

MASTERCARD INC  
Form 10-Q  
May 04, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

Or

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from            to

Commission file number: 001-32877

**MasterCard Incorporated**

(Exact name of registrant as specified in its charter)

Edgar Filing: MASTERCARD INC - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**13-4172551**  
(IRS Employer  
Identification Number)

**2000 Purchase Street**  
**Purchase, NY**  
(Address of principal executive offices)

**10577**  
(Zip Code)

**(914) 249-2000**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Act) Yes  No

As of April 28, 2010, there were 110,830,051 shares outstanding of the registrant's Class A common stock, par value \$.0001 per share, 19,977,657 shares outstanding of the registrant's Class B common stock, par value \$.0001 per share, and 1,864 shares outstanding of the registrant's Class M common stock, par value \$.0001 per share.

**Table of Contents**

**MASTERCARD INCORPORATED**

**FORM 10-Q**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
<b><u>ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)</u></b>	
<u>Consolidated Balance Sheets March 31, 2010 and December 31, 2009</u>	3
<u>Consolidated Statements of Operations Three Months Ended March 31, 2010 and 2009</u>	4
<u>Consolidated Statements of Cash Flows Three Months Ended March 31, 2010 and 2009</u>	5
<u>Consolidated Statement of Changes in Equity Three Months Ended March 31, 2010</u>	6
<u>Consolidated Condensed Statements of Comprehensive Income Three Months Ended March 31, 2010 and 2009</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<b><u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	
	30
<b><u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	
	43
<b><u>ITEM 4. CONTROLS AND PROCEDURES</u></b>	
	44
<u>Report of Independent Registered Public Accounting Firm</u>	45
<b><u>PART II OTHER INFORMATION</u></b>	
<b><u>ITEM 1. LEGAL PROCEEDINGS</u></b>	
	46
<b><u>ITEM 1A. RISK FACTORS</u></b>	
	46
<b><u>ITEM 5. OTHER INFORMATION</u></b>	
<b><u>ITEM 6. EXHIBITS</u></b>	
	46
<b><u>SIGNATURES</u></b>	47

**Table of Contents****PART I FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements (Unaudited)**  
**MASTERCARD INCORPORATED**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
	<b>(In millions, except share data)</b>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 2,119	\$ 2,055
Investment securities available-for-sale, at fair value	831	824
Investment securities held-to-maturity	151	
Accounts receivable	505	536
Settlement due from customers	410	459
Restricted security deposits held for customers	444	446
Prepaid expenses	278	313
Deferred income taxes	276	244
Other current assets	92	126
<b>Total Current Assets</b>	<b>5,106</b>	<b>5,003</b>
Property, plant and equipment, at cost, net of accumulated depreciation	433	449
Deferred income taxes	182	264
Goodwill	293	309
Other intangible assets, net of accumulated amortization of \$436 and \$422, respectively	408	415
Auction rate securities available-for-sale, at fair value	172	180
Investment securities held-to-maturity	187	338
Prepaid expenses	346	328
Other assets	159	184
<b>Total Assets</b>	<b>\$ 7,286</b>	<b>\$ 7,470</b>
<b>LIABILITIES AND EQUITY</b>		
Accounts payable	\$ 251	\$ 290
Settlement due to customers	433	478
Restricted security deposits held for customers	444	446
Obligations under litigation settlements	606	607
Accrued expenses	935	1,225
Other current liabilities	153	121
<b>Total Current Liabilities</b>	<b>2,822</b>	<b>3,167</b>
Deferred income taxes	74	80
Obligations under litigation settlements	125	263
Long-term debt	21	22
Other liabilities	412	426
<b>Total Liabilities</b>	<b>3,454</b>	<b>3,958</b>

Edgar Filing: MASTERCARD INC - Form 10-Q

**Commitments and Contingencies**

**Stockholders Equity**

Class A common stock, \$.0001 par value; authorized 3,000,000,000 shares, 117,560,176 and 116,534,029 shares issued and 110,819,586 and 109,793,439 outstanding, respectively		
Class B common stock, \$.0001 par value; authorized 1,200,000,000 shares, 19,977,657 issued and outstanding, respectively		
Class M common stock, \$.0001 par value; authorized 1,000,000 shares, 1,846 and 1,812 shares issued and outstanding, respectively		
Additional paid-in-capital	3,403	3,412
Class A treasury stock, at cost, 6,740,590 shares, respectively	(1,250)	(1,250)
Retained earnings	1,583	1,148
Accumulated other comprehensive income:		
Cumulative foreign currency translation adjustments	107	212
Defined benefit pension and other postretirement plans, net of tax	(15)	(15)
Investment securities available-for-sale, net of tax	(4)	(3)
Total accumulated other comprehensive income	88	194
<b>Total Stockholders Equity</b>	<b>3,824</b>	<b>3,504</b>
Non-controlling interests	8	8
<b>Total Equity</b>	<b>3,832</b>	<b>3,512</b>
<b>Total Liabilities and Equity</b>	<b>\$ 7,286</b>	<b>\$ 7,470</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**MASTERCARD INCORPORATED**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(In millions, except per share data)</b>	
<b>Revenues, net</b>	\$ 1,308	\$ 1,156
Operating Expenses		
General and administrative	458	448
Advertising and marketing	115	116
Depreciation and amortization	35	31
Total operating expenses	608	595
Operating income	700	561
<b>Other Income (Expense)</b>		
Investment income	10	17
Interest expense	(15)	(36)
Other income (expense), net		8
Total other income (expense)	(5)	(11)
Income before income taxes	695	550
Income tax expense	240	183
Net income	455	367
Income attributable to non-controlling interests		
<b>Net Income Attributable to MasterCard</b>	<b>\$ 455</b>	<b>\$ 367</b>
<b>Basic Earnings per Share</b>	<b>\$ 3.47</b>	<b>\$ 2.81</b>
<b>Basic Weighted Average Shares Outstanding</b>	<b>130</b>	<b>130</b>
<b>Diluted Earnings per Share</b>	<b>\$ 3.46</b>	<b>\$ 2.80</b>
<b>Diluted Weighted Average Shares Outstanding</b>	<b>131</b>	<b>130</b>

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

**MASTERCARD INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(In millions)</b>	
<b>Operating Activities</b>		
Net income	\$ 455	\$ 367
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35	31
Share based payments	16	15
Stock units withheld for taxes	(122)	(7)
Tax benefit for share based compensation	(91)	(8)
Impairment of assets		15
Accretion of imputed interest on litigation settlements	11	26
Deferred income taxes	49	40
Other	3	(2)
Changes in operating assets and liabilities:		
Accounts receivable	19	102
Income taxes receivable		190
Settlement due from customers	29	(69)
Prepaid expenses	4	(19)
Obligations under litigation settlements	(150)	(152)
Accounts payable	(36)	3
Settlement due to customers	(21)	32
Accrued expenses	(134)	(135)
Net change in other assets and liabilities	28	(13)
Net cash provided by operating activities	95	416
<b>Investing Activities</b>		
Purchases of property, plant and equipment	(3)	(12)
Capitalized software	(17)	(16)
Purchases of investment securities available-for-sale	(33)	(15)
Proceeds from sales of investment securities, available-for-sale	20	12
Proceeds from maturities of investment securities, available-for-sale	11	1
Investment in affiliates	(1)	(18)
Acquisition of business, net of cash acquired		(3)
Other investing activities		1
Net cash used in investing activities	(23)	(50)
<b>Financing Activities</b>		
Payment of debt		(149)
Dividends paid	(20)	(20)
Tax benefit for share based compensation	91	8
Cash proceeds from exercise of stock options	6	1
Redemption of non-controlling interest		(5)

## Edgar Filing: MASTERCARD INC - Form 10-Q

Net cash provided by (used in) financing activities	77	(165)
Effect of exchange rate changes on cash and cash equivalents	(85)	(28)
Net increase in cash and cash equivalents	64	173
Cash and cash equivalents - beginning of period	2,055	1,505
Cash and cash equivalents - end of period	\$ 2,119	\$ 1,678

The accompanying notes are an integral part of these consolidated financial statements.



Table of Contents

**MASTERCARD INCORPORATED**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**(UNAUDITED)**

	Total	Common Stock		Additional Paid-In Capital	Class A Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income, net of tax	Non- Controlling Interests
		Class A	Class B					
<b>Balance at December 31, 2009</b>	\$ 3,512	\$	\$	\$ 3,412	\$ (1,250)	\$ 1,148	\$ 194	\$ 8
Net income	455					455		
Other comprehensive loss, net of tax	(106)						(106)	
Cash dividends declared on Class A and Class B common stock, \$0.15 per share	(20)					(20)		
Share based payments	16			16				
Stock units withheld for taxes	(122)			(122)				
Tax benefit for share based compensation	91			91				
Exercise of stock options	6			6				
<b>Balance at March 31, 2010</b>	\$ 3,832	\$	\$	\$ 3,403	\$ (1,250)	\$ 1,583	\$ 88	\$ 8

**MASTERCARD INCORPORATED**  
**CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME**  
**(UNAUDITED)**

	Three Months Ended March 31,	
	2010	2009
	(In millions)	
<b>Net Income</b>	\$ 455	\$ 367
Other comprehensive loss:		
Foreign currency translation adjustments	(105)	(75)
Defined benefit pension and postretirement plans, net of tax		1
Unrealized gain (loss) and reclassification adjustment for realized (gain) loss on investment securities available-for-sale, net of tax	(1)	5
Other comprehensive loss	(106)	(69)
<b>Comprehensive Income</b>	349	298
Income attributable to non-controlling interests		
<b>Comprehensive Income Attributable to MasterCard</b>	\$ 349	\$ 298

The accompanying notes are an integral part of these consolidated financial statements.



---

**Table of Contents**

**MASTERCARD INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**(In millions, except per share and percent data, unless otherwise stated)**

**Note 1. Summary of Significant Accounting Policies**

***Organization***

MasterCard Incorporated and its consolidated subsidiaries, including MasterCard International Incorporated ( MasterCard International ) and MasterCard Europe sprl ( MasterCard Europe ) (together, MasterCard or the Company ), provide payment solutions, including transaction processing and related services to customers principally in support of their credit, deposit access (debit), electronic cash and Automated Teller Machine ( ATM ) payment card programs, and travelers cheque programs. Our financial institution customers are generally either principal members ( principal members ) of MasterCard International, which participate directly in MasterCard International s business, or affiliate members of MasterCard International, which participate indirectly in MasterCard International s business through a principal member.

***Consolidation and basis of presentation***

The consolidated financial statements include the accounts of MasterCard and its majority-owned and controlled entities. The Company also evaluates its interests in variable interest entities, as applicable, to determine whether consolidation is required. Intercompany transactions and balances have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the 2010 presentation. The Company follows accounting principles generally accepted in the United States of America ( GAAP ).

The balance sheet as of December 31, 2009 was derived from the audited consolidated financial statements as of December 31, 2009. The consolidated financial statements for the three months ended March 31, 2010 and 2009 and as of March 31, 2010 are unaudited, and in the opinion of management, include all normal recurring adjustments that are necessary to present fairly the results for interim periods. Due to seasonal fluctuations and other factors, the results of operations for the three months ended March 31, 2010 are not necessarily indicative of the results to be expected for the full year. The Company has evaluated subsequent events through the date that the consolidated financial statements were issued.

The accompanying unaudited consolidated financial statements are presented in accordance with the U.S. Securities and Exchange Commission requirements of Quarterly Reports on Form 10-Q and, consequently, do not include all of the disclosures required by GAAP. Reference should be made to the MasterCard Incorporated Annual Report on Form 10-K for the year ended December 31, 2009 for additional disclosures, including a summary of the Company s significant accounting policies.

***Recent accounting pronouncements***

*Transfers of financial assets* - In June 2009, the accounting standard for transfers and servicing of financial assets and extinguishments of liabilities was amended. The change eliminates the qualifying special purpose entity concept, establishes a new unit of account definition that must be met for the transfer of portions of financial assets to be eligible for sale accounting, clarifies and changes the derecognition criteria for a transfer to be accounted for as a sale, changes the amount of gain or loss on a transfer of financial assets accounted for as a sale when beneficial interests are received by the transferor, and requires additional new disclosures. The Company adopted the new standard upon its effective date of January 1, 2010. The adoption did not have an impact on the Company s financial position or results of operations as of or for the three months ended March 31, 2010.

*Variable interest entities* - In June 2009, there was a revision to the accounting standard for the consolidation of variable interest entities. The revision eliminates the exemption for qualifying special purpose entities, requires a new qualitative approach for determining whether a reporting entity should consolidate a variable interest entity, and changes the requirement of when to reassess whether a reporting entity should consolidate a variable interest entity. During February 2010, the scope of the revised standard was modified to indefinitely exclude certain entities from the requirement to be assessed for consolidation. The Company adopted the new standard upon its effective date of January 1, 2010. The adoption did not have an impact on the Company s financial position or results of operations as of or for the three months ended March 31, 2010.



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

*Revenue arrangements with multiple deliverables* - In September 2009, the accounting standard for the allocation of revenue in arrangements involving multiple deliverables was amended. Current accounting standards require companies to allocate revenue based on the fair value of each deliverable, even though such deliverables may not be sold separately either by the company itself or other vendors. The new accounting standard eliminates (i) the residual method of revenue allocation and (ii) the requirement that all undelivered elements must have objective and reliable evidence of fair value before a company can recognize the portion of the overall arrangement fee that is attributable to items that already have been delivered. The Company will adopt the revised accounting standard effective January 1, 2011 via prospective adoption. The Company is currently evaluating the requirements of the standard to determine the impact on the Company's financial position or results of operations.

*Improving fair value disclosures* - The Company measures certain of its assets and liabilities at fair value on a recurring basis by estimating the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When valuing liabilities, the Company also considers the Company's creditworthiness. The Company classifies these recurring fair value measurements into a three-level hierarchy ( Valuation Hierarchy ) and discloses the significant assumptions utilized in measuring assets and liabilities at fair value. In January 2010, fair value disclosure requirements were amended such that MasterCard is required to present detailed disclosures about transfers to and from Level 1 and 2 of the Valuation Hierarchy effective January 1, 2010 and MasterCard will also be required to disclose purchases, sales, issuances, and settlements on a gross basis within the Level 3 (of the Valuation Hierarchy) reconciliation effective January 1, 2011. The Company adopted the new guidance for disclosures about transfers to and from Level 1 and 2 of the Valuation Hierarchy effective January 1, 2010. The adoption did not have an impact on the Company's financial position or results of operations as of or for the three months ended March 31, 2010. The Company will adopt the guidance that requires disclosure of a reconciliation of purchases, sales, issuances, and settlements on a gross basis within Level 3 (of the Valuation Hierarchy) during 2011, as required, and the adoption will have no impact on the Company's financial position or results of operations.

**Note 2. Earnings Per Share**

Earnings per share ( EPS ) is calculated including the effects of certain instruments granted in share-based payment transactions under the two-class method. Unvested share-based payment awards which receive non-forfeitable dividend rights, or dividend equivalents, are considered participating securities and are required to be included in computing EPS under the two-class method. The Company declared non-forfeitable dividends on unvested restricted stock units and contingently issuable performance stock units ( Unvested Units ) which were granted prior to 2009.

The components of basic and diluted EPS for common shares are as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Numerator:</b>		
Net income attributable to MasterCard	\$ 455	\$ 367
Less: Net income allocated to Unvested Units	2	3
Net income attributable to MasterCard allocated to common shares	\$ 453	\$ 364
<b>Denominator:</b>		
Basic EPS weighted average shares outstanding	130	130
Dilutive stock options and stock units	1	
Diluted EPS weighted average shares outstanding	131	130

## Edgar Filing: MASTERCARD INC - Form 10-Q

<b>Earnings per Share</b>		
Total Basic	\$ 3.47	\$ 2.81
Total Diluted	\$ 3.46	\$ 2.80

The calculation of diluted EPS for the three month periods ended March 31, 2010 and 2009 excluded 88 thousand and 290 thousand stock options, respectively, because the effect would be antidilutive.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)****Note 3. Non-Cash Investing and Financing Activities**

The following table includes non-cash investing and financing information for the three month periods ended March 31:

	2010	2009
Dividend declared but not yet paid	\$ 20	\$ 20
Software licenses financed	10	
Municipal bonds cancelled		154
Revenue bonds received		(154)
Building and land assets recorded pursuant to capital lease		(154)
Capital lease obligation		154
Fair value of assets acquired, net of original investment, cash paid and cash acquired		17
Fair value of liabilities assumed related to investments in affiliates		15 <sup>1</sup>
Fair value of non-controlling interest acquired		8

<sup>1</sup> Includes \$9 to be extinguished in 2013 and 2016 for future benefits to be provided by MasterCard in the establishment of a joint venture. Effective March 1, 2009, MasterCard executed a new ten-year lease between MasterCard, as tenant, and the Missouri Development Finance Board ( MDFB ), as landlord, for MasterCard's global technology and operations center located in O'Fallon, Missouri, called Winghaven. The lease includes a bargain purchase option and is thus classified as a capital lease. The building and land assets and capital lease obligation have been recorded at \$154, which represents the lesser of the present value of the minimum lease payments and the fair value of the building and land assets. The Company received refunding revenue bonds issued by MDFB in the exact amount, \$154, and with the same payment terms as the capital lease and which contain the legal right of setoff with the capital lease. The Company has netted its investment in the MDFB refunding revenue bonds and the corresponding capital lease obligation in the consolidated balance sheet.

