PayPal Holdings, Inc.
Form 10-Q
October 25, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016.
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 001-36859

PayPal Holdings, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	47-2989869
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2211 North First Street San Jose, California	95131
(Address of Principal Executive Offices)	(Zip Code)

(408) 967-1000
(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 [ ]
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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [x] 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 ý	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 Exchange Act). Yes [ ] No [x]

As of October 19, 2016, there were 1,206,645,916 shares of the registrant's common stock, $0.0001 par value, outstanding, which is the only class of common or voting stock of the registrant issued.

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements

PayPal Holdings, Inc.
CONDENSED CONSOLIDATED BALANCE SHEET

	September 30, 2016	December 31, 2015
	(In millions, except par value)	
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$1,369	$ 1,393
Short-term investments	3,719	2,018
Accounts receivable, net	187	137
Loans and interest receivable, net of allowances of $314 in 2016 and $233 in 2015	4,815	4,184
Funds receivable and customer accounts	13,320	12,261
Prepaid expenses and other current assets	751	655
Total current assets	24,161	20,648
Long-term investments	1,339	2,348
Property and equipment, net	1,451	1,344
Goodwill	4,068	4,069
Intangible assets, net	245	358
Other assets	92	114
Total assets	$31,356	$ 28,881
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$174	$ 145
Funds payable and amounts due to customers	14,120	12,261
Accrued expenses and other current liabilities	1,272	1,179
Income taxes payable	50	32
Total current liabilities	15,616	13,617
Deferred tax liability and other long-term liabilities	1,548	1,505
Total liabilities	17,164	15,122
Commitments and contingencies (Note 11)		
Equity:		
Common stock, $0.0001 par value; 4,000 shares authorized; 1,206 and 1,224 outstanding	—	—
Treasury stock at cost, 26 shares as of September 30, 2016	(945)	—
Additional paid-in-capital	13,419	13,100
Retained earnings	1,679	668
Accumulated other comprehensive income (loss)	39	(9)
Total equity	14,192	13,759
Total liabilities and equity	$31,356	$ 28,881

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

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PayPal Holdings, Inc.
CONDENSED COMBINED AND CONSOLIDATED STATEMENT OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions, except per share data) (Unaudited)			
Net revenues	$2,667	$2,258	$7,861	$6,692
Operating expenses:				
Transaction expense	830	651	2,392	1,860
Transaction and loan losses	271	201	781	564
Customer support and operations	325	284	939	811
Sales and marketing	233	226	716	682
Product development	215	197	619	584
General and administrative	261	216	753	648
Depreciation and amortization	184	153	535	444
Restructuring	—	—	—	49
Total operating expenses	2,319	1,928	6,735	5,642
Operating income	348	330	1,126	1,050
Other income (expense), net	12	20	36	20
Income before income taxes	360	350	1,162	1,070
Income tax expense	37	49	151	209
Net income	$323	$301	$1,011	$861
Net income per share:				
Basic	$0.27	$0.25	$0.83	$0.71
Diluted	$0.27	$0.25	$0.83	$0.70
Weighted average shares:				
Basic	1,207	1,221	1,211	1,221
Diluted	1,214	1,227	1,218	1,227

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

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PayPal Holdings, Inc.
CONDENSED COMBINED AND CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions) (Unaudited)			
Net income	$323	$301	$1,011	$861
Other comprehensive income (loss), net of reclassification adjustments:				
Foreign currency translation	1	(9)	4	(33)
Unrealized gains (losses) on investments, net	(3)	(6)	18	(8)
Tax (expense) benefit on unrealized gains (losses) on investments, net	1	1	(4)	1
Unrealized gains (losses) on hedging activities, net	(13)	(7)	30	(67)
Tax (expense) benefit on unrealized gains (losses) on hedging activities, net	1	—	—	—
Other comprehensive income (loss), net of tax	(13)	(21)	48	(107)
Comprehensive income	$310	$280	$1,059	$754

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

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PayPal Holdings, Inc.
CONDENSED COMBINED AND CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended September 30,	
	2016	2015
	(In millions) (Unaudited)	
Cash flows from operating activities:		
Net income	$1,011	$861
Adjustments:		
Transaction and loan losses	781	564
Depreciation and amortization	535	444
Stock-based compensation	313	256
Deferred income taxes	71	87
Excess tax benefits from stock-based compensation	(36)	(24)
Gain on sale of principal loans receivable held for sale, net	(17)	(35)
Changes in assets and liabilities:		
Accounts receivable	(50)	(98)
Receivable from eBay	—	121
Changes in principal loans receivable held for sale, net	17	9
Accounts payable	28	2
Payable to eBay	—	(217)
Income taxes payable	51	75
Other assets and liabilities	(469)	(227)
Net cash provided by operating activities	2,235	1,818
Cash flows from investing activities:		
Purchases of property and equipment	(517)	(558)
Proceeds from sales of property and equipment	—	26
Changes in principal loans receivable, net	(884)	(146)
Purchases of investments	(16,984)	(17,253)
Maturities and sales of investments	14,614	11,003
Acquisitions, net of cash acquired	(19)	(283)
Funds receivable and customer accounts	620	314
Notes and receivables from eBay	—	575
Net cash used in investing activities	(3,170)	(6,322)
Cash flows from financing activities:		
Proceeds from issuance of common stock	58	36
Purchases of treasury stock	(945)	—
Excess tax benefits from stock-based compensation	36	24
Contribution from eBay	—	3,858
Tax withholdings related to net share settlements of equity awards	(95)	(7)
Repayments under financing arrangements, net	(21)	(877)
Funds payable and amounts due to customers	1,862	1,190
Net cash provided by financing activities	895	4,224
Effect of exchange rate changes on cash and cash equivalents	16	(41)
Net change in cash and cash equivalents	(24)	(321)
Cash and cash equivalents at beginning of period	1,393	2,201
Cash and cash equivalents at end of period	$1,369	$1,880

Supplemental cash flow disclosures:		
Cash paid for interest	$3	$14
Cash paid for income taxes	$43	$56

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

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PayPal Holdings, Inc.
NOTES TO CONDENSED COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Overview and Summary of Significant Accounting Policies

Overview and Organization

PayPal Holdings, Inc. ("PayPal," the "Company," "we," "us," or "our") was incorporated in Delaware in January 2015 and is a leading technology platform company that enables digital and mobile payments on behalf of consumers and merchants worldwide. We put our customers at the center of everything we do. We strive to increase our relevance for consumers, merchants, friends and family to access and move their money anywhere in the world, anytime, on any platform and through any device (e.g., mobile, tablets, personal computers or wearables). We provide safer and simpler ways for businesses of all sizes to accept payments from merchant websites, mobile devices and applications, and at offline retail locations through a wide range of payment solutions. We also facilitate person to person payments through PayPal, Venmo and Xoom. Our combined payment solution capabilities, including our PayPal, PayPal Credit, Braintree, Venmo, and Xoom products, comprise our proprietary Payments Platform.

We operate globally in a rapidly evolving regulatory environment characterized by a heightened regulatory focus on all aspects of the payments industry. Government regulation impacts key aspects of our business, and we are subject to regulations that affect the payments industry in the many countries in which we operate. Changes in or non-compliance with laws and regulations, changes in the interpretation of laws and regulations, and the enactment of new laws and regulations applicable to us could have a material adverse impact on our business, results of operations and financial condition.

Significant Accounting Policies

Basis of Presentation and Principles of Combination and Consolidation

On July 17, 2015 (the "distribution date"), PayPal became an independent publicly-traded company through the pro rata distribution by eBay Inc. ("eBay") of 100% of the outstanding common stock of PayPal to eBay stockholders (which we refer to as the "separation" or the "distribution"). Each eBay stockholder of record as of the close of business on July 8, 2015 received one share of PayPal common stock for every share of eBay common stock held on the record date. Approximately 1.2 billion shares of PayPal common stock were distributed on July 17, 2015 to eBay stockholders. PayPal's common stock began "regular way" trading under the ticker symbol "PYPL" on The NASDAQ Stock Market on July 20, 2015.

Prior to the separation, eBay transferred substantially all of the assets and liabilities and operations of eBay's payments business to PayPal, which was completed in June 2015 (the "capitalization"). The combined financial statements prior to the capitalization were prepared on a stand-alone basis and were derived from eBay's consolidated financial statements and accounting records. The combined financial statements reflect our financial position, results of operations, comprehensive income and cash flows as our business was operated as part of eBay prior to the capitalization. Following the capitalization, the consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All periods presented have been accounted for in conformity with U.S. generally accepted accounting principles ("GAAP").

For periods prior to the capitalization, the condensed combined financial statements include expenses associated with real estate and information technology that were previously allocated to the payments business of eBay, and additional expenses related to certain corporate functions, including senior management, legal, human resources and finance. These expenses also include allocations related to stock-based compensation. The expenses that were incurred by eBay were allocated to us based on direct usage or benefit where identifiable, with the remainder allocated on a pro rata basis of revenue, headcount, or other systematic measure. We consider the expense allocation methodology and results to be reasonable for all periods presented. The condensed combined financial statements also include certain assets and liabilities that were historically held at the eBay corporate level, but which are specifically identifiable and attributable to us. The condensed combined and consolidated financial position, results of operations and cash flows of PayPal, prior to the distribution, may not be indicative of our results had we been a separate stand-alone entity throughout the periods presented, nor are the results stated herein indicative of what the Company’s financial position, results of operations and cash flows may be in the future. All intercompany transactions and accounts have been eliminated. Transactions between the Company and eBay are included in these condensed combined and consolidated financial statements for all periods presented.

Beginning with the first quarter of 2016, we reclassified certain operating expenses in our condensed combined and consolidated statements of income to better align our external and internal financial reporting. These classification changes relate primarily to real estate and information technology operating expenses that were previously allocated among customer support and operations

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expense, sales and marketing expense and product development expense. As of the first quarter of 2016, our management did not allocate these operating expenses for internal financial reporting and general management of the business and has therefore discontinued this allocation for external financial reporting purposes. As a result, starting with the first quarter of 2016, these operating expenses were reported as part of general and administrative expenses. These changes have no impact on the previously reported condensed combined and consolidated net income for prior periods, including total operating expenses, financial position or cash flows for any periods presented, and do not eliminate any of the costs allocated to us by eBay for any periods prior to the separation. Prior period amounts have been reclassified to conform to the current period presentation.
The following table presents the effects of the changes on the presentation of operating expenses to the previously reported condensed combined and consolidated statement of income:

	Three Months Ended September 30, 2015		
In millions	As Reported	Adjustments	Revised
Transaction expense	$651	$ —	$ 651
Transaction and loan losses	201	—	201
Customer support and operations	317	(33)	284
Sales and marketing	235	(9)	226
Product development	230	(33)	197
General and administrative	141	75	216
Depreciation and amortization	153	—	153
Restructuring	—	—	—
Total operating expenses	$1,928	$ —	$ 1,928

	Nine Months Ended September 30, 2015		
In millions	As Reported	Adjustments	Revised
Transaction expense	$1,860	$ —	$ 1,860
Transaction and loan losses	564	—	564
Customer support and operations	900	(89)	811
Sales and marketing	716	(34)	682
Product development	695	(111)	584
General and administrative	414	234	648
Depreciation and amortization	444	—	444
Restructuring	49	—	49
Total operating expenses	$5,642	$ —	$ 5,642

The accompanying condensed combined and consolidated financial statements include the financial statements of PayPal and our wholly and majority-owned subsidiaries. Investments in entities where we hold less than a 20% ownership interest are generally accounted for using the cost method of accounting, and our share of the investees' results of operations is included in other income (expense), net on our condensed combined and consolidated statement of income to the extent dividends are received. Our investment balance is included in long-term investments on our condensed consolidated balance sheet.
These condensed combined and consolidated financial statements and accompanying notes should be read in conjunction with the audited combined and consolidated financial statements and accompanying notes for the year

ended December 31, 2015 included in our Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission.

In the opinion of management, these condensed combined and consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for fair presentation of the condensed combined and consolidated financial statements for interim periods. We have evaluated all subsequent events through the date the financial statements were issued.

Use of Estimates

The preparation of condensed combined and consolidated financial statements in conformity with GAAP requires management 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 condensed combined and consolidated financial statements and the reported amounts of revenues and expenses, including allocations from eBay for periods presented prior to the separation, during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to provisions for transaction and loan losses, loss contingencies, income taxes, revenue recognition and the valuation of goodwill and intangible assets. We base our estimates on historical experience and on various other assumptions which we believe to be reasonable under the circumstances. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents are short-term, highly liquid investments with original maturities of three months or less when purchased and are comprised primarily of bank deposits, government and agency securities and commercial paper.

Customer accounts

We hold all customer balances (both in the U.S. and internationally) as direct claims against us which are reflected on our consolidated balance sheet as a liability classified as amounts due to customers. Various jurisdictions where PayPal operates require us to hold eligible liquid assets, as defined by the regulators in these jurisdictions, equal to at least 100% of the aggregate amount of all customer balances. Therefore, we use the assets underlying the customer balances to meet these regulatory requirements and separately classify the assets as customer accounts in our condensed consolidated balance sheet. We classify the assets underlying the customer balances as current based on their purpose and availability to fulfill our direct obligation under amounts due to customers.

In March 2016, as approved by management and our Luxembourg banking subsidiary Supervisory Board and as permitted within regulations set forth by the Luxembourg Commission de Surveillance du Secteur Financier (the “CSSF”), we designated $800 million of European customer balances held in our Luxembourg banking subsidiary to be used to extend credit to our European customers. This is consistent with our strategy of diversifying funding sources for our credit business and does not represent a change in our credit business development strategy or risk appetite. These funds are classified as cash and cash equivalents in our condensed consolidated balance sheet and represent approximately 20% of European customer balances potentially available for corporate use by the Company at September 30, 2016 as determined by applying financial regulations maintained by the CSSF. The remaining assets underlying the customer balances remain separately classified as customer accounts in our condensed consolidated balance sheet. We do not commingle these customer accounts with corporate funds and maintain these assets separately in interest and non-interest bearing bank deposits, time deposits, corporate debt securities and U.S. and foreign government and agency securities. See “Note 6—Funds Receivable and Customer Accounts” for additional information related to customer accounts. Due to the above approved plan, we have presented changes in funds receivable and customer accounts as cash flows from investing activities in our condensed combined and consolidated statements of cash flows based on the nature of the activity underlying our customer accounts. We have elected to conform the prior year statement of cash flows to the current period presentation to provide comparability.

The following table presents the effects of the changes on the presentation of the statement of cash flows to the previously reported cash flows from investing activities and cash flows from financing activities in the condensed combined statement of cash flows for the nine months ended September 30, 2015. These changes have no impact on the previously reported total net cash flows:

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NOTES TO CONDENSED COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

	Nine Months Ended September 30, 2015		
In millions	As Reported	Adjustments	Revised
Cash flows from investing activities:			
Purchases of investments	$(6,722)	$ (10,531)	$(17,253)
Maturities and sales of investments	1,976	9,027	11,003
Funds receivable and customer accounts	—	314	314
Cash flows from financing activities:			
Funds receivable and customer accounts	(1,190)	1,190	—
Net change	$(5,936)	$ —	$(5,936)

Recent Accounting Pronouncements

In 2014, the Financial Accounting Standards Board (FASB) issued new accounting guidance related to revenue recognition. This new standard will replace all current GAAP guidance on this topic and eliminate all industry-specific guidance. The new revenue recognition guidance provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. In 2015, the FASB deferred the effective date to fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. In 2016, the FASB updated the guidance for reporting revenue gross versus net to improve the implementation guidance on principal versus agent considerations, and for identifying performance obligations and the accounting of intellectual property licenses. In addition, the FASB introduced practical expedients and made narrow scope improvements to the new accounting guidance. This guidance can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. We are evaluating the impact and approach to adopting this new accounting guidance on our financial statements.

In 2016, the FASB issued new accounting guidance related to the classification and measurement of financial instruments. This new standard makes limited amendments to the guidance in GAAP by requiring equity investments to be measured at fair value with changes in fair value recognized in net income. This new standard also amends the presentation of certain fair value changes for financial liabilities measured at fair value and it also amends certain disclosure requirements associated with the fair value of financial instruments. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted in limited situations. We are required to apply the new guidance on a modified retrospective basis to all outstanding instruments, with a cumulative effect adjustment as of the date of adoption. We are evaluating the impact and approach to adopting this new accounting guidance on our financial statements.

In 2016, the FASB issued new accounting guidance related to accounting for leases, which will require lessees to recognize lease assets and lease liabilities on the balance sheet for the rights and obligations created by all leases with terms greater than twelve months. As we are not a lessor, other changes in the standard applicable to lessors do not apply. The standard is effective for fiscal years and interim periods within those years beginning after December 15, 2018, with early adoption permitted. We are required to adopt the guidance using a modified retrospective basis and can elect to apply optional practical expedients. We are evaluating the impact and approach to adopting this new accounting guidance on our financial statements.

In 2016, the FASB issued new accounting guidance to simplify the analysis for embedded derivatives. The new guidance clarifies that when assessing whether a contingent call or put option qualifies as a separate derivative from the host contract (e.g., the debt instrument), the nature of the exercise contingency would be excluded from the assessment. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early adoption permitted. We are required to apply the new guidance on a modified retrospective basis to all existing debt instruments as of the beginning of the fiscal year for which the amendments are effective. The adoption of this standard is not expected to have a material impact on our financial statements.

In 2016, the FASB issued new accounting guidance on investments that qualify for the equity method of accounting as a result of an increase in the level of ownership interest or degree of influence. The new guidance eliminates the requirement for retrospective adjustment of the investment, results of operations and retained earnings as if the equity method had been in effect during all the previous periods that the investment had been held. Instead, under the new guidance, the cost of acquiring the additional interest in the investee would be added to the current basis of the previously held interest and equity method accounting would be adopted as of the date the investment becomes qualified for equity method accounting. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016 with early adoption permitted. The guidance should be applied prospectively after adoption. The adoption of this standard is not expected to have a material impact on our financial statements.

In 2016, the FASB issued new guidance on the accounting for share-based payment compensation. The new guidance makes amendments to the following areas: accounting for income taxes upon vesting or settlement of awards, presentation of excess tax benefits or tax deficiencies on the statement of cash flows, accounting for forfeitures, minimum statutory withholding requirements and presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet minimum statutory withholding requirements. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016 with early adoption permitted. We will adopt the new guidance effective January 1, 2017. As a result of the adoption, stock-based compensation ("SBC") excess tax benefits or tax deficiencies will be reflected in the consolidated statement of income within the provision for income taxes rather than in the consolidated balance sheet within additional paid-in capital. This change will be applied prospectively. The amount of the impact to the provision for income taxes will depend on the difference between the market value of share-based awards at vesting or settlement and the grant date fair value recognized through SBC. Additionally, we will present the cash flows related to the applicable SBC excess tax benefits or tax deficiencies in operating activities along with other income tax cash flows rather than in financing activities on a prospective basis. Finally, we will continue to utilize an estimate of forfeitures as our approach when determining SBC. The remaining amendments are not expected to have a material impact on our combined and consolidated financial statements.

In 2016, the FASB issued new guidance on the measurement of credit losses on financial instruments. Credit losses on loans, trade and other receivables, held-to-maturity debt securities and other instruments will reflect our current estimate of the expected credit losses that generally will result in the earlier recognition of allowances for losses. Credit losses on available-for-sale debt securities with unrealized losses will be recognized as allowances for credit losses limited to the amount by which fair value is below amortized cost. Additional disclosures will be required, including information used to track credit quality by year of origination for most financing receivables. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 with early adoption permitted. We are required to apply the standard’s provisions as a cumulative effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted with impairment of available-for-sale debt securities applied prospectively after adoption. We are evaluating the impact and approach to adopting this new accounting guidance on our financial statements.

In 2016, the FASB issued new guidance on classifying certain cash receipts and cash payments on the statement of cash flows. The new guidance addresses the classification of cash flows related to: debt prepayment or extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance, including bank-owned life insurance, distributions received from equity method investees and beneficial interests in securitization transactions. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017 with early adoption permitted. The guidance should be applied retrospectively after adoption. The adoption of this standard is not expected to have a material impact on our financial statements.

Note 2 - Net Income Per Share

Basic net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. The weighted average number of common shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2016 was based on the weighted average number of common shares outstanding for the period. The weighted average number of common shares outstanding for basic and diluted earnings per share for the three and nine months ended September 30, 2015 was based on the weighted average number of common shares outstanding for the period beginning after the distribution date. On the distribution date, eBay stockholders of record as of the close of business on July 8, 2015 received one share of PayPal common stock for every share of eBay common stock held as of the record date. Approximately 1.2 billion shares of PayPal common stock were distributed on July 17, 2015 to eBay stockholders. Diluted net income per share is computed by dividing net income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding for the period. The dilutive effect of outstanding equity incentive awards is reflected in diluted net income per share by application of the treasury stock method. The calculation of diluted net income per share excludes all anti-dilutive common shares.

