as campus-based aid, are subject to an “overaward tolerance” of \$300. If the amount of the overaward exceeds financial need by less than the overaward tolerance, the student is allowed to keep the overaward. Otherwise, the institution must reduce the need-based aid package until it exceeds financial need by no more than the overaward tolerance. The purpose of the overaward tolerance is to avoid the need to revise the financial aid package for small overaward situations.

II. Award Displacement without an Overaward: Student Contributions/Self-Help and “Gapping”

Award displacement can also occur without an overaward situation. Many institutions¹⁶ have policies¹⁷ that leave all students with unmet need. When a student receives a private scholarship, some of these institutions will displace the scholarship instead of allowing the scholarship to fill the unmet¹⁸ need gap. For example, some institutions have a “minimum student contribution expectation”¹⁹ that requires all students to contribute a specified amount (typically

15 Similar timing issues can occur with the awarding of scholarships. If a scholarship is awarded after the college has already disbursed student aid funds, the only options available to the institution may involve adjusting undisbursed student aid funds, reducing the amount of financial aid in the next payment period or requiring the student to repay the excess student aid funds.

16 According to US News & World Report, only 64 (5.5%) of the 1,164 colleges and universities they surveyed reported meeting 100% of financial need. See Katy Hopkins, Universities That Claim to Meet Full Financial Need, US News & World Report, February 11, 2013. <http://www.usnews.com/education/best-colleges/paying-for-college/articles/2013/02/11/universities-that-claim-to-meet-full-financial-need>.

17 Based on an analysis of the 2007-08 National Postsecondary Student Aid Survey (NPSAS), about three fifths (59.6%) of all undergraduate students were left with unmet need. Among all students with demonstrated financial need (i.e., undergraduate, graduate, and professional) nearly seven eighths (85.5%) were left with unmet need. More than four fifths (81.8%) of financially needy students at four-year institutions were left with unmet need, compared with 89.7% at two-year institutions and 95.0% at less-than-two-year institutions. There were similar unmet need statistics for students at public four-year institutions (80.2%) and private non-profit four-year institutions (81.1%), but a higher rate at private for-profit four-year institutions (90.7%). It is reasonable to conclude that most institutions have financial aid policies that leave students with unmet financial need. The analysis involved the SNEED4, SNEED1, CONTROL, LEVEL, SECTOR1 and UGDEG variables.

18 Unmet need is often referred to as a gap. Gapping is the practice of leaving a student with unmet need (e.g., failing to meet full demonstrated financial need). In some cases gapping refers to policies that force every needy student to have unmet need by not allowing other forms of financial aid to fill the gap. This nuance is not universal.

\$1,500 to \$3,500) to their higher education, regardless of the amount of financial need, the EFC or income.²⁰ Many of these institutions do not allow private scholarships to satisfy the student contribution expectation even though the student is not overawarded.²¹ For example, suppose an institution has a student contribution expectation of \$2,500 from term-time and/or summer earnings. The student is awarded both a \$1,000 institutional grant and a \$1,000 private scholarship toward his/her \$3,500 financial need. However, when the institution learns that the student has been awarded the \$1,000 private scholarship, the institution takes back their \$1,000 institutional grant. The student is then still left with the burden of the required \$2,500 “student contribution” even though s/he tried to contribute \$1,000 of private scholarship funding to address the issue.

Institutions have a variety of reasons for requiring a minimum student contribution. Some require a minimum student contribution as a way of rationing limited institutional financial aid funds. Some assume that all students are capable of contributing something to pay for their education.²² For-profit institutions may require a minimum student contribution to help the college comply with the 90/10 rule, which limits the percentage of the institution’s revenues that can come from Title IV federal student aid.²³ Some institutions require a minimum student contribution because they believe that a student will not appreciate the education if it is completely free. Some require a minimum student contribution because of a belief that it leads to improved academic performance.²⁴

It is important to consider that not all students are capable of paying a student contribution. Low-income students may already be working to support themselves and could be the primary wage earner for their family. \$2,500 can be 10% of a low-income family’s annual income. Summer jobs are not always available in some parts of the country, and, if available, may not pay well. Additionally, qualifying to borrow from private student loan programs is not an available option for all students.

The federal need analysis formula implicitly includes a minimum student contribution, since the formula does not allow the EFC to go below zero²⁵ and caps student aid at the COA. This affects students with exceptional financial need who have negative available income (i.e., family income below the income protection allowance).

19 A student contribution expectation is not necessarily the same as a self-help level or summer work expectation. A self-help level specifies that financial need will be met with a combination of work and loans for the first several thousand dollars of a student’s financial need. A summer work expectation is a variation on the self-help level. In contrast, a student contribution expectation requires every student to contribute financially to his/her education, even if they have full demonstrated financial need. Some institutions use these terms interchangeably. The displacement that occurs, however, is similar in both situations.

20 Institutions rarely acknowledge that a student contribution expectation is a form of gapping that leaves the student with unmet need. Often colleges will refer to themselves as meeting the student’s full demonstrated financial need despite having a minimum student contribution expectation, so long as s/he don’t have an additional gap beyond this figure. In effect, they redefine the term full demonstrated financial need.

21 Even colleges that allow private scholarships to reduce unmet need sometimes insist on preserving the minimum student contribution requirement.

22 Assuming that students can work 10 to 12 hours per week during a 30-week academic year and 20 to 40 hours per week during a 12-week summer break, a total of 540 to 840 hours, annual earnings total \$3,915 to \$6,090 at the federal minimum wage of \$7.25/hour. Dividing these figures in half yields \$1,958 to \$3,045.

23 Section 487(a)(24) of the Higher Education Act of 1965 [20 USC 1094(a)(24)].

24 Retrieved 08/2013 from www.theseedfoundation.com/PracticesandProgramsthatPrepareStudentsforCollegeGraduation.pdf/p.15.

25 Leo Kornfeld and Mark Kantrowitz, A New ‘Independence Day’ for Student Financial Aid, *Chronicle of Higher Education*, February 9, 2007. <http://chronicle.com/article/A-New-Independence-Day-for/33412>.

III. Restrictive Scholarships and Award Displacement

Award displacement can also be caused by scholarship provider policies that restrict the scholarships to a limited subset of the components of the COA. For example, some private scholarships are restricted to just tuition and fees and some just to textbooks. If the student receives a tuition-only private scholarship and other forms of financial aid that are also restricted to tuition, it is possible for the combination of tuition-restricted aid to exceed tuition, leading to award displacement. One private scholarship might even displace another private scholarship. This type of award displacement occurs because of a lack of flexibility by two or more sources of student aid funds.

IV. Renewable Scholarships and Hidden Award Displacement

In some cases the award displacement will be hidden, without an explicit revision in a previously awarded financial aid package. For example, if the institution anticipates that a student will receive a private scholarship when assembling the initial financial aid package, it might adjust the amount of other forms of financial aid accordingly.^{28, 29} Scholarship providers who provide renewable scholarships have noticed that some institutions reduce the student's institutional grants in subsequent award years. While it is possible that this pattern is due to the front-loading (the practice of some colleges to include more grants than loans in freshmen financial aid award letters. As a student progresses in school, the grants included decrease and the loans increase) of grants, often the reduction precisely equals the anticipated amount of the private scholarship. Even at institutions that practice front-loading of grants, the reduction in gift aid for private scholarship recipients may exceed the reduction in gift aid for non-recipients. Some scholarship providers do not award renewable scholarships because of concerns about hidden award displacement.

Another situation that can be inadvertently “hidden” from students is called the “cliff effect;” this happens when receipt of a private scholarship is conditioned on Pell Grant eligibility. Students who qualify for a Pell Grant get both the grant and the private scholarship. Students who fall just beyond Pell Grant eligibility get neither, yielding a steep increase in the net price. Thus slight changes in the student's financial situation can cause disproportionate changes in the student's financial aid eligibility.

26 The Internal Revenue Code of 1986 restricts tax-free treatment of scholarship and fellowship payments to qualified higher education expenses, which are defined as tuition, required fees and course-related expenses such as books, supplies and equipment that are required by the college. Scholarships amounts used for room and board, personal and miscellaneous expenses, and travel are taxable.

27 Examples include the American Opportunity Tax Credit (previously the Hope Scholarship tax credit), some state grant programs, and institutional tuition-only academic scholarships.

28 Hidden displacement may not be consistent with the college's stated outside scholarship policy. In some cases a college will reduce institutional grants dollar-for-dollar when the college knows about a private scholarship in advance, even though the outside scholarship policy states that the college reduces loans before grants.

29 On the other hand, some institutions will reduce unmet need or self-help aid when they anticipate the receipt of a private scholarship. These institutions apply their outside scholarship policies consistently, regardless of whether they learn about the private scholarships before or after assembling the initial financial aid package.

V. Last Dollar Financial Aid Policies

The terms “first dollar” and “last dollar” concern the prioritization of financial aid funds. The Federal Pell Grant is a form of financial aid that is intended to cover the first dollar of demonstrated financial need. First dollar funds are almost never displaced. However, most other sources of financial aid want their funds to be considered last dollar and applied to students financial need after all other funds have been added. The goal is to stretch funds as much as possible by filling in the gaps left by all other sources of financial aid. Conflicts between these last dollar financial aid policies can lead to award displacement.

Discussion: Negative Outcomes Associated with Award Displacement

As previously noted, award displacement can occur when an institution reduces a student’s need-based grants and scholarships if the student receives one or more private scholarships. Displacement can also occur when an institution reduces a student’s loans by the amount of the private scholarship. Reducing a student’s debt burden, however, is generally not considered harmful. The discussion in this section is limited to scenarios in which the receipt of a private scholarship results in a reduction in grants and scholarships.

I. Award Displacement and a Student’s Ability to Pay for Higher Education Costs

Perhaps the most significant negative consequence of award displacement is that a student will not realize a net financial gain in his/her ability to pay for his/her higher education costs, despite winning a private scholarship. While award displacement of grant and scholarship aid may result in financial hardship for any student, its effects can be especially detrimental for students who are low-income or the first generation in their family to pursue a higher education. These students are less likely to be aware of the private scholarship policies and practices of institutions, and more likely to rely on their private scholarship awards to pay for school.

An institution’s student budget may underestimate some of the components of the COA³⁰ figure, such as textbooks, transportation and/or personal miscellaneous expenses. Private scholarships are often needed to help pay bills and living expenses associated with institutional attendance that are not addressed by other sources of financial aid. This is particularly true for students from low-income households. Often, one or more of a low-income student’s parents are absent, ill or disabled, and the student is the primary wage earner for his or her family.

³⁰ Cost of Attendance (COA) is defined as tuition & fees, room and board, books & supplies, transportation, and personal/miscellaneous expenses.

The student's financial and family situation may be precarious and unstable, and the student does not have the resources to overcome setbacks. Students from low-income backgrounds may not have the funds for basic necessities that students from more financially-resourced families take for granted, such as, bedding, clothing appropriate for hot or cold weather, parking and transportation, computers, health insurance, textbooks, etc. All of these items and other basic living expenses are required for a student to feel comfortable and stable so s/he can apply his/her energy to learning and being successful in college. If the COA is not increased and private scholarships are not allowed to assist with these costs, and an institution uses a private scholarship to replace grants or other scholarships, the private scholarship does not reduce the recipient's need to work or to borrow and there is a greater risk that the student will discontinue his or her studies.³¹ One Gates Millennium Scholar has said, "Seeing friends who face financial barriers in college makes me feel so grateful and so privileged to have the scholarship. Some didn't have money to pay for tuition, so they dropped out of college, worked full-time and/or lived in their cars."³²

Low-income students and their families tend to be risk-averse, especially with regard to penalties for failure, such as debt without a degree. Even when they are willing to take on student loans for the sake of pursuing a higher education, low-income students may still be at a disadvantage in terms of difficulty qualifying for private student and PLUS loans. Unless the COA is increased and private scholarships are allowed to help cover additional expenses, a student may have to spend more time working, leaving an inadequate amount of time for his/her academic work.