**Note 4. Fair Value****Financial Instruments Recurring Measurements**

In accordance with accounting requirements for financial instruments, the Company is disclosing the estimated fair values as of March 31, 2010 and December 31, 2009 of the financial instruments that are within the scope of the accounting guidance, as well as the methods and significant assumptions used to estimate the fair value of those financial instruments. Furthermore, the Company classifies its fair value measurements in the Valuation Hierarchy. No transfers were made among the three levels in the Valuation Hierarchy during the three months ended March 31, 2010.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

The distribution of the Company's financial instruments which are measured at fair value on a recurring basis within the Valuation Hierarchy is as follows:

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at March 31, 2010
Municipal bonds <sup>1</sup>	\$	\$ 519	\$	\$ 519
Taxable short-term bond funds	312			312
Auction rate securities			172	172
Foreign currency forward contracts		(5)		(5)
Other				
Total	\$ 312	\$ 514	\$ 172	\$ 998

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value at December 31, 2009
Municipal bonds <sup>1</sup>	\$	\$ 514	\$	\$ 514
Taxable short-term bond funds	310			310
Auction rate securities			180	180
Foreign currency forward contracts		(1)		(1)
Other				
Total	\$ 310	\$ 513	\$ 180	\$ 1,003

<sup>1</sup> Available-for-sale municipal bonds are carried at fair value and are included in the above tables. However, held-to-maturity municipal bonds are carried at amortized cost and excluded from the above tables.

The fair value of the Company's available-for-sale municipal bonds are based on quoted prices for similar assets in active markets and are therefore included in Level 2 of the Valuation Hierarchy.

The fair value of the Company's short-term bond funds are based on quoted prices and are therefore included in Level 1 of the Valuation Hierarchy.

The Company's auction rate securities (ARS) investments have been classified within Level 3 of the Valuation Hierarchy as their valuation requires substantial judgment and estimation of factors that are not currently observable in the market due to the lack of trading in the securities. This valuation may be revised in future periods as market conditions evolve. The Company has considered the lack of liquidity in the ARS market and the lack of comparable, orderly transactions when estimating the fair value of its ARS portfolio. Therefore, the Company uses the income approach, which included a discounted cash flow analysis of the estimated future cash flows adjusted by a risk premium for the ARS portfolio, to estimate the fair value of its ARS portfolio. The Company estimated the fair value of its ARS portfolio to be a 15% discount to the



## Edgar Filing: MASTERCARD INC - Form 10-Q

par value as of March 31, 2010 and December 31, 2009. When a determination is made to classify a financial instrument within Level 3, the determination is based upon the significance of the unobservable parameters to the overall fair value measurement. However, the fair value determination for Level 3 financial instruments may include observable components.

The Company's foreign currency forward contracts have been classified within Level 2 of the Valuation Hierarchy, as the fair value is based on broker quotes for the same or similar derivative instruments. See Note 19 (Foreign Exchange Risk Management) for further details.

---

**Table of Contents**

**MASTERCARD INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**(In millions, except per share and percent data, unless otherwise stated)**

***Financial Instruments Non-Recurring Measurements***

Certain financial instruments are carried on the consolidated balance sheets at cost, which approximates fair value due to their short-term, highly liquid nature. These instruments include cash and cash equivalents, accounts receivable, settlement due from customers, restricted security deposits held for customers, prepaid expenses, accounts payable, settlement due to customers and accrued expenses.

***Investment Securities Held-to-Maturity***

The Company utilizes quoted prices for similar securities from active markets to estimate the fair value of its held-to-maturity securities. See Note 5 (Investment Securities) for fair value disclosure.

***Short-term and Long-term Debt***

The Company estimates the fair value of its debt by applying a current period discount rate to the remaining cash flows under the terms of the debt. As of March 31, 2010 and December 31, 2009, the carrying value on the consolidated balance sheet totaled \$21 and \$22 and the fair value totaled \$21 and \$22, respectively, for the Company's debt.

***Obligations Under Litigation Settlements***

The Company estimates the fair value of its obligations under litigation settlements by applying a current period discount rate to the remaining cash flows under the terms of the litigation settlements. At March 31, 2010 and December 31, 2009, the carrying value on the consolidated balance sheet totaled \$731 and \$870 and the fair values totaled \$741 and \$895, respectively, for these obligations. For additional information regarding the Company's obligations under litigation settlements, see Note 15 (Obligations Under Litigation Settlements).

***Settlement Guarantee Liabilities***

The Company estimates the fair value of its settlement guarantees by applying market assumptions for relevant though not directly comparable undertakings, as the latter are not observable in the market given the proprietary nature of such guarantees. Additionally, loss probability and severity profiles against the Company's gross and net settlement exposures are considered. The carrying value and estimated fair value of settlement guarantee liabilities were de minimis as of March 31, 2010 and December 31, 2009. For additional information regarding the Company's settlement guarantee liabilities, see Note 18 (Settlement and Travelers Cheque Risk Management).

***Refunding Revenue Bonds***

The Company holds refunding revenue bonds with the same payment terms, and which contain the right of set-off with a capital lease obligation related to the Company's global technology and operations center located in O'Fallon, Missouri, called Winghamen. The Company has netted the refunding revenue bonds and the corresponding capital lease obligation in the consolidated balance sheet and estimates that the carrying value approximates the fair value for these bonds. See Note 3 (Non-Cash Investing and Financing Activities) for further details.

***Non-Financial Instruments***

Certain assets and liabilities are measured at fair value on a nonrecurring basis. The Company's assets and liabilities measured at fair value on a nonrecurring basis include property, plant and equipment, goodwill and other intangible assets. These assets are not measured at fair value on an ongoing basis; however, they are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment.

## Edgar Filing: MASTERCARD INC - Form 10-Q

The valuation methods for goodwill and other intangible assets involve assumptions concerning comparable company multiples, discount rates, growth projections and other assumptions of future business conditions. As the assumptions employed to measure these assets on a nonrecurring basis are based on management's judgment using internal and external data, these fair value determinations are classified in Level 3 of the Valuation Hierarchy.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)****Note 5. Investment Securities*****Amortized Costs and Fair Values Available-for-Sale Investment Securities:***

The major categories of the Company's available-for-sale investment securities, for which unrealized gains and losses are recorded as a separate component of other comprehensive income (loss) on the consolidated statements of comprehensive income (loss), and their respective cost basis and fair values are as follows:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss <sup>1</sup>	Fair Value at March 31, 2010
Municipal bonds	\$ 500	\$ 19	\$	\$ 519
Taxable short-term bond funds	307	5		312
Auction rate securities	202		(30)	172
Other				
<b>Total</b>	<b>\$ 1,009</b>	<b>\$ 24</b>	<b>\$ (30)</b>	<b>\$ 1,003</b>

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss <sup>1</sup>	Fair Value at December 31, 2009
Municipal bonds	\$ 492	\$ 22	\$	\$ 514
Taxable short-term bond funds	306	4		310
Auction rate securities	212		(32)	180
Other				
<b>Total</b>	<b>\$ 1,010</b>	<b>\$ 26</b>	<b>\$ (32)</b>	<b>\$ 1,004</b>

<sup>1</sup> The unrealized losses have been in an unrealized loss position longer than 12 months, but have not been deemed other-than-temporarily impaired.

The municipal bond portfolio is comprised of tax exempt bonds and is diversified across states and sectors. The portfolio has an average credit quality of double-A.

The short-term bond funds invest in fixed income securities, including corporate bonds, mortgage-backed securities, and asset-backed securities.

The Company holds investments in ARS. Interest on these securities is exempt from U.S. federal income tax and the interest rate on the securities typically resets every 35 days. The securities are fully collateralized by student loans with guarantees (ranging from approximately 95% to 98% of principal and interest) by the U.S. government via the Department of Education.

Beginning on February 11, 2008, the auction mechanism that normally provided liquidity to the ARS investments began to fail. Since mid-February 2008, all investment positions in the Company's ARS investment portfolio have experienced failed auctions. The securities for

## Edgar Filing: MASTERCARD INC - Form 10-Q

which auctions have failed have continued to pay interest in accordance with the contractual terms of such instruments and will continue to accrue interest and be auctioned at each respective reset date until the auction succeeds, the issuer redeems the securities or they mature. As of March 31, 2010, the ARS market remained illiquid but issuer call and redemption activity in the ARS student loan sector has occurred periodically since the auctions began to fail. During the three months ended March 31, 2010, the Company did not sell any ARS in the auction market but there were some calls at par.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

The table below includes a roll-forward of the Company's ARS investments from January 1, 2010 to March 31, 2010.

	<b>Significant Unobservable Inputs (Level 3)</b>
Fair value, January 1, 2010	\$ 180
Calls, at par	(9)
Recovery of unrealized losses due to issuer calls	1
Fair value, March 31, 2010	\$ 172

The Company evaluated the estimated impairment of its ARS portfolio to determine if it was other-than-temporary. The Company considered several factors including, but not limited to, the following: (1) the reasons for the decline in value (changes in interest rates, credit event, or market fluctuations); (2) assessments as to whether it is more likely than not that it will hold and not be required to sell the investments for a sufficient period of time to allow for recovery of the cost basis; (3) whether the decline is substantial; and (4) the historical and anticipated duration of the events causing the decline in value. The evaluation for other-than-temporary impairments is a quantitative and qualitative process, which is subject to various risks and uncertainties. The risks and uncertainties include changes in credit quality, market liquidity, timing and amounts of issuer calls, and interest rates. As of March 31, 2010, the Company believed that the unrealized losses on the ARS were not related to credit quality but rather due to the lack of liquidity in the market. The Company believes that it is more likely than not that the Company will hold and not be required to sell its ARS investments until recovery of their cost bases which may be at maturity or earlier if called. Therefore, MasterCard does not consider the unrealized losses to be other-than-temporary. The Company estimated a 15% discount to the par value of the ARS portfolio at March 31, 2010 and December 31, 2009. The pre-tax impairment included in accumulated other comprehensive income related to the Company's ARS was \$30 and \$32 as of March 31, 2010 and December 31, 2009, respectively. A hypothetical increase of 100 basis points in the discount rate used in the discounted cash flow analysis would have increased the impairment by \$18 and \$23 as of March 31, 2010 and December 31, 2009, respectively.

*Carrying and Fair Values Held-to-Maturity Investment Securities:*

As of March 31, 2010, the Company also owned held-to-maturity investment securities, which consisted of U.S. Treasury notes and a municipal bond yielding interest at 5.0% per annum. The bond relates to the Company's back-up processing center in Kansas City, Missouri. The carrying value, gross unrecorded gains and fair value of these held-to-maturity investment securities were as follows:

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Carrying value	\$ 338	\$ 338
Gross unrecorded gains	2	2
Fair value	\$ 340	\$ 340

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)***Investment Maturities:*

The maturity distribution based on the contractual terms of the Company's investment securities at March 31, 2010 was as follows:

	Available-For-Sale Amortized		Held-To-Maturity	
	Cost	Fair Value	Carrying Value	Fair Value
Due within 1 year	\$ 34	\$ 34	\$ 151	\$ 151
Due after 1 year through 5 years	363	379	187	189
Due after 5 years through 10 years	107	109		
Due after 10 years	198	169		
No contractual maturity	307	312		
Total	\$ 1,009	\$ 1,003	\$ 338	\$ 340

The majority of securities due after ten years are ARS. Taxable short-term bond funds have been included in the table above in the no contractual maturity category, as these investments do not have a stated maturity date.

The table below summarizes the maturity ranges of the ARS portfolio, based on relative par value, as of March 31, 2010:

	Par Amount	% of Total
Due within 10 years	\$ 4	2%
Due year 11 through year 20	26	13%
Due year 21 through year 30	135	67%
Due after year 30	37	18%
Total	\$ 202	100%

*Investment Income:*

Investment income was \$10 and \$17 for the three months ended March 31, 2010 and 2009, respectively. It primarily consisted of interest income generated from cash, cash equivalents, available-for-sale investment securities and municipal bonds held-to-maturity. Dividend income and gross realized gains and losses were not significant.

**Note 6. Prepaid Expenses**

Prepaid expenses consisted of the following:

March 31, 2010	December 31, 2009
-------------------	----------------------

Edgar Filing: MASTERCARD INC - Form 10-Q

Customer and merchant incentives	\$ 508	\$ 445
Advertising	40	56
Income taxes	24	93
Data processing	32	29
Other	20	18
Total prepaid expenses	624	641
Prepaid expenses, current	(278)	(313)
Prepaid expenses, long-term	\$ 346	\$ 328

Prepaid customer and merchant incentives represent payments made to customers and merchants under business agreements.



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(In millions, except per share and percent data, unless otherwise stated)

**Note 7. Other Assets**

Other assets consisted of the following:

	March 31, 2010	December 31, 2009
Customer and merchant incentives	\$ 156	\$ 216
Cost and equity method investments	36	35
Cash surrender value of keyman life insurance	25	23
Other	34	36
<b>Total other assets</b>	<b>251</b>	<b>310</b>
Other assets, current	(92)	(126)
<b>Other assets, long-term</b>	<b>\$ 159</b>	<b>\$ 184</b>

Certain customer and merchant business agreements provided incentives upon entering into the agreement. As of March 31, 2010 and December 31, 2009, other assets included amounts to be paid for these incentives and the related liability was included in accrued expenses and other liabilities. Once the payment is made, the liability is relieved and the other asset is reclassified to a prepaid expense.

**Note 8. Property, Plant and Equipment**

Property, plant and equipment consisted of the following:

	March 31, 2010	December 31, 2009
Property, plant and equipment	\$ 747	\$ 753
Less accumulated depreciation and amortization	(314)	(304)
<b>Property, plant and equipment, net</b>	<b>\$ 433</b>	<b>\$ 449</b>

As of March 31, 2010 and December 31, 2009, capital leases, excluding the Winghaven facility, of \$10 and \$14, respectively, were included in equipment. Accumulated amortization of these capital leases was \$4 and \$6 as of March 31, 2010 and December 31, 2009, respectively. The Winghaven facility is discussed further in Note 3 (Non-Cash Investing and Financing Activities).

Depreciation expense for the above property, plant and equipment, including amortization for capital leases, was \$16 and \$17 for the three months ended March 31, 2010 and 2009, respectively.

**Note 9. Accrued Expenses**

Accrued expenses consisted of the following:

Edgar Filing: MASTERCARD INC - Form 10-Q

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
Customer and merchant incentives	\$ 548	\$ 598
Personnel costs	203	367
Advertising	61	131
Income taxes	30	32
Other	93	97
Total accrued expenses	\$ 935	\$ 1,225

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)****Note 10. Pension Plans**

The Company maintains a non-contributory, qualified, defined benefit pension plan (the Qualified Plan) with a cash balance feature covering substantially all of its U.S. employees hired before July 1, 2007. Company contributions in 2009 and favorable investment returns increased the Qualified Plan's fair value of assets at December 31, 2009 as compared to December 31, 2008, thereby reducing net periodic pension cost for the three months ended March 31, 2010 versus the same period in 2009. Additionally, the Company has an unfunded non-qualified supplemental executive retirement plan (the Non-qualified Plan) that provides certain key employees with supplemental retirement benefits in excess of limits imposed on qualified plans by U.S. tax laws. The term Pension Plans includes both the Qualified Plan and the Non-qualified Plan. The net periodic pension cost for the Pension Plans was as follows:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2010</b>	<b>2009</b>
Service cost	\$ 4	\$ 5
Interest cost	3	3
Expected return on plan assets	(4)	(3)
Amortization:		
Actuarial loss	1	2
Prior service credit	(1)	(1)
<b>Net periodic pension cost</b>	<b>\$ 3</b>	<b>\$ 6</b>

The Company made voluntary contributions totaling \$5 to the Qualified Plan during the three months ended March 31, 2010 and contributed an additional \$5 in April 2010. The Company currently expects to make \$10 in additional contributions to the Qualified Plan during the remainder of 2010. During the three months ended March 31, 2009, the Company contributed \$14 to the Qualified Plan.

