MASTERCARD INC
Form 10-Q
October 30, 2014
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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, 2014
Or

o 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)
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 x No o

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

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	x	Accelerated filer	o
Non-accelerated filer	o (do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x
As of October 23, 2014, there were 1,112,920,270 shares outstanding of the registrant's Class A common stock, par value $0.0001 per share; and 39,934,825 shares outstanding of the registrant's Class B common stock, par value $0.0001 per share.

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In this Report on Form 10-Q (“Report”), references to the “Company,” “MasterCard,” “we,” “us” or “our” refer to the MasterC brand generally, and to the business conducted by MasterCard Incorporated and its consolidated subsidiaries, including our operating subsidiary, MasterCard International Incorporated.

Forward-Looking Statements

This Report contains forward-looking statements pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts may be forward-looking statements. When used in this Report, the words “believe”, “expect”, “could”, “may”, “would”, “will”, “trend” and similar wor 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, statements relating to:

- the Company’s focus on growing, diversifying and building its business;
- the Company’s focus on providing value to merchants, governments, consumers and financial institutions;
- the Company’s development of innovative platforms and solutions;
- the Company’s focus on ensuring the safety and security of the payments system;
- the stability of economies around the globe;
- the Company’s advertising and marketing strategy and investment;
- the Company’s belief that its existing cash, cash equivalents and investment securities balances, its cash flow generating capabilities, its borrowing capacity and its access to capital resources are sufficient to satisfy its future operating cash needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations and potential obligations; and
- the manner and amount of purchases by the Company pursuant to its share repurchase program, dependent upon price and market 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. Such risk factors include: legislation, competition-related regulatory proceedings, regulation by central banks and similar types of regulatory authorities, and litigation related to interchange fees and other practices; regulation established by the Dodd-Frank Act (as defined below) in the United States; the requirement to permit U.S. merchants to surcharge credit cards; regulation or other regulatory activity with respect to the payments industry in one jurisdiction or of one product resulting in regulation (or impact on pending regulatory proceedings) in other jurisdictions or of other products; competitive issues caused by preferential or protective government actions; regulation of the payments industry, consumer privacy, data use and/or security; potential or incurred liability and limitations on business resulting from litigation; potential changes in tax laws; substantial and increasingly intense competition in the payments industry; potential future changes in the competitive landscape; competitive pressure on pricing; banking industry consolidation; loss of significant business from significant customers; merchant activity; the relationship of our competitors with our issuers and acquirers; our relationship with our issuers and acquirers; brand perceptions and reputation; our work with governments; global economic events and the overall business environment; decline in cross-border travel; the effect of general economic and global political conditions on consumer spending trends; exposure to loss or illiquidity due to guarantees of settlement and certain other third-party obligations; impact of a failure or breach of our security systems or infrastructure as a result of cyber attacks; disruptions to our transaction processing systems and other services; account data breaches; reputation damage from increases in fraudulent activity; the challenges resulting from rapid technological developments in the payments industry; the effect of adverse currency fluctuation; acquisition, entry into new businesses and other integration issues; and issues relating to our Class A common stock and corporate governance structure. Please see a complete discussion of these risk factors in Part I, Item 1A - Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2013 and in Part II, Item 1A (Risk Factors) of the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014. We caution you that the important factors referenced above may not contain all of the factors that are important to you. Our forward-looking statements speak only as of the date of this Report or as of the date they are made, and we undertake no obligation to update our forward-looking statements.

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PART I — FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (Unaudited)

MASTERCARD INCORPORATED
CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	September 30, 2014	December 31, 2013
	(in millions, except share data)	
ASSETS		
Cash and cash equivalents	$4,462	$3,599
Restricted cash for litigation settlement	540	723
Investment securities available-for-sale, at fair value	1,857	2,696
Accounts receivable	1,071	966
Settlement due from customers	1,188	1,351
Restricted security deposits held for customers	953	911
Prepaid expenses and other current assets	602	471
Deferred income taxes	283	233
Total Current Assets	10,956	10,950
Property, plant and equipment, net of accumulated depreciation of $433 and $394, respectively	553	526
Deferred income taxes	102	70
Goodwill	1,456	1,122
Other intangible assets, net of accumulated amortization of $651 and $534, respectively	705	672
Other assets	887	902
Total Assets	$14,659	$14,242
LIABILITIES AND EQUITY		
Accounts payable	$319	$338
Settlement due to customers	1,226	1,433
Restricted security deposits held for customers	953	911
Accrued litigation	789	886
Accrued expenses	2,098	2,101
Other current liabilities	464	363
Total Current Liabilities	5,849	6,032
Long-term debt	1,494	—
Deferred income taxes	119	117
Other liabilities	649	598
Total Liabilities	8,111	6,747
Commitments and Contingencies (Note 13)		
Stockholders' Equity		
Class A common stock, $0.0001 par value; authorized 3,000,000,000 shares, 1,349,345,980 and 1,341,541,110 shares issued and 1,114,440,917 and 1,148,838,370 outstanding, respectively	—	—
Class B common stock, $0.0001 par value; authorized 1,200,000,000 shares, 40,060,155 and 45,350,070 issued and outstanding, respectively	—	—