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015(1)	2016	2015(1)
(In millions, except per share amounts)				
Numerator:				
Net income	$323	$ 301	$1,011	$ 861
Denominator:				
Weighted average shares of common stock - basic	1,207	1,221	1,211	1,221
Dilutive effect of equity incentive awards	7	6	7	6
Weighted average shares of common stock - diluted	1,214	1,227	1,218	1,227
Net income per share:				
Basic	$0.27	$ 0.25	$0.83	$ 0.71
Diluted	$0.27	$ 0.25	$0.83	$ 0.70
Common stock equivalents excluded from income per diluted share because their effect would have been anti-dilutive	11	3	9	3

[1] On July 17, 2015, the distribution date, eBay stockholders of record as of the close of business on July 8, 2015 received one share of PayPal common stock for every share of eBay common stock held as of the record date. Basic and diluted net income per share for the three and nine months ended September 30, 2015 is calculated using the weighted average number of common shares outstanding for the period beginning after the distribution date.

Note 3 - Business Combinations

There were no acquisitions or divestitures completed in the three and nine months ended September 30, 2016. During 2015, we completed four acquisitions, reflecting 100% of the equity interests of the acquired companies, for an aggregate amount of $1.4 billion as described in "Part IV, Item 15, Note 3—Business Combinations" in our Annual Report on Form 10-K for the year ended December 31, 2015. In the three months ended September 30, 2016, we finalized the allocation of the purchase consideration for one of our 2015 acquisitions which did not result in any material changes to the allocation. In the nine months ended September 30, 2016, we finalized the allocation of the purchase consideration for Paydiant, CyActive and one other acquisition which did not result in any material changes to the allocation.

Note 4 - Goodwill and Intangible Assets

Goodwill

The following table presents goodwill balances and adjustments to those balances during the nine months ended September 30, 2016 (in millions):

	December 31, 2015	Goodwill Acquired	Adjustments	September 30, 2016

Total Goodwill	$ 4,069	$ —	$ (1)	$ 4,068

PayPal Holdings, Inc.
NOTES TO CONDENSED COMBINED AND CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Intangible Assets

The components of identifiable intangible assets are as follows:

	September 30, 2016				December 31, 2015			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life (Years)
	(In millions, except years)							
Intangible assets:								
Customer lists and user base	$605	$ (533)	$ 72	4	$605	$ (501)	$ 104	4
Marketing related	197	(180)	17	2	197	(150)	47	3
Developed technologies	245	(198)	47	3	245	(176)	69	3
All other	243	(134)	109	5	243	(105)	138	5
Intangible assets, net	$1,290	$ (1,045)	$ 245		$1,290	$ (932)	$ 358	

Amortization expense for intangible assets was $37 million and $24 million for the three months ended September 30, 2016 and 2015, respectively. Amortization expense for intangible assets was $114 million and $66 million for the nine months ended September 30, 2016 and 2015, respectively.

Expected future intangible asset amortization as of September 30, 2016 was as follows (in millions):

Fiscal years:	
Remaining 2016	$35
2017	101
2018	68
2019	24
2020	17
	$245

Note 5 - Geographical Information

The following tables summarize the allocation of net revenues and long-lived assets based on geography:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Net revenues:				
U.S.	$1,436	$1,138	$4,186	$3,338
U.K.	298	294	923	857
Other Countries	933	826	2,752	2,497
Total net revenues	$2,667	$2,258	$7,861	$6,692

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	September 30, 2016	December 31, 2015
	(In millions)	
Long-lived assets:		
U.S.	$1,362	$ 1,256
Other Countries	89	88
Total long-lived assets	$1,451	$ 1,344

Net revenues are attributed to U.S., U.K. and other countries primarily based upon the country in which the merchant is located, or in the case of a cross border transaction, may be earned from the country in which the consumer and the merchant respectively reside. Net revenues earned from value added services are typically attributed to the country in which either the customer or partner reside. Tangible long-lived assets for the three and nine months ended September 30, 2016 and 2015 consisted of property and equipment. Long-lived assets attributed to the U.S. and other countries are based upon the country in which the asset is located or owned.

Note 6 - Funds Receivable and Customer Accounts

The following table summarizes the assets underlying our funds receivable and customer accounts as of September 30, 2016 and December 31, 2015.

	September 30, 2016	December 31, 2015
	(In millions)	
Cash and cash equivalents	$4,213	$ 5,245
Government and agency securities	5,557	4,305
Time deposits	445	830
Corporate debt securities	991	180
Funds receivable	2,114	1,701
Total funds receivable and customer accounts	$13,320	$ 12,261

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At September 30, 2016 and December 31, 2015, the estimated fair value of our investments classified as available-for-sale included within funds receivable and customer accounts was as follows:

	September 30, 2016			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Government and agency securities	$5,130	$ 1	$ (1)	$ 5,130
Time deposits	445	—	—	445
Corporate debt securities	317	—	—	317
Total	$5,892	$ 1	$ (1)	$ 5,892

	December 31, 2015			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Government and agency securities	$3,299	$ —	$ (1)	$ 3,298
Time deposits	830	—	—	830
Total	$4,129	$ —	$ (1)	$ 4,128

We elect to account for certain investments within customer accounts, including foreign-currency denominated available-for-sale investments, under the fair value option. As a result, any gains and losses from fair value changes on such investments are recognized in other income (expense), net on the condensed combined and consolidated statement of income. Election of the fair value option allows us to significantly reduce the accounting asymmetry that would otherwise arise when recognizing the changes in the fair value of available-for-sale investments and the corresponding foreign exchange gains and losses relating to customer liabilities. At September 30, 2016 and December 31, 2015, the estimated fair value of our investments included within funds receivable and customer accounts under the fair value option was $1.1 billion and $1.2 billion, respectively. In the three months ended September 30, 2016 and 2015, $10 million of net gain and $15 million of net loss from fair value changes, respectively, were recognized in other income (expense), net on the condensed combined and consolidated statement of income. In the nine months ended September 30, 2016 and 2015, $3 million of net gain and $36 million of net losses from fair value changes, respectively, were recognized in other income (expense), net on the condensed combined and consolidated statement of income.

The aggregate fair value of investments in an unrealized loss position was $2.6 billion as of September 30, 2016. The aggregate gross unrealized loss on our short-term and long-term investments was not material as of September 30, 2016. We believe the decline in value is due to temporary market conditions and expect to recover the entire amortized cost basis of the securities. We neither intend nor anticipate the need to sell the securities before recovery. We continue to monitor the performance of the investment portfolio and assess market and interest rate risk when evaluating whether other-than-temporary impairment exists.

As of September 30, 2016, we had no material investments that have been in a continuous unrealized loss position for greater than 12 months. Amounts reclassified to earnings from unrealized gains and losses were not material for the nine months ended September 30, 2016 and 2015.

The estimated fair values of our investments classified as available-for-sale included within funds receivable and customer accounts by date of contractual maturity at September 30, 2016 were as follows:

	September 30, 2016
	(In millions)
One year or less	$ 5,638
One year through two years	254
Total	$ 5,892

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Note 7 - Investments

At September 30, 2016 and December 31, 2015, the estimated fair value of our short-term and long-term investments classified as available-for-sale was as follows:

	September 30, 2016			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Short-term investments[1]:				
Corporate debt securities	$3,104	$ 1	$ —	$ 3,105
Government and agency securities	50	—	—	50
Time deposits	162	—	—	162
Long-term investments:				
Corporate debt securities	1,229	2	(1)	1,230
Government and agency securities	10	—	—	10
Total[1]	$4,555	$ 3	$ (1)	$ 4,557

[1] Excludes short-term restricted cash of $18 million.

	December 31, 2015			
	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In millions)			
Short-term investments[1]:				
Corporate debt securities	$2,000	$ —	$ (2)	$ 1,998
Time deposits	2	—	—	2
Long-term investments[1]:				
Corporate debt securities	2,328	—	(14)	2,314
Total[1]	$4,330	$ —	$ (16)	$ 4,314

[1] Excludes short-term restricted cash of $18 million and long-term restricted cash of $8 million.

In the second quarter of 2016, we elected to account for foreign denominated available-for-sale investments held in our Luxembourg banking subsidiary under the fair value option. Election of the fair value option allows us to recognize any gains and losses from fair value changes on such investments in other income (expense), net on the condensed combined and consolidated statement of income to offset certain foreign exchange gains and losses on our foreign denominated customer liabilities. As of September 30, 2016, the estimated fair value of our investments included within short term investments and long term investments under the fair value option was $433 million. In the three and nine months ended September 30, 2016, $11 million and $26 million of net losses from fair value changes, respectively, were recognized in other income (expense), net on the condensed combined and consolidated statement of income.

We have short-term restricted cash that we intend to use to support our global sabbatical program. In addition, in connection with the acquisition of Xoom, we have long-term restricted cash required as collateral by payment processors and for licensing rules in India.

As of September 30, 2016, we had no material long-term or short-term investments that have been in a continuous unrealized loss position for greater than 12 months. Amounts reclassified to earnings from unrealized gains and losses were not material for the three and nine months ended September 30, 2016 and 2015.

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The estimated fair values of our short-term and long-term investments classified as available-for-sale by date of contractual maturity at September 30, 2016 were as follows:

	September 30, 2016 (In millions)
One year or less	$ 3,317
One year through two years	641
Two years through three years	487
Three years through four years	58
Four years through five years	29
Greater than five years	25
Total[(1)]	$ 4,557

(1) Excludes short-term restricted cash of $18 million.

Other Investments

We have cost method investments which are reported in long-term investments on our condensed consolidated balance sheet. Our cost method investments totaled $50 million and $26 million as of September 30, 2016 and December 31, 2015, respectively. The increase in our cost method investments was due to additional investments made in the nine months ended September 30, 2016.

Note 8 - Fair Value Measurement of Assets and Liabilities

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2016 and December 31, 2015:

Description	Balances at September 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
	(In millions)		
Assets:			
Cash and cash equivalents	$338	$ —	$ 338
Short-term investments:			
Restricted Cash	18	18	—
Corporate debt securities	3,108	—	3,108
Government and agency securities	431	—	431
Time deposits	162	—	162
Total short-term investments	$3,719	$ 18	$ 3,701
Funds receivable and customer accounts	7,192	—	7,192
Derivatives	128	—	128
Long-term investments:			
Corporate debt securities	1,253	—	1,253
Government and agency securities	36	—	36
Total long-term investments	1,289	—	1,289
Total financial assets	$12,666	$ 18	$ 12,648

Liabilities:			
Derivatives	$43	$ —	$ 43

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Description	Balances at December 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
	(In millions)		
Assets:			
Cash and cash equivalents	$406	$ —	$ 406
Short-term investments:			
Restricted Cash	18	18	—
Corporate debt securities	1,998	—	1,998
Time deposits	2	—	2
Total short-term investments	2,018	18	2,000
Funds receivable and customer accounts	6,978	—	6,978
Derivatives	97	—	97
Long-term investments:			
Restricted Cash	8	8	—
Corporate debt securities	2,314	—	2,314
Total long-term investments	2,322	8	2,314
Total financial assets	$11,821	$ 26	$ 11,795
Liabilities:			
Derivatives	$25	$ —	$ 25

Our financial assets and liabilities are valued using market prices on both active markets (Level 1) and less active markets (Level 2). Level 1 instrument valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 instrument valuations are obtained from readily available pricing sources for comparable instruments, identical instruments in less active markets, or models using market observable inputs.

The majority of our derivative instruments are valued using pricing models that take into account the contract terms as well as multiple inputs where applicable, such as currency rates, interest rate yield curves, option volatility and equity prices. Our derivative instruments are primarily short-term in nature, generally one month to one year in duration. Certain foreign currency contracts designated as cash flow hedges may have a duration of up to 18 months.

We did not have any transfers of financial instruments between valuation levels during the nine months ended September 30, 2016 and 2015. As of September 30, 2016, we did not have any assets or liabilities requiring measurement at fair value without observable market values that would require a high level of judgment to determine fair value (Level 3).

Cash and cash equivalents are short-term, highly liquid investments with original maturities of three months or less when purchased and are comprised primarily of bank deposits, government and agency securities and commercial paper.

We elect to account for foreign currency denominated available-for-sale investments underlying funds receivable and customer accounts, short term investments and long term investments under the fair value option as further discussed in "Note 6—Funds Receivable and Customer Accounts" and "Note 7—Investments."

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Note 9 - Derivative Instruments

Summary of Derivative Instruments

Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates. Our derivatives expose us to credit risk to the extent that our counterparties may be unable to meet the terms of the arrangement. We seek to mitigate such risk by limiting our counterparties to, and by spreading the risk across, major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored on an ongoing basis.

Foreign Exchange Contracts

We transact business in various foreign currencies and have significant international revenues as well as costs denominated in foreign currencies, which subjects us to foreign currency risk. We have a foreign currency exposure management program whereby we designate certain foreign currency exchange contracts, generally with maturities of 18 months or less, to reduce the volatility of cash flows primarily related to forecasted revenues and expenses denominated in foreign currencies. The objective of the foreign exchange contracts is to help mitigate the risk that the U.S. dollar-equivalent cash flows are adversely affected by changes in the applicable U.S. dollar/foreign currency exchange rate. These derivative instruments are designated as cash flow hedges and accordingly, the effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and subsequently reclassified into earnings in the same period the forecasted transaction affects earnings. The ineffective portion of the unrealized gains and losses on these contracts, if any, is recorded immediately in earnings. We evaluate the effectiveness of our foreign exchange contracts on a quarterly basis by comparing the change in the fair value of the derivative instruments with the change in the fair value of the forecasted cash flows of the hedged item. We do not use any foreign exchange contracts for trading or speculative purposes.

For our derivative instruments designated as cash flow hedges, the amounts recognized in earnings related to the ineffective portion were not material in each of the periods presented, and we did not exclude any component of the changes in fair value of the derivative instruments from the assessment of hedge effectiveness. During the three and nine months ended September 30, 2016 and 2015, we did not discontinue any cash flow hedges because it was probable that the original forecasted transaction would not occur and as such, did not reclassify any gains or losses to earnings. As of September 30, 2016, we estimated that $81 million of net derivative gains related to our cash flow hedges included in accumulated other comprehensive income will be reclassified into earnings within the next 12 months.

We have an additional foreign currency exposure management program whereby we use foreign exchange contracts to offset the foreign exchange risk on our assets and liabilities denominated in currencies other than the functional currency of our subsidiaries. These contracts are not designated as hedging instruments and reduce, but do not entirely eliminate, the impact of currency exchange rate movements on our assets and liabilities. The foreign currency gains and losses on our assets and liabilities are recorded in "Other income (expense), net," which is offset by the gains and losses on the foreign exchange contracts.

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Fair Value of Derivative Contracts

The fair value of our outstanding derivative instruments as of September 30, 2016 and December 31, 2015 was as follows:

	Balance Sheet Location	September 30, 2016	December 31, 2015
		(In millions)	
Derivative Assets:			
Foreign exchange contracts designated as cash flow hedges	Other Current Assets	$ 99	$ 59
Foreign exchange contracts not designated as hedging instruments	Other Current Assets	29	38
Total derivative assets		$ 128	$ 97
Derivative Liabilities:			
Foreign exchange contracts designated as cash flow hedges	Other Current Liabilities	$ 12	$ 2
Foreign exchange contracts not designated as hedging instruments	Other Current Liabilities	31	23
Total derivative liabilities		$ 43	$ 25
Net fair value of derivative instruments		$ 85	$ 72

Under the master netting agreements with the respective counterparties to our foreign exchange contracts, subject to applicable requirements, we are allowed to net settle transactions of the same type with a single net amount payable by one party to the other. However, we have elected to present the derivative assets and derivative liabilities on a gross basis in our balance sheet. As of September 30, 2016, the potential effect of rights of setoff associated with our foreign exchange contracts would be an offset to both assets and liabilities by $39 million, resulting in net derivative assets of $89 million and net derivative liabilities of $4 million. We are not required to pledge, nor are we entitled to receive, cash collateral related to these derivative transactions.

Effect of Derivative Contracts on Accumulated Other Comprehensive Income

The following table summarizes the activity of derivative contracts that qualify for hedge accounting as of September 30, 2016 and December 31, 2015, and the impact of designated derivative instruments on accumulated other comprehensive income for the nine months ended September 30, 2016 and 2015:

	December 31, 2015	Amount of gain recognized in other comprehensive income (effective portion)	Less: Amount of gain reclassified from accumulated other comprehensive income to net revenue (effective portion)	September 30, 2016
	(In millions)			
Foreign exchange contracts designated as cash flow hedges	$57	$ 99	$ 69	$ 87

	December 31, 2014	Amount of gain recognized in other	Less: Amount of gain	September 30, 2015

		comprehensive income (effective portion)	reclassified from accumulated other comprehensive income to net revenue (effective portion)	
	(In millions)			
Foreign exchange contracts designated as cash flow hedges	$126	$ 83	$ 150	$ 59

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Effect of Derivative Contracts on Combined and Consolidated Statements of Income

The following table provides the location in the financial statements of the recognized gains or losses related to our derivative instruments:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Foreign exchange contracts designated as cash flow hedges recognized in net revenues	$28	$ 38	$69	$150
Foreign exchange contracts not designated as cash flow hedges recognized in other income (expense), net	11	14	28	14
Total gain recognized from derivative contracts in the combined statement of income	$39	$ 52	$97	$164

The gains and losses related to foreign exchange contracts not designated as cash flow hedges are offset by the foreign currency gains and losses on our assets and liabilities recognized in "Other income (expense), net."

Notional Amounts of Derivative Contracts

Derivative transactions are measured in terms of the notional amount, but this amount is not recorded on the balance sheet and is not, when viewed in isolation, a meaningful measure of the risk profile of the derivative instruments. The notional amount is generally not exchanged, but is used only as the underlying basis on which the value of foreign exchange payments under these contracts is determined. The following table provides the notional amounts of our outstanding derivatives:

	September 30, 2016	September 30, 2015
	(In millions)	
Foreign exchange contracts designated as cash flow hedges	$1,779	$ 1,198
Foreign exchange contracts not designated as hedging instruments	3,986	1,999
Total	$5,765	$ 3,197

Note 10 - Loans and Interest Receivable, Net

We offer credit products to consumers who choose PayPal Credit as their funding source at checkout and working capital advances to certain small and medium-sized PayPal merchants through our PayPal Working Capital product. In the U.S., we work with independent chartered financial institutions that extend credit to the consumer or merchant using our credit products. For our consumer credit products outside the U.S., we extend credit through our Luxembourg banking subsidiary. For our merchant credit products outside the U.S., we extend working capital advances in the U.K. through our Luxembourg banking subsidiary, and we extend working capital advances in Australia through an Australian subsidiary. We purchase the related receivables extended by an independent chartered financial institution in the U.S. and are responsible for servicing functions related to all our credit products. During the nine months ended September 30, 2016 and 2015, we purchased approximately $6.0 billion and $5.1 billion, respectively, in credit receivables. As part of the arrangement with an independent chartered financial institution in the U.S., we sell back a participation interest in the pool of consumer receivables outstanding under PayPal Credit consumer accounts. Under this arrangement, we do not recognize gains or losses on the sale of the participation interest as the carrying amount of the participation interest sold approximates the fair value at time of transfer. However, we have a separate arrangement with certain investors under which we sold to these investors a participation interest in certain consumer loans receivable that we purchased, where the consideration received exceeded the carrying amount of the participation interest sold which resulted in a gain reflected as net revenues in our condensed combined and consolidated financial statements. Loans, advances and interest and fees receivable are reported at their outstanding principal balances, net of any participation interest sold and pro-rata allowances, including unamortized deferred origination costs and estimated collectible interest and fees.

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Consumer receivables

As of September 30, 2016, the total outstanding balance in our pool of consumer receivables was $4.5 billion, net of the participation interest sold to the independent chartered financial institution and other investors of $0.9 billion. As of December 31, 2015, the total outstanding balance in our pool of consumer receivables was $4.0 billion, net of the participation interest sold to the independent chartered financial institution and other investors of $1.0 billion. The independent chartered financial institution and other investors have no recourse against us related to their participation interests for failure of debtors to pay when due. The participation interests held by the chartered financial institution and other investors have the same priority to the interests held by us and are subject to the same credit, prepayment, and interest rate risk associated with this pool of consumer receivables. All risks of loss are shared equally based on participation interests held amongst all participating stakeholders.

We use a consumer's FICO score, where available, among other measures, in evaluating the credit quality of our U.S. PayPal Credit consumer receivables. A FICO score is a type of credit score that lenders use to assess an applicant's credit risk and whether to extend credit. Individual FICO scores generally are obtained each quarter in which the U.S. consumer has an outstanding consumer receivable owned by PayPal Credit. The weighted average U.S. consumer FICO scores related to our loans and interest receivable balance outstanding at September 30, 2016 and December 31, 2015 were 686.

As of September 30, 2016 and December 31, 2015, approximately 53.7% and 53.6%, respectively, of the pool of U.S. consumer receivables and interest receivable balance was due from U.S. consumers with FICO scores greater than 680, which is generally considered "prime" by the consumer credit industry. As of September 30, 2016 and December 31, 2015, approximately 8.9% and 9.4%, respectively, of the pool of U.S. consumer receivables and interest receivable balance was due from U.S. customers with FICO scores below 599. As of September 30, 2016 and December 31, 2015, approximately 89.9% and 90.1%, respectively, of the portfolio of consumer receivables and interest receivable was current.

The following table presents the principal amount of U.S. consumer loans and interest receivable segmented by a FICO score range:

	September 30, 2016	December 31, 2015
	(In millions)	
> 760	$598	$ 569
680 - 759	1,786	1,529
600 - 679	1,663	1,449
< 599	396	369
Total	$4,443	$ 3,916

The table above excludes certain outstanding consumer loans outside of the U.S., for which no FICO scores are available, with an outstanding balance of $94 million and $70 million at September 30, 2016 and December 31, 2015, respectively.

