Incentive Research Foundation

U.S. Federal Regulations and Non-Cash Awards

An IRF Signature Study

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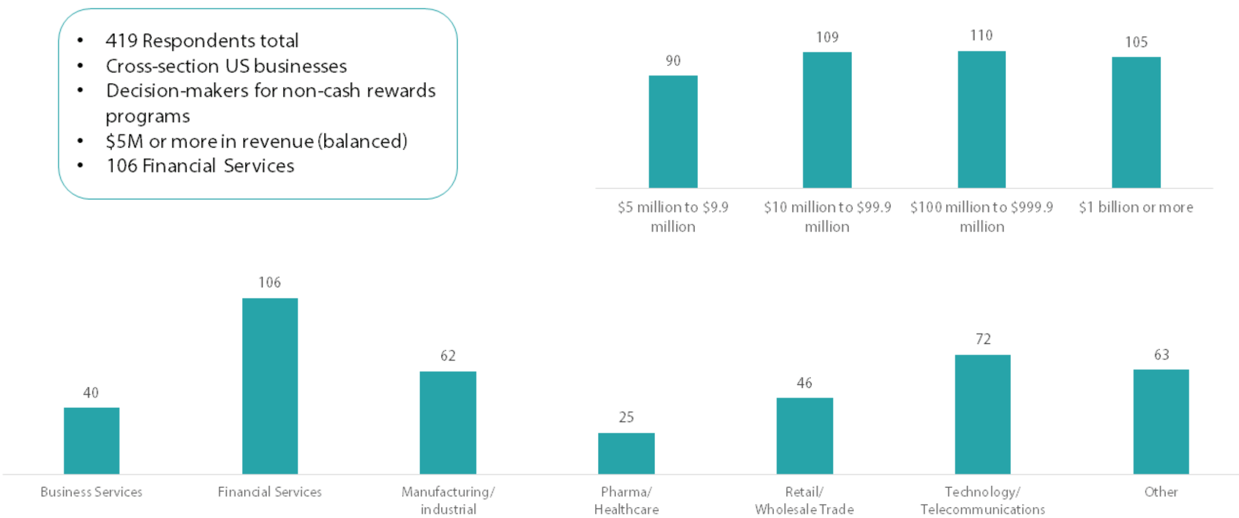
In 2017, to develop a baseline understanding of the awareness, understanding, and accommodations of U.S. businesses regarding regulations impacting reward and recognition programs, the Incentive Research Foundation launched its inaugural Regulations Signature Study. The research examined program owners' understanding of the regulatory environment, generally as well as in relation to six key regulations[1] (DOL Fiduciary Rule, 274j, OSHA, FLSA, Fair Market Value, and Sweepstakes/Lottery). The survey was designed and executed by Intellective Group during the summer of 2017 to a cross-section of 419 businesses, 106 operating in the financial services sector. Program owners were targeted based on sector and revenue size: $5 - $9.9 million, $10 to $99 million, $100 to $999 million, and $1 billion or more. The findings are weighted by revenue size, and are statistically representative of the population of U.S. businesses with a 95% confidence level and a 5% margin of error.

Figure 1: Respondents



General Understanding of Regulations

Most program owners understand their reward and recognition activities are impacted by the regulatory environment, but aren't really sure how. While 67% of program owners are aware there are regulatory considerations for their programs, only 38% consider themselves very knowledgeable about those regulations and tax requirements. For the smallest businesses surveyed ($5 - $9.9 million in annual revenue), awareness drops by ten percentage points to 57%.

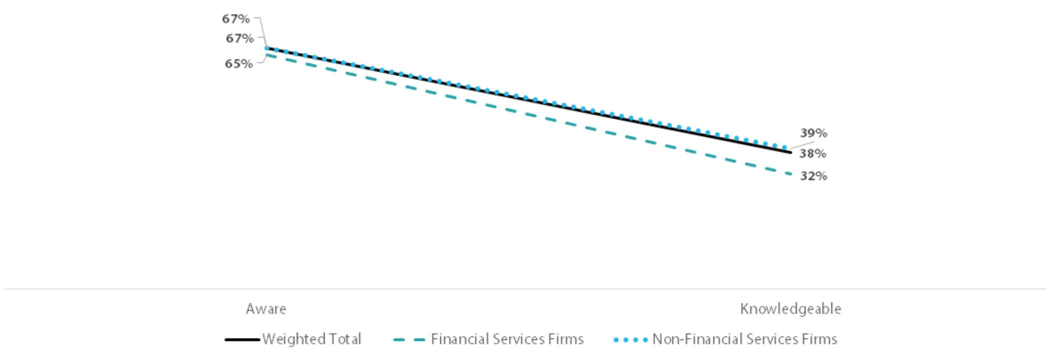
Despite this, program owners are confident that their companies have identified and addressed any relevant regulations. Only financial services firms and small businesses indicate lower confidence – specifically regarding a detailed understanding of the requirements and the consequences of non-compliance.