**Note 11. Postemployment and Postretirement Benefits**

The Company maintains a postretirement plan (the Postretirement Plan) providing health coverage and life insurance benefits for substantially all of its U.S. employees and retirees hired before July 1, 2007. Net periodic postretirement benefit cost was \$1 for each of the three month periods ended March 31, 2010 and 2009. The cost included amounts for interest cost, service cost and amortization of the transition obligation partially offset by the amortization of the actuarial gain. The majority of the cost represented interest cost.

The Company does not make any contributions to its Postretirement Plan other than funding benefits payments.

**Note 12. Share Based Payment and Other Benefits**

On March 1, 2010, the Company granted approximately 150 thousand restricted stock units, 169 thousand stock options and 42 thousand performance units under the MasterCard Incorporated 2006 Long-Term Incentive Plan (LTIP). The fair value of the restricted stock units and performance units, based on the closing price of the Class A common stock, par value \$.0001 per share, on the New York Stock Exchange on March 1, 2010, was \$232.74. The fair value of the stock options estimated on the date of grant using a Black-Scholes option pricing model was \$84.79. Vesting of the shares underlying the restricted stock units and performance units will occur on February 28, 2013. The stock options vest in four equal annual installments beginning on March 1, 2011, and have a term of ten years. Compensation expense is recorded net of estimated forfeitures over the shorter of the vesting period or the date the individual becomes eligible to retire under the LTIP. The Company uses the straight-line method of attribution over the requisite service period for expensing equity awards.

## Edgar Filing: MASTERCARD INC - Form 10-Q

With regard to the performance units granted on March 1, 2010, whether and the extent to which, the performance stock units will vest will be based on the Company's performance against a predetermined return on equity goal, with an average of return on equity over the three-year period commencing January 1, 2010 against

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

threshold, target and maximum performance goals. In the event the performance units do vest on February 28, 2013, the ultimate number of shares to be released on the vesting date will be based on meeting or exceeding average annual return on equity goals and achievement of quantitative and qualitative goals determined by the Company's compensation committee over the performance period, which includes performance against the corporate scorecard. These performance units have been classified as equity awards, will be settled by delivering stock to the employees and contain service and performance conditions. Given that the performance terms are subjective and not fixed on the date of grant, the performance units will be remeasured at the end of each reporting period, at fair value, until the time the performance conditions are fixed and the ultimate number of shares to be issued is determined. Estimates are adjusted as appropriate. Compensation expense is calculated using the number of performance stock units expected to vest; multiplied by the period ending price of a share of MasterCard's Class A common stock on the New York Stock Exchange; less previously recorded compensation expense.

**Note 13. Stockholders' Equity**

In February 2010, the Company's Board of Directors authorized programs to facilitate conversions of shares of Class B common stock on a one-for-one basis into shares of Class A common stock for subsequent sale or transfer to public investors, beginning after May 31, 2010. The conversion programs follow the expiration on May 31, 2010 of a 4-year post initial public offering restriction period with respect to the conversion of shares of Class B common stock. The Company currently expects that the first 2010 conversion program will consist of four one-week periods in June 2010. Holders of shares of Class B common stock will be able to make conversion elections in a program to be modeled on the Company's 2008 and 2009 programs, except that there will not be a limit on the number of shares of Class B common stock that are eligible for conversion by any one holder. Starting in early July 2010, the Company expects to run a subsequent, continuous conversion program for remaining shares of Class B common stock, featuring an "open window" for elections of any size.

All outstanding Class M common stock will be automatically transferred to the Company and retired and unavailable for issue or reissue on the day on which the number of outstanding shares of Class B common stock represent less than 15% of the total outstanding shares of Class A common stock and Class B common stock.

**Note 14. Commitments**

At March 31, 2010, the Company had the following future minimum payments due under non-cancelable agreements:

	<b>Total</b>	<b>Capital Leases <sup>1</sup></b>	<b>Operating Leases</b>	<b>Sponsorship, Licensing &amp; Other</b>
Remainder of 2010	\$ 232	\$ 3	\$ 19	\$ 210
2011	167	4	19	144
2012	113	3	16	94
2013	60	37	10	13
2014	14		8	6
Thereafter	26		23	3
<b>Total</b>	<b>\$ 612</b>	<b>\$ 47</b>	<b>\$ 95</b>	<b>\$ 470</b>

## Edgar Filing: MASTERCARD INC - Form 10-Q

Excludes non-cash transactions relating to the Company's Winghaven facility. See Note 3 (Non-Cash Investing and Financing Activities) for more information.

Included in the table above are capital leases with imputed interest expense of \$6 and a net present value of minimum lease payments of \$41. In addition, at March 31, 2010, \$38 of the future minimum payments in the table above for operating leases, sponsorship, licensing and other agreements was accrued. Consolidated rental expense for the Company's leased office space, which is recognized on a straight line basis over the life of the lease, was \$7 and \$14 for the three months ended March 31, 2010 and 2009, respectively. Consolidated lease expense for automobiles, computer equipment and office equipment was \$2 for each of the three month periods ended March 31, 2010 and 2009.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)****Note 15. Obligations Under Litigation Settlements**

On June 24, 2008, MasterCard entered into a settlement agreement (the American Express Settlement) with American Express Company (American Express) relating to the U.S. federal antitrust litigation between MasterCard and American Express. The American Express Settlement ended all existing litigation between MasterCard and American Express. Under the terms of the American Express Settlement, MasterCard is obligated to make 12 quarterly payments of up to \$150 per quarter beginning in the third quarter of 2008. MasterCard's maximum nominal payments will total \$1,800. The amount of each quarterly payment is contingent on the performance of American Express's U.S. Global Network Services business. The quarterly payments will be in an amount equal to 15% of American Express's U.S. Global Network Services billings during the quarter, up to a maximum of \$150 per quarter. If, however, the payment for any quarter is less than \$150, the maximum payment for subsequent quarters will be increased by the difference between \$150 and the lesser amount that was paid in any quarter in which there was a shortfall. MasterCard has assumed American Express will achieve these financial hurdles. MasterCard recorded the present value of \$1,800, at a 5.75% discount rate, or \$1,649 in the quarter ended June 30, 2008 with respect to the American Express Settlement.

Total liabilities for the American Express Settlement and other litigation settlements changed from December 31, 2009, as follows:

Balance as of December 31, 2009	\$ 870
Interest accretion on American Express Settlement	11
Payments on American Express Settlement	(150)
Other payments, accruals and accretion, net	
Balance as of March 31, 2010	\$ 731

See Note 17 (Legal and Regulatory Proceedings) for additional discussion regarding the Company's legal proceedings.

**Note 16. Income Taxes**

The effective income tax rates were 34.6% and 33.2% for the three months ended March 31, 2010 and 2009, respectively. The rate for the three months ended March 31, 2010 was higher than the comparable period in 2009 due primarily to an adjustment to the Company's balance of deferred taxes during the three months ended March 31, 2009, partially offset by lower state tax rates and a more favorable geographic distribution of earnings for the three months ended March 31, 2010.

**Note 17. Legal and Regulatory Proceedings**

MasterCard is a party to legal and regulatory proceedings with respect to a variety of matters in the ordinary course of business. Some of these proceedings involve complex claims that are subject to substantial uncertainties and unascertainable damages. Therefore, the probability of loss and an estimation of damages are not possible to ascertain at present. Accordingly, except as discussed below, MasterCard has not established reserves for any of these proceedings. MasterCard has recorded liabilities for certain legal proceedings which have been settled through contractual agreements. Except as described below, MasterCard does not believe that any legal or regulatory proceedings to which it is a party would have a material impact on its results of operations, financial position, or cash flows. Although MasterCard believes that it has strong defenses for the litigations and regulatory proceedings described below, it could in the future incur judgments and/or fines, enter into settlements of claims or be required to change its business practices in ways that could have a material adverse effect on its results of operations, financial position or cash flows. Notwithstanding MasterCard's belief, in the event it were found liable in a large class-action lawsuit or on the basis of a claim entitling the plaintiff to treble damages or under which it were jointly and severally liable, charges it may be required to record could be significant and could materially and adversely affect its results of operations, cash flow and financial condition, or, in certain circumstances, even cause MasterCard to become insolvent. Moreover, an adverse outcome in a regulatory proceeding could result in fines and/or lead to the

## Edgar Filing: MASTERCARD INC - Form 10-Q

filing of civil damage claims and possibly result in damage awards in amounts that could be significant and could materially and adversely affect the Company's results of operations, cash flows and financial condition.



---

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)****Department of Justice Antitrust Litigation and Related Private Litigations**

In October 1998, the U.S. Department of Justice ( DOJ ) filed suit against MasterCard International, Visa U.S.A., Inc. and Visa International Corp. in the U.S. District Court for the Southern District of New York alleging that both MasterCard's and Visa's governance structure and policies violated U.S. federal antitrust laws. First, the DOJ claimed that dual governance—the situation where a financial institution has a representative on the Board of Directors of MasterCard or Visa while a portion of its card portfolio is issued under the brand of the other association—was anti-competitive and acted to limit innovation within the payment card industry. Second, the DOJ challenged MasterCard's Competitive Programs Policy ( CPP ) and a Visa bylaw provision that prohibited financial institutions participating in the respective associations from issuing competing proprietary payment cards (such as American Express or Discover). The DOJ alleged that MasterCard's CPP and Visa's bylaw provision acted to restrain competition.

On October 9, 2001, District Court Judge Barbara Jones issued an opinion upholding the legality and pro-competitive nature of dual governance. However, the judge also held that MasterCard's CPP and the Visa bylaw constituted unlawful restraints of trade under the federal antitrust laws. On November 26, 2001, the judge issued a final judgment that ordered MasterCard to repeal the CPP insofar as it applies to issuers and enjoined MasterCard from enacting or enforcing any bylaw, rule, policy or practice that prohibits its issuers from issuing general purpose credit or debit cards in the United States on any other general purpose card network. The Second Circuit upheld the final judgment and the Supreme Court denied certiorari.

Shortly after the Supreme Court's denial of certiorari, both American Express and Discover Financial Services, Inc. filed complaints against MasterCard and Visa in which they alleged that the implementation and enforcement of MasterCard's CPP and Visa's bylaw provision violated both Section 1 of the Sherman Act, which prohibits contracts, combinations and conspiracies that unreasonably restrain trade and Section 2 of the Sherman Act, which prohibits monopolization and attempts or conspiracy to monopolize a particular market. These actions were designated as related cases to the DOJ litigation. On June 24, 2008, MasterCard entered into a settlement agreement with American Express to resolve all current litigation between American Express and MasterCard. Under the terms of the settlement agreement, MasterCard is obligated to make twelve quarterly payments of up to \$150 per quarter with the first payment having been made in September 2008. See Note 15 (Obligations under Litigation Settlements) for additional discussion. On October 27, 2008, MasterCard and Visa entered into a settlement agreement with Discover, ending all litigation between the parties for a total of \$2,750. The MasterCard share of the settlement, paid to Discover in November 2008, was approximately \$863. In addition, in connection with the Discover Settlement and pursuant to a separate agreement, Morgan Stanley, Discover's former parent company, paid MasterCard \$35 in November 2008.

On April 29, 2005, a complaint was filed in California state court on behalf of a putative class of consumers under California unfair competition law (Section 17200) and the Cartwright Act (the Attridge action). The claims in this action seek to piggyback on the portion of the DOJ antitrust litigation discussed above with regard to the district court's findings concerning MasterCard's CPP and Visa's related bylaw. MasterCard and Visa moved to dismiss the complaint and the court granted the defendants' motion to dismiss the plaintiffs' Cartwright Act claims but denied the defendants' motion to dismiss the plaintiffs' Section 17200 unfair competition claims. MasterCard filed an answer to the complaint on June 19, 2006 and the parties have proceeded with discovery. On September 14, 2009, MasterCard executed a settlement agreement that is subject to court approval in the California consumer litigations (see U.S. Merchant and Consumer Litigations). The agreement includes a release that the parties believe encompasses the claims asserted in the Attridge action. On January 5, 2010, the court in the California consumer actions executed an order preliminarily approving the settlement, overruling objections by the plaintiff in the Attridge case. A hearing on final approval of the settlement is set for July 16, 2010. At this time, it is not possible to determine the outcome of, or estimate the liability related to, the Attridge action and no incremental provision for losses has been provided in connection with it.

**Currency Conversion Litigations**

MasterCard International, together with Visa U.S.A., Inc. and Visa International Corp., are defendants in a state court lawsuit in California. The lawsuit alleges that MasterCard and Visa wrongfully imposed an asserted one



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

percent currency conversion fee on every credit card transaction by U.S. MasterCard and Visa cardholders involving the purchase of goods or services in a foreign country, and that such alleged fee is unlawful. This action, titled *Schwartz v. Visa Int'l Corp., et al.* (the Schwartz action), was brought in the Superior Court of California in February 2000, purportedly on behalf of the general public. Trial of the Schwartz action commenced on May 20, 2002 and concluded on November 27, 2002. The Schwartz action claims that the alleged fee grossly exceeds any costs the defendants might incur in connection with currency conversions relating to credit card purchase transactions made in foreign countries and is not properly disclosed to cardholders. MasterCard denies these allegations.

On April 8, 2003, the trial court judge issued a final decision in the Schwartz matter. In his decision, the trial judge found that MasterCard's currency conversion process does not violate the Truth in Lending Act or regulations, nor is it unconscionably priced under California law. However, the judge found that the practice is deceptive under California law, and ordered that MasterCard mandate that members disclose the currency conversion process to cardholders in cardholder agreements, applications, solicitations and monthly billing statements. As to MasterCard, the judge also ordered restitution to California cardholders. The judge issued a decision on restitution on September 19, 2003, which requires a traditional notice and claims process in which consumers have approximately nine months to submit their claims. The court issued its final judgment on October 31, 2003. On December 29, 2003, MasterCard appealed the judgment. The final judgment and restitution process were stayed pending MasterCard's appeal. On August 6, 2004, the court awarded plaintiff's attorneys' fees and costs in the amount of approximately \$28 to be paid equally by MasterCard and Visa. Accordingly, during the three months ended September 30, 2004, MasterCard accrued amounts totaling approximately \$14. MasterCard subsequently filed a notice of appeal on the attorneys' fee award on October 1, 2004. With respect to restitution, MasterCard believed that it was likely to prevail on appeal. In February 2005, MasterCard filed an appeal regarding the applicability of Proposition 64, which amended sections 17203 and 17204 of the California Business and Professions Code, to this action. On September 28, 2005, the appellate court reversed the trial court, finding that the plaintiff lacked standing to pursue the action in light of Proposition 64. On May 8, 2007, the trial court dismissed the case.

MasterCard International, Visa U.S.A., Inc., Visa International Corp., several member banks including Citibank (South Dakota), N.A., Chase Manhattan Bank USA, N.A., Bank of America, N.A. (USA), MBNA, and Citicorp Diners Club Inc. are also defendants in a number of federal putative class actions that allege, among other things, violations of federal antitrust laws based on the asserted one percent currency conversion fee. Pursuant to an order of the Judicial Panel on Multidistrict Litigation, the federal complaints have been consolidated in MDL No. 1409 before Judge William H. Pauley III in the U.S. District Court for the Southern District of New York. In January 2002, the federal plaintiffs filed a Consolidated Amended Complaint (MDL Complaint) adding MBNA Corporation and MBNA America Bank, N.A. as defendants. This pleading asserts two theories of antitrust conspiracy under Section 1 of the Sherman Act: (i) an alleged inter-association conspiracy among MasterCard (together with its members), Visa (together with its members) and Diners Club to fix currency conversion fees allegedly charged to cardholders of no less than 1% of the transaction amount and frequently more; and (ii) two alleged intra-association conspiracies, whereby each of Visa and MasterCard is claimed separately to have conspired with its members to fix currency conversion fees allegedly charged to cardholders of no less than 1% of the transaction amount and to facilitate and encourage institution and collection of second tier currency conversion surcharges. The MDL Complaint also asserts that the alleged currency conversion fees have not been disclosed as required by the Truth in Lending Act and Regulation Z.

