

CHILDREN'S SAVINGS ACCOUNTS AND FINANCIAL AID

an examination of the consequences of children's savings account ownership on financial aid eligibility



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INTRODUCTION

A growing body of academic research suggests that saving plays an important role in educational attainment, changing aspirations, and breaking the cycle of poverty. Anecdotal evidence suggests that a lack of hope is a factor in many of the poor choices made by young people. With nest egg savings, all children may be able to look toward a future in which they have the resources and know-how to invest in themselves.

The Saving for Education, Entrepreneurship and Downpayment (SEED) Policy and Practice Initiative is a multi-year national effort to test this idea by implementing a limited number of matched savings accounts for children and youth in 12 sites across the country. These demonstration sites are experimenting with a variety of program structures and providing evidence for state and federal policymakers that SEED accounts should be universally available to all children in the United States. CFED's experience with these demonstration sites, however, has raised concerns about whether SEED accountholders will face unintended negative consequences as a result of their savings when they apply for financial aid to attend college. This concern has led us to explore the implications of children's savings account ownership on eligibility for financial aid. This work has implications both for the approximately 2,000 children participating in the demonstration programs, as well as for children who in the future might have the opportunity to open an account as a result of a state or federal policy change.

In this paper we:

- review how financial aid is currently calculated;
- clarify how assets are treated in financial aid calculation;
- describe the experiences with children's savings accounts in SEED that are pertinent for this inquiry;
- explore how the most common college savings instruments are treated in financial aid calculations; and
- discuss the implications of this review for possible large-scale delivery of SEED or children's savings accounts and identify policy changes that may serve to minimize the negative consequences of account ownership on financial aid eligibility for asset-poor households.

Although the SEED Initiative is encouraging savings for education, homeownership, and small business development, most children participating in the 12 demonstration programs intend to use their accounts for higher education. With the cost of higher education increasing at a rate faster than inflation and the cost of college at a four-year public university reaching 71 percent of a low-income family's total income,¹ it is likely that — even with the assistance of a children's savings account — most accountholders will require need-based financial aid to pay for college. Eligibility for need-based

¹ *Trends in College Pricing 2003*, the College Board, New York, 2003. For academic year 2003-04.

aid — whether federal, state or institutional — is usually determined based on a variety of factors, including the assets of both the student and the student’s family.

In the past year, there have been significant federal policy changes in the way student-held assets are treated for the purposes of determining a family’s expected contribution. Most importantly, beginning in 2007, 20 percent of student assets will be considered available to cover higher education costs, compared to 35 percent under current rules. Another significant change is that beginning in 2006, student-owned 529 savings accounts will be assessed at the same rate as parent-owned 529 accounts: 5.64 percent, compared to the prior assessment rate of 35 percent.² This change is particularly important because 529 accounts are a viable account platform for more universally established children’s savings accounts, should they be enacted into state or federal law.

Even with these recent changes that lessen the penalty for low-income students for holding assets, CFED continues to be concerned about the remaining financial consequences for low-income students. For that reason, we identify and discuss policy options for further reducing these penalties, as well as other threats to financial aid eligibility that warrant further consideration.

FINANCIAL AID AND THE EXPECTED FAMILY CONTRIBUTION

Eligibility for Pell grants, subsidized Stafford loans, Perkins loans, institutional grants and other need-based financial aid is based on a needs analysis. This analysis assumes that students and their families will contribute from their own resources to pay for the students’ higher education expenses. There are two types of methodologies used to calculate need-based financial aid. The Federal Methodology (FM) is used to determine eligibility for federal financial aid such as Pell grants and Perkins and Stafford loans; the Institutional Methodology (IM) was developed by the College Board for post-secondary schools to use to determine financial aid provided to a student by the school itself. The IM is intended to serve as a guideline for post-secondary institutions; however, schools are free to alter the IM, use the FM, or use their own methodology in calculating a student’s financial need.³

In both methodologies, the amount that students and families are assumed to contribute is called the expected family contribution (EFC). The EFC is based on the student’s dependency status and the family’s size, income, expenses, number of family members enrolled in college or trade school, and assets. When a prospective student applies either for federal financial aid through the Free Application

² Note that, although Congress’ apparent intention was for student-owned 529s to be assessed at 5.64 percent, what appears to be a drafting error created a loophole allowing these assets to be disregarded in financial aid calculations. Higher education experts have suggested that this error will be corrected as soon as there is an appropriate legislative vehicle. Because we expect that this loophole will not be permanent, we have assumed Congress’ intended treatment of student-owned 529 accounts for the purposes of this paper.