The following tables present the delinquency status of the principal amount of consumer loans and interest receivable:
September 30, 2016
(In millions)

Current	30 - 59 Days Past Due	60 - 89 Days Past Due	90 - 180 Days Past Due	Total Past Due	Total
$4,078	$190	$77	$192	$459	$4,537

December 31, 2015
(In millions)

Current	30 - 59 Days Past Due	60 - 89 Days Past Due	90 - 180 Days Past Due	Total Past Due	Total
$3,593	$172	$66	$155	$393	$3,986

We charge off consumer loan receivable balances in the month in which a customer balance becomes 180 days past due. Bankrupt accounts are charged off 60 days after receipt of notification of bankruptcy. Past due loans receivable continue to accrue interest until such time they are charged off.

The following table summarizes the activity in the allowance for consumer loans and interest receivable, net of participation interest sold for nine months ended September 30, 2016 and 2015:

	September 30, 2016			September 30, 2015		
	Consumer Loans Receivable	Interest Receivable	Total Allowance	Consumer Loans Receivable	Interest Receivable	Total Allowance
	(In Millions)					
Beginning Balance	$179	$ 32	$ 211	$158	$ 30	$ 188
Reclassification from loans receivable to loans held for sale	—	—	—	(22)	—	(22)
Provisions	278	82	360	186	61	247
Charge-offs	(232)	(77)	(309)	(182)	(61)	(243)
Recoveries	20	—	20	18	—	18
Ending Balance	$245	$ 37	$ 282	$158	$ 30	$ 188

The table above excludes receivables from other consumer credit products of $11 million and $8 million at September 30, 2016 and December 31, 2015, respectively, and allowances of $2 million and $1 million at September 30, 2016 and December 31, 2015, respectively.

The provision for loan losses relating to our consumer loans receivable portfolio is recognized in transaction and loan losses and the provisions for interest receivable is recognized in net revenues from other value added services as a reduction in revenue.

Merchant receivables

We offer credit products to certain existing small and medium-sized merchants through our PayPal Working Capital product. We closely monitor credit quality for all working capital advances that we extend or purchase through that product to manage and evaluate our related exposure to credit risk. To assess a merchant who wishes to obtain a PayPal Working Capital advance, we use, among other indicators, a risk model that we have internally developed that we refer to as our PayPal Working Capital Risk Model ("PRM"), as a credit quality indicator to help predict the merchant's ability to repay the principal balance and fixed fee related to the working capital advance. The PRM uses multiple variables as predictors of the merchant's ability to repay a working capital advance. Primary drivers of the model include the merchant's annual payment volume and payment processing history with PayPal, prior repayment history with the PayPal Working Capital product, and other measures. Merchants are assigned a PRM credit score within the range of 350 to 750. We generally expect that merchants to which we extend a working capital advance will have PRM scores greater than 525. We generally consider scores above 610 to be very good and to pose less credit risk. For all outstanding working capital advances that we own, we assess the participating merchant's PRM score on a recurring basis. At September 30, 2016 and December 31, 2015, the weighted average PRM score related to our PayPal Working Capital balances outstanding was 633 and 630, respectively.

The following table presents the principal amount of PayPal Working Capital advances and fees receivable segmented by our internal PRM score range:

	September 30, 2016	December 31, 2015
	(In millions)	
> 630	$373	$ 255
566-629	111	94
<565	97	72
Total	$581	$ 421

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Through our PayPal Working Capital product, merchants can borrow a certain percentage of their annual payment volume processed by PayPal and are charged a fixed fee for the advance, which targets an annual percentage rate based on the overall credit assessment of the merchant. The fee is fixed at the time the advance is extended and recognized as deferred revenues in our condensed consolidated balance sheet. Advances plus the fixed fee are repaid through a fixed percentage of the merchant's future payment volume that PayPal processes. The fixed fee is amortized to net revenues from other value added services based on the amount repaid over the repayment period. We estimate the repayment period based on PayPal's payment processing history with the merchant. There is no stated interest rate and there is a general requirement that at least 10% of the original amount advanced plus the fixed fee must be repaid every 90 days. We generally calculate the repayment rate of the merchant's future payment volume so that repayment of the advance and fixed fee is expected to occur within 9 to 12 months from the date of the advance. On a monthly basis, we recalculate the repayment period based on the repayment activity on the receivable. As such, actual repayment periods are dependent on actual payment processing volumes. We monitor receivables with repayment periods greater than the original expected repayment period. We charge off the receivable when the updated repayment period is 180 days past the original expected repayment period and the merchant has not made a payment in the last 60 days. We also charge off the receivable when the updated repayment period is 360 days past the original expected repayment period regardless of whether or not the merchant has made a payment within the last 60 days. The total PayPal Working Capital advances and fees receivable outstanding as of September 30, 2016 and December 31, 2015 were approximately $581 million and $421 million, respectively.

The following tables present our estimate of the principal amount of PayPal Working Capital advances and fees receivable past their original expected repayment period. In the second quarter of 2016, we refined our estimate of the original expected repayment period to take into account the variability in repayment patterns. Prior period amounts have been updated to reflect this change.

September 30, 2016
(In millions)

Within Original Expected Repayment Period	30 - 59 Days Greater	60 - 89 Days Greater	90 - 180 Days Greater	180+ Days	Total Past Original Expected Repayment Period	Total
$487	$ 35	$ 19	$ 29	$ 11	$ 94	$581

December 31, 2015
(In millions)

Within Original Expected Repayment Period	30 - 59 Days Greater	60 - 89 Days Greater	90 - 180 Days Greater	180+ Days	Total Past Original Expected Repayment Period	Total
$367	$ 24	$ 13	$ 15	$ 2	$ 54	$421

The following table summarizes the activity in the allowance for PayPal Working Capital advances and fees receivable, for the nine months ended September 30, 2016 and 2015:

	September 30, 2016	September 30, 2015

	PayPal Working Capital Advances	Fees Receivable	Total Allowance	PayPal Working Capital Advances	Fees Receivable	Total Allowance
	(In millions)					
Beginning Balance	$19	$ 3	$ 22	$6	$ 1	$ 7
Provisions	32	4	36	18	1	19
Charge-offs	(27)	(4)	(31)	(9)	(1)	(10)
Recoveries	3	—	3	1	—	1
Ending Balance	$27	$ 3	$ 30	$16	$ 1	$ 17

The provision for loan losses relating to our PayPal Working Capital advances is recognized in transaction and loan losses and the provisions for fees receivable is recognized in deferred revenues in our condensed consolidated balance sheet as a reduction in deferred revenue.

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Note 11 - Commitments and Contingencies

Commitments

As of September 30, 2016, approximately $28.7 billion of unused credit was available to PayPal Credit account holders. As of December 31, 2015, approximately $24.8 billion of unused credit was available to PayPal Credit account holders. While this amount represents the total unused credit available, we have not experienced, and do not anticipate, that all of our PayPal Credit account holders will access their entire available credit at any given point in time. In addition, the individual lines of credit that make up this unused credit are subject to periodic review and termination by the chartered financial institution that is the issuer of PayPal Credit products based on, among other things, account usage and customer creditworthiness. When a consumer funds a purchase in the U.S. using a PayPal Credit product issued by a chartered financial institution, the chartered financial institution extends credit to the consumer, funds the extension of credit at the point of sale and advances funds to the merchant. We subsequently purchase the receivables related to the consumer loans extended by the chartered financial institution and, as a result of such purchase, bear the risk of loss in the event of loan defaults. Although the chartered financial institution continues to own each customer account, we own the related receivable (excluding participation interests sold) and are responsible for all servicing functions related to the account.

In the third quarter of 2015, we entered into a credit agreement ("Credit Agreement") that provides for an unsecured $2.0 billion, five-year revolving credit facility that includes a $150 million letter of credit sub-facility and a $150 million swingline sub-facility, with available borrowings under the revolving credit facility reduced by the amount of any letters of credit and swingline borrowings outstanding from time to time. Borrowings and other amounts payable under the Credit Agreement are guaranteed by PayPal, Inc. (the "Guarantor"). We may also, subject to the agreement of the applicable lenders, increase the commitments under the revolving credit facility by up to $500 million. Subject to specified conditions, we may designate one or more of our subsidiaries as additional borrowers under the Credit Agreement provided that we and the Guarantor guarantee all borrowings and other obligations of any such subsidiaries under the Credit Agreement. As of September 30, 2016, no subsidiaries were designated as additional borrowers. Funds borrowed under the Credit Agreement may be used for working capital, capital expenditures, acquisitions and other general corporate purposes. As of September 30, 2016, no borrowings or letters of credit were outstanding under the Credit Agreement. Accordingly, at September 30, 2016, $2.0 billion of borrowing capacity was available for the purposes permitted by the Credit Agreement subject to customary conditions to borrowing.

Litigation and Regulatory Matters

Overview

We are involved in legal and regulatory proceedings on an ongoing basis. Many of these proceedings are in early stages, and may seek an indeterminate amount of damages. If we believe that a loss arising from such matters is probable and can be reasonably estimated, we accrue the estimated liability in our financial statements. If only a range of estimated losses can be determined, we accrue an amount within the range that, in our judgment, reflects the most likely outcome; if none of the estimates within that range is a better estimate than any other amount, we accrue the low end of the range. For those proceedings in which an unfavorable outcome is reasonably possible but not probable, we have disclosed an estimate of the reasonably possible loss or range of losses or we have concluded that an estimate of the reasonably possible loss or range arising directly from the proceeding (i.e., monetary damages or amounts paid in judgment or settlement) are not material. If we cannot estimate the probable or reasonably possible loss or range of losses arising from a legal proceeding, we have disclosed that fact. In assessing the materiality of a legal proceeding, we evaluate, among other factors, the amount of monetary damages claimed, as well as the potential impact of non-monetary remedies sought by plaintiffs (e.g., injunctive relief) that may require us to change our business practices in a manner that could have a material adverse impact on our business. With respect to the matters disclosed in this Note 11, we are unable to estimate the possible loss or range of losses that could potentially result from the application of such non-monetary remedies.

Amounts accrued for legal and regulatory proceedings for which we believe a loss is probable were not material for the nine months ended September 30, 2016. Except as otherwise noted for the proceedings described in this Note 11, we have concluded, based on currently available information, that reasonably possible losses arising directly from the proceedings (i.e., monetary damages or amounts paid in judgment or settlement) in excess of our recorded accruals are also not material. However, legal and regulatory proceedings are inherently unpredictable and subject to significant uncertainties. If one or more matters were resolved against us in a reporting period for amounts in excess of management's expectations, the impact on our operating results or financial condition for that reporting period could be material.

Regulatory Proceedings

We are subject to U.S. economic and trade sanctions administered by the U.S. Department of the Treasury’s Office of Foreign Assets Control ("OFAC"). We have self-reported to OFAC certain transactions that were inadvertently processed but subsequently identified as possible violations of U.S. economic and trade sanctions. In March 2015, we reached a settlement with OFAC regarding possible violations arising from our sanctions compliance practices between 2009 and 2013, prior to the implementation of our real-time transaction scanning program. Subsequently, we have self-reported additional transactions as possible violations, and we have received new subpoenas from OFAC seeking additional information about certain of these transactions. Such self-reported transactions could result in claims or actions against us, including litigation, injunctions, damage awards, fines or penalties, or require us to change our business practices that could result in a material loss, require significant management time, result in the diversion of significant operational resources or otherwise harm our business.

On March 28, 2016, we received a Civil Investigative Demand (“CID”) from the Federal Trade Commission (“FTC”) as part of its investigation to determine whether we, through our Venmo service, have been or are engaged in deceptive or unfair practices in violation of the Federal Trade Commission Act. The CID requests the production of documents and answers to written questions related to our Venmo service. We are cooperating with the FTC in connection with the CID. The CID could lead to an enforcement action and/or one or more consent orders, which may result in substantial costs, including legal fees, fines, penalties, and remediation expenses and actions, and could require us to change aspects of the manner in which we operate Venmo.

General Matters

Other third parties have from time to time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We are subject to patent disputes, and expect that we will increasingly be subject to additional patent infringement claims involving various aspects of our business as our products and services continue to expand in scope and complexity. Such claims may be brought directly or indirectly against our companies and/or against our customers (who may be entitled to contractual indemnification under their contracts with us), and we are subject to increased exposure to such claims as a result of our acquisitions, particularly in cases where we are entering into new lines of business in connection with such acquisitions. We have in the past been forced to litigate such claims, and we believe that additional lawsuits alleging such claims will be filed against us. Intellectual property claims, whether meritorious or not, are time consuming and costly to defend and resolve, could require expensive changes in our methods of doing business or could require us to enter into costly royalty or licensing agreements on unfavorable terms or make substantial payments to settle claims or to satisfy damages awarded by courts.

From time to time, we are involved in other disputes or regulatory inquiries that arise in the ordinary course of business, including suits by our customers (individually or as class actions) alleging, among other things, improper disclosure of our prices, rules or policies, that our practices, prices, rules, policies or customer/user agreements violate applicable law or that we have acted unfairly and/or not acted in conformity with such prices, rules, policies or agreements. In addition to these types of disputes and regulatory inquiries, our operations are also subject to regulatory and/or legal review and/or challenges that tend to reflect the increasing global regulatory focus to which the payments industry is subject and, when taken as a whole with other regulatory and legislative action, such actions could result in the imposition of costly new compliance burdens on our business and customers and may lead to increased costs and decreased transaction volume and revenue. Further, the number and significance of these disputes and inquiries are increasing as our Company has grown larger, our business has expanded in scope (both in terms of the range of products and services that we offer and our geographical operations) and our products and services have increased in complexity. Any claims or regulatory actions against us, whether meritorious or not, could be time consuming, result in costly litigation, settlement payments, damage awards (including statutory damages for certain causes of action in certain jurisdictions), fines, penalties, injunctive relief or increased costs of doing business through adverse judgment or settlement, require us to change our business practices in expensive ways, require significant amounts of management time, result in the diversion of significant operational resources or otherwise harm our business.

Indemnification Provisions

We entered into a separation and distribution agreement and various other agreements with eBay to govern the separation and relationship of the two companies going forward. These agreements provide for specific indemnity and liability obligations and could lead to disputes between us and eBay, which may be significant. In addition, the indemnity rights we have against eBay under the agreements may not be sufficient to protect us and our indemnity obligations to eBay may be significant.

In the ordinary course of business, we include limited indemnification provisions in certain of our agreements with parties with whom we have commercial relationships, including our standard marketing, promotions, and application-programming-interface license (API) agreements. Under these contracts, we generally indemnify, hold harmless, and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by any third party with respect to our domain names, trademarks, logos, and other branding elements to the extent that such marks are related to the subject agreement. In a limited number of agreements, we have provided an indemnity for other types of third-party claims, which are indemnities mainly related to intellectual property rights. We have also provided an indemnity to our payments processors in the event of certain third-party claims or card association fines against the processor arising out of conduct by us or our customers. It is not possible to determine the maximum potential loss under these indemnification provisions due to our limited history of prior indemnification claims and the unique facts and circumstances involved in each particular situation. To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions.

Off-Balance Sheet Arrangements

As of September 30, 2016, we had no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our combined and consolidated financial condition, results of operations, liquidity, capital expenditures or capital resources.

Protection Programs

We provide merchants and consumers with protection programs on substantially all transactions completed through our Payments Platform. These programs protect both merchants and consumers from loss primarily due to fraud and counterparty performance. Our Buyer Protection Program provides protection to consumers for qualifying purchases by reimbursing the consumer for the full amount of the purchase if a purchased item does not arrive or does not match the seller's description. Our Seller Protection Programs provide protection to merchants against claims that a transaction was not authorized by the buyer or claims that an item was not received by covering the seller for the full amount of the payment on eligible sales.

The maximum potential exposure under our protection programs is estimated to be the portion of total eligible transaction volume (TPV) for which buyer or seller protection claims may be raised under our existing user agreements. Since eligible transactions are typically completed in a period significantly shorter than the period under which disputes may be opened, and based on our historical losses to date, we do not believe that that the maximum potential exposure is representative of our actual potential exposure. The actual amount of potential exposure cannot be quantified as we are unable to determine total eligible transactions where performance by a merchant or customer is incomplete or completed transactions that may result in a claim under our protection programs. We record a liability with respect to losses under these protection programs when they are probable and the amount can be reasonably estimated.

The following table provides management's estimate of the maximum potential exposure related to our protection programs as of September 30, 2016 and December 31, 2015:

	September 30, 2016	December 31, 2015
	(In millions)	
Maximum potential exposure	$119,880	$ 109,496

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The following table provides the amount of allowance for transaction losses related to our protection programs as of September 30, 2016 and December 31, 2015:

	September 30, 2016	December 31, 2015
	(In millions)	
Allowance for transaction losses	$ 184	$ 185

Note 12 - Related Party Transactions

As of September 30, 2016, there were no material amounts payable to or amounts receivable from related parties. All contracts with related parties are at rates and terms that we believe are comparable with those that could be entered into with independent third parties. For all periods subsequent to the distribution, there were no material related party transactions.

Prior to the distribution, our business comprised the Payments segment of eBay and thus our transactions with eBay were considered related party transactions. In connection with the separation, we entered into a separation and distribution agreement as well as various other agreements that govern our relationships with eBay going forward, including an operating agreement, transition services agreement, tax matters agreement, employee matters agreement, intellectual property matters agreement and colocation services agreements. Information included in this Note 12 with respect to eBay is strictly limited to our related party transactions with eBay prior to the separation (i.e., periods up to July 17, 2015). Following separation, transactions with eBay represent third-party transactions on an arms-length basis.

We earned net revenues of $3 million from eBay and its subsidiaries during the three months ended September 30, 2015. We earned net revenues of $59 million from eBay and its subsidiaries during the nine months ended September 30, 2015.

Prior to the distribution, we recovered certain amounts from eBay related to customer protection programs offered on eligible eBay purchases made with PayPal. These costs included the actual transaction losses associated with customer-filed claims as well as an allocation of salary-related expenses for our customer support teams working on customer claims and disputes related to eligible eBay purchases. Recoveries associated with transaction losses incurred on eligible eBay purchases during the three and nine months ended September 30, 2015 were $5 million and $27 million, respectively, which were recorded as a reduction to transaction and loan loss. Other costs recovered from eBay related to the customer protection programs during the three and nine months ended September 30, 2015 were $1 million and $12 million, respectively, and were included as a reduction to customer support and operations and general and administrative expenses in our condensed combined statement of income. Following the distribution, eBay's customer protection programs are no longer administered by us, and therefore these costs are no longer reimbursed by eBay.

Prior to the distribution, we incurred user acquisition fees from eBay on payment volume which we processed from purchases made on eBay’s platform. User acquisition fees during the three and nine months ended September 30, 2015 were $4 million and $64 million, respectively. Following the distribution, pursuant to the operating agreement, we incur referral services fees from eBay based on a fixed rate per new user.

Prior to the distribution, these condensed combined and consolidated financial statements include expenses associated with workplace resources and information technology that were previously allocated to the Payments segment of eBay, and additional expenses related to certain corporate functions, including senior management, legal, human resources and finance. These expenses also include allocations related to share based compensation. These expenses allocated to us by eBay are based on direct usage or benefit where identifiable, with the remainder allocated on a pro rata basis of revenue, headcount, or other systematic measure. We consider the expense allocation methodology and results to be reasonable for all periods presented. The corporate costs and allocation of expenses to us from eBay included within customer support and operations, sales and marketing, product development, and general and administrative expenses were not material during the three months ended September 30, 2015. The corporate costs and allocation of expenses to us from eBay included within customer support and operations, sales and marketing, product development, and general and administrative expenses were $303 million for the nine months ended September 30, 2015.

Note 13 - Stock Repurchase Program

In January 2016, our Board of Directors authorized a stock repurchase program that provides for the repurchase of up to $2 billion of our common stock, with no expiration from the date of authorization. This stock repurchase program is intended to offset the

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impact of dilution from our equity compensation programs and, subject to market conditions and other factors, may also be used to make opportunistic repurchases of our common stock to reduce outstanding share count. Any share repurchases under our stock repurchase program may be made through open market transactions, block trades, privately negotiated transactions or other means at times and in such amounts as management deems appropriate and will be funded from our working capital or other financing alternatives. However, any stock repurchases are subject to market conditions and other uncertainties and we cannot predict if or when any stock repurchases will be made. Moreover, we may terminate our stock repurchase program at any time without notice.

The stock repurchase activity under our stock repurchase program during the nine months ended September 30, 2016 is summarized as follows:

	Shares Repurchased	Average Price Paid per Share[(1)]	Value of Shares Repurchased	Remaining Amount Authorized
	(In millions, except per share amounts)			
Authorization of plan in January 2016				$ 2,000
Repurchases of shares of common stock for three months ended March 31, 2016	16.9	$ 35.27	596	(596)
Repurchases of shares of common stock for three months ended June 30, 2016	7.8	$ 38.67	300	(300)
Repurchases of shares of common stock for three months ended September 30, 2016	1.3	$ 36.80	49	(49)
Balance as of September 30, 2016	26.0		$ 945	$ 1,055

(1) Average price paid per share includes broker commissions.

These repurchased shares of common stock were recorded as treasury stock and were accounted for under the cost method. No repurchased shares of common stock have been retired.

