

MASTERCARD INC  
Form 10-Q  
November 04, 2008  
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**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 September 30, 2008

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)

Delaware

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

13-4172551

*(IRS Employer  
Identification Number)*

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**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 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

Smaller reporting company

(do not check if a 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 October 29, 2008, there were 98,385,273 shares outstanding of the registrant's Class A common stock, par value \$.0001 per share, 30,848,778 shares outstanding of the registrant's Class B common stock, par value \$.0001 per share, and 1,728 shares outstanding of the registrant's Class M common stock, par value \$.0001 per share.

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**MASTERCARD INCORPORATED**  
**CONSOLIDATED BALANCE SHEETS**  
**(UNAUDITED)**

|   | September 30,<br>2008             | December 31,<br>2007 |
|---|-----------------------------------|----------------------|
|   | (In thousands, except share data) |                      |
| <b>ASSETS</b>   |                                   |                      |
| Cash and cash equivalents   | \$ 2,071,457                      | \$ 1,659,295         |
| Investment securities, at fair value:   |                                   |                      |
| Trading   |                                   | 2,561                |
| Available-for-sale  | 679,645                           | 1,308,126            |
| Municipal bonds held-to-maturity  | 154,000                           |                      |
| Accounts receivable   | 610,760                           | 532,633              |
| Income taxes receivable   | 256,469                           |                      |
| Settlement due from customers   | 625,185                           | 712,558              |
| Restricted security deposits held for customers   | 142,359                           | 142,052              |
| Prepaid expenses  | 261,334                           | 156,258              |
| Deferred income taxes   | 228,944                           | 44,525               |
| Other current assets  | 40,490                            | 33,733               |
| <b>Total Current Assets</b>   | <b>5,070,643</b>                  | <b>4,591,741</b>     |
| Property, plant and equipment, at cost (less accumulated depreciation of \$280,439 and \$250,888) | 299,791                           | 290,200              |
| Deferred income taxes   | 654,481                           | 263,143              |
| Goodwill  | 239,297                           | 239,626              |
| Other intangible assets (less accumulated amortization of \$377,624 and \$347,977)                | 370,964                           | 320,758              |
| Investment securities available-for-sale, at fair value   | 219,015                           |                      |
| Municipal bonds held-to-maturity  | 37,450                            | 192,489              |
| Prepaid expenses  | 299,664                           | 274,962              |
| Other assets  | 81,670                            | 87,122               |
| <b>Total Assets</b>   | <b>\$ 7,272,975</b>               | <b>\$ 6,260,041</b>  |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                                   |                      |
| Accounts payable  | \$ 224,255                        | \$ 252,391           |
| Settlement due to customers   | 535,966                           | 604,212              |
| Restricted security deposits held for customers   | 142,359                           | 142,052              |
| Obligations under litigation settlements (Note 12)  | 1,569,623                         | 107,235              |
| Accrued expenses  | 1,061,297                         | 1,071,557            |
| Short-term debt   | 149,380                           | 80,000               |
| Other current liabilities   | 117,503                           | 105,895              |
| <b>Total Current Liabilities</b>  | <b>3,800,383</b>                  | <b>2,363,342</b>     |
| Deferred income taxes   | 76,181                            | 71,278               |
| Obligations under litigation settlements (Note 12)  | 1,243,551                         | 297,201              |
| Long-term debt  | 19,586                            | 149,824              |
| Other liabilities   | 363,523                           | 346,469              |
| <b>Total Liabilities</b>  | <b>5,503,224</b>                  | <b>3,228,114</b>     |
| <b>Commitments and Contingencies (Notes 15 and 17)</b>  |                                   |                      |
| Minority interest   | 4,620                             | 4,620                |
| <b>Stockholders Equity</b>  |                                   |                      |

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|  |                     |                     |
|--|---------------------|---------------------|
| Class A common stock, \$.0001 par value; authorized 3,000,000,000 shares, 105,125,863 and 91,243,433 shares issued and 98,385,273 and 87,321,541 outstanding, respectively | 10                  | 9                   |
| Class B common stock, \$.0001 par value; authorized 1,200,000,000 shares, 30,848,778 and 43,948,778 shares issued and outstanding, respectively                            | 4                   | 5                   |
| Class M common stock, \$.0001 par value, authorized 1,000,000 shares, 1,713 and 1,664 shares issued and outstanding, respectively  |                     |                     |
| Additional paid-in capital   | 3,309,413           | 3,312,380           |
| Class A treasury stock, at cost, 6,740,590 and 3,921,892 shares, respectively  | (1,250,000)         | (600,532)           |
| Retained earnings (accumulated deficit)  | (475,559)           | 37,699              |
| Accumulated other comprehensive income:  |                     |                     |
| Cumulative foreign currency translation adjustments  | 197,603             | 216,651             |
| Defined benefit pension and other postretirement plans, net of tax   | (3,133)             | (3,555)             |
| Investment securities available-for-sale, net of tax   | (13,207)            | 64,650              |
| <b>Total accumulated other comprehensive income</b>  | <b>181,263</b>      | <b>277,746</b>      |
| <b>Total Stockholders Equity</b>   | <b>1,765,131</b>    | <b>3,027,307</b>    |
| <b>Total Liabilities and Stockholders Equity</b>   | <b>\$ 7,272,975</b> | <b>\$ 6,260,041</b> |

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

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

|   | Three Months Ended    |              | Nine Months Ended     |              |
|---|-----------------------|--------------|-----------------------|--------------|
|   | September 30,<br>2008 | 2007         | September 30,<br>2008 | 2007         |
| (In thousands, except per share data)                       |                       |              |                       |              |
| <b>Revenues, net</b>  | \$ 1,338,178          | \$ 1,082,850 | \$ 3,766,766          | \$ 2,994,912 |
| <b>Operating Expenses</b>                                   |                       |              |                       |              |
| General and administrative                                  | 493,740               | 432,848      | 1,435,089             | 1,262,838    |
| Advertising and marketing                                   | 267,460               | 264,425      | 769,737               | 711,128      |
| Litigation settlements                                      | 827,500               |              | 2,476,845             | 3,400        |
| Charitable contributions to the MasterCard Foundation       |                       | 10,000       |                       | 10,000       |
| Depreciation and amortization                               | 28,742                | 22,274       | 81,956                | 71,490       |
| Total operating expenses                                    | 1,617,442             | 729,547      | 4,763,627             | 2,058,856    |
| Operating income (loss)                                     | (279,264)             | 353,303      | (996,861)             | 936,056      |
| <b>Other Income (Expense)</b>                               |                       |              |                       |              |
| Investment income, net                                      | 22,626                | 146,322      | 163,081               | 219,036      |
| Interest expense  | (36,319)              | (16,439)     | (67,075)              | (41,964)     |
| Other income (expense), net                                 | (715)                 | (879)        | 72,582                | 91,268       |
| Total other income (expense)                                | (14,408)              | 129,004      | 168,588               | 268,340      |
| Income (loss) before income taxes                           | (293,672)             | 482,307      | (828,273)             | 1,204,396    |
| Income tax expense (benefit)                                | (100,090)             | 167,846      | (334,916)             | 422,743      |
| <b>Net Income (Loss)</b>                                    | \$ (193,582)          | \$ 314,461   | \$ (493,357)          | \$ 781,653   |
| <b>Basic Net Income (Loss) per Share (Note 2)</b>           | \$ (1.49)             | \$ 2.32      | \$ (3.79)             | \$ 5.76      |
| <b>Basic Weighted Average Shares Outstanding (Note 2)</b>   | 129,536               | 135,357      | 130,342               | 135,687      |
| <b>Diluted Net Income (Loss) per Share (Note 2)</b>         | \$ (1.49)             | \$ 2.31      | \$ (3.79)             | \$ 5.73      |
| <b>Diluted Weighted Average Shares Outstanding (Note 2)</b> | 129,536               | 136,228      | 130,342               | 136,502      |

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

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

|  | <b>Nine Months<br/>Ended September 30,<br/>2008                      2007<br/>(In thousands)</b> |             |
|--|--|-------------|
| <b>Operating Activities</b>  |  |             |
| Net income (loss)  | \$ (493,357)   | \$ 781,653  |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |  |             |
| Depreciation and amortization  | 81,956   | 71,490      |
| Gain on sale of Redecard S.A. available-for-sale securities                              | (85,903)   | (107,042)   |
| Share based payments (Note 13)   | 44,217   | 35,909      |
| Stock units settled in cash for taxes  | (66,095)   | (11,193)    |
| Tax benefit for share based compensation   | (48,901)   | (7,598)     |
| Impairment of investments  | 10,600   |             |
| Accretion of imputed interest on litigation settlements                                  | 47,490   | 28,248      |
| Deferred income taxes  | (531,454)  | (8,170)     |
| Other  | 9,482  | 8,855       |
| Changes in operating assets and liabilities:   |  |             |
| Trading securities   | 2,561  | 7,225       |
| Accounts receivable  | (75,851)   | (68,655)    |
| Income taxes receivable  | (256,469)  |             |
| Settlement due from customers  | 74,875   | (9,499)     |
| Prepaid expenses   | (105,880)  | (32,657)    |
| Other current assets   | (9,759)  | (1,375)     |
| Prepaid expenses, non-current  | (28,882)   | (19,352)    |
| Litigation settlement accruals   | 2,361,248  | (10,525)    |
| Accounts payable   | (31,871)   | (36,109)    |
| Settlement due to customers  | (58,448)   | (18,038)    |
| Accrued expenses   | 41,914   | 72,644      |
| Net change in other assets and liabilities   | 49,111   | 41,852      |
| <br>Net cash provided by operating activities  | <br>930,584  | <br>717,663 |
| <b>Investing Activities</b>  |  |             |
| Purchases of property, plant and equipment   | (51,250)   | (59,339)    |
| Capitalized software   | (71,267)   | (52,322)    |
| Purchases of investment securities available-for-sale                                    | (495,606)  | (2,749,413) |
| Proceeds from sales and maturities of investment securities available-for-sale           | 851,987  | 2,928,342   |
| Other investing activities   | (2,223)  | 8,551       |
| <br>Net cash provided by investing activities  | <br>231,641  | <br>75,819  |
| <b>Financing Activities</b>  |  |             |
| Dividends paid   | (59,576)   | (53,805)    |
| Cash proceeds from exercise of stock options   | 9,335  | 1,083       |
| Tax benefit for share based compensation   | 48,901   | 7,598       |
| Payment of debt  | (80,000)   |             |
| Purchase of treasury stock   | (649,468)  | (277,164)   |

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|  |              |              |
|--|--------------|--------------|
| Net cash used in financing activities                        | (730,808)    | (322,288)    |
| Effect of exchange rate changes on cash and cash equivalents | (19,255)     | 31,149       |
| Net increase in cash and cash equivalents                    | 412,162      | 502,343      |
| Cash and cash equivalents beginning of period                | 1,659,295    | 1,185,080    |
| Cash and cash equivalents end of period                      | \$ 2,071,457 | \$ 1,687,423 |

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



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## MASTERCARD INCORPORATED

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

|   | Total        | Retained Earnings<br>(Accumulated Deficit) | Accumulated Other Comprehensive Income, net of tax | Common Shares |         | Additional Paid-In Capital | Treasury Stock |
|---|--------------|--|--|---------------|---------|----------------------------|----------------|
|   |              |  |  | Class A       | Class B |                            |                |
| (In thousands, except per share data)   |              |  |  |               |         |                            |                |
| <b>Balance at December 31, 2007</b>   | \$ 3,027,307 | \$ 37,699                                  | \$ 277,746   | \$ 9          | \$ 5    | \$ 3,312,380               | \$ (600,532)   |
| Net loss  | (493,357)    | (493,357)                                  |  |               |         |                            |                |
| Other comprehensive loss, net of tax  | (96,483)     |  | (96,483)   |               |         |                            |                |
| Cash dividends declared on Class A and Class B common stock, \$0.45 per share | (59,226)     | (19,901)                                   |  |               |         | (39,325)                   |                |
| Share based payments  | 44,217       |  |  |               |         | 44,217                     |                |
| Stock units settled in cash for taxes   | (66,095)     |  |  |               |         | (66,095)                   |                |
| Tax benefit for share based compensation                                      | 48,901       |  |  |               |         | 48,901                     |                |
| Purchases of treasury stock   | (649,468)    |  |  |               |         |                            | (649,468)      |
| Conversion of Class B to Class A common stock                                 |              |  |  | 1             | (1)     |                            |                |
| Cash proceeds from exercise of stock options                                  | 9,335        |  |  |               |         | 9,335                      |                |
| <b>Balance at September 30, 2008</b>  | \$ 1,765,131 | \$ (475,559)                               | \$ 181,263   | \$ 10         | \$ 4    | \$ 3,309,413               | \$ (1,250,000) |

## MASTERCARD INCORPORATED

## CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

|   | Three Months Ended September 30, |            | Nine Months Ended September 30, |              |
|---|----------------------------------|------------|---------------------------------|--------------|
|   | 2008                             | 2007       | 2008                            | 2007         |
| (In thousands)  |                                  |            |                                 |              |
| <b>Net Income (Loss)</b>  | \$ (193,582)                     | \$ 314,461 | \$ (493,357)                    | \$ 781,653   |
| Other comprehensive income (loss):  |                                  |            |                                 |              |
| Foreign currency translation adjustments  | (95,898)                         | 46,998     | (19,048)                        | 71,857       |
| Defined benefit pension and postretirement plans, net of tax  | 140                              | 4          | 422                             | 1,727        |
| Unrealized gain (loss) and reclassification adjustment for realized (gain) loss on investment securities available-for-sale, net of tax | 1,008                            | 240,861    | (77,857)                        | 237,960      |
| Derivatives accounted for as hedges and reclassification adjustment, net of tax   |                                  | 489        |                                 | (499)        |
| Other comprehensive income (loss), net of tax   | (94,750)                         | 288,352    | (96,483)                        | 311,045      |
| <b>Comprehensive Income (Loss)</b>  | \$ (288,332)                     | \$ 602,813 | \$ (589,840)                    | \$ 1,092,698 |

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



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**MASTERCARD INCORPORATED**

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

**(In thousands, except per share and percent data)**

**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 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.

*Consolidation and basis of presentation* The consolidated financial statements include the accounts of MasterCard and its majority-owned and controlled entities, including the Company s variable interest entity. The Company s variable interest entity was established for the purpose of constructing the Company s global technology and operations center; it is not an operating entity and has no employees. Intercompany transactions and balances are eliminated in consolidation. The Company follows accounting principles generally accepted in the United States of America.

The balance sheet as of December 31, 2007 was derived from the audited consolidated financial statements as of December 31, 2007. Certain prior period amounts have been reclassified to conform to the 2008 presentation. The consolidated financial statements for the three and nine months ended September 30, 2008 and 2007 and as of September 30, 2008 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 and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year.

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 accounting principles generally accepted in the United States of America. Reference should be made to the MasterCard Incorporated Annual Report on Form 10-K for the year ended December 31, 2007 for additional disclosures, including a summary of the Company s significant accounting policies.

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

(In thousands, except per share and percent data)

**Note 2. Earnings (Loss) Per Share ( EPS )**

The components of basic and diluted earnings (loss) per share are as follows:

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2008                                | 2007       | 2008                               | 2007       |
| <b>Numerator:</b>                                 |                                     |            |                                    |            |
| Net income (loss)                                 | \$ (193,582)                        | \$ 314,461 | \$ (493,357)                       | \$ 781,653 |
| <b>Denominator:</b>                               |                                     |            |                                    |            |
| Basic EPS weighted-average shares outstanding     | 129,536                             | 135,357    | 130,342                            | 135,687    |
| Dilutive stock options and restricted stock units |                                     | 871        |                                    | 815        |
| Diluted EPS weighted-average shares outstanding   | 129,536                             | 136,228    | 130,342                            | 136,502    |
| <b>Earnings (Loss) per Share:</b>                 |                                     |            |                                    |            |
| Basic   | \$ (1.49)                           | \$ 2.32    | \$ (3.79)                          | \$ 5.76    |
| Diluted   | \$ (1.49)                           | \$ 2.31    | \$ (3.79)                          | \$ 5.73    |

The calculation of diluted loss per share for each of the three and nine month periods ended September 30, 2008 excluded approximately 1,043 restricted stock units, 143 performance stock units and 706 stock options because the effect would be antidilutive. All restricted stock units and stock options were dilutive for the three months ended September 30, 2007. The calculation of diluted earnings per share for the nine months ended September 30, 2007 excluded approximately 185 stock options because the effect would be antidilutive.