³ Federal aid represents nearly two-thirds of all aid distributed in 2004-05; institutional grants, on the other hand, represent approximately one-fifth of all aid distributed in 2004-05. (“Trends in Student Aid 2005,” the College Board, New York, 2005).

for Federal Student Aid (FAFSA) or for institutional grants through an institution's financial aid office, the information reported is fed into a formula that calculates the applicant's EFC. The gap between the price of attending the institution and the family's EFC is the student's financial need.

Students applying for financial aid fall into one of three dependency categories: dependent students; independent students without a dependent other than a spouse; and independent students with one or more dependents other than a spouse. A student's dependency status plays a critical role in the determination of his or her financial need; therefore, we will consider the treatment of income and assets in the EFC for each of these categories separately.

Dependent Students: Treatment of Income and Assets in the Federal EFC

In considering a dependent student's financial need, the Federal EFC assumes that a portion of the income *and* assets of the student and his or her family will be available to pay for college.⁴ Fifty percent of a student's income is considered available to pay for college. The parents' income is assessed on a progressive scale that applies higher rates to additional dollars of discretionary income. Both students and parents, however, may subtract from their available income an **income protection allowance**.

Until new rules take effect in 2007, 35 percent of the assets owned by the student are considered available to pay for higher education expenses. After July 1, 2007, student assets will be assessed at a rate of 20 percent. Parents' assets are assessed on a progressive scale up to a maximum of 5.64 percent (which will not change in 2007). Parents also are permitted an **asset protection allowance**, based on the older parent's age, the size of the household and the number of students in the household; students are not granted an asset protection allowance.

Asset Protection Allowance for Parents of Dependent Students

The Federal Methodology includes an asset protection allowance for all families; however, the asset protection allowance only becomes relevant in determining the EFC if a family's assets aren't excluded through other mechanisms such as the simplified formula or zero EFC. The asset protection allowance is intended to protect parents in case of emergencies and to allow them to save for retirement. Thus, the older the elder parent, the more assets will be excluded.⁵

⁴ Assets considered in the EFC calculation include cash, savings, stocks, bonds, mutual funds, non-retirement investment programs and real estate (excluding the family's primary residence). To assess the assets available to the parent(s), the EFC calculation takes the value of these assets — excluding home equity and retirement savings — and subtracts an asset protection allowance. The value of an asset protection allowance is based on household adjusted gross income, the age of the parents, and the number (and age) of children in the household. There is no asset protection allowance for student-held financial assets.

⁵ The asset protection allowance does not include equity in a primary residence and assets in retirement accounts, both of which are excluded completely in the EFC calculation to begin with.

The table below shows the estimated parental contribution at various income and asset levels, and indicates the rates at which additional assets are assessed for each income level. As evidenced by the table, the maximum 5.64 marginal rate applies only to relatively high levels of income and assets. In most cases, low-income parents would not be expected to contribute anything toward the EFC. For example, parents earning up to \$50,000 with \$80,000 in net assets would not be expected to contribute any of their assets toward the EFC.