Small businesses struggle more than their larger counterparts in dealing with the regulatory environment, and are less confident in their understanding and actions to maintain compliance.

Regardless of their confidence, fewer than two-thirds of U.S. businesses have formal mechanisms and structures in place to ensure their programs remain compliant with regulatory and tax requirements. While the program owner has some responsibility for compliance, many also look to their legal or compliance teams for guidance, particularly in large firms (over $1 billion). The most common structural oversight tool is regular reviews of non-cash programs, with 62% of businesses using this as a compliance device.

Overall Awareness of Regulatory Requirements – Firm Type

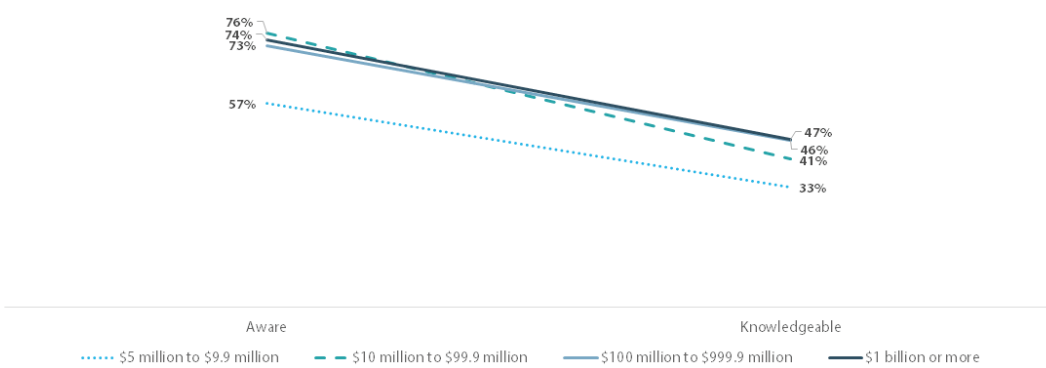
Percent indicating 'aware' and 'extremely knowledgeable'



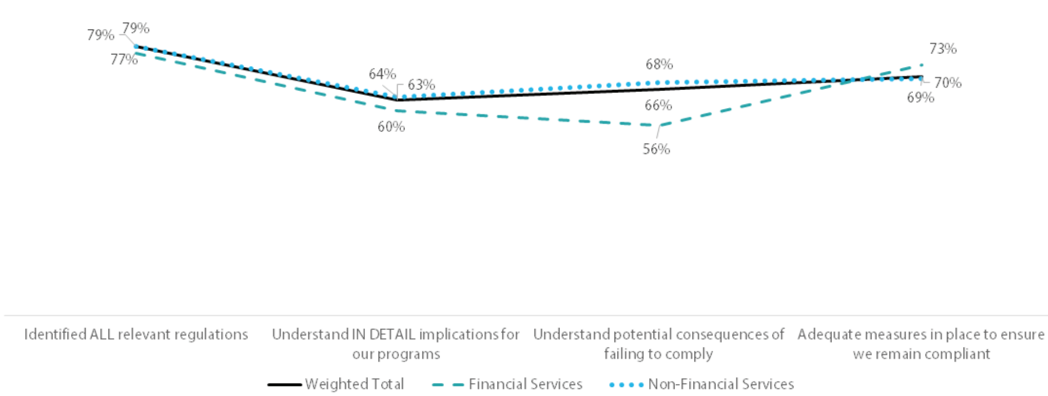
*Are you **aware** of the **regulatory and tax codes** that impact the business use of non-cash rewards?*
*How **knowledgeable** are you regarding the **regulatory and tax requirements** that businesses must comply with for their non-cash reward programs?*