*Recent Accounting Pronouncements* In June 2008, the Financial Accounting Standards Board ( FASB ) issued Staff Position Emerging Issues Task Force 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities ( FSP EITF 03-6-1 ). FSP EITF 03-6-1 requires entities to allocate earnings to unvested and contingently issuable share-based payment awards that have non-forfeitable rights to dividends or dividend equivalents when calculating EPS and also present both basic EPS and diluted EPS pursuant to the two-class method described in Statement of Financial Accounting Standards No. 128, Earnings per Share . FSP EITF 03-6-1 is effective January 1, 2009 and requires retrospective application. The company will adopt FSP EITF 03-6-1 during 2009 and is not able to project its impact on future presentations of EPS due to the inherent complexities associated with projecting future financial performance. For periods for which EPS has previously been presented, including full year 2007 and quarter-to-date and year-to-date periods for 2008, the company anticipates basic EPS and diluted EPS to (decrease)/increase as follows:

|                                   | Three<br>Months<br>Ended<br>September 30,<br>2008 | Nine<br>Months<br>Ended<br>September 30,<br>2008 | Three<br>Months<br>Ended<br>June 30,<br>2008 | Six<br>Months<br>Ended<br>June 30,<br>2008 | Three<br>Months<br>Ended<br>March 31,<br>2008 | Year<br>Ended<br>December 31,<br>2007 |
|-----------------------------------|---|--|--|--|---|---------------------------------------|
| <b>Earnings (Loss) per Share:</b> |   |  |  |  |   |                                       |
| Basic                             | \$ 0.01   | \$ 0.03  | \$ 0.04                                      | \$ 0.01                                    | \$ (0.03)                                     | \$ (0.07)                             |

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|                |    |      |    |      |    |      |    |      |    |        |    |        |
|----------------|----|------|----|------|----|------|----|------|----|--------|----|--------|
| <b>Diluted</b> | \$ | 0.01 | \$ | 0.03 | \$ | 0.04 | \$ | 0.01 | \$ | (0.01) | \$ | (0.04) |
|----------------|----|------|----|------|----|------|----|------|----|--------|----|--------|

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

|                                     | <b>Nine Months Ended<br/>September 30,</b> |             |
|-------------------------------------|--|-------------|
|                                     | <b>2008</b>                                | <b>2007</b> |
| Dividends declared but not yet paid | \$ 19,703                                  | \$ 20,327   |
| MasterCard France Acquisition       | 20,432                                     |             |

On April 1, 2008, the Company and Europay France integrated their operating structures in France by forming a new entity, MasterCard France ( MCF ). The Company accounted for this transaction as a 100% acquisition, in accordance with the terms of the acquisition agreement, by recording a liability for the present value of the fixed purchase price of 15,000 euros to be paid in three years.

On September 9, 2008, the Company's Board of Directors declared a quarterly cash dividend of \$0.15 per share, payable on November 10, 2008 to holders of record of Class A common stock, par value \$.0001 per share (the Class A common stock ), and Class B common stock, par value \$.0001 per share (the Class B common stock ), on October 10, 2008. The aggregate amount payable for this dividend is \$19,697. The difference to the amount in the table above relates to the timing of payments of dividends on deferred stock units issued to members of the Board of Directors. The declaration and payment of any future dividends will be at the sole discretion of the Board of Directors after taking into account various factors, including the Company's financial condition, settlement guarantees, operating results, available cash and anticipated cash needs.

**Note 4. Fair Value Measurement**

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ), for assets and liabilities measured at fair value on a recurring basis. SFAS 157 accomplishes the following key objectives:

Defines fair value as 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;

Establishes a three-level hierarchy ( Valuation Hierarchy ) for fair value measurements;

Requires consideration of the Company's creditworthiness when valuing liabilities; and

Expands disclosures about instruments measured at fair value.

The Valuation Hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the Valuation Hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of the Valuation Hierarchy and the distribution of the Company's financial assets within it are as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. The fair values of the Company's short-term bond funds are based on quoted prices and are therefore classified as level 1.

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Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. The fair values of the Company's available-for-sale municipal bonds are based on quoted prices for similar assets in active markets and are therefore classified as level 2. Also included in level 2 is the estimated fair value of the Company's foreign exchange forward contracts, which are based on broker quotes for the same or similar instruments. See Note 19, Foreign Exchange Risk Management, for more information.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement. See below for further discussion of the Company's level 3 fair value measurements, including auction rate securities (ARS).

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The Company's assets carried at fair value on a recurring basis are as follows:

|                               | Quoted Market<br>Prices in<br>Active<br>Markets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Fair Value at<br>September 30,<br>2008 |
|-------------------------------|--|---|--|--|
| Municipal bonds <sup>1</sup>  | \$   | \$ 576,166  | \$   | \$ 576,166                             |
| Taxable short-term bond funds | 103,452  |   |  | 103,452                                |
| Auction rate securities       |  |   | 219,015  | 219,015                                |
| Other                         | 27   | 9,993   |  | 10,020                                 |
| <b>Total</b>                  | <b>\$ 103,479</b>  | <b>\$ 586,159</b>   | <b>\$ 219,015</b>                                  | <b>\$ 908,653</b>                      |

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

Certain financial instruments are carried at cost on the consolidated balance sheets, which approximated fair value as of September 30, 2008 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.

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. The table below summarizes the maturity ranges of the ARS portfolio, based on relative par value, as of September 30, 2008:

| Par Amount        | % of Total  | Maturity (years) |
|-------------------|-------------|------------------|
| \$ 4,000          | 2%          | 0-10             |
| 38,100            | 16%         | 11-20            |
| 137,600           | 56%         | 21-30            |
| 63,650            | 26%         | > 30             |
| <b>\$ 243,350</b> | <b>100%</b> |                  |

Beginning on February 11, 2008, the auction mechanism that normally provided liquidity to the ARS investments began to fail. Since mid-February 2008, all ARS investments in the Company's portfolio have experienced failed auctions. The securities for 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. No ARS were sold or called by the issuer at less than par value during the three or nine months ended September 30, 2008. Due to the lack of liquidity, the Company reclassified its ARS portfolio from short-term available-for-sale to long-term available-for-sale investment securities as of March 31, 2008.



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As of September 30, 2008, the ARS market remained illiquid but there had been some call and redemption activity in the ARS student loan sector. Due to the continued lack of liquidity in the ARS market, the Company has determined that the fair value of the ARS does not approximate par value. Accordingly, the Company maintained a 10% discount to the par value of the ARS portfolio and the temporary impairment within accumulated other comprehensive income. The 10% discount on the ARS par value reflects the Company's assessment of fair value based on the income approach, as set forth in SFAS 157. The income approach included a discounted cash flow analysis of the estimated future cash flows for the ARS portfolio as of September 30, 2008.

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In determining whether the decline in value of the ARS investments was other-than-temporary, the Company considered several factors including, but not limited to, the following: (1) the reasons for the decline in value (credit event, interest related or market fluctuations); (2) MasterCard's ability and intent to hold the investments for a sufficient period of time to allow for recovery of value; (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 the credit quality of the securities, changes in liquidity as a result of normal market mechanisms or issuer calls of the securities, and the effects of changes in interest rates. The Company has the intent and ability to hold its ARS investments until recovery of fair value, which may be maturity or earlier if called, and therefore does not consider these unrealized losses to be other-than-temporary.

The ARS investments have been classified within level 3 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.

In October 2008, the FASB issued Staff Position 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active," (FSP SFAS 157-3). FSP SFAS 157-3 provides guidance on how management's internal cash flow and discount rate assumptions should be considered when measuring fair value when relevant observable data does not exist, how observable market information in a market that is not active should be considered when measuring fair value and how the use of market quotes should be considered when assessing the relevance of observable and unobservable data available to measure fair value. The Company has incorporated the considerations of FSP SFAS 157-3 in its assessment of the fair value of its ARS as of September 30, 2008.

The table below includes a roll-forward of the Company's ARS investments from January 1, 2008 to September 30, 2008, and a reclassification of these investments from level 2 to level 3 in the Valuation Hierarchy. 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.

|                                    | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> |
|------------------------------------|--|--|
| Fair value January 1, 2008         | \$ 348,000   | \$   |
| Purchases                          | 321,550  |  |
| Sales, January 1 - March 31, 2008  | (420,400)  |  |
| Transfers in (out)                 | (249,150)  | 249,150  |
| Sales, April 1 - June 30, 2008     |  | (50)   |
| Calls, July 1 - September 30, 2008 |  | (5,750)  |
| Unrealized losses                  |  | (24,335) <sup>1</sup>  |
| Fair value September 30, 2008      | \$   | \$ 219,015   |

<sup>1</sup> Unrealized losses on available-for-sale securities are recorded as a separate component of other comprehensive income (loss) on the consolidated statements of comprehensive income (loss).



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In February 2008, the FASB issued Staff Position 157-2 ( FSP 157-2 ). FSP 157-2 permits delayed adoption of SFAS 157 for certain non-financial assets and liabilities, which are not recognized at fair value on a recurring basis, until fiscal years and interim periods beginning after November 15, 2008. As permitted by FSP 157-2, the Company has elected to delay the adoption of SFAS 157 for qualifying non-financial assets and liabilities, such as property, plant and equipment, goodwill and intangible assets. The Company is in the process of evaluating the impact, if any, that the application of SFAS 157 to the Company's non-financial assets will have on the Company's consolidated results of operations or financial position.

Also effective January 1, 2008, the Company adopted SFAS No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Election of the fair value option is irrevocable and is applied on a contract-by-contract basis. The Company has elected not to apply the fair value option to its eligible financial assets and liabilities, and accordingly, the adoption of SFAS 159 had no financial statement impact.

**Note 5. Prepaid Expenses**

Prepaid expenses consisted of the following:

|                                    | <b>September 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|------------------------------------|-------------------------------|------------------------------|
| Customer and merchant incentives   | \$ 397,321                    | \$ 357,761                   |
| Income taxes                       | 78,426                        |                              |
| Advertising                        | 36,458                        | 33,603                       |
| Other                              | 48,793                        | 39,856                       |
| <b>Total prepaid expenses</b>      | <b>560,998</b>                | <b>431,220</b>               |
| Prepaid expenses, current          | (261,334)                     | (156,258)                    |
| <b>Prepaid expenses, long-term</b> | <b>\$ 299,664</b>             | <b>\$ 274,962</b>            |

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

**Note 6. Other Assets**

Other assets consisted of the following:

|   | <b>September 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---|-------------------------------|------------------------------|
| Customer and merchant incentives              | \$ 71,012                     | \$ 70,043                    |
| Cash surrender value of keyman life insurance | 21,717                        | 23,957                       |
| Cost and equity method investments            | 12,563                        | 8,286                        |
| Other   | 16,868                        | 18,569                       |

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|                         |           |           |
|-------------------------|-----------|-----------|
| Total other assets      | 122,160   | 120,855   |
| Other assets, current   | (40,490)  | (33,733)  |
| Other assets, long-term | \$ 81,670 | \$ 87,122 |

Certain customer and merchant business agreements provide a bonus for entering into the agreement. As of September 30, 2008 and December 31, 2007, other assets included payments to be made for these bonuses and the related liability was included in accrued expenses. The bonus is amortized over the life of the agreement. Once the payment is made, the liability is relieved and the other asset is reclassified to a prepaid expense.

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## MASTERCARD INCORPORATED

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

(In thousands, except per share and percent data)

**Note 7. Other Intangible Assets**

The following table sets forth net intangible assets, other than goodwill:

|                                       | September 30, 2008          |                             |                           | December 31, 2007           |                             |                           |
|---------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                                       | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| <b>Amortized intangible assets:</b>   |                             |                             |                           |                             |                             |                           |
| Capitalized software                  | \$ 489,518                  | \$ (348,075)                | \$ 141,443                | \$ 422,739                  | \$ (319,067)                | \$ 103,672                |
| Trademarks and tradenames             | 25,102                      | (23,577)                    | 1,525                     | 25,259                      | (22,609)                    | 2,650                     |
| Customer relationships                | 16,870                      | (422)                       | 16,448                    |                             |                             |                           |
| Other                                 | 6,304                       | (5,550)                     | 754                       | 6,304                       | (6,301)                     | 3                         |
| <b>Total</b>                          | <b>537,794</b>              | <b>(377,624)</b>            | <b>160,170</b>            | <b>454,302</b>              | <b>(347,977)</b>            | <b>106,325</b>            |
| <b>Unamortized intangible assets:</b> |                             |                             |                           |                             |                             |                           |
| Customer relationships                | 210,794                     |                             | 210,794                   | 214,433                     |                             | 214,433                   |
| <b>Total</b>                          | <b>\$ 748,588</b>           | <b>\$ (377,624)</b>         | <b>\$ 370,964</b>         | <b>\$ 668,735</b>           | <b>\$ (347,977)</b>         | <b>\$ 320,758</b>         |

Additions to capitalized software primarily include internal projects associated with system enhancements and infrastructure improvements adjusted for the translation of capitalized software denominated in a foreign currency. Amortizable trademarks and tradenames, amortizable customer relationships and unamortizable customer relationships include assets which are denominated in a foreign currency. As such, a component of the net change in these intangible assets is attributable to foreign currency translation. In particular, unamortizable customer relationships decreased \$3,639 as of September 30, 2008 versus December 31, 2007 since these assets relate to the acquisition of Europay International S.A. on June 28, 2002 and therefore are denominated in euros.

On April 1, 2008, the Company and Europay France integrated their operating structures by forming a new entity, MCF, which resulted in the Company recording \$18,443 of amortizable customer relationships. Amortizable customer relationships are being amortized on a straight line basis over 20 years. These amortizable customer relationships decreased \$1,573 to \$16,870 as of September 30, 2008 since they are denominated in euros.

Amortization and impairment expense on the assets above amounted to the following:

|              | Three Months<br>Ended September 30, |           | Nine Months<br>Ended September 30, |           |
|--------------|-------------------------------------|-----------|------------------------------------|-----------|
|              | 2008                                | 2007      | 2008                               | 2007      |
| Amortization | \$ 14,184                           | \$ 11,630 | \$ 38,790                          | \$ 36,080 |
| Impairment   |                                     |           | 498                                | 217       |

During the nine months ended September 30, 2008, impairment charges of \$498 were recorded primarily in connection with decisions to discontinue the use of various technologies included in capitalized software. The Company performed an impairment analysis on the related technology and estimated the fair value at zero based on expectations that use of the underlying technology will be discontinued. Impairment charges are recorded in general and administrative expense on the consolidated statements of operations.

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The following table sets forth the estimated future amortization expense on amortizable intangible assets for the years ending December 31:

|                       |           |
|-----------------------|-----------|
| The remainder of 2008 | \$ 14,134 |
| 2009                  | 53,655    |
| 2010                  | 40,846    |
| 2011                  | 22,111    |
| 2012 and thereafter   | 29,424    |

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued****(In thousands, except per share and percent data)****Note 8. Pension Plans**

The Company maintains a noncontributory, 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. Additionally, the Company has an unfunded nonqualified supplemental executive retirement plan that provides certain key employees with supplemental retirement benefits in excess of limits imposed on qualified plans by U.S. tax laws. For both plans, net periodic pension cost was as follows:

|                                | Three Months                |          | Nine Months                 |           |
|--------------------------------|-----------------------------|----------|-----------------------------|-----------|
|                                | Ended September 30,<br>2008 | 2007     | Ended September 30,<br>2008 | 2007      |
| Service cost                   | \$ 4,995                    | \$ 4,717 | \$ 14,985                   | \$ 14,150 |
| Interest cost                  | 3,409                       | 3,048    | 10,228                      | 9,143     |
| Expected return on plan assets | (4,008)                     | (4,091)  | (12,023)                    | (12,275)  |
| Amortization:                  |                             |          |                             |           |
| Actuarial loss                 | 419                         |          | 1,256                       |           |
| Prior service credit           | (582)                       | (58)     | (1,746)                     | (172)     |
| Net periodic pension cost      | \$ 4,233                    | \$ 3,616 | \$ 12,700                   | \$ 10,846 |

The funded status of the Qualified Plan exceeded minimum funding requirements at September 30, 2008. Pursuant to the requirements of the Pension Protection Act of 2006, the Company did not have a mandatory contribution to the Qualified Plan in 2008. However, the Company did make a voluntary contribution to the Qualified Plan of \$21,500 in September 2008. No contributions were made during the nine months ended September 30, 2007.