Note 14 - Stock-Based Plans

Stock Option Activity

The following table summarizes stock option activity of our employees under our equity incentive plans for the nine months ended September 30, 2016:

	Options (In thousands)
Outstanding at January 1, 2016	6,008
Granted	124
Exercised	(1,210)
Forfeited/expired/canceled	(239)
Outstanding at September 30, 2016	4,683

The weighted average grant-date fair value of stock options granted during the nine months ended September 30, 2016 was $8.79 per share. The weighted average exercise price of stock options granted during the nine months ended September 30, 2016 was $36.32 per share.

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Restricted Stock Unit Activity

The following table summarizes the restricted stock units granted under our equity incentive plans for the nine months ended September 30, 2016:

	Units (In thousands)
Outstanding at January 1, 2016	28,005
Awarded	11,913
Vested	(8,293)
Forfeited	(2,895)
Outstanding at September 30, 2016	28,730
Expected to vest	24,411

The weighted average grant-date fair value of restricted stock units granted during the nine months ended September 30, 2016 was $39.10 per share.

Performance-Based Restricted Stock Units (PBRSUs)

In the first quarter of 2016, we granted PBRSUs under PayPal's 2015 Equity Incentive Award Plan to officers and certain employees providing services to the Company. PBRSUs are equity awards that may be earned based on an initial target number with the final number of PBRSUs that may be vested and settled determined based on the product of the initial target number of PBRSUs multiplied by a performance factor based on measurements of the Company’s performance against pre-established performance metrics over a predefined performance period. Over the performance period, the number of PBRSUs that will be issued and related stock-based compensation expense that is recognized is adjusted upward or downward based upon the probability of achieving the approved performance targets against the performance metrics. As of September 30, 2016, 1.7 million PBRSUs were outstanding which is based on the Company's best estimate of the number of PBRSUs that will vest over the performance period.

Stock-based Compensation Expense

Prior to the separation, we were charged by eBay for stock-based compensation expense related to our direct employees. eBay allocated to us costs of certain employees of eBay (including stock-based compensation) who provided general and administrative services on our behalf. Following the separation, we record stock-based compensation expense for our equity incentive plans in accordance with the provisions of the authoritative accounting guidance, which requires the measurement and recognition of compensation expense based on estimated fair values. Beginning in the first quarter of 2016, we started granting restricted stock units that vest in equal annual installments over a period of three years, subject to the employees' continuing service. Previously our restricted stock units granted to eligible employees under our equity incentive plans vested in equal annual installments over a period of four years, subject to the employees' continuing service.

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The impact on our results of operations of recording stock-based compensation expense under eBay's and PayPal's equity incentive plans for the three and nine months ended September 30, 2016 and 2015 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Customer support and operations	$21	$ 16	$61	$44
Sales and marketing	21	18	59	42
Product development	34	33	102	97
General and administrative	31	25	91	68
Depreciation and amortization	2	2	4	6
Total stock-based compensation expense	$109	$ 94	$317	$257
Capitalized as part of internal use software and website development costs	$4	$ 2	$10	$6

Note 15 - Income Taxes

For periods ended on or prior to July 17, 2015, we were a member of the eBay consolidated group and our U.S. taxable income was included in the consolidated U.S. federal income tax return of eBay as well as in returns filed by eBay with certain state and local taxing jurisdictions. Our foreign income tax returns are filed on a separate company basis. For periods ended on or prior to July 17, 2015, our income tax liability has been computed and presented herein under the “separate return method” as if it were a separate tax paying entity, as modified by the benefits-for-loss approach. Accordingly, our operating losses and other tax attributes are characterized as utilized when those attributes have been utilized by other members of the eBay consolidated group; however, the benefits-for-loss approach does not impact our tax expense. Federal and unitary state income taxes incurred for periods ended on or prior to July 17, 2015 are remitted to eBay pursuant to a tax sharing agreement between the companies.

In connection with the distribution, eBay and PayPal entered into various agreements that govern the relationship between the parties going forward, including a tax matters agreement. The tax matters agreement was entered into on the distribution date. Under the tax matters agreement, eBay generally is responsible for all additional taxes (and will be entitled to all related refunds of taxes) imposed on eBay and its subsidiaries (including subsidiaries that were transferred to PayPal pursuant to the separation) arising after the distribution date with respect to the taxable periods (or portions thereof) ended on or prior to July 17, 2015 except for those taxes for which PayPal has reflected an unrecognized tax benefit in its financial statements on the distribution date.

Our effective tax rate for the three and nine months ended September 30, 2016 was 10% and 13%, respectively. The difference between our effective tax rate and the U.S. federal statutory rate of 35% in both periods was primarily the result of foreign income taxed at different rates.

On July 27, 2015, the U.S.Tax Court, in Altera Corp. v. Commissioner, invalidated part of a Treasury Regulation requiring stock based compensation to be included in a qualified intercompany cost sharing arrangement. A final decision was entered by the U.S. Tax Court on December 1, 2015. On February 19, 2016, the Internal Revenue Service filed a notice of appeal to the Ninth Circuit Court of Appeals. On September 9, 2016 Altera filed a brief with the appeals court. We have reviewed this case and its impact on PayPal and concluded that no adjustment to the consolidated financial statements is appropriate at this time. We will continue to monitor ongoing developments and potential impacts to our consolidated financial statements.

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Note 16 - Accumulated Other Comprehensive (Loss) Income

The following table summarizes the changes in accumulated balances of other comprehensive income for the three months ended September 30, 2016:

Three Months Ended September 30, 2016	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Investments	Foreign Currency Translation	Estimated tax (expense) benefit	Total
	(In millions)				
Beginning balance	$100	$ 5	$ (50)	$ (3)	$52
Other comprehensive income (loss) before reclassifications	15	(4)	1	2	14
Less: Amount of gain (loss) reclassified from accumulated other comprehensive income	28	(1)	—	—	27
Net current period other comprehensive income (loss)	(13)	(3)	1	2	(13)
Ending balance	$87	$ 2	$ (49)	$ (1)	$39

The following table summarizes the changes in accumulated balances of other comprehensive income for the three months ended September 30, 2015:

Three Months Ended September 30, 2015	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Investments	Foreign Currency Translation	Estimated tax (expense) benefit	Total
	(In millions)				
Beginning balance	$66	$ (2)	$ (40)	$ —	$24
Other comprehensive income (loss) before reclassifications	31	(6)	(9)	1	17
Less: Amount of gain reclassified from accumulated other comprehensive income	38	—	—	—	38
Net current period other comprehensive income (loss)	(7)	(6)	(9)	1	(21)
Ending balance	$59	$ (8)	$ (49)	$ 1	$3

The following table summarizes the changes in accumulated balances of other comprehensive income for the nine months ended September 30, 2016:

Nine Months Ended September 30, 2016	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Investments	Foreign Currency Translation	Estimated tax (expense) benefit	Total
	(In millions)				

Beginning balance	$57	$ (16)	$ (53)	$ 3	$(9)
Other comprehensive income (loss) before reclassifications	99	14	4	(4)	113
Less: Amount of gain (loss) reclassified from accumulated other comprehensive income	69	(4)	—	—	65
Net current period other comprehensive income (loss)	30	18	4	(4)	48
Ending balance	$87	$ 2	$ (49)	$ (1)	$39

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The following table summarizes the changes in accumulated balances of other comprehensive income for the nine months ended September 30, 2015:

Nine Months Ended September 30, 2015	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Investments	Foreign Currency Translation	Estimated tax (expense) benefit	Total
	(In millions)				
Beginning balance	$126	$ —	$ (16)	$ —	$110
Other comprehensive income (loss) before reclassifications	83	(8)	(33)	1	43
Less: Amount of gain reclassified from accumulated other comprehensive income	150	—	—	—	150
Net current period other comprehensive income (loss)	(67)	(8)	(33)	1	(107)
Ending balance	$59	$ (8)	$ (49)	$ 1	$3

The following table provides details about reclassifications out of accumulated other comprehensive income for the three months ended September 30, 2016 and 2015:

Details about Accumulated Other Comprehensive Income Components	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income Three Months Ended September 30, 2016	2015	Affected Line Item in the Statement of Income
	(In millions)		
Gains on cash flow hedges-foreign exchange contracts	$ 28	$ 38	Net revenues
Unrealized losses on investments	(1)	—	Other income (expense), net
	$ 27	$ 38	Income before income taxes
	—	—	Income tax expense
Total reclassifications for the period	$ 27	$ 38	Net income

The following table provides details about reclassifications out of accumulated other comprehensive income for the nine months ended September 30, 2016 and 2015:

Details about Accumulated Other Comprehensive Income Components	Amount of Gain (Loss) Reclassified from Accumulated Other	Affected Line Item in the Statement of Income

	Comprehensive Income Nine Months Ended September 30,		
	2016	2015	
	(In millions)		
Gains on cash flow hedges-foreign exchange contracts	$ 69	$ 150	Net revenues
Unrealized losses on investments	(4)	—	Other income (expense), net
	$ 65	$ 150	Income before income taxes
	—	—	Income tax expense
Total reclassifications for the period	$ 65	$ 150	Net income

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Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements that involve expectations, plans or intentions (such as those relating to future business, future results of operations or financial condition, new or planned features or services, or management strategies). These forward-looking statements can be identified by words such as “may,” “will,” “would,” “should,” “could,” “expect,” “anticipate,” “believe,” “estimate,” “intend,” other similar expressions. These forward-looking statements involve risks and uncertainties that could cause our actual results and financial condition to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those discussed in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2015, as supplemented and, to the extent inconsistent, superseded by some of the information in the risk factors set forth below in Part II, Item 1A, Risk Factors, of this Form 10-Q, as well as in our unaudited condensed combined and consolidated financial statements, related notes, and the other information appearing elsewhere in this report and our other filings with the Securities and Exchange Commission, or the SEC. We do not intend, and undertake no obligation, to update any of our forward-looking statements after the date of this report to reflect actual results or future events or circumstances. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the unaudited condensed combined and consolidated financial statements and the related notes that appear elsewhere in this report.

The Separation from eBay Inc.

On September 30, 2014, eBay Inc. (“eBay”) announced its intent to separate its payments business into an independent, publicly-traded company. To accomplish this separation, in January 2015, eBay incorporated PayPal Holdings, Inc. (“PayPal”) which is now the parent of PayPal, Inc. and holds directly or indirectly all of the assets and liabilities associated with PayPal, Inc. In June 2015, the Board of Directors of eBay approved the separation (the "separation") of eBay's payments business through the distribution (the "distribution") of 100% of the outstanding common stock of PayPal to eBay's stockholders. PayPal's registration statement on Form 10, as amended, was declared effective by the U.S. Securities and Exchange Commission on June 29, 2015. On July 17, 2015 (the "distribution date"), PayPal became an independent publicly-traded company through the pro rata distribution by eBay of 100% of the outstanding common stock of PayPal to eBay stockholders. Each eBay stockholder of record as of the close of business on July 8, 2015 received one share of PayPal common stock for every share of eBay common stock held on the record date. Approximately 1.2 billion shares of PayPal common stock were distributed on July 17, 2015 to eBay stockholders. PayPal's common stock began "regular way" trading under the ticker symbol "PYPL" on The NASDAQ Stock Market on July 20, 2015.

Prior to the separation, eBay transferred substantially all of the assets and liabilities and operations of eBay's payments business to PayPal, which was completed in June 2015 (the "capitalization"). The combined financial statements prior to the capitalization were prepared on a stand-alone basis and were derived from eBay's consolidated financial statements and accounting records. The combined financial statements reflect our financial position, results of operations, comprehensive income and cash flows as our business was operated as part of eBay prior to the capitalization. Following the capitalization, our consolidated financial statements include the accounts of PayPal and its wholly-owned subsidiaries. The condensed combined and consolidated financial position, results of operations and cash flows as of dates and for periods prior to the separation may not be indicative of what our financial position, results of operations and cash flows would have been as a separate stand-alone entity during the periods presented, nor are they indicative of what our financial position, results of operations and cash flows may be in the future. For additional information, see Note 1 to our condensed combined and consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

Unless otherwise expressly stated or the context otherwise requires, references to “we,” “our,” “us,” “the Company” and “PayPal” refer to PayPal Holdings, Inc. and its consolidated subsidiaries or, in the case of information as of dates or for periods prior to the separation, the combined and consolidated entities of the payments business of eBay, including PayPal, Inc. and certain other assets and liabilities that had been historically held at the eBay corporate level but were specifically identifiable and attributable to the payments business.

Business Environment

We are a leading technology platform company that enables digital and mobile payments on behalf of consumers and merchants worldwide. We believe in providing simple, affordable, secure and reliable financial services and digital payments to help our customers around the world to achieve their financial goals. We strive to increase our relevance for consumers, merchants, friends and family to access and move their money anywhere in the world, anytime, on any platform and through any device (e.g., mobile, tablets, personal computers or wearables). Our goal is to provide safer and simpler ways for businesses of all sizes to accept payments from merchant websites, mobile devices and applications, and at offline retail locations through a wide range of payment solutions. We also facilitate person to person payments through PayPal, Venmo and Xoom. Our combined payment solution capabilities, including our PayPal, PayPal Credit, Braintree, Venmo, and Xoom products, comprise our proprietary Payments Platform.
We provide merchants and consumers with protection programs on substantially all transactions completed through our Payments Platform. These programs protect both merchants and consumers from loss primarily due to fraud and counterparty non-performance. Our risk management capabilities allow us to provide these protections, which we believe are generally broader than those protections provided by other participants in the payments industry. Most major payments providers do not offer merchant protection in general, and those that do so generally do not provide protection of online or card not present transactions. As a result, merchants may incur losses for chargebacks and other claims on certain transactions when using other payments providers that they would not incur if they had used PayPal's payments services. PayPal also provides consumer protection against losses on qualifying purchases and accepts claims for 180 days post transaction in the markets that PayPal serves. We believe that this protection is generally consistent with, or better than, that offered by other major payments providers. We believe that as a result of these programs, consumers can be confident that they will only be required to pay if they receive the product in the condition as described, and merchants can be confident that they will receive payment for the product that they are delivering to the customer.
Our Payments Platform and open application programming interfaces ("APIs") are designed to allow developers to innovate with ease and to offer cutting edge applications to a large ecosystem of merchants and consumers, while at the same time maintaining the security of our customers' financial information. We provide developers with easy to use, flexible and powerful tools that are designed to leverage our global reach and payment capabilities. Our software developer kits ("SDKs") are specifically focused on the mobile application market and are designed to remove friction by not requiring a redirect to PayPal.com or an additional login. We are using a true "mobile first" approach to make payments simple and intuitive.

Information security risks for global payments and technology companies have significantly increased in recent years. Although we are not aware of any material impacts relating to cyber-attacks or other information security breaches on our Payments Platform, there can be no assurance that we are immune to these risks and will not suffer such losses in the future. See "Risk Factors—Our business is subject to cyberattacks and security and privacy breaches" described in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2015.

We operate globally and in a rapidly evolving regulatory environment characterized by a heightened regulatory focus on all aspects of the payments industry. That focus continues to become even more heightened as regulators on a global basis focus on such important issues as countering terrorist financing, anti-money laundering, privacy and consumer protection. Some of the laws and regulations to which we are subject were enacted recently and the laws and regulations applicable to us, including those enacted prior to the advent of digital and mobile payments, are continuing to evolve through legislative and regulatory action and judicial interpretation. Non-compliance with laws and regulations, increased penalties and enforcement actions related to non-compliance, changes in laws and regulations or their interpretation, and the enactment of new laws and regulations applicable to us could have a material adverse impact on our business, results of operations and financial condition. Therefore, we monitor these areas closely to ensure compliant solutions for our customers who depend on us.

The United Kingdom (U.K.) held a referendum on June 23, 2016 in which a majority of voters approved an exit from the European Union (EU) ("Brexit"). The outcome of this referendum caused volatility in global stock markets and foreign currency exchange rate fluctuations. Brexit could adversely affect U.K., European and worldwide economic and market conditions and could contribute to instability in regional or global financial and foreign exchange markets, including volatility in the value of the British Pound and Euro. We have foreign exchange exposure management programs designed to help minimize the impact from foreign currency rate movements. For the three months ended September 30, 2016 and 2015, net revenues generated from our U.K. operations constituted 11% and 13%, respectively, of total net revenues. For the nine months ended September 30, 2016 and 2015, net revenues generated from our U.K. operations constituted 12% and 13%, respectively, of total net revenues. During each of these periods, net revenues generated from the EU (excluding the U.K.) constituted approximately 20% of total net revenues.

For additional information on how Brexit could affect our business, see Part II, Item 1A—Risk Factors—"The United Kingdom's departure from the European Union could adversely affect us" in this Form 10-Q.

Overview of Results of Operations

The following table provides a summary of our combined and consolidated GAAP financial measures for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Percent Increase/(Decrease)	Nine Months Ended September 30,		Percent Increase/(Decrease)
	2016	2015		2016	2015	
	(In millions, except percentages and per share data)					
Net revenues	$2,667	$2,258	18 %	$7,861	$6,692	17 %
Operating expenses	2,319	1,928	20 %	6,735	5,642	19 %
Operating income	348	330	5 %	1,126	1,050	7 %
Operating margin	13 %	15 %	**	14 %	16 %	**
Income tax expense	37	49	(24)%	151	209	(28)%
Effective tax rate	10 %	14 %	**	13 %	20 %	**
Net income	$323	$301	7 %	$1,011	$861	17 %
Net income per diluted share[1]	$0.27	$0.25	8 %	$0.83	$0.70	18 %

All amounts in tables are rounded to the nearest millions, except as otherwise noted. As a result, certain amounts may not recalculate using the rounded amounts provided.

[1] On July 17, 2015, the distribution date, eBay stockholders of record as of the close of business on July 8, 2015 received one share of PayPal common stock for every share of eBay common stock held as of the record date. Basic and diluted net income per share for the three and nine months ended September 30, 2015 is calculated using the weighted average number of common shares outstanding for the period beginning after the distribution date.

** Not Meaningful

Three months ended September 30, 2016 and 2015

Net revenues increased $409 million, or 18%, in the three months ended September 30, 2016 compared to the same period of the prior year. The increase was primarily driven by growth in TPV (as defined below under "Net Revenues") of 25% compared to the same period of the prior year. Growth in TPV and net revenues in the current period was not materially impacted by our acquisition of Xoom.

Total operating expenses increased $391 million, or 20%, in the three months ended September 30, 2016 compared to the same period of the prior year. The increase in total operating expenses was due primarily to the increase in transaction expense and transaction and loan losses primarily driven by growth in TPV and higher loan losses incurred in the current period compared to the same period of the prior year. General and administrative and customer support and operations expenses also contributed to the increase in total operating expenses due primarily to higher expenses incurred to operate as an independent public company. Growth in total operating expenses was also impacted by expenses incurred in the current period related to our acquisition of Xoom.

Operating income increased $18 million, or 5%, in the three months ended September 30, 2016 compared to the same period of the prior year primarily due to the increase in net revenues and operating efficiencies within other expenses which include customer support and operations, sales and marketing, product development, general and administrative, and depreciation and amortization offset by growth in transaction expense and transaction and loan losses. Our operating margin was 13% and 15% in the three months ended September 30, 2016 and 2015, respectively. Operating margin decreased primarily due to growth in transaction expense and transaction and loan losses which increased 29% in the three months ended September 30, 2016 compared to net revenues which increased

18% in the three months ended September 30, 2016. The decrease in operating margin was partially offset by operating efficiencies within other operating expenses which increased 13% or slower than the growth in net revenues in the three months ended September 30, 2016.

Net income increased by $22 million, or 7%, in the three months ended September 30, 2016 compared to the same period of the prior year. The increase in net income was attributable to an increase in operating income of $18 million and a decrease in income tax expense of $12 million partially offset by a decrease in other income (expense), net of $8 million. For the three months ended September 30, 2016, our diluted net income per share was $0.27, a $0.02 increase compared to the same period of the prior year.

We generated net cash flows from operating activities of $801 million for the three months ended September 30, 2016, compared to $652 million for the three months ended September 30, 2015, reflecting a year over year increase of $149 million.

Nine months ended September 30, 2016 and 2015

Net revenues increased $1.2 billion, or 17%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase was primarily driven by growth in TPV (as defined below under "Net Revenues") of 27% compared to the same period of the prior year. Growth in TPV and net revenues in the current period was not materially impacted by our acquisition of Xoom. The growth in net revenues in the nine months ended September 30, 2016 was negatively impacted by $57 million of additional revenue earned in the same period of the prior year related to our credit program agreement with Synchrony Financial (formerly GE Capital Retail Bank) and the gain of $26 million recognized on the initial sale of approximately $708 million in certain consumer loans receivable which was completed in the same period of the prior year.

Total operating expenses increased $1.1 billion, or 19%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in total operating expenses was due primarily to the increase in transaction expense and transaction and loan losses primarily driven by growth in TPV and higher loan losses incurred in the current period compared to the same period of the prior year. General and administrative, customer support and operations and depreciation and amortization expenses also contributed to the increase in total operating expenses, due primarily to higher expenses incurred to operate as an independent public company, although these increases were partially offset by a decrease in restructuring expense recognized in the prior year. Growth in total operating expenses was also impacted by expenses incurred in the current period related to our acquisition of Xoom.