Estimated Expected Parental Contribution and Marginal Assessment Rates for 2004-05 Academic Year

	Net Assets (Excluding Primary Residence, Family Farm, & Assets in Retirement Accounts)				
	\$47,900	\$60,000	\$80,000	\$100,000	\$200,000
Parents' 2003 Before-Tax Income					
\$20,000	\$0	\$0 (0.00%)	\$0 (0.00%)	\$0 (0.00%)	\$0 (0.00%)
\$30,000	\$0	\$0 (0.00%)	\$0 (0.00%)	\$0 (0.00%)	\$0 (0.21%)
\$40,000	\$0	\$0 (0.00%)	\$0 (0.00%)	\$0 (0.00%)	\$1,188 (1.73%)
\$50,000	\$0	\$0 (0.00%)	\$0 (0.00%)	\$30 (2.30%)	\$2,674 (2.72%)
\$60,000	\$136	\$456 (2.64%)	\$984 (2.64%)	\$1,512 (2.64%)	\$4,509 (3.34%)
\$70,000	\$1,618	\$1,937 (2.64%)	\$2,465 (2.72%)	\$3,036 (3.09%)	\$7,103 (4.58%)
\$80,000	\$3,119	\$3,482 (3.05%)	\$4,178 (3.48%)	\$4,959 (4.08%)	\$10,199 (5.42%)
\$90,000	\$4,783	\$5,277 (4.08%)	\$6,208 (4.69%)	\$7,254 (5.48%)	\$12,894 (5.64%)
\$100,000	\$7,011	\$7,964 (5.64%)	\$8,822 (5.64%)	\$9,950 (5.64%)	\$15,590 (5.64%)
\$150,000	\$20,293	\$20,976 (5.64%)	\$22,104 (5.64%)	\$23,232 (5.64%)	\$28,872 (5.64%)
\$200,000	\$33,739	\$34,421 (5.64%)	\$35,549 (5.64%)	\$36,677 (5.64%)	\$42,317 (5.64%)

Source: Jennifer Ma, "College Savings Options and the Impact of Savings on Financial Aid," Research Dialogue, TIAA-CREF Institute, New York, March 2005.

Note: Numbers in parentheses indicate the average rates at which additional assets are assessed for a given income level in the EFC calculation.

Assumptions: a two-parent family with two dependent children; the older parent is 50 and both parents are employed; income is from employment in 2003; parents are required to file an IRS Form 1040 tax return for 2003; the family used the standard deduction; only one child is enrolled in college; and parents are residents of New York state.

Asset Exclusions for Low- and Moderate-Income Parents of Dependent Students

In addition to these basic rules, the Federal Methodology includes a pair of features – the simplified EFC formula and the zero EFC – intended to make it easier for low-income households to fill out the FAFSA form and to ensure that a greater portion of need-based financial aid does in fact go to low-income families. A dependent student is eligible for the **simplified EFC formula**, which excludes all assets from consideration, if:

- the parents' income is below \$50,000;
- the parents filed or are eligible to file an IRS Form 1040A or 1040EZ, or the parents are not required to file any income tax return; and
- the student filed or is eligible to file an IRS Form 1040A or 1040EZ, or is not required to file any income tax return.

A dependent student automatically qualifies for a **zero EFC**, meaning that student and his or her family are not expected to contribute anything toward the cost of college, if:

- the parents' income is \$20,000 or less;
- the parents filed or are eligible to file an IRS Form 1040A or 1040EZ, or the parents are not required to file any income tax return; and
- the student filed or is eligible to file an IRS Form 1040A or 1040EZ, or is not required to file any income tax return.

Although it is intended to ease the application for and access to financial aid for low-income families, the simplified formula has limits in its applicability. There are instances where a family has an income below \$50,000 but cannot file the 1040A or 1040EZ form. For example, if a family either pays or receives alimony, they must file a regular 1040 form. A model constructed by the Urban-Brookings Tax Policy Center suggests that a substantial share of tax filers with adjusted gross income below \$50,000 are not eligible to file the 1040A or 1040EZ, and therefore would not qualify for the exclusion of all assets from financial aid tests.

Independent Students with Dependents: Treatment of Income and Assets in the Federal EFC

In the federal EFC calculation, an independent student with one or more dependents (other than a spouse) may subtract from their available income an **income protection allowance** and other allowances. The student's remaining available income is then assessed on a progressive scale.

Like parents of dependent students, independent students with dependents are afforded an **asset protection allowance**. Assets above this asset protection allowance are assessed on a progressive scale. Until new rules take effect in 2007, a maximum of 12 percent of the assets owned by an independent student with dependents are considered available to pay for higher education expenses. After July 1, 2007, the assets of independent students with dependents will be assessed at a maximum rate of seven percent.