First-generation college students frequently come from families that are unfamiliar with higher education and how student financial aid works. The families may be confused about the requirement to reduce need-based aid when a student wins a private scholarship and believe that the student can receive the private scholarship in addition to the other aid. Additionally, their families may not be supportive, financially and/or emotionally, of the student's pursuit of a higher education.^{37,38} For low-income and first-generation students, winning a private schol-

31 Based on an analysis by Mark Kantrowitz of data from the 2009 follow-up to the 2003-04 Beginning Postsecondary Students longitudinal study, among students who intended to obtain a Bachelor's degree, 68.4% of students who worked 12 hours or less per week graduated with a Bachelor's degree in six years, compared with 54.8% of those who worked 13-25 hours per week, 43.1% of those who worked 26-39 hours per week and 27.6% of those who worked 40 or more hours per week. Similar results apply to low-income students (e.g., students who received a Pell Grant), with Bachelor's degree attainment rates of 56.0%, 46.9%, 41.4% and 20.6%, respectively.

32 See *Scholars Have a Lighter Financial Burden* Section in *The Institute for Higher Education Policy, Expanding Access and Opportunity: The Impact of Gates Millennium Scholars Program*, 19-20, January 2010.

33 Thomas G. Mortenson, *Attitudes of Americans Toward Borrowing to Finance Educational Expenses 1959-1983*. ACT Student Financial Aid Research Report Series, 88-2, 1988.

34 Pamela Burdman, *Fear of Borrowing: Debt Aversion Is a Barrier to College Access, Especially for Low-Income Students*, *National Crosstalk*, 14(2):11-12, 2006. <http://www.highereducation.org/crosstalk/ct0206/voices0206-burdman.shtml>.

35 Patricia McDonough and Shannon Calderone, *The Meaning of Money*, *American Behavioral Scientist*, 49(12):1703-1718, 2006. <http://abs.sagepub.com/content/49/12/1703.abstract>.

36 L. G. Tornatzky, R. Cutler and J. Lee, *College Knowledge: What Latino Parents Need to Know and Why They Don't Know It*, Tomás Rivera Policy Institute, 2002.

37 Based on data from the 2007-08 National Postsecondary Student Aid Study (NPSAS), dependent students with family AGI under \$50,000 were twice as likely to have no help from their parents as students with family AGI of \$50,000 or more (15.1% vs. 7.0%). Focusing on those who had help from their parents, the low-income dependent students were twice as likely to have help with non-tuition expenses only (42.5% vs. 20.5%) and much less likely to have help with both tuition and non-tuition expenses (39.8% vs. 69.7%). About the same percentage of low-income students had help with tuition only (2.5% vs. 2.8%). Low-income students are also more likely to be independent (63.6% vs. 25.1%).

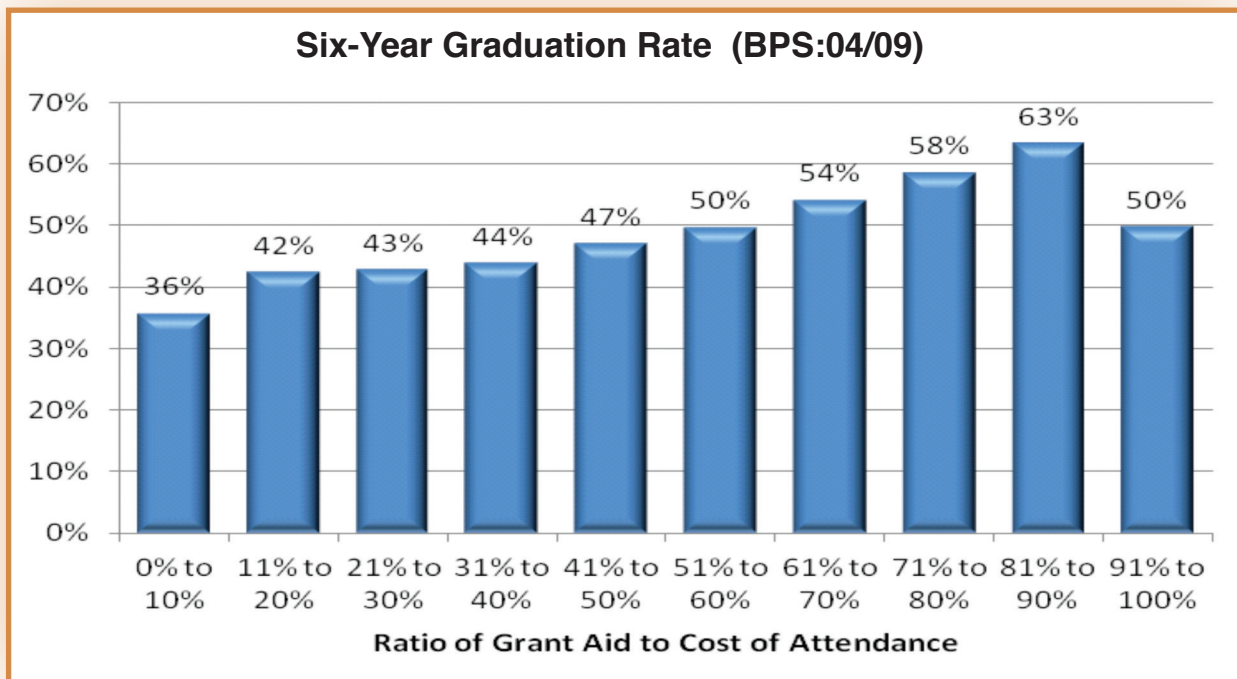
38 Alisa Cunningham, Wendy Erisman and Shannon Looney, *From Aspiration to Action: The Role of Middle School Parents in Making the Dream of College a Reality*, Institute for Higher Education Policy, 2007. <http://www.ihep.org/Publications/publications-detail.cfm?id=92>.

arship can make a difference between enrolling in higher education or not, between staying in school or dropping out and between academic success or failure. When a private scholarship is displaced, it can be devastating for the student, derailing his/her plans despite their hard work.

II. Award Displacement and Graduation Rates

Data shows that increasing the amount of student financial aid (including private scholarships) that a low- or middle-income³⁹ student receives can have a big impact on higher education access, retention and completion. The six-year graduation rate is 45% for low-income students whose grants cover less than a quarter of their higher education costs, compared with 68% for low-income students whose grants cover more than three quarters of their costs. For middle-income students the graduation rate also increases by 23 percentage points, from 65% to 88%. But high-income students demonstrate only minimal improvement, increasing graduation rates from 78% to 79%.⁴⁰

The following graph shows the relationship between the grant ratio (the percentage of the COA that is met with grants and scholarships) and the six-year degree attainment rate for low-income students, based on data from the 2009 follow-up to the 2003-04 Beginning Postsecondary Students Longitudinal Study (BPS:04/09). It demonstrates that graduation rates generally increase with increases in the grant ratio.

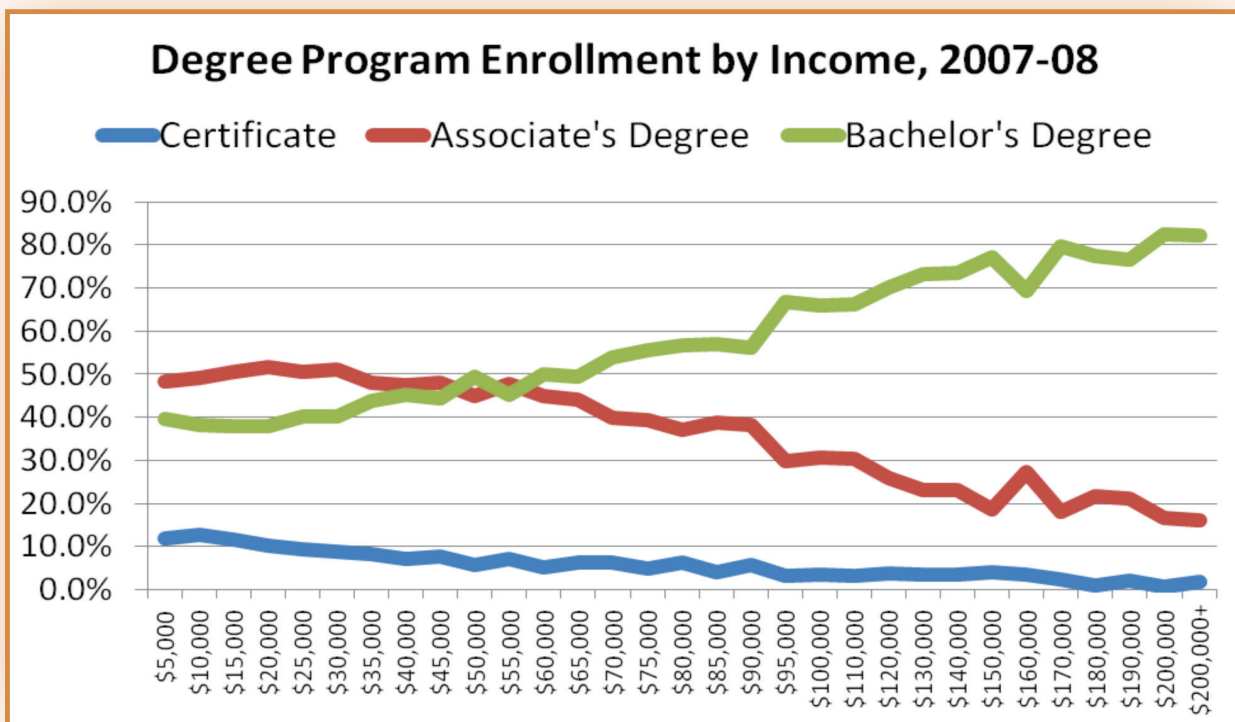


³⁹ Based on an analysis by Mark Kantrowitz of data from the 2009 follow-up to the 2003-04 Beginning Postsecondary Students longitudinal study. Low-income students are defined as students with family adjusted gross income (AGI) less than \$50,000. Middle-income students are defined as students with family AGI of \$50,000 to \$100,000. High-income students are defined as students with family AGI of \$100,000 or more.

⁴⁰ Beginning Postsecondary Students Longitudinal Study. This data was analyzed by the Mark Kantrowitz using the PowerStats tool for the 2009 follow-up to the 2003-04 Beginning Postsecondary Students Longitudinal Study (BPS:04/09). The unrounded numbers are as follows: Low-income: 45.3%, 67.9%; Middle-income: 64.8%, 88.4%; High-income: 78.3%, 79.1%.

Due to the failure of grants to keep pace with increases in higher education costs and stagnant household incomes, students from middle-income families also need help paying for higher education. Low and moderate income students address funding shortfalls by shifting their enrollment to lower cost schools, such as from private non-profit institution to public institutions and from four-year to two-year institutions. This leads to a decline in Bachelor's degree attainment. Low-income students are also increasingly being priced out of a higher education due to the inadequacy of need-based grants.⁴¹

The following graph of the distribution of degree level by income shows an enrollment shift away from Bachelor's degree programs and a shift toward Associate's degree and certificate programs with declines in family adjusted gross income.⁴²



III. Award Displacement and Student Loan Debt

The impact of award displacement on undergraduate students goes beyond access and higher education degree completion. Undergraduate students who graduate with no debt are twice as likely to enroll in graduate school as undergraduate students who graduate with some debt.⁴³ Many scholarship providers want their private scholarships to reduce the student's loan and work burden. But when an institution displaces a private scholarship by reducing institutional grants instead of loans, there is no decrease in the student's debt at graduation.

41 The Rising Price of Inequality: How Inadequate Grant Aid Limits College Access and Persistence, Advisory Committee on Student Financial Assistance, June 2010.
 42 This graph is based on an analysis of data from the 2007-08 National Postsecondary Student Aid Study (NPSAS) by Mark Kantrowitz.
 43 Mark Kantrowitz, Undergraduate Debt Causes "Pipeline Leakage" from Undergraduate School to Graduate and Professional School, November 22, 2010. <http://www.finaid.org/educators/20101122gradpipelineleakage.pdf>.

Accordingly, when an institution reduces grants instead of loans, there is no improvement in the likelihood that the student will continue his or her education in a graduate or professional degree program after graduating with an undergraduate degree.

With the exception of about six dozen institutions with generous “no loans” financial aid policies,^{44,45} most institutions do not meet the student’s full demonstrated financial need with grants.⁴⁶ Student financial aid packages also include loans, which have to be repaid, usually with interest. As a result, many financially needy families pay more than just the EFC. Of students with financial need, 42.4% have subsidized loans in the financial aid package, based on data from the 2007-08 National Postsecondary Student Aid Study (NPSAS). The prevalence of subsidized loans in the financial aid package varies by type of institution, as shown in the following table.