On July 20, 2006, MasterCard and the other defendants in the MDL action entered into agreements settling the MDL action and related matters, as well as the Schwartz matter. Pursuant to the settlement agreements, MasterCard paid approximately \$72 to be used for the defendants settlement fund to settle the MDL action and approximately \$13 to settle the Schwartz matter. On November 8, 2006, Judge Pauley granted preliminary approval of the settlement agreements, which were subject to both final approval by Judge Pauley and resolution of all appeals. On November 15, 2006, the plaintiff in one of the New York state court cases appealed the preliminary approval of the settlement agreement to the U.S. Court of Appeals for the Second Circuit. On November 3, 2009, Judge Pauley signed a Final Judgment and Order of Dismissal granting final approval to the settlement agreements. On November 20, 2009, the same plaintiff in the New York state cases filed notice of appeal of final settlement approval in the MDL action. Within the time period for appeal in the MDL action, twelve other such notices of appeal were filed. Subsequently, several plaintiffs have requested to withdraw their appeals. With regard to other state court currency conversion actions, MasterCard has reached agreements in principle with the plaintiffs for a



---

**Table of Contents**

**MASTERCARD INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**(In millions, except per share and percent data, unless otherwise stated)**

total of approximately \$4, which has been accrued. Settlement agreements have been executed with plaintiffs in the Ohio, Pennsylvania, Florida, Texas, Arkansas, Tennessee, Arizona, New York, Minnesota, Illinois and Missouri actions. At this time, it is not possible to predict with certainty the ultimate resolution of these matters.

**U.S. Merchant and Consumer Litigations**

Commencing in October 1996, several class action suits were brought by a number of U.S. merchants against MasterCard International and Visa U.S.A., Inc. challenging certain aspects of the payment card industry under U.S. federal antitrust law. Those suits were later consolidated in the U.S. District Court for the Eastern District of New York. The plaintiffs claimed that MasterCard's Honor All Cards rule (and a similar Visa rule), which required merchants who accept MasterCard cards to accept for payment every validly presented MasterCard card, constituted an illegal tying arrangement in violation of Section 1 of the Sherman Act. Plaintiffs claimed that MasterCard and Visa unlawfully tied acceptance of debit cards to acceptance of credit cards. On June 4, 2003, MasterCard International signed a settlement agreement to settle the claims brought by the plaintiffs in this matter, which the Court approved on December 19, 2003. On January 24, 2005, the Second Circuit Court of Appeals issued an order affirming the District Court's approval of the settlement agreement thus making it final. On July 1, 2009, MasterCard International entered into an agreement with the plaintiffs to prepay MasterCard International's remaining payment obligations under the settlement agreement at a discount. On August 26, 2009, the court entered a final order approving the prepayment agreement. The agreement became final pursuant to its terms on September 25, 2009 as there were no appeals of the court's approval, and the prepayment was made on September 30, 2009.

In addition, individual or multiple complaints have been brought in nineteen different states and the District of Columbia alleging state unfair competition, consumer protection and common law claims against MasterCard International (and Visa) on behalf of putative classes of consumers. The claims in these actions largely mirror the allegations made in the U.S. merchant lawsuit and assert that merchants, faced with excessive merchant discount fees, have passed these overcharges to consumers in the form of higher prices on goods and services sold. MasterCard has been successful in dismissing cases in seventeen of the jurisdictions as courts have granted MasterCard's motions to dismiss for failure to state a claim or plaintiffs have voluntarily dismissed their complaints. However, there are outstanding cases in New Mexico and California. The parties are awaiting a decision on MasterCard's motion to dismiss in New Mexico. As discussed above under Department of Justice Antitrust Litigation and Related Private Litigations, on September 14, 2009, the parties to the California state court actions executed a settlement agreement which required a payment by MasterCard of \$6, subject to approval by the California state court. On January 5, 2010, the court executed an order preliminarily approving the settlement. A hearing on final approval of the settlement is set for July 16, 2010.

At this time, it is not possible to determine the outcome of, or, except as indicated above in the California consumer action, estimate the liability related to, the remaining consumer cases and no provision for losses has been provided in connection with them. The consumer class actions are not covered by the terms of the settlement agreement in the U.S. merchant lawsuit.

**Interchange Litigation and Regulatory Proceedings**

Interchange fees represent a sharing of payment system costs among the financial institutions participating in a four-party payment card system such as MasterCard's. Typically, interchange fees are paid by the acquirer to the issuer in connection with purchase transactions initiated with the payment system's cards. These fees reimburse the issuer for a portion of the costs incurred by it in providing services which are of benefit to all participants in the system, including acquirers and merchants. MasterCard or its customer financial institutions establish default interchange fees in certain circumstances that apply when there is no other interchange fee arrangement between the issuer and the acquirer. MasterCard establishes a variety of interchange rates depending on such considerations as the location and the type of transaction, and collects the interchange fee on behalf of the institutions entitled to receive it and remits the interchange fee to eligible institutions. As described more fully below, MasterCard's interchange fees are subject to regulatory and/or legal review and/or challenges in a number of jurisdictions. At this time, it is not possible to determine the ultimate resolution of, or estimate the liability related to, any of the interchange proceedings described below. Except as described below, no provision for losses has been provided in connection with them.



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

*United States.* On June 22, 2005, a purported class action lawsuit was filed by a group of merchants in the U.S. District Court of Connecticut against MasterCard International Incorporated, Visa U.S.A., Inc., Visa International Service Association and a number of member banks alleging, among other things, that MasterCard's and Visa's purported setting of interchange fees violates Section 1 of the Sherman Act, which prohibits contracts, combinations and conspiracies that unreasonably restrain trade. In addition, the complaint alleges MasterCard's and Visa's purported tying and bundling of transaction fees also constitutes a violation of Section 1 of the Sherman Act. The suit seeks treble damages in an unspecified amount, attorneys' fees and injunctive relief. Since the filing of this complaint, there have been approximately fifty similar complaints (the majority of which are styled as class actions, although a few complaints are on behalf of individual plaintiffs) filed on behalf of merchants against MasterCard and Visa (and in some cases, certain member banks) in federal courts in California, New York, Wisconsin, Pennsylvania, New Jersey, Ohio, Kentucky and Connecticut. On October 19, 2005, the Judicial Panel on Multidistrict Litigation issued an order transferring these cases to Judge Gleeson of the U.S. District Court for the Eastern District of New York for coordination of pre-trial proceedings in MDL No. 1720. On April 24, 2006, the group of purported class plaintiffs filed a First Amended Class Action Complaint. Taken together, the claims in the First Amended Class Action Complaint and in the complaints brought on the behalf of the individual merchants are generally brought under both Section 1 of the Sherman Act and Section 2 of the Sherman Act, which prohibits monopolization and attempts or conspiracies to monopolize a particular industry. Specifically, the complaints contain some or all of the following claims: (i) that MasterCard's and Visa's setting of interchange fees (for both credit and offline debit transactions) violates Section 1 of the Sherman Act; (ii) that MasterCard and Visa have enacted and enforced various rules, including the no surcharge rule and purported anti-steering rules, in violation of Section 1 or 2 of the Sherman Act; (iii) that MasterCard's and Visa's purported bundling of the acceptance of premium credit cards to standard credit cards constitutes an unlawful tying arrangement; and (iv) that MasterCard and Visa have unlawfully tied and bundled transaction fees. In addition to the claims brought under federal antitrust law, some of these complaints contain certain unfair competition law claims under state law based upon the same conduct described above. These interchange-related litigations seek treble damages, as well as attorneys' fees and injunctive relief. On June 9, 2006, MasterCard answered the complaint and moved to dismiss or, alternatively, moved to strike the pre-2004 damage claims that were contained in the First Amended Class Action Complaint and moved to dismiss the Section 2 claims that were brought in the individual merchant complaints. On January 8, 2008, the district court dismissed the plaintiffs' pre-2004 damage claims. On May 14, 2008, the court denied MasterCard's motion to dismiss the Section 2 monopolization claims. Fact discovery has been proceeding and was generally completed by November 21, 2008. Briefs have been submitted on plaintiffs' motion for class certification. The court heard oral argument on the plaintiffs' class certification motion on November 19, 2009. The parties are awaiting a decision on the motion.

On January 29, 2009, the class plaintiffs filed a Second Consolidated Class Action Complaint. The allegations and claims in this complaint generally mirror those in the first amended class action complaint described above although plaintiffs have added additional claims brought under Sections 1 and 2 of the Sherman Act against MasterCard, Visa and a number of banks alleging, among other things, that the networks and banks have continued to fix interchange fees following each network's initial public offering. On March 31, 2009, MasterCard and the other defendants in the action filed a motion to dismiss the Second Consolidated Class Action Complaint in its entirety, or alternatively, to narrow the claims in the complaint. The parties have fully briefed the motion and the court heard oral argument on the motion on November 18, 2009. The parties are awaiting decisions on the motions.

On July 5, 2006, the group of purported class plaintiffs filed a supplemental complaint alleging that MasterCard's initial public offering of its Class A Common Stock in May 2006 (the "IPO") and certain purported agreements entered into between MasterCard and its member financial institutions in connection with the IPO: (1) violate Section 7 of the Clayton Act because their effect allegedly may be to substantially lessen competition, (2) violate Section 1 of the Sherman Act because they allegedly constitute an unlawful combination in restraint of trade and (3) constitute a fraudulent conveyance because the member banks are allegedly attempting to release without adequate consideration from the member banks MasterCard's right to assess the member banks for MasterCard's litigation liabilities in these interchange-related litigations and in other antitrust litigations pending against it. The plaintiffs seek unspecified damages and an order reversing and unwinding the IPO. On September 15, 2006, MasterCard moved to dismiss all of the claims contained in the supplemental complaint. On November 25, 2008, the district court granted MasterCard's motion to dismiss the plaintiffs' supplemental complaint in its entirety with leave to file an amended complaint. On January 29, 2009, the class plaintiffs replied their complaint directed at MasterCard's IPO by filing a First Amended Supplemental Class Action Complaint. The causes of action in the





---

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

complaint generally mirror those in the plaintiffs' original IPO-related complaint although the plaintiffs have attempted to expand their factual allegations based upon discovery that has been garnered in the case. The class plaintiffs seek treble damages and injunctive relief including, but not limited to, an order reversing and unwinding the IPO. On March 31, 2009, MasterCard filed a motion to dismiss the First Amended Supplemental Class Action Complaint in its entirety. The parties have fully briefed the motion to dismiss and the court heard oral argument on the motion on November 18, 2009. The parties are awaiting a decision on the motion. On July 2, 2009, the class plaintiffs and individual plaintiffs served confidential expert reports detailing the plaintiffs' theories of liability and alleging damages in the tens of billions of dollars. The defendants served their expert reports on December 14, 2009 countering the plaintiffs' assertions of liability and damages. Briefing on dispositive motions, including summary judgment motions, is currently scheduled to be completed on February 4, 2011. No trial date has been scheduled. The parties have also entered into court-recommended mediation.

On October 10, 2008, the Antitrust Division of the DOJ issued a civil investigative demand to MasterCard and other payment industry participants seeking information regarding certain rules relating to merchant point of acceptance rules, particularly with respect to merchants' ability to steer customers to payment forms preferred by merchants. Subsequently, MasterCard received requests for similar information from certain State Attorneys General, including the Attorneys General of Ohio and Texas. In addition, on December 23, 2009, MasterCard received a request from the Texas Attorney General's office for MasterCard's responses to questions concerning both its merchant point of acceptance rules as well as its practices surrounding the setting of default interchange rates. MasterCard is cooperating with the DOJ and the offices of the State Attorneys General in connection with their requests for information.

*European Union.* In September 2000, the European Commission issued a Statement of Objections challenging Visa International's cross-border default interchange fees under European Community competition rules. On July 24, 2002, the European Commission announced its decision to exempt the Visa interchange fees from these rules through the end of 2007 based on certain changes proposed by Visa to its interchange fees. Among other things, in connection with the exemption order, Visa agreed to adopt a cost-based methodology for calculating its interchange fees similar to the methodology employed by MasterCard, which considers the costs of certain specified services provided by issuers, and to reduce its interchange rates for debit and credit transactions to amounts at or below certain specified levels.

On September 25, 2003, the European Commission issued a Statement of Objections challenging MasterCard Europe's cross-border default interchange fees. On June 23, 2006, the European Commission issued a supplemental Statement of Objections covering credit, debit and commercial card fees. On November 14 and 15, 2006, the European Commission held hearings on MasterCard Europe's cross-border default interchange fees. On March 23, 2007, the European Commission issued a Letter of Facts, also covering credit, debit and commercial card fees and discussing its views on the impact of the IPO on the case. MasterCard Europe responded to the Statements of Objections and Letter of Facts and made presentations on a variety of issues at the hearings.

The European Commission announced its decision on December 19, 2007. The decision applies to MasterCard's default cross-border interchange fees for MasterCard and Maestro branded consumer payment card transactions in the European Economic Area (EEA) (the European Commission refers to these as MasterCard's MIF), but not to commercial card transactions (the European Commission stated publicly that it has not yet finished its investigation of commercial card interchange fees). The decision applies to MasterCard's MIF for cross-border consumer card payments and to any domestic consumer card transactions that default to MasterCard's MIF, of which currently there are none. The decision required MasterCard to stop applying the MasterCard MIF, to refrain from repeating the conduct, and not apply its then recently adopted (but never implemented) Maestro SEPA and Intra-Eurozone default interchange fees to debit card payment transactions within the Eurozone. MasterCard understood that the decision gave MasterCard until June 21, 2008 to comply, with the possibility that the European Commission could have extended this time at its discretion. The decision also required MasterCard to issue certain specific notices to financial institutions and other entities that participate in its MasterCard and Maestro payment systems in the EEA and make certain specific public announcements regarding the steps it has taken to comply. The decision did not impose a fine on MasterCard, but provides for a daily penalty of up to 3.5% of MasterCard's daily consolidated global turnover in the preceding business year (which MasterCard estimates to be approximately \$0.5 U.S. per day) in the event that MasterCard fails to comply. On March 1, 2008, MasterCard filed an application for annulment of the European Commission's decision with the General Court of the European Union.



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

On March 26, 2008, the European Commission announced that it has opened formal antitrust proceedings against, and on April 6, 2009, the European Commission announced that it had issued a Statement of Objections to, Visa Europe Limited, under Article 81 of the EC Treaty. The proceedings are in relation to Visa's multilateral interchange fees for cross-border and certain domestic consumer payment card transactions within the EEA and Visa's honor all cards' rule as it applies to these transactions.

The December 19, 2007 decision against MasterCard permits MasterCard to establish other default cross-border interchange fees for MasterCard and Maestro branded consumer payment card transactions in the EEA if MasterCard can demonstrate by empirical proof to the European Commission's satisfaction that the new interchange fees create efficiencies that outweigh the restriction of competition alleged by the European Commission, that consumers get a fair share of the benefits of the new interchange fees, that there are no less restrictive means of achieving the efficiencies of MasterCard's payment systems, and that competition is not eliminated altogether. In March 2008, MasterCard entered into discussions with the European Commission about, among other things, the nature of the empirical proof it would require for MasterCard to establish other default cross-border interchange fees consistent with the decision and so as to understand more fully the European Commission's position as to how it may comply with the decision. MasterCard requested an extension of time to comply with the decision and, on April 26, 2008, the European Commission informed MasterCard that it had rejected such request. On June 12, 2008, MasterCard announced that, effective June 21, 2008, MasterCard would temporarily repeal its then current default intra-EEA cross-border consumer card interchange fees in conformity with the decision. On October 17, 2008, MasterCard received an information request from the European Commission in connection with the decision concerning certain pricing changes that MasterCard implemented as of October 1, 2008. MasterCard submitted its response on November 13, 2008.