An independent student with dependents qualifies for the **simplified EFC formula**, which excludes all assets from consideration, if:

- the student's (and spouse's) income is below \$50,000; and
- the student (and the student's spouse, if any) filed or is eligible to file an IRS Form 1040A or 1040EZ, or is not required to file any income tax return.

An independent student with dependents automatically qualifies for a **zero EFC** if:

- the student's (and spouse's) income is below \$20,000; and
- the student (and the student's spouse, if any) filed or is eligible to file an IRS Form 1040A or 1040EZ, or is not required to file any income tax return.

Independent Students without Dependents: Treatment of Income and Assets in the Federal EFC

The income of independent students without dependents is treated the same as dependent students' income: it is assessed at 50 percent. Until new rules take effect in 2007, 35 percent of the assets owned by an independent student *without* dependents are considered available to pay for higher education expenses. After July 1, 2007, the assets of independent students will be assessed at a rate of 20 percent.

The criteria for qualifying for the **simplified EFC** formula are the same for both independent students without dependents and independent students with dependents other than a spouse. However, independent students without dependents **are not eligible for a zero EFC**.

Treatment of Income and Assets in the Institutional Methodology

The Institutional Model treats the income of both the student and the student's family in much the same way that the Federal Methodology does, with a few exceptions. The IM:

- assumes the student will devote some time each year to earning money, and that this income will be available to pay for higher education expenses;
- includes in total income any paper depreciation, business, rental, or capital losses which artificially reduce adjusted gross income; and
- makes allowances for medical expenses, private elementary and secondary school tuition, and unusual circumstances.

The IM also treats assets differently than the FM does. Some key differences between the two methodologies are that the IM:

- assesses student assets at 25 percent, whereas the FM currently assesses student assets at 35 percent, declining to 20 percent in 2007;
- includes a broader range of family assets, including home equity and family farm equity;
- assumes non-custodial parents will pay a share of educational costs; and
- does not take the age of the parent(s) into account.

EXPERIENCE WITH CHILDREN'S SAVINGS ACCOUNTS IN THE SEED INITIATIVE

The SEED Initiative currently includes 11 sites across the country, each of which has enrolled approximately 75 children in the program. In addition, there is one quasi-experimental site that includes 500 children with SEED (children's savings) accounts.⁶ During the four years of the demonstration phase of the Initiative, most — but not all — SEED sites are offering SEED accounts that are standard, statement savings accounts set up at a local bank or financial institution. Like individual

⁶ An additional component of SEED, the Universal Model experiment, will add 1,000 accountholders in one particular state who will be randomly chosen to receive a SEED account from birth.

development accounts (IDAs), deposits of accountholders and their families are matched, and these match funds are kept separately in a pooled account owned by the organization running the program.

For the most part, these savings accounts are set up as “custodial” accounts, with the organization running the program as custodian. The legal basis for this kind of custodial account is the Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA), both of which have been adopted by nearly all states.⁷ Custodial accounts are owned by minors, but the custodian is empowered to make decisions regarding the account as long as the decisions are for the benefit of the minor. Thus, the custodian has all legal rights to the account except ownership. Organizations running SEED programs decided to use the custodial structure because they wanted to be sure that funds in the accounts would not be depleted during the program for unqualified purposes.

Not all SEED sites are using this account model, however. At three SEED sites, participants are saving directly into longer-term savings vehicles that provide more variable returns based on market investments. At two of those sites, participants save directly into a 529 College Savings Plan; at the third site, participants’ savings are currently held in a Smith Barney investment account.

By the end of the demonstration phase (four years), CFED expects all of the organizations running SEED programs to have developed a plan to roll over funds accumulated in SEED accounts, plus match funds accumulated in the pooled account, into a long-term, restricted savings vehicle that would be controlled by the SEED participant and/or his or her family. Thus, whether SEED accountholders are currently saving in a 529 account or other investment-type account (such as an IRA or Roth IRA) or whether they will eventually roll over a standard savings account into one of these vehicles, it is these kinds of accounts that will ultimately come into play in financial aid calculations for the vast majority of SEED participants pursuing higher education. Moreover, emerging policy proposals at both the federal and state level to create universal systems of children’s savings accounts, such as the federal ASPIRE Act,⁸ use these accounts as the platform for larger systems of accounts. As a result, the next section of this paper focuses on the implications for need-based financial aid of these accounts.