Operating income increased $76 million, or 7%, in the nine months ended September 30, 2016 compared to the same period of the prior year. Operating income increased primarily due to the increase in net revenues, a decrease in restructuring expenses recognized in the nine months ended September 30, 2015 and other operating efficiencies. Our operating margin was 14% and 16% in the nine months ended September 30, 2016 and 2015, respectively. Operating margin decreased primarily due to growth in our transaction expense and transaction and loan losses which increased 31% in the nine months ended September 30, 2016 compared to net revenues which increased 17% in the nine months ended September 30, 2016.

Net income increased by $150 million, or 17%, in the nine months ended September 30, 2016 compared to the same period in the prior year. The increase in net income was attributable to an increase in operating income of $76 million, a decrease in income tax expense of $58 million and an increase in other income (expense), net of $16 million. For the nine months ended September 30, 2016, our diluted net income per share was $0.83, a $0.13 increase compared to the same period of the prior year.

We generated net cash flows from operating activities of $2.2 billion for the nine months ended September 30, 2016, compared to $1.8 billion for the nine months ended September 30, 2015, reflecting a year over year increase of $0.4 billion.

Non-GAAP financial measures

The following table provides a summary of our combined and consolidated non-GAAP financial measures for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Percent Increase/(Decrease)	Nine Months Ended September 30,		Percent Increase/(Decrease)
	2016	2015		2016	2015	
	(In millions, except percentages and per share data)					
Non-GAAP operating income	$490	$450	9 %	$1,555	$1,443	8 %
Non-GAAP operating margin	18 %	20 %	**	20 %	22 %	**

Non-GAAP income tax expense	$77	$81	(5)%	$278	$306	(9)%
Non-GAAP net income	$425	$377	13 %	$1,313	$1,145	15 %
Non-GAAP net income per diluted share[(1)]	$0.35	$0.31	14 %	$1.08	$0.93	16 %
Free cash flow	$618	$519	19 %	$1,718	$1,260	36 %

All amounts in tables are rounded to the nearest millions, except as otherwise noted. As a result, certain amounts may not recalculate using the rounded amounts provided.

[(1)] Non-GAAP net income per diluted share for the three and nine months ended September 30, 2015 is calculated using the weighted average number of common shares outstanding for the period beginning after the distribution date.

** Not meaningful

Non-GAAP operating income, non-GAAP operating margin, non-GAAP income tax expense, non-GAAP net income, non-GAAP net income per diluted share and free cash flow are not financial measures prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). For information on how we compute these non-GAAP financial measures and a reconciliation to the most directly comparable financial measures prepared in accordance with GAAP, please refer to "Non-GAAP Financial Information" below.

Impact of Foreign Currency Exchange Rates

We have significant operations internationally that are denominated in foreign currencies, primarily the British Pound, Euro, Australian Dollar and Canadian Dollar, subjecting us to foreign currency risk which may adversely impact our financial results. The strengthening or weakening of the U.S. dollar versus the British Pound, Euro, Australian Dollar and Canadian Dollar, as well as other currencies in which we conduct our international operations, impacts the translation of our net revenues and expenses generated in these foreign currencies into the U.S. dollar. In the three months ended September 30, 2016 and 2015, we generated approximately 46% and 50% of our net revenues from customers domiciled outside of the United States, respectively. In the nine months ended September 30, 2016 and 2015, we generated approximately 47% and 50% of our net revenues from customers domiciled outside of the United States, respectively. Other than the United States, the United Kingdom (U.K.) was the only country where we generated more than 10% of total net revenues in the three and nine months ended September 30, 2016 and 2015. During each of these periods, net revenues generated from the EU (excluding the U.K.) constituted approximately 20% of total net revenues. Because we have generated substantial net revenues internationally in recent periods, including during the periods presented, we are subject to the risks of doing business in foreign countries. See Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2015, as supplemented and, to the extent inconsistent, superseded below in Part II, Item 1A, Risk Factors in this Form 10-Q.
We calculate the year-over-year impact of foreign currency movements on our business using prior period foreign currency exchange rates applied to current period transactional currency amounts. While changes in foreign currency exchange rates affect our reported results, we have a foreign currency exchange exposure management program whereby we designate certain foreign currency exchange contracts as cash flow hedges to help minimize the impact on earnings from foreign currency rate movements. Gains and losses from these foreign currency exchange contracts are recognized as a component of transaction revenues in the same period the forecasted transactions impact earnings.

In the three and nine months ended September 30, 2016 and three and nine months ended September 30, 2015, the year-over-year foreign currency movements relative to the U.S. dollar had the following impact on our reported results:

	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016
	(in millions)	
Unfavorable impact to net revenues (exclusive of hedging impact)	$(47)	$ (119)
Hedging impact	28	69
Unfavorable impact to net revenues	(19)	(50)
Favorable impact to operating expense	15	56
Net impact to operating income	$(4)	$ 6

	Three Months Ended September 30,	Nine Months Ended September 30, 2015

	2015	
	(In millions)	
Unfavorable impact to net revenues (exclusive of hedging impact)	$(139)	$ (417)
Hedging impact	38	150
Unfavorable impact to net revenues	(101)	(267)
Favorable impact to operating expense	80	239
Net impact to operating income	$(21)	$ (28)

While we enter into foreign currency exchange contracts to minimize the impact on earnings from foreign currency rate movements, it is impossible to predict or eliminate the effects of this exposure.

Additionally, in connection with our services in multiple currencies, we generally set our foreign currency exchange rates twice per day, and may face financial exposure if we incorrectly set our foreign currency exchange rates or as a result of fluctuations in foreign currency exchange rates between the times that we set our foreign currency exchange rates. Given that we also have foreign exchange risk on our assets and liabilities denominated in currencies other than the functional currency of our subsidiaries, we have an additional foreign currency exchange exposure management program whereby we use foreign currency exchange contracts to offset the impact of currency exchange rate movements on our assets and liabilities. The foreign currency gains and losses on our assets and liabilities are recorded in "Other income (expense), net," which are offset by the gains and losses on the foreign currency exchange contracts. These foreign exchange contracts reduce, but do not entirely eliminate, the impact of currency exchange rate movements on our assets and liabilities.

Financial Results

Net revenues

We earn revenue from the following types of transactions:

- Transaction revenues: Net transaction fees charged to consumers and merchants based on the volume of activity processed through our Payments Platform, including our PayPal, PayPal Credit, Venmo, Braintree and Xoom products.

- Other value added services: Net revenues derived principally from interest and fees earned on our PayPal Credit loans receivable portfolio, subscription fees, gateway fees, gain on sale of participation interests in certain consumer loans receivable, revenue share we earn through partnerships, interest earned on certain PayPal customer account balances, fees earned through our Paydiant products and other services that we provide to consumers and merchants.

Net revenue analysis

The components of our net revenue for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended September 30,		Percent Increase/(Decrease)		Nine Months Ended September 30,		Percent Increase/(Decrease)	
	2016	2015			2016	2015		
	(In millions, except percentages)							
Transaction revenues	$2,314	$1,982	17	%	$6,875	$5,866	17	%
Other value-added services	353	276	28	%	986	826	19	%
Net revenues	$2,667	$2,258	18	%	$7,861	$6,692	17	%

Transaction revenue grew by $332 million, or 17%, for the three months ended September 30, 2016 and $1 billion or 17%, for the nine months ended September 30, 2016, in each case compared to the same period in the prior year. The increase in transaction revenues in the three and nine months ended September 30, 2016 was due primarily to the growth in TPV and the growth in total number of payment transactions on our Payments Platform, both of which were due to increased engagement from our customers and growth from our Braintree products. Transaction revenue for both the three and nine months ended September 30, 2016 includes additional revenue from our acquisition of Xoom for which there was no revenue in the same periods of the prior year. Net gains from our foreign currency exchange contracts recognized as a component of transaction revenues in the three and nine months ended September 30, 2016 were $28 million and $69 million, respectively, compared to $38 million and $150 million in the three and nine months ended September 30, 2015, respectively. Refer to "Note 9-Derivative Instruments" in the notes to the combined and consolidated financial statements in Part I, Item 1 of this Form 10-Q for additional information on our foreign currency exposure management program.

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The following table provides a summary of our active customer accounts, number of payment transactions, TPV and related metrics:

	Three Months Ended September 30,		Percent Increase/(Decrease)	Nine Months Ended September 30,		Percent Increase/(Decrease)
	2016	2015		2016	2015	
	(In millions, except percentages)					
Active customer accounts[1]	192	173	11 %	192	173	11 %
Number of payment transactions[2]	1,512	1,216	24 %	4,374	3,500	25 %
Payment transactions per active account[3]	30.2	26.9	13 %	30.2	26.9	13 %
Total TPV[4]	$87,403	$69,738	25 %	$254,666	$200,241	27 %
Percent of cross-border TPV	22 %	21 %	**	22 %	22 %	**

All amounts in tables are rounded to the nearest millions, except as otherwise noted. As a result, certain amounts may not recalculate using the rounded amounts provided.

[1] An active customer account is a registered account that successfully sent or received at least one payment or payment reversal through our Payments Platform, excluding transactions processed through our gateway and Paydiant products, in the past 12 months.

[2] Payment transactions are the total number of payments, net of payment reversals, successfully completed through our Payments Platform, excluding transactions processed through our gateway and Paydiant products.

[3] Number of payment transactions per active customer account reflects the total number of payment transactions within the previous 12 month period, divided by active customer accounts at the end of the period

[4] Total Payment Volume or “TPV” is the value of payments, net of payment reversals, successfully completed through our Payments Platform, excluding transactions processed through our gateway and Paydiant products.

** Not meaningful

The growth in transaction revenues was lower than both the growth in TPV and the growth in payment transactions for the three and nine months ended September 30, 2016 due to a higher portion of person-to-person ("P2P") transactions, primarily from our PayPal P2P and Venmo products for which we earn lower rates, and a higher portion of TPV generated by large merchants who generally pay lower rates with higher transaction volume. The percentage of TPV generated by large merchants increased two percentage points in the three and nine months ended September 30, 2016. As we execute our strategy to increase our ubiquity and relevance to our customers by expanding into large merchants and driving consumer engagement through P2P, we expect that the growth in transaction revenue will continue to be lower than the growth in TPV and the growth in payment transactions. The impact of changes in prices charged to our customers did not significantly impact revenue growth in the three and nine months ended September 30, 2016.

In the three months ended September 30, 2016, net revenues from other value-added services increased $77 million, or 28%, compared to the same period in the prior year. In the nine months ended September 30, 2016, net revenues from other value-added services increased $160 million, or 19%. Growth in net revenues from other value-added services in the three and nine months ended September 30, 2016 was due primarily to interest and fee income earned on our PayPal Credit loans receivable portfolio. The total consumer and merchant loans receivable balance as of September 30, 2016 and September 30, 2015 was $5.1 billion and $3.8 billion, respectively, reflecting a year over year increase of 35%. Growth in net revenues from other value-added services in the nine months ended September 30, 2016 was negatively impacted by additional revenue earned in the prior year related to our credit program agreement with Synchrony Financial (formerly GE Capital Retail Bank) of $57 million and the gain recognized of $26 million on the initial sale of approximately $708 million in certain consumer loans receivable which was completed in the same period of the prior year.

Operating Expenses

Beginning with the first quarter of 2016, we reclassified certain operating expenses in our condensed combined and consolidated statements of income to better align our external and internal financial reporting. These classification changes relate primarily to real estate and information technology operating expenses that were previously allocated among customer support and operations expense, sales and marketing expense and product development expense. Our management no longer allocates these operating expenses for internal financial reporting purposes or general management of the business and has therefore discontinued this allocation for external financial reporting purposes. As a result, starting with the first quarter of 2016 these operating expenses were reported as part of general and administrative expenses. These changes have no impact on the previously reported condensed combined and consolidated net income for prior periods, including total operating expenses, financial position or cash flows for any periods presented, and do not eliminate any of the costs allocated to us by eBay for any periods prior to the separation. Prior period amounts have been reclassified to conform to the current period presentation. See “Note 1-Overview and Summary of Significant Accounting Policies" in the notes to the combined and consolidated financial statements in Part I, Item 1 of this Form

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10-Q for additional information on the effects of the changes on the presentation of operating expenses to our previously reported condensed combined and consolidated statement of income. Growth rates presented below are calculated based upon the reclassified prior period amounts.

The following table summarizes our operating expenses and related metrics we use to assess the trend in each:

	Three Months Ended September 30,		Percent Increase/(Decrease)	Nine Months Ended September 30,		Percent Increase/(Decrease)
	2016	2015		2016	2015	
	(In millions, except percentages)					
Transaction expense	$830	$651	27 %	$2,392	$1,860	29 %
Transaction and loan losses	271	201	35 %	781	564	38 %
Customer support and operations	325	284	14 %	939	811	16 %
Sales and marketing	233	226	3 %	716	682	5 %
Product development	215	197	9 %	619	584	6 %
General and administrative	261	216	21 %	753	648	16 %
Depreciation and amortization	184	153	20 %	535	444	20 %
Restructuring	—	—	**	—	49	**
Total operating expenses	$2,319	$1,928	20 %	$6,735	$5,642	19 %
Transaction expense rate[1]	0.95 %	0.93 %	**	0.94 %	0.93 %	**
Transaction and loan loss rate[2]	0.31 %	0.29 %	**	0.31 %	0.28 %	**

[1] Transaction expense rate is calculated by dividing transaction expense by TPV.

[2] Transaction and loan loss rate is calculated by dividing transaction and loan loss by TPV.

** Not meaningful

Transaction expense

Transaction expense increased by $179 million, or 27%, in the three months ended September 30, 2016 compared to the same period of the prior year. Transaction expense increased by $532 million, or 29%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in transaction expense in the three and nine months ended September 30, 2016 was primarily attributable to an increase in TPV, which increased 25% and 27% in the three and nine months ended September 30, 2016, respectively.

Our transaction expense rate in the three and nine months ended September 30, 2016 increased compared to the same periods of the prior year. Our transaction expense rate is impacted by funding mix and assessments charged by payments processors and other financial institutions when we draw funds from a customer's credit or debit card, bank account or other funding sources. The cost of funding a transaction with a credit or debit card is generally more costly than the cost of funding a transaction from a bank or through internal sources such as a PayPal account balance or PayPal Credit. As we expand the availability or presentation of alternative funding sources to our customers, a change in funding mix could increase or decrease our transaction expense rate. For example, in connection with our customer choice initiatives, we expect that our transaction expense rate will increase. Increases in our transaction expense rate for the three and nine months ended September 30, 2016 and 2015 was due primarily to changes in funding mix. For the three and nine months ended September 30, 2016 and 2015, approximately 2% of TPV was funded with PayPal Credit. For the three and nine months ended September 30, 2016 and 2015, approximately 45% of TPV was generated outside of the U.S. Interest expense on borrowings incurred to finance our portfolio of loans receivable, included in transaction expense, was not material in the three and nine months ended September 30, 2016 and 2015.

Transaction and loan losses

The components of our transaction and loan losses for the three and nine months ended September 30, 2016 and 2015 were as follows:

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Percent Increase/(Decrease)	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015	Percent Increase/(Decrease)
	(In millions, except percentages)					
Transaction losses	$157	$133	18 %	$471	$360	31 %
Loan losses	114	68	68 %	310	204	52 %
Transaction and loan losses	$271	$201	35 %	$781	$564	38 %

Transaction and loan losses increased by $70 million, or 35%, in the three months ended September 30, 2016 compared to the same period of the prior year. Transaction and loan losses increased by $217 million, or 38%, in the nine months ended September 30, 2016 compared to the same period of the prior year.

Prior to the distribution on July 17, 2015, we recovered certain amounts from eBay related to customer protection programs offered on eligible eBay purchases made with PayPal. These costs included the actual amount of protection losses associated with eBay's customer protection programs that we administered and funded on behalf of eBay, which were included as a reduction of transaction and loan losses. Recoveries associated with transaction losses incurred on eligible eBay purchases during the three and nine months ended September 30, 2015 were $5 million and $27 million, respectively. Following the distribution, we no longer administer eBay's customer protection programs or recover amounts from eBay associated with transaction losses incurred on eligible eBay purchases; instead, PayPal and eBay independently administers its own customer protection programs. Further, our customer protection programs extend to customers' eligible purchases on eBay and therefore we have incurred incremental costs associated with our customer protection programs following the distribution.

Transaction losses increased by $24 million, or 18%, in the three months ended September 30, 2016 compared to the same period of the prior year. Our transaction loss rates, calculated by dividing transaction loss by TPV, decreased in the three months ended September 30, 2016 compared to the same period of the prior year. The growth in transaction losses in the three months ended September 30, 2016 was lower than the growth in TPV for the three months ended September 30, 2016 due primarily to our risk management capabilities offset by lower transaction losses in the prior period as a result of recoveries associated with transaction losses incurred on eligible eBay purchases.

Transaction losses increased by $111 million, or 31%, in the nine months ended September 30, 2016 compared to the same period of the prior year. Our transaction loss rates, calculated by dividing transaction loss by TPV, in the nine months ended September 30, 2016 were flat compared to the same periods of the prior year. The growth in transaction losses in the nine months ended September 30, 2016 was higher than the growth in TPV for the nine months ended September 30, 2016 due primarily to lower transaction losses in the prior period as a result of recoveries associated with transaction losses incurred on eligible eBay purchases.

Loan losses increased by $46 million or 68%, in the three months ended September 30, 2016 compared to the same period of the prior year. Loan losses increased by $106 million, or 52%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in loan losses for the three and nine months ended September 30, 2016 compared to the same periods of the prior year was due primarily to an increase in the loans receivable balance year over year and additional reserves recorded in the current period due to increases to forecasted principal balance delinquency rates.

The total consumer loans receivable balance as of September 30, 2016 and September 30, 2015 was $4.5 billion and $3.4 billion, respectively, reflecting a year over year increase of 32%. The increase in consumer loans receivables was due to the growth in the portfolio of loans receivable outstanding arising from consumers who chose PayPal Credit as a funding option.

The following table provides information regarding the credit quality of our pool of consumer loans and interest receivable balance:

	September 30, 2016	September 30, 2015

Weighted average U.S. consumer FICO scores[1]	686		686	
Percentage of loans receivable with FICO scores > 680[1]	53.7	%	53.5	%
Percentage of loans receivable with FICO scores < 599[1]	8.9	%	10.0	%
Percent of loans and interest receivable current	89.9	%	89.6	%
Percent of loans and interest receivable > 90 days outstanding	4.2	%	4.0	%
Net charge off rate[2]	6.0	%	5.6	%

(1) Excludes certain outstanding consumer loans outside of the U.S., for which no FICO scores are available, with an outstanding balance of $94 million and $31 million at September 30, 2016 and September 30, 2015, respectively.
(2) Net charge off rate is the annualized ratio of net credit losses on consumer loans receivables as a percentage of the average daily amount of consumer loans and interest receivables balance during the period.

We offer credit products to certain existing small and medium-sized merchants through our PayPal Working Capital product. The total PayPal Working Capital advances and fees receivable ("merchant receivables") outstanding as of September 30, 2016 and September 30, 2015 was $581 million and $352 million, respectively, reflecting a year over year increase of 65% due to the increase

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in the availability of our credit products domestically and internationally. To assess a merchant seeking a PayPal Working Capital advance, we use, among other indicators, a risk model that we have internally developed that we refer to as our PayPal Working Capital Risk Model ("PRM"), as a credit quality indicator to help predict the merchant's ability to repay the principal balance and fixed fee related to the working capital advance. The PRM uses multiple variables as predictors of the merchant's ability to repay a working capital advance. Primary drivers of the model include the merchant's annual payment volume and payment processing history with PayPal, prior repayment history with the PayPal Working Capital product, and other measures. Merchants are assigned a PRM credit score within the range of 350 to 750. We generally expect that merchants to which we extend a working capital advance will have PRM scores greater than 525. We generally consider scores above 610 to be very good and to pose less credit risk. We assess a participating merchant's PRM score on a recurring basis. At September 30, 2016 and September 30, 2015, the weighted average PRM score related to our PayPal Working Capital balances outstanding was 633 and 641, respectively.

The determination of the number of days our merchant receivables are outstanding is based on the current expected repayment period of the advance and fixed fee as compared to an original expected repayment period. We generally calculate the repayment rate of the merchant's future payment volume so that repayment of the advance and fixed fee is expected to occur within 9 to 12 months from the date of the advance. On a monthly basis, we recalculate the repayment period based on the repayment activity on the receivable. As such, actual repayment periods are dependent on actual payment processing volumes. We monitor receivables with repayment periods greater than the original expected repayment period. In the second quarter of 2016, we refined our estimate of the original expected repayment period to take into account the variability in repayment patterns. Prior period amounts have been updated to reflect this change.

The following table provides information regarding the credit quality of our merchant receivables:

	September 30, 2016		September 30, 2015	
Percentage of Merchant Receivable with PRM scores > 630	64.2	%	65.9	%
Percentage of Merchant Receivable with PRM scores < 565	16.7	%	13.4	%
Percent of Merchant Receivable within original expected repayment period[1]	83.8	%	89.2	%
Percent of Merchant Receivable > 90 days outstanding[1]	6.9	%	3.4	%

[1] Amounts in the prior periods were updated to reflect changes in our estimate of the original expected repayment period.

The changes in percentage of merchant receivables past their expected repayment period at September 30, 2016 over September 30, 2015 was due primarily to the increase in loan duration in 2016 compared to the prior year, which increased the seasonality of repayments trends. Modifications to the acceptable risk parameters of our PayPal Credit products for the periods presented did not have a material impact on our loans.

