ROYAL BANK OF SCOTLAND GROUP PLC
Form 20-F
March 27, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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**FORM 20-F**

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2016**

**OR**

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

**OR**

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 001-10306

**THE ROYAL BANK OF SCOTLAND GROUP plc**

(Exact name of Registrant as specified in its charter)

**United Kingdom**

(Jurisdiction of incorporation)

**RBS Gogarburn, PO Box 1000, Edinburgh EH12 1HQ, United Kingdom**

(Address of principal executive offices)

**Aileen Taylor, Chief Governance Officer and Board Counsel, Tel: +44 (0) 131 626 4099, Fax: +44 (0) 131 626 3081**

**PO Box 1000, Gogarburn, Edinburgh EH12 1HQ**

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

| Title of each class | Name of each exchange on which registered |
| --- | --- |
| American Depositary Shares, each representing 2 ordinary shares, nominal value £1 per share | New York Stock Exchange |
| Ordinary shares, nominal value £1 per share | |
| | New York Stock Exchange* |
| American Depositary Shares Series F, H, L, S, and U each representing one Non-Cumulative Dollar Preference Share, Series F, H, L, S, and U respectively | |
| | New York Stock Exchange |
| Dollar Perpetual Regulatory Tier 1 Securities | |
| | New York Stock Exchange |
| Floating Rate Senior Notes due 2017 | |
| | New York Stock Exchange |
| 1.875% Senior Notes due 2017 | |
| | New York Stock Exchange |
| 4.70% Subordinated Notes due 2018 | |
| | New York Stock Exchange |
| 5.625% Senior Notes due 2020 | |
| | New York Stock Exchange |
| 6.125% Senior Notes due 2021 | |
| | New York Stock Exchange |
| 6.125% Subordinated Tier 2 Notes due 2022 | |
| | New York Stock Exchange |
| 6.000% Subordinated Tier 2 Notes due 2023 | |
| | New York Stock Exchange |
| 6.100% Subordinated Tier 2 Notes due 2023 | |
| | New York Stock Exchange |
| 5.125% Subordinated Tier 2 Notes due 2024 | |
| | NYSE MKT |
| Leveraged CPI Linked Securities due January 13, 2020 | |

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* Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares pursuant to the requirements of the Securities and Exchange Commission.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

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**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

| | |
|---|---|
| Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2020 | Irish Stock Exchange |
| Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2021 | Irish Stock Exchange |
| Perpetual Subordinated Contingent Convertible Additional Tier 1 Capital Notes callable 2025 | Irish Stock Exchange |

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of December 31, 2016, the close of the period covered by the annual report:

| (Title of each class) | (Number of outstanding shares) |
|---|---|
| Ordinary shares of £1 each | 11,823,163,184 |
| 11% cumulative preference shares | 500,000 |
| 5½% cumulative preference shares | 400,000 |
| Non-cumulative dollar preference shares, Series F, H, L and S to U | 72,430,109 |
| Non-cumulative convertible dollar preference shares, Series 1 | 64,772 |
| Non-cumulative euro preference shares, Series 1 to 3 | 2,044,418 |
| Non-cumulative convertible sterling preference shares, Series 1 | 14,866 |
| Non-cumulative sterling preference shares, Series 1 | 54,442 |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

x Yes ¨ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

¨ Yes x No

*Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.*

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.

x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 ¨ No

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

Large accelerated filer x Accelerated filer ¨ Non-Accelerated filer ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

¨ U.S. GAAP

x International Financial Reporting Standards as issued by the International Accounting Standards Board

¨ Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

¨ Yes x No

**SEC Form 20-F cross reference guide**


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| **1** | Identity of Directors, Senior Management and Advisers | Not applicable |
| **2** | Offer Statistics and Expected Timetable | Not applicable |
| **3** | Key Information | |
| | Selected financial data | 174, 216-217, 378-384, 492-504 |
| | Capitalisation and indebtedness | Not applicable |
| | Reasons for the offer and use of proceeds | Not applicable |
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| | Organisational structure | 3, 156, 242-245, Exhibit 8. |
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| **4a** | Unresolved Staff Comments | Not applicable |
| **5** | Operating and Financial Review and Prospects | 5-23, 47-49, 50-52, 54-55, 56, 174-217, 349-374<br>402-406, 475 |
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| | Liquidity and capital resources | 213-217, 242-254, 255-269, 380, 384, 435-438, 447-448 |
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| | Dilution * | Not applicable |
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| | Material contracts | 505-507 |
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| | Statement of experts | Not applicable |
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| **12** | Description of Securities other than Equity Securities | 507-508 |