⁷ Both UTMA and UGMA accounts are custodial arrangements that allow an individual to open an account in a child’s name. With both types of account, the minor technically owns the account but cannot access the account until a certain age. Two key differences between UTMAs and UGMAs are: 1) With a UTMA account, the beneficiary gains control of the account at age 21 or 25, depending on the state, while with a UGMA account, the beneficiary gains control at age 18 or 21, depending on the state; and 2) UGMA contributions are limited to securities, cash, annuities, and insurance, whereas UTMA accounts allow for contributions of additional types of assets, such as real estate and works of art.

⁸ The America Saving for Personal Investment, Retirement, and Education (ASPIRE) Act, first introduced in Congress in the 108th Congress and re-introduced in the 109th Congress, would provide a KIDS account for every newborn child in 2007 and beyond. See www.AspireAct.org. Related proposals have been put forth in several states, such as Arkansas, Kentucky and Oklahoma.

TREATMENT OF COMMON COLLEGE SAVINGS INSTRUMENTS IN FEDERAL EFC CALCULATIONS

529 College Savings Accounts.

529 accounts (named for the relevant section of the tax code) are state-sponsored education savings plans that allow for tax-sheltered savings for future educational expenses. Each state offers its own plan through a designated financial institution. Most states' plans are available to residents of any state and plan details vary widely.⁹

529 plans may be owned by a parent or an organization for the benefit of a child. (Minors cannot own 529s directly because they are invested in securities. They can, however, own 529s through a custodial/UTMA arrangement.) This ownership structure has been beneficial from a financial aid perspective, since only 5.64 percent of assets owned by parents are counted toward the child's EFC. Beginning July 1, 2006, 529s indirectly owned by minors through an UGMA/UTMA arrangement will no longer be treated as student-owned assets in the EFC formula; even if the account is in the minor's name, these accounts now will be assessed at no more than 5.64 percent.

The bottom line: The student-owned 529 rule change significantly improves the attractiveness of 529s as a vehicle for children's savings accounts, as they will be assessed at 5.64 percent regardless of the account's owner. Furthermore, once the rule change is in effect, it may actually be beneficial for 529 accounts to be owned by the student if a family has more than one dependent child because all parent-owned 529 accounts will have to be reported for EFC calculations for each child, whereas a custodial 529 account will be assessed only for the child who holds the account.

Coverdell Education Savings Accounts (ESAs).

Formerly known as education IRAs, Coverdell ESAs are tax-sheltered UTMA's set up with the child as beneficiary and bank or financial institution as custodian. An adult, generally a parent or guardian, is designated as a "responsible individual" in charge of making decisions about the account. There are income limits on those who can contribute to Coverdells and a limit to the amount that can be contributed each year, with annual contributions capped at \$2,000. Contributions can be made only for children under the age of 18, and the balance in the account must be spent or rolled over to another eligible beneficiary by the time the beneficiary reaches age 30.¹⁰

⁹ For more on 529s as a possible structure for more universal children's savings accounts, see Margaret Clancy, Peter Orszag, and Michael Sherraden, "College Savings Plans: A Platform for Inclusive Saving Policy?" Center for Social Development, Washington University in St. Louis, February 2004.

¹⁰ For more on Coverdell ESAs and a comparison with 529 accounts, see Susan Dynarski, "Who Benefits from the Education Saving Incentives? Income, Educational Expectations and the Value of the 529 and Coverdell," Kennedy School of Government, Harvard University, April 5, 2004.

Following an ED ruling in January 2004, a Coverdell account is considered an asset of the account custodian.¹¹ The ruling also states that qualified distributions from Coverdells — those that are not subject to federal income tax — are not considered parent or student income and thus are excluded from financial aid calculations.