Customer support and operations

Customer support and operations expenses increased by $41 million, or 14%, in the three months ended September 30, 2016 compared to the same period of the prior year. Customer support and operations expenses increased by $128 million, or 16%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in the three and nine months ended September 30, 2016 was due primarily to an increase in contractor related expenses to service the growth in our active customer accounts and the number of payment transactions occurring on our Payments Platform and an increase in employee related expenses, including stock based compensation expense.

Sales and marketing

Sales and marketing expenses increased by $7 million, or 3%, in the three months ended September 30, 2016 compared to the same period of the prior year. Sales and marketing expenses increased by $34 million, or 5%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in the three and nine months ended September 30, 2016 was due primarily to higher marketing spend related to Xoom on advertising campaigns intended to enhance our global brand recognition.

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Product development

Product development expenses increased by $18 million, or 9%, in the three months ended September 30, 2016 compared to the same period of the prior year. The increase in the three months ended September 30, 2016 was due primarily to an increase in employee related expenses, driven primarily by Xoom. Product development expenses increased by $35 million, or 6%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in the nine months ended September 30, 2016 was due primarily to an increase in employee related expenses, driven primarily by Xoom, offset by a decrease in contractor related expenses.

General and administrative

General and administrative expenses increased by $45 million, or 21%, in the three months ended September 30, 2016 compared to the same period of the prior year. General and administrative expenses increased by $105 million, or 16%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in the three and nine months ended September 30, 2016 was due primarily to an increase in employee expenses, contractor related expenses incurred to operate as an independent public company and continued investments in compliance programs.

Depreciation and amortization

Depreciation and amortization expenses increased by $31 million, or 20%, in the three months ended September 30, 2016 compared to the same period of the prior year. Depreciation and amortization expenses increased by $91 million, or 20%, in the nine months ended September 30, 2016 compared to the same period of the prior year. The increase in the three and nine months ended September 30, 2016 was due primarily to additional depreciation expense associated with investments in our technology platforms. Amortization expense for intangible assets was $37 million and $24 million for the three months ended September 30, 2016 and 2015, respectively, reflecting a year over year increase of 54% due primarily to acquisitions completed during 2015. Amortization expense for intangible assets was $114 million and $66 million for the nine months ended September 30, 2016 and 2015, respectively, reflecting a year over year increase of 73% due primarily to acquisitions completed during 2015.

Restructuring
In January 2015, at a regular meeting of eBay's Board of Directors (the "eBay Board"), the eBay Board approved a plan to implement a strategic reduction of its existing global workforce. The reduction was substantially completed in the first half of 2015. Restructuring expenses were $49 million in the nine months ended September 30, 2015. No restructuring expenses were recognized in the three and nine months ended September 30, 2016.

Income Tax Expense

Our effective income tax rate was 10% and 14% for the three months ended September 30, 2016 and 2015, respectively. The decrease in our effective income tax rate for the three months ended September 30, 2016 compared to the same period of the prior year was due primarily to discrete tax adjustments.

Our effective income tax rate was 13% and 20% for the nine months ended September 30, 2016 and 2015, respectively. The decrease in our effective income tax rate over the same period of the prior year was primarily due to favorable discrete tax adjustments during the nine months ended September 30, 2016 and other separation-related costs incurred during the nine months ended September 30, 2015.

Non-GAAP Financial Information

Non-GAAP financial information is defined as a numerical measure of a company’s performance that excludes or includes amounts that creates differences between the most directly 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, the following portion of this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” includes 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 our financial results prepared in accordance with GAAP.

We present non-GAAP financial measures to enhance an investor’s evaluation of our ongoing operating results and to facilitate meaningful comparisons of our results between periods. Management uses these non-GAAP financial measures to, among other

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things; evaluate our ongoing operations, for internal planning and forecasting purposes and in the calculation of performance-based compensation.

We exclude the following items from non-GAAP net income, non-GAAP net income per diluted share, non-GAAP operating income, non-GAAP operating margin and non-GAAP effective tax rate:

- Stock-based compensation expense and related employer payroll taxes. This consists of expenses for equity awards under our equity incentive plans. We exclude stock-based compensation expense from our non-GAAP measures primarily because they are non-cash expenses that management does not believe are reflective of ongoing operating results. The related employer payroll taxes are dependent on our stock price and the timing and size of exercises and vesting of equity awards, over which management has limited to no control, and as such management does not believe it correlates to the operation of our business.
- Amortization or impairment of acquired intangible assets, impairment of goodwill, and transaction expenses from the acquisition or disposal of a business. We incur amortization or impairment of acquired intangible assets and goodwill in connection with acquisitions and may incur significant gains or losses or transactional expenses from the acquisition or disposal of a business and therefore exclude these amounts from our non-GAAP measures. We exclude these items because management does not believe they are reflective of our ongoing operating results.
- Separation. These are significant expenses related to the separation of our business from eBay into a separate, independent publicly-traded company. These consist primarily of third-party consulting fees, legal fees, employee retention payments and other expenses incurred to complete the separation. We exclude these items because management does not believe they are reflective of our ongoing operating results.
- Restructuring. These consist of expenses for employee severance and other exit and disposal costs. We exclude restructuring charges primarily because management does not believe they are reflective of ongoing operating results.
- Other certain significant gains, losses, or charges that are not indicative of our core operating results. These are significant gains, losses, or charges during a period that are the result of isolated events or transactions which have not occurred frequently in the past and are not expected to occur regularly in the future. We exclude these amounts from our results because management does not believe they are indicative of our ongoing operating results.
- Tax effect of non-GAAP adjustments. This amount is used to present stock-based compensation and the other amounts described above on an after-tax basis consistent with the presentation of non-GAAP net income.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
GAAP operating income	$348	$330	$1,126	$1,050
Stock-based compensation expense and related employer payroll taxes	110	95	328	266
Amortization of acquired intangible assets	32	20	101	56
Separation	—	3	—	17
Restructuring	—	—	—	49
Acquisition related transaction expense	—	2	—	5
Total non-GAAP operating income adjustments	142	120	429	393
Non-GAAP operating income	$490	$450	$1,555	$1,443
Non-GAAP operating margin	18 %	20 %	20 %	22 %

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
GAAP income before income taxes	$360	$350	$1,162	$1,070
GAAP income tax expense	37	49	151	209
GAAP net income	323	301	1,011	861
Non-GAAP adjustments to net income:				
Non-GAAP operating income adjustments (see table above)	142	120	429	393
Separation (Other income (expense), net)	—	(12)	—	(12)
Tax effect of non-GAAP adjustments	(40)	(32)	(127)	(97)
Non-GAAP net income	$425	$377	$1,313	$1,145
Non-GAAP net income per diluted share	$0.35	$0.31	$1.08	$0.93
Shares used in non-GAAP diluted share calculation[1]	1,214	1,227	1,218	1,227
GAAP income tax expense	$37	$49	$151	$209
Tax effect of non-GAAP adjustments	40	32	127	97
Non-GAAP income tax expense	$77	$81	$278	$306
GAAP effective tax rate	10 %	14 %	13 %	20 %
Tax effect of non-GAAP adjustments to net income	5 %	4 %	4 %	1 %
Non-GAAP effective tax rate	15 %	18 %	17 %	21 %

[1] Non-GAAP net income per diluted share for the three and nine months ended September 30, 2015 is calculated using the weighted average number of common shares outstanding for the period beginning after the distribution date.

In addition to the non-GAAP measures discussed above, we also use free cash flow to assess our performance. Free cash flow represents cash flows from operating activities less purchases of property and equipment. We consider free cash flow to be a liquidity measure that provides useful information to management and investors about the amount of cash generated by the business after the purchases of property and equipment, including investments in our Payments Platform, which can then be used to, among other things, invest in our business, make strategic acquisitions, and repurchase stock. A limitation of the utility of free cash flow as a measure of financial performance is that it does not represent the total increase or decrease in our cash balance for the period. A reconciliation of free cash flow to the most directly comparable GAAP financial measure is presented below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In millions)			
Net cash provided by operating activities	$801	$652	$2,235	$1,818
Less: Purchases of property and equipment	(183)	(133)	(517)	(558)
Free cash flow	$618	$519	$1,718	$1,260

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Liquidity and Capital Resources

We require liquidity and access to capital to fund our global operations, including customer protection programs, our PayPal Credit products, capital expenditures, investments in our business, potential acquisitions, working capital and other cash needs. The following table summarizes the cash, cash equivalents and investment balances available as of September 30, 2016 and December 31, 2015:

	September 30, 2016	December 31, 2015
	(In millions)	
Cash, cash equivalents and available-for-sale investment securities[1][2]	$6,359	$ 5,707

[1]Excludes assets related to customer accounts of $13.3 billion and 12.3 billion at September 30, 2016 and December 31, 2015, respectively.
[2] Excludes total restricted cash of $18 million and $26 million at September 30, 2016 and December 31, 2015, respectively, and cost method investments of $50 million and $26 million as of September 30, 2016 and December 31, 2015, respectively.

Cash, cash equivalents and investments held by our foreign subsidiaries (i.e., any entities where earnings would be subject to United States tax upon repatriation) were $5.1 billion as of September 30, 2016 and $4.2 billion at December 31, 2015, or 79% and 74% of our total cash, cash equivalents and investments as of those dates, respectively.

In July 2015, we entered into a credit agreement ("Credit Agreement") that provides for an unsecured $2.0 billion five-year revolving credit facility that includes a $150 million letter of credit sub-facility and a $150 million swingline sub-facility, with available borrowings under the revolving credit facility reduced by the amount of any letters of credit and swingline borrowings outstanding from time to time. Borrowings and other amounts payable under the Credit Agreement are guaranteed by PayPal, Inc. (the "Guarantor"). We may also, subject to the agreement of the applicable lenders, increase the commitments under the revolving credit facility by up to $500 million. Subject to specified conditions, we may designate one or more of our subsidiaries as additional borrowers under the Credit Agreement provided that we and the Guarantor guarantee all borrowings and other obligations of any such subsidiaries under the Credit Agreement. As of September 30, 2016, no subsidiaries were designated as additional borrowers. Funds borrowed under the Credit Agreement may be used for working capital, capital expenditures, acquisitions and other general corporate purposes.

As of September 30, 2016, no borrowings or letters of credit were outstanding under the Credit Agreement. Accordingly, at September 30, 2016, $2.0 billion of borrowing capacity was available for the purposes permitted by the Credit Agreement subject to customary conditions to borrowings.

Loans under the Credit Agreement bear interest at either (i) the London Interbank Offered Rate (“LIBOR”) plus a margin (based on our public debt ratings) ranging from 1.00 percent to 1.625 percent or (ii) a formula based on the agent bank’s prime rate, the federal funds effective rate or LIBOR plus a margin (based on our public debt ratings) ranging from zero percent to 0.625 percent. Subject to certain conditions stated in the Credit Agreement, we and any of our subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts under the revolving credit facility at any time during the term of the Credit Agreement. The Credit Agreement will terminate and all amounts owing thereunder will be due and payable on July 17, 2020, unless (a) the commitments are terminated earlier, either at our request or, if an event of default occurs, by the lenders (or automatically in the case of certain bankruptcy-related events), or (b) the maturity date is extended upon our request, subject to the agreement of the lenders. The Credit Agreement contains customary representations, warranties, affirmative and negative covenants, including financial covenants, events of default and indemnification provisions in favor of the banks. The negative covenants include restrictions regarding the incurrence of liens, subject to certain exceptions. The financial covenants require us to meet a quarterly financial test with respect to a minimum consolidated interest coverage ratio and a maximum consolidated leverage ratio, based on our public debt ratings.

We have a cash pooling arrangement with a financial institution for cash management purposes. The arrangement allows for cash withdrawals from the financial institution based upon our aggregate operating cash balances held within the financial institution ("Aggregate Cash Deposits"). The arrangement also allows us to withdraw amounts exceeding the Aggregate Cash Deposits up to an agreed-upon limit. The net balance of the withdrawals and the Aggregate Cash Deposits are used by the financial institution as a basis for calculating our net interest expense or income under these arrangements. As of September 30, 2016, we had a total of $2.0 billion in cash withdrawals offsetting our $2.0 billion in Aggregate Cash Deposits held within the financial institution under the cash pooling arrangement.

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Growth in the portfolio of loan receivables increases our liquidity needs and any failure to meet those liquidity needs could adversely affect our business. We continue to evaluate partnerships and third party sources of funding of our credit portfolio, including, but not limited to, commercial banks, securitization markets, private equity firms and sovereign wealth funds. Consistent with this strategy, in March 2016, as approved by management and our Luxembourg banking subsidiary Supervisory Board and as permitted within regulations set forth by the Luxembourg Commission de Surveillance du Secteur Financier (the "CSSF"), we designated $800 million of European customer balances held in our Luxembourg banking subsidiary to be used to extend credit to our European customers. These funds are classified as cash and cash equivalents in our condensed consolidated balance sheet and represent 20% of European customer balances potentially available for corporate use by us at September 30, 2016 as determined by applying financial regulations maintained by the CSSF. We may periodically seek to designate additional amounts of customer balances, if necessary, based on utilization of the approved funds and anticipated credit funding requirements. Our objective is to expand the availability of our credit products with capital from external sources, although there can be no assurance that we will be successful in achieving that goal.

As of September 30, 2016, we were rated investment grade by Standard and Poor's Financial Services, LLC and Fitch Ratings, Inc. We expect that these credit rating agencies will continue to monitor our performance, including our capital structure and results of operations. Our goal is to be rated investment grade, but as circumstances change there are factors that could result in our credit ratings being downgraded or put on a watch list for possible downgrading. If that were to occur, it could increase our borrowing costs, including the interest rate on loans under our Credit Agreement.

The risk of losses from our customer protection programs are specific to individual customers, merchants and transactions, and may also be impacted by regional variations in the programs and modifications to the programs resulting from changes to regulatory requirements. For the periods presented in these condensed combined and consolidated financial statements included in this report, our transaction loss rates, calculated by dividing transaction loss by TPV, ranged between 0.18% and 0.19% of TPV. Historical trends may not be an indication of future results. In addition, prior to the distribution, we recovered certain amounts from eBay related to customer protection programs offered on eligible eBay purchases made with PayPal. These costs included the actual amount of protection losses associated with eBay's customer protection programs that we administered and funded on behalf of eBay, which are included as a reduction of transaction and loan losses. Following the distribution, we no longer administer eBay's customer protection programs or recover amounts from eBay associated with transaction losses incurred on eligible eBay purchases; instead, we and eBay each independently administer our own customer protection programs. Further, our customer protection programs extend to customers’ eligible purchases on eBay and therefore we have incurred and expect to continue to incur incremental costs associated with our customer protection programs following the distribution.

In January 2016, our Board of Directors authorized a stock repurchase program that provides for the repurchase of up to $2 billion of our common stock, with no expiration from the date of authorization. This stock repurchase program is intended to offset the impact of dilution from our equity compensation programs and, subject to market conditions and other factors, may also be used to make opportunistic repurchases of our common stock to reduce outstanding share count. Any share repurchases under our stock repurchase program may be made through open market transactions, block trades, privately negotiated transactions or other means at times and in such amounts as management deems appropriate and will be funded from our working capital or other financing alternatives. However, any stock repurchases are subject to market conditions and other uncertainties and we cannot predict if or when any stock repurchases will be made. Moreover, we may terminate our stock repurchase program at any time without notice. During the nine months ended September 30, 2016, we repurchased approximately $945 million of our common stock under our stock repurchase program. As of September 30, 2016, a total of approximately $1.1 billion remained available for future repurchases of our common stock under our stock repurchase program.

Our liquidity, access to capital and borrowing costs could be adversely impacted by declines in our credit rating, our financial performance, and global credit market conditions, as well as a broad range of other factors. In addition, our liquidity, access to capital and borrowing costs could also be negatively impacted by the outcome of any of the legal or regulatory proceedings to which we are a party. See Part I, Item 1A , Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2015 as supplemented and, to the extent inconsistent, superseded below in Part II, Item 1A, Risk Factors in this Form 10-Q, as well as “Note 11—Commitments and Contingencies” to the condensed combined and consolidated financial statements in Item 1 of Part I of this Form 10-Q for additional discussion of these and other risks facing our business.

We believe that our existing cash, cash equivalents, available-for-sale investments, cash expected to be generated from operations, and our expected access to capital markets, together with potential external funding through third party sources, such as commercial banks, private equity firms, and sovereign wealth funds, will be sufficient to fund our operating activities, anticipated capital expenditures, and PayPal Credit products for the foreseeable future.

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Cash Flows

In March 2016, we designated $800 million of European customer balances held in our Luxembourg banking subsidiary to be used to extend credit to our European customers. We have presented changes in funds receivable and customer accounts as cash flows from investing activities in our condensed combined and consolidated statements of cash flows based on the nature of the activity underlying our customer accounts which includes purchases of investments, maturities and sales of investments and changes in funds receivable and customer accounts. We have elected to conform the prior period statement of cash flows to the current period presentation to enhance transparency and provide comparability. See “Note 1—Overview and Summary of Significant Accounting Policies" in the notes to our condensed combined and consolidated financial statements in Item 1 of Part I of this Form 10-Q for additional information on the effects of the changes on the presentation of our statement of cash flows to our previously reported combined and consolidated statement of cash flows.

The following table summarizes our condensed combined and consolidated statement of cash flows:

	Nine Months Ended September 30,	
	2016	2015
	(In millions)	
Net cash provided by (used in):		
Operating activities	$2,235	$1,818
Investing activities	(3,170)	(6,322)
Financing activities	895	4,224
Effect of exchange rates on cash and cash equivalents	16	(41)
Net increase/(decrease) in cash and cash equivalents	$(24)	$(321)

Operating Activities

Cash flows from operating activities includes net income adjusted for certain non-cash expenses, timing differences between expenses recognized for provision for transaction and loan losses and actual transaction losses paid, and changes in other assets and liabilities. Significant non-cash expenses for the period include depreciation and amortization, stock-based compensation, and deferred tax expenses. The cash impact from actual transaction losses incurred during a period are reflected as a negative impact to changes in other current and non-current assets in cash from operating activities. The expenses recognized during the period for provision for loan losses are estimates of probable incurred losses on our PayPal Credit products for which the receivable has not been charged off. Actual charge offs of receivables related to our PayPal Credit products are reflected as a reduction in changes in principal loans receivable which are reflected as investing activities and thus have no impact on cash from operating activities.

We generated cash from operating activities of $2.2 billion in the nine months ended September 30, 2016 due primarily to operating income of approximately $1.1 billion. Adjustments for non-cash expenses of depreciation and amortization and stock-based compensation (including excess tax benefits from stock-based compensation) were approximately $812 million during the nine months ended September 30, 2016. Adjustments for non-cash expenses related to provision for transaction and loan losses were approximately $781 million during the nine months ended September 30, 2016. The cash generated from operating activities was negatively impacted by changes in other assets and liabilities of $469 million primarily related to actual transaction losses paid during the period.

We generated cash from operating activities of $1.8 billion in the nine months ended September 30, 2015 due primarily to operating income of $1.1 billion. Adjustments for non-cash expenses of depreciation and amortization and stock-based compensation (including excess tax benefits from stock-based compensation) were approximately

$676 million during the nine months ended September 30, 2015. Adjustments for non-cash expenses related to provision for transaction and loan losses were approximately $564 million during the nine months ended September 30, 2015. The cash generated from operating activities was negatively impacted by increases in accounts receivable of $98 million, net cash outflows related to settlement of payables and receivables with eBay of $96 million and changes in other assets and liabilities of $227 million primarily related to actual transaction losses paid during the period.

Cash paid for income taxes in the nine months ended September 30, 2016 and 2015 was $43 million and $56 million, respectively.

Investing Activities

The net cash used in investing activities of $3.2 billion in the nine months ended September 30, 2016 was due primarily to purchases of investments of $17.0 billion, changes in principal loans receivable, net of $884 million and purchases of property and equipment

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of $517 million. These net cash outflows were offset by maturities and sales of investments of $14.6 billion and decreases in funds receivable from customers and customer accounts of $620 million partially due to classifying $800 million of European customer balances held in our Luxembourg banking subsidiary as cash and cash equivalents.

The net cash used in investing activities of $6.3 billion in the nine months ended September 30, 2015 was due primarily to purchases of investments of $17.3 billion, purchases of property and equipment of $558 million, acquisitions, net of cash acquired of $283 million. These net cash outflows were offset by maturities and sales of investments of $11.0 billion, increases in funds receivable from customers and customer accounts of $314 million, and net cash inflows relating to receivables from eBay of $575 million.

Financing Activities

The net cash provided by financing activities of $895 million in the nine months ended September 30, 2016 was due primarily to increases in funds payable and amounts due to customers of $1.9 billion offset by the repurchase of $945 million of our common stock under our stock repurchase program.

The net cash provided by financing activities of $4.2 billion in the nine months ended September 30, 2015 was due primarily to a contribution of approximately $3.9 billion of cash from eBay and increases in funds payable and amounts due to customers of $1.2 billion offset by repayments of borrowings from eBay of $877 million.

Free Cash Flow

We define free cash flow as cash flows from operating activities less purchases of property and equipment. Free cash flow was $1.7 billion in the nine months ended September 30, 2016, an increase of $458 million from the same period of the prior year. The increase in free cash flow during the period was primarily due to higher cash generated from operating activities of $417 million and lower purchases of property and equipment of $41 million. Free cash flow generated during the nine months ended September 30, 2016 was used for repurchasing our common stock under our stock repurchase program, funding our credit portfolio and general business purposes.