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| PART II | | |
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| **14** | Material Modifications to the Rights of Security Holders and Use of Proceeds | Not applicable |
| **15** | Controls and Procedures | 13-1, 80, 85, 150-151, 152-153, Exhibits 12.1, 12.2 |
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| **16f** | Change in Registrant’s Certifying Accountant | Not applicable |
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## Forward looking statements

### Cautionary statement regarding forward-looking statements

Certain sections in this document contain ‘forward-looking statements’ as that term is defined in the United States Private Securities Litigation Reform Act of 1995, such as statements that include the words ‘expect’, ‘estimate’, ‘project’, ‘anticipate’, ‘commit’, ‘believe’, ‘should’, ‘intend’, ‘plan’, ‘could’, ‘probability’, ‘risk’, ‘Value-at-Risk (VaR)’, ‘target’, ‘goal’, ‘objective’, ‘may’, ‘endeavour’, ‘outlook’, ‘optimistic’, ‘prospects’ and similar expressions or variations on these expressions.

In particular, this document includes forward-looking statements relating, but not limited to: future profitability and performance, including financial performance targets such as return on tangible equity; cost savings and targets, including cost:income ratios; litigation and government and regulatory investigations, including the timing and financial and other impacts thereof; structural reform and the implementation of the UK ring-fencing regime; the implementation of RBS’s transformation programme, including the further restructuring of the NatWest Markets business; the satisfaction of the Group’s residual EU State Aid obligations; the continuation of RBS’s balance sheet reduction programme, including the reduction of risk-weighted assets (RWAs) and the timing thereof; capital and strategic plans and targets; capital, liquidity and leverage ratios and requirements, including CET1 Ratio, RWA equivalents (RWAe), Pillar 2 and other regulatory buffer requirements, minimum requirement for own funds and eligible liabilities, and other funding plans; funding and credit risk profile; capitalisation; portfolios; net interest margin; customer loan and income growth; the level and extent of future impairments and write-downs, including with respect to goodwill; restructuring and remediation costs and charges; future pension contributions; RBS’s exposure to political risks, operational risk, conduct risk, cyber and IT risk and credit rating risk and to various types of market risks, including as interest rate risk, foreign exchange rate risk and commodity and equity price risk; customer experience including our Net Promotor Score (NPS); employee engagement and gender balance in leadership positions.

### Limitations inherent to forward-looking statements

These statements are based on current plans, estimates, targets and projections, and are subject to significant inherent risks, uncertainties and other factors, both external and relating to the Group’s strategy or operations, which may result in the Group being unable to achieve the current targets, predictions, expectations and other anticipated outcomes expressed or implied by such forward-looking statements. In addition certain of these disclosures are dependent on choices relying on key model characteristics and assumptions and are subject to various limitations, including assumptions and estimates made by management. By their nature, certain of these disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated. Accordingly, undue reliance should not be placed on these statements. Forward-looking statements speak only as of the date we make them and we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Group’s expectations with

regard thereto or any change in events, conditions or circumstances on which any such statement is based.

### Important factors that could affect the actual outcome of the forward-looking statements

We caution you that a large number of important factors could adversely affect our results or our ability to implement our strategy, cause us to fail to meet our targets, predictions, expectations and other anticipated outcomes or affect the accuracy of forward-looking statements we describe in this document including in the risk factors set as set out on pages 509 to 578 and other uncertainties discussed in this document. These include the significant risks for RBS presented by the outcomes of the legal, regulatory and governmental actions and investigations that RBS is or may be subject to (including active civil and criminal investigations) and any resulting material adverse effect on RBS of unfavourable outcomes and the timing thereof (including where resolved by settlement); economic, regulatory and political risks, including as may result from the uncertainty arising from the EU Referendum; RBS's ability to satisfy its residual EU State Aid obligations and the timing thereof; RBS's ability to successfully implement the significant and complex restructuring required to be undertaken in order to implement the UK ring-fencing regime and related costs; RBS's ability to successfully implement the various initiatives that are comprised in its transformation programme, particularly the proposed further restructuring of the NatWest Markets business, the balance sheet reduction programme and its significant cost-saving initiatives and whether RBS will be a viable, competitive, customer focused and profitable bank especially after its restructuring and the implementation of the UK ring-fencing regime; the exposure of RBS to cyber-attacks and its ability to defend against such attacks; RBS's ability to achieve its capital and leverage requirements or targets which will depend in part on RBS's success in reducing the size of its business and future profitability as well as developments which may impact its CET1 capital including additional litigation or conduct costs, additional pension contributions, further impairments or accounting changes; ineffective management of capital or changes to regulatory requirements relating to capital adequacy and liquidity or failure to pass mandatory stress tests; RBS's ability to access sufficient sources of capital, liquidity and funding when required; changes in the credit ratings of RBS, RBS entities or the UK government; declining revenues resulting from lower customer retention and revenue generation in light of RBS's strategic refocus on the UK; as well as increasing competition from new incumbents and disruptive technologies.