Additional paid-in-capital	3,843	3,762
Class A treasury stock, at cost, 234,905,063 and 192,702,740 shares, respectively	(9,803)	(6,577)
Retained earnings	12,553	10,121
Accumulated other comprehensive income (loss)	(92)	178
Total Stockholders' Equity	6,501	7,484
Non-controlling interests	47	11
Total Equity	6,548	7,495
Total Liabilities and Equity	$14,659	$14,242

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

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MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF OPERATIONS
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(in millions, except per share data)			
Net Revenue	$2,503	$2,218	$7,057	$6,220
Operating Expenses				
General and administrative	797	701	2,207	1,930
Advertising and marketing	203	205	525	520
Depreciation and amortization	83	64	237	187
Total operating expenses	1,083	970	2,969	2,637
Operating income	1,420	1,248	4,088	3,583
Other Income (Expense)				
Investment income	8	11	21	30
Interest expense	(11)	3	(32)	(7)
Other income (expense), net	1	(8)	(5)	(17)
Total other income (expense)	(2)	6	(16)	6
Income before income taxes	1,418	1,254	4,072	3,589
Income tax expense	403	375	1,256	1,096
Net Income	$1,015	$879	$2,816	$2,493
Basic Earnings per Share	$0.88	$0.73	$2.41	$2.05
Basic Weighted-Average Shares Outstanding	1,157	1,205	1,169	1,215
Diluted Earnings per Share	$0.87	$0.73	$2.40	$2.05
Diluted Weighted-Average Shares Outstanding	1,160	1,209	1,172	1,219

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

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MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(in millions)			
Net Income	$1,015	$879	$2,816	$2,493
Other comprehensive income (loss):				
Foreign currency translation adjustments	(274)	137	(262)	65
Defined benefit pension and other postretirement plans	—	(2)	2	(1)
Income tax effect	—	1	—	1
Defined benefit pension and other postretirement plans, net of income tax effect	—	(1)	2	—
Investment securities available-for-sale	(8)	(1)	(14)	(9)
Income tax effect	2	1	4	3
Investment securities available-for-sale, net of income tax effect	(6)	—	(10)	(6)
Other comprehensive income (loss), net of tax	(280)	136	(270)	59
Comprehensive Income	$735	$1,015	$2,546	$2,552

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

MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(UNAUDITED)

	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock Class A	Common Stock Class B	Additional Paid-In Capital	Class A Treasury Stock	Non-Controlling Interests
	(in millions, except per share data)							
Balance at December 31, 2013	$7,495	$10,121	$ 178	$—	$—	$ 3,762	$(6,577)	$ 11
Net income	2,816	2,816	—	—	—	—	—	—
Activity related to non-controlling interests	36	—	—	—	—	—	—	36
Other comprehensive income (loss), net of tax	(270)	—	(270)	—	—	—	—	—
Cash dividends declared on Class A and Class B common stock, $0.33 per share	(384)	(384)	—	—	—	—	—	—
Purchases of treasury stock	(3,231)	—	—	—	—	—	(3,231)	—
Share-based payments	86	—	—	—	—	81	5	—