Free cash flow is a non-GAAP financial measure. See "Non-GAAP Financial Information" above for information on how we compute free cash flow and a reconciliation to the most directly comparable GAAP financial measure.

Effect of Exchange Rates on Cash

The effect of foreign currency exchange rates on cash and cash equivalents during the nine months ended September 30, 2016 was a favorable impact of $16 million due to the weakening of the U.S. dollar against certain foreign currencies, primarily the Euro. The effect of currency exchange rates on cash and cash equivalents during the nine months ended September 30, 2015 was an unfavorable impact of $41 million due to the strengthening of the U.S. dollar against certain foreign currencies, primarily the Euro.

Off-Balance Sheet Arrangements

As of September 30, 2016, we had no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our combined and consolidated financial condition, results of operations, liquidity, capital expenditures or capital resources.

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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. Management establishes and oversees the implementation of policies governing our investing, funding, and foreign currency derivative activities in order to mitigate market risks. We monitor risk exposures on an ongoing basis.

Interest Rate Risk

We are exposed to interest-rate risk relating to our investment portfolio and from interest-rate sensitive assets underlying the customer balances we hold on our condensed consolidated balance sheet as customer accounts. We seek to reduce earnings volatility that may result from changes in interest rates.

As of September 30, 2016 and December 31, 2015, approximately 22% and 24% of our total cash and investment portfolio was held in cash and cash equivalents. The assets underlying the customer balances we hold on our condensed consolidated balance sheet as customer accounts are maintained in interest and non-interest bearing bank deposits, time deposits, and U.S. and foreign government and agency securities and corporate debt securities. We classify the assets underlying the customer balances as current based on their purpose and availability to fulfill our direct obligation under amounts due to customers. We seek to preserve principal while holding eligible liquid assets, as defined by applicable regulatory requirements and commercial law in the jurisdictions where we operate, equal to at least 100% of the aggregate amount of all customer balances. We do not pay interest on amounts due to customers. On July 17, 2015, we entered into a $2 billion senior unsecured credit facility maturing in 2020. Borrowings under the revolving facility, if any, bear interest at floating rates. As a result, we will be exposed to fluctuations in interest rates to the extent of our borrowings under the revolving credit facility. As of September 30, 2016, no borrowings or letters of credit were outstanding under the Credit Agreement.

Interest rates may also adversely impact our customers' spending levels and ability and willingness to pay outstanding amounts owed to us. Higher interest rates often lead to higher payment obligations by customers to us and other lenders under mortgage, credit card and other consumer loans, which may reduce our customers' ability to remain current on their obligations to us and therefore lead to increased delinquencies, charge-offs and allowance for loan and interest receivable, which could have an adverse effect on our net earnings.

A 100 basis point increase in interest rates would not have had a material impact on our financial assets or liabilities at September 30, 2016 and December 31, 2015.

Foreign Currency Risk

We have significant operations internationally that are denominated in foreign currencies, primarily the British Pound, Euro, Australian Dollar and Canadian Dollar, subjecting us to foreign currency risk which may adversely impact our financial results. We transact business in various foreign currencies and have significant international revenues as well as costs. In addition, we charge our international subsidiaries for their use of intellectual property and technology and for certain corporate services. Our cash flow, results of operations and certain of our intercompany balances that are exposed to foreign exchange rate fluctuations may differ materially from expectations and we may record significant gains or losses due to foreign currency fluctuations and related hedging activities. We are generally a net receiver of foreign currencies and therefore benefit from a weakening of the U.S. dollar, and are adversely affected by a strengthening of the U.S. dollar, relative to foreign currencies.

We have a foreign exchange exposure management program designed to identify material foreign currency exposures, manage these exposures and reduce the potential effects of currency fluctuations on our reported condensed combined and consolidated cash flows and results of operations through the execution of foreign currency exchange contracts. These foreign currency exchange contracts are accounted for as derivative instruments; for additional details related to our foreign currency exchange contracts, please see “Note 9—Derivative Instruments” to the condensed combined and consolidated financial statements included in this report.

We use foreign exchange forward contracts to protect our forecasted U.S. dollar-equivalent earnings from adverse changes in foreign currency exchange rates. These hedging contracts reduce, but do not entirely eliminate, the impact of adverse currency exchange rate movements. We designate these contracts as cash flow hedges for accounting purposes. The effective portion of the derivative’s gain or loss is initially reported as a component of accumulated other comprehensive income ("AOCI") and subsequently reclassified into revenue in the same period the forecasted transaction affects earnings. The ineffective portion of the unrealized gains and losses on these contracts, if any, is recorded immediately in earnings.

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that changes in exchange rates of 20% for all currencies could be experienced in the near term. If the U.S. dollar weakened by 20% at September 30, 2016 and December 31, 2015, the amount recorded in AOCI related to our foreign currency exchange forward contracts, before taxes, would have been approximately $334 million and $321 million lower, respectively. If the U.S. dollar strengthened by 20% at September 30, 2016 and December 31, 2015, the amount recorded in AOCI related to our foreign currency exchange forward contracts, before taxes, would have been approximately $334 million and $321 million higher, respectively.

We have an additional foreign exchange management program whereby we use foreign currency exchange contracts to offset the foreign currency exchange risk on our assets and liabilities denominated in currencies other than the functional currency of our subsidiaries. These contracts are not designated as hedging instruments and reduce, but do not entirely eliminate, the impact of currency exchange rate movements on our assets and liabilities. The foreign currency gains and losses on our assets and liabilities are recorded in “Other income (expense), net,” which are offset by the gains and losses on the foreign exchange contracts.

Adverse changes in exchange rates of 20% for all currencies would have resulted in an adverse impact on income before income taxes of approximately $104 million and $136 million at September 30, 2016 and December 31, 2015, respectively, without considering the offsetting effect of hedging. Foreign currency exchange contracts in place as of September 30, 2016 would have positively impacted income before income taxes by approximately $102 million, resulting in a net negative impact of approximately $2 million. Foreign currency exchange contracts in place as of December 31, 2015 would have positively impacted income before income taxes by approximately $133 million, resulting in a net negative impact of approximately $3 million. These reasonably possible adverse changes in exchange rates of 20% were applied to total monetary assets and liabilities denominated in currencies other than the functional currencies of our subsidiaries at the balance sheet dates to compute the adverse impact these changes would have had on our income before income taxes in the near term.

Equity Price Risk

As of September 30, 2016 and December 31, 2015, our cost method investments totaled $50 million and $26 million, respectively, which represented less than 1% of our total cash and investment portfolio and were primarily related to cost method investments in privately held companies. We did not hold any marketable equity instruments. We review our investments for impairment when events and circumstances indicate a decline in fair value of such assets below carrying value is other-than-temporary. Our analysis includes a review of recent operating results and trends, recent sales and acquisitions of the securities in which we have invested and other publicly available data.

European Debt Exposures

We actively monitor our exposure to the European markets, including the impact of sovereign debt issues associated with Cyprus, Greece, Ireland, Italy, Portugal and Spain. As of September 30, 2016 and December 31, 2015, we did not have any direct investments in the sovereign debt of these countries or in debt securities issued by corporations or financial institutions organized in these countries. We maintain a small number of operating bank accounts with local and foreign banks in the aforementioned countries that have balances that we do not consider material.

Item 4: Controls and Procedures

(a) Evaluation of disclosure controls and procedures. Based on the evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) required by Rules 13a-15(b) or 15d-15(b) under the Securities Exchange Act of 1934, our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

(b) Changes in internal controls. There were no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1: Legal Proceedings

The information set forth under “Note 11- Commitments and Contingencies, Litigation and Regulatory Matters” to the condensed combined and consolidated financial statements included in Part I, Item 1 of this report is incorporated herein by reference.

Item 1A: Risk Factors

We are subject to various risks and uncertainties, which could materially affect our business, results of operations, financial condition, and future results and the trading price of our common stock. You should carefully read the following information together with the information appearing in Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2015. The following information supplements and, to the extent inconsistent, supersedes some of the information appearing in the Risk Factors section of our Annual Report on Form 10-K. These risk factors, as well as our condensed combined and consolidated financial statements and notes thereto and the other information appearing in this report, should be reviewed carefully for important information regarding risks that affect us.

Changes in how consumers fund their PayPal transactions could harm our business.
We pay significant transaction fees when consumers fund payment transactions using credit cards, lower fees when consumers fund payments with debit cards, nominal fees when consumers fund payment transactions by electronic transfer of funds from bank accounts, and nominal fees when consumers fund payment transactions from an existing PayPal account balance or through our PayPal Credit products. Our financial success is sensitive to changes in the rate at which our consumers fund payments using credit and debit cards (collectively, “payment cards”), which can significantly increase our costs. Despite our efforts to provide consumers with the opportunity to use their existing PayPal account balance to fund payment transactions, some of our consumers may prefer to use payment cards, especially if these payment cards offer functionality and benefits not associated with the use of their bank accounts. Some of our offerings, including the ability of consumers to make a limited number of “guest” payments without opening a PayPal account, have a higher rate of payment card funding than our basic product offering. An increase in the portion of our payment volume funded using payment cards or in fees associated with our funding mix, or other events or developments that make it more difficult or costly for us to fund transactions by electronic transfer of funds from bank accounts or existing PayPal account balances, could materially and adversely affect our financial performance and significantly harm our business. Some of our plans to lower our funding costs, including our PayPal Credit products and enabling consumers to defer payment for a short period of time on some transactions, may increase the risk to us of nonpayment by consumers.
Negotiated arrangements with payment card networks and/or issuing banks, promoting greater choice and options for consumers to fund payment transactions could have an uncertain impact on our business. We announced that we have entered into a strategic partnership with Visa, Inc. ("Visa") to further expand our relationship with Visa in a way that will make it easier for merchants to accept and consumers to choose to pay with Visa credit and debit cards. As part of the agreement, we will gain access to Visa’s tokenization services in the U.S. for in-store point-of-sale PayPal transactions. Similarly, we also announced that we have entered into a strategic partnership with MasterCard Incorporated (“MasterCard”). As part of that agreement, we will gain access to MasterCard’s tokenization services in the U.S. for in-store point-of-sale PayPal transactions. While we anticipate these and similar strategic partnerships we may enter in the future will result in an increase in the number of transactions and transaction volume that we process, we also anticipate that a greater percentage of customer transactions will be executed using a credit or debit card, which could increase our funding costs. If our transaction volume does not increase as expected, our business and results of operations could be adversely affected due to increased costs associated with our funding mix.

Changes to payment card networks or bank fees, rules, or practices could harm our business.

We do not directly access the payment card networks, such as Visa and MasterCard, that enable our acceptance of credit cards and debit cards, including some types of prepaid cards. Accordingly, we must rely on banks or other payment processors to process transactions and must pay fees for the services. From time to time, payment card networks have increased, and may increase in the future, the interchange fees and assessments that they charge for each transaction which accesses their networks. Payment card networks have or may impose special assessments for transactions that are executed through a “digital wallet” such as PayPal’s, and such fees could particularly impact us and significantly increase our costs. Our payment card processors may have the right to pass any increases in interchange fees and assessments on to us as well as increase their own fees for processing. Any changes in interchange fees and assessments could increase our operating costs and reduce our operating income. We recently announced that we have entered into strategic partnerships with Visa and MasterCard to further expand our relationships with these networks in a way that will make it easier for merchants to accept and consumers to choose to pay with Visa and MasterCard credit and debit cards. During the term of the agreements, Visa and MasterCard have each agreed to not enact or impose any fees or rules solely targeted at PayPal. Upon termination of the agreements, PayPal could become subject to special digital wallet fees or other special assessments.

In addition, in some jurisdictions, governments have required Visa and MasterCard to reduce interchange fees, or have opened investigations as to whether Visa's or MasterCard's interchange fees and practices violate antitrust law. In the United States, the Federal Reserve Board issued a final rule capping debit card interchange fees at significantly lower rates than Visa or MasterCard previously charged. In the European Union, the Multilateral Interchange Fee Regulation limits credit and debit interchange fees for payments and imposes business rules on card processing services. Any material reduction in credit or debit card interchange rates in the United States or other markets could adversely affect our competitive position against traditional credit and debit card service providers, and may subject us to pricing pressure, although it would also lower our costs. Future changes to those regulations could potentially adversely affect our business.

We are required by our processors to comply with payment card network operating rules, including special operating rules for payment service providers to merchants, and we have agreed to reimburse our processors for any fines they are assessed by payment card networks as a result of any rule violations by us or our merchants. The payment card networks set and interpret the card operating rules. From time to time, the networks have alleged that various aspects of our business model violate these operating rules. If such allegations are not resolved favorably, they may result in material fines and penalties or require changes in our business practices that may be costly. The payment card networks could adopt new operating rules or interpret or re-interpret existing rules that we or our processors might find difficult or even impossible to follow, or costly to implement. As a result, we could lose our ability to give consumers the option of using payment cards to fund their payments or the choice of currency in which they would like their payment card to be charged. If we are unable to accept payment cards or are meaningfully limited in our ability to do so, our business would be adversely affected.

We and our payment card processors have implemented specific business processes for merchants to comply with payment card network operating rules for providing services to merchants. Any failure to comply with these rules could result in fines. We are also subject to fines from payment card networks if we fail to detect that merchants are engaging in activities that are illegal or that are considered "high risk," primarily the sale of certain types of digital content. For "high risk" merchants, we must either prevent such merchants from using our PayPal services or register such merchants with the payment card networks and conduct additional monitoring with respect to such merchants. Although the amount of these fines has not been material to date, additional fines in the future could become material and could result in a termination of our ability to accept payment cards or require changes in our process for registering new customers, which would materially harm our business. Payment card network rules may also increase the cost of, impose restrictions on, or otherwise negatively impact the development of, our retail point-of-sale solutions, which may negatively impact their deployment and adoption.

Failure to deal effectively with fraud, fictitious transactions, bad transactions, and negative customer experiences would increase our loss rate and harm our business, and could severely diminish merchant and consumer confidence in and use of our services.

We incur substantial losses due to claims from consumers that merchants have not performed or that their goods or services do not match the merchant's description. We seek to recover such losses from the merchant, but may not be able to recover in full if the merchant is unwilling or unable to pay. In addition, in the event of the bankruptcy or other business interruption of a merchant that sells goods or services in advance of the date of their delivery or use (e.g., airline, cruise or concert tickets, custom-made goods and subscriptions), we could be liable to the buyers of such goods or services, either through our buyer protection program or through chargebacks on payment cards used by customers to fund their payment. While we have established reserves based on assumptions and estimates that we believe are reasonable to cover such eventualities, these reserves may be insufficient.

We also incur losses from claims that the consumer did not authorize the purchase, from consumer fraud, from erroneous transmissions and from customers who have closed bank accounts or have insufficient funds in them to satisfy payments. In addition, if losses incurred by us related to payment card transactions become excessive, they could potentially result in our losing the right to accept payment cards for payment, which would harm our business. We have taken measures to detect and reduce the risk of fraud, but these measures need to be continually improved and may not be effective against new and continually evolving forms of fraud or in connection with new product offerings. If these measures do not succeed, our business could be harmed.

The United Kingdom's departure from the European Union could adversely affect us.

The United Kingdom (U.K.) held a referendum on June 23, 2016 in which a majority of voters approved an exit from the European Union (EU) ("Brexit"). Negotiations are expected to commence to determine the future terms of the U.K.'s relationship with the EU, including, among other things, the terms of trade between the U.K. and the EU. The effects of Brexit will depend on any agreements the U.K. reaches to retain access to EU markets either during a transitional period or more permanently. The outcome

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of this referendum caused volatility in global stock markets and foreign currency exchange rate fluctuations and may continue to do so in the future. Brexit could adversely affect U.K., regional (including European) and worldwide economic and market conditions and could contribute to instability in global financial and foreign exchange markets, including volatility in the value of the British Pound and Euro, which in turn could adversely affect the companies and customers with which we do business, particularly in the U.K. In addition, Brexit could lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which EU laws to replace or replicate. In particular, depending on the terms of Brexit, we may face new regulatory costs and challenges, including the following:

- we could lose our ability for our EU operations to passport into the U.K. market through the banking license of PayPal (Europe) S.à r.l. et Cie, SCA ("PayPal (Europe)"), our wholly-owned subsidiary that is licensed and subject to regulation as a bank in Luxembourg;
- we could be required to obtain additional regulatory licensing to operate in the U.K. market, adding costs and potential inconsistency to our business;
- we could lose our ability to rely on Luxembourg as our lead regulatory authority for certain aspects of our U.K. operations; and
- we could also be required to comply with regulatory requirements in the U.K. that are in addition to, or inconsistent with, the regulatory requirements of the EU.

Any of these effects of Brexit and others we cannot anticipate could adversely affect our business, results of operations, financial condition and cash flows.

Our business is subject to extensive government regulation and oversight, as well as extensive, complex, overlapping and frequently changing rules, regulations and legal interpretations.

Our business is subject to extensive government regulation and oversight. For a discussion of how government regulation impacts key aspects of our business, please see Item I—"Business—Government Regulation" in our Annual Report on Form 10-K for the year ended December 31, 2015. Our business is also subject to laws, rules, regulations, policies and legal interpretations in the markets in which we operate, including (but not limited to) those governing banking, credit, deposit taking, cross-border and domestic money transmission, foreign exchange, privacy, data protection, banking secrecy, payment services (including payment processing and settlement services), consumer protection, economic and trade sanctions, anti-money laundering, and counter-terrorist financing. The legal and regulatory requirements applicable to us are extensive, complex, frequently changing, and increasing in number, and may impose overlapping and/or conflicting requirements or obligations.

Financial and political events have increased the level of regulatory scrutiny on the payments industry, and regulatory agencies may view matters or interpret laws and regulations differently than they have in the past and in a manner adverse to our business. Our success and increased visibility may result in increased regulatory oversight and tighter enforcement of rules and regulations that may apply to our business.

As we expand and localize our international activities, we are increasingly becoming obligated to comply with the laws of the countries or markets in which we operate. In addition, because our services are accessible worldwide and we facilitate sales of goods and provide services to customers worldwide, one or more jurisdictions may claim that we or our customers are required to comply with their laws. Laws regulating the Internet, mobile and related technologies outside of the United States often impose different, more specific, or even conflicting obligations on us, as well as broader liability. For example, certain transactions that may be permissible in a local jurisdiction may be prohibited by regulations of U.S. Department of Treasury's Office of Foreign Assets Control ("OFAC") or U.S. anti-money laundering or counter-terrorist financing regulations.

Any failure or perceived failure to comply with existing or new laws and regulations (including changes to or expansion of the interpretation of those laws and regulations), including those discussed in this risk factor, may subject us to significant fines, penalties, criminal and civil lawsuits, forfeiture of significant assets, and other enforcement actions in one or more jurisdictions; result in additional compliance and licensure requirements; increase regulatory scrutiny of our business; restrict our operations; force us to change our business practices, make product or operational changes or delay planned product launches or improvements. The foregoing could, individually or in the aggregate, expose us to significant liability, impose significant costs, require us to expend substantial resources, increase the cost and complexity of compliance, damage our brand and business, make our products and services less attractive, result in the loss of customers, limit our ability to grow the business, adversely affect our results of operations, and harm our reputation. The complexity of U.S. federal and state regulatory and enforcement regimes, coupled with the global scope of our operations and the evolving global regulatory environment, could result in a single event giving rise to a large number of overlapping investigations and legal and regulatory proceedings by multiple government authorities in different jurisdictions. We have implemented policies and procedures designed to help ensure compliance with applicable laws, and regulations, but there can be no assurance that our employees, contractors, or agents will not violate such laws and regulations.

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Payments Regulation

In the U.S., PayPal, Inc. has obtained licenses to operate as a money transmitter (or its equivalent) in the states where it is required, as well as in the District of Columbia, the U.S. Virgin Islands and Puerto Rico. These licenses include not only the PayPal branded products and services in these states, but also our Venmo and Xoom branded products and services. As a licensed money transmitter, PayPal is subject to restrictions with respect to their investment of customer funds, reporting requirements, bonding requirements and inspection by state regulatory agencies. Accordingly, if we violate these laws or regulations, we could be subject to liability and/or additional restrictions, forced to cease doing business with residents of certain states, forced to change our business practices or be required to obtain additional licenses or regulatory approvals that could impose substantial costs.

While we currently allow our customers with credit cards to send payments from approximately 200 markets, we allow customers in only approximately half of those markets (including the U.S.) to also receive payments, in some cases with significant restrictions on the manner in which customers can withdraw funds. These limitations may affect our ability to grow our business in these markets. Of the markets whose residents can use our PayPal services, almost 30 of them are in member states of the European Union. We provide our services to customers in the European Union through PayPal (Europe) S.à r.l. et Cie, SCA (“PayPal (Europe)”), our wholly-owned subsidiary that is licensed and subject to regulation as a bank in Luxembourg. Accordingly, PayPal (Europe) is subject to significant fines or other enforcement action if it violates the disclosure, reporting, anti-money-laundering, capitalization, fund management, corporate governance, privacy, data protection, information security, banking secrecy, taxation, sanctions, or other requirements imposed on Luxembourg banks. In addition, European Union laws and regulations are typically subject to different and potentially inconsistent interpretations by the countries that are members of the European Union, which can make compliance more costly and operationally difficult to manage.