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## Forward looking statements

In addition, there are other risks and uncertainties that could adversely affect our results, ability to implement our strategy, cause us to fail to meet our targets or the accuracy of forward-looking statements in this document. These include operational risks that are inherent to RBS's business and will increase as a result of RBS's significant restructuring initiatives being concurrently implemented; the potential negative impact on RBS's business of global economic and financial market conditions and other global risks; the impact of a prolonged period of low interest rates or unanticipated turbulence in interest rates, yield curves, foreign currency exchange rates, credit spreads, bond prices, commodity prices, equity prices; basis, volatility and correlation risks; the extent of future write-downs and impairment charges caused by depressed asset valuations; deteriorations in borrower and counterparty credit quality; heightened regulatory and governmental scrutiny and the increasingly regulated environment in which RBS operates as well as divergences in regulatory requirements in the jurisdictions in which RBS operates; the risks relating to RBS's IT systems or a failure to protect itself and its customers against cyber threats, reputational risks; risks relating to increased pension liabilities and the impact of pension risk on RBS's capital position; risks relating to the failure to embed and maintain a robust conduct and risk culture across the organisation or if its risk management framework is ineffective; RBS's ability to attract and retain qualified personnel; limitations on, or additional requirements imposed on, RBS's activities as a result of HM Treasury's investment in RBS; the value and effectiveness of any credit protection purchased by RBS; risks relating to the reliance on valuation, capital and stress test models and any inaccuracies resulting therefrom or failure to accurately reflect changes in the micro and macroeconomic environment in which RBS operates, risks relating to changes in applicable accounting policies or rules which may impact the preparation of RBS's financial statements or adversely impact its capital position; the impact of the recovery and resolution framework and other prudential rules to which RBS is subject; the recoverability of deferred tax assets by the Group; and the success of RBS in managing the risks involved in the foregoing.

The forward-looking statements contained in this document speak only as at the date hereof, and RBS does not assume or undertake any obligation or responsibility to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The information, statements and opinions contained in this document do not constitute a public offer under any applicable legislation or an offer to sell or solicit of any offer to buy any securities or financial instruments or any advice or recommendation with respect to such securities or other financial instruments.



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## Presentation of information

In this document, and unless specified otherwise, the term ‘company’ or ‘RBSG’ means The Royal Bank of Scotland Group plc, ‘RBS’, ‘RBS Group’ or the ‘Group’ means the company and its subsidiaries, ‘the Royal Bank’ or ‘RBS plc’ means The Royal Bank of Scotland plc and ‘NatWest’ means National Westminster Bank Plc.

The company publishes its financial statements in pounds sterling (‘£’ or ‘sterling’). The abbreviations ‘£m’ and ‘£bn’ represent millions and thousands of millions of pounds sterling, respectively, and references to ‘pence’ represent pence in the United Kingdom (‘UK’). Reference to ‘dollars’ or ‘$’ are to United States of America (‘US’) dollars. The abbreviations ‘$m’ and ‘$bn’ represent millions and thousands of millions of dollars, respectively, and references to ‘cents’ represent cents in the US. The abbreviation ‘€’ represents the ‘euro’, and the abbreviations ‘€m’ and ‘€bn’ represent millions and thousands of millions of euros, respectively.

### Non-GAAP financial information

RBS prepares its financial statements in accordance with IFRS as issued by the IASB which constitutes a body of generally accepted accounting principles (‘GAAP’). This document contains a number of non-GAAP (or non-IFRS) financial measures. A non-GAAP financial measure is defined as one that measures historical or future financial performance, financial position or cash flows but which excludes or includes amounts that would not be so adjusted in the most comparable GAAP measure.

The non-GAAP measures used in this document generally exclude certain items which management believe are not representative of the underlying performance of the business and which distort period-on-period comparison. These measures are used internally by management, in conjunction with IFRS financial measures, to measure performance and make decisions regarding the future direction of the business. Management believes these non-GAAP measures, when provided in combination with reported IFRS results, provide helpful supplementary information for investors. These adjusted measures, derived from the reported results are non-IFRS financial measures but are not a substitute to IFRS reported measures.

