

IMPLEMENTING ERM



GIFT CARD PROGRAMS

- Do we have a best-in-class method for measuring the liability for cards that may never be redeemed (i.e., “breakage”)?
- How are we assessing redemption rates and costs?
- What are the costs and benefits of making changes to our program?
- What motivates customers to buy and/or use our cards, and does it improve loyalty to our brand?

OVERVIEW

Gift card programs have become an essential business feature for many retail companies. As customers increasingly choose to purchase gift cards over merchandise, retailers are seeing the benefits in their sales and marketing efforts, cash flow and bottom line.

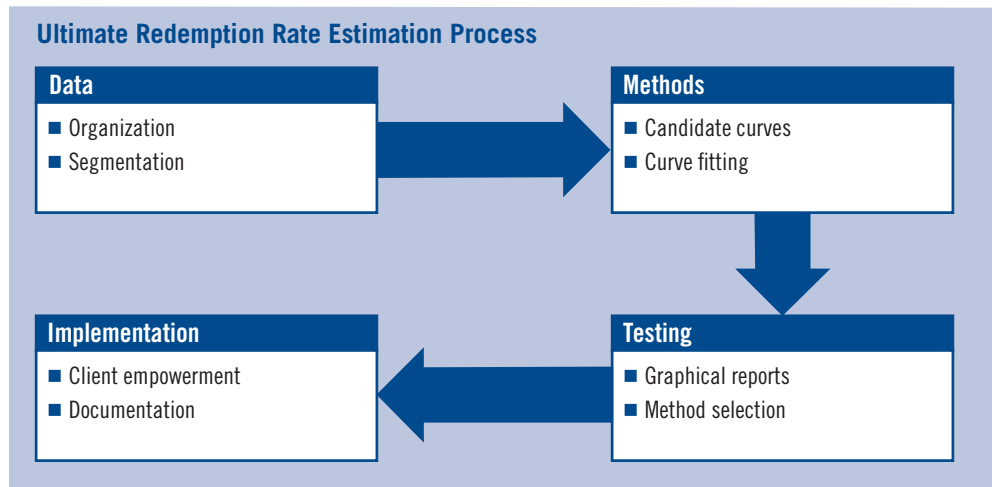
However, after the cards are purchased, recipients generally use them on a discretionary basis — anywhere from immediately, to several months later, to never. This lag period creates challenges for the issuers in estimating their potential liability and understanding their customers’ behavior. The increase in the number and value of outstanding cards drives risks that must be managed in two main areas: the proportion of cards that will be redeemed and the timing of card redemption.

Towers Perrin can help you measure your gift card program’s exposure to redemption risks, its compliance with accounting rules and an overall program assessment.

THE TOWERS PERRIN APPROACH

Redemption Rates and Costs

We help you evaluate the risks of your program and the proportion of issued cards that will ultimately be redeemed.



Our extensive experience with gift card programs and other types of reward programs, coupled with nontraditional actuarial and statistical models, helps us to analyze customer behavior and guide you in measuring program risk.

Our approach recognizes the unique features that will likely impact redeemed cards, including:

- specific card issuance date
- length of time since card issuance date
- card value.

Our analysis of gift card programs reveals trends in redemption rates over time (e.g., redemption rates of larger-value versus smaller-value cards). Our work leads to a better assessment of the drivers of the gift card program and can help you assess the impact of program changes, including related costs.

We also provide you with better insight into the cost/benefit relationship of the gift card program by helping you improve your data organization and improve the quantification of risks and the related volatility.



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Accounting Issues Related to Gift Card Programs

While there are different methods to account for the liability of gift card programs, most card issuers defer revenue related to the sale of the cards until they have fulfilled their obligation to supply the goods or services, the obligation is assumed by a third party or the obligation is voided (e.g., the card has expired). The ability of a company to estimate the timing and the ultimate redemption percentage of issued cards is essential in recognizing its revenue related to card sales and in positively impacting its bottom line. Towers Perrin's approach is designed to answer your key liability questions and support you in your discussions with auditors and regulators regarding this liability.

A RECORD OF SUCCESS

Towers Perrin works with gift card programs and other loyalty reward programs in the retail, hospitality, financial and airline industries. Our approach and research, which have been well received by our clients' management and board of directors, are used to identify trends in consumer behavior and to guide management toward valuable program improvements. We add value by helping you weigh the cost of enhancing your programs' benefits against the value of the program change so you can make the best financial and operational decisions.

ABOUT TOWERS PERRIN

Towers Perrin is a global professional services firm that helps organizations improve performance through effective people, risk and financial management. The firm provides innovative solutions in the areas of human capital strategy, program design and management, and in the areas of risk and capital management, insurance and reinsurance intermediary services, and actuarial consulting.

The firm's Corporate Enterprise Risk Management practice (CERM) offers clients the ability to understand the full spectrum of risks faced by their organization and to create value by actively managing their key risks.

To contact us or learn more about how Towers Perrin's CERM practice can assist your company, please visit www.towersperrin.com/rfs/cerm.