In Australia, we serve our customers through PayPal Australia Pty. Ltd. (“PayPal Australia”), which is licensed by the Australian Securities and Investments Commission as a provider of a non-cash payment product and by the Australian Prudential Regulation Authority as a purchased payment facility provider, which is a type of authorized depository institution. Accordingly, PayPal Australia is subject to significant fines or other enforcement action if it violates the product disclosure, reporting, anti-money laundering, capital requirements, privacy, corporate governance or other requirements imposed on Australian depository institutions.

In many of the other markets in which we do business, we serve our customers through PayPal Pte. Ltd., our wholly-owned subsidiary that is based in Singapore. PayPal Pte. Ltd. is supervised by the Monetary Authority of Singapore and is designated as a holder of a stored value facility and does not hold a remittance license. As a result, PayPal Pte. Ltd. is not able to offer outbound remittance payments (including donations to charities) from Singapore, and can only offer payments for the purchase of goods and services in Singapore. In many of the markets (other than Singapore) served by PayPal Pte. Ltd., it is unclear and uncertain whether our Singapore-based service is subject only to Singapore law or, if it is subject to the application of local laws, whether such local laws would require a payment processor like us to be licensed as a payments service, bank, financial institution or otherwise.

We are also subject to regulation in other markets in which we do business and we have been and expect to continue to be required to apply for various licenses, certifications and regulatory approvals in a number of the countries where we provide our services. There can be no assurance that we will be able to obtain any such licenses. Even if we were able to obtain such licenses, there are substantial costs and potential product changes involved in maintaining such licenses, and we could be subject to fines or other enforcement action if we are found to violate disclosure, reporting, anti-money laundering, capitalization, corporate governance or other requirements of such licenses. These factors could impose substantial additional costs and involve considerable delay to the development or provision of our products or services, or could require significant and costly operational changes or prevent us from providing any products or services in a given market.

In many other countries it may not be clear whether we are required to be licensed as a payment services provider, bank, financial institution or otherwise. In such markets, we may rely on local banks to process payments and conduct foreign exchange in local currency. Local regulators may use their power to slow or halt payments to local merchants conducted through the local bank or otherwise prohibit us from doing business in a country. Such regulatory actions or the need to obtain licenses, certifications or other regulatory approvals could impose substantial costs, involve considerable delay to the provision or development of our services in, or could require significant and costly operational changes or prevent us from providing any products or services in a given market. For example, in June 2016, we suspended our operations in Turkey following cease and desist instructions from Turkey’s regulatory body, Bankacýlýk Düzenleme Ve Denetleme Kurumu ("BDDK"), following the BDDK’s rejection of our application for an e-money payments license.

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Consumer Protection

The financial services sector is subject to significant regulation and we are subject to consumer protection laws and regulations in the countries in which we operate. In the U.S., we are subject to federal and state consumer protection laws and regulations applicable to our activities, including the Electronic Fund Transfer Act ("EFTA") and Regulation E as implemented by the Consumer Financial Protection Bureau (“CFPB”). Under such regulations we are required to provide advance disclosure of changes to our services, follow specified error resolution procedures, and reimburse consumers for losses from certain transactions not authorized by the consumer, among other requirements. Additionally, technical violations of consumer protection laws could result in the assessment of actual damages or statutory damages or penalties of up to $1,000 in individual cases or up to $500,000 per violation in any class action and treble damages in some instances; we could also be liable for plaintiffs’ attorneys’ fees in such cases. We are subject to, and have paid amounts in settlement of, lawsuits containing allegations that our business violated the EFTA and Regulation E or otherwise advance claims for relief relating to our business practices (e.g., that we improperly held consumer funds or otherwise improperly limited consumer accounts).

On October 5, 2016, the CFPB issued a final rule on prepaid accounts with an effective date of October 1, 2017. The rule’s definition of prepaid account includes certain loadable accounts whose primary function is to conduct transactions with multiple, unaffiliated merchants, at ATMs and/or for person-to-person transfers, including certain digital wallets. The rule’s requirements include: the disclosure of fees and other information to the consumer prior to the creation of a prepaid account; the extension of Regulation E liability limits and error-resolution requirements to all prepaid accounts; the application of Credit Card Accountability Responsibility and Disclosure Act of 2009 credit card requirements to prepaid accounts with overdraft and credit features; and the submission of prepaid account agreements to the CFPB and their publication to the general public. We are evaluating the rule and its requirements. Implementation of the rule could require changes to our business practices, the design of certain products, the allocation of additional resources, and increase our costs, which could negatively affect our business.

In May 2015, we entered into a Stipulated Final Judgment and Consent Order ("Consent Order") with the CFPB in which we settled regulatory claims arising from PayPal Credit practices between 2011 and 2015. The Consent Order included obligations on PayPal to pay $15 million in redress to consumers and a $10 million civil monetary penalty, and required PayPal to make various changes to PayPal Credit disclosures and related business practices. We continue to cooperate and engage with the CFPB and work to ensure compliance with the Consent Order, which may result in us incurring additional costs.

PayPal (Europe) offers its services in European Union countries through a “passport” notification process through the Luxembourg regulator to regulators in other European Union member states pursuant to European Union Directives, and has completed the “passport” notification process in all European Union member countries. The regulators in these countries could notify PayPal (Europe) of local consumer protection laws that apply to its business, in addition to Luxembourg consumer protection law, and could also seek to persuade the Luxembourg regulator to order PayPal (Europe) to conduct its activities in the local country through a branch office. These or similar actions by these regulators could increase the cost of, or delay, our plans to expand our business in European Union countries. In addition, the countries that are members of the European Union may each have different and potentially inconsistent interpretations of regulations implementing the European Union Payment Services Directive and the E-Money Directive, which could make compliance more costly and operationally difficult to manage. The Revised Payment Services Directive (“PSD2”) entered into force in January 2016 and will need to be implemented into national legislation by January 2018. The implementation of the PSD2 may negatively affect our business. Finally, if the assets of PayPal (Europe) exceed certain thresholds, or if the European Central Bank ("ECB") determines that PayPal (Europe) is a significant supervised entity or that some activity of PayPal (Europe) is subject to oversight by the ECB, PayPal (Europe) or certain of its activities could become directly regulated by the ECB in addition to the Luxembourg regulator, the Commission de Surveillance du Secteur Financier, as its national supervisor, which could subject us to additional requirements and would likely increase compliance costs.

Economic and Trade Sanctions

We are subject to U.S. economic and trade sanctions administered by OFAC. We have self-reported to OFAC certain transactions that were inadvertently processed but subsequently identified as possible violations of U.S. economic and trade sanctions. In March 2015, we reached a settlement with OFAC regarding possible violations arising from our sanctions compliance practices between 2009 and 2013, prior to the implementation of our real-time transaction scanning program. Subsequently, we have self-reported additional transactions as possible violations, and we have received new subpoenas from OFAC seeking additional information about certain of these transactions. Such self-reported transactions could result in claims or actions against us, including litigation, injunctions, damage awards, fines or penalties, or require us to change our business practices that could result in a material loss, require significant management time, result in the diversion of significant operational resources or otherwise harm our business.

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Anti-Money Laundering and Counter-Terrorist Financing

We are subject to various anti-money laundering and counter-terrorist financing laws and regulations around the world that prohibit, among other things, our involvement in transferring the proceeds of criminal activities. U.S. and other regulators globally continue to increase their scrutiny of compliance with these obligations, which may require us to further revise or expand our compliance program, including the procedures we use to verify the identity of our customers and to monitor international and domestic transactions. Many countries in which we operate also have anti-money laundering and counter-terrorist financing laws and regulations, and we have been and continue to be required to make changes to our compliance program in various jurisdictions in response. Regulators regularly re-examine the transaction volume thresholds at which we must obtain and keep applicable records or verify identities of customers and any change in such thresholds could result in greater costs for compliance. The European Commission has proposed revisions to the Fourth Anti-Money Laundering Directive, which was recently approved by the European Parliament. The implementation of this directive and the recently-adopted regulation on information accompanying transfer of funds (commonly known as the Revised Wire Transfer Regulation) could make compliance more costly and operationally difficult to manage.

Privacy and Protection of User Data

We are subject to a number of laws, rules and directives (which we refer to as "privacy laws") relating to the collection, use, retention, security, processing and transfer (which we refer to as "process") of personally identifiable information about our customers and employees (which we refer to as "personal data") in the countries where we operate. Much of the personal data that we process, especially financial information, is regulated by multiple privacy laws and, in some cases, the privacy laws of multiple jurisdictions. In many cases, these laws apply not only to third-party transactions, but also to transfers of information between or among us, our subsidiaries, and other parties with which we have commercial relationships.

Regulatory scrutiny of privacy, data protection, collection, use and sharing of data is increasing on a global basis. There is uncertainty associated with the legal and regulatory environment around privacy and data protection laws, which continue to develop in ways we cannot predict. Privacy and data protection laws may be interpreted and applied inconsistently from country to country and impose inconsistent or conflicting requirements. Complying with varying jurisdictional requirements could increase the costs and complexity of compliance or require us to change our business practices in a manner adverse to our business, and violations of privacy and data protection-related laws can result in significant penalties and damage to our brand and business. In addition, compliance with inconsistent privacy laws may restrict our ability to provide products and services to our customers. A determination that there have been violations of privacy or data protection laws could expose us to significant damage awards, fines and other penalties that could, individually or in the aggregate, materially harm our business and reputation.

In October 2015, the European Court of Justice ruled that the U.S.-EU Safe Harbor framework clauses, one compliance method by which companies could transfer personal data regarding citizens of the European Union to the United States, could no longer be relied upon. The U.S. and EU authorities have agreed in principle on a replacement for Safe Harbor known as “Privacy Shield”. The Privacy Shield approach has not been fully ratified by all parties and we anticipate that there may be challenges to this initiative. PayPal has chosen to adopt EU model clauses published by the European Commission as a basis for the export of data from the EU to the U.S. for those parts of our business that had previously relied on Safe Harbor. In addition, because PayPal (Europe) is headquartered in Luxembourg and subject to regulation as a bank in that jurisdiction, we have relied on the “one-stop-shop” concept under which Luxembourg has been our lead data protection regulator in the EU. However, a recent European Court of Justice ruling (Weltimmo) affecting companies that do business in the EU potentially could make us subject to the local data protection laws or regulatory enforcement activities of the various EU member states in which we have established legal entities and which apply privacy laws that are different than, and which may even conflict with, those in Luxembourg.

In addition, because of the large number of text messages, emails, phone calls and other communications we send or make to our customers for various business purposes, communication-related privacy laws that provide a specified monetary damage award or fine for each violation could result in particularly significant damage awards or fines. For example, under the Telephone Consumer Protection Act ("TCPA"), in the U.S., plaintiffs may seek actual monetary loss or statutory damages of $500 per violation, whichever is greater, and courts may treble the damage award for willful or knowing violations. We have been, are, and may continue to be subject to lawsuits (including class-action lawsuits) containing allegations that our business violated the TCPA. These lawsuits seek damages (including statutory damages) and injunctive relief, among other remedies. Given the large number of communications we send to our customers, a determination that there have been violations of the TCPA or other communications-based statutes could expose us to significant damage awards that could, individually or in the aggregate, materially harm our business.

The EU has recently adopted a comprehensive overhaul of its data protection regime from the current national legislative approach to a single European Economic Area Privacy Regulation, the General Data Protection Regulation ("GDPR"), which comes into

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effect in 2018. The proposed EU data protection regime extends the scope of the EU data protection law to all foreign companies processing data of EU residents. It provides for a harmonization of the data protection regulations throughout the EU, thereby making it easier for non-European companies to comply with these regulations. It imposes a strict data protection compliance regime with severe penalties of up to the greater of 4% of worldwide turnover and €20 million and includes new rights such as the “portability” of personal data. Although the GDPR will apply across the EU without a need for local implementing legislation, as has been the case under the current data protection regime, local data protection authorities ("DPAs") will still have the ability to interpret the GDPR, which has the potential to create inconsistencies on a country-by-country basis. We are evaluating the rule and its requirements. Implementation of the GDPR could require changes to certain of our business practices, thereby increasing our costs.
We post on our websites our privacy policies and practices including concerning the collection, use and disclosure of user data. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any applicable regulatory requirements or orders, or privacy, data protection, information security or consumer protection-related privacy laws and regulations in one or more jurisdictions could result in proceedings or actions against us by governmental entities or others, including class action privacy litigation in certain jurisdictions, subject us to significant fines, penalties, judgments and negative publicity, require us to change our business practices, increase the costs and complexity of compliance, and adversely affect our business. Data protection, privacy and information security have become the subject of increasing public, media and legislative concern. If our customers were to reduce their use of our products and services as a result of these concerns, our business could be materially harmed. As noted above, we are also subject to the possibility of security and privacy breaches, which themselves may result in a violation of these privacy laws.

If one or more of our counterparty financial institutions default on their financial or performance obligations to us or fail, we may incur significant losses.

We have significant amounts of cash, cash equivalents and other investments on deposit or in accounts with banks or other financial institutions in the United States and abroad. As part of our currency hedging activities, we enter into transactions involving derivative financial instruments with various financial institutions. Certain banks and financial institutions are also lenders under our revolving credit facility. We regularly monitor our exposure to counterparty credit risk, and actively manage this exposure to mitigate the associated risk. Despite these efforts, we may be exposed to the risk of default by, or deteriorating operating results or financial condition or failure of these counterparty financial institutions. The risk of counterparty default, deterioration or failure may be heightened during economic downturns and periods of uncertainty in the financial markets. If one of our counterparties were to become insolvent or file for bankruptcy, our ability to recover losses incurred as a result of default or our assets that are deposited or held in accounts with such counterparty may be limited by the counterparty’s liquidity or the applicable laws governing the insolvency or bankruptcy proceedings. In the event of default or failure of one or more of our counterparties, we could incur significant losses, which could negatively impact our results of operations and financial condition.

PayPal is not a bank or licensed lender in the United States and relies upon third parties to make loans and provide other products critical to our business.

As PayPal is neither a chartered financial institution nor licensed to make loans in any state, we rely on a third party chartered financial institution to issue the PayPal Credit consumer product in the U.S., and a different chartered financial institution to issue the PayPal Working Capital product in the U.S. Both of these chartered financial institutions are industrial banks chartered by the State of Utah. In the event of a termination or interruption in the ability of the chartered financial institution that currently issues the PayPal Credit consumer product in the U.S. to lend under the PayPal Credit consumer product, our chartered financial institution that issues the PayPal Working Capital product in the U.S. has agreed to take ownership of (and originate loans with respect to) all consumer accounts. Nevertheless, any termination or interruption of either bank’s ability to lend could result in the inability to originate any new PayPal Credit or PayPal Working Capital loans. In the event of either bank's inability to lend, we would either need to reach a similar agreement with another chartered financial institution or obtain our own bank charter or licenses. We may be unable to reach a similar agreement with another partner on favorable terms or at all, and obtaining a bank charter or lending licenses would be a time-consuming and costly process and would subject us to additional laws and regulatory requirements, which could be burdensome and increase our costs. In addition, our commercial relationships with third parties which are federally supervised U.S. financial institutions could subject us to examination by their federal banking regulators with respect to certain services that we provide.

A recent judicial decision by the U.S. Second Circuit Court of Appeals, Madden v. Midland Funding, LLC (786 F.3d 246 (2d Cir. 2015)), concluded that the debt buyer of a charged off credit card account could not rely on the National Bank Act's preemption of state interest rate limits for interest at rates imposed by the debt buyer after charge-off. A petition to the United States Supreme Court to review the decision was denied on June 27, 2016; the case will now be remanded to the lower court to be determined in

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accordance with the ruling of the Second Circuit. The decision has resulted in some uncertainty as to whether non-bank entities purchasing loans originated by a bank may rely on federal preemption of state usury laws, and may create an increased risk of litigation by plaintiffs challenging our ability to collect interest in accordance with the terms of certain of our loans. Although the Madden decision specifically addressed preemption under the National Bank Act, this decision could support future challenges to federal preemption for other institutions, including FDIC-insured, state chartered industrial banks like those that we rely on to issue our loan products in the United States. Although we believe the Madden case can be distinguished from the manner in which we offer our credit products, there can be no assurances as to the outcome of any potential litigation, or that the possible impact of such litigation will not have a material adverse impact on our business. Additionally, certain issues to be decided on remand in the Madden case, including those related to the choice of law provision for the loans, might alleviate some of the uncertainty related to the ruling.

Our failure to manage our customer funds and the assets underlying our customer funds properly could harm our business.

Our ability to manage and account accurately for the assets underlying our customer funds requires a high level of internal controls. As our business continues to grow and we expand our product offerings, we must continue to strengthen our associated internal controls. In March 2016, as approved by the Supervisory Board of our Luxembourg banking subsidiary and as permitted within regulations set forth by the CSSF, we have designated certain European customer balances held in our Luxembourg banking subsidiary to be used to extend credit to our European customers. Our success requires significant public confidence in our ability to properly manage our customers' balances and handle large and growing transaction volumes and amounts of customer funds. Any failure to maintain the necessary controls or to manage our customer funds and the assets underlying our customer funds accurately could result in reputational harm, lead customers to discontinue or reduce their use of our products and result in significant penalties and fines, which could materially harm our business.

Our retail point of sale solutions expose us to additional risks.

We have announced several retail point of sale solutions, which enable merchants to accept payments using a payments card reader attached to, or otherwise communicating with, a mobile device or to scan payment cards and codes using the mobile device's embedded camera, and which enable consumers to use their mobile devices to pay at the point of sale. We recently announced that we have entered into strategic partnerships with Visa and MasterCard to further expand our relationship with each company in a way that will make it easier for merchants to accept and consumers to choose to pay with Visa and MasterCard credit and debit cards. As part of those agreements, we will gain access to each of Visa's and MasterCard's tokenization services in the U.S. for in-store point-of-sale PayPal transactions, which we expect will increase the number of point of sale transactions that we process. As we continue to expand our product and service offerings at the retail point of sale, we will face additional risks, including:

- increased expectations from offline retailers regarding the reliability and availability of our systems and services and correspondingly lower amounts of downtime, which we may not be able to meet;
- significant competition at the retail point of sale, particularly from established payment card providers such as Visa, MasterCard and American Express, many of which have substantially greater resources than we do;
- increased targeting by fraudsters; given that our fraud models are less developed in this area, we may experience increases in fraud and associated transaction losses as we adjust to fraudulent activity at the point of sale;
- exposure to product liability claims to the extent that hardware devices that we produce for use at the retail point of sale malfunction or are not in compliance with laws, which could result in substantial liability and require product recalls or other actions;
- exposure to additional laws, rules and regulations;
- increased reliance on third parties involved with processing in-store payments, including independent software providers, electronic point of sale providers, hardware providers (such as cash register and pin-pad providers), payment processors and banks that enable in-store transactions; and

- lower operating income than our other payment solutions.

Unless we are able to successfully manage these risks, including driving adoption of, and significant volume through, our retail point of sale solutions over time, our business may be harmed.

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Item 2: Unregistered Sales of Equity Securities and Use of Proceeds

In January 2016, our Board of Directors authorized a stock repurchase program that provides for the repurchase of up to $2 billion of our common stock, with no expiration from the date of authorization. This stock repurchase program is intended to offset the impact of dilution from our equity compensation programs and, subject to market conditions and other factors, to be used to make opportunistic repurchases of our common stock to reduce outstanding share count. Any share repurchases under our stock repurchase program may be made through open market transactions, block trades, privately negotiated transactions or other means at times and in such amounts as management deems appropriate and will be funded from our working capital or other financing alternatives. However, any stock repurchases are subject to market conditions and other uncertainties and we cannot predict if or when any stock repurchases will be made. Moreover, we may terminate our stock repurchase program at any time without notice.

The stock repurchase activity under our stock repurchase program during the three months ended September 30, 2016 is summarized as follows:

	Shares Repurchased	Average Price Paid per Share[1]	Value of Shares Repurchased	Remaining Amount Authorized
	(In millions, except per share amounts)			
Period ended July 31, 2016	—	$ 36.99	—	$ 1,104
Period ended August 31, 2016	0.8	$ 36.74	29	$ 1,075
Period ended September 30, 2016	0.5	$ 36.89	20	$ 1,055
	1.3		$ 49	

[1] Average price paid per share includes broker commissions.

These repurchased shares of common stock were recorded as treasury stock and were accounted for under the cost method. No repurchased shares of common stock have been retired.

Item 3: Defaults Upon Senior Securities

Not applicable.

Item 4: Mine Safety Disclosures

Not applicable.

Item 5: Other Information

Not applicable.

Item 6: Exhibits

The information required by this Item is set forth in the Index of Exhibits that follows the signature page of this Quarterly Report.

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SIGNATURES

Pursuant to the requirements 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.

PayPal Holdings, Inc.
Principal Executive Officer:

By: /s/ Daniel H. Schulman
Daniel H. Schulman
President and Chief Executive Officer

Date: October 25, 2016

Principal Financial Officer:

By: /s/ John D. Rainey
John D. Rainey
Executive Vice President, Chief Financial Officer

Date: October 25, 2016

Principal Accounting Officer:

By: /s/ Aaron A. Anderson
Aaron A. Anderson
Vice President, Chief Accounting Officer

Date: October 25, 2016

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INDEX TO EXHIBITS

Exhibit 31.01	Certification of Registrant's Chief Executive Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.02	Certification of Registrant's Chief Financial Officer, as required by Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.01	Certification of Registrant's Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.02	Certification of Registrant's Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document