**Note 9. Postretirement Health and Life Insurance 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 as follows:

|  | Three Months                |          | Nine Months                 |          |
|--|-----------------------------|----------|-----------------------------|----------|
|  | Ended September 30,<br>2008 | 2007     | Ended September 30,<br>2008 | 2007     |
| Service cost                             | \$ 487                      | \$ 588   | \$ 1,463                    | \$ 1,766 |
| Interest cost                            | 822                         | 848      | 2,466                       | 2,544    |
| Amortization:                            |                             |          |                             |          |
| Actuarial gain                           | (129)                       |          | (388)                       |          |
| Transition obligation                    | 53                          | 54       | 160                         | 160      |
| Net periodic postretirement benefit cost | \$ 1,233                    | \$ 1,490 | \$ 3,701                    | \$ 4,470 |

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





**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued****(In thousands, except per share and percent data)****Note 10. Accrued Expenses**

Accrued expenses consisted of the following:

|                                  | September 30,<br>2008 | December 31,<br>2007 |
|----------------------------------|-----------------------|----------------------|
| Customer and merchant incentives | \$ 517,102            | \$ 497,281           |
| Personnel costs                  | 247,593               | 296,031              |
| Advertising                      | 120,186               | 160,232              |
| Income taxes                     | 63,257                | 10,028               |
| Other                            | 113,159               | 107,985              |
| Total                            | \$ 1,061,297          | \$ 1,071,557         |

**Note 11. Debt**

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 will remain at \$2,500,000 through April 27, 2010 and then decrease to \$2,000,000 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 September 30, 2008 or December 31, 2007. The majority of Credit Facility lenders are customers or affiliates of customers of MasterCard International.

In June 1998, the Company issued \$80,000 of ten-year unsecured, subordinated notes paying a fixed interest rate of 6.67% per annum. The Company repaid the principal amount of \$80,000 plus accrued interest of \$2,668 on June 30, 2008 pursuant to the terms of such notes.

On August 31, 1999, MasterCard International entered into a ten-year synthetic lease agreement for a global technology and operations center located in O'Fallon, Missouri, called Winghaven. The lessor under the lease agreement is MasterCard International O'Fallon 1999 Trust (the Trust). The Trust, which is a variable interest entity, was established for a single discrete purpose, is not an operating entity, has a limited life and has no employees. The Trust financed the operations center through a combination of a third-party equity investment in the amount of \$4,620 and the issuance of 7.36 percent Series A Senior Secured Notes (the Secured Notes) in the amount of \$149,380 and due September 1, 2009. On August 29, 2008, MasterCard notified the equity investor and holders of the Secured Notes of its intent to repay the obligations issued through the Trust. The repayment of aggregate outstanding principal and accrued interest on the Secured Notes will occur by March 1, 2009. MasterCard was in compliance with the covenants of the Secured Notes at September 30, 2008. In addition, on August 29, 2008 MasterCard exercised its option to extend the lease agreement for one additional ten-year term.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued****(In thousands, except per share and percent data)****Note 12. Litigation Settlements**

On October 27, 2008, MasterCard and Visa Inc. ( Visa ) entered into a settlement agreement (the Discover Settlement ) with Discover Financial Services, Inc. ( Discover ) relating to the U.S. federal antitrust litigation amongst the parties. The Discover Settlement ended all litigation between the parties for a total of \$2,750,000. In July 2008, MasterCard and Visa had entered into a judgment sharing agreement that allocated responsibility for any judgment or settlement of the Discover action between the parties. Accordingly, the MasterCard share of the Discover Settlement is \$862,500, which will be paid to Discover in November 2008. In addition, in connection with the Discover Settlement, Morgan Stanley, Discover's former parent company, agreed to pay MasterCard \$35,000 in November 2008, pursuant to a separate agreement. This receivable from Morgan Stanley is included in accounts receivable at September 30, 2008. The net impact of \$827,500 is included in litigation settlements in the three and nine months ended September 30, 2008.

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 \$150,000 per quarter beginning in the third quarter of 2008. MasterCard's maximum nominal payments will total \$1,800,000. 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 \$150,000 per quarter. If, however, the payment for any quarter is less than \$150,000, the maximum payment for subsequent quarters will be increased by the difference between \$150,000 and the lesser amount that was paid in any quarter in which there was a shortfall. MasterCard assumes American Express will achieve these financial hurdles. MasterCard recorded the present value of \$1,800,000, at a 5.75% discount rate, or \$1,649,345 in June 2008.

In 2003, MasterCard entered into a settlement agreement (the U.S. Merchant Lawsuit Settlement ) related to the U.S. merchant lawsuit described under the caption U.S. Merchant and Consumer Litigations in Note 17 and contract disputes with certain customers. Under the terms of the U.S. Merchant Lawsuit Settlement, the Company is required to pay \$125,000 in 2003 and \$100,000 annually each December from 2004 through 2012. In addition, in 2003, several other lawsuits were initiated by merchants who opted not to participate in the plaintiff class in the U.S. merchant lawsuit. The opt-out merchant lawsuits were not covered by the terms of the U.S. Merchant Lawsuit Settlement and all have been individually settled.

The Company recorded liabilities for certain litigation settlements in prior periods. Total liabilities for litigation settlements changed during the nine months ended September 30, 2008 as follows:

|  |              |
|--|--------------|
| Balance as of December 31, 2007                        | \$ 404,436   |
| Provision for Discover Settlement                      | 862,500      |
| Provision for American Express Settlement              | 1,649,345    |
| Interest accretion on U.S. Merchant Lawsuit Settlement | 24,412       |
| Interest accretion on American Express Settlement      | 23,060       |
| Payments on American Express Settlement                | (150,000)    |
| Other payments and accretion                           | (579)        |
| Balance as of September 30, 2008                       | \$ 2,813,174 |

See Note 17 for additional discussion regarding the Company's legal proceedings.



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**MASTERCARD INCORPORATED**

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

**(In thousands, except per share and percent data)**

**Note 13. Share Based Payment and Other Benefits**

On March 1, 2008, the Company granted approximately 234 performance units, 131 stock options and 2 restricted stock units under the MasterCard Incorporated 2006 Long-Term Incentive Plan ( LTIP ). The fair value of the performance units and restricted stock units, based on the closing price of the Class A common stock, par value \$.0001, on the New York Stock Exchange on the date of grant, was \$190.00. The fair value of the stock options estimated on the date of grant using a Black-Scholes option pricing model was \$78.54. The performance units and restricted stock units will primarily vest on February 28, 2011. The stock options vest ratably over four years and expire ten years from the date of grant. 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 for expensing equity awards. With regard to the performance units, the ultimate number of shares to be received by the employee upon vesting will be determined by the Company's performance against predetermined net income (two-thirds weighting) and operating margin (one-third weighting) goals for the three-year period commencing January 1, 2008. Estimates are adjusted as appropriate. No significant grants under the LTIP were made subsequent to March 1, 2008.

**Note 14. Stockholders' Equity**

**Class B Common Stock Conversion**

In February 2008, the Company's Board of Directors authorized the conversion and sale or transfer of up to 13,100 shares of Class B common stock into shares of Class A common stock. In May 2008, the Company implemented and completed a conversion program in which all of the 13,100 authorized shares of Class B common stock were converted into an equal number of shares of Class A common stock and subsequently sold or transferred by participating holders of Class B common stock to public investors.

**Stock Repurchase Program**

During 2008, the Company repurchased approximately 2,819 shares of Class A common stock at a cost of \$649,468, completing its aggregate authorized share repurchase program of \$1,250,000. The Company records the repurchase of shares of common stock at cost based on the settlement date of the transaction. These shares are classified as treasury stock, which is a reduction to stockholders' equity. Treasury stock is included in authorized and issued shares but excluded from outstanding shares.

**Table of Contents****MASTERCARD INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued****(In thousands, except per share and percent data)****Note 15. Commitments**

The future minimum payments under non-cancelable leases for office buildings and equipment, sponsorships, licensing and other agreements at September 30, 2008 were as follows:

|                       | <b>Total</b>      | <b>Capital<br/>Leases</b> | <b>Operating<br/>Leases</b> | <b>Sponsorship,<br/>Licensing<br/>and<br/>Other</b> |
|-----------------------|-------------------|---------------------------|-----------------------------|---|
| The remainder of 2008 | \$ 213,394        | \$ 3,553                  | \$ 11,300                   | \$ 198,541  |
| 2009                  | 226,182           | 6,757                     | 34,931                      | 184,494   |
| 2010                  | 134,945           | 2,758                     | 16,875                      | 115,312   |
| 2011                  | 78,059            | 1,978                     | 10,647                      | 65,434  |
| 2012                  | 59,798            | 1,819                     | 8,861                       | 49,118  |
| Thereafter            | 72,159            | 36,837                    | 26,568                      | 8,754   |
| <b>Total</b>          | <b>\$ 784,537</b> | <b>\$ 53,702</b>          | <b>\$ 109,182</b>           | <b>\$ 621,653</b>                                   |

Included in the table above are capital leases with imputed interest expense of \$9,527 and a net present value of minimum lease payments of \$44,175. In addition, at September 30, 2008, \$55,627 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 office space was approximately \$11,533 and \$8,974 for the three months ended September 30, 2008 and 2007, respectively, and \$31,868 and \$26,199 for the nine months ended September 30, 2008 and 2007, respectively. Consolidated lease expense for automobiles, computer equipment and office equipment was \$1,499 and \$2,057 for the three months ended September 30, 2008 and 2007, respectively, and \$5,832 and \$5,735 for the nine months ended September 30, 2008 and 2007, respectively.

**Note 16. Income Taxes**

The effective income tax rates were a 34.1% benefit and a 34.8% expense for the three months ended September 30, 2008 and 2007, respectively, and a 40.4% benefit and a 35.1% expense for the nine months ended September 30, 2008 and 2007, respectively. The decrease in the effective tax rate in the three months ended September 30, 2008 versus the comparable period in 2007 was primarily due to the tax benefit related to the charge for the Discover Settlement, partially offset by a tax charge in the three months ended September 30, 2008 for the remeasurement of deferred tax assets as a result of a change in the Company's estimated effective state tax rate. As a result of the remeasurement, the Company's deferred tax assets were reduced by \$20,100 with a corresponding increase in income tax expense. The increase in the effective tax rate in the nine months ended September 30, 2008 versus the comparable period in 2007 was primarily due to the tax benefits related to the charges for the Discover Settlement and the American Express Settlement, partially offset by the tax charge in the three months ended September 30, 2008 for the remeasurement of deferred tax assets. The effect of the charges significantly changed the geographic distribution of pre-tax income (loss) from jurisdictions with lower tax rates to those with higher tax rates.

In addition, the charge for the Discover Settlement, recorded in September 2008, will be deductible for tax purposes in 2008 when the payment is made. Accordingly, an income tax refund receivable has been recorded for \$256,469 related to the recovery of estimated tax payments made previously in 2008.



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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, 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 for those matters 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 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 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.

**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. The parties agreed that October 15, 2004 would serve as the effective date of the final judgment. The final judgment also provided for a two-year period of rescission rights for an issuer to enter into an agreement with American Express or Discover.

On September 18, 2003, MasterCard filed a motion before the District Court judge in the DOJ case seeking to enjoin Visa from enforcing a newly-enacted bylaw requiring Visa's 100 largest issuers of debit cards in the United States to pay a so-called settlement service fee if they reduce their Visa debit volume by more than 10%. This bylaw was later modified to clarify that the settlement service fee would only be imposed if an issuer shifted its portfolio of debit cards to MasterCard. Visa implemented this bylaw provision following the settlement of the U.S. merchant lawsuit described under the heading U.S. Merchant and Consumer Litigations below. MasterCard believes that this bylaw is punitive and violates the final judgment in the DOJ litigation, which enjoins Visa and MasterCard from enacting, maintaining, or enforcing any bylaw or policy that prohibits issuers from issuing general purpose cards or debit cards in the United States on any other general purpose card network. On July 7, 2006, a special master appointed by the District Court to conduct an evidentiary hearing issued a report and recommendation to the District Court finding that the continuation of Visa's settlement service fee after the effective date of the final judgment on October 15, 2004 violated the final judgment. On June 7, 2007, the District Court judge issued an opinion and order agreeing with the special master's finding that the SSF violated the final judgment in the DOJ





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litigation. The Court's order requires Visa to repeal the SSF and also permits any of Visa's largest 100 debit issuers who entered into an agreement relating to debit card issuance with Visa while the SSF was in place to terminate its agreement with Visa in order to enter into an agreement with MasterCard to issue MasterCard-branded debit cards. On June 13, 2007, MasterCard and Visa entered into an agreement to extend the statute of limitations on the time MasterCard has to file potential claims that MasterCard may have against Visa in connection with the SSF. On June 29, 2007, Visa filed a notice of appeal with the Second Circuit. Briefing on Visa's appeal was completed on November 21, 2007. On July 29, 2008, in connection with the execution of the judgment sharing agreement in the Discover litigation described below, and as separate consideration to MasterCard reflected in the allocation provisions of that agreement, Visa agreed to dismiss its appeal and MasterCard released any potential claims that it may have against Visa in connection with the SSF.

On February 25, 2008, the Antitrust Division of the DOJ issued a Civil Investigative Demand (CID) to MasterCard seeking information regarding a potential violation of the final judgment in the DOJ litigation discussed in the preceding paragraphs. The CID seeks documents, data and narrative responses to several interrogatory and document requests which focus on whether early termination and waiver provisions in agreements between MasterCard and issuers violate the DOJ final judgment. MasterCard is cooperating with the DOJ in connection with the CID.