Balance at September 30, 2014	$6,548	$12,553	$ (92)	$—	$—	$ 3,843	$(9,803)	$ 47

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

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MASTERCARD INCORPORATED
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended September 30, 2014	2013
	(in millions)	
Operating Activities		
Net income	$2,816	$2,493
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	237	187
Share-based payments	(43)	27
Deferred income taxes	(80)	(34)
Other	24	48
Changes in operating assets and liabilities:		
Accounts receivable	(96)	(67)
Income taxes receivable	(12)	158
Settlement due from customers	86	(192)
Prepaid expenses	(156)	(44)
Accrued litigation and legal settlements	(97)	—
Accounts payable	(39)	(76)
Settlement due to customers	(124)	126
Accrued expenses	60	209
Net change in other assets and liabilities	106	101
Net cash provided by operating activities	2,682	2,936
Investing Activities		
Purchases of investment securities available-for-sale	(1,977)	(1,936)
Acquisition of businesses, net of cash acquired	(336)	—
Purchases of property, plant and equipment	(97)	(65)
Capitalized software	(75)	(88)
Proceeds from sales of investment securities available-for-sale	1,444	1,349
Proceeds from maturities of investment securities available-for-sale	1,322	959
Decrease (increase) in restricted cash for litigation settlement	184	(1)
Proceeds from maturities of investment securities held-to-maturity	—	36
Other investing activities	(17)	(19)
Net cash provided by investing activities	448	235
Financing Activities		
Purchases of treasury stock	(3,231)	(1,692)
Proceeds from debt	1,487	—
Dividends paid	(388)	(182)
Tax benefit for share-based payments	53	23
Cash proceeds from exercise of stock options	23	22
Other financing activities	(39)	(8)
Net cash used in financing activities	(2,095)	(1,837)
Effect of exchange rate changes on cash and cash equivalents	(172)	27
Net increase in cash and cash equivalents	863	1,361
Cash and cash equivalents - beginning of period	3,599	2,052
Cash and cash equivalents - end of period	$4,462	$3,413

Non-Cash Investing and Financing Activities		
Fair value of assets acquired, net of cash acquired	$574	$—
Fair value of liabilities assumed related to acquisitions	$134	$—

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

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MASTERCARD INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Note 1. Summary of Significant Accounting Policies
Organization
MasterCard Incorporated and its consolidated subsidiaries, including MasterCard International Incorporated (“MasterCard International” and together with MasterCard Incorporated, “MasterCard” or the “Company”), is a technology company in the global payments industry that connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and checks. The Company facilitates the processing of payment transactions including authorization, clearing and settlement, and delivers related products and services. The Company makes payments easier and more efficient by creating a wide range of payment solutions and services through a family of well-known brands, including MasterCard®, Maestro® and Cirrus®. The Company also provides value-added offerings such as loyalty and reward programs, information services and consulting. The Company’s network is designed to ensure safety and security for the global payments system. A typical transaction on the Company’s network involves four participants in addition to the Company: cardholder, merchant, issuer (the cardholder’s financial institution) and acquirer (the merchant’s financial institution). The Company’s customers encompass a vast array of entities, including financial institutions and other entities that act as “issuers” and “acquirers”, as well as merchants, governments, telecommunication companies and other businesses. The Company does not issue cards, extend credit, determine or receive revenue from interest rates or other fees charged to cardholders by issuers, or establish the “merchant discount” rate charged in connection with the acceptance of cards and other payment devices that carry MasterCard’s brands.
Consolidation and basis of presentation
The consolidated financial statements include the accounts of MasterCard and its majority-owned and controlled entities, including any variable interest entities for which the Company is the primary beneficiary. Intercompany transactions and balances have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the 2014 presentation. The Company follows accounting principles generally accepted in the United States of America (“GAAP”).
The balance sheet as of December 31, 2013 was derived from the audited consolidated financial statements as of December 31, 2013. The consolidated financial statements for the three and nine months ended September 30, 2014 and 2013 and as of September 30, 2014 are unaudited, and in the opinion of management, include all normal recurring adjustments that are necessary to present fairly the results for interim periods. The results of operations for the three and nine months ended September 30, 2014 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 for Quarterly Reports on Form 10-Q and, consequently, do not include all of the disclosures required by GAAP. Reference should be made to the MasterCard Incorporated Annual Report on Form 10-K for the year ended December 31, 2013 for additional disclosures, including a summary of the Company’s significant accounting policies.
Non-controlling interest amounts are included in the consolidated statement of operations within other income (expense). For the three and nine months ended September 30, 2014 and 2013 income/loss from non-controlling interests was insignificant.
In December 2012, the Company made a payment into a qualified cash settlement fund related to its U.S. merchant class litigation. The Company has presented these funds as restricted cash for litigation settlement since the use of the funds under the qualified cash settlement fund is restricted for payment under the settlement agreement. In January 2014, $164 million was returned to MasterCard from the qualified cash settlement fund related to the opt-out merchants and has been reclassified to cash and cash equivalents. See Note 12 (Legal and Regulatory Proceedings) for further detail.
Recent accounting pronouncements
Revenue Recognition - In May 2014, the Financial Accounting Standards Board (“FASB”) issued accounting guidance that provides a single, comprehensive revenue recognition model for all contracts with customers and supersedes most

of the existing revenue recognition requirements. Under this guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance is effective for fiscal years beginning after December 15, 2016. Early application is not permitted. The Company is in the process of evaluating the potential effects of this guidance.