On March 30, 2009, MasterCard gave certain undertakings to the European Commission and, in response, on April 1, 2009, the Commissioner for competition policy and DG Competition informed MasterCard that, subject to MasterCard's fulfilling its undertakings, they do not intend to pursue proceedings for non-compliance with or circumvention of the decision of December 19, 2007 or for infringing the antitrust laws in relation to the October 1, 2008 pricing changes, the introduction of new cross-border consumer default interchange fees or any of the other MasterCard undertakings. MasterCard's undertakings include: (1) repealing the October 1, 2008 pricing changes; (2) adopting a specific methodology for the setting of cross-border consumer default interchange fees; (3) establishing new default cross-border consumer interchange fees as of July 1, 2009 such that the weighted average interchange fee for credit card transactions does not exceed 30 basis points and for debit card transactions does not exceed 20 basis points; (4) introducing a new rule prohibiting its acquirers from requiring merchants to process all of their MasterCard and Maestro transactions with the acquirer; and (5) introducing a new rule requiring its acquirers to provide merchants with certain pricing information in connection with MasterCard and Maestro transactions. The undertakings will be effective until a final decision by the General Court of the European Union regarding MasterCard's application for annulment of the European Commission's December 19, 2007 decision.

Although MasterCard believes that any other business practices it would implement in response to the decision would be in compliance with the December 19, 2007 decision, the European Commission may deem any such practice not in compliance with the decision, or in violation of European competition law, in which case MasterCard may be assessed fines for the period that it is not in compliance. Furthermore, because a balancing mechanism like default cross-border interchange fees constitutes an essential element of MasterCard Europe's operations, the December 19, 2007 decision could also significantly impact MasterCard International's European customers' and MasterCard Europe's business. The European Commission decision could also lead to additional competition authorities in European Union member states commencing investigations or proceedings regarding domestic interchange fees or, in certain jurisdictions, regulation. In addition, the European Commission's decision could lead to the filing of private actions against MasterCard Europe by merchants and/or consumers which, if MasterCard is unsuccessful in its application for annulment of the decision, could result in MasterCard owing substantial damages.

*United Kingdom Office of Fair Trading.* On September 25, 2001, the Office of Fair Trading of the United Kingdom (OFT) issued a Rule 14 Notice under the U.K. Competition Act 1998 challenging the MasterCard default interchange fees and multilateral service fee (MSF), the fee paid by issuers to acquirers when a customer uses a MasterCard-branded card in the United Kingdom either at an ATM or over the counter to obtain a cash advance. Until November 2004, the interchange fees and MSF were established by MasterCard U.K. Members



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

Forum Limited ( MMF ) (formerly MasterCard Europay U.K. Ltd.) for domestic credit card transactions in the United Kingdom. The notice contained preliminary conclusions to the effect that the MasterCard U.K. default interchange fees and MSF infringed U.K. competition law and did not qualify for an exemption in their present forms. On February 11, 2003, the OFT issued a supplemental Rule 14 Notice, which also contained preliminary conclusions challenging MasterCard s U.K. interchange fees (but not the MSF) under the Competition Act. On November 10, 2004, the OFT issued a third notice (now called a Statement of Objections) claiming that the interchange fees infringed U.K. and European Union competition law.

On November 18, 2004, MasterCard s board of directors adopted a resolution withdrawing the authority of the U.K. members to set domestic MasterCard interchange fees and MSFs and conferring such authority on MasterCard s President and Chief Executive Officer.

On September 6, 2005, the OFT issued its decision, concluding that MasterCard s U.K. interchange fees that were established by MMF prior to November 18, 2004 contravene U.K. and European Union competition law. The OFT decided not to impose penalties on MasterCard or MMF. MMF and MasterCard appealed the OFT s decision to the U.K. Competition Appeals Tribunal. On June 19, 2006, the U.K. Competition Appeals Tribunal set aside the OFT s decision, following the OFT s request to the Tribunal to withdraw the decision and end its case against MasterCard s U.K. default interchange fees in place prior to November 18, 2004.

Shortly thereafter, the OFT commenced a new investigation of MasterCard s current U.K. default credit card interchange fees and announced on February 9, 2007 that the investigation would also cover so-called immediate debit cards. To date, the OFT has issued a number of requests for information to MasterCard Europe and financial institutions that participate in MasterCard s payment system in the United Kingdom. MasterCard understands that the OFT is considering whether to commence a formal proceeding through the issuance of a Statement of Objections. The OFT has informed MasterCard that it does not intend to issue such a Statement of Objections prior to the judgment of the General Court of the European Union with respect to MasterCard s appeal of the December 2007 decision of the European Commission. If the OFT ultimately determines that any of MasterCard s U.K. interchange fees contravene U.K. and European Union competition law, it may issue a new decision and possibly levy fines accruing from the date of its first decision. MasterCard would likely appeal a negative decision by the OFT in any future proceeding to the Competition Appeals Tribunal. Such an OFT decision could lead to the filing of private actions against MasterCard by merchants and/or consumers which, if its appeal of such an OFT decision were to fail, could result in an award or awards of substantial damages and could have a significant adverse impact on the revenues of MasterCard International s U.K. customers and MasterCard s overall business in the U.K.

*Poland.* In April 2001, in response to merchant complaints, the Polish Office for Protection of Competition and Consumers (the PCA ) initiated an investigation of MasterCard s (and Visa s) domestic credit and debit card default interchange fees. MasterCard Europe filed several submissions and met with the PCA in connection with the investigation. In January 2007, the PCA issued a decision that MasterCard s (and Visa s) interchange fees are unlawful under Polish competition law, and imposed fines on MasterCard s (and Visa s) licensed financial institutions. As part of this decision, the PCA also decided that MasterCard (and Visa) had not violated the law. MasterCard and the financial institutions appealed the decision to the court of first instance. On November 12, 2008, the court of first instance reversed the decision of the PCA and also rejected MasterCard s appeal on the basis that MasterCard did not have a legal interest in the PCA s decision because its conduct was not found to be in breach of the relevant competition laws. MasterCard has appealed this part of the court of first instance s decision because it has significant interest in the outcome of the case. The PCA appealed the other parts of the decision. On April 22, 2010 the court of appeals issued an oral decision (to be followed by a written decision) in which it reinstated MasterCard s appeal, reversed a specific finding of the court of first instance and sent the case back to the court of first instance for further proceedings. If on appeal the PCA s decision is ultimately allowed to stand, it could have a significant adverse impact on the revenues of MasterCard s Polish customers and on MasterCard s overall business in Poland.

*Hungary.* In January 2008, the Hungarian Competition Authority ( HCA ) notified MasterCard that it had commenced a formal investigation of MasterCard Europe s (and Visa Europe s) domestic interchange fees. This followed an informal investigation that the HCA had been conducting since the middle of 2007. On July 12, 2009, the HCA issued to MasterCard a Preliminary Position that MasterCard Europe s historic domestic interchange fees violate Hungarian competition law. MasterCard responded to the Preliminary Position both in writing and at a



**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

hearing which was held on September 8 and 9, 2009. On September 24, 2009, the HCA ruled that MasterCard's (and Visa's) historic interchange fees violated the law and fined MasterCard Europe and Visa Europe each approximately \$3, which was paid during the fourth quarter of 2009. The HCA issued its formal decision on December 2, 2009 and on December 18, 2009, MasterCard appealed the decision to the Hungarian courts. If the HCA's decision is not reversed on appeal, it could have a significant adverse impact on the revenues of MasterCard's Hungarian customers and on MasterCard's overall business in Hungary.

*Italy.* On July 15, 2009, the Italian Competition Authority (ICA) commenced a proceeding against MasterCard and a number of its customers concerning MasterCard Europe's domestic interchange fees in Italy. MasterCard, as well as each of the banks involved in the proceeding, offered to give certain undertakings to the ICA, which were rejected (and which MasterCard has now sought to appeal). If the Italian Competition Authority issues a Statement of Objections to MasterCard in connection with the matter, MasterCard would have the opportunity to respond both in writing and at a hearing and, if a negative decision were reached, to appeal the decision. A negative decision could result in MasterCard and/or its customers being fined and, if not reversed on appeal, could have a significant adverse impact on the revenues of MasterCard's Italian customers and on MasterCard's overall business in Italy.

*Australia.* In 2002, the Reserve Bank of Australia (RBA) announced regulations under the Payments Systems (Regulation) Act of 1998 applicable to four-party credit card payment systems in Australia, including MasterCard's. Those regulations, among other things, mandate the use of a formula for determining domestic interchange fees that effectively caps their weighted average at 50 basis points. Operators of three-party systems, such as American Express and Diners Club, were unaffected by the interchange fee regulation. In 2007, the RBA commenced a review of such regulations and, on September 26, 2008, the RBA released its final conclusions. These indicated that the RBA was willing to withdraw its regulations if MasterCard and Visa made certain undertakings regarding the future levels of their respective credit card interchange fees and other practices, including their honor all cards rules. If the undertakings were not made, the RBA said it would consider imposing in 2009 additional regulations that could further reduce the domestic interchange fees of MasterCard and Visa in Australia. On August 26, 2009, the RBA announced that it had decided not to withdraw its regulations and that it would maintain them in their current form pending further consideration of the regulations. MasterCard plans to continue discussions with the RBA as to the nature of the undertakings that MasterCard may be willing to provide. The effect of the undertakings or any such additional regulations could put MasterCard at an even greater competitive disadvantage relative to competitors in Australia that purportedly do not operate four-party systems or, in the case of the undertakings, possibly increase MasterCard's legal exposure under Australian competition laws, which could have a significant adverse impact on MasterCard's business in Australia.

*South Africa.* On August 4, 2006, the South Africa Competition Commission created a special body, the Jali Enquiry (the Enquiry), to examine competition in the payments industry in South Africa, including interchange fees. After nearly two years of investigation, including several rounds of public hearings in which MasterCard participated, on June 25, 2008, the Enquiry published an Executive Summary of its findings. The Enquiry's full report was made public on December 12, 2008. The Enquiry recommends, among other things, that an independent authority be established to set payment card interchange fees in South Africa and that payment systems (including MasterCard's) respective honor all cards rules be modified to give merchants greater freedom to choose which types of cards to accept. The Enquiry's report is non-binding but is under active consideration by South African regulators. If adopted, the Enquiry's recommendations could have a significant adverse impact on MasterCard's business in South Africa.

On October 21, 2008, the South African National Assembly (the National Assembly) adopted amendments to that country's competition laws concerning so-called complex monopolies and criminalizing certain violations of those laws (the South Africa Bill). On January 29, 2009, the then President of South Africa referred the South Africa Bill back to the National Assembly for further consideration and, in early February 2009, the National Assembly readopted the South Africa Bill. The President also stated that he might submit the South Africa Bill to that country's Constitutional Court for review. In April 2009, South Africa elected a new President, who signed the South Africa Bill on August 27, 2009 without either referring it to the Constitutional Court or setting a date on which the South Africa Bill will enter into force. If and when the South Africa Bill becomes effective, it could have a significant adverse impact on MasterCard's business in South Africa.





**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****(In millions, except per share and percent data, unless otherwise stated)**

*Other Jurisdictions.* In January 2006, a German retailers association filed a complaint with the Federal Cartel Office (FCO) in Germany concerning MasterCard's (and Visa's) domestic default interchange fees. The complaint alleges that MasterCard's (and Visa's) German domestic interchange fees are not transparent to merchants and include so-called extraneous costs. On December 21, 2009, the FCO sent MasterCard a questionnaire concerning its domestic interchange fees.

In July 2009, the Canadian Competition Bureau informed MasterCard that it intends to review MasterCard's (and Visa's) interchange fees and related rules, such as the honor all cards and no surcharge rules.

MasterCard is aware that regulatory authorities and/or central banks in certain other jurisdictions including Belgium, Brazil, Colombia, Czech Republic, Estonia, France, Israel, the Netherlands, Norway, Switzerland, Turkey and Venezuela are reviewing MasterCard's and/or its members interchange fees and/or related practices (such as the honor all cards rule) and may seek to regulate the establishment of such fees and/or such practices.

**Note 18. Settlement and Travelers Cheque Risk Management**

MasterCard International's rules generally guarantee the payment of certain MasterCard, Cirrus and Maestro branded transactions between its principal members. The term and amount of the guarantee are unlimited. Settlement risk is the exposure to members under MasterCard International's rules (Settlement Exposure), due to the difference in timing between the payment transaction date and subsequent settlement. Settlement Exposure is estimated using the average daily card volumes during the quarter multiplied by the estimated number of days to settle. The Company has global risk management policies and procedures, which include risk standards, to provide a framework for managing the Company's settlement risk. Member-reported transaction data and the transaction clearing data underlying the settlement risk calculation may be revised in subsequent reporting periods.

In the event that MasterCard International effects a payment on behalf of a failed member, MasterCard International may seek an assignment of the underlying receivables. Subject to approval by the Board of Directors, members may be charged for the amount of any settlement loss incurred during the ordinary activities of the Company.

MasterCard requires certain members that are not in compliance with the Company's risk standards in effect at the time of review to post collateral, typically in the form of cash, letters of credit, or bank guarantees. This requirement is based on management review of the individual risk circumstances for each member that is out of compliance. In addition to these amounts, MasterCard holds collateral to cover variability and future growth in member programs. The Company also holds collateral to pay merchants in the event of merchant bank/acquirer failure. Although it is not contractually obligated under MasterCard International's rules to effect such payments to merchants, the Company may elect to do so to protect brand integrity. MasterCard monitors its credit risk portfolio on a regular basis and the adequacy of collateral on hand. Additionally, from time to time, the Company reviews its risk management methodology and standards. As such, the amounts of estimated settlement risk are revised as necessary.

Estimated Settlement Exposure, and the portion of the Company's uncollateralized Settlement Exposure for MasterCard-branded transactions that relates to members that are deemed not to be in compliance with, or that are under review in connection with, the Company's risk management standards, were as follows:

	March 31, 2010	December 31, 2009
<b>MasterCard-branded transactions:</b>		
Gross Settlement Exposure	\$ 25,669	\$ 26,373
Collateral held for Settlement Exposure	(3,444)	(2,759)

Edgar Filing: MASTERCARD INC - Form 10-Q

Net uncollateralized Settlement Exposure	\$ 22,225	\$ 23,614
<b>Uncollateralized Settlement Exposure attributable to non-compliant members</b>	<b>\$ 195</b>	<b>\$ 211</b>
<b>Cirrus and Maestro transactions:</b>		
Gross Settlement Exposure	\$ 2,851	\$ 3,433

**Table of Contents**

**MASTERCARD INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**(In millions, except per share and percent data, unless otherwise stated)**

Although MasterCard holds collateral at the member level, the Cirrus and Maestro estimated settlement exposures are calculated at the regional level. Therefore, these settlement exposures are reported on a gross basis, rather than net of collateral.

Of the total uncollateralized Settlement Exposure under the MasterCard brand, the United States accounted for approximately 42% and 40% at March 31, 2010 and December 31, 2009, respectively. No individual country other than the United States accounted for more than 10% of total uncollateralized Settlement Exposure at either March 31, 2010 or December 31, 2009. Of the total uncollateralized Settlement Exposure attributable to non-compliant members, five members represented approximately 64% and 56% at March 31, 2010 and December 31, 2009, respectively.

MasterCard guarantees the payment of MasterCard-branded travelers cheques in the event of issuer default. The guarantee estimate is based on all outstanding MasterCard-branded travelers cheques, reduced by an actuarial determination of cheques that are not anticipated to be presented for payment. The term and amount of the guarantee are unlimited. MasterCard calculated its MasterCard-branded travelers cheques exposure under this guarantee as \$378 and \$401 at March 31, 2010 and December 31, 2009, respectively. The reduction in travelers cheques exposure is attributable to MasterCard-branded travelers cheques no longer being issued.

A significant portion of the Company's travelers cheques risk is concentrated in one MasterCard travelers cheques issuer. MasterCard obtained an unlimited guarantee estimated at \$294 and \$313 at March 31, 2010 and December 31, 2009, respectively, from a financial institution that is a member, to cover all of the exposure of outstanding travelers cheques with respect to such issuer. In addition, MasterCard obtained a limited guarantee estimated at \$14 as of March 31, 2010 and December 31, 2009 from a financial institution that is a member in order to cover the exposure of outstanding travelers cheques with respect to another issuer. These guarantee amounts have also been reduced by an actuarial determination of travelers cheques that are not anticipated to be presented for payment.

Beginning in 2008 and continuing in 2009, many of the Company's financial institution customers were directly and adversely impacted by the unprecedented events that occurred in the financial markets around the world. The ongoing economic turmoil presents increased risk that the Company may have to perform under its settlement and travelers cheque guarantees. General economic conditions and political conditions in countries in which MasterCard operates may also affect the Company's settlement risk. The Company's global risk management policies and procedures, which are revised and enhanced from time to time, continue to be effective as evidenced by the historically low level of losses that the Company has experienced from customer financial institution failures, including no losses in the last several years.