The main non-GAAP measures used in this document include:

- ‘Adjusted’ measures of financial performance, principally operating profit, operating expenses, total income and other performance measures before: own credit adjustments; gain or loss on redemption of own debt; strategic disposals, restructuring costs, litigation and conduct costs and write down of goodwill. RFS Holdings minority interest (RFS MI) was shown separately for 2014 only;

- Certain performance ratios based on the adjusted performance measures described above, including the adjusted cost:income ratio (calculated using adjusted operating income and costs), adjusted return on equity ratio (calculated using adjusted operating profit) and the 2016 cost saving progress and targets (calculated using operating expenses excluding litigation and conduct costs, restructuring costs, write down of goodwill, the impairment of other intangible assets, the operating costs of Williams & Glyn and the VAT recovery);

- Personal & Business Banking (PBB) franchise results, combining the reportable segments of UK Personal & Business Banking (UK PBB) and Ulster Bank RoI, Commercial & Private Banking (CPB) franchise results, combining the reportable segments of Commercial Banking, Private Banking and RBS International (RBSI) and 'core bank' results combining PBB, CPB and NatWest Markets results which are presented to provide investors with a summary of the Group's business performance (see page 172 for further business descriptions); and

Reconciliations of these non-GAAP measures to the closest equivalent GAAP measure are presented throughout this document and in the 2016 performance on page 6.

## Key operating indicators

This document includes a number of operational metrics which management believes may be helpful to investors in understanding the Group's business, including the Groups position against its own targets. These metrics include performance, funding and credit metrics such as 'return on tangible equity' and related RWA equivalents incorporating the effect of capital deductions (RWAes), total assets excluding derivatives (funded assets) and net interest margin (NIM) adjusted for items designated at fair value through profit or loss (non-statutory NIM), cost:income ratio, loan:deposit ratio and REIL/impairment provision ratios. These are internal metrics used to measure business performance.

## Capital and liquidity measures

Certain liquidity and capital measures and ratios are presented in this document as management believes they are helpful for investors' understanding of the liquidity and capital profile of the business and the Group's position against its own targets and applicable regulatory requirements. Some of these measures are used by management for risk management purposes and may not yet required to be disclosed by a government, governmental authority or self-regulatory organisation. As a result, the basis of calculation of these measures may not be the same as that used by the Group's peers. These capital and liquidity measures and ratios include: the liquidity coverage ratio, stressed outflow coverage and net stable funding ratio.

## Transfers

The year on year comparison of the Commercial Banking results is affected by a number of internal business transfers which took place in 2015 and 2016. In line with changes to the business model, the UK and Western European corporate loan portfolios were transferred to Commercial Banking in Q2 2015 and

Q4 2015. Ulster Bank NI transferred Q1 2016 and a transfer of clients to Retail Q2 2016. The prior period financials were not restated.



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## Presentation of information

## Recent developments

### Board Appointment

RBS announced on 24 February 2017 that Mark Seligman has been appointed as a Non-executive Director with effect from 1 April 2017.

### Payment Protection Insurance (PPI)

On 2 March 2017, the FCA published Policy Statement 17/3 containing its final rules and guidance on PPI complaint handling. The Policy Statement made clear the FCA's intention to implement a two year PPI complaints deadline with effect from 29 August 2017, bringing an end to new PPI complaints in August 2019. New rules for the handling of Plevin complaints will also come into force on 29 August 2017. The proposals in the Policy Statement are largely as previously anticipated and RBS does not currently consider that an additional provision will be required.

### London Interbank Offered Rate (LIBOR)

As previously disclosed, certain members of the Group have been named as defendants in US class actions relating to alleged manipulation of various interest rate benchmarks, each of which is pending in the United States District Court for the Southern District of New York. On 10 March 2017, the court in the action relating primarily to over-the-counter derivatives allegedly linked to JPY LIBOR and Euroyen TIBOR dismissed the case on the ground that the plaintiffs lack standing. The dismissal by the court may be subject to appeal.

### Claim by the US Federal Deposit Insurance Corporation

On 10 March 2017, the US Federal Deposit Insurance Corporation, on behalf of 39 failed US banks, issued a claim in the High Court of Justice of England and Wales against RBS, other LIBOR panel banks and the British Bankers' Association, alleging collusion with respect to the setting of USD LIBOR. The action alleges that the defendants breached English and European competition law as well as asserting common law claims of fraud under US law.

### Regulator requests concerning certain historic Russian transactions

Recent media coverage has highlighted an alleged money laundering scheme involving Russian entities between 2010 and 2014. Allegedly certain European banks, including 17 UK based financial institutions, and certain US banks, were involved in processing certain transactions associated with this scheme.