On October 4, 2004, Discover Financial Services, Inc. filed a complaint against MasterCard, Visa U.S.A. Inc. and Visa International Services Association. The complaint was filed in the U.S. District Court for the Southern District of New York and was designated as a related case to the DOJ litigation, and was assigned to Judge Barbara Jones, the same judge who issued the DOJ decision described above. In an amended complaint filed on January 7, 2005, Discover alleged that the implementation and enforcement of MasterCard's CPP, Visa's bylaw provision and the Honor All Cards rule violated Sections 1 and 2 of the Sherman Act in an alleged market for general purpose card network services and an alleged market for debit card network services. Specifically, Discover claimed that MasterCard's CPP unreasonably restrained trade by prohibiting financial institutions who were members of MasterCard from issuing payment cards on the Discover network. Discover requested that the District Court apply collateral estoppel with respect to its final judgment in the DOJ litigation and enter an order that the CPP and Visa's bylaw provision have injured competition and caused injury to Discover. Under the doctrine of collateral estoppel, a court has the discretion to preclude one or more issues from being relitigated in a subsequent action but only if: (1) those issues are identical to issues actually litigated and determined in the prior action, (2) proof of those issues were necessary to reach the prior judgment, and (3) the party to be estopped had a full and fair opportunity to litigate those issues in the prior action. Accordingly, if the District Court were to give effect to collateral estoppel on one or more issues in the future, then significant elements of plaintiff's claims would be established, thereby making it more likely that MasterCard would be found liable and making the possibility of an award of damages that much more likely. In the event all issues are subsequently decided against MasterCard in dispositive motions during the course of the litigation, then there is the possibility that the sole issue remaining will be whether a damage award is appropriate and, if so, what the amount of damages should be. Discover sought treble damages in an amount to be proved at trial along with attorneys' fees and costs. On February 7, 2005, MasterCard moved to dismiss Discover's amended complaint in its entirety for failure to state a claim. In a series of rulings, the District Court denied most aspects of MasterCard's motion to dismiss although it did dismiss Discover's Section 2 monopolization and attempted monopolization claims against MasterCard. On April 14, 2005, the District Court denied, at that stage in the litigation, Discover's request to give collateral estoppel effect to the findings in the DOJ litigation. However, the District Court indicated that Discover could refile a motion for collateral estoppel after discovery. On June 7, 2007, Discover filed a second amended complaint that mirrored the claims in its amended complaint but deleted allegations relating to MasterCard's Honor All Cards rule as well as Discover's Section 2 monopolization and attempted monopolization claims against MasterCard based upon the court's prior dismissal of those claims. Fact discovery was completed on May 31, 2007. Discover submitted expert reports purporting to demonstrate that it had incurred damages in excess of \$6,000,000 before trebling. MasterCard submitted expert reports countering the damages arguments made in Discover's reports and concluding that damages are negative. On February 15, 2008, MasterCard and Visa moved for summary judgment with respect to all, or in the alternative, portions of Discover's claims. Also on February 15, 2008, Discover filed a motion for summary judgment seeking collateral estoppel with respect to its Section 1 claims against MasterCard, as well as an order precluding MasterCard from litigating certain issues Discover contends were tried in the underlying DOJ litigation. Briefing on these motions was completed on April 25, 2008. On August 20, 2008, the Court issued its ruling on the summary judgment motions. The Court: (i) granted Discover's collateral estoppel motion with respect to market definition, market power, consumer injury and



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injury to Discover, thus giving collateral estoppel effect to these determinations at trial; (ii) granted MasterCard's summary judgment motion with respect to Discover's claim of an inter-association conspiracy between MasterCard and Visa and dismissed such claim; (iii) granted MasterCard's summary judgment motion with respect to Discover's debit-related claims against MasterCard and dismissed such claims; and (iv) granted Visa's summary judgment motions with respect to Discover's debit monopolization claims against Visa and dismissed such claims. The court otherwise denied all other aspects of the parties' summary judgment motions. Trial was scheduled to commence on October 14, 2008. In response to MasterCard's and Visa's requests, on April 18, 2008, the District Court ordered Discover, MasterCard and Visa to confer and stipulate to a process that would govern a non-binding mediation of the litigation. On July 29, 2008, MasterCard and Visa entered into a judgment sharing agreement that provided for the apportionment of certain costs and liabilities which MasterCard and Visa might incur, jointly and/or severally, in the event of an adverse judgment or settlement in the Discover litigation. The judgment sharing agreement provided that Visa would be responsible for the substantial majority of any judgment or settlement in the litigation, based primarily on relevant volumes. On October 27, 2008, MasterCard and Visa entered into a settlement agreement with Discover, ending all litigation between the parties for a total of \$2,750,000. The MasterCard share of the settlement, to be paid to Discover in November 2008, is \$862,500. In addition, in connection with the Discover Settlement and pursuant to a separate agreement, Morgan Stanley, Discover's former parent company, agreed to pay MasterCard \$35,000 in November 2008.

On November 15, 2004, American Express filed a complaint against MasterCard, Visa and eight member banks, including JPMorgan Chase & Co., Bank of America Corp., Capital One Financial Corp., U.S. Bancorp, Household International Inc., Wells Fargo & Co., Provident Financial Corp. and USAA Federal Savings Bank. Between June 2005 and December 2005, USAA Federal Savings Bank, Bank of America Corp. and Household International Inc. announced settlements with American Express and were dismissed from the case. The complaint, which was filed in the U.S. District Court for the Southern District of New York, was designated as a related case to the DOJ litigation and was assigned to Judge Jones. The complaint alleges that the implementation and enforcement of MasterCard's CPP and Visa's bylaw provision violated Sections 1 and 2 of the Sherman Act in an alleged market for general purpose card network services and a market for debit card network services. Specifically, American Express claimed that MasterCard's CPP unreasonably restrained trade by prohibiting financial institutions who were members of MasterCard from issuing payment cards on the American Express network. American Express sought treble damages in an amount to be proved at trial, along with attorneys' fees and costs. In November 2007, Visa and the remaining bank defendants reached a settlement with American Express and were dismissed from the case. On June 24, 2008, MasterCard entered into a settlement agreement with American Express to resolve all current litigation between American Express and MasterCard, following which Judge Jones dismissed the case without prejudice, pending full payment. Under the terms of the settlement agreement, MasterCard is obligated to make twelve quarterly payments of up to \$150,000 per quarter beginning in the third quarter of 2008, which MasterCard commenced paying on September 15, 2008. See Note 12 for additional discussion. MasterCard's maximum nominal payments will total \$1,800,000. The amount of each quarterly payment is contingent on the performance of American Express' U.S. Global Network Services business. The quarterly payments will be in an amount equal to 15% of American Express' U.S. Global Network Services billings during the quarter, up to a maximum of \$150,000 per quarter. If, however, the payment for any quarter is less than \$150,000, the maximum payment for subsequent quarters will be increased by the difference between \$150,000 and the lesser amount that was paid in any quarter in which there was a shortfall. MasterCard assumes American Express will achieve these financial hurdles. Total future payments discounted at 5.75% over the payment term, or \$1,649,345, are reflected on MasterCard's Statement of Operations as a litigation settlement for the nine months ended September 30, 2008.

**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 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.*, was brought in the Superior Court of California in February 2000, purportedly on behalf of the general public. Trial of the Schwartz matter 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.



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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 have been stayed pending MasterCard's appeal. On August 6, 2004, the court awarded plaintiff's attorneys' fees and costs in the amount of \$28,224 to be paid equally by MasterCard and Visa. Accordingly, during the three months ended September 30, 2004, MasterCard accrued amounts totaling \$14,112. MasterCard subsequently filed a notice of appeal on the attorneys' fee award on October 1, 2004. With respect to restitution, MasterCard believes that it is 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 \$72,480 to be used for defendants' settlement fund to settle the MDL action and \$13,440 to settle the Schwartz matter. On November 8, 2006, Judge Pauley granted preliminary approval of the settlement agreements. The settlement agreements are subject to final approval by Judge Pauley, and resolution of all appeals. The hearing on final approval of the settlement agreements was held on March 31, 2008 and Judge Pauley reserved decision on final approval. 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 June 6, 2007, the appellate court granted MasterCard's motion to defer briefing until a final settlement is approved in the MDL action.

With regard to other state court currency conversion actions, MasterCard has reached agreements in principle with the plaintiffs for a total of \$3,557, which has been accrued. Settlement agreements have been executed with plaintiffs in the Ohio, Pennsylvania, Florida, Texas, Arkansas, Tennessee, Arizona, New York, Minnesota and Illinois actions, but such an agreement has not been executed with plaintiffs in the Missouri action. 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



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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. The plaintiffs also claimed that MasterCard and Visa conspired to monopolize what they characterized as the point-of-sale debit card market, thereby suppressing the growth of regional networks such as ATM payment systems. 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. Accordingly, the settlement is now final.

In addition, individual or multiple complaints have been brought in 19 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, California and West Virginia. The parties are awaiting a decision on MasterCard's motion to dismiss in New Mexico. The parties in the California cases briefed and argued the narrow issue of whether as a legal matter the summary judgment ruling in the U.S. merchant lawsuit could constitute a final judgment on the merits to which collateral estoppel could potentially apply. On October 31, 2007, the California state court ruled in MasterCard and Visa's favor and found that the U.S. merchant lawsuit summary judgment ruling would have no collateral estoppel effect in this proceeding. Limited discovery is proceeding in the California cases. Based upon litigation developments and settlement negotiations in that state, MasterCard recorded legal reserves for the West Virginia consumer litigation during the second quarter of 2007. On January 7, 2008, MasterCard executed a settlement agreement, in which it agreed to resolve the West Virginia consumer action for a payment by MasterCard of \$3,400, which is within the reserve that MasterCard had established for the case. The court granted preliminary approval of the settlement on January 14, 2008 and final approval on August 22, 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 claims in this action seek to piggyback on the portion of the DOJ antitrust litigation in which the United States District Court for the Southern District of New York found that MasterCard's CPP and Visa's bylaw constitute unlawful restraints of trade under the federal antitrust laws. See Department of Justice Antitrust Litigation and Related Private Litigations. 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 are proceeding with discovery.

At this time, it is not possible to determine the outcome of, or, except as indicated above in the West Virginia 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.

**eFunds Litigation**

In December 2003, MasterCard and eFunds Corporation (eFunds) entered into a Marketing Sales and Services Alliance Agreement (the Agreement) whereby the parties agreed to work together to provide debit processing services to financial institutions. After analysis of the needs of its customers and its business, on December 13, 2006, MasterCard notified eFunds that, pursuant to one of the provisions in the Agreement, it was terminating the Agreement. On or about January 30, 2007, eFunds filed a verified complaint against MasterCard in Superior Court for the State of Arizona, alleging that MasterCard's termination of the Agreement was improper. The complaint asserts several causes of action including declaratory judgment, breach of contract, breach of the covenant of good faith and fair dealing, and fraudulent inducement. eFunds seeks a declaratory judgment that the Agreement remains in full force and effect, or, in the alternative, monetary damages. MasterCard moved to dismiss certain of eFunds' causes of action and the court heard oral argument on the motion on June 29, 2007. On August 16, 2007, the court granted parts of MasterCard's motion to dismiss although eFunds' claim for damages for breach of contract and related causes of action remain. On September 4, 2007, MasterCard answered the complaint and filed





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counterclaims against eFunds. In addition, on April 18, 2008, MasterCard filed an amended answer and counterclaims. On May 8, 2008, eFunds answered MasterCard's counterclaims and added additional claims in an amended complaint. On July 1, 2008, MasterCard moved to dismiss certain of eFunds' claims. The parties are briefing MasterCard's motion and are proceeding with discovery.

At this time, it is not possible to determine the outcome of, or estimate the liability related to, the eFunds litigation and no provision for losses has been provided in connection with it.

**Global Interchange 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 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 a default interchange fee in certain circumstances that applies 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 or its members' interchange fees are subject to regulatory 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. No provision for losses has been provided in connection with them.

*United States.* On October 8, 2004, a purported class action lawsuit was filed by a group of merchants in the U.S. District Court for the Northern District of California against MasterCard International, Visa U.S.A., Inc., Visa International Corp. and several member banks in California alleging, among other things, that MasterCard's and Visa's interchange fees contravene the Sherman Act and the Clayton Act. The plaintiffs seek damages and an injunction against MasterCard (and Visa) setting interchange and engaging in joint marketing activities, which plaintiffs allege include the purported negotiation of merchant discount rates with certain merchants. MasterCard moved to dismiss the claims in the complaint for failure to state a claim and, in the alternative, also moved for summary judgment with respect to certain of the claims. On July 25, 2005, the court issued an order granting MasterCard's motion to dismiss and dismissed the complaint with prejudice which plaintiffs have appealed. Oral argument on the appeal was held on June 11, 2007. On March 7, 2008, the Court of Appeals affirmed the district court's dismissal of the complaint. The time in which plaintiffs could file a petition for certiorari with the Supreme Court has expired.

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. 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 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 Sections 1 and 2 of the Sherman Act. 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



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certain unfair competition law claims under state law based upon the same conduct described above. These interchange-related litigations also seek treble damages in an unspecified amount (although several of the complaints allege that the plaintiffs expect that damages will range in the tens of billions of dollars), 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 September 7, 2007, Magistrate Judge Orenstein issued a report and recommendation that MasterCard's motion to dismiss the pre-2004 damages claims should be granted in its entirety. On January 8, 2008, the district court adopted the magistrate judge's report and recommendation and dismissed the plaintiffs' pre-2004 damage claims. On January 11, 2008, the magistrate judge issued a report and recommendation that MasterCard's motion to dismiss the individual merchant defendants' Section 2 claims should be denied. On February 15, 2008, MasterCard filed objections to the magistrate judge's report and recommendation. On May 14, 2008, the court issued an order rejecting MasterCard's objections and adopted the magistrate's recommendation denying MasterCard's motion to dismiss. Fact discovery has been proceeding and is currently scheduled to be completed by November 21, 2008. Briefing on class certification is to be completed by January 12, 2009, and briefing on case dispositive motions is to be completed by December 21, 2009. No trial date has been scheduled. 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 February 12, 2008, Magistrate Judge Orenstein issued a report and recommendation that granted in part and denied in part MasterCard's motion to dismiss. Specifically, Magistrate Orenstein recommended that MasterCard's motion to dismiss plaintiffs' fraudulent conveyance claims be granted but he allowed plaintiffs leave to replead those claims. Magistrate Orenstein otherwise recommended the denial of all other aspects of MasterCard's motion to dismiss plaintiffs' Section 7 and Section 1 claims described above. On April 4, 2008, MasterCard filed objections to Magistrate Orenstein's report and recommendation. The court has not yet ruled on MasterCard's objections. The parties have also entered into court-recommended mediation.

On October 10, 2008, the Antitrust Division of the DOJ issued a CID to MasterCard and other payment industry participants seeking information regarding certain rules relating to merchant acceptance, particularly with respect to merchants' ability to steer customers to payment forms preferred by merchants. The CID seeks documents, data and narrative responses to several interrogatory and document requests which focus on reasons merchants may have decreased their acceptance of certain cards, information on penetration rates by merchant category, co-brand cards and transactions in various countries. MasterCard is cooperating with the DOJ in connection with the CID.

*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 March 26, 2008, the European Commission announced that it has opened formal antitrust proceedings against Visa Europe Limited, under Article 81 of the EC Treaty, in relation to Visa's multilateral interchange fees for cross-border consumer payment card transactions within the European Economic Area (the "EEA") and Visa's honor all cards' rule as it applies to these transactions.

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



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

**(In thousands, except per share and percent data)**

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 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 cease applying the MasterCard MIF, to refrain from repeating the infringement, and not to apply its recently adopted (but never implemented) Maestro SEPA and Intra-Eurozone default interchange fees to debit 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 does not impose a fine on MasterCard, but provides for a daily penalty of 3.5% of MasterCard's daily consolidated global turnover in the preceding business year (which MasterCard estimates to be approximately \$400 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 EU Court of First Instance. MasterCard also has the right to seek interim relief to prevent the decision from becoming effective before the outcome of its appeal or with respect to other aspects of the decision, although it is uncertain whether MasterCard would receive any such relief.

The decision 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. MasterCard has 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. Discussions are continuing between MasterCard and the European Commission concerning what interchange fee setting methodology MasterCard might employ in compliance with the decision.

Although MasterCard believes that any business practices it would implement would be in compliance with the 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 decision could also significantly impact MasterCard International's European customers and MasterCard Europe's business. The European Commission decision could also lead to competition authorities in one or more EU Member States commencing investigations or proceedings regarding domestic interchange fees. 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 appeal of the decision, could result in MasterCard owing substantial damages. On October 16, 2008, MasterCard



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received an information request from the European Commission in connection with the decision concerning certain pricing and interchange fees that MasterCard has recently implemented. MasterCard's response is due on November 10, 2008.

*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 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 exclusively 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.

The OFT has commenced a new investigation of MasterCard's current U.K. default 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 intends to commence a formal proceeding through the issuance of a Statement of Objections in the near future. 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.

*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. MasterCard and the financial institutions have appealed the decision. If the appeals are unsuccessful and the PCA's decision is 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.