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MASTERCARD INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

Foreign currency - In March 2013, the FASB issued clarifying accounting guidance on the release of cumulative translation adjustment into net income when an entity ceases to have a controlling financial interest in a subsidiary or a group of assets that is a business within a foreign entity. The revised accounting guidance became effective January 1, 2014 and did not have an impact on the Company’s consolidated financial statements.

Income taxes - In July 2013, the FASB issued accounting guidance that requires entities to present an unrecognized tax benefit net with certain deferred tax assets when specific requirements are met. The Company adopted the revised accounting guidance effective January 1, 2014. This new accounting guidance did not have a material impact on the Company’s consolidated financial statements.

Note 2. Acquisitions

In the nine months ended September 30, 2014, the Company acquired five businesses. Two of the business combinations were achieved in stages, with non-controlling interests acquired in previous years. One of the business combinations was a transaction for less than 100 percent of the equity interest. The total consideration transferred was $389 million, paid in cash. The Company’s preliminary estimate of the aggregate excess of the purchase price over the fair value of net assets acquired of $385 million was recorded as goodwill. The goodwill is not expected to be deductible for local tax purposes. The consolidated financial statements include the operating results of the acquired businesses from the dates of their respective acquisition. Pro forma information related to acquisitions was not included because the impact on the Company's consolidated results of operations was not considered to be material. The Company acquired no businesses in the nine months ended September 30, 2013.

Note 3. Earnings Per Share

The components of basic and diluted earnings per share (“EPS”) for common stock were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(in millions, except per share data)			
Numerator:				
Net income	$1,015	$879	$2,816	$2,493
Denominator:				
Basic weighted-average shares outstanding	1,157	1,205	1,169	1,215
Dilutive stock options and stock units	3	4	3	4
Diluted weighted-average shares outstanding [1]	1,160	1,209	1,172	1,219
Earnings per Share				
Basic	$0.88	$0.73	$2.41	$2.05
Diluted	$0.87	$0.73	$2.40	$2.05

[1] For the periods presented, the calculation of diluted EPS excluded a minimal amount of anti-dilutive share-based payment awards.

Note 4. Fair Value and Investment Securities

Financial Instruments – Recurring Measurements

The Company classifies its fair value measurements of financial instruments into a three-level hierarchy (the “Valuation Hierarchy”). No transfers were made among the three levels in the Valuation Hierarchy during the three and nine months ended September 30, 2014.

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MASTERCARD INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

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

	September 30, 2014			
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
	(in millions)			
Municipal securities	$—	$147	$—	$147
U.S. government and agency securities [1]	—	254	—	254
Corporate securities	—	1,006	—	1,006
Asset-backed securities	—	362	—	362
Other [2]	11	71	11	93
Total	$11	$1,840	$11	$1,862

	December 31, 2013			
	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value
	(in millions)			
Municipal securities	$—	$267	$—	$267
U.S. government and agency securities [1]	—	560	—	560
Corporate securities	—	1,426	—	1,426
Asset-backed securities	—	364	—	364
Other [2]	—	79	11	90
Total	$—	$2,696	$11	$2,707

[1] Excludes amounts held in escrow related to the U.S. merchant class litigation settlement of $540 million and $723 million at September 30, 2014 and December 31, 2013, respectively, which would be included in Levels 1 and 2 of the Valuation Hierarchy. See Note 6 (Accrued Expenses and Accrued Litigation) and Note 12 (Legal and Regulatory Proceedings) for further details.
[2] The amounts classified within Level 3 of the Valuation Hierarchy represent auction rate securities ("ARS") with values that are not currently observable in the market due to the lack of trading in the securities.

The fair value of the Company's available-for-sale municipal securities, U.S. government and agency securities, corporate securities, asset-backed securities and other fixed income securities included in the Other category are based on quoted prices for similar assets in active markets and are therefore included in Level 2 of the Valuation Hierarchy. The Company's foreign currency derivative contracts have also been classified within Level 2 in the Other category of the Valuation Hierarchy, as the fair value is based on broker quotes for the same or similar derivative instruments. See Note 14 (Foreign Exchange Risk Management) for further details.

Financial Instruments - Non-Recurring Measurements

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

payable, settlement due to customers and accrued expenses. In addition, nonmarketable equity investments are measured at fair value on a nonrecurring basis for purposes of initial recognition and impairment testing.
Debt
The Company estimates the fair value of its long-term debt using the market pricing approach which applies market assumptions for relevant though not directly comparable undertakings. Long-term debt is classified as Level 2 of the Valuation Hierarchy. At September 30, 2014, the carrying value and fair value of long-term debt was $1.5 billion. The Company did not have any long-term debt at December 31, 2013. See Note 7 (Debt).