In common with other banks, in March 2017 RBS received a request for information from the FCA in relation to this matter. RBS has also received similar requests from regulators in other jurisdictions. RBS has responded to the FCAnd six months ended June 30, 2007, (losses) gains of $(0.2) million and $0.3 million, respectively, were reclassified from Accumulated other comprehensive loss to earnings in connection with the sale of the underlying securities compared to losses of $(0.3) million and $(0.5) million for the three and six months ended June 30, 2006, respectively.

Gross realized gains and losses on sales of investments, using the specific identification method, and other-than-temporary impairments were as follows:

| | **Three Months Ended June 30** | | **Six Months Ended June 30** | |
|---|---|---|---|---|
| ***(Amounts in Thousands)*** | **2007** | **2006** | **2007** | **2006** |
| Gross realized gains | $ 136 | $ 1,210 | $ 3,929 | $ 2,848 |
| Gross realized losses | | (3) | (1,951) | (1,268) |
| Other-than-temporary impairments | (517) | (1,647) | (1,495) | (2,439) |
| Net securities gains (losses) | $(381) | $ (440) | $ 483 | $ (859) |

Impairments in the three and six months ended June 30, 2007 related to investments backed by home equity loans. Impairments in the three and six months ended June 30, 2006 related primarily to investments backed by automobile, aircraft and manufactured housing collateral.

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At June 30, 2007, the available-for-sale investment portfolio had the following aged unrealized losses:

| | Less than 12 months | | 12 months or More | | Total | |
|---|---|---|---|---|---|---|
| *(Amounts in Thousands)* | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of states and political subdivisions | $ 5,187 | $ (89) | $ 5,137 | $ (206) | $ 10,324 | $ (295) |
| Commercial mortgage-backed securities | 134,224 | (5,264) | 33,547 | (534) | 167,771 | (5,798) |
| Residential mortgage-backed securities | 355,173 | (5,264) | 1,021,609 | (27,115) | 1,376,782 | (32,379) |
| Other asset-backed securities | 1,216,468 | (57,358) | 293,156 | (10,676) | 1,509,624 | (68,034) |
| U.S. government agencies | 29,762 | (239) | 320,465 | (7,234) | 350,227 | (7,473) |
| Corporate debt securities | 29,501 | (4) | 14,345 | (657) | 43,846 | (661) |
| Preferred and common stock | 5,494 | (213) | 12,570 | (1,896) | 18,064 | (2,109) |
| | $1,775,809 | $(68,431) | $1,700,829 | $(48,318) | $3,476,638 | $(116,749) |

At December 31, 2006, the available-for-sale investment portfolio had the following aged unrealized losses:

| | Less than 12 months | | 12 months or More | | Total | |
|---|---|---|---|---|---|---|
| *(Amounts in Thousands)* | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of states and political subdivisions | $ 22,467 | $ (180) | $ 25,075 | $ (310) | $ 47,542 | $ (490) |
| Commercial mortgage-backed securities | 97,747 | (812) | 110,859 | (1,336) | 208,606 | (2,148) |
| Residential mortgage-backed securities | 173,179 | (653) | 1,213,278 | (22,566) | 1,386,457 | (23,219) |
| Other asset-backed securities | 292,742 | (2,066) | 318,944 | (5,773) | 611,686 | (7,839) |
| U.S. government agencies | | | 321,117 | (6,589) | 321,117 | (6,589) |
| Corporate debt securities | 6,306 | (7) | 60,832 | (463) | 67,138 | (470) |
| Preferred and common stock | 5,663 | (45) | 12,173 | (2,292) | 17,836 | (2,337) |
| | $598,104 | $(3,763) | $2,062,278 | $(39,329) | $2,660,382 | $(43,092) |

The Company has determined that the unrealized losses reflected above represent temporary impairments. As of June 30, 2007 and December 31, 2006, 167 and 188 securities had unrealized losses for more than 12 months, respectively. The Company believes that the unrealized losses generally are caused by liquidity discounts and risk premiums required by market participants in response to temporary market conditions, rather than a fundamental weakness in the credit quality of the issuer or underlying assets or changes in the expected cash flows from the investments. Temporary market conditions at June 30, 2007 and December 31, 2006 are primarily due to changes in interest rates and credit spreads due to market conditions caused by subprime mortgages and excess leverage in the

credit market. The Company regularly monitors its investment portfolio to ensure that investments that may be other-than-temporarily impaired are identified in a timely manner and that any impairments are charged against earnings in the proper period. Pursuant to the Company s impairment review process, changes in individual security values are regularly monitored to identify potential impairment indicators. The process includes a monthly review of all securities using a screening process to identify those securities for which fair value falls below established thresholds for certain time periods, or which are identified through other monitoring criteria such as ratings downgrades. Given the facts and circumstances, the Company has determined the securities presented in the above unrealized loss table were temporarily impaired when evaluated at June 30, 2007. The Company has both the intent and ability to hold these investments to maturity.

