

# Customer Loyalty Rewards Programs

- Do we have a “best in class” method for assessing redemption rates and costs?
- What are the costs and benefits of making changes to our program?
- What motivates customers to use our program, and does it improve loyalty?
- Are we in compliance with accounting rules, such as IFRIC 13, EITF 00-21 and FAS 157, relating to fair-value measurement?

## Overview

Loyalty rewards programs (LRPs) have become a needed-to-play feature for many companies. LRPs attract spending on goods and services by offering rewards (e.g., points or miles) that can be used to purchase a variety of other goods and services.

LRP members accumulate rewards for a period of time before redeeming them. Accumulation of points drives company risks that must be managed in three main areas — (1) the proportion of rewards that will be redeemed, (2) the timing of reward redemption and (3) the variety and cost of goods or services for which rewards will be redeemed.

The measurement of LRP exposure to redemption risks, compliance with accounting rules and overall program assessment are at the core of the services we offer to our clients.

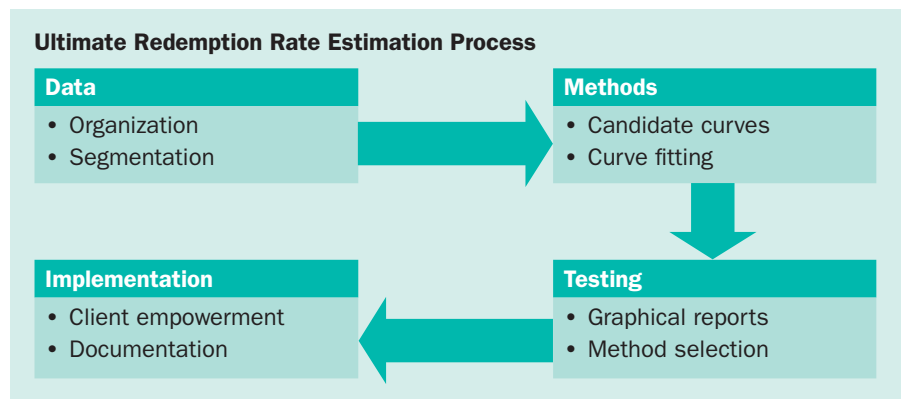
## The Towers Watson Approach

### Reward Redemption Rates and Costs

Using sophisticated models, we empower our clients to evaluate the risks of LRPs, including the proportion of rewards earned and the amount that will ultimately be redeemed by LRP members. We use our extensive experience with LRPs, coupled with nontraditional actuarial and statistical models, to guide clients in measuring their LRP risks.

Our approach recognizes those unique features that are likely to impact the proportion of rewards redeemed by your LRP members, including:

- Type of membership
- Members’ enrollment inception date



- Tenures of memberships
- Amounts of annual rewards credited or earned
- Geography

Our experience with LRPs reveals the presence of trends in redemption rates over time. LRPs typically experience higher redemption rates among newer members as compared to longer-term members. Risk varies at the segment level since each market segment will have its own redemption trend. Our work leads to a better assessment of the drivers of the LRP program, and this information is useful in assessing the impact of changes to, and costs associated with, the program.

We can also draw on our experience to provide better insight into the cost/benefit relationship of your LRP to the organization. Support to improve an LRP’s data organization, along with superior quantification of risk and related volatility, is a core service that we offer to our clients.

## Trend Toward Standard Accounting for Loyalty Rewards Programs

Many companies have historically treated their LRP exposure as a liability on the balance sheet and as an expense on the income statement. In order to standardize the accounting used by organizations that provide such programs, the International Accounting Standards Board published IFRIC 13 to be effective for financial statement years beginning on or after July 1, 2008.

IFRIC 13 emphasizes that entities should recognize their future obligations related to LRPs as a separately identifiable component of the initial sales transaction based on the fair value to the member. A portion of the proceeds of the initial sales transaction should be allocated to the rewards credited to members and deferred as a liability. Organizations are guided to defer recognition of the revenue in respect of the rewards until they have fulfilled their obligation to supply the goods or services, or until such obligation is assumed by a third party.

Deferral of revenue and the use of fair value are key differences between IFRIC 13 and other accounting treatments. While it is our understanding that the conclusions reached by the IFRIC do not directly impact U.S. GAAP accounting for loyalty programs, multiple accounting standards (e.g., FIN 45, EITF 00-21 and FAS 157) exhibit a trend toward similar treatment. We help our clients evaluate the fair value of LRP rewards in compliance with IFRIC 13.

## A Record of Success

Towers Watson works with LRPs in the hospitality, financial, airline and retail industries, and our approach has been received with enthusiasm by our clients' management and board of directors. Our work is used to identify trends in consumer behavior and guide management toward more valuable program enhancements. We have been instrumental in assisting clients to evaluate whether the cost of enhancing LRP benefits is offset by the value of the program change to the company.

We facilitate financial decisions that would not be possible otherwise, and our approach brings substantial value to our LRP clients.

To learn more about how Towers Watson can assist your needs, please visit [www.towerswatson.com](http://www.towerswatson.com).

## About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.