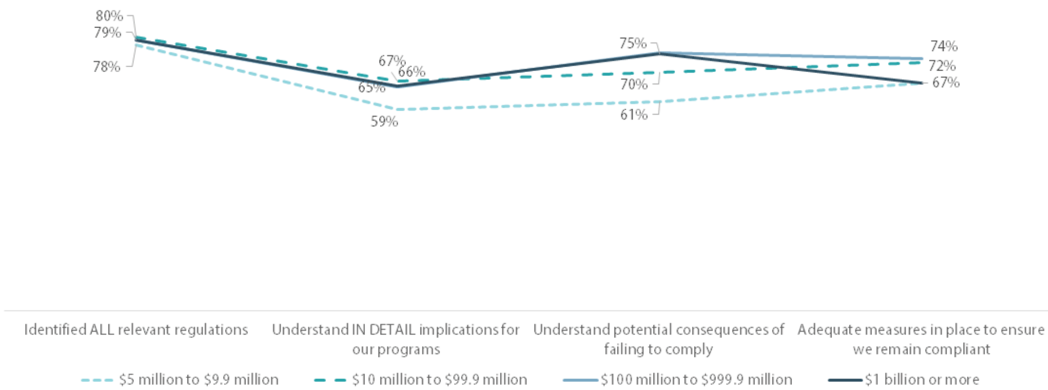
Overall Awareness of Regulatory Requirements – Firm Size

Percent indicating 'aware' and 'extremely knowledgeable'



Confidence in Addressing Regulations – Firm Type





Program Design Changes

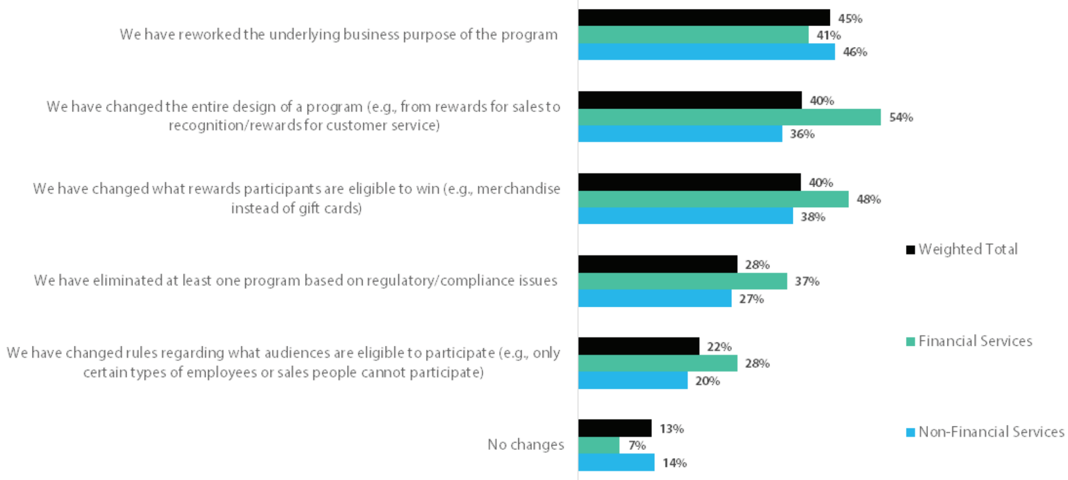
Reward and recognition programs are not static – 86% of U.S. businesses make some revision to their program on an annual basis. This is true across all business sizes and all sectors. And there is no one type of program change that rises above the others; sometimes it's a revision of the rules, sometimes it's the reward selection, sometimes it's a simple revision to the language used to describe the program. The regulatory environment plays two roles in program design – it provides a potential impetus for revision of the program, and it informs the design and approval of those revisions.

In 2017, 93% of U.S. businesses made at least one change to program design based on the regulatory environment. Half of U.S. businesses made eight or more changes for this reason. There are no differences by business size or sector, meaning small businesses, despite their relative lack of knowledge and certainty, are still making an effort to meet the compliance requirements for their programs.

The most common design revisions are to general program design (87% of businesses) or program communications (85%). Specific changes made by at least 40% of U.S. businesses to address regulations include:

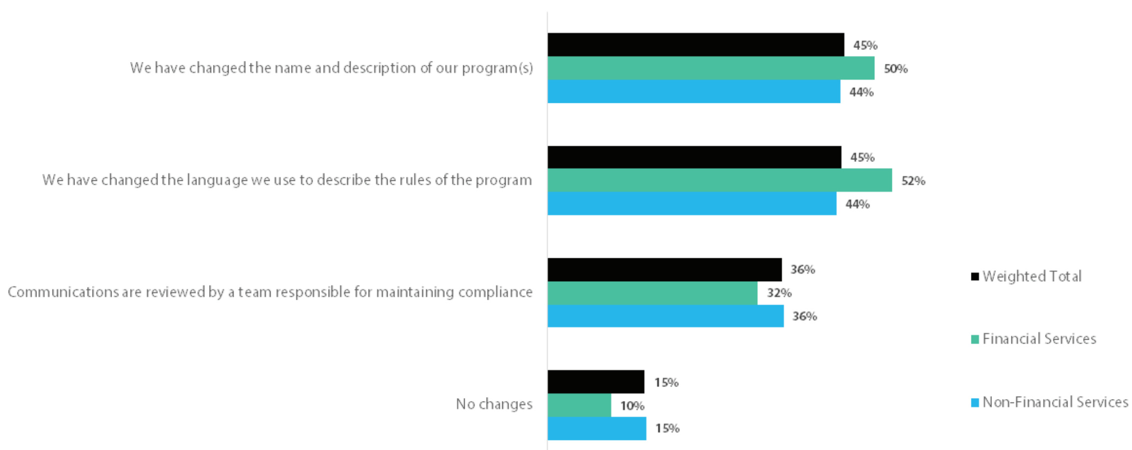
- Underlying business purpose of the program
- A complete redesign of the program (especially financial services firms)
- Changing the rewards mix (especially financial services firms)
- Changing the name or description of the program (especially financial services firms)
- Editing the language used to communicate the rules (especially financial services firms)
- Changing the products included in a sales or channel incentive program
- Changing cash rewards to non-cash (especially financial services firms)
- Redesign of group incentive travel events (especially financial services firms)
- Increased scrutiny on program statistics
- Increased scrutiny on program accounting (specifically W2s and 1099s)
- Increased program budgets to pay for these changes (especially financial services firms)

Regulatory Accommodations - Program Design



*Which of the options below **best describes** how your non-cash reward programs have been designed or changed to comply with regulatory and tax requirements: Select all that apply.*

Regulatory Accommodations - Communications



*Which of the options below **best describes** how your non-cash reward programs have been designed or changed to comply with regulatory and tax requirements: Select all that apply.*

Financial services firms were more likely than their counterparts to be making some additional changes:

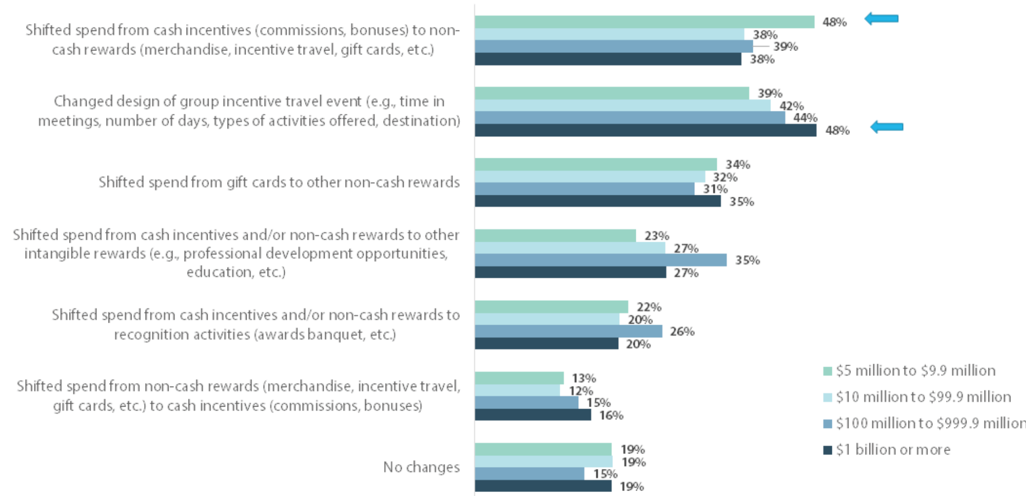
- Outright elimination of a program
- Shift rewards from gift cards to other non-cash rewards
- Shift rewards from cash or non-cash to other intangible rewards
- Increased scrutiny on program outcomes, including ROI
- Increased staff support to accommodate regulatory environment

The largest and smallest firms have specific areas of particular focus. Small businesses are the most likely to be shifting from cash rewards to non-cash (and driving the continued increase of non-cash reward use in the U.S. market), while large firms are more likely than small and mid-sized businesses to be doing the following:

- Redesigning a group incentive travel event
- Outright elimination of a reward and recognition program