Of the $116.7 million of unrealized losses at June 30, 2007, $5.1 million relate to four asset-backed securities which each have an unrealized loss greater than 20 percent of amortized cost. The remaining $111.6 million of unrealized losses at June 30, 2007 relate to securities with an unrealized loss position of less than 20 percent of amortized cost, the degree of which suggests that these securities do not pose a high risk of being or becoming other than temporarily impaired. Of the $111.6 million, $90.5 million relate to unrealized losses on investment grade securities. Investment grade is defined as a security having a Moody s equivalent rating of Aaa, Aa, A or Baa or a Standard & Poor s or Fitch equivalent rating of AAA, AA, A or BBB. The remaining $21.1 million is comprised of $17.5 million of U.S. government agency and fixed income securities and $3.6 million of asset-backed securities. These securities were evaluated considering factors such as the financial condition and near-term and long-term prospects of the issuer and deemed to be temporarily impaired.

The Company holds securities that are collateralized by subprime mortgages which are classified in Other asset-backed securities. At June 30, 2007, $384.0 million, or less than 7 percent of the fair value of the Company s investment portfolio, had direct exposure to subprime mortgages as collateral. Approximately 12 percent, 43 percent and 42 percent of the $384.0 million had a credit rating of AAA, AA and A, respectively. In addition, 88 percent of the $384.0 million is exposed to subprime mortgages originated prior to 2006, which is significant as the loss experience in pre-2006 collateral appears to be much lower than more recent vintages of subprime mortgages. Approximately 1 percent, 10 percent, 19 percent, 39 percent and 31 percent of the $384.0 million of these other asset-backed securities originated in 2007, 2006, 2005, 2004 and 2003 and earlier.

At June 30, 2007, other asset-backed securities had gross unrealized losses of $68.0 million, which includes gross unrealized losses of $6.6 million for securities with direct exposure to subprime mortgages as collateral. These unrealized losses are included in the Consolidated Balance Sheet in Accumulated other comprehensive loss.

Also included in the fair value of Other asset-backed securities is $620.1 million of collateralized debt obligations ( CDO ) which are backed by diversified collateral pools that may include subprime mortgages of various vintages. At June 30, 2007, 36 percent, 27 percent and 30 percent of the $620.1 million of these CDOs had a credit rating of AAA, AA and A, respectively.

**5. Derivative Financial Instruments**

The notional amount of the Company s swap agreements totaled $1.8 billion and $2.6 billion at June 30, 2007 and December 31, 2006, respectively, with an average fixed pay rate of 4.3 percent and an average variable receive rate of 5.2 percent at both June 30, 2007 and December 31, 2006, respectively. The variable rate portion of the swaps is generally based on Treasury bill, federal funds or 6-month LIBOR. As the swap payments are settled, the net difference between the fixed amount the Company pays and the variable amount the Company receives is reflected in the Consolidated Statements of Income in Investment commissions expense. The amount recognized in earnings due to ineffectiveness of the cash flow hedges was not material for the three and six months ended June 30, 2007 and 2006. As of June 30, 2007, the Company estimates that $6.9 million (net of tax) of the unrealized gain included in Accumulated other comprehensive loss in the Consolidated Balance Sheet will be recognized in the Consolidated Statement of Income in Investment commissions expense within the next 12 months as the swap payments are settled.

**6. Sale of Receivables**

The balance of sold receivables as of June 30, 2007 and December 31, 2006 was $328.2 million and $297.6 million, respectively. The average receivables sold totaled $369.7 million and $369.9 million during the three and six months ended June 30, 2007, respectively, and $374.8 million and $383.8 million during the three and six months ended June 30, 2006, respectively. The expense of selling the agent receivables is included in the Consolidated Statements of Income in Investment commissions expense and totaled $5.9 million and $12.0 million for the three and six months ended June 30, 2007, respectively, and $5.9 million and $11.6 million for the three and six months ended June 30, 2006, respectively.

**7. Income Taxes**

The Company adopted the provisions of Financial Accounting Standards Board ( FASB ) Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes,* on January 1, 2007. The cumulative effect of applying FIN No. 48 is reported as an adjustment to the opening balance of retained income. As a result of the implementation of FIN No. 48, the Company recognized a $29.6 million increase in the liability for unrecognized tax benefits, a $7.6 million increase in deferred tax assets and a $22.0 million reduction to the opening balance of retained income. The $29.6 million increase in the liability for unrecognized tax benefits is recorded as a non-cash item in Accounts payable and other liabilities in the Consolidated Balance Sheets.