The Bottom Line: Although they offer no significant earnings advantages over 529 accounts, Coverdell ESAs offer a slightly more flexible range of investments and slightly more flexible use (since pre-college education is an eligible use). These accounts may be equally attractive as 529s as an option for children's savings accounts, especially for lower-income families, who are unlikely to exceed the \$2,000 cap on annual contributions.¹²

Traditional and Roth Individual Retirement Accounts (IRAs).

IRAs are tax-sheltered savings vehicles designed to provide retirement income; however, they allow for early withdrawals for certain asset purchases and other restricted purposes. Funds can be withdrawn without penalty at retirement (after age 59½) or earlier if used for first-time home purchase, postsecondary education for the account holder or a close relative, and a few other uses. IRAs are the most flexible of the tax-advantaged accounts in terms of uses allowed without incurring penalties. Under the ASPIRE Act, "KIDS Accounts" for account holders 18 years of age and older would be governed by the rules that apply to Roth IRAs.

There are no restrictions on minors owning IRAs (even for adults, IRAs are set up as custodial instruments with the financial institution as custodian), but contributions to IRAs must come from earned income. Since the EFC calculations entirely exclude pension savings, IRA assets are completely disregarded in determining federal financial aid eligibility, although withdrawals are included in the calculation of income. This treatment applies to accounts owned by students as well as parents.

In an important recent development, the Savings Competitiveness Act of 2006 (S. 2431), sponsored by Sen. Max Baucus (D-MT), includes proposed Youth Savings Accounts that would allow contributions to Roth IRAs from sources other than earned income.

The Bottom Line: IRAs currently benefit from highly advantageous treatment in terms of calculating eligibility for federal need-based financial aid. However, because of the current requirement that contributions come from earned income, their use for children's savings accounts would be limited to older youth.

¹¹ "Summary: Treatment of Coverdell Accounts and 529 Tuition Plans," U.S. Department of Education, Information for Financial Aid Professionals Library, DCL ID: GEN-04-02, posted January 22, 2004.

¹² However, because of the annual contribution cap, Coverdells might not be a viable option for rolling over existing SEED accounts with balances greater than \$2,000.

DISCUSSION

The recent rule changes regarding the assessment of student-owned assets have mitigated some concerns around accountholders' eligibility for financial aid, particularly related to 529 accounts. However, with growing interest in children's savings accounts, there remain several areas of concern — both for asset-poor students who are saving for college and who likely will require additional financial aid, and for the treatment of assets in EFC calculations in general — in the context of proposals to encourage more universal children's savings accounts as a matter of public policy. We discuss these areas of concern and possible policy solutions below.

Re-think treatment of assets in financial aid calculations

There are limited resources in the federal financial aid system. Faced with this shortage, some argue that the most appropriate use of those dollars is for those with the greatest need. Yet accurately targeting need has led to complex eligibility rules. Unfortunately, this complexity creates a barrier to the same low-income students whom more precise eligibility rules are supposed to assist. In a recent working paper, John F. Kennedy School of Government professors Susan Dynarski and Judith Scott-Clayton argue that the complexity of the federal system for distributing student financial aid “disproportionately burdens those with the least ability to pay and undermines redistributive goals.”¹³ Using data from federal student aid applications, the authors show that a radically simplified aid process using income and family structure, but dropping assets, closely mirrors the results you would get from the more complex system for calculating aid. For this reason, and also because the treatment of assets in the aid formula creates “horizontal inequities” (i.e., identical households with identical lifetime earnings are treated differently, with less aid going to families that forego current consumption to save for college), some higher education finance experts suggest the complete removal of asset tests in determining financial aid eligibility.

While removing asset tests might allow a small minority of students and families with sizeable assets to qualify for increased federal financial aid, proponents of a simplified approach argue that the costs of such a process would be more than offset by reductions in bureaucracy and increased ease in accessing the financial aid system. Thus, if the primary goal is to increase the number of low-income individuals who attend college, then simplifying the financial aid process may be the best approach. **We recommend that policymakers and other higher education experts investigate further the merits of completely removing assets from financial aid calculations.**

¹³ Susan Dynarski and Judith Scott-Clayton, “The Cost of Complexity in Federal Student Aid: Lessons from Optimal Tax Theory and Behavioral Economics,” John F. Kennedy School of Government Faculty Research Working Paper RWP06-013, April 2006. Dynarski and Scott-Clayton found that this radically simplified aid process explains 86 percent of the variation in Pell grants and 84 percent of the variation in the EFC.