Settlement and Other Guarantee Liabilities

The Company estimates the fair value of its settlement and other guarantees using the market pricing approach which applies market assumptions for relevant though not directly comparable undertakings, as the latter are not observable in the market given the proprietary nature of such guarantees. At September 30, 2014 and December 31, 2013, the carrying value and fair value of settlement and other guarantee liabilities were not material. Settlement and other guarantee liabilities are classified as Level 3 of the Valuation Hierarchy as their valuation requires substantial judgment and estimation of factors that are not currently observable in the market. For additional information regarding the Company's settlement and other guarantee liabilities, see Note 13 (Settlement and Other Risk Management).

Refunding Revenue Bonds

The Company holds refunding revenue bonds with the same payment terms, and which contain the right of set-off with a capital lease obligation related to the Company's global technology and operations center located in O'Fallon, Missouri. The Company has netted the refunding revenue bonds and the corresponding capital lease obligation in the consolidated balance sheet and estimates that the carrying value approximates the fair value for these bonds.

Non-Financial Instruments

Certain assets and liabilities are measured at fair value on a nonrecurring basis for purposes of initial recognition and impairment testing. The Company's non-financial assets and liabilities measured at fair value on a nonrecurring basis include property, plant and equipment, goodwill and other intangible assets. These assets are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment.

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

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MASTERCARD INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

Amortized Costs and Fair Values – Available-for-Sale Investment Securities

The major classes of the Company's available-for-sale investment securities, for which unrealized gains and losses are recorded as a separate component of other comprehensive income on the consolidated statement of comprehensive income, and their respective amortized cost basis and fair values as of September 30, 2014 and December 31, 2013 were as follows:

	September 30, 2014			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(in millions)			
Municipal securities	$147	$—	$—	$147
U.S. government and agency securities	254	—	—	254
Corporate securities	1,005	1	—	1,006
Asset-backed securities	362	—	—	362
Other [1]	114	—	(15)	99
Total	$1,882	$1	$(15)	$1,868

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
	(in millions)			
Municipal securities	$267	$—	$—	$267
U.S. government and agency securities	560	—	—	560
Corporate securities	1,425	2	(1)	1,426
Asset-backed securities	364	—	—	364
Other [1]	91	—	(1)	90
Total	$2,707	$2	$(2)	$2,707

[1] Other includes ARS, which are included in other assets on the consolidated balance sheet. The unrealized losses related to ARS have been in an unrealized loss position longer than 12 months, but have not been deemed other-than-temporarily impaired.

The municipal securities are primarily comprised of tax-exempt bonds and are diversified across states and sectors. The U.S. government and agency securities are primarily invested in U.S. government bonds and U.S. government sponsored agency bonds. Corporate securities are comprised of commercial paper and corporate bonds. The asset-backed securities are investments in bonds which are collateralized primarily by automobile loan receivables.

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MASTERCARD INCORPORATED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) – (Continued)

Investment Maturities

The maturity distribution based on the contractual terms of the Company's investment securities at September 30, 2014 was as follows:

	Available-For-Sale	
	Amortized Cost	Fair Value
	(in millions)	
Due within 1 year	$1,045	$1,046
Due after 1 year through 5 years	796	796
Due after 5 years through 10 years	4	4
Due after 10 years	12	11
No contractual maturity	25	11
Total	$1,882	$1,868

All the securities due after ten years are ARS. Equity securities have been included in the No contractual maturity category, as these securities do not have stated maturity dates.

Investment Income

Investment income was $8 million and $11 million for the three months ended September 30, 2014 and 2013, respectively, and $21 million and $30 million for the nine months ended September 30, 2014 and 2013, respectively. Investment income primarily consisted of interest income generated from cash, cash equivalents, and investment securities available-for-sale. Dividend income and gross realized gains and losses were not significant.

Note 5. Prepaid Expenses and Other Assets

Prepaid expenses and other current assets consisted of the following:

	September 30, 2014	December 31, 2013
	(in millions)	
Customer and merchant incentives	$286	$239
Prepaid income taxes	159	36
Other	157	196
Total prepaid expenses and other current assets	$602	$471

Other assets consisted of the following:

	September 30, 2014	December 31, 2013
	(in millions)	
Customer and merchant incentives	$541	$531
Nonmarketable equity investments	163	229
Income taxes receivable	92	78
Other	91	64
Total other assets	$887	$902

Certain customer and merchant business agreements provide incentives upon entering into the agreement. Customer and merchant incentives represent p