Type of College	Percentage of Needy Students Receiving Subsidized Loans
Public	29.9%
4-Year	48.4%
2-Year	14.2%
< 2-Year	16.7%
Non-Profit	55.9%
4-Year	56.3%
2-Year	50.1%
< 2-Year	33.0%
For-Profit	88.6%
4-Year	93.4%
2-Year	95.8%
< 2-Year	68.7%

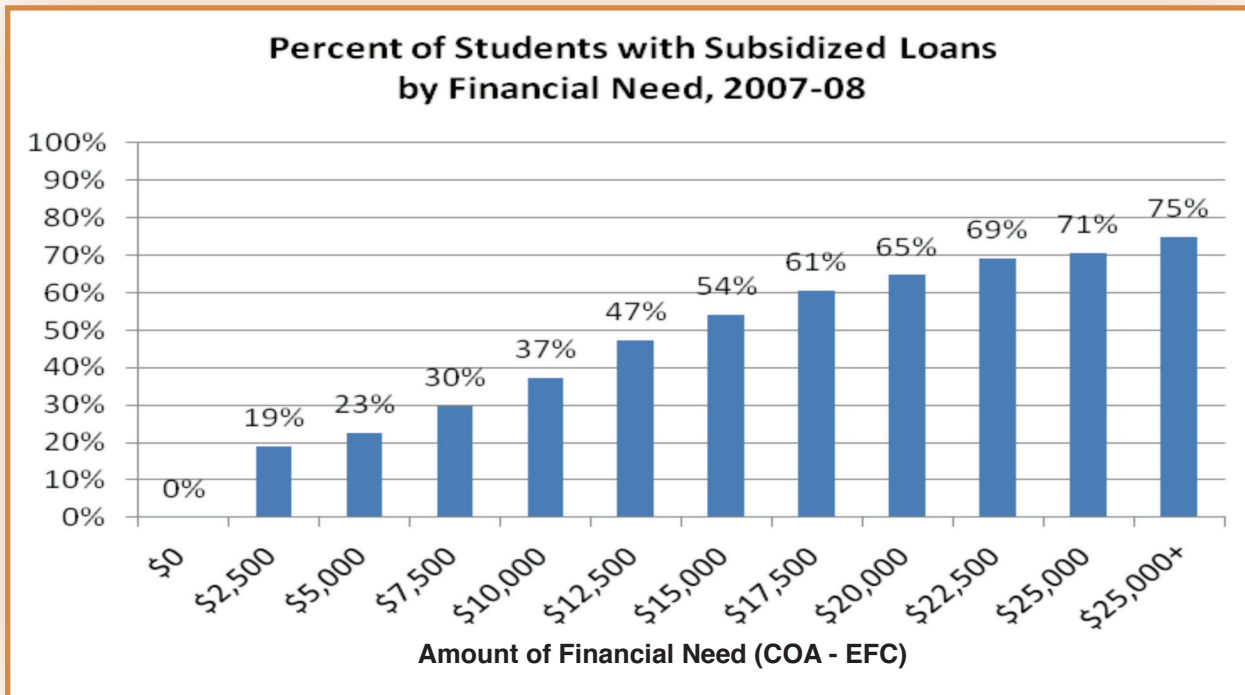
44 A list of institutions with “no loans” financial aid policies may be found at www.finaid.org/noloans.

45 Additional information on colleges that have pledged to reduce or eliminate student loans from student financial aid packages can be found at http://www.ticas.org/pub_view.php?idx=831.

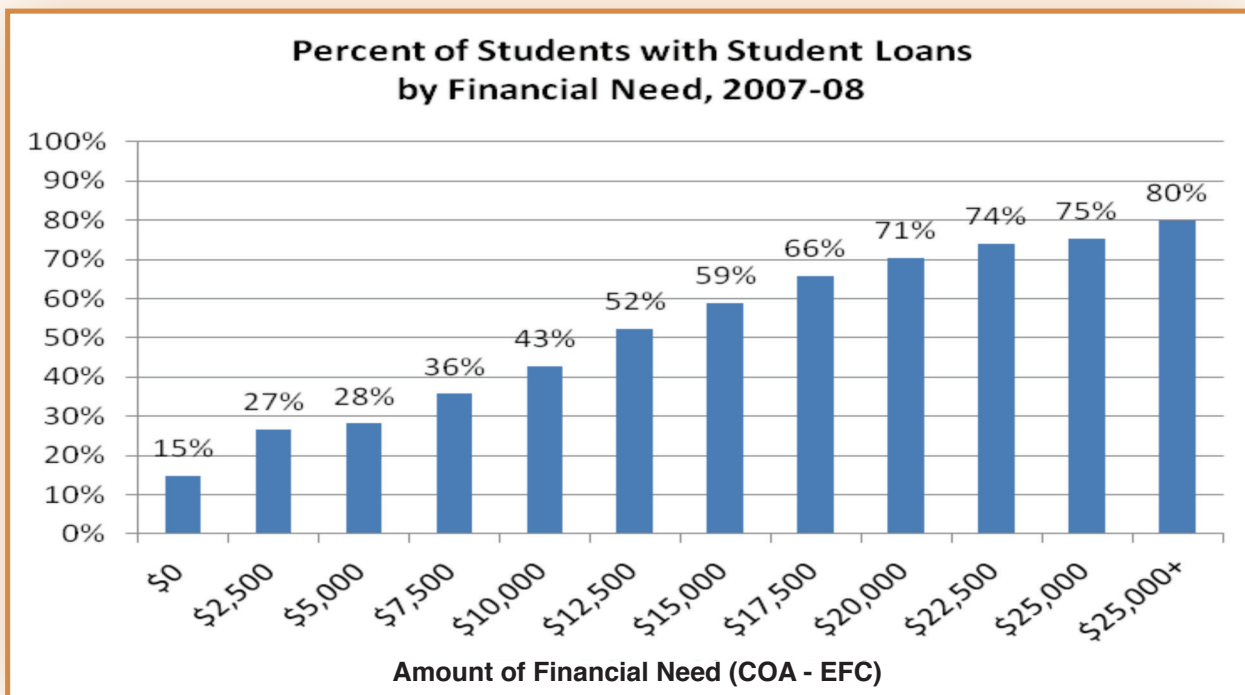
46 More than 85% of students with demonstrated financial need are left with unmet need, according to an analysis of data from the 2007-08 National Postsecondary Student Aid Study (NPSAS). But even among the institutions that meet the full demonstrated financial need, most meet it with a combination of loans and grants. However, three quarters of the institutions who responded to the NSPA survey do allow private scholarships to reduce unmet need first.

The likelihood of a student receiving subsidized student loans as part of the financial aid package increases with financial need, as shown in the next chart.

This demonstrates that financially needy students are more likely to be burdened by debt, not less likely.



A similar trend occurs with regard to all student loans, not just subsidized loans. Students with greater financial need are more likely to borrow.



Many scholarship providers seek to improve retention and completion by reducing or eliminating student debt. As one scholarship provider said, “We view ourselves as a college retention and completion program that just happens to use scholarships as one of our tools.”

Current government and institutional policies preclude families from using private scholarships to pay for the EFC portion of their higher education costs.⁴⁷ Since scholarship providers are interested in incentivizing students to enroll in college and intend for their scholarships to help students pay for the family’s share of college costs, the existence of these policies is frustrating to scholarship providers. If the national goal of the United States of America is to regain its position of having the highest proportion of college graduates in the world by the year 2020,⁴⁸ then policies discouraging private scholarship providers from helping students and their families to obtain a college education is contrary to this goal.

Therefore, in order to help students and their families cut college costs, many scholarship providers have focused on eliminating loans from the student’s financial aid package.⁴⁹ But when institutional and government policies lead to award displacement, it thwarts this effort, yielding no net improvement in retention and completion to degree. In these cases, scholarship providers may have difficulty justifying a scholarship program’s costs to their boards when there is no improvement in outcomes for the students they serve.⁵⁰ This may ultimately lead to a decline in funding for private scholarships as the scholarship providers seek more effective ways to spend their money for the betterment of society.

IV. Award Displacement and the Cost of Higher Education

Award displacement may also confuse families about the true cost of a higher education. The net price is the difference between the COA and gift aid, such as grants. It is the amount a family must pay to cover all college costs. When an institution displaces the student’s private scholarships by reducing grants, there is no reduction in the student’s net price. This is in contrast with an institution that does not displace the student’s private scholarships, yielding a reduction in the net price. Thus it is important for families to consider each institution’s outside scholarship policies when evaluating which school is more affordable.

Private scholarship programs sometimes adopt a broader view of the expenses students incur while attending school than the narrow criteria specified by the government and postsecondary institutions. These expenses may include, but are not limited to, the student’s health care costs, household expenses for a spouse and dependents (including living expenses and health care), the cost of caring for an ailing parent or sibling, child care costs, transportation costs, bedding costs, computer equipment, clothing and business attire. Conflicts can also arise when each funding source has a different definition of institutional costs and some funding sources seek to

47 There is an exception to this circumstance. That is, unless the student is not receiving any need-based aid, in which case the non-need-based grant may be used to cover the student’s EFC without penalty. Again, there is an inequity in the disparate treatment of low-income and high-income students by government and institutional financial aid policies.

48 President Barack Obama, Address to Joint Session of Congress, February 24, 2009.

49 Some scholarship programs would not pay for a student’s EFC in any case. Some lack the funds to cover the EFC. Other providers want students to have “skin in the game.”

50 If a scholarship provider wanted to help the institution, they’d award a grant to the institution as opposed to supporting individual students.

impose their definitions on the others. For example, federal student aid laws and regulations and institutional financial aid policies treat private scholarships as “estimated financial assistance” that reduces eligibility for need-based aid, even if these scholarships have a different definition of need due to a different definition of institutional costs.

Challenges of Packaging Student Financial Aid with Private Scholarships

For students that qualify for financial aid, a patchwork of federal, state, student, and private financial resources is used to help pay for the cost of higher education. Because public funds are used, this package of financial aid is subject to complex federal and state regulations that institutions are required to follow, and held accountable for administering.⁵¹ Additionally, myriad of differences between institutions and private scholarship providers in organizational and legal structures (e.g. differences in mandates, charters, visions, missions, etc.), funding sources, and community needs lead to different approaches to supporting students.

Goals of Private Scholarship Providers

The goals of private scholarship providers include helping particular students gain access, choice and success in their higher education pursuits. Students are awarded private scholarships to fulfill the goals of the scholarship donors. These goals are implemented in a variety of ways, many of which are focused on helping their scholars meet 100% of their financial need to pay for a higher education. The approaches and philosophies of donors are diverse and can include, but are not limited to, policies that reduce or eliminate a student’s unmet demonstrated financial need, policies that reduce or eliminate a student’s debt burden, policies that eliminate or reduce the number of hours a student must work while in school, and policies on replacing self-help aid with gift aid.

Additionally, private scholarship providers measure the effectiveness of their scholarship programs through the impact on outcomes for the students they serve, such as improvements in retention and graduation rates, improvements in access to more prestigious institutions and programs, improvements in academic performance, and increases in subsequent enrollment in graduate and professional degree programs. Scholarship providers want to make a difference in the lives of their students. If private scholarship programs are unable to document that their scholarships provide the recipients with a net financial benefit, then it is difficult to demonstrate improvements in programmatic outcomes. This makes it difficult for private scholarship providers to justify funding their scholarship programs. By failing to consider the goals of scholarship providers and not addressing their concerns, government and institutional policies and practices may eventually cause a decline in private scholarship program funding.

⁵¹ If an institution fails to comply with the federal laws and regulations, it may lose eligibility for federal student aid. Even if a compliance problem does not lead to the ultimate sanction, the US Department of Education can fine the institution and/or require the institution to reimburse the federal government for the federal student aid that was improperly awarded.