- Revising the name or description of a program
- Increasing staff support to accommodate regulatory compliance

Regulatory Accommodations - Rewards



*Which of the options below **best describes** how your non-cash reward programs have been designed or changed to comply with regulatory and tax requirements: Select all that apply.*

Specific Regulations

When asked about their awareness and understanding of specific regulations, program owners respond consistently across the various regulations:

- A high level of awareness of that regulation, but a much lower level of knowledge about the specific requirements for compliance
- Although larger firms report awareness and knowledge, the drop-off between awareness and knowledge is similar to that of their counterparts.
- Small businesses report lower awareness, very low knowledge, and are the least likely to feel any given regulation is clear in its requirement for compliance.

Despite these patterns, it is not the largest or the smallest firms that find it most challenging to remain compliant. That distinction falls to mid-sized firms, those with between $100 million and $1 billion in annual revenue. It's likely these firms have grown to a size that indicates significant complexity in their organizations, and therefore their programs, without the hard-wired compliance mechanisms found in the Fortune 500.

Segmentation

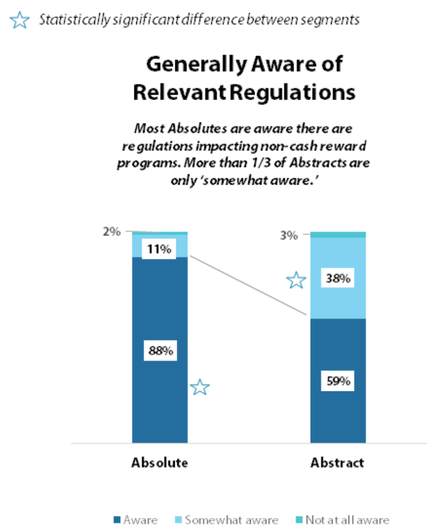
During analysis, it became clear that there were some underlying patterns in the data that couldn't be explained by firm size or sector. A segmentation of respondents using cluster analysis was performed, resulting in the identification of two key and distinct types of program owners:

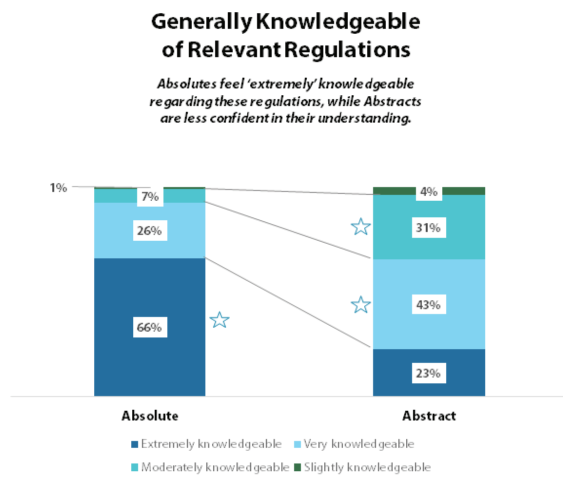
- "Absolutes" are assured in their awareness, understanding, and accommodation of regulations. They are somewhat more likely than their counterparts to be executives operating in larger firms, but are present at every management level across all business sizes and sectors. Their firms typically have more structures in place to address the regulatory environment. Despite (or maybe because) of their knowledge and responsibility, they find it 'extremely challenging' to remain compliant with regulations.

- “Abstracts” are comparatively less confident about regulations (both generally and specifically), what the requirements are, and their own ability to achieve compliance for their programs. They do not feel knowledgeable about regulations and aren’t even sure if various regulations apply to their programs. They have fewer mechanisms in place to address program compliance, and, perhaps because of their uncertainty, find maintaining compliance only ‘moderately challenging.’ Like their counterparts, they are found across all management levels and within all sizes and sectors of business, although they are somewhat over-represented in smaller firms.

These two segments are equally prevalent in the U.S. business market – Absolutes account for 55% of program owners, while Abstracts account for 45%.

General Awareness and Knowledge





Implications

The regulatory environment and its consequences for non-cash reward and recognition programs are not well-understood by a large proportion of those responsible for operating these programs. Many program owners find regulations unclear and challenging to accommodate, but are making numerous changes to their programs in an effort to comply. Financial services and small businesses, in particular, struggle with understanding what regulations mean for their programs and how to best address these requirements.

ENDNOTES

For a review of the legal standards for these and additional regulations, please see the IRF’s *Summary of Legal Issues Affecting Non-Cash Award Programs*.