The Company enters into business agreements in the ordinary course of business under which the Company agrees to indemnify third parties against damages, losses and expenses incurred in connection with legal and other proceedings arising from relationships or transactions with the Company. As the extent of the Company's obligations under these agreements depends entirely upon the occurrence of future events, the Company's potential future liability under these agreements is not determinable.

**Note 19. Foreign Exchange Risk Management**

The Company enters into foreign currency forward contracts to manage risk associated with anticipated receipts and disbursements which are either transacted in a non-functional currency or valued based on a currency other than its functional currencies. The Company also enters into foreign currency forward contracts to offset possible changes in value due to foreign exchange fluctuations of assets and liabilities denominated in foreign currencies. The objective of this activity is to reduce the Company's exposure to transaction gains and losses resulting from fluctuations of foreign currencies against its functional currencies.

The Company does not designate foreign currency forward contracts as hedging instruments pursuant to the accounting standards for derivative instruments and hedging activities. The Company records the change in the estimated fair value of the outstanding forward contracts at the end of the reporting period to its consolidated balance sheet and consolidated statement of operations.



Table of Contents

## MASTERCARD INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

(In millions, except per share and percent data, unless otherwise stated)

As of March 31, 2010, all contracts to purchase and sell foreign currency had been entered into with customers of MasterCard International. MasterCard's outstanding forward contracts are classified by functional currency as summarized below:

## U.S. Dollar Functional Currency

	March 31, 2010		December 31, 2009	
	Notional	Estimated Fair Value <sup>1</sup>	Notional	Estimated Fair Value <sup>1</sup>
Commitments to purchase foreign currency	\$ 36	\$	\$ 38	\$
Commitments to sell foreign currency	230	(2) <sup>1</sup>	50	(1) <sup>1</sup>
<i>Balance Sheet Location:</i>				
Accounts Receivable		\$ 2		\$ 1
Other Current Liabilities		(4)		(2)

## Euro Functional Currency

	March 31, 2010		December 31, 2009	
	Notional	Estimated Fair Value <sup>1</sup>	Notional	Estimated Fair Value <sup>1</sup>
Commitments to purchase foreign currency	\$ 6	\$	\$ 16	\$
Commitments to sell foreign currency	92	(3) <sup>1</sup>	45	
<i>Balance Sheet Location:</i>				
Accounts Receivable		\$		\$
Other Current Liabilities		(3)		

	Amount and Location of Gain (Loss) Recognized in Income Three Months Ended March 31, 2010		2009
<b>Derivatives Not Designated As Hedging Instruments</b>			
Foreign Currency Forward Contracts			
General and administrative		\$ (5)	\$ (8)
Revenues		(1)	4
Total		\$ (6)	\$ (4)

<sup>1</sup> Amounts represent gross fair value amounts while these amounts may be netted for actual balance sheet presentation. The currencies underlying the foreign currency forward contracts consist primarily of the Australian dollar, Canadian dollar, Chinese renminbi, euro, Mexican peso, Turkish lira and U.K. pound sterling. The fair value of the foreign currency forward contracts generally reflects the estimated amounts that the Company would receive or (pay), on a pre-tax basis, to terminate the contracts at the reporting date based on broker quotes for the same or similar instruments. The terms of the foreign currency forward contracts are generally less than 18 months. The Company

## Edgar Filing: MASTERCARD INC - Form 10-Q

had no deferred gains or losses in accumulated other comprehensive income as of March 31, 2010 and December 31, 2009 as there were no derivative contracts accounted for under hedge accounting.

The Company's derivative financial instruments are subject to both credit and market risk. Credit risk is the risk of loss due to failure of the counterparty to perform its obligations in accordance with contractual terms. Market risk is the potential change in an instrument's value caused by fluctuations in interest rates and other variables related to currency exchange rates. Credit and market risk related to derivative instruments were not material at March 31, 2010 and December 31, 2009.

Generally, the Company does not obtain collateral related to forward contracts because of the high credit ratings of the counterparties. The amount of loss the Company would incur if the counterparties failed to perform according to the terms of the contracts is not considered material.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the consolidated financial statements and notes of MasterCard Incorporated and its consolidated subsidiaries, including MasterCard International Incorporated ( MasterCard International ) and MasterCard Europe sprl ( MasterCard Europe ) (together, MasterCard or the Company ) included elsewhere in this Report. Percentage changes provided throughout Management's Discussion and Analysis of Financial Condition and Results of Operations were calculated on amounts rounded to the nearest thousand.*

**Forward-Looking Statements**

This Report on Form 10-Q contains forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. When used in this Report, the words believe, expect, could, may, would, will and similar words are intended to identify forward-looking statements. These forward-looking statements relate to the Company's future prospects, developments and business strategies and include, without limitation, the Company's belief in the continuing trend from paper-based forms of payment toward electronic forms of payment and its ability to drive growth by: further penetrating its existing customer base and by expanding its role in targeted geographies and higher-growth segments of the global payments industry, pursuing incremental payment processing opportunities throughout the world, enhancing its relationships with merchants, continuing to develop e-commerce capabilities, building and commercializing payment innovations, expanding points of acceptance for its brands, seeking to maintain unsurpassed acceptance and continuing to invest in its brands, increasing its volume of business with customers over time and increasing global MasterCard brand awareness preference and usage through integrated advertising, sponsorships and related activity on a global scale. Many factors and uncertainties relating to our operations and business environment, all of which are difficult to predict and many of which are outside of our control, influence whether any forward-looking statements can or will be achieved. Any one of those factors could cause our actual results to differ materially from those expressed or implied in writing in any forward-looking statements made by MasterCard or on its behalf. We believe there are certain risk factors that are important to our business, and these could cause actual results to differ from our expectations. Reference should be made to Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009 for a complete discussion of these risk factors.

In this Report, references to the Company, MasterCard, we, us or our refer to the MasterCard brand generally, and to the business conducted by MasterCard Incorporated and its consolidated subsidiaries, including our principal operating subsidiary, MasterCard International Incorporated (d/b/a MasterCard Worldwide).

**Overview**

MasterCard is a leading global payment solutions company that provides a variety of services in support of the credit, debit and related payment programs of approximately 23,000 financial institutions and other entities that are our customers. We develop and market payment solutions, process payment transactions, and provide support services to our customers and, depending upon the service, to merchants and other clients. We manage a family of well-known, widely accepted payment card brands, including MasterCard®, MasterCard Electronic®, Maestro® and Cirrus®, which we license to our customers. As part of managing these brands, we also establish and enforce rules and standards surrounding the use of our payment card network. We generate revenues from the fees that we charge our customers for providing transaction processing and other payment-related services and by assessing our customers based primarily on the dollar volume of activity on the cards that carry our brands. Cardholder and merchant relationships are managed principally by our customers. Accordingly, we do not issue cards, extend credit to cardholders, determine the interest rates (if applicable) or other fees charged to cardholders by issuers, or establish the merchant discount charged by acquirers in connection with the acceptance of cards that carry our brands.

Our net income was \$455 million, or \$3.46 per diluted share, for the three months ended March 31, 2010 versus net income of \$367 million, or \$2.80 per diluted share, for the three months ended March 31, 2009. As of March 31, 2010, our liquidity and capital positions remained strong, with \$3.0 billion in cash and cash equivalents and current available-for-sale securities and \$3.8 billion in equity. In addition, during the three months ended March 31, 2010, we generated cash flows from operations of \$95 million.

---

## **Table of Contents**

Our net revenues increased 13.1% in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to increased dollar volume of activity and transactions on cards carrying our brands, higher pricing and favorable foreign currency exchange impacts. The U.S. dollar weakened versus the euro and Brazilian real, which increased net revenues by 2.9 percentage points for the three months ended March 31, 2010, compared to the three months ended March 31, 2009. During the three months ended March 31, 2010, net pricing actions contributed approximately 5 percentage points to our net revenue growth. These net pricing actions included price increases in April 2009 and October 2009, which were partially offset by an increase in cross-border rebates and the repeal of pricing relating to our interim arrangement with the European Commission.

Overall, revenue growth was moderated by an increase in rebates and incentives relating to higher cross-border rebates to encourage certain behaviors of customers, new and renewed customer agreements and increased volumes. Rebates and incentives as a percentage of gross revenues were 25.2% and 22.6% in the three months ended March 31, 2010 and 2009, respectively.

Our revenues depend heavily upon the overall level of consumer, business and government spending. Changes in cardholder spending behavior, influenced by economic environments, may impact our ability to grow our revenues. Our revenues are primarily based on volumes and transactions. In the three months ended March 31, 2010, volume-based revenues (domestic assessments and cross-border volume fees) and transaction-based revenues (transaction processing fees) increased compared to the three months ended March 31, 2009. Our volumes are impacted by the number of transactions and the dollar amount of each transaction. During the three months ended March 31, 2010, our volumes increased 8.3% on a local currency converted basis and our processed transactions increased 4.6%. This compares to increased volumes of 0.2% on a local currency converted basis and increased processed transactions of 5.7% during the three months ended March 31, 2009. Our growth in processed transactions in 2010 is lower than in 2009 due to debit portfolio losses.

Our operating expenses increased 2.2% in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to unfavorable foreign currency exchange impacts of the euro and the Brazilian real against the dollar which contributed 1.7 percentage points to the increase. Additionally, operating expenses increased during the three months ended March 31, 2010, compared to the three months ended March 31, 2009 due to increased general and administrative expenses, exclusive of foreign currency exchange impacts.

Our ratios of operating income as a percentage of net revenues, or operating margins, were 53.5% in the three months ended March 31, 2010 versus 48.6% in the comparable period in 2009.

We believe the trend within the global payments industry from paper-based forms of payment, such as cash and checks, toward electronic forms of payment, such as payment card transactions, creates significant opportunities for the growth of our business over the longer term. See [-Business Environment](#) for a discussion of environmental considerations related to our long-term strategic objectives.

### **Business Environment**

We process transactions from more than 210 countries and territories and in more than 150 currencies. The United States is our largest geographic market based on revenues. Revenue generated in the United States was approximately 44.2% and 48.4% of total revenues in the three months ended March 31, 2010 and 2009, respectively. No individual country, other than the United States, generated more than 10% of total revenues in the three months ended March 31, 2010 or 2009, but differences in market maturity, economic health, price changes and foreign exchange fluctuations in certain countries have increased the proportion of revenues generated outside the United States over time. While the global nature of our business helps protect our operating results from adverse economic conditions in a single or a few countries, the significant concentration of our revenues generated in the United States makes our business particularly susceptible to adverse economic conditions in the United States.

The competitive and evolving nature of the global payments industry provides both challenges to and opportunities for the continued growth of our business. Unprecedented events which began during 2008 have impacted the financial markets around the world, including continued distress in the credit environment, continued equity market volatility and additional government intervention. In particular, the economies of the United States and the United Kingdom have been significantly impacted by this economic turmoil, and it is also impacting other economies around the world. Some existing customers have been placed in receivership or administration or have a



## **Table of Contents**

significant amount of their stock owned by their governments. Many financial institutions are facing increased regulatory and governmental influence, including potential further changes in laws and regulations. Many of our financial institution customers, merchants that accept our brands and cardholders who use our brands have been directly and adversely impacted.

MasterCard's financial results may be negatively impacted by actions taken by individual financial institutions or by governmental or regulatory bodies in response to the economic crisis. The severity of the economic environment may accelerate the timing of or increase the impact of risks to our financial performance that have historically been present. As a result, our revenue growth has been and may be negatively impacted, or the Company may be impacted in several ways, including but not limited to the following:

Declining economies, foreign currency fluctuations and the pace of economic recovery can change consumer spending behaviors; for example, a significant portion of our revenues is dependent on cross-border travel patterns, which may continue to change.

Constriction of consumer and business confidence, such as in recessionary environments and those markets experiencing relatively high unemployment, may continue to cause decreased spending by cardholders.

Our customers may restrict credit lines to cardholders or limit the issuance of new cards to mitigate increasing cardholder defaults.

Uncertainty and volatility in the performance of our customers' businesses may make estimates of our revenues, rebates, incentives and realization of prepaid assets less predictable.

Our customers may implement cost reduction initiatives that reduce or eliminate payment card marketing or increase requests for greater incentives or greater cost stability.

Our customers may decrease spending for optional or enhanced services.

Government intervention and/or investments in our customers may have potential negative effects on our business with those banking institutions or otherwise alter their strategic direction away from our products.

Tightening of credit availability could impact the ability of participating financial institutions to lend to us under the terms of our credit facility.

Our customers may default on their settlement obligations. See Note 18 (Settlement and Travelers Cheque Risk Management) to the consolidated financial statements included in Part I, Item 1 for further discussion of our settlement exposure.

Our business and prospects, as well as our revenue and profitability, could be materially and adversely affected by consolidation of our customers. See Consolidation or other changes affecting the banking industry could result in a loss of business for MasterCard and may result in lower prices and/or more favorable terms for our customers, which may materially and adversely affect our revenues and profitability in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009 for further discussion.

In addition, our business is subject to regulation in many countries. Regulatory bodies may seek to impose rules and price controls on certain aspects of our business and the payments industry. For example, see Note 17 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 and Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009

for further discussion.

MasterCard continues to monitor the extent and pace of economic recovery around the world to identify opportunities for the continued growth of our business and to evaluate the evolution of the global payments industry. In recent months, we have observed certain positive economic indicators, such as increased retail spending and stabilizing unemployment rates in the U.S. Notwithstanding some encouraging trends, the extent and pace of economic recovery in various regions remains uncertain and the overall business environment may present challenges for MasterCard to grow its business.

Our strategy is to continue to grow by further penetrating our existing customer base and by expanding our role in targeted geographies and higher-growth segments of the global payments industry (such as premium/affluent, quick-service/low value, commercial/small business, debit, prepaid and issuer and acquirer processor services), pursuing incremental processing opportunities throughout the world, enhancing our merchant relationships, continuing to develop e-commerce capabilities, building and commercializing payment innovations, expanding points of acceptance for our brands, seeking to maintain unsurpassed acceptance and continuing to invest in our brands. We are

**Table of Contents**

committed to providing our customers with coordinated services through integrated and dedicated account teams in a manner that allows us to capitalize on our expertise in payment programs, marketing, product development, technology, processing and consulting and information services for these customers. By investing in strong customer relationships over the long term, we believe that we can increase our volume of business with customers over time.

**Financial Results**

Our operating results for the three months ended March 31, 2010 and 2009, were as follows:

	For the Three Months Ended March 31,		Percent Increase
	2010	2009	(Decrease) 2010 vs. 2009
	<b>(In millions, except per share, percentages and GDV amounts)</b>		
Revenues, net	\$ 1,308	\$ 1,156	13.1%
General and administrative	458	448	2.1%
Advertising and marketing	115	116	(0.7)%
Depreciation and amortization	35	31	13.3%
Total operating expenses	608	595	2.2%
Operating income	700	561	24.6%
Total other income (expense)	(5)	(11)	(59.2)%
Income before income taxes	695	550	26.4%
Income tax expense	240	183	31.5%
Net income	455	367	23.8%
Income attributable to non-controlling interests			
Net Income Attributable to MasterCard	\$ 455	\$ 367	23.8%
Basic Earnings per Share	\$ 3.47	\$ 2.81	23.5%
Basic Weighted Average Shares Outstanding	130	130	0.6%
Diluted Earnings per Share	\$ 3.46	\$ 2.80	23.6%
Diluted Weighted Average Shares Outstanding	131	130	0.7%
Effective income tax rate	34.6%	33.2%	*
Gross dollar volume ( GDV ) on a U.S. dollar converted basis (in billions)	\$ 631	\$ 550	14.8%
Processed transactions	5,373	5,137	4.6%

\* Not meaningful.

**Table of Contents**

**Impact of Foreign Currency Rates**

Our overall operating results are impacted by changes in foreign currency exchange rates, especially the strengthening or weakening of the U.S. dollar versus the euro and Brazilian real. The functional currency of MasterCard Europe, our principal European operating subsidiary, is the euro, and the functional currency of our Brazilian subsidiary is the Brazilian real. Accordingly, the strengthening or weakening of the U.S. dollar versus the euro and Brazilian real impacts the translation of our European and Brazilian subsidiaries' operating results into the U.S. dollar. During the three months ended March 31, 2010, the U.S. dollar weakened against the euro and Brazilian real, as compared to the comparable period in 2009, resulting in increased revenues and expenses.