Goals of Higher Education Institutions

Post-secondary institutions seek to ensure that the student population as a whole benefits, in contrast with private scholarship providers that often focus on specific students. Institutions may also distribute their own grant aid to optimize the institution's student recruitment, degree completion and financial goals. Budget cuts at state institutions, reductions in grant programs, and decreases in investment and endowment earnings have increased the financial pressure on institutions, and they try to distribute limited funds fairly to as many students as possible. This pressure can lead to a conflict between the best interests of individual students and the best interests of the school's student population as a whole. The institution may view private scholarship funds as an opportunity to free up institutional financial aid funds by shifting money from scholarship recipients to other eligible students.

Additionally, institutions have their own philosophies about the purpose of student aid and seek to impose these policies on scholarship providers. Some schools require students to work during the school year and summer vacations. But as noted previously, some low-income students are the primary wage-earners for their families and so are already working to provide for themselves and their families. Some schools require all students receiving need-based financial aid to borrow to pay for their education. Some institutions insist on every aid recipient having a minimum self-help level and refuse to allow private scholarships to substitute their funds for these requirements. Some schools have policies that preclude a student with a private scholarship from being awarded an institutional grant when there are other students in need who did not get a private scholarship. However, some institutions leverage their financial aid policies to recruit wealthy students – who don't demonstrate financial need – by awarding them merit-based grants. This practice can contribute to inequity in access to higher education.

Conflicts between the Goals of Scholarship Providers and Institutions

Despite a shared goal of helping students to succeed in higher education, financial aid administrators and private scholarship providers are still challenged with different definitions of higher education costs and financial need, different prioritization of student aid funds, differences in the timing of scholarship awards, communication on the issues involved, and the need to mitigate award displacement.

However, to some extent both scholarship providers and institutions are trying to leverage each other's financial aid funds. Institutions may seek to replace institutional grant funds with private scholarship funds, while private scholarship providers may seek to award scholarships on top of institutional gift aid. Thus each is dependent on the other's financial aid funds. The difference is whether the scholarship is supplanting or supplementing the institutional gift aid.

⁵² Some of the same institutions, however, do not require wealthy students to participate in student employment or to assume education debt.

It is often not possible to simultaneously fulfill the goals of both scholarship providers and schools. Accordingly, it may be necessary to compromise, so that both sides have partial success in achieving their priorities. For example, if a private scholarship provider is unable to achieve its goals at a particular institution, it may decide to not fund students who enroll there, or steer the students away from choosing that school. On the other hand, private scholarship providers might consider allowing part of the scholarship to replace a portion of institutional grant funds.

Since both parties are working in the best interest of students, private scholarship providers and institutions may want to consider addressing the needs of the other by creating and adopting policies on the timing of scholarship awards, standardizing financial aid award letters, and engaging in structured communications.

Policies and Practices that Contribute to Award Displacement

I. Determination of Demonstrated Financial Need

The basic philosophy behind student financial aid need analysis is to assess a portion of the family's discretionary income. Discretionary income is calculated by subtracting mandatory expenses from total income. Mandatory expenses include expenses that by law must be paid, such as allowances for payroll/income taxes and basic living expenses. Total income includes taxable income and untaxed income and benefits, as well as a percentage of net assets. This analysis yields a measure of the family's financial strength, often called an EFC.

Some financial aid, such as the Federal Pell Grant, is awarded based only on the EFC. Other financial aid is awarded based on demonstrated financial need, which is the difference between the COA and the EFC. The COA includes such institutional costs as tuition and required fees, room and board, books and supplies, transportation and miscellaneous personal expenses. The COA may be adjusted by the financial aid administrator to include other education-related expenses, such as dependent care and the cost of a computer. Financial need increases with increases in the COA⁵³ and with decreases in the EFC.

Different organizations may have different determinations of a student's demonstrated financial need based on different formulas for calculating the EFC. They may also differ in their definition of college costs. There are two main formulas for calculating the EFC, Federal Methodology (FM) and Institutional Methodology (IM).

The FM is used to award financial aid from the federal and state governments, and from all but about 250 mostly private institutions. Many private scholarship providers also rely on the

53 This contributes to a wealthier mix of students receiving need-based financial aid at more expensive institutions.

federal methodology. The FM EFC is calculated when a student files the Free Application for Federal Student Aid (FAFSA). The FM is based on the family size, the number of children enrolled in higher education, the age of the older parent, and the income and assets of the parents and the student. Unlike the IM, the FM does not consider the net value of the family's principal place of residence or small businesses owned and controlled by the family.

The IM is used by these 250 mostly private institutions to award institutional grants and scholarships.⁵⁴ It is also used by some private scholarship programs to award scholarships, where all or part of the award is based on financial need. The IM EFC is calculated when a student files the CSS Financial Aid PROFILE form.⁵⁵ Some institutions have their own financial aid forms that differ from the PROFILE form. Even schools that rely on the PROFILE form may tweak the formula, for example, by capping the value of home equity. Nevertheless, all such formulas are identified as implementing an "institutional methodology." The PROFILE is much longer and more detailed than the FAFSA. The additional data elements are designed to address exceptional situations that might make a wealthy student look poor.

The primary differences between the FM and the Institutional IM for calculating the EFC are as follows:⁵⁶

- ◆ The IM considers more family assets than the FM, such as a portion of net home equity for the family's principal place of residence. The IM does not ignore family assets for families with income less than \$50,000, unlike the simplified needs test in the FM. The IM can also consider assets in the name of siblings when the siblings are under age 19 and not enrolled in higher education.
- ◆ The IM assumes a minimum student contribution based on an expectation of earnings from summer employment.
- ◆ The IM removes paper losses such as depreciation, net operating loss carry-forwards, business/farm losses, and capital losses that artificially reduce the adjusted gross income. As a result, the IM is more focused on current cash flow than the FM.
- ◆ The IM solicits information about some of the more common unusual circumstances, instead of requiring the family to ask for a professional judgment review. These include medical and dental expenses not covered by insurance and private K-12 tuition.
- ◆ The IM considers the finances of the non-custodial parent in divorce or marital separation cases, in addition to the income and assets of the custodial parent. The FM ignores the finances of the non-custodial parent. Both the IM and the FM consider the income and assets of the stepparent if the custodial parent is remarried.

54 The institutions that use an "institutional methodology" for awarding their own grant funds must still use the federal methodology to award federal and state government aid.

55 profileonline.collegeboard.com.

56 Reprinted from Mark Kantrowitz, Proposal for Standardization of Financial Aid Award Letters and Net Price Calculators, March 17, 2011, pages 18-19. Written testimony presented before a hearing of the Advisory Committee on Student Financial Assistance (ACSFA). <http://www.finaid.org/educators/20110317awardletters.pdf>. Reprinted with permission.

- ◆ The IM has a smaller reduction in the parent contribution when more than one child is enrolled in college at the same time.
- ◆ The IM subtracts allowances for cumulative education savings and an emergency reserve from assets.
- ◆ The IM has regional allowances for differences in cost of living.

The IM will yield a higher EFC for most families and a lower eligibility for need-based aid than the FM.

Some sources of financial aid may consider themselves to be last dollar, meaning that they base their award on the student's remaining financial need, after financial aid has been awarded by all other sources. As noted previously, when two sources both consider themselves to be last dollar and use different formulas for determining financial need, conflicts can arise. For example, suppose that an institution uses the IM for calculating the EFC for its institutional funds while a scholarship provider uses the FM. Sometimes the IM results in a higher or lower EFC, yielding a different figure for demonstrated financial need. If the scholarship provider awards a scholarship to cover a student's remaining financial need based on a higher figure for financial need, the college might then consider the student to be overawarded. After all, the student's financial aid from all sources will exceed the college's definition of demonstrated financial need. When the institution compensates for the overaward by reducing its grants, the student will be left with some unmet need based on the scholarship provider's definition of financial need.⁵⁷ Thus differences in definitions of EFC and financial need can lead to award displacement.

II. Institutional Financial Aid Packaging Philosophies That Inform Policies

An institution's packaging philosophy specifies the composition of a student's financial aid package. This determines how much the student receives of each of the three main types of financial aid to help pay for college costs:

- ◆ Gift aid that does not need to be repaid, such as grants and scholarships.
- ◆ Student employment, where the student works a part-time job during the school year and/or a full or part-time job during the summer to earn money to pay for higher education.
- ◆ Education loans, which must be repaid, usually with interest. (Student employment and education loans are collectively referred to as "self-help aid.")

⁵⁷ Sometimes colleges insist on maintaining a gap based on the institutional definition of financial need, even when the scholarship provider offers to fill the gap by increasing the scholarship amount. This practice is particularly frustrating for scholarship providers because it bureaucratically stops them from helping a particular student.

There are many components to a packaging philosophy:

- ◆ Some institutions provide enough financial aid to cover the student's full demonstrated financial need; others leave some or all students with unmet need (a gap).
- ◆ Some institutions award only need-based aid, while others also award merit-based aid and/or non-need-based aid.
- ◆ Some institutions practice leveraging, where the composition of the financial aid package is used to achieve recruiting and enrollment management goals.⁵⁸ Leveraging is typically used to attract academically talented students, star athletes or a wealthier mix of students.
- ◆ Some institutions award loans first and grants last by establishing a self-help level, so that every student receiving financial aid is expected to borrow to help cover college costs. A self-help level requires the first several thousand dollars (or more) of financial need for all students to be met with loans and/or student employment. Often the self-help level is the same for all students.
- ◆ Some institutions award grants first and loans last, awarding all the gift aid to which the student is entitled first, and then filling in the gaps with an explicit ranking of the various types of financial aid.⁵⁹ For example, the Federal Pell Grant program functions like an entitlement and is usually awarded first.
- ◆ Institutions may also prioritize which students receive gift aid and how much. Some institutions award every student a small grant. Some institutions give some students larger grants and other students none. Often institutions set minimum and maximum amounts for each type of aid. Some may provide more gift aid to a subset of the student population, such as students with exceptional financial need (e.g., students with very low-income, a zero EFC or who have received a Federal Pell Grant),⁶⁰ students who are enrolled full-time (as opposed to part-time), students with higher grade point averages (GPA) and students who file financial aid applications by the institution's deadline (sometimes by a priority deadline). Some award financial aid first to first-year and returning students and last to transfer students. Some may have a set policy for awarding federal campus-based aid⁶¹ and institutional gift aid and award this money first to students with a greater amount of financial need (i.e., in order of EFC from lowest to highest) until they run out of funds. Some institutions award money on a first-come, first-served basis.
- ◆ Some institutions have adopted generous "no loans" financial aid policies that replace loans with grants in the financial aid package.

58 Leveraging is sometimes referred to as "preferential packaging." In some cases leveraging will involve awarding gift aid to students who do not demonstrate financial need.

59 This is often referred to as a packaging order.

60 Research has shown that low-income students are more risk averse than middle and upper income students, so student loans have a chilling effect on their enrollment and completion. They fear the potential consequences of a failure to graduate, such as being stuck with debt and no degree. Some packaging philosophies try to minimize their debt by increasing grants, which has a positive impact on higher education completion.

61 Campus-based aid includes the Federal Supplemental Educational Opportunity Grant (SEOG), the Federal Perkins Loan and the Federal Work-Study program. Student financial aid administrators have the discretion to decide which students receive such campus-based aid funds.

- ◆ Some institutions practice front-loading of grants, where students receive a greater proportion of grants during the first year and less grants in subsequent years. Some colleges do the opposite, awarding more grants to students who are closer to academic degree completion.
- ◆ Some institutions require a minimum student contribution and/or a summer work expectation from all students, regardless of the student's financial need.
- ◆ Some institutions base financial aid on direct costs first (e.g., tuition and fees) and indirect costs second (e.g., room and board, books and supplies, transportation, miscellaneous expenses).
- ◆ Some institutions apply different standards to institutional merit-based awards and private scholarships.

Various aspects of institutions' packaging philosophies can lead to award displacement. Some require students to "self-help" and require all students⁶² to borrow and/or work and do not permit private scholarships to reduce or eliminate the student's debt and work burden. Similarly, some institutions have minimum student contributions or summer work expectations, and⁶³ some do not allow private scholarships to replace unmet need. These policies are especially problematic when a student's income or family situation makes it unreasonable to expect them to borrow or work.⁶⁴

Many institutions state their packaging philosophies are intended to distribute limited funds fairly and impartially to as many eligible students as possible. Yet, some institutional policies, such as leveraging, merit-based aid and athletic scholarships, are inconsistent with these stated goals. For example, some colleges insist on displacing private scholarships, yet don't apply the same rules to their own institutional grant funds, such as institutional merit-based scholarships and institutional athletic scholarships. This appears to be more than just a philosophical difference over helping specific students versus helping the student population as a whole. The impression is that institutions are placing a greater priority on their institutional goals than on respecting the intent of private scholarship donors.