As of January 1, 2007, the liability for unrecognized tax benefits was $39.1 million, which is included in Accounts payable and other liabilities in the Consolidated Balance Sheets. Of the $39.1 million, $31.4 million could impact the effective tax rate if recognized. The balance at January 1, 2007 includes $5.7 million for interest and penalties. The Company records interest and penalties for unrecognized tax benefits in Income tax expense in the Consolidated Statements of Income. During the three and six months ended June 30, 2007, the Company recognized $0.8 million and $1.6 million in interest and penalties, respectively.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state and local, or foreign income tax examinations for years prior to 2001. The Company is currently subject to certain state and foreign income tax examinations for 2001 through 2004.



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The effective tax rate was 32.4 percent for the three and six months ended June 30, 2007 and 2006, respectively, compared to 29.2 percent and 30.6 percent for the three and six months ended June 30, 2006, respectively. The increase in the effective rate is due to tax exempt investment income declining as a percentage of total pre-tax income.

**8. Stockholders Equity**

The Company has 12.0 million shares authorized for repurchase including 5.0 million shares approved by the Board of Directors on May 9. 2007. During the three and six months ended June 30, 2007, the Company repurchased 650,000 shares and 1,150,000 shares of its common stock at an average cost of $28.89 per share and $29.14 per share, respectively. As of June 30, 2007, the Company had repurchased 6.3 million shares under the authorization and has remaining authorization to purchase up to 5.7 million shares. Following is a summary of common stock issued and outstanding:

| *(Amounts in thousands)* | **June 30, 2007** | **December 31, 2006** |
|---|---|---|
| Common shares issued | 88,556 | 88,556 |
| Treasury stock | (5,517) | (4,286) |
| Restricted stock | (246) | (323) |
| Shares held in employee equity trust | (102) | (456) |
| Common shares outstanding | 82,691 | 83,491 |

Following is a summary of treasury stock share activity during the six months ended June 30, 2007:

| *(Amounts in thousands)* | **Treasury Stock Shares** |
|---|---|
| Balance at December 31, 2006 | 4,286 |
| Stock repurchases | 1,150 |
| Submission of shares for withholding taxes upon exercise of stock options and release of restricted stock | 81 |
| Balance at June 30, 2007 | 5,517 |

The Company has an employee equity trust (the Trust ) used to fund the issuance of shares under employee compensation and benefit plans. The fair value of the shares held by the Trust is recorded in the Unearned employee benefits component in the Consolidated Balance Sheets and is reduced as shares are released to fund employee benefits. During the six months ended June 30, 2007, the Company released 354,256 shares upon the exercise of stock options and the vesting of restricted stock.

The components of accumulated other comprehensive loss include:

| *(Amounts in thousands)* | **June 30, 2007** | **December 31, 2006** |
|---|---|---|
| Unrealized (loss) gain on securities classified as available-for-sale | $(36,534) | $ 24,607 |
| Unrealized gain on derivative financial instruments | 13,875 | 11,345 |
| Cumulative foreign currency translation adjustments | 6,914 | 6,011 |

| | | |
|---|---|---|
| Prior service cost for pension and postretirement benefits, net of tax | (1,056) | (1,115) |
| Unrealized losses on pension and postretirement benefits, net of tax | (45,816) | (47,140) |
| Accumulated other comprehensive loss | $(62,617) | $ (6,292) |

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**9. Pensions and Other Benefits**

Net periodic pension benefit expense for the Company s defined benefit pension plan and the combined supplemental executive retirement plans ( SERPs ) includes the following components:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in thousands)* | **2007** | **2006** | **2007** | **2006** |
| Service cost | $ 574 | $ 480 | $ 1,149 | $ 960 |
| Interest cost | 2,975 | 2,896 | 5,950 | 5,792 |
| Expected return on plan assets | (2,521) | (2,231) | (5,042) | (4,462) |
| Amortization of prior service cost | 121 | 176 | 242 | 352 |
| Recognized net actuarial loss | 1,057 | 1,080 | 2,113 | 2,160 |
| Net periodic pension cost | $ 2,206 | $ 2,401 | $ 4,412 | $ 4,802 |

Benefits paid through the defined benefit pension plan and the combined SERPs were $4.0 million for the three months ended June 30, 2007 and 2006, respectively, and $8.1 million and $8.0 million for the six months ended June 30, 2007 and 2006, respectively. The Company made contributions to the combined SERPs totaling $0.9 million and $1.8 million during the three and six months ended June 30, 2007, respectively. No contributions were made to the defined benefit pension plan during the three and six months ended June 30, 2007. The Company made contributions to the defined benefit pension plan and the combined SERPs totaling $4.0 million and $6.9 million during the three and six months ended June 30, 2006.