In addition, changes in foreign currency exchange rates directly impact the calculation of gross dollar volume ( GDV ) and gross euro volume ( GEV ), which are used in the calculation of our domestic assessments, cross-border volume fees and volume related rebates and incentives. In most non-European regions, GDV is calculated based on local currency spending volume converted to U.S. dollars using average exchange rates for the period. In Europe, GEV is calculated based on local currency spending volume converted to euros using average exchange rates for the period. As a result, our domestic assessments, cross-border volume fees and volume related rebates and incentives are impacted by the strengthening or weakening of the U.S. dollar versus most non-European local currencies and the strengthening or weakening of the euro versus European local currencies. The strengthening or weakening of the U.S. dollar is evident when GDV on a U.S. dollar-converted basis is compared to GDV on a local currency basis. In the three months ended March 31, 2010, GDV increased 14.8% when measured on a U.S. dollar converted basis and increased 8.3% when measured on a local currency basis, versus the comparable period in 2009.

**Revenues**

***Revenue Descriptions***

MasterCard's business model involves four participants in addition to us: cardholders, merchants, issuers (the cardholders' banks) and acquirers (the merchants' banks). Our gross revenues are typically based on the volume of activity on cards that carry our brands, the number of transactions we process for our customers or the nature of other payment-related services we provide to our customers. Our revenues are based upon transactional information accumulated by our systems or reported by our customers. Our primary revenue billing currencies are the U.S. dollar, euro and Brazilian real.

We process transactions denominated in more than 150 currencies through our global system, providing cardholders with the ability to utilize, and merchants to accept, MasterCard cards across multiple country borders. We process most of the cross-border transactions using MasterCard, Maestro and Cirrus-branded cards and process the majority of MasterCard-branded domestic transactions in the United States, United Kingdom, Canada, Brazil and Australia.

Our pricing is complex and is dependent on the nature of the volumes, types of transactions and other products and services we offer to our customers. A combination of the following factors determines the pricing:

Domestic or cross-border

Signature-based (credit and offline debit) or PIN-based (on-line debit, including automated teller machine ( ATM ) cash withdrawals and retail purchases)

Tiered pricing, with rates decreasing as customers meet incremental volume/transaction hurdles

Geographic region or country

Retail purchase or cash withdrawal

## Edgar Filing: MASTERCARD INC - Form 10-Q

Cross-border transactions generate greater revenue than domestic transactions for a transaction of the same amount, since cross-border fees are higher than domestic fees. We review our pricing and implement pricing changes on an on-going basis and expect pricing to continue to be a component of revenue growth in the future. In addition, standard pricing varies among our regional businesses, and such pricing can be customized further for our customers through incentive and rebate agreements.

---

**Table of Contents**

The Company classifies its net revenues into the following five categories:

1. **Domestic assessments:** Domestic assessments are fees charged to issuers and acquirers based primarily on the volume of activity on MasterCard and Maestro-branded cards where the merchant country and the cardholder country are the same. A portion of these assessments is estimated based on aggregate transaction information collected from our systems and projected customer performance and is calculated by converting the aggregate volume of usage (purchases, cash disbursements, balance transfers and convenience checks) from local currency to the billing currency and then multiplying by the specific price. In addition, domestic assessments include items such as card assessments, which are fees charged on the number of cards issued or assessments for specific purposes, such as acceptance development or market development programs. Acceptance development fees are charged primarily to U.S. issuers based on components of volume, and support our focus on developing merchant relationships and promoting acceptance at the point of sale.
  
2. **Cross-border volume fees:** Cross-border volume fees are charged to issuers and acquirers based on the volume of activity on MasterCard and Maestro-branded cards where the merchant country and the cardholder country are different. Cross-border volume fees are calculated by converting the aggregate volume of usage (purchases and cash disbursements) from local currency to the billing currency and then multiplying by the specific price. Cross-border volume fees also include fees, charged to issuers, for performing currency conversion services.
  
3. **Transaction processing fees:** Transaction processing fees are charged for both domestic and cross-border transactions and are primarily based on the number of transactions. These fees are calculated by multiplying the number and type of transactions by the specific price for each service. Transaction processing fees include charges for the following:

*Transaction Switching Authorization, Clearing and Settlement.*

- a. *Authorization* refers to a process in which a transaction is approved by the issuer or, in certain circumstances such as when the issuer's systems are unavailable or cannot be contacted, by MasterCard or others on behalf of the issuer in accordance with either the issuer's instructions or applicable rules. MasterCard's rules, which vary across regions, establish the circumstances under which merchants and acquirers must seek authorization of transactions. Fees for authorization are primarily paid by issuers.
  
- b. *Clearing* refers to the exchange of financial transaction information between issuers and acquirers after a transaction has been completed. Fees for clearing are primarily paid by issuers.
  
- c. *Settlement* refers to facilitating the exchange of funds between parties. Fees for settlement are primarily paid by issuers.

*Connectivity fees* are charged to issuers and acquirers for network access, equipment and the transmission of authorization and settlement messages. These fees are based on the size of the data being transmitted through and the number of connections to the Company's network.

4. **Other revenues:** Other revenues for other payment-related services are primarily dependent on the nature of the products or services provided to our customers but are also impacted by other factors, such as contractual agreements. Examples of other revenues are fees associated with the following:

## Edgar Filing: MASTERCARD INC - Form 10-Q

*Fraud products and services* used to prevent or detect fraudulent transactions. This includes warning bulletin fees which are charged to issuers and acquirers for listing invalid or fraudulent accounts either electronically or in paper form and for distributing this listing to merchants.

*Cardholder services fees* are for benefits provided with MasterCard-branded cards, such as insurance, telecommunications assistance for lost cards and locating automated teller machines.

**Table of Contents**

*Consulting and research fees* are primarily generated by MasterCard Advisors, the Company's professional advisory services group. The Company's business agreements with certain customers and merchants may include consulting services as an incentive. The contra-revenue associated with these incentives is included in rebates and incentives.

The Company also charges for a variety of other payment-related services, including compliance and penalty fees, account and transaction enhancement services, holograms and publications.

5. **Rebates and incentives (contra-revenue):** Rebates and incentives are provided to certain MasterCard customers and are recorded as contra-revenue in the same period that performance occurs. Performance periods vary depending on the type of rebate or incentive, including commitments to the agreement term, hurdles for volumes, transactions or issuance of new cards and the launch of new programs or the execution of marketing programs. Rebates and incentives are calculated based on estimated performance, the timing of new and renewed agreements and the terms of the related business agreements.

**Revenue Analysis**

Gross revenues increased \$255 million, or 17.1%, in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to increased dollar volume of activity and transactions on cards carrying our brands, higher pricing and favorable foreign currency exchange impacts. The U.S. dollar weakened versus the euro and Brazilian real, which increased gross revenues by 2.8 percentage points for the three months ended March 31, 2010, compared to the three months ended March 31, 2009. Rebates and incentives as a percentage of gross revenues were 25.2% in the three months ended March 31, 2010 versus 22.6% for the comparable period in 2009. Our net revenues increased 13.1% in the three months ended March 31, 2010 versus the comparable period in 2009.

Pricing changes increased net revenues by approximately 5 percentage points in the three months ended March 31, 2010. The price increases primarily related to increases to transaction processing fees in April 2009 and cross-border volume fees in October 2009. These price increases were partially offset by an approximate 3 percentage point decrease relating to the October 2008 pricing changes which were repealed at the end of June 2009 as part of our interim arrangement with the European Commission. See Note 17 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 for more information.

The significant components of our revenues were as follows for the three months ended March 31:

	For the Three Months Ended March 31,		Dollar Increase	Percent Increase
	2010	2009	(Decrease) 2010 vs. 2009	(Decrease) 2010 vs. 2009
	(In millions, except percentages)			
Domestic assessments	\$ 587	\$ 553	\$ 34	6.1%
Cross-border volume fees	446	321	125	39.0%
Transaction processing fees	509	436	73	16.7%
Other revenues	206	183	23	12.6%
Gross revenues	1,748	1,493	255	17.1%
Rebates and incentives (contra-revenues)	(440)	(337)	(103)	30.7%
Net revenues	\$ 1,308	\$ 1,156	\$ 152	13.1%



---

**Table of Contents**

*Domestic assessments* The increase in domestic assessments of 6.1% in the three months ended March 31, 2010 versus the comparable period in 2009 was due to:

GDV increased 8.3% during the three months ended March 31, 2010 when measured in local currency terms, and increased 14.8% when measured on a U.S. dollar-converted basis, versus the comparable period in 2009. The benefit of GDV growth was partially offset by a change in geographic mix of GDV, as domestic assessments fees vary on a country by country basis.

The impact of foreign currency relating to the translation of domestic assessments from our functional currencies to U.S. dollars contributed approximately 3 percentage points to the increase in the three months ended March 31, 2010.

These increases were partially offset by a net decrease of approximately 2 percentage points in pricing changes. The pricing changes included the repeal of certain October 2008 pricing changes at the end of June 2009 as part of our interim arrangement with the European Commission and pricing increases implemented in April 2009 in certain regions. See Note 17 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 for more information.

*Cross-border volume fees* The increase in cross-border volume fees of 39.0% in the three months ended March 31, 2010 versus the comparable period in 2009 was due to:

Pricing changes implemented in 2009 represented approximately 27 percentage points of the increase in the three months ended March 31, 2010. The structure of the October 2009 pricing change included a rebate to encourage certain behaviors of our customers, therefore a significant portion of these pricing increases were offset by an increase in rebates and incentives. In addition, in June 2009 as part of our interim arrangement with the European Commission, certain October 2008 pricing increases were repealed, representing a 5 percentage point decrease during the quarter. See Note 17 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 for more information.

Cross-border volumes increased 10.9% in the three months ended March 31, 2010, when measured in local currency terms, and 18.8%, when measured on a U.S. dollar-converted basis, versus the comparable period in 2009.

The impact of foreign currency relating to the translation of cross-border volume fees from our functional currencies to U.S. dollars contributed approximately 3 percentage points to the increase in the three months ended March 31, 2010.

*Transaction processing fees* The increase in transaction processing fees of 16.7% during the three months ended March 31, 2010 versus the comparable period in 2009 was due to:

Pricing changes implemented in April 2009 which represented approximately 11 percentage points of the increase in the three months ended March 31, 2010.

The impact of foreign currency relating to the translation of transaction processing fees from our functional currencies to U.S. dollars contributed approximately 3 percentage points to the increase in the three months ended March 31, 2010.

Processed transactions increased 4.6% during the three months ended March 31, 2010.

*Other revenues* The increase of 12.6% in the three months ended March 31, 2010 versus the comparable period in 2009, was due to:

Higher compliance and penalty fees and customer agreement termination fees in the three months ended March 31, 2010.

**Table of Contents**

The impact of foreign currency relating to the translation of other revenues from our functional currencies to U.S. dollars increased other revenues by approximately 2 percentage points in the three months ended March 31, 2010.

*Rebates and incentives* The increase in rebates and incentives of 30.7% during the three months ended March 31, 2010 versus the comparable period in 2009 was due to:

As discussed above in cross border volume fees, cross-border pricing actions in October 2009 included an increase to a cross-border rebate to encourage certain behaviors of our customers. The increase in this cross-border rebate contributed approximately 17 percentage points to the increase in rebates and incentives.

The impact of higher rebates and incentives for certain new and renewed agreements. We intend to continue to enter into and maintain business agreements with certain customers and merchants that provide rebates and incentives.

The impact of foreign currency relating to the translation of rebates and incentives from our functional currencies to U.S. dollars increased rebates and incentives by approximately 2 percentage points in the three months ended March 31, 2010.

**Operating Expenses**

Our operating expenses are comprised of general and administrative, advertising and marketing and depreciation and amortization expenses. In the three months ended March 31, 2010, operating expenses increased by \$13 million versus the comparable period in 2009. These increases were primarily due to increased general and administrative expenses and depreciation and amortization expenses, which were partially offset by decreased advertising and marketing expenses. Unfavorable foreign currency exchange impacts of the euro and the Brazilian real against the dollar also contributed approximately 2 percentage points to the increase in operating expenses in the three months ended March 31, 2010, compared to the three months ended March 31, 2009.

**General and Administrative**

General and administrative expenses increased \$10 million, or 2.1%, in the three months ended March 31, 2010 versus the comparable period in 2009. Over half of the increase was due to unfavorable foreign currency exchange impacts of the euro and the Brazilian real against the dollar. The major components of general and administrative expenses are as follows:

	Three Months Ended March 31,		Dollar Increase	Percent Increase
	2010	2009	(Decrease) 2010 vs. 2009	(Decrease) 2010 vs. 2009
	(In millions, except percentages)			
Personnel	\$ 315	\$ 306	\$ 9	2.9%
Professional fees	35	32	3	11.1%
Telecommunications	15	18	(3)	(18.9)%
Data processing	22	19	3	13.3%
Travel and entertainment	13	9	4	38.9%
Other	58	64	(6)	(8.6)%
General and administrative expenses	\$ 458	\$ 448	\$ 10	2.1%

---

**Table of Contents**

Personnel expense increased in the three months ended March 31, 2010 versus the comparable period in 2009. The increase was primarily due to higher employment taxes related to the vesting of equity compensation awards and incremental merit awards. The increase in the three months ended March 31, 2010 was partially offset by reduced severance expense, lower contractor costs and reduced payroll costs due to reduced staffing levels.

Professional fees consist primarily of third-party services and legal costs to defend our outstanding litigation. Professional fees increased in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to increased usage of third-party services.

Telecommunications expense consists of expenses to support our global payments system infrastructure as well as our other telecommunication needs. These expenses vary with business volume growth, system upgrades and usage. Telecommunications expense decreased in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to negotiated fee reductions.

Data processing consists of expenses to operate and maintain MasterCard's computer systems. These expenses vary with business volume growth, system upgrades and usage. Data processing fees increased in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to increased maintenance fees for new systems.

Travel and entertainment expenses are incurred primarily for travel to customer and regional meetings. Travel and entertainment expense increased in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to increased meeting travel. In the three months ended March 31, 2009, travel and entertainment expense had decreased \$16 million, or 64%, from the comparable period in 2008, primarily due to cost containment initiatives.

Other includes rental expense for our facilities, foreign exchange gains and losses, charges for impairment of assets and other miscellaneous administrative expenses. The decrease in the three months ended March 31, 2010 versus the comparable period in 2009 was primarily due to the reduction in rental expense for the Company's global technology and operations center, called Winghaven, which since March 31, 2009 has been classified as a capital lease. Prior to March 31, 2009, the lease for the Winghaven facility was included in rental expense. See Note 3 (Non-Cash Investing and Financing Activities) to the consolidated financial statements included in Part I, Item 1 for more information. Additionally, the Company recorded an impairment of assets in the three months ended March 31, 2009. The decrease in other general and administrative expenses was partially offset by increased expense for foreign exchange losses.

*Advertising and Marketing*

Our brands, principally MasterCard, are valuable strategic assets that drive card acceptance and usage and facilitate our ability to successfully introduce new service offerings and access new markets globally. Our advertising and marketing strategy is to increase global MasterCard brand awareness, preference and usage through integrated advertising, sponsorship, promotional, interactive media and public relations programs on a global scale. We will also continue to invest in marketing programs at the regional and local levels and sponsor diverse events aimed at multiple target audiences.

Advertising and marketing expenses remained relatively flat during the three months ended March 31, 2010 versus the comparable period in 2009. Excluding the impact of foreign currency relating to the translation of amounts from our functional currencies to U.S. dollars, advertising and marketing expenses decreased approximately 4% versus the comparable period in 2009.

*Depreciation and Amortization*

Depreciation and amortization expenses increased \$4 million, or 13.3%, in the three months ended March 31, 2010 versus the comparable period in 2009, primarily due to increased investments in data center equipment, capitalized software and leasehold and building improvements. Additionally, the increase included depreciation on the Company's global technology and operations center, which was acquired under a capital lease arrangement in



**Table of Contents**

March 2009. See Note 3 (Non-Cash Investing and Financing Activities) to the consolidated financial statements included in Part I, Item 1 for more information. We expect that depreciation and amortization will continue to increase as we continue to invest in property, plant and equipment and capitalized software.

**Other Income (Expense)**

Other income (expense) is comprised primarily of investment income, interest expense and other gains and losses.