III. Overaward Regulations

Federal overaward regulations⁶⁵ require reductions in campus-based aid, such as the Federal Perkins Loan, Federal Work-Study and FSEOG, as well as reductions in the Federal Direct subsidized Stafford loan, when a student is overawarded. An overaward can occur when a student's total need-based financial aid exceeds demonstrated financial need. An overaward can also occur when total financial aid, including non-need-based aid, exceeds the institution's COA. Effectively, certain forms of financial aid are subject to caps based on financial need and the COA.

62 Such policies apply only to students receiving need-based financial aid. Very few institutions require wealthy students who do not qualify for financial aid to work and borrow, despite arguments about the need for students to have "skin in the game." This can lead to a caste system on campus, where low-income students serve food to wealthy students in the cafeteria as part of their work-study jobs.

63 Even some colleges with "no loans" financial aid policies, which necessarily displace private scholarships, require a minimum student contribution and so do not really replace all loans with grants.

64 Low-income students may already be working to provide for their families, so requiring them to work to pay for school may take away too much time from academics, hurting college completion rates. Some students may be unable to borrow enough to cover college costs due to a recent bankruptcy, bad credit or explicit or implicit redlining. Low-income students may lack the resources to cover a minimum student contribution.

65 The federal overaward regulations at 34 CFR 673.5(b), (c) and (d) are based on sections 428(a)(2)(C), 428H(c) and (d), 443(b)(4), 471 and 480(j) of the Higher Education Act of 1965.

Even though federal overaward regulations are sometimes blamed for the reduction in financial aid when a student wins a private scholarship, institutional policies often control how the financial aid package is adjusted. It is institutional policies – not federal overaward regulations – that can reduce institutional grants instead of student loans. There are also situations in which a student is not overawarded according to federal rules but the institution’s policies require displacement of the scholarship, such as when they insist on maintaining a gap between financial aid and demonstrated financial need.

IV. The Taxing of Scholarships

The Tax Reform Act of 1986 changed the tax treatment of scholarships and fellowships, effective January 1, 1987.^{66, 67} Only amounts that can be used for tuition, required fees, books, supplies and equipment are excluded from income, and only for students pursuing an academic degree or certificate. Amounts used for living expenses are subject to ordinary income taxes, as are any amounts that represent pay-for services. This treatment differs from other education tax benefits, such as tax-free distributions from 529 college savings plans, where the funds may be used for room and board in certain circumstances. Note also that the American Opportunity Tax Credit and Lifetime Learning Tax Credit are not subject to overaward regulations, per 20 USC 1087vv(j)(2).

If too many of a student’s financial aid awards are restricted to tuition and fees, it may cause the total amount of restricted funds to exceed the tuition and fees, leading to a tax liability or preventing the student from obtaining a tax benefit. This can also limit a student’s eligibility for certain types of financial aid, causing a different kind of award displacement. For example, coordination restrictions in the Internal Revenue Code prevent “double dipping,” where a taxpayer earns two education tax benefits for the same qualified education expense. The American Opportunity Tax Credit (AOTC) is restricted to tuition, required fees and course materials.⁶⁸ Due to coordination restrictions in 26 USC 25A(g)(2), the tax-free portion of a student’s private scholarships will reduce the student’s eligibility for the AOTC. This causes some scholarships to displace the student’s eligibility for the AOTC. Coordination restrictions are designed to limit a combination of several types of financial aid to the most restrictive of the corresponding definitions of qualified higher education expenses. This prevents some students from using the scholarships they earned for their needs without penalty. In effect, the federal government is taxing the generosity of private scholarship providers, earning hundreds of millions of dollars of tax revenue each year from the taxable portion of private scholarships and fellowships.⁶⁹

As is outlined in the recommendations section below, scholarship providers can address these limitations by providing flexibility in the design of their scholarship programs, such as by allowing all or part of a scholarship to be deferred to a subsequent year. Scholarship providers could also allow recipients to use their scholarships for more than just tuition and fees, such as by allowing scholarships to be used for textbooks in addition to tuition and fees, or even allowing the scholarship to be used for living expenses or other components of the COA.

66 Mark Kantrowitz, History of the Tax Status of Scholarships, September 13, 2013. <http://www.edvisors.com/student-aid-policy/tax-status-scholarships.php>.

67 The exclusion from income for qualified scholarships appears in 26 USC 117.

68 The AOTC is an enhancement of the Hope Scholarship tax credit.

69 Thus the federal government displaces private scholarships twice, once through overaward regulations and once through taxes.

V. Absence of a Universal Financial Aid Award Letter

The lack of a universal standard for college financial aid award letters affects scholarship providers in two ways. First, some scholarship providers use financial aid award letters to determine an individual student's scholarship amount and to assess the potential for award displacement and to determine the student's direct and indirect costs. The lack of a standard increases the work load of scholarship providers as they try to evaluate the award letters. It may even lead to award displacement, if the scholarship provider does not understand the college's outside scholarship policy or the types of aid in the financial aid package. Second, some scholarship providers help students and their families make more informed decisions about the tradeoffs between college affordability and college quality. The lack of a standard for financial aid award letters makes it more difficult to decode the award letters. Even scholarship provider staff who previously worked as financial aid administrators can have difficulty interpreting some financial aid award letters.

Recommendations to Help Mitigate Award Displacement

The key findings of the NSPA survey revealed that scholarship award displacement is occurring at institutions across the country and that federal, institutional and scholarship program policies and practices are exacerbating the situation for students. To mitigate the negative impact of scholarship award displacement on students, the NSPA recommends implementing the proposed changes to federal, institutional and scholarship program policies and practices.

The key findings of the NSPA survey revealed that scholarship award displacement is occurring at institutions across the country and that federal, institutional and scholarship program policies and practices are exacerbating the situation for students. To mitigate the negative impact of scholarship award displacement on students, the NSPA recommends implementing the proposed changes to federal, institutional and scholarship program policies and practices.

I. Recommended Federal Policy Changes

- ◆ The federal government should modify student financial aid overaward regulations to better benefit students, since the current regulations do not yield a financial benefit to the federal government. One approach would establish a priority order that requires institutions to reduce unmet need before loans, loans before student employment and student employment before grants, similar in concept to the regulations that establish an order for the return of unearned Federal Title IV aid. Another approach would prevent scholarships and fellowships from displacing other aid by striking the references to scholarships and fellowships in the definition of estimated financial assistance and various coordinating restrictions.⁷⁰ A third approach would increase the overaward tolerance from \$300 to \$1,000.

⁷⁰ See Appendix III, Statutory and Regulatory References, specifically the overaward regulations in Section 673.5(c) (1) (vi), Definition of Estimated Financial Assistance; and Section 428(a)(2)(C)(ii)(II) of the Higher Education Act of 1965, Definition of Other Financial Assistance; and Section 480(j)(1) of the Higher Education Act of 1965.

- ◆ Congress should stop indirectly taxing 501(c)(3) scholarship providers by taxing private scholarship awards made to students. Congress should allow scholarships to be used tax-free for the full institutional COA, not just for tuition, required fees, books, supplies and equipment.⁷¹
- ◆ Congress should establish a mandatory standard for financial aid award letters or eligibility determinations for all Title IV eligible institutions.⁷² This is a low cost solution that will help families make more informed decisions about the tradeoffs between college affordability and institutional quality. One solution would require institutions to adopt the Financial Aid Shopping Sheet developed by the US Department of Education and the Consumer Financial Protection Bureau.
- ◆ The definition of COA should be expanded to include other common college costs, such as the cost of a computer and student health insurance. The cost for these items vary depending on the institution and its geographic location. Also, the inclusion of these items is at the discretion of the college's financial aid office, who may be less willing to include them because they are not explicitly listed in the federal definition of COA.
- ◆ Congress should allow the EFC to go negative when the family income falls below the subsistence level as reflected by the income protection allowance. Current policies set a minimum EFC of zero, effectively capping financial need and need-based student aid at the COA, making institutions less affordable for students at or below the poverty level.

II. Recommended Institutional Policy Changes

- ◆ Student financial aid administrators could take steps to improve the disclosure of their school's financial aid policies, especially policies concerning the displacement of other aid when a student wins a private scholarship, whether the institution practices front-loading of grants, and whether the institution leaves students with unmet need (gapping). The policies could be published on the institution's websites and in printed materials.
- ◆ Institutions might consider providing students with clear, correct and complete information about institutional costs and student financial aid in the financial aid award letters, including the prominent disclosure of the net price (total COA minus just grants and other gift aid) and subtotals for grants, loans and student employment and estimated out-of-pocket costs. Information could also include four-year projected costs with estimated annual percentage increases for tuition, fees, and room and board. Additionally, information could also include the institution's average four-year graduation rate.

⁷¹ See Edvisors.com.

⁷² Policymakers sometimes refer to financial aid award letters as financial aid offer forms.

- ◆ Student financial aid administrators could also publish a calendar or timeline for key financial aid events such as: dates the financial aid office will determine students' demonstrated financial need, when the financial aid award letters will be created and sent, and by what date(s) the students must accept the institution's offer of admission and financial aid.
- ◆ Student financial aid administrators should consider adopting packaging policies that compromise on satisfying the goals of both the institution and the scholarship provider. It is important to take action to minimize award displacement on behalf of students. For instance, private scholarships should be allowed to fill the gap (unmet need) and then replace loans and student employment before reducing grants.
- ◆ Student financial aid administrators are encouraged to consider increasing a student's COA to better reflect a student's actual education-related expenses and indirect costs, such as the cost of dependent care or the cost of a computer. Financial aid administrators can also use professional judgment to decrease the EFC.
- ◆ Student financial aid administrators are encouraged to consider waiving any minimum student and/or parent contributions and summer work expectations for high financial need scholarship recipients.

III. Recommended Private Scholarship Program Policy Changes

- ◆ Prior to sending a scholarship check to the school or student, students should be encouraged to complete a FERPA waiver form authorizing the scholarship providers and financial aid officer to discuss a student's scholarship and financial aid awards. Examples of such FERPA release forms can be found on the Internet.
- ◆ Scholarship providers can support their scholars by creating a template of important questions that students should ask of their chosen institution, along with a list of student rights to shape their financial aid awards, and a list of their chosen institution's financial aid packaging policies and practices. This could be a two-page document that providers post on their websites, share with high school counselors, college access and community organizations, and mail to students along with award notifications and checks. For examples of questions for students to ask financial aid administrators, see Fastweb's Quick Reference Guide to Evaluating Financial Aid Award Letters <http://www.finaid.org/fafsa/FinancialAidAwardLetters.pdf>.
- ◆ Scholarship providers can help their scholars increase their financial literacy and student financial aid literacy. This can be done by creating a video (like a public service announcement) and posting it to the program's website, social media channels, and/or by e-mailing students. There are many financial literacy resources already created that can be utilized by scholarship programs as well. It is imperative to meet students "where they are" by utilizing technology to convey information that will help them make informed decisions about paying for their education and taking out student loans.