*New Zealand.* In November 2003, MasterCard assumed responsibility for setting domestic default interchange fees in New Zealand, which previously had been set by MasterCard's customer financial institutions in New Zealand. In early 2004, the New Zealand Competition Commission (the NZCC) commenced an investigation of MasterCard's domestic interchange fees. MasterCard cooperated with the NZCC in its investigation, made a number of submissions concerning its New Zealand domestic default interchange fees and met with the NZCC on several occasions to discuss its investigation. In November 2006, the NZCC filed a lawsuit alleging that MasterCard's (and Visa's) domestic default interchange fees and certain other of MasterCard's practices including its honor all cards rule do not comply with New Zealand competition law, and seeking penalties. Several large merchants subsequently





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filed similar lawsuits seeking damages. The litigations, which have been consolidated, are currently in the discovery phase and are not expected to go to trial until the latter part of 2009. A negative decision in these lawsuits could have a significant adverse impact on the revenues of MasterCard's New Zealand customers and on MasterCard's overall business in New Zealand.

*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 indicate that the RBA is considering imposing in 2009 additional regulations that could further reduce the domestic interchange fees of four-party credit card systems in Australia. Alternatively, the RBA is considering allowing average interchange fee levels to remain the same but requiring some changes to the honor all cards rules. The effect of 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, which could have a significant adverse impact on MasterCard's business in Australia.

*South Africa.* On August 4, 2006, the South Africa Competition Commission (SACC) 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. It is expected that the Enquiry's full report will be made public in the near future. Based on the Executive Summary, it appears that the Enquiry will recommend, 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. If adopted, the Enquiry's recommendations could have a significant adverse impact on MasterCard's business in South Africa.

*Other Jurisdictions.* In January 2006, a German retailers association filed a complaint with the Federal Cartel Office 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. MasterCard understands that the Federal Cartel Office is continuing to review the complaint.

In January 2008, the Hungarian Competition Authority notified MasterCard that it has commenced a formal investigation of MasterCard Europe's domestic interchange fees. This follows an informal investigation that the Authority had been conducting since the middle of 2007.

MasterCard is aware that regulatory authorities and/or central banks in certain other jurisdictions including Brazil, Colombia, Mexico, Singapore, Norway, Portugal and Switzerland are reviewing MasterCard's and/or its members' interchange fees and/or related practices and may seek to regulate the establishment of such fees and/or such practices.

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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 charges 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. Further, 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 letters of credit and 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, the Company may elect to do so to protect brand integrity. MasterCard monitors its credit risk portfolio on a regular basis to estimate potential concentration risks 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:

|   | September 30,<br>2008 | December 31,<br>2007 |
|---|-----------------------|----------------------|
| <b>MasterCard-branded transactions:</b>   |                       |                      |
| Gross Settlement Exposure   | \$ 23,162,902         | \$ 22,783,200        |
| Collateral held for Settlement Exposure   | (1,998,067)           | (2,161,754)          |
| Net uncollateralized Settlement Exposure  | \$ 21,164,835         | \$ 20,621,446        |
| <b>Uncollateralized Settlement Exposure attributable to non-compliant members</b> | <b>\$ 41,615</b>      | <b>\$ 108,141</b>    |
| <b>Cirrus and Maestro transactions:</b>   |                       |                      |
| Gross Settlement Exposure   | \$ 3,825,264          | \$ 3,347,853         |

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 estimated Settlement Exposure under the MasterCard brand, net of collateral, the U.S. accounted for approximately 47% and 43% at September 30, 2008 and December 31, 2007, respectively. The United Kingdom accounted for approximately 10% and 11% at September 30,

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2008 and December 31, 2007, respectively. Of the total uncollateralized Settlement Exposure attributable to non-compliant members, five members represented approximately 55% and 64% at September 30, 2008 and December 31, 2007, respectively.

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MasterCard guarantees the payment of MasterCard-branded travelers cheques in the event of issuer default. The exposure 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 \$486,065 and \$563,087 at September 30, 2008 and December 31, 2007, respectively. The reduction in travelers cheques exposure is attributable to the continued wind-down of the MasterCard travelers cheques program.

A significant portion of the Company's travelers cheque risk is concentrated in one MasterCard travelers cheque issuer. MasterCard has obtained an unlimited guarantee estimated at \$385,647 and \$452,134 at September 30, 2008 and December 31, 2007, 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 has obtained a limited guarantee estimated at \$16,514 and \$18,004 at September 30, 2008 and December 31, 2007, respectively, from a financial institution that is a member, 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 cheques that are not anticipated to be presented for payment.

Based on the Company's ability to charge its members for settlement and travelers cheque losses, the effectiveness of the Company's global risk management policies and procedures, and the historically low level of losses that the Company has experienced from settlement and travelers cheques, management believes that the probability of future payments for settlement and travelers cheque losses in excess of existing reserves is negligible.

**Note 19. Foreign Exchange Risk Management**

The Company enters into foreign currency forward contracts to minimize risk associated with anticipated receipts and disbursements which are either transacted in a non-functional currency or valued based on a currency other than our functional currencies. The Company also enters into contracts to offset possible changes in value due to foreign exchange fluctuations of assets and liabilities denominated in foreign currencies. At September 30, 2008, all contracts to purchase and sell foreign currency had been entered into with customers of MasterCard International. MasterCard's forward contracts are classified by functional currency as summarized below:

**U.S. Dollar Functional Currency**

|  | September 30, 2008 |                      | December 31, 2007 |                      |
|--|--------------------|----------------------|-------------------|----------------------|
|  | Notional           | Estimated Fair Value | Notional          | Estimated Fair Value |
| <b>Forward Contracts</b>                 |                    |                      |                   |                      |
| Commitments to purchase foreign currency | \$ 52,740          | \$ (676)             | \$ 39,933         | \$ (286)             |
| Commitments to sell foreign currency     | 210,616            | 8,561                | 22,088            | 388                  |

**Euro Functional Currency**

|                                      | September 30, 2008 |                      | December 31, 2007 |                      |
|--------------------------------------|--------------------|----------------------|-------------------|----------------------|
|                                      | Notional           | Estimated Fair Value | Notional          | Estimated Fair Value |
| <b>Forward Contracts</b>             |                    |                      |                   |                      |
| Commitments to sell foreign currency | \$ 70,032          | \$ 2,108             | \$ 49,698         | \$ (275)             |

The currencies underlying the foreign currency forward contracts consist primarily of the euro, U.K. pound sterling, Brazilian real, Canadian dollar, Mexican peso and Australian dollar. 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 had no deferred gains

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or losses in accumulated other comprehensive income as of September 30, 2008 and December 31, 2007 as there were no derivative contracts accounted for under hedge accounting.

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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 September 30, 2008 and December 31, 2007, respectively.

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.

**Note 20. Other Income**

During the nine months ended September 30, 2008, MasterCard sold all of its remaining 6,141 shares of Redecard S.A. and realized pre-tax gains, net of commissions, of approximately \$86,000 in investment income. During the three and nine months ended September 30, 2007, MasterCard sold approximately 6,900 shares of Redecard S.A. and realized pre-tax gains, net of commissions, of \$107,042 in investment income.

During the nine months ended September 30, 2008, the Company recognized \$75,000, pre-tax, in other income, related to the termination of a customer business agreement for a customer exiting a specific line of business. During the nine months ended September 30, 2007, the Company recognized \$90,000, pre-tax, in other income related to a settlement agreement to discontinue its relationship with the organization which operates the World Cup soccer events and not sponsor the 2010 and 2014 World Cup soccer events.

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*The following discussion should be read in conjunction with the consolidated financial statements and notes of MasterCard Incorporated and its consolidated subsidiaries. In this discussion, 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 (doing business as MasterCard Worldwide), and MasterCard Europe sprl ( MasterCard Europe ).*

**Forward-Looking Statements and Non-GAAP Financial Information**

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 strong liquidity and capital position; the Company's belief in 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, enhancing its merchant relationships, growing acceptance and continuing to invest in its brands, pursuing incremental payment processing opportunities throughout the world, increasing its volume of business with customers over time, maintaining and enhancing its brands and images through advertising and marketing efforts on a global scale and continuing to invest in marketing programs at regional and local levels; the potential impact on the Company's business and/or the payment industry of regulatory developments, marketing developments, a change in payment patterns by consumers and/or a decrease in issuance and/or promotion of MasterCard payment solutions by the Company's customers; and the potential impact on the Company's business of economic circumstances, including consolidation of the Company's banking customers, tightening of credit availability, inflation and other challenging economic conditions. 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 Item 1A in Part II of the Quarterly Report on Form 10-Q for the quarter ended June 30, 2008 and Item 1A in Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for additional discussion of these and other risks facing our business.

Non-GAAP financial information is defined as a numerical measure of a company's performance that excludes or includes amounts so as to be different than the most comparable measure calculated and presented in accordance with accounting principles generally accepted in the United States ("GAAP"). Pursuant to the requirements of Regulation S-K, portions of this "Management's Discussion and Analysis of Financial Condition and Results of Operations" include a reconciliation of certain non-GAAP financial measures to the most directly comparable GAAP financial measures. The presentation of non-GAAP financial measures should not be considered in isolation or as a substitute for the Company's related financial results prepared in accordance with GAAP.

MasterCard has presented non-GAAP financial measures for operating expenses in the three and nine months ended September 30, 2008 and 2007 and the effective income tax rate for the three and nine months ended September 30, 2008 as supplements to GAAP measures, to enhance an investor's evaluation of MasterCard's ongoing operating results and to aid in forecasting future periods. MasterCard's management uses these non-GAAP financial measures to, among other things, evaluate its ongoing operations in relation to historical results, for internal planning and forecasting purposes and in the calculation of performance-based compensation. More specifically, with respect to the non-GAAP financial measures presented in this discussion:

**Operating expenses**— Litigation settlements have been excluded since MasterCard monitors litigation settlements separately from ongoing operations and evaluates ongoing operating performance without these settlements. See **Operating Expenses** for a table which provides a reconciliation of operating expenses excluding litigation settlements to the most directly comparable GAAP measure to allow for a more meaningful comparison of results between periods.

**Effective income tax rate**— The income tax benefits associated with litigation settlements have been excluded to provide a comparison of the effective income tax rate associated with ongoing operations of the business. See **Income Taxes** for a table which provides a reconciliation of the effective income tax rate excluding litigation settlements to the most directly comparable GAAP measure to allow for a more meaningful comparison of results between periods.



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### Overview

We are a global payment solutions company that provides a variety of services in support of our customers' credit, debit and related payment programs. We manage a family of well-known, widely accepted payment card brands including MasterCard®, MasterCard Electronic®, Maestr® 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 system. 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 financial results during the three and nine months ended September 30, 2008 were significantly impacted by the legal environment in which we operate our business. During the three and nine months ended September 30, 2008, we recorded provisions for litigation settlements of \$828 million and \$2.477 billion, respectively. See Notes 12 and 17 to the Consolidated Financial Statements included in Part I, Item 1 and Operating Expenses in Part I, Item 2 of this Form 10-Q for further discussion. As a result of these settlements, we recorded net losses of \$194 million, or \$1.49 per diluted share, and \$493 million, or \$3.79 per diluted share, for the three and nine months ended September 30, 2008, respectively, versus net income of \$314 million, or \$2.31 per diluted share, and \$782 million, or \$5.73 per diluted share, in the comparable periods in 2007. As of September 30, 2008, our liquidity and capital positions remained strong with \$2.8 billion in cash, cash equivalents and current available-for-sale securities, and \$1.8 billion in stockholders' equity.

We achieved net revenue growth of 23.6% and 25.8% for the three and nine months ended September 30, 2008, respectively, primarily due to increased transactions and volumes. Pricing increases accounted for approximately 5 percentage points of our net revenue growth in each of the three and nine months ended September 30, 2008 versus the comparable periods in 2007. Foreign currency fluctuation of the euro and Brazilian real against the U.S. dollar accounted for 3.5 and 4.6 percentage points of our net revenue growth for the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007.

Our operating expenses increased 121.7% and 131.4% for the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007. Excluding the impact of litigation settlements identified in the table included in Operating Expenses, our operating expenses increased 8.3% and 11.3% in the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007, of which 2.4 and 3.3 percentage points, respectively, were due to the foreign currency fluctuation of the euro and Brazilian real against the U.S. dollar. See Impact of Foreign Currency Rates.

Other income in the nine months ended September 30, 2008 included realized gains of approximately \$86 million for the sale of the remaining shares of our available-for-sale security, Redecard S.A., and \$75 million related to the termination of a customer business agreement. See Other Income (Expense).

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 cards, creates significant opportunities for the continued growth of our business. Our strategy is to continue our growth 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 and contactless cards, commercial payments and debit), enhancing our merchant relationships, growing acceptance and continuing to invest in our brands. We also intend to pursue incremental payment processing opportunities throughout the world. We are committed to providing our customers with coordinated services through integrated, dedicated account teams in a manner that allows us to capitalize on our expertise in payment programs, marketing, product development, technology, processing, consulting and information services. By investing in strong customer relationships over the long-term, we believe that we can increase our volume of business with customers over time. See Business Environment Challenges for discussion of environmental considerations related to our strategic objectives.

**Table of Contents****Financial Results**

|   | Three Months   |         | Percent    | Nine Months         |          | Percent    |
|---|--|---------|------------|---------------------|----------|------------|
|   | Ended September 30,                                      |         | Increase   | Ended September 30, |          | Increase   |
|   | 2008   | 2007    | (Decrease) | 2008                | 2007     | (Decrease) |
|   | (In millions, except per share, percent and GDV amounts) |         |            |                     |          |            |
|   |  |         | 2008 vs.   |                     |          | 2008 vs.   |
|   |  |         | 2007       |                     |          | 2007       |
| Net operations fees   | \$ 996   | \$ 792  | 25.8 %     | \$ 2,793            | \$ 2,174 | 28.5 %     |
| Net assessments   | 342  | 291     | 17.5 %     | 974                 | 821      | 18.6 %     |
| Total revenues, net   | 1,338  | 1,083   | 23.6 %     | 3,767               | 2,995    | 25.8 %     |
| General and administrative  | 494  | 433     | 14.1 %     | 1,435               | 1,263    | 13.6 %     |
| Advertising and marketing   | 267  | 264     | 1.1 %      | 770                 | 711      | 8.2 %      |
| Litigation settlements  | 828  |         | **         | 2,477               | 3        | **         |
| Charitable contributions to the MasterCard Foundation                           |  | 10      | **         |                     | 10       | **         |
| Depreciation and amortization   | 29   | 22      | 29.0 %     | 82                  | 71       | 14.6 %     |
| Total operating expenses  | 1,617  | 730     | 121.7 %    | 4,764               | 2,059    | 131.4 %    |
| Operating income (loss)   | (279)  | 353     | (179.0)%   | (997)               | 936      | (206.5)%   |
| Total other income (expense), net   | (14)   | 129     | (111.2)%   | 169                 | 268      | (37.2)%    |
| Income (loss) before income tax expense   | (294)  | 482     | (160.9)%   | (828)               | 1,204    | (168.8)%   |
| Income tax expense (benefit)  | (100)  | 168     | (159.6)%   | (335)               | 423      | (179.2)%   |
| Net income (loss)   | \$ (194)   | \$ 314  | (161.6)%   | \$ (493)            | \$ 782   | (163.1)%   |
| Net income (loss) per share (basic)   | \$ (1.49)  | \$ 2.32 | (164.2)%   | \$ (3.79)           | \$ 5.76  | (165.8)%   |
| Weighted average shares outstanding (basic)                                     | 130  | 135     | (4.3)%     | 130                 | 136      | (3.9)%     |
| Net income (loss) per share (diluted)   | \$ (1.49)  | \$ 2.31 | (164.5)%   | \$ (3.79)           | \$ 5.73  | (166.1)%   |
| Weighted average shares outstanding (diluted)                                   | 130  | 136     | (4.9)%     | 130                 | 137      | (4.5)%     |
| Effective income tax rate   | 34.1%  | 34.8%   | **         | 40.4%               | 35.1%    | **         |
| Gross dollar volume on a U.S. dollar converted basis <sup>1</sup> (in billions) | \$ 662   | \$ 576  | 14.8 %     | \$ 1,926            | \$ 1,638 | 17.6 %     |
| Processed transactions <sup>2</sup>   | 5,380  | 4,760   | 13.0 %     | 15,464              | 13,562   | 14.0 %     |

\* Note that the figures in the preceding table may not sum due to rounding

\*\* Percentage change calculation not meaningful.