	Three Months Ended March 31,		Dollar Increase	Percent Increase
	2010	2009	(Decrease) 2010 vs. 2009	(Decrease) 2010 vs. 2009
	(In millions, except percentages)			
Investment income	\$ 10	\$ 17	\$ (7)	(44.3)%
Interest expense	(15)	(36)	(21)	(57.1)%
Other income (expense), net		8	(8)	(85.2)%
Total other income (expense)	\$ (5)	\$ (11)	(6)	(59.2)%

Investment income decreased \$7 million in the three months ended March 31, 2010 as compared to the similar period in 2009. The decrease for the three months ended March 31, 2010 was primarily due to lower interest income as a result of lower interest rates which was partially offset by a higher average investment balance.

Interest expense decreased \$21 million in the three months ended March 31, 2010 as compared to the similar period in 2009, primarily due to a decrease in interest accretion on the litigation settlements as the amounts due are paid.

Other income (expense) decreased \$8 million for the three months ended March 31, 2010 as compared to the similar period in 2009. This decrease was primarily due to gains on various transactions that were recognized in the three months ended March 31, 2009.

**Income Taxes**

The effective income tax rates were 34.6% and 33.2% for the three months ended March 31, 2010 and 2009, respectively. The rate for the three months ended March 31, 2010 was higher than the comparable period in 2009 due primarily to an adjustment to the Company's balance of deferred taxes during the three months ended March 31, 2009, partially offset by lower state tax rates and a more favorable geographic distribution of earnings for the three months ended March 31, 2010.

**Liquidity and Capital Resources**

We need liquidity and access to capital to fund our global operations; to provide for credit and settlement risk; to finance capital expenditures and any future acquisitions; and to service our obligations related to litigation settlements. At March 31, 2010 and December 31, 2009, we had \$3.0 billion and \$2.9 billion, respectively, of cash and cash equivalents and current available-for-sale securities to use for our operations. Our equity was \$3.8 billion and \$3.5 billion as of March 31, 2010 and December 31, 2009, respectively. We believe that the cash generated from operations, our borrowing capacity and our access to capital resources are sufficient to meet our future operating capital needs and litigation settlement obligations. Our liquidity and access to capital could be negatively impacted by the adverse outcome of any of the legal or regulatory proceedings to which we are still a party. See Item 1A in Part 1 in the Company's Annual Report on Form 10-K for the year ended December 31, 2009. See also Notes 15 (Obligations Under Litigation Settlements) and 17 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Item 1 and -Business Environment for more information.



**Table of Contents**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in millions)</b>	
<b>Cash Flow Data:</b>		
Net cash provided by operating activities	\$ 95	\$ 416
Net cash used in investing activities	(23)	(50)
Net cash provided by (used in) financing activities	77	(165)
	<b>March 31,</b>	<b>December 31,</b>
	<b>2010</b>	<b>2009</b>
	<b>(in millions)</b>	
<b>Balance Sheet Data:</b>		
Current assets	\$ 5,106	\$ 5,003
Current liabilities	2,822	3,167
Long-term liabilities	632	791
Equity	3,832	3,512

Net cash provided by operating activities for the three months ended March 31, 2010 was \$95 million versus \$416 million for the comparable period in 2009. Cash from operations for the three months ended March 31, 2010 was primarily due to operating income partially offset by litigation settlement payments, a reduction in accrued expenses and the effect of stock units withheld for taxes. Net cash provided by operating activities for the three months ended March 31, 2009 was primarily due to operating income and the collection of accounts receivable and income taxes receivable, partially offset by litigation settlement payments and a reduction in accrued expenses.

Net cash used in investing activities for the three months ended March 31, 2010 and 2009 primarily related to expenditures for our global network. Additionally, in the three months ended March 31, 2009, cash was used for investments in affiliates.

Cash provided by financing activities for the three months ended March 31, 2010 primarily related to the tax benefit for share based compensation partially offset by the payment of \$20 million in dividends to our stockholders. Cash used in financing activities for the three months ended March 31, 2009 related primarily to the payment of \$149 million of debt and \$20 million in dividends to our stockholders.

On February 2, 2010, our Board of Directors declared a quarterly cash dividend of \$0.15 per share payable on May 10, 2010 to holders of record on April 9, 2010 of our Class A common stock and Class B common stock. The aggregate amount of this dividend is \$20 million. The declaration and payment of future dividends will be at the sole discretion of our Board of Directors after taking into account various factors, including our financial condition, settlement guarantees, operating results, available cash and anticipated cash needs.

On November 4, 2009, the Company filed a universal shelf registration statement to provide additional access to capital, if needed. Pursuant to the shelf registration statement, the Company may from time to time offer to sell debt securities, preferred stock or Class A common stock in one or more offerings.

On April 28, 2008, the Company extended its committed unsecured revolving credit facility, dated as of April 28, 2006 (the Credit Facility), for an additional year. The new expiration date of the Credit Facility is April 26, 2011. The available funding under the Credit Facility remained at \$2.5 billion through April 27, 2010 and then decreased to \$2.0 billion during the final year of the Credit Facility agreement. Other terms and conditions in the Credit Facility remain unchanged. The Company's option to request that each lender under the Credit Facility extend its commitment was provided pursuant to the original terms of the Credit Facility agreement. MasterCard was in compliance with the covenants of the Credit Facility and had no borrowings under the Credit Facility at March 31, 2010 and December 31, 2009. The majority of Credit Facility lenders are customers or affiliates of customers of MasterCard International.

Moody's Investors Service assigned issuer credit ratings of A3 long-term and P-2 short-term with a stable outlook for MasterCard Incorporated on September 9, 2009. Standard & Poor's assigned counterparty credit ratings



**Table of Contents**

of BBB+ long-term and A-2 short-term with a stable outlook for MasterCard Incorporated and affirmed the counterparty credit ratings of BBB+ long-term and A-2 short-term with a stable outlook for MasterCard International on October 13, 2009. At MasterCard's request, Standard & Poor's has subsequently withdrawn ratings on MasterCard International. Our access to capital and liquidity has been sufficient with these ratings. Securities ratings are not recommendations to buy, sell, or hold securities and may be subject to revision or withdrawal at any time.

*Future Obligations*

The following table summarizes our obligations as of March 31, 2010 that are expected to impact liquidity and cash flow in future periods. We believe we will be able to fund these obligations through cash generated from operations and our cash balances.

	Payments Due by Period				2015 and thereafter
	Total	Remaining 2010	2011-2012 (In millions)	2013-2014	
Capital leases <sup>1</sup>	\$ 47	\$ 3	\$ 7	\$ 37	\$
Operating leases <sup>2</sup>	95	19	35	18	23
Sponsorship, licensing and other <sup>3,4</sup>	476	216	238	19	3
Litigation settlements <sup>5</sup>	759	459	300		
Debt <sup>6</sup>	21		21		
Total	\$ 1,398	\$ 697	\$ 601	\$ 74	\$ 26

<sup>1</sup> Mostly related to certain property, plant and equipment. Capital lease for global technology and operations center located in O'Fallon, Missouri has been excluded from this table; see Note 3 (Non-Cash Investing and Financing Activities) to the consolidated financial statements included in Part I, Item 1 of this Form 10-Q for further discussion. There is a capital lease for the Kansas City, Missouri co-processing data center.

<sup>2</sup> We enter into operating leases in the normal course of business. Substantially all lease agreements have fixed payment terms based on the passage of time. Some lease agreements provide us with the option to renew the lease or purchase the leased property. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional lease agreements.

<sup>3</sup> Amounts primarily relate to sponsorships with certain organizations to promote the MasterCard brand. The amounts included are fixed and non-cancelable. In addition, these amounts include amounts due in accordance with merchant agreements for future marketing, computer hardware maintenance, software licenses and other service agreements. Future cash payments that will become due to our customers under agreements which provide pricing rebates on our standard fees and other incentives in exchange for transaction volumes are not included in the table because the amounts due are indeterminable and contingent until such time as performance has occurred. MasterCard has accrued \$548 million as of March 31, 2010 related to customer and merchant agreements.

<sup>4</sup> Includes current liability of \$6 million relating to the accounting for uncertainty in income taxes. Due to the high degree of uncertainty regarding the timing of the non-current liabilities for uncertainties in income taxes, we are unable to make reasonable estimates of the period of cash settlements with the respective taxing authority.

<sup>5</sup> Represents amounts due in accordance with the American Express Settlement and other litigation settlements. The American Express Settlement requires five remaining quarterly payments of \$150 million each.

<sup>6</sup> Debt primarily represents amounts due for the acquisition of MasterCard France. We also have various credit facilities for which there were no outstanding balances at March 31, 2010 that, among other things, would provide liquidity in the event of settlement failures by our members. Our debt obligations would change if one or more of our members failed and we borrowed under these credit facilities to settle on our members' behalf or for other reasons.

*Recent Accounting Pronouncements*

*Transfers of financial assets* - In June 2009, the accounting standard for transfers and servicing of financial assets and extinguishments of liabilities was amended. The change eliminates the qualifying special purpose entity concept, establishes a new unit of account definition that must be met for the transfer of portions of financial assets to be eligible for sale accounting, clarifies and changes the derecognition criteria for a transfer to be accounted for as a sale, changes the amount of gain or loss on a transfer of financial assets accounted for as a sale when beneficial interests are received by the transferor, and requires additional new disclosures. The Company adopted the new standard upon its effective date.

## Edgar Filing: MASTERCARD INC - Form 10-Q

of January 1, 2010. The adoption did not have an impact on the Company's financial position or results of operations as of or for the three months ended March 31, 2010.

*Variable interest entities* - In June 2009, there was a revision to the accounting standard for the consolidation of variable interest entities. The revision eliminates the exemption for qualifying special purpose entities, requires a new qualitative approach for determining whether a reporting entity should consolidate a variable interest entity, and changes the requirement of when to reassess whether a reporting entity should consolidate a variable interest entity. During February 2010, the scope of the revised standard was modified to indefinitely exclude certain entities from the requirement to be assessed for consolidation. The Company adopted the new standard upon its effective date of January 1, 2010. The adoption did not have an impact on the Company's financial position or results of operations as of or for the three months ended March 31, 2010.

## **Table of Contents**

*Revenue arrangements with multiple deliverables* In September 2009, the accounting standard for the allocation of revenue in arrangements involving multiple deliverables was amended. Current accounting standards require companies to allocate revenue based on the fair value of each deliverable, even though such deliverables may not be sold separately either by the company itself or other vendors. The new accounting standard eliminates (i) the residual method of revenue allocation and (ii) the requirement that all undelivered elements must have objective and reliable evidence of fair value before a company can recognize the portion of the overall arrangement fee that is attributable to items that already have been delivered. The Company will adopt the revised accounting standard effective January 1, 2011 via prospective adoption. The Company is currently evaluating the requirements of the standard to determine the impact on the Company's financial position or results of operations.

*Improving fair value disclosures* The Company measures certain of its assets and liabilities at fair value on a recurring basis by estimating the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When valuing liabilities, the Company also considers the Company's creditworthiness. The Company classifies these recurring fair value measurements into a three-level hierarchy ( Valuation Hierarchy ) and discloses the significant assumptions utilized in measuring assets and liabilities at fair value. In January 2010, fair value disclosure requirements were amended such that MasterCard is required to present detailed disclosures about transfers to and from Level 1 and 2 of the Valuation Hierarchy effective January 1, 2010 and MasterCard will also be required to disclose purchases, sales, issuances, and settlements on a gross basis within the Level 3 (of the Valuation Hierarchy) reconciliation effective January 1, 2011. The Company adopted the new guidance for disclosures about transfers to and from Level 1 and 2 of the Valuation Hierarchy effective January 1, 2010. The adoption did not have an impact on the Company's financial position or results of operations as of or for the three months ended March 31, 2010. The Company will adopt the guidance that requires disclosure of a reconciliation of purchases, sales, issuances, and settlements on a gross basis within Level 3 (of the Valuation Hierarchy) during 2011, as required, and the adoption will have no impact on the Company's financial position or results of operations.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the potential for economic losses to be incurred on market risk sensitive instruments arising from adverse changes in market factors such as interest rates, foreign currency exchange rates and equity price risk. We have limited exposure to market risk from changes in interest rates, foreign exchange rates and equity price risk. Management establishes and oversees the implementation of policies, which have been approved by the Board of Directors, governing our funding, investments and use of derivative financial instruments. We monitor risk exposures on an ongoing basis. There were no material changes in our market risk exposures at March 31, 2010 as compared to December 31, 2009.

**Table of Contents**

**Item 4. Controls and Procedures**

***Evaluation of Disclosure Controls and Procedures***

MasterCard Incorporated's management, including the Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that MasterCard Incorporated had effective disclosure controls and procedures for (i) recording, processing, summarizing and reporting information that is required to be disclosed in its reports under the Securities Exchange Act of 1934, as amended, within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) ensuring that information required to be disclosed in such reports is accumulated and communicated to MasterCard Incorporated's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

***Changes in Internal Control over Financial Reporting***

In connection with the evaluation by the Company's Chief Executive Officer and Chief Financial Officer of changes in internal control over financial reporting that occurred during the Company's last fiscal quarter, no change in the Company's internal control over financial reporting was identified that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

---

**Table of Contents**

**Other Financial Information**

With respect to the unaudited consolidated financial information of MasterCard Incorporated and its subsidiaries for the three months ended March 31, 2010 and 2009, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their report dated May 4, 2010 appearing below, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (the "Act") for their report on the unaudited consolidated financial information because that report is not a report or a part of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

**Report of Independent Registered Public Accounting Firm**

We have reviewed the accompanying consolidated balance sheet of MasterCard Incorporated and its subsidiaries (the "Company") as of March 31, 2010, and the related consolidated statements of operations, the consolidated statements of cash flows and consolidated condensed statements of comprehensive income for the three month periods ended March 31, 2010 and 2009, and the consolidated statement of changes in stockholders equity for the three month period ended March 31, 2010. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial information for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2009, and the related consolidated statements of operations, of comprehensive income (loss), of changes in stockholders' equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 18, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2009, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP

New York, New York

May 4, 2010

**Table of Contents**

**MASTERCARD INCORPORATED**

**FORM 10-Q**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Refer to Note 17 to the consolidated financial statements included in Part I, Item 1 herein.

**Item 1A. Risk Factors**

For a discussion of the Company's risk factors, see the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

**Item 5. Other Information**

On April 28, 2010, the Company, in the ordinary course of business, issued 35 shares of its Class M common stock to new principal members of MasterCard International, which was offset by the retirement of 17 shares of Class M common stock due to the terminations of principal members, pursuant to the Company's Charter. In the aggregate, these issuances of new shares of Class M common stock were more than one percent of the total number of shares of Class M common stock outstanding. Pursuant to Article IV, Section 4.3(G) of the Company's Charter, the Company issues a share of Class M common stock upon each principal member of MasterCard International becoming a member and executing a license agreement with MasterCard International. The shares of Class M common stock were issued in reliance upon the exemption from registration contained in Section 4(2) of the Securities Act of 1933, as amended, on the basis that the transaction, the issuance of a share upon the issuance of a license, did not involve any public offering.

**Item 6. Exhibits**

Refer to the Exhibit Index included herein.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 4, 2010

MASTERCARD INCORPORATED  
*(Registrant)*

Date May 4, 2010

By: /s/ ROBERT W. SELANDER  
**Robert W. Selander**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

Date: May 4, 2010

By: /s/ MARTINA HUND-MEJEAN  
**Martina Hund-Mejean**  
**Chief Financial Officer**  
  
**(Principal Financial Officer)**

Date: May 4, 2010

By: /s/ MELISSA J. BALLENGER  
**Melissa J. Ballenger**  
**Corporate Controller**  
**(Principal Accounting Officer)**

**Table of Contents****EXHIBIT INDEX**

<b>Exhibit</b>	
<b>Number</b>	<b>Exhibit Description</b>
10.1+	Form of Restricted Stock Unit Agreement for Awards under 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2010).
10.2+	Form of Stock Option Agreement for Awards under 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2010).
10.3+	Form of Performance Unit Agreement for Awards under 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2010).
12.1	Computation of Ratio of Earnings to Fixed Charges.
15	Awareness Letter from the Company's Independent Registered Public Accounting Firm.
31.1	Certification of Robert W. Selander, Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Martina Hund-Mejean, Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Robert W. Selander, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Martina Hund-Mejean, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Scheme Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document +Management contracts or compensatory plans or arrangements.