- ◆ Scholarship providers might consider adopting more flexible policies concerning the use of scholarship funds, such as allowing scholarships to be used for any component of the COA, not just tuition or textbooks, and allowing scholarships to be deferred to a subsequent year when a student will not be overawarded. If a private scholarship program's leadership chooses to be flexible with the use of scholarship funds, it is important that students be made aware of federal tax policies.
- ◆ It is important for scholarship providers to be sensitive to institutional financial aid application and packaging timelines. Many financial aid administrators don't use a student self-reporting scholarship tool and the origin of scholarships can be hard to determine. Therefore, entering freshmen, their families and the scholarship provider should communicate as soon as possible to make an educated and informed decision about college affordability. Students should be advised to work with their school's financial aid office as soon as they receive the scholarship award letter (notify the school by phone or e-mail) and request a revised financial aid award letter prior to the National Candidate's Reply Date May 1 confirmation deadline. The student needs to know how the scholarship will impact his/her existing student financial award from the institution in order to make an informed decision.
- ◆ The name of the scholarship recipient and the name of the scholarship program should be clearly identified on each disbursement check.
- ◆ Scholarship providers could prepare concise summaries of their policies in a standardized format and give them to colleges attended by their scholars. These policies should include any restrictions on the use of the award, policies concerning deferment or the return of funds if the student is overawarded, requirements for renewal of the award in subsequent years, and policies concerning the disbursement of the award (e.g., in one lump sum or in multiple installments) and any other donor requirements, such as academic progress. The policy summary should include contact information in case the college financial aid administrator has questions.
- ◆ Scholarship providers might want to consider coordinating their efforts to minimize the collective burden of private scholarship programs on student financial aid administrators, and reporting requirements, by establishing a common award notification date or dates, and by streamlining their award notifications with the National Candidates Reply Date of May 1.
- ◆ Scholarship providers should help students comply with institutional and government reporting requirements.
- ◆ Scholarship providers should consider offering education to families about award displacement so that they aren't surprised when the institution reduces the loans, student employment and/or grants in the financial aid package after receipt of a private scholarship. Some scholarship programs do this during their scholar orientation.
- ◆ Scholarship providers may want to consider developing relationships with one person in the financial aid department or offices of the schools their scholars attend.

Conclusion

A national goal of the United States of America is to once again have the highest proportion of college graduates in the world by the year 2020.⁷³ If the country is to succeed in this goal, students who qualify for grants and scholarships must be able to realize the full value of these types of aid to pay for a higher education. Perhaps nearly as critical, government and institutional policymakers must not directly or indirectly discourage the efforts of scholarship donors by implementing award displacement and creating negative consequences on a student's ability to pay for all costs associated with a higher education. To encourage the creation of new private scholarship programs and the expansion of existing programs, and to make significant gains toward the national goal of having the highest proportion of college graduates in the world, all parties must work together to ensure that the scholarship recipients derive a significant financial benefit from the private scholarships they have earned. Otherwise, the only benefits received by the student will be non-financial in nature, which are not as effective in improving outcomes as a combination of financial and non-financial benefits.

About the National Scholarship Providers Association (NSPA)

The National Scholarship Providers Association (NSPA) is the professional association for organizations involved in awarding and administering scholarships for higher education with a mission to advance the collective impact of scholarship providers and the scholarships they award. NSPA promotes student access and success in higher education. NSPA's members collectively award more than \$1 billion in scholarships each year.

NSPA formed the Maximizing Student Awards Committee in January 2009. The members of this committee include private scholarship providers and institutional scholarship/financial aid professionals. This committee seeks to facilitate dialog between institutional and non-institutional sources of financial aid funds and to ensure that students gain maximum benefit from the private, institutional, state and federal financial aid resources they receive to pay for their higher education pursuits. Much of the committee's discussions have centered on the topic of scholarship displacement. The committee would like to thank Sara Goldrick-Rab, David Levy, and Matt Reed for their contributions and assistance with the editing of this paper.

⁷³ President Barack Obama, Address to Joint Session of Congress, February 24, 2009.

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*With the exception of the NSPA, please note that the recommendations and opinions stated in this paper are attributed to the individuals who served on the committee and not the organizations or institutions in which they are employed.

Appendix I: Insights into Award Displacement Policies and Practices from the NSPA Award Displacement Survey

The National Scholarship Providers Association circulated an 11-question “Scholarship Award Displacement” survey to 100 financial aid offices from a stratified sample of four-year colleges and universities in September 2011.⁷⁴ The survey concerned institutional outside scholarship policies and the displacement of other forms of financial aid when a student receives a private scholarship. The responses were well-distributed according to a variety of institutional characteristics.

- ◆ Geography: 20% of the colleges were from the Midwest, 28% from the North, 24% from the South and 28% from the West.
- ◆ Pell Percentage: 22% had a low percentage of undergraduate students receiving Federal Pell Grants ($\leq 10\%$), 49% had a medium percentage of undergraduate students receiving Federal Pell Grants (11% to 20%) and 29% had a high percentage of undergraduate students receiving Federal Pell Grants ($> 20\%$)
- ◆ Tuition and Fees: Tuition and required fees ranged from a low of \$3,800 to a high of \$53,100,⁷⁵ averaging \$26,715. The colleges were divided into low tuition and high tuition groups, splitting at \$18,000 in tuition and fees.
- ◆ Enrollment: Enrollment ranged from a low of 950 to a high of 38,200,⁷⁶ averaging 11,101. The colleges were divided into low, medium and high enrollment groups, splitting at enrollment levels of 3,000 and 16,000 students.
- ◆ Minority Percentage: The percentage of students who were minorities ranged from 16% to 100%, averaging 49%. The colleges were split into low and high minority percentage groups at 50%.
- ◆ Selectivity: The percentage of applicants admitted ranged from 7% to 99%, averaging 42%. The colleges were split into low and high selectivity groups at 50%.
- ◆ College Type: There were 31 private four-year colleges and 20 public four-year colleges. Nine colleges were of unknown type due to partial completion of the surveys.

A total of 61 responses were received, of which 46 were complete and 15 were partial, representing total undergraduate enrollment of 566,152. Although the survey was not designed to be statistically significant, the results are suggestive of broad trends in displacement practices.

74 Mark Kantrowitz, NSPA Scholarship Displacement Survey, September 16, 2013: <http://www.edvisors.com/student-aid-policy/scholarship-displacement-survey.php>.

75 Figures are rounded to avoid identifying individual colleges.

76 Figures are rounded to avoid identifying individual colleges.

Analysis of the survey results was performed by Mark Kantrowitz, Publisher of Fastweb.com and FinAid.org (now at Edvisors.com), and a member of the NSPA Board of Directors, in November 2011.⁷⁷ Mr. Kantrowitz offered the following summary of the analysis. The most significant findings of the survey were as follows:

Publication of Outside Scholarship Policies

90% of colleges publish their outside scholarship policies on their websites. Two fifths of colleges provided their outside scholarship policies in hardcopy format. High enrollment colleges were less likely to distribute the outside scholarship policies in hardcopy format. Almost two thirds of low enrollment colleges distributed the policies in hardcopy format, compared with two fifths of medium enrollment colleges and one fifth of high enrollment colleges.

Methods of Responding to an Overaward

When an outside scholarship results in an overaward, four fifths of colleges reduce self-help, half reduce institutional gift aid, half contact the scholarship donor and/or the student to discuss options and almost a third use professional judgment to increase the cost of attendance. One sixth of colleges will reduce state gift aid, mainly because many states require colleges to treat state grants as last dollar.

Public colleges and colleges with a high percentage of Federal Pell Grant recipients, high overall enrollment or low tuition and fees were much more likely to use professional judgment to increase the cost of attendance.⁷⁸

Private colleges and colleges with high tuition and fees were twice as likely to reduce institutional gift aid in an overaward situation.

About half of the colleges used an institutional methodology (IM) for determining a student's eligibility for non-federal institutional aid. Overall, colleges with a low percentage of Federal Pell Grant recipients, low enrollment and high tuition were more likely to use IM. More selective colleges and private colleges were also more likely to use IM. Of the colleges that use IM, about half will allow outside scholarships to fill the gap between IM and FM.

Of colleges that do not meet the full demonstrated financial need, three quarters allow outside scholarships to reduce unmet need and one quarter do not. Of those that reduce unmet need first, 85% reduce loans and work-study before institutional grants.

Prioritization of Reductions in Different Types of Aid

Colleges had different approaches to prioritizing the type of aid that would be reduced in response to a potential overaward. Some reduced self-help first while others reduced gift aid first.

⁷⁷ Full survey results are available at <http://www.finaid.org/scholarships/displacementsurvey.pdf>.

⁷⁸ These figures report the percentage of colleges with particular practices, not the prioritization. The prioritization of the reductions in various types of financial aid is discussed in the next section.

Of the colleges that meet the full demonstrated financial need, 88% reduced loans and work-study before institutional grants.

Nearly four fifths (79%) of the colleges had outside scholarship policies that reduced unmet need (if any) before self-help and self-help before gift aid.

One sixth (17%) of colleges either reduced gift aid first or required students to maintain some amount of unmet need (e.g., summer work expectations).

Public colleges and colleges with a high percentage of Federal Pell Grant recipients, high enrollment or low tuition are more likely to reduce unmet need first.

More than four fifths (81%) of colleges used the same outside scholarship policy, regardless of whether they learned about the private scholarship before packaging or after the student was packaged with aid. Of the colleges that had differences in their outside scholarship policies, most shifted from reducing loans and institutional gift aid first toward reducing work-study first.

Two fifths of colleges (40%) said that they adjust a student's financial aid package for future academic years based on the expectation that an outside scholarship will be renewed.

Packaging and Disbursement of Financial Aid

The timing of packaging and disbursement of financial aid varied among the colleges.

Most (91%) of colleges send conditional or estimated financial aid eligibility determinations to new students in February, March or April. Eight percent send financial aid eligibility determinations after the National Candidates Reply Date of May 1.

Disbursement of aid ranged from the first week of July to the last week of September. The third week of August was reported as the most common disbursement period. Three fifths of the colleges disburse aid during August, one eighth in July and one quarter in September. This suggests that scholarship providers should send the funds to the college no later than mid-June in order to avoid forcing a revision in the financial aid package after disbursement.

Appendix II: Suggested Changes in Policy and Practice for Mitigating Award Displacement

There are several policies and best practices that policymakers, colleges and universities, and scholarship providers should adopt to mitigate the potential for award displacement and help students receive the maximum financial benefit from their financial aid packages.

Recommended Federal Policy Changes

- ◆ The federal government should modify overaward regulations to better benefit students. The intention of overaward regulations is to stretch limited federal funding further by preventing students from receiving need-based aid in excess of financial need, non-need-based aid in excess of the EFC and any aid in excess of the cost of attendance. There is little evidence of any savings to the federal government from the overaward regulations, since colleges and universities usually reduce institutional aid to eliminate the overaward. Nevertheless, blame for the reduction in the student's financial aid package is often assigned to the federal government and not to institutional outside scholarship policies.
- ◆ Since financial aid packages usually include loans, which do not reduce college costs, overaward regulations can lead to a substitution of loans for grants instead of a substitution of grants for loans. This could be addressed by establishing a priority order that requires colleges to reduce loans before grants, similar to the regulations that establish an order for the return of unearned Title IV aid in 34 CFR 668.22(i). The optimal order would require private scholarship funds to be applied first to any unmet need, then to reducing student loan debt, then to student employment and, last, to grants.
- ◆ Alternately, the displacement of scholarships and fellowships could be prevented by striking references to scholarships and fellowships from the definition of estimated financial assistance and the coordinating restrictions in 34 CFR 673.5(c)(1)(vi) and (viii), 20 USC 1078(a)(2)(C)(ii)(II), 20 USC 1087vv(j)(1) and 26 USC 25A(g)(2) and by adding exclusions for scholarships and fellowships in 34 CFR 673.5(c)(2).
- ◆ Since January 1, 1987, the federal government has taxed the generosity of scholarship providers by restricting the tax-free status of scholarships to only those amounts used for tuition, fees, books, supplies and equipment. Amounts used for direct and indirect living expenses, such as room and board, transportation and miscellaneous expenses, are taxable. These expenses, nevertheless, are often real expenses that affect college affordability. Some students are forced to work full time while enrolled in college to cover these costs. But working full time hurts academic performance enough that graduation rates are cut in half. Congress should consider allowing scholarships to be used tax-free for any amounts included in the college's cost of attendance. One approach would involve replacing the definition of qualified tui-

tion and related expenses in 26 USC 117 with a cross-reference to the definition of qualified higher education expenses in 26 USC 529(e)(3). Consistent definitions between the IRS and US Department of Education would be helpful.

- ◆ Congress should establish a mandatory standard for financial aid offer forms. This is a low-cost solution that will help families make more informed decisions about the tradeoffs between college affordability and college quality. One solution would be to require colleges to adopt the Financial Aid Shopping Sheet developed by the US Department of Education and the Consumer Financial Protection Bureau. This could be implemented by enacting the Understanding the True Cost of College Act of 2012 (S. 3244) in the Senate and H.R. 6506 in the House. This bipartisan legislation amends section 484 of the Higher Education Act of 1965 [20 USC 1092] to further develop the model financial aid offer form established by the Higher Education Opportunity Act of 2008 and make it mandatory.
- ◆ It would help if the definition of cost of attendance in section 472 of the Higher Education Act of 1965 [20 USC 1087ll] were expanded to include other common living expenses, such as the cost of a computer and student health insurance.
- ◆ Another approach would involve increasing the overaward tolerance from \$300 to \$1,000 in 34 CFR 673.5(d) and (e), 34 CFR 682.604(i), 34 CFR 685.303(e), and Section 443(b)(4) of the Higher Education Act of 1965 [42 USC 2753 (b)(4)].