<sup>1</sup> MasterCard branded card volume only.

<sup>2</sup> MasterCard, Maestro and Cirrus branded transactions.

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### **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 2008 and 2007, the U.S. dollar weakened against the euro and Brazilian real which increased revenues and expenses. More recently, the U.S. dollar has begun to strengthen against the euro and Brazilian real and if this trend continues revenues and expenses will be negatively impacted.

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 assessment revenues. 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 assessment revenues 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. In the three and nine months ended September 30, 2008, the U.S. dollar weakened as evidenced by a 14.8% and 17.6% increase, respectively, in GDV on a U.S. dollar converted basis versus local currency growth of approximately 12.3% and 13.1%, respectively, from the same periods in the prior year.

### **Revenues**

We generate revenues from the fees that we charge our customers for providing transaction processing and other payment-related services (operations fees) and by charging assessments to our customers based on the GDV of activity on the cards that carry our brands (assessments). GDV includes the aggregated dollar amount of usage (purchases, cash disbursements, balance transfers and convenience checks) on MasterCard-branded cards. Our pricing for transactions and services is complex. Each category of revenue has numerous fee components depending on the types of transactions or services provided. We review our pricing and implement pricing changes on an ongoing 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. Our revenues are based upon transactional information accumulated by our systems or reported by our customers.

Operations fees are transaction-based and are also volume-based and are charged for facilitating the processing and acceptance of payment transactions and information management among our customers. MasterCard's system for transaction processing involves four participants in addition to us: issuers (the cardholders' banks), acquirers (the merchants' banks), merchants and cardholders. Operations fees are charged to issuers, acquirers or their delegated processors for transaction processing services, specific programs to promote MasterCard-branded card acceptance and additional services to assist our customers in managing their businesses. The significant components of operations fees are as follows:

Authorization occurs when a merchant requests approval for a cardholder's transaction. We charge a fee for routing the authorization for approval to or from the issuer or, in certain circumstances, such as when the issuer's systems are unavailable, for approval by us or others on behalf of the issuer in accordance with the issuer's instructions. Our rules, which vary across regions, establish the circumstances under which merchants and acquirers must seek authorization of transactions. These fees are primarily paid by issuers.

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Settlement refers to the process in which we determine the amounts due between issuers and acquirers for payment transactions and associated fees. First, we clear a transaction by transferring the financial transaction details among issuers, acquirers or their designated third-party processors. Then we settle or exchange the related funds among the issuers and acquirers. We charge a fee for these settlement and clearing services. These fees are primarily paid by issuers.

Switch fees are charges for the use of the MasterCard Debit Switch (the MDS), our debit processing system. The MDS transmits financial messages between acquirers and issuers and provides transaction and statistical reporting and performs settlement between customers and other debit transaction processing networks. These fees are primarily paid by issuers.

Currency conversion and cross-border are volume-based revenues. Cross-border volumes are generated by transactions in which the cardholder and merchant geography are different. We process transactions denominated in more than 160 currencies through our global system, providing cardholders with the ability to utilize, and merchants to accept, MasterCard cards across multiple country borders. We charge issuers and acquirers for all cross-border volumes. In January 2008, we increased the charge to acquirers for cross-border volumes. We can also perform currency conversion services by processing transactions in a merchant's local currency and converting the amount to the currency of the issuer, who in turn may add foreign exchange charges and post the transaction on the cardholder's statement in their own home currency. We charge issuers for performing currency conversion.

Acceptance development fees are charged to issuers based on components of GDV and support our focus on developing merchant relationships and promoting acceptance at the point of sale. These fees are primarily U.S.-based.

Warning bulletin fees 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.

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 volume of information being transmitted through and the number of connections to our systems.

Consulting and research fees are primarily generated by MasterCard Advisors, our professional advisory services group. We provide a wide range of consulting and research services associated with our customers' payment activities and programs. Research includes revenues from subscription-based services, access to research inquiry, and peer networking services generated by our independent financial and payments industry research group. We do not anticipate consulting and research fees becoming a significant percentage of our business.

Other operations fees represent various revenue streams, including cardholder services, a variety of account and transaction enhancement services, fees for U.S. acquirers accepting transactions from cardholders with non-U.S. issuers, compliance and penalty fees, holograms and publications. In January 2008, we increased the fee for U.S. acquirers accepting transactions from cardholders with non-U.S. issuers. Cardholder services are benefits provided with MasterCard-branded cards, such as insurance, telecommunications assistance for lost cards and locating automated teller machines.

Assessments that are based on quarterly GDV are estimated utilizing aggregate transaction information and projected customer performance. From time to time, the Company may introduce assessments for specific purposes such as market development programs.

Our gross revenues from operations fees and assessments vary and are dependent on the nature of the transactions and GDV generated from those transactions. The combination of the following transaction characteristics for operations fees determines the pricing:

Domestic or cross-border

Credit, online debit (PIN-based), offline debit (signature-based)

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

Geographic region or country

In addition to the factors above, assessment fee pricing also considers retail purchases or cash withdrawals.

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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. Cross-border transactions generate greater revenue than domestic transactions due to higher operations fees for settlement, authorization and switch, and are also subject to cross-border and currency conversion fees. In addition, higher operations fees are charged on signature transactions than online transactions.

Gross revenues grew 21.1% and 23.4% in the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007. Revenue growth was the result of increased transactions and GDV, as well as price increases and currency fluctuation. Our overall revenue growth is being moderated by the demand from our customers for better pricing arrangements and greater rebates and incentives. Accordingly, we have entered into business agreements with certain customers and merchants to provide GDV and other performance-based support incentives. The rebates and incentives are calculated on a monthly basis based upon estimated performance and the terms of the related business agreements. Rebates and incentives are recorded as a reduction of gross revenue in the same period that performance occurs. The continued consolidation of our customers and the growing influence of merchants have led to enhanced competition in the global payments industry and demand for better pricing arrangements. Our revenue growth was moderated by a \$42 million, or 13.1%, and a \$140 million, or 15.5%, increase in rebates and incentives to our customers and merchants in the three and nine months ended September 30, 2008, respectively.

Rebates and incentives as a percentage of gross revenues were approximately 21.3% and 21.7% for the three and nine months ended September 30, 2008, respectively, versus 22.9% and 23.2% for the comparable periods in 2007. During the nine months ended September 30, 2008, MasterCard reduced estimates of rebates and incentives for certain customers that did not or may not achieve contractual performance hurdles. These reductions in estimated rebates and incentives decreased rebates and incentives as a percentage of gross revenues.

### ***Business Environment Challenges***

We operate in the competitive and continuously evolving global payments industry, processing transactions in approximately 210 countries and territories and in more than 160 currencies. As a result of the global and evolving nature of the payments industry, there are many factors that represent both challenges to and opportunities for the continued growth of our business. Our business is also subject to regulation in many countries. Regulatory activities may seek to impose rules and price controls on certain aspects of our business and the payments industry.

Current market turmoil and tightening of credit have led to an increased level of consumer and commercial delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. The resulting economic pressure on consumers and lack of confidence in the financial markets has, in some cases, adversely affected our customers' businesses, financial conditions and results of operations. Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in cardholder payment delinquencies and default rates, which may impact our customers' charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on our customers. The change in payment patterns by consumers, and any decrease in issuance and/or promotion of MasterCard payment solutions by our customers, could cause a decline in overall card usage and GDV, which may have a negative impact on our revenues and profitability.

Furthermore, in recent months, many economies, including the U.S. economy, have been impacted by bank failures, tightening of available credit and inflation. U.S. processed transactions and volume growth rates are slowing versus historical periods. Some non-U.S. economies, including the economies of certain countries in Europe, are experiencing similar trends. However, various emerging market economies around the world continue to experience strong growth. These and other changes can impact our business in a variety of ways, including but not limited to the following:

Consolidation of our banking customers can impact our net revenues due to the tiered pricing structure of most customer agreements, which typically offer lower pricing as higher business volumes are achieved.

Consolidation of and the financial challenges confronting our banking customers can increase the bargaining power of our customers during new and renewal contract negotiations and increase requests for additional rebates and incentives which may lower our net revenues.

Our customers may limit their purchases or decrease spending for optional or enhanced services, such as consulting, thereby reducing our net revenues.

Tightening of credit availability can impact our revenues by limiting the number of cards or amount of credit lines that are issued, which may cause processed transaction growth or volumes to slow or decline.

Inflation and declining economies can impact consumer spending behaviors. Consumers may travel less thereby lowering cross-border volumes and transactions which may reduce our net revenues.

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Challenging economic conditions increase uncertainty and volatility in the performance of our customers' businesses, which may make estimates of our revenues, rebates, incentives and realization of prepaid assets less predictable.

The U.S. remains our largest geographic market based on revenues. Revenue generated in the U.S. was approximately 44.7% and 47.3% of total revenues in the three and nine months ended September 30, 2008, respectively, versus 50.5% and 51.7% in the comparable periods in 2007.

Some non-U.S. revenues grew at a faster rate than U.S. revenues in the three and nine months ended September 30, 2008 versus the comparable periods in 2007. Changes in foreign currency exchange rates impact these percentages.

Technological developments and application of technological solutions in the global payments industry have continued in 2008. We continue to invest in technological development in order to maintain and expand our competitive advantages. However, payment system competitors have continued to emerge, especially in the internet environment, and gain market share.

See Item 1A in Part II of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008 and Item 1A in Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for additional discussion of these and other risks facing our business.

**Operations Fees**

|                                      | Three Months        |        | Dollar Increase (Decrease) | Percent Increase (Decrease) | Nine Months         |          | Dollar Increase (Decrease) | Percent Increase (Decrease) |
|--------------------------------------|---------------------|--------|----------------------------|-----------------------------|---------------------|----------|----------------------------|-----------------------------|
|                                      | Ended September 30, |        |                            |                             | Ended September 30, |          |                            |                             |
|                                      | 2008                | 2007   | 2008 vs. 2007              | 2008 vs. 2007               | 2008                | 2007     | 2008 vs. 2007              | 2008 vs. 2007               |
| (In millions, except percentages)    |                     |        |                            |                             |                     |          |                            |                             |
| Authorization, settlement and switch | \$ 437              | \$ 356 | \$ 81                      | 22.8 %                      | \$ 1,225            | \$ 1,000 | \$ 225                     | 22.5%                       |
| Currency conversion and cross-border | 319                 | 241    | 78                         | 32.4 %                      | 876                 | 634      | 242                        | 38.2%                       |
| Acceptance development fees          | 78                  | 70     | 8                          | 11.4 %                      | 227                 | 195      | 32                         | 16.4%                       |
| Warning bulletin fees                | 21                  | 19     | 2                          | 10.5 %                      | 58                  | 56       | 2                          | 3.6%                        |
| Connectivity                         | 31                  | 26     | 5                          | 19.2 %                      | 86                  | 73       | 13                         | 17.8%                       |
| Consulting and research fees         | 21                  | 23     | (2)                        | (8.7)%                      | 60                  | 59       | 1                          | 1.7%                        |
| Other operations fees                | 190                 | 144    | 46                         | 31.9 %                      | 538                 | 394      | 144                        | 36.5%                       |
| Gross operations fees                | 1,097               | 879    | 218                        | 24.8 %                      | 3,070               | 2,411    | 659                        | 27.3%                       |
| Rebates                              | (101)               | (87)   | (14)                       | 16.1 %                      | (277)               | (237)    | (40)                       | 16.9%                       |
| Net operations fees                  | \$ 996              | \$ 792 | \$ 204                     | 25.8 %                      | \$ 2,793            | \$ 2,174 | \$ 619                     | 28.5%                       |

Authorization, settlement and switch revenues increased primarily due to increases in the number of transactions processed through our systems of 13.0% and 14.0% in the three and nine months ended September 30, 2008 versus the comparable periods in 2007. In addition, \$16 million and \$32 million of the increase in the three and nine months ended September 30, 2008, respectively, was due to net foreign exchange gains relating to exchange rate volatility on settlement activities.

Currency conversion and cross-border revenues increased due to increases in cross-border volumes of 18.0% and 19.5% in the three and nine months ended September 30, 2008, respectively, compared to 19.2% and 18.8% in the three and nine months ended September 30, 2007, respectively. In June 2008, we refined our methodology to calculate cross-border volume growth rates primarily by changing the definition of cross border volumes from volumes where the issuer country and acquirer country are different to volumes where the issuer country and merchant country are different. Prior period growth rates have been restated to be consistent with the revised methodology. In addition, a price increase on acquiring cross-border volumes implemented in January 2008 accounted for approximately 19 and 20 percentage points of the percentage increases in the three and nine month periods ended September 30, 2008, respectively, from the comparable periods in 2007.



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Acceptance development fees in the three and nine months ended September 30, 2008 increased versus the comparable periods in 2007 primarily due to increased volumes and the implementation of a new fee in April 2007. The new fee accounted for approximately 3 percentage points of the percentage increase in the nine months ended September 30, 2008 from the comparable period in 2007.

Warning bulletin fees are primarily based on customer requests for distribution of invalid account information.

Connectivity revenues in the three and nine months ended September 30, 2008 increased versus the comparable periods in 2007 primarily due to increased data volumes.

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Consulting and research fees in the three and nine months ended September 30, 2008 remained consistent with the comparable periods in 2007. Our business agreements with certain customers include consulting services as an incentive. Consulting services provided to customers as a result of incentive agreements were 48.8% and 53.0% of consulting and research fees in the three and nine months ended September 30, 2008, respectively, versus 33.9% and 35.6%, respectively, in the comparable periods in 2007.

Other operations fees represent various revenue streams, including cardholder services, compliance and penalty fees, holograms, user pay for a variety of account and transaction enhancement services, and manuals and publications. In the three and nine months ended September 30, 2008 versus the comparable periods in 2007, no increase in any component of other operations fees was material, other than the following :

Our account enhancement program, implemented in the second quarter of 2007, resulted in an increase of \$5 million and \$31 million for the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007. The program enables issuers to more closely align the economics of reward programs with cardholder value, including card customization and features.

Pricing for retail purchases in the U.S. by non-U.S. cardholders increased in January 2008. This price increase, coupled with an increase in retail purchase volumes, resulted in revenue increases of \$13 million and \$38 million for the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007.

Rebates relating to operations fees are primarily based on transactions and volumes and, accordingly, increase as these variables increase. Rebates have been increasing due to ongoing consolidation of our customers and the impact of restructured pricing, but at a slower rate than gross operations fees due to customer performance. Accordingly, rebates as a percentage of gross operations fees were 9.2% and 9.0% in the three and nine months ended September 30, 2008, respectively, versus 9.9% and 9.8% in the comparable periods in 2007. During the nine months ended September 30, 2008, MasterCard reduced estimates of rebates for certain customers that did not or may not achieve contractual performance hurdles. These reductions in estimated rebates decreased rebates as a percentage of gross operations fees.

**Assessments**

Assessments are revenues that are calculated based on our customers' GDV. The components of assessments are as follows:

|                                   | Three Months           |        | Dollar<br>Increase<br>(Decrease) | Percent<br>Increase<br>(Decrease) | Nine Months            |          | Dollar<br>Increase<br>(Decrease) | Percent<br>Increase<br>(Decrease) |
|-----------------------------------|------------------------|--------|----------------------------------|-----------------------------------|------------------------|----------|----------------------------------|-----------------------------------|
|                                   | Ended<br>September 30, |        |                                  |                                   | Ended<br>September 30, |          |                                  |                                   |
|                                   | 2008                   | 2007   | 2008 vs.<br>2007                 | 2008 vs.<br>2007                  | 2008                   | 2007     | 2008 vs.<br>2007                 | 2008 vs.<br>2007                  |
| (In millions, except percentages) |                        |        |                                  |                                   |                        |          |                                  |                                   |
| Gross assessments                 | \$ 604                 | \$ 525 | \$ 79                            | 15.0%                             | \$ 1,741               | \$ 1,488 | \$ 253                           | 17.0%                             |
| Rebates and incentives            | (262)                  | (234)  | (28)                             | 12.0%                             | (767)                  | (667)    | (100)                            | 15.0%                             |
| Net assessments                   | \$ 342                 | \$ 291 | \$ 51                            | 17.5%                             | \$ 974                 | \$ 821   | \$ 153                           | 18.6%                             |

Gross assessments grew versus the comparable periods in 2007 partially due to GDV growth of approximately 12.3% and 13.1% in the three and nine months ended September 30, 2008, respectively, when measured in local currency terms, and 14.8% and 17.6% respectively, when measured on a U.S. dollar converted basis. Assessment revenues are impacted by the overall strengthening or weakening of the U.S. dollar, euro or real compared to the foreign currencies of the related local volumes in each period.

