



## **Executive Summary**

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

September 16, 2013

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### Objective

The purpose of this paper is to inform federal, state, institutional<sup>1</sup> 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 scholarships<sup>2</sup> 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 displacement<sup>3</sup> 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 price<sup>4</sup> 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.

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<sup>4</sup> 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.<sup>5</sup> 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:<sup>6</sup>

- ◆ 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<sup>7,8</sup>), four fifths of the institutions surveyed reduce the loans and work requirements in a student’s financial aid package (self-help aid),<sup>9</sup> 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 percentage<sup>10</sup> 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](http://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 fees<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup> 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.<sup>14</sup> 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.<sup>15</sup>

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 institutions<sup>16</sup> have policies<sup>17</sup> 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 unmet<sup>18</sup> need gap. For example, some institutions have a “minimum student

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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.

contribution expectation”<sup>19</sup> that requires all students to contribute a specified amount (typically \$1,500 to \$3,500) to their higher education, regardless of the amount of financial need, the EFC or income.<sup>20</sup> Many of these institutions do not allow private scholarships to satisfy the student contribution expectation even though the student is not overawarded.<sup>21</sup> 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.<sup>22</sup> 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.<sup>23</sup> 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.<sup>24</sup>

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 zero<sup>25</sup> 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).

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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/hers 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](http://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>.

## 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.")

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.<sup>26</sup> 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.<sup>27</sup> 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

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<sup>26</sup> 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.

<sup>27</sup> This is often referred to as a packaging order.

Pell Grant),<sup>28</sup> 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 aid<sup>29</sup> 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.
- ◆ 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 students<sup>30</sup> 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, and<sup>31</sup> 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.<sup>32</sup>

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

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28 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.

29 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.

30 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.

31 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.

32 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.

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 regulations<sup>33</sup> 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. 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.<sup>34,35</sup> 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

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33 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.

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

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

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.<sup>36</sup> 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.<sup>37</sup>

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.

## **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

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<sup>36</sup> The AOTC is an enhancement of the Hope Scholarship tax credit.

<sup>37</sup> Thus the federal government displaces private scholarships twice, once through overaward regulations and once through taxes.

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.<sup>38</sup> A third approach would increase the overaward tolerance from \$300 to \$1,000.
- ◆ 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.<sup>39</sup>
- ◆ Congress should establish a mandatory standard for financial aid award letters or eligibility determinations for all Title IV eligible institutions.<sup>40</sup> 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.

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38 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.

39 See Edvisors.com.

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

## 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.
- ◆ 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.<sup>73</sup> 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.