Recommended Institutional Policies & Practices

- ◆ Improve the disclosure of financial aid information by colleges and universities.
 - ◆ Publish the college's financial aid policies, especially policies concerning the treatment of private scholarships and the packaging of financial aid, on the college's websites as well as in all printed materials.
 - ◆ Publish a clear description of the college's packaging philosophy, especially whether the college leaves students with unmet need (gapping).
 - ◆ Publish the college's outside scholarship policy, describing how a student's financial aid package will change if the student receives a private scholarship. Also, explain the treatment of scholarships in subsequent years.
 - ◆ Publish descriptions of how institutional grants will vary, if at all, from the initial year of enrollment to subsequent years of enrollment. Does the college practice front-loading of grants? If so, how does this affect the composition of the financial aid package from one year to the next?
 - ◆ Provide clear, correct and complete information about college costs and financial aid in the financial aid award letters.
 - ◆ Publish a calendar/timeline for key events, such as when financial aid packages are determined, when award letters will be sent, and by when students must accept the offer of admission and financial aid.
- ◆ Adopt more favorable financial aid packaging policies, especially in regard to award displacement.

- ◆ Allow private scholarships to fill the gap or “unmet need.”
- ◆ After a private scholarship has eliminated unmet need, allow the scholarship to replace loans and work-study before reducing any institutional grants or scholarships.
- ◆ Proactively solicit professional judgment appeals from students who are low-income or who may be under extreme financial distress. When addressing the needs of low-income students, it is important to take a proactive approach instead of a reactive approach.
- ◆ Consider increasing a student’s cost of attendance (COA) to better reflect the student’s actual expenses and indirect costs, especially if the student has a very low or zero EFC. These costs can include childcare, eldercare, health care, health insurance, transportation, computer equipment, bedding, disability-related expenses, and warm or cold weather clothing. For example, if a student’s actual textbook spending on required textbooks exceeds the allowance in the college’s financial aid package, encourage students to appeal for an increase in the allowance. Encourage the students to keep the receipts from their textbooks and supplies not only for this purpose but also for the possible reduction of any potential income tax liability.
- ◆ Waive minimum student contributions and summer work expectations for low-income students. Many low-income students are working regardless of these expectations; however, the money they earn is used to help their families financially and is not intended as extra money for college costs or extracurricular activities.
- ◆ Facilitate interactions with private scholarship providers.
 - ◆ Provide students with a standardized form they can use to provide the scholarship providers with a FERPA waiver, so that the scholarship provider can advocate on their behalf.
 - ◆ Encourage students to submit copies of their Federal Student Aid Report (SAR) and financial aid award letters to private scholarship providers. This will help the private scholarship provider determine a clearer picture of the student’s “true” financial need. Original documents should be retained by the student.
 - ◆ Help students comply with scholarship provider policies for renewal of renewable scholarships.
 - ◆ Modify administrative software to allow the name of external, private scholarships to be specified in financial aid award letters and reports.
 - ◆ Work with private scholarship providers and other college financial aid administrators to create a centralized database of institution policies and calendars/timelines.

Recommendations for Standardized Financial Aid Award Letters

Scholarship providers recommend that the following best practices be included in the standards for financial aid award letters.

- ◆ Award letters should list the full cost of attendance, with a detailed breakdown into the major cost components, such as tuition, required fees, textbooks and supplies, room and board, transportation and miscellaneous personal expenses.
- ◆ Award letters should disclose the college's outside scholarship policy.
- ◆ Award letters should disclose whether the college practices front-loading of grants.
- ◆ Award letters should indicate whether the institutional awards are based on the Federal Methodology or an Institutional Methodology or both for the respective source and type of aid, and provide the EFC figures on the aid eligibility determination.
- ◆ Award letters should clearly distinguish between grants, loans and student employment, and include subtotals for each.
- ◆ Award letters should state the net price (the difference between the total cost of attendance and just grants).

In addition, it would be helpful if colleges were to adopt an electronic data standard for award letters to make it possible to upload a student's award letter into scholarship management systems and other administrative tools.

Recommended Private Scholarship Provider Policies & Practices

- ◆ Work with students and their families.
 - ◆ Empower students and their families by helping them understand and navigate the financial aid process. Students have options in their use of financial aid and may exercise an appeal for professional judgment to accommodate unusual circumstances with the college. Successful appeals can reduce a student's EFC or increase their COA (i.e., for dependent care expenses, cost of computer, etc.)
 - ◆ Help students and their families evaluate financial aid award letters, such as helping them understand the importance of the college's net price. Explain the problems with net price figures, such as how the net price can be affected by a college's outside scholarship policy, the front-loading of grants and other college policies concerning private scholarships. College choice should be based on more than just the financial considerations, but helping families understand the financial aid award letter ensures that they make a more informed decision about the tradeoffs between college affordability, college quality and other factors.
 - ◆ Help increase student and parent financial literacy and financial aid literacy through such programs as College Goal Sunday, Cash for College, the National Financial Literacy Foundation and the National Endowment for Financial Education.
- ◆ Review and understand college and university policies and practices.
 - ◆ Understand the terms "Federal Methodology" and "Institutional Methodology." Know which method is being used by the institution for awarding its own student aid funds. Colleges and universities (especially non-profits) sometimes use two different EFC measures to determine a student's demonstrated financial need.

- ◆ Understand the college's financial aid application and packaging timeline. For example, scholarship providers should send funds to the college no later than mid-June in order to avoid forcing a revision in the financial aid package after disbursement.
- ◆ Adopt more flexible policies.
 - ◆ Scholarship providers should adopt more flexible policies concerning the use of scholarship funds, allowing scholarships to be used for any component of the cost of attendance, not just tuition or textbooks.
 - ◆ Scholarship providers should allow scholarships to be deferred to a future academic or enrollment period when a student is overawarded.
- ◆ Improve communication with colleges and universities.
 - ◆ Create a unique identifier for each scholarship recipient. To help colleges credit a scholarship to the correct student, scholarship providers should identify the scholarship recipient more precisely, including full legal name (not nickname), home address, date of birth, and campus ID number, if known. The check should also include the name of the scholarship program and/or provider and contact information. (This is a particularly common problem with the use of third-party payers).
 - ◆ Specification of scholarship provider policies. Scholarship providers should include a list of provider policies with the scholarship check, such as restrictions on use of the award, policies concerning deferment or the return of funds if the student is overawarded, requirements for renewal of the award in subsequent years and policies concerning how the award should be disbursed (e.g., immediately or in one or more installments per academic term).
 - ◆ Coordinate efforts with other scholarship providers to minimize the collective burden of private scholarship programs on college financial aid administrators, such as by standardizing scholarship provider policies, reporting requirements and forms, establishing a common award notification date or dates, and streamlining award disbursement.
- ◆ Help students comply with reporting requirements.
 - ◆ Students are required to report all private scholarships they receive to the financial aid office of the college they attend.
 - ◆ Students are required to report the taxable portion of a scholarship to the IRS on their federal income tax returns. The taxable portion of scholarships includes funds received for non-qualified expenses such as room and board, miscellaneous expenses, hobbies and transportation. The taxable portion of a scholarship should be reported on line 1 (IRS Form 1040EZ) or line 7 (IRS Form 1040A or IRS Form 1040). If the taxable amount was not reported on IRS Form W-2, write "SCH" and the taxable amount in the space to the left of the corresponding line on the federal income tax return.⁷⁹

⁷⁹ Additional details may be found in Chapter 1 of IRS Publication 970, Tax Benefits for Education. See <http://www.irs.gov/publications/p970/ch01.html> or <http://www.irs.gov/pub/irs-pdf/p970.pdf>.

Appendix III: Statutory and Regulatory References

Overaward Regulations

34 CFR 673.5 Overaward.

(a) Overaward prohibited —

- ◆ Since financial aid packages usually include loans, which do not reduce college costs, overaward regulations can lead to a substitution of loans for grants instead of a substitution of grants for loans. This could be addressed by establishing a priority order that requires colleges to reduce loans before grants, similar to the regulations that establish an order for the return of unearned Title IV aid in 34 CFR 668.22(i). The optimal order would require private scholarship funds to be applied first to any unmet need, then to reducing student loan debt, then to student employment and, last, to grants.
- ◆ Alternately, the displacement of scholarships and fellowships could be prevented by striking references to scholarships and fellowships from the definition of estimated financial assistance and the coordinating restrictions in 34 CFR 673.5(c)(1)(vi) and (viii), 20 USC 1078(a)(2)(C)(ii)(II), 20 USC 1087vv(j)(1) and 26 USC 25A(g)(2) and by adding exclusions for scholarships and fellowships in 34 CFR 673.5(c)(2).

(b) Awarding and disbursement.

- ◆ When awarding and disbursing a Federal Perkins Loan or an FSEOG or awarding FWS employment to a student, the institution shall take into account those amounts of estimated financial assistance it —
 - ◆ Can reasonably anticipate at the time it awards Federal Perkins Loan funds, an FSEOG or FWS funds to the student;
 - ◆ Makes available to its students; or
 - ◆ Otherwise knows about.
- ◆ If a student receives amounts of estimated financial assistance at any time during the award period that were not considered in calculating the Federal Perkins Loan amount or the FWS or FSEOG award, and the total amount of estimated financial assistance including the loan, the FSEOG, or the prospective FWS wages exceeds the student's need, the overaward is the amount that exceeds need.

(c) Estimated financial assistance.

- ◆ Except as provided in paragraphs (c)(2) and (c)(3) of this section, the Secretary considers that “estimated financial assistance” includes, but is not limited to, any —
 - ◆ Funds a student is entitled to receive from a Federal Pell Grant;
 - ◆ William D. Ford Federal Direct Loans;
 - ◆ Federal Family Education Loans;
 - ◆ Long-term need-based loans, including Federal Perkins Loans;
 - ◆ Grants, including FSEOGs, State grants, Academic Competitiveness Grants, and National SMART Grants;
 - ◆ Scholarships, including athletic scholarships;
 - ◆ Waivers of tuition and fees;
 - ◆ Fellowships or assistantships, except non-need-based employment portions of such awards;
 - ◆ Except as provided in paragraph (c)(2)(v) of this section, veterans’ education benefits;
 - ◆ National service education awards or post-service benefits paid for the cost of attendance under title I of the National and Community Service Act of 1990 (AmeriCorps);
 - ◆ Net earnings from need-based employment;
 - ◆ Insurance programs for the student’s education; and
 - ◆ Any educational benefits paid because of enrollment in a postsecondary education institution, or to cover postsecondary education expenses.