Rebates and incentives are primarily based on GDV but may also contain components for the issuance of new cards, launch of new programs or the execution of marketing programs. The rebates and incentives are recorded as a reduction of gross revenue in the same period that performance occurs. Rebates and incentives as a percentage of gross assessments were 43.4% and 44.1% in the three and nine months ended

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September 30, 2008, respectively, versus 44.6% and 44.8%, respectively, for the comparable periods in 2007. Rebates and incentives increased during the three and nine months ended September 30, 2008 versus the comparable periods in 2007 due to new and renewals of customer agreements and increased volumes for certain merchants, partially offset by the timing and terms of other non-GDV based incentives. However, the increase during the nine months ended September 30, 2008 was partially offset by reductions of estimated rebates and incentives for certain customers that did not or may not achieve contractual performance hurdles. These reductions in estimated rebates and incentives decreased rebates and incentives as a percentage of gross assessments. However, non-GDV performance-based rebates and incentives vary depending on the agreement terms and the timing of our customers' performance. Accordingly, our rebates and incentives for non-GDV

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performance metrics, such as the issuance of new cards, the launch of new programs or the execution of marketing programs, impact the relationship between gross assessments and net assessments.

**Operating Expenses**

Our operating expenses are comprised primarily of general and administrative, advertising and marketing, litigation settlements and depreciation and amortization expenses. In the three and nine month periods ended September 30, 2008, there was an increase in operating expenses of approximately \$0.9 billion and \$2.7 billion, respectively, versus the comparable periods in 2007. These increases are primarily due to the settlement of antitrust litigations with Discover Financial Services ( Discover and the Discover Settlement ) and American Express Company ( American Express and the American Express Settlement ). The following table compares and reconciles operating expenses, excluding litigation settlements ( Special Items ), which is a non-GAAP financial measure, to the operating expenses including litigation settlements, which is the most directly comparable GAAP measurement. Management believes this analysis may be helpful in evaluating ongoing operating expenses.

|  | Three Months Ended<br>September 30, 2008 |                  |                | Three Months Ended<br>September 30, 2007 |                  |                | Percent<br>Increase<br>(Decrease)<br>Actual | Percent<br>Increase<br>(Decrease)<br>As Adjusted |
|--|--|------------------|----------------|--|------------------|----------------|---|--|
|  | Actual                                   | Special<br>Items | As<br>Adjusted | Actual                                   | Special<br>Items | As<br>Adjusted |   |  |
| (In millions, except percentages)                              |  |                  |                |  |                  |                |   |  |
| General and administrative                                     | \$ 494                                   | \$               | \$ 494         | \$ 433                                   | \$               | \$ 433         | 14.1%                                       | 14.1%  |
| Advertising and marketing                                      | 267                                      |                  | 267            | 264                                      |                  | 264            | 1.1%  | 1.1%   |
| Litigation settlements   | 828                                      | 828              |                |  |                  |                | **  | **   |
| Charitable contributions                                       |  |                  |                | 10                                       |                  | 10             | **  | **   |
| Depreciation and amortization                                  | 29                                       |                  | 29             | 22                                       |                  | 22             | 29.0%                                       | 29.0%  |
| Total operating expenses                                       | \$ 1,617                                 | \$ 828           | \$ 790         | \$ 730                                   | \$               | \$ 730         | 121.7%                                      | 8.3%   |
| Total operating expenses as a percentage of total net revenues | 120.9%                                   |                  | 59.0%          | 67.4%                                    |                  | 67.4%          |   |  |

|  | Nine Months Ended<br>September 30, 2008 |                  |                | Nine Months Ended<br>September 30, 2007 |                  |                | Percent<br>Increase<br>(Decrease)<br>Actual | Percent<br>Increase<br>(Decrease)<br>As Adjusted |
|--|---|------------------|----------------|---|------------------|----------------|---|--|
|  | Actual                                  | Special<br>Items | As<br>Adjusted | Actual                                  | Special<br>Items | As<br>Adjusted |   |  |
| (In millions, except percentages)                              |   |                  |                |   |                  |                |   |  |
| General and administrative                                     | \$ 1,435                                | \$               | \$ 1,435       | \$ 1,263                                | \$               | \$ 1,263       | 13.6%                                       | 13.6%  |
| Advertising and marketing                                      | 770                                     |                  | 770            | 711                                     |                  | 711            | 8.2%  | 8.2%   |
| Litigation settlements   | 2,477                                   | 2,477            |                | 3                                       | 3                |                | **  | **   |
| Charitable contributions                                       |   |                  |                | 10                                      |                  | 10             | **  | **   |
| Depreciation and amortization                                  | 82                                      |                  | 82             | 71                                      |                  | 71             | 14.6%                                       | 14.6%  |
| Total operating expenses                                       | \$ 4,764                                | \$ 2,477         | \$ 2,287       | \$ 2,059                                | \$ 3             | \$ 2,055       | 131.4%                                      | 11.3%  |
| Total operating expenses as a percentage of total net revenues | 126.5%                                  |                  | 60.7%          | 68.7%                                   |                  | 68.6%          |   |  |

\* Note that the figures in the preceding tables may not sum due to rounding.

\*\* Percentage change calculation not meaningful.



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General and administrative expenses consist primarily of personnel, professional fees, telecommunications, data processing and travel expenses. The major components of general and administrative expenses were as follows:

|                                     | Three Months        |        | Dollar Increase (Decrease) | Percent Increase (Decrease) | Nine Months         |          | Dollar Increase (Decrease) | Percent Increase (Decrease) |
|-------------------------------------|---------------------|--------|----------------------------|-----------------------------|---------------------|----------|----------------------------|-----------------------------|
|                                     | Ended September 30, |        |                            |                             | Ended September 30, |          |                            |                             |
|                                     | 2008                | 2007   | 2008 vs. 2007              | 2008 vs. 2007               | 2008                | 2007     | 2008 vs. 2007              | 2008 vs. 2007               |
| Personnel                           | \$ 324              | \$ 289 | \$ 35                      | 12.1%                       | \$ 968              | \$ 823   | \$ 145                     | 17.6%                       |
| Professional fees                   | 58                  | 52     | 6                          | 11.5%                       | 167                 | 158      | 9                          | 5.7%                        |
| Telecommunications                  | 19                  | 19     |                            |                             | 59                  | 53       | 6                          | 11.3%                       |
| Data processing                     | 21                  | 16     | 5                          | 31.3%                       | 56                  | 46       | 10                         | 21.7%                       |
| Travel and entertainment            | 20                  | 25     | (5)                        | (20.0)%                     | 74                  | 81       | (7)                        | (8.6)%                      |
| Other                               | 52                  | 32     | 20                         | 62.5%                       | 111                 | 102      | 9                          | 8.8%                        |
| General and administrative expenses | \$ 494              | \$ 433 | \$ 61                      | 14.1%                       | \$ 1,435            | \$ 1,263 | \$ 172                     | 13.6%                       |

Personnel expense increased in the three and nine months ended September 30, 2008 primarily due to higher costs for new personnel and higher contractor costs. In addition, we incurred greater severance costs during the nine months ended September 30, 2008 due to cost reductions and the realignment of certain personnel to better enable us to execute our strategic objectives.

Professional fees consist primarily of legal costs to defend our outstanding litigation and third-party consulting services related to strategic initiatives.

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.

Data processing consists of expenses to operate and maintain MasterCard's computer systems. These expenses vary with business volume growth, system upgrades and usage.

Travel and entertainment expenses are incurred primarily for travel to customer and regional meetings. Overall, these expenses decreased for the three and nine months ended September 30, 2008, versus the comparable periods in 2007, due to cost containment initiatives.

Other includes rental expense for our facilities, foreign exchange transaction gains and losses and other miscellaneous administrative expenses. The increase for the three months ended September 30, 2008 is primarily driven by unfavorable fluctuations in foreign exchange rates and higher rent for office facilities. The increase for the nine months ended September 30, 2008 is primarily driven by higher rental expense for office facilities.

**Advertising and Marketing**

Our approach to advertising and marketing activities combines advertising, sponsorships, promotions, interactive media and public relations as part of an integrated program designed to increase MasterCard brand awareness/preference and usage of MasterCard cards. Also included within

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advertising and marketing are costs associated with offering cardholder benefits, such as insurance and travel assistance, for certain programs. Advertising and marketing expenses increased \$3 million and \$59 million, or 1.1% and 8.2%, in the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007. Approximately 3 and 5 percentage points of the increases for the three and nine months ended September 30, 2008, respectively, were related to the impact of foreign currency fluctuation of the euro and Brazilian real to the U.S. dollar. In addition, in 2008, the timing of certain advertising and marketing expenses varied due to their relationship to specific sponsorships or promotions. We intend to continue to sponsor diverse events aimed at multiple target audiences.

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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. Our marketing initiatives continue to support our customer-focused strategy. We are committed to maintaining and enhancing our brands and image through advertising and marketing efforts on a global scale. We will continue to invest in marketing programs at the regional and local levels.

**Litigation Settlements**

On October 27, 2008, MasterCard and Visa Inc. ( Visa ) entered into the Discover Settlement with Discover relating to the U.S. federal antitrust litigation amongst the parties. The Discover Settlement ended all litigation between the parties for a total of \$2.75 billion. In July 2008, MasterCard and Visa had entered into a judgment sharing agreement. Accordingly, the MasterCard share of the Discover Settlement is \$863 million, which will be paid to Discover in November 2008. In addition, in connection with the Discover Settlement, Morgan Stanley, Discover's former parent company, agreed to pay MasterCard \$35 million in November 2008, pursuant to a separate agreement. This receivable from Morgan Stanley is included in accounts receivable at September 30, 2008. The net impact of \$828 million is included in litigation settlements in the three and nine months ended September 30, 2008.

On June 24, 2008, MasterCard entered into the American Express Settlement which ended all existing litigation between American Express and MasterCard. Under the terms of the American Express Settlement, beginning on September 15, 2008, MasterCard is required to pay American Express up to \$150 million each quarter for 12 quarters, payable in cash on the 15<sup>th</sup> day of the last month of each quarter, for a maximum amount of \$1.8 billion. The charge is based on MasterCard's assumption that American Express will achieve certain financial performance hurdles. The quarterly payments will be in an amount equal to 15% of American Express' United States Global Network Services billings during the quarter, up to a maximum of \$150 million per quarter. If, however, the payment for any quarter is less than \$150 million, the maximum payment for subsequent quarters will be increased by the difference between \$150 million and the lesser amount that was paid in any quarter in which there was a shortfall. MasterCard recorded the present value of \$1.8 billion, at a 5.75% discount rate, or \$1.649 billion during June 2008.

We recorded liabilities for certain litigation settlements in prior periods. Total liabilities for litigation settlements changed during the nine months ended September 30, 2008 as follows:

|   |                 |
|---|-----------------|
| Balance as of December 31, 2007                   | \$ 404          |
| Provision for Discover Settlement                 | 863             |
| Provision for American Express Settlement         | 1,649           |
| Interest accretion on U.S. merchant lawsuit       | 24              |
| Interest accretion on American Express Settlement | 23              |
| Payments on American Express Settlement           | (150)           |
| <b>Balance as of September 30, 2008</b>           | <b>\$ 2,813</b> |

See Note 17 to the Consolidated Financial Statements included in Part I for additional discussion.

**Other Income (Expense)**

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

Investment income decreased \$124 million and \$56 million in the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007. The decrease versus the three months ended September 30, 2007, is primarily due to the realization of \$107 million in gains on the sale of 25% of our investment in Redecard S.A. during that quarter. The decrease versus the nine months ended September 30, 2007 is primarily due to lower gains of \$21 million on our Redecard investment, lower Redecard dividend income of \$11 million, lower interest income on money market and short-term bond fund investments of \$14 million and higher realized losses on current available-for-sale investments of \$9 million.

Interest expense increased \$20 million and \$25 million in the three and nine months ended September 30, 2008, respectively, versus the comparable periods in 2007. The quarterly and year-to-date increases are primarily due to higher interest expense associated with the American Express Settlement. Interest expense is expected to increase by an additional \$21 million, \$66 million, \$35 million and \$5 million in 2008, 2009, 2010 and 2011, respectively, due to the accretion of interest associated with the American Express Settlement.





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Other income (expense) decreased \$19 million in the nine months ended September 30, 2008 versus the comparable period in 2007. The decrease was primarily due to the recognition in 2007 of a \$90 million settlement gain with the organization that operates the World Cup soccer events, partially offset by the recognition in 2008 of a \$75 million settlement gain related to the termination of a customer business agreement.

**Income Taxes**

The effective income tax rates were a 34.1% benefit and a 34.8% expense for the three months ended September 30, 2008 and 2007, respectively, and a 40.4% benefit and a 35.1% expense for the nine months ended September 30, 2008 and 2007, respectively. The decrease in the effective tax rate in the three months ended September 30, 2008 versus the comparable period in 2007 was primarily due to the tax benefit related to the charge for the Discover Settlement, partially offset by a tax charge in the three months ended September 30, 2008 for the remeasurement of deferred tax assets as a result of a change in the Company's estimated effective state tax rate. As a result of the remeasurement, the Company's deferred tax assets were reduced by \$20 million with a corresponding increase in income tax expense. The increase in the effective tax rate in the nine months ended September 30, 2008 versus the comparable period in 2007 was primarily due to the tax benefits related to the charges for the Discover Settlement and the American Express Settlement, partially offset by the tax charge in the three months ended September 30, 2008 for the remeasurement of deferred tax assets. The effect of the charges significantly changed the geographic distribution of pre-tax income (loss) from jurisdictions with lower tax rates to those with higher tax rates.

In addition, the charge for the Discover Settlement, recognized for book purposes in September 2008, will be deductible for tax purposes in 2008 when the payment is made. Accordingly, an income tax refund receivable has been recorded for \$256 million related to the recovery of estimated tax payments made previously in 2008.