Increase horizontal equity and progressivity in the treatment of assets in financial aid calculations

It is unclear whether such a significant change to the EFC calculation is feasible, either with the Federal Methodology or with the Institutional Methodology. Absent such a radical change in the treatment of assets, there are a number of more modest changes within the existing system that may slightly increase complexity, but would also provide greater asset protection for low-income families and better target scarce financial aid to needy students:

- The current rules for simplified EFC and zero EFC unintentionally exclude some who should be eligible based on need alone. For families with incomes below \$50,000 who are not eligible to file a 1040A or 1040EZ IRS form, the exclusion of assets for the purposes of calculating the EFC is ineffective. **We recommend that policymakers and higher education experts re-craft the simplified EFC and zero EFC tests to correct for their unintentional impact on some low-income students.**
- At present, all retirement savings are excluded in the federal methodology. Over the past decade, federal policy has created new opportunities for tax-preferred retirement savings. As a result, families can shelter more of their assets from inclusion in EFC calculations.¹⁴ Exclusion of retirement savings means that more students with less relative need are eligible for need-based aid, thereby increasing demand. However, to better target scarce resources, some argue that financial aid calculations should no longer entirely exclude retirement savings. **We recommend that policymakers and higher education experts consider the implications of increased retirement savings by those with less relative need on the fairness of financial aid eligibility rules, and also explore whether removing this exclusion would more effectively target aid to those with the greatest need.**¹⁵

¹⁴ Edward N. Wolff, "Recent Trends in Wealth Ownership," *Assets for the Poor: The Benefits of Spreading Asset Ownership*, Ch. 2, Russell Sage Foundation, New York, 2001. Between 1983 and 1998, retirement account holdings as a percentage of total household assets rose from 1.5 to 11.6 percent. Wolff attributes this increase to households substituting tax-free retirement accounts for taxable savings deposits.

¹⁵ According to the 2004 *Survey of Consumer Finances*, 82.5 percent of families in or above the 90th percentile in net assets had retirement accounts, the median value of which was \$264,000; conversely, only 14.3 percent of families in the bottom quartile in net assets had retirement accounts, the median value of which was \$2,900. Furthermore, between 1989 and 2004, the percentage of families with retirement accounts increased by double-digit percentage points for all net asset quartiles except for the bottom quartile. (*Survey of Consumer Finances*, Federal Reserve Board, Washington, D.C., 2004).

Address the unique needs of independent student, including foster youth

While the rule change taking effect in 2007 will lower the rate at which students' assets are assessed from 35 to 20 percent, for low-income independent students — especially those without dependents — this rate may still be too high a penalty for saving for college. In addition, the treatment of a subset of independent students, foster youth, is also of concern.¹⁶ Will the reduction in assessment rate from 35 to 20 percent be sufficient to increase higher education access for foster youth? Are there other policy ideas — such as tuition remission — that are feasible and might have a greater impact than changes to the EFC? **We recommend that policymakers and higher education experts explore ways to amend the federal EFC rules so that independent students' income and assets are assessed at a more favorable rate.**

¹⁶ Tom Wolanin, "Progressing to Higher Education and a Degree," *Higher Education Opportunities for Foster Youth: A Primer for Policymakers*, Ch. 5, Institute for Higher Education Policy, Washington, D.C., 2005. Compared to their peers, foster youth are far more likely to be poor before entering foster care, during their stay in foster care, and after leaving foster care. For the 2005-06 academic year, even if a foster youth received the maximum Pell Grant and maximum Education and Training Voucher (ETV), he or she still would "not have enough grant money to pay for full-time study as a commuter at the average-price public community college." Nearly 30 states offer aid specifically targeted to foster youth in addition to ETVs; many of these programs offer public college tuition remission for foster youth.