- ◆ The Secretary does not consider as estimated financial assistance —
 - ◆ Any portion of the estimated financial assistance described in paragraph (c)(1) of this section that is included in the calculation of the student’s EFC;
 - ◆ Earnings from non-need-based employment;
 - ◆ Those amounts used to replace EFC, including the amounts of any TEACH Grants, unsubsidized Federal Stafford or Direct Loans, Federal PLUS or Federal Direct PLUS Loans, and non-federal non-need-based loans, including private, state-sponsored, and institutional loans. However, if the sum of the amounts received that are being used to replace the student’s EFC actually exceed the EFC, the excess amount must be treated as estimated financial assistance;

- ◆ Assistance not received under a title IV, HEA program, if that assistance is designated to offset all or a portion of a specific component of the cost of attendance and that amount is excluded from the cost of attendance as well. If that assistance is excluded from either estimated financial assistance or cost of attendance, that amount must be excluded from both;
- ◆ Federal veterans' education benefits paid under —
 - ◆ Chapter 103 of title 10, United States Code (Senior Reserve Officers' Training Corps);
 - ◆ Chapter 106A of title 10, United States Code (Educational Assistance for Persons Enlisting for Active Duty);
 - ◆ Chapter 1606 of title 10, United States Code (Selected Reserve Educational Assistance Program);
 - ◆ Chapter 1607 of title 10, United States Code (Educational Assistance Program for Reserve Component Members Supporting Contingency Operations and Certain Other Operations);
 - ◆ Chapter 30 of title 38, United States Code (All-Volunteer Force Educational Assistance Program, also known as the "Montgomery GI Bill—Active Duty");
 - ◆ Chapter 31 of title 38, United States Code (Training and Rehabilitation for Veterans with Service-Connected Disabilities);
 - ◆ Chapter 32 of title 38, United States Code (Post-Vietnam Era Veterans' Educational Assistance Program);
 - ◆ Chapter 33 of title 38, United States Code (Post 9/11 Educational Assistance);
 - ◆ Chapter 35 of title 38, United States Code (Survivors' and Dependents' Educational Assistance Program);
 - ◆ Section 903 of the Department of Defense Authorization Act, 1981 (10 U.S.C. 2141 note) (Educational Assistance Pilot Program);
 - ◆ Section 156(b) of the "Joint Resolution making further continuing appropriations and providing for productive employment for the fiscal year 1983, and for other purposes" (42 U.S.C. 402 note) (Restored Entitlement Program for Survivors, also known as "Quayle benefits");
 - ◆ The provisions of chapter 3 of title 37, United States Code, related to subsistence allowances for members of the Reserve Officers Training Corps; and
 - ◆ Any program that the Secretary may determine is covered by section 480(c)(2) of the HEA; and

- ◆ Iraq and Afghanistan Service Grants made under section 420R of the HEA.
- ◆ The institution may also exclude as estimated financial assistance any portion of a subsidized Federal Stafford or Direct Loan that is equal to or less than the amount of a student's national service education awards or post-service benefits paid for the cost of attendance under title I of the National and Community Service Act of 1990 (AmeriCorps).

(d) Treatment of estimated financial assistance in excess of need—General.

An institution shall take the following steps if it learns that a student has received additional amounts of estimated financial assistance not included in the calculation of Federal Perkins Loan, FWS, or FSEOG eligibility that would result in the student's total amount of estimated financial assistance exceeding his or her financial need by more than \$300:

- ◆ The institution shall decide whether the student has increased financial need that was unanticipated when it awarded financial aid to the student. If the student demonstrates increased financial need and the total amount of estimated financial assistance does not exceed this increased need by more than \$300, no further action is necessary.
- ◆ If the student's total amount of estimated financial assistance still exceeds his or her need by more than \$300, as recalculated pursuant to paragraph (d)(1) of this section, the institution shall cancel any undisbursed loan or grant (other than a Federal Pell Grant).
- ◆ Federal Perkins Loan and FSEOG overpayment. If the student's total amount of estimated financial assistance still exceeds his or her need by more than \$300, after the institution takes the steps required in paragraphs (d)(1) and (2) of this section, the institution shall consider the amount by which the estimated financial assistance amount exceeds the student's financial need by more than \$300 as an overpayment.

(e) Termination of FWS employment.

- ◆ An institution may fund a student's FWS employment with FWS funds only until the amount of the FWS award has been earned or until the student's financial need, as recalculated under paragraph (d)(1) of this section, is met.
- ◆ Notwithstanding the provisions of paragraph (e)(1) of this section, an institution may provide additional FWS funding to a student whose need has been met until that student's cumulative earnings from all need-based employment occurring subsequent to the time his or her financial need has been met exceed \$300.

(f) Liability for and recovery of Federal Perkins Loans and FSEOG overpayments.

- ◆ Except as provided in paragraphs (f)(2) and (f)(3) of this section, a student is liable for any Federal Perkins Loan or FSEOG overpayment made to him or her. An FSEOG overpayment for purposes of this paragraph does not include the non-Federal share of an FSEOG award if an institution meets its FSEOG matching share by the individual recipient method or the aggregate method.
- ◆ The institution is liable for a Federal Perkins Loan or FSEOG overpayment if the overpayment occurred because the institution failed to follow the procedures in this part or 34 CFR parts 668, 674, or 676. The institution shall restore an amount equal to the overpayment and any administrative cost allowance claimed on that amount to its loan fund for a Federal Perkins Loan overpayment or to its FSEOG account for an FSEOG overpayment.
- ◆ A student is not liable for, and the institution is not required to attempt recovery of, a Federal Perkins Loan or FSEOG overpayment, nor is the institution required to refer an FSEOG overpayment to the Secretary, if the overpayment —
 - ◆ Is less than \$25; and
 - ◆ Is neither a remaining balance nor a result of the application of the overaward threshold in paragraph (d) of this section.
 - ◆ Except as provided in paragraph (f)(3) of this section, if an institution makes a Federal Perkins Loan or FSEOG overpayment for which it is not liable, it shall promptly send a written notice to the student requesting repayment of the overpayment amount. The notice must state that failure to make that repayment, or to make arrangements satisfactory to the holder of the overpayment debt to pay the overpayment, makes the student ineligible for further title IV, HEA program funds until final resolution of the overpayment.
 - ◆ If a student objects to the institution's Federal Perkins Loan or FSEOG overpayment determination on the grounds that it is erroneous, the institution shall consider any information provided by the student and determine whether the objection is warranted.
- ◆ Except as provided in paragraph (f)(3) of this section, if a student fails to repay an FSEOG overpayment or make arrangements satisfactory to the holder of the overpayment debt to repay the FSEOG overpayment after the institution has taken the action required by paragraph (f)(4) of this section, the institution must refer the FSEOG overpayment to the Secretary for collection purposes in accordance with procedures required by the Secretary. After referring the FSEOG overpayment to the Secretary under this section, the institution need make no further effort to recover the overpayment.

Definition of Estimated Financial Assistance

Section 428(a)(2)(C) of the Higher Education Act of 1965

[20 USC 1078(a)(2)(C)]

(C) For the purpose of this paragraph—

- ◆ a student's cost of attendance shall be determined under section 1087ll of this title;
- ◆ a student's estimated financial assistance means, for the period for which the loan is sought —
- ◆ the amount of assistance such student will receive under subpart 1 of part A of this subchapter (as determined in accordance with section 1091 (b) of this title), subpart 3 of part A of this subchapter, and part C of subchapter I of chapter 34 of title 42 and part D of this subchapter; plus
- ◆ other scholarship, grant, or loan assistance, but excluding —
 - (aa) any national service education award or post-service benefit under title I of the National and Community Service Act of 1990 [42 U.S.C. 12511 et seq.]; and
 - (bb) any veterans' education benefits as defined in section 1087vv (c) of this title; and
- ◆ the determination of need and of the amount of a loan by an eligible institution under subparagraph (B) with respect to a student shall be calculated in accordance with part E of this subchapter.

COA – Aid Cap on Loan Amounts

Section 428H(c) of the Higher Education Act of 1965 [20 USC 1078-8(c)]

(c) Determination of amount of loan

- ◆ The determination of the amount of a loan by an eligible institution under subsection (b) of this section shall be calculated by subtracting from the estimated cost of attendance at the eligible institution any estimated financial assistance reasonably available to such student. An eligible institution may not, in carrying out the provisions of subsection (b) of this section, provide a statement which certifies the eligibility of any student to receive any loan under this section in excess of the amount calculated under the preceding sentence.

Overaward Tolerance for Federal Work-Study

Section 443(b)(4) of the Higher Education Act of 1965 [42 USC 2753 (b)(4)]

(c) Determination of amount of loan

- (4) provide that for a student employed in a work-study program under this part, at time income derived from any need-based employment is in excess of the determination of the amount of such student's need by more than \$300, continued employment shall not be subsidized with funds appropriated under this part;

Definition of Financial Need

Section 471 of the Higher Education Act of 1965 [20 USC 1087kk]

Except as otherwise provided therein, the amount of need of any student for financial assistance under this subchapter and part C of subchapter I of chapter 34 of title 42 (except subparts 1 or 2 of part A of this subchapter) is equal to —

- ◆ the cost of attendance of such student, minus
- ◆ the EFC for such student, minus
- ◆ estimated financial assistance not received under this subchapter and part C of subchapter I of chapter 34 of title 42 (as defined in section 1087vv(j) of this title).

Definition of Other Financial Assistance

Section 480(j) of the Higher Education Act of 1965 [20 USC 1087vv(j)]

- (j) Other financial assistance
- ◆ For purposes of determining a student's eligibility for funds under this subchapter and part C of subchapter I of chapter 34 of title 42, estimated financial assistance not received under this subchapter and part C of subchapter I of chapter 34 of title 42 shall include all scholarships, grants, loans, or other assistance known to the institution at the time the determination of the student's need is made, including national service educational awards or post-service benefits under title I of the National and Community Service Act of 1990 (42 U.S.C. 12511 et seq.), but excluding veterans' education benefits as defined in subsection (c).

- ◆ Notwithstanding paragraph (1), a tax credit taken under section 25A of title 26, or a distribution that is not includable in gross income under section 529 of such title, under another prepaid tuition plan offered by a State, or under a Coverdell education savings account under section 530 of such title, shall not be treated as estimated financial assistance for purposes of section 1087kk(3) of this title.
- ◆ Notwithstanding paragraph (1) and section 1087ll of this title, assistance not received under this subchapter and part C of subchapter I of chapter 34 of title 42 may be excluded from both estimated financial assistance and cost of attendance, if that assistance is provided by a State and is designated by such State to offset a specific component of the cost of attendance. If that assistance is excluded from either estimated financial assistance or cost of attendance, it shall be excluded from both.
- ◆ Notwithstanding paragraph (1), special combat pay shall not be treated as estimated financial assistance for purposes of section 1087kk (3) of this title.

Treatment of Excess Loan Proceeds

34 CFR 682.604(h) and (i)

- (h) Treatment of excess loan proceeds. Except as provided under paragraph (i) of this section if, before the delivery of any Stafford, SLS or PLUS loan disbursement, the school learns that the borrower will receive or has received financial aid for the period of enrollment for which the loan was made that exceeds the amount of assistance for which the student is eligible, the school shall reduce or eliminate the overaward by either —
- ◆ Using the student’s SLS, PLUS, nonsubsidized or unsubsidized Stafford, or State-sponsored or private loan to cover the EFC, if not already done;
 - ◆ Returning the entire undelivered disbursement to the lender or escrow agent; and
 - ◆ Providing the lender with a written statement —
 - ◆ Describing the reason for the return of the funds, if any;
 - ◆ Setting forth the student’s revised financial need; and
 - ◆ Directing the lender to re-disburse a revised amount and, if necessary, revise subsequent disbursements to eliminate the overaward; or
 - ◆ Returning to the lender any portion of the disbursement for which the student is ineligible and providing the lender with a written statement explaining the return of the funds.

- (i) For purposes of paragraph (h) of this section, funds obtained from any Federal College Work-Study employment that do not exceed the borrower's financial need by more than \$300 may not be considered as excess loan proceeds.

34 CFR 685.303(e)

- (e) Treatment of excess loan proceeds. Before the disbursement of any Direct Subsidized, Direct Unsubsidized, or Direct PLUS Loan proceeds, if a school learns that the borrower will receive or has received financial aid for the period of enrollment for which the loan was intended that exceeds the amount of assistance for which the student is eligible (except for Federal Work-Study Program funds up to \$300), the school shall reduce or eliminate the overaward by either —
 - ◆ Using the student's Direct Unsubsidized, Direct PLUS, or State-sponsored or another non-Federal loan to cover the EFC, if not already done; or
 - ◆ Reducing one or more subsequent disbursements to eliminate the overaward.

Coordination Restrictions for the American Opportunity Tax Credit

26 USC 25A(g)(2)

- (2) Adjustment for certain scholarships, etc.

The amount of qualified tuition and related expenses otherwise taken into account under subsection (a) with respect to an individual for an academic period shall be reduced (before the application of subsections (b), (c), and (d)) by the sum of any amounts paid for the benefit of such individual which are allocable to such period as —

- ◆ a qualified scholarship which is excludable from gross income under section 117,
- ◆ an educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code, and
- ◆ a payment (other than a gift, bequest, devise, or inheritance within the meaning of section 102 (a)) for such individual's educational expenses, or attributable to such individual's enrollment at an eligible educational institution, which is excludable from gross income under any law of the United States.



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