The Company's GAAP effective income tax rate for the three month and nine month periods ended September 30, 2008, were significantly affected by the tax benefit related to the charge for the American Express and Discover Settlements. Due to the non-recurring nature of the American Express and Discover Settlements, the Company believes that the calculation of the 2008 effective tax rate, exclusive of the charge, will be helpful in comparing effective tax rates for the three and nine months ended September 30, 2008.

|   | GAAP<br>Actual | GAAP<br>Effective<br>Tax Rate | Litigation<br>Settlements | Non-GAAP<br>Adjusted | Adjusted<br>Effective<br>Tax Rate<br>Non-GAAP |
|---|----------------|-------------------------------|---------------------------|----------------------|---|
| <b>Three months ended September 30, 2008:</b> |                |                               |                           |                      |   |
| <i>(In millions, except percentages)</i>      |                |                               |                           |                      |   |
| Income (loss) before income taxes             | \$ (294)       | 34.1%                         | \$ 828                    | \$ 534               | 39.7%   |
| Income tax expense (benefit)                  | (100)          |                               | 312                       | 212                  |   |
| Net income (loss)                             | \$ (194)       |                               | \$ 516                    | \$ 322               |   |

  

|  | GAAP<br>Actual | GAAP<br>Effective<br>Tax Rate | Litigation<br>Settlements | Non-GAAP<br>Adjusted | Adjusted<br>Effective<br>Tax Rate<br>Non-GAAP |
|--|----------------|-------------------------------|---------------------------|----------------------|---|
| <b>Nine months ended September 30, 2008:</b> |                |                               |                           |                      |   |
| <i>(In millions, except percentages)</i>     |                |                               |                           |                      |   |
| Income (loss) before income taxes            | \$ (828)       | 40.4%                         | \$ 2,477                  | \$ 1,649             | 36.6%   |
| Income tax expense (benefit)                 | (335)          |                               | 939                       | 604                  |   |
| Net income (loss)                            | \$ (493)       |                               | \$ 1,538                  | \$ 1,045             |   |

\* Note that the figures in the preceding table may not sum or recalculate due to rounding



**Table of Contents****Liquidity**

We need capital resources and liquidity to fund our global operations; to provide for credit and settlement risk; to finance capital expenditures and any future acquisitions; to service the payments of principal and interest on our outstanding debt; and to service our obligations related to litigation settlements. At September 30, 2008 and December 31, 2007, we had \$2.8 billion and \$3.0 billion of cash, cash equivalents and current available-for-sale securities, respectively, to use for our operations. We expect that the cash generated from operations and our borrowing capacity will be sufficient to meet our future operating, working capital and capital needs and to fund future debt and litigation settlement obligations. However, our liquidity could be negatively impacted by the adverse outcome of any of the legal or regulatory proceedings to which we are a party. See Item 1A in Part II of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008 and Item 1A in Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for additional discussion of these and other risks facing our business. See also Notes 12 and 17 to the Consolidated Financial Statements included in Item 1 and Business Environment Challenges for more information.

|   | <b>Nine Months<br/>Ended September 30,</b> |                     |
|---|--|---------------------|
|   | <b>2008</b>                                | <b>2007</b>         |
|   | <b>(in millions)</b>                       |                     |
| <b>Cash flow data:</b>                    |  |                     |
| Net cash provided by operating activities | \$ 931                                     | \$ 718              |
| Net cash provided by investing activities | 232  | 76                  |
| Net cash used in financing activities     | (731)                                      | (322)               |
|   | <b>September 30,</b>                       | <b>December 31,</b> |
|   | <b>2008</b>                                | <b>2007</b>         |
|   | <b>(in millions)</b>                       |                     |
| <b>Balance sheet data:</b>                |  |                     |
| Current assets                            | \$ 5,071                                   | \$ 4,592            |
| Current liabilities                       | 3,800                                      | 2,363               |
| Long-term liabilities                     | 1,703                                      | 865                 |
| Equity                                    | 1,765                                      | 3,027               |

Net cash provided by operating activities for the nine months ended September 30, 2008 was primarily due to net revenues exceeding general and administrative and advertising and marketing expenses, partially offset by the initial \$150 million payment under the American Express Settlement, payments for income taxes and payments to merchants and customers under business agreements.

Net cash provided by investing activities for the nine months ended September 30, 2008 primarily relates to net sales of available-for-sale securities, including the sale of the remaining portion of our Redecard S.A. shares, ARS and short-term bond fund investments. Cash provided by investing activities in 2008 was partially offset by cash used for investments in leasehold and building improvements to support increased workforce and data center equipment, as well as investments in capitalized software to expand our core functionality, including development of a debit and prepaid processing platform. We intend to continue to invest in our infrastructure to support our growing business and strategic initiatives.

Cash used in financing activities for the nine months ended September 30, 2008 related to the repurchase of approximately 2.8 million shares of our Class A common stock through a share repurchase plan, the payment of approximately \$60 million in quarterly dividends to our stockholders and the repayment of \$80 million related to the Company's ten-year unsecured, subordinated notes that matured in June 2008. See Notes 11 and 14 to the Consolidated Financial Statements included in Part I for more information on our debt repayment and stock repurchase plan, respectively.

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On October 27, 2008, MasterCard and Visa entered into the Discover Settlement relating to the U.S. Federal antitrust litigation amongst the parties. In connection with the Discover Settlement, MasterCard will pay \$863 million to Discover and receive \$35 million from Morgan Stanley, Discover's former parent company, in November 2008. Also, on June 24, 2008, MasterCard entered into the American Express Settlement. Under its terms, beginning on September 15, 2008, MasterCard is required to pay American Express up to \$150 million each quarter for 12 quarters, payable in cash on the 15th day of the last month of each quarter, for a maximum amount of \$1.8 billion. See Notes 12 and 17 to the Consolidated Financial Statements included in Part I for additional information on these litigation settlements.

As of September 30, 2008, the Company held \$219 million of auction rate securities ( ARS ) classified as long-term available-for-sale securities. As of December 31, 2007, the Company held \$249 million of ARS classified as current available-for-sale securities. This change in classification is due to failure of the auction mechanism and a continued lack of liquidity in the ARS market. The stated maturity of the securities ranges from 10 to 33 years, and the securities are 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. We determined that the fair value of the ARS does not approximate par value, assigned a 10% discount to the par value of the ARS portfolio and recorded a temporary impairment within other comprehensive income during the nine months ended September 30, 2008. We have the intent and ability to hold the ARS until recovery of fair value, which may be maturity or earlier if called or if liquidity is restored in the market. See Note 4 to the Consolidated Financial Statements included in Part I for more information.

On September 9, 2008, our Board of Directors declared a quarterly cash dividend of \$0.15 per share payable on November 10, 2008 to holders of record on October 10, 2008 of our Class A common stock and Class B common stock. The aggregate amount payable for this dividend is \$20 million. The declaration and payment of any 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 August 29, 2008, MasterCard notified the equity investor and holders of secured notes related to its variable interest entity (the Trust ) of its intent to repay the equity investor and the obligations issued through the Trust. The repayment of aggregate outstanding principal and accrued interest on the secured notes, and repayment of the equity investor, will occur by March 1, 2009 for a total amount of \$154 million. In conjunction with this repayment we will record the operations center as an asset on the balance sheet. MasterCard was in compliance with the covenants of the secured notes at September 30, 2008. See Note 11 to the Consolidated Financial Statements included in Part I for further discussion.

On October 28, 2008, Standard & Poor's reaffirmed our BBB+ long-term and A-2 short-term counterparty credit ratings, with a stable outlook.

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 will remain at \$2.5 billion through April 27, 2010 and then decrease 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 September 30, 2008 and December 31, 2007, respectively. The majority of Credit Facility lenders are customers or affiliates of customers of MasterCard International.

In June 2007, the Company's stockholders approved amendments to the Company's certificate of incorporation designed to facilitate an accelerated, orderly conversion of Class B common stock into Class A common stock for subsequent sale. In February 2008, the Company's Board of Directors authorized the conversion and sale or transfer of up to 13.1 million shares of Class B common stock into Class A common stock. In May 2008, the Company implemented and completed a conversion program in which all of the 13.1 million authorized shares of Class B common stock were converted into an equal number of Class A common stock and subsequently sold or transferred by participating holders of Class B common stock to public investors. See Note 14 to the Consolidated Financial Statements included in Item 1 for additional information.

**Table of Contents****Future Obligations**

The following table summarizes, as of September 30, 2008, our obligations 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 existing cash balances.

|   | Total    | Payments Due by Period |                              |             | 2013 and<br>Thereafter |
|---|----------|------------------------|------------------------------|-------------|------------------------|
|   |          | Remaining<br>2008      | 2009 - 2010<br>(In millions) | 2011 - 2012 |                        |
| Capital leases <sup>1</sup>                   | \$ 54    | \$ 4                   | \$ 9                         | \$ 4        | \$ 37                  |
| Operating leases <sup>2</sup>                 | 109      | 11                     | 52                           | 19          | 27                     |
| Sponsorship, licensing & other <sup>3,4</sup> | 635      | 199                    | 313                          | 114         | 9                      |
| Litigation settlements <sup>5</sup>           | 3,019    | 1,119                  | 1,400                        | 500         |                        |
| Debt <sup>6</sup>                             | 170      |                        | 150                          | 20          |                        |
| Total   | \$ 3,987 | \$ 1,333               | \$ 1,924                     | \$ 657      | \$ 73                  |

<sup>1</sup> Most capital leases relate to certain property, plant and equipment used in our business. Our largest capital lease relates to our Kansas City, Missouri co-processing facility.

<sup>2</sup> We enter into operating leases in the normal course of business, including the lease on our facility in St. Louis, Missouri. 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 increased transaction volumes are not included in the table because the amounts due are indeterminable and contingent until such time as performance has occurred. MasterCard had accrued \$517 million as of September 30, 2008 related to customer and merchant agreements.

<sup>4</sup> We have included our current liability of \$13 million relating to FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). Due to the high degree of uncertainty regarding the timing of the non-current FIN 48 liabilities, 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 Discover Settlement, American Express Settlement, U.S. merchant lawsuit and other litigation settlements.

<sup>6</sup> Debt primarily represents principal owed on our Series A Senior Secured Notes due September 2009 and amounts due for the acquisition of MasterCard France. See Notes 11 and 3, respectively, to the Consolidated Financial Statements included in Part I for further discussion on these matters. The Company expects to pay the Series A Senior Secured Notes on March 1, 2009. We also have various credit facilities for which there were no outstanding balances at September 30, 2008 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.

**Table of Contents****Recent Accounting Pronouncements**

In June 2008, the Financial Accounting Standards Board ( FASB ) issued Staff Position Emerging Issues Task Force 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP EITF 03-6-1 ). FSP EITF 03-6-1 requires entities to allocate earnings to unvested and contingently issuable share-based payment awards that have non-forfeitable rights to dividends or dividend equivalents when calculating EPS and also present both basic EPS and diluted EPS pursuant to the two-class method described in Statement of Financial Accounting Standards No. 128, *Earnings per Share*. FSP EITF 03-6-1 is effective January 1, 2009 and requires retrospective application. The Company will adopt FSP EITF 03-6-1 during 2009 and is not able to project its impact on future presentations of EPS due to the inherent complexities associated with projecting future financial performance. For periods for which EPS has previously been presented, including full year 2007 and quarter-to-date and year-to-date periods for 2008, the company anticipates basic EPS and diluted EPS to (decrease)/increase as follows:

|                                   | Three<br>Months<br>Ended<br>September 30,<br>2008 | Nine<br>Months<br>Ended<br>September 30,<br>2008 | Three<br>Months<br>Ended<br>June 30,<br>2008 | Six<br>Months<br>Ended<br>June 30,<br>2008 | Three<br>Months<br>Ended<br>March 31,<br>2008 | Year<br>Ended<br>December 31,<br>2007 |
|-----------------------------------|---|--|--|--|---|---------------------------------------|
| <b>Earnings (Loss) per Share:</b> |   |  |  |  |   |                                       |
| <b>Basic</b>                      | \$ 0.01   | \$ 0.03  | \$ 0.04                                      | \$ 0.01                                    | \$ (0.03)                                     | \$ (0.07)                             |
| <b>Diluted</b>                    | \$ 0.01   | \$ 0.03  | \$ 0.04                                      | \$ 0.01                                    | \$ (0.01)                                     | \$ (0.04)                             |

**Critical Accounting Estimates**

Our accounting policies are integral to understanding our results of operations and financial condition. We are required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. We have established detailed policies and control procedures to ensure that the methods used to make estimates and assumptions are well controlled and are applied consistently from period to period. The following is a brief, updated description of our current accounting policies involving significant management judgments. See Note 1 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for more information on the Company's accounting policies.

**Financial Statement****Caption/Critical Accounting****Effect if Actual Results Differ****Estimate****Assumptions/Approach Used****from Assumptions*****Discount Rate for Litigation Settlements***

We have discounted two litigation settlements over their respective payment terms.

The U.S. merchant litigation settlement was discounted at 8% over the ten-year payment term.

We estimate the discount rate used to calculate the present value of our obligations under litigation settlements. The discount rate is a matter of management judgment at the time of each settlement, which considers our expected post-settlement credit rating and rates for sources of credit that could be used to finance the payment of such obligations with similar terms.

For the U.S. merchant litigation settlement, a one percent increase in the discount rate would have increased annual interest expense in 2007 by approximately \$4 million, and declining amounts thereafter. The reverse impact would be experienced for a one percent decrease in such discount rate.

The American Express Settlement was discounted at 5.75% over the three-year payment term.

For the American Express Settlement, a one percent increase in the discount rate would have decreased the litigation settlement expense for the nine months ended September 30, 2008 by approximately \$24 million. The

reverse impact would be experienced for a one percent decrease in such discount rate.

For the American Express Settlement, a one percent increase in the discount rate would have increased interest expense for the nine months ended September 30, 2008 by approximately \$4 million. The reverse impact would be experienced for a one percent decrease in such discount rate.



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**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 currency exchange rates and equity price risk. Management establishes and oversees the implementation of policies, which have been approved by the Company's Board of Directors, governing our funding, investments and use of derivative financial instruments. Market volatility impacts market risk exposures, however, we monitor risk exposures on an ongoing basis. There have been no material changes in our market risk exposures at September 30, 2008 versus December 31, 2007.

**Item 4. *Controls and Procedures***

*Evaluation of Disclosure Controls and Procedures*

The management of MasterCard Incorporated, including the President and Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the Company's disclosure controls and procedures (as defined in Rule 15d-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 President and 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 President and 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.

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**Other Financial Information**

With respect to the unaudited consolidated financial information of MasterCard Incorporated and its subsidiaries for the three and nine months ended September 30, 2008 and 2007, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their report dated November 3, 2008 appearing below, states that they did not audit and they do not express an opinion on that unaudited financial information. PricewaterhouseCoopers LLP has not carried out any significant or additional audit tests beyond those which would have been necessary if their report had not been included. 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 Section 7 and 11 of the Act.

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

of MasterCard Incorporated:

We have reviewed the accompanying consolidated balance sheet of MasterCard Incorporated and its subsidiaries (the Company ) as of September 30, 2008, and the related consolidated statements of operations and consolidated condensed statements of comprehensive income (loss) for each of the three and nine month periods ended September 30, 2008 and 2007, and the consolidated statements of cash flows for each of the nine month periods ended September 30, 2008 and 2007, and the consolidated statement of changes in stockholders equity for the nine month period ended September 30, 2008. This interim financial information 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, 2007, and the related consolidated statements of operations, comprehensive income, of changes in stockholders equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 20, 2008, 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, 2007, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

**PricewaterhouseCoopers LLP**

New York, New York

November 3, 2008

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**MASTERCARD INCORPORATED**

**FORM 10-Q**

**PART II OTHER INFORMATION**

**Item 1. *Legal Proceedings***

Refer to Note 17 to the Consolidated Financial Statements included 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, 2007 and the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008. See Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Business Environment Challenges in this Form 10-Q for a discussion of the conditions in the financial markets and economic conditions affecting our business. This discussion updates, and should be read together with, the risk factor entitled Global economic, political and other conditions may adversely affect trends in consumer spending, which may materially and adversely impact our revenue and profitability. in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**Item 5. *Other Information***

On October 28, 2008, the Company, in the ordinary course of business, issued 31 shares of its Class M common stock to new principal members of MasterCard International, which was offset by the retirement of 16 shares of Class M common stock due to the terminations of principal members, pursuant to the amended and restated certificate of incorporation of the Company (the 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 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.

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**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: November 3, 2008

MASTERCARD INCORPORATED  
*(Registrant)*

Date: November 3, 2008

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

Date: November 3, 2008

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

Date: November 3, 2008

By: /s/ TARA A. MAGUIRE  
Tara A. Maguire  
*Corporate Controller*  
*(Principal Accounting Officer)*

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**EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Exhibit Description</b>  |
|-----------------------|---|
| 10.1                  | Release and Settlement Agreement dated as of October 27, 2008 by and among MasterCard, Discover and Visa.   |
| 10.2                  | Agreement, dated as of October 27, 2008, by and among MasterCard International Incorporated, MasterCard Incorporated, Morgan Stanley, Visa Inc., Visa U.S.A. Inc. and Visa International Service Association. |
| 15                    | Awareness Letter from the Company's Independent Registered Public Accounting Firm   |
| 31.1                  | Certification of Robert W. Selander, President and 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, President and 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.                                      |