The net loss and prior service cost for the defined benefit pension plan and SERPs that the Company amortized from Accumulated other comprehensive loss into net periodic benefit expense was $1.1 million ($0.7 million, net of tax) and $0.1 million (less than $0.1 million, net of tax), respectively, during the three months ended June 30, 2007 and $2.1 million ($1.3 million, net of tax) and $0.2 million ($0.1 million, net of tax), respectively, during the six months ended June 30, 2007.

Net periodic benefit expense for the Company s defined benefit postretirement plan includes the following components:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in thousands)* | **2007** | **2006** | **2007** | **2006** |
| Service cost | $174 | $159 | $ 349 | $ 318 |
| Interest cost | 209 | 179 | 418 | 358 |
| Amortization of prior service cost | (74) | (74) | (147) | (148) |
| Recognized net actuarial loss | 23 | 6 | 45 | 12 |
| Net periodic benefit expense | $332 | $270 | $ 665 | $ 540 |

Benefits paid through, and contributions made to, the defined benefit postretirement plan were $0.2 million and less than $0.1 million during the three months ended June 30, 2007 and 2006, respectively, and $0.2 million and $0.1 million during the six months ended June 30, 2007 and 2006, respectively.

The net loss and prior service credit for the defined benefit postretirement plan amortized from Accumulated other comprehensive loss into net periodic benefit expense was nominal during the three and six months ended June 30, 2007.

Contribution expense for the 401(k) defined contribution plan totaled $0.8 million and $0.7 million for the three months ended June 30, 2007 and 2006, respectively, and $1.6 million and $1.3 million for the six months ended June 30, 2007 and 2006, respectively. In addition, the Company made discretionary profit sharing contributions to the 401(k) defined contribution plan totaling $2.5 million and $2.1 million during the six months ended June 30, 2007 and 2006, respectively.

**10. Debt**

On June 30, 2007 and December 31, 2006, the interest rate under the Company s bank credit facility was 5.86 percent, exclusive of the effect of commitment fees and other costs, and the facility fee was 0.125 percent. At June 30, 2007 and December 31, 2006, the interest rate debt swaps used to hedge the cash flows of the Company s variable rate debt had an average fixed pay rate of 4.3 percent and an average variable receive rate of 4.7 percent and 4.6 percent, respectively. See Note 5 for further information regarding the Company s portfolio of derivative financial instruments.

**11. Stock-Based Compensation**

Option awards are granted with an exercise price equal to the quoted market price (average of the high and low price) of the Company s common stock on the date of grant. Stock options granted in 2007 become exercisable over a three-year period in equal installments and have a term of ten years. For purposes of determining the fair value of stock option awards, the Company uses the Black-Scholes single option pricing model and the assumptions set forth in the following table. Expected volatility is based on the historical volatility of the price of the Company s common stock since the spin-off on June 30, 2004. The Company uses historical information to estimate option exercise and employee termination within the valuation model. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Compensation cost is recognized using a straight-line method over the vesting or service period and is net of estimated forfeitures.

| | **2007** | **2006** |
|---|---|---|
| Expected dividend yield | 0.7% | 0.6% |
| Expected volatility | 29.1% | 26.5% |
| Risk-free interest rate | 4.6% | 4.7% |
| Expected life | 6.5 years | 6.5 years |

Following is a summary of stock option activity:

| | **Shares** | **Weighted Average Exercise Price** | **Weighted-Average Remaining Contractual Term (in years)** | **Aggregate Intrinsic Value ($000)** |
|---|---|---|---|---|
| Options outstanding at December 31, 2006 | 4,099,514 | $19.52 | | |
| Granted | 395,500 | 29.25 | | |
| Exercised | (175,159) | 18.47 | | |
| Forfeited | (33,281) | 25.61 | | |
| Options outstanding at June 30, 2007 | 4,286,574 | $20.42 | 5.00 years | $32,796 |
| Vested or expected to vest at June, 2007 | 4,151,462 | $20.26 | 4.91 years | $32,394 |
| Options exercisable at June 30, 2007 | 3,325,063 | $18.96 | 4.20 years | $29,905 |

The weighted-average grant date fair value of options granted during 2007 and 2006 was $11.64 and $10.38, respectively.

The Company has granted both restricted stock and performance-based restricted stock. Restricted stock typically vests three years from the date of grant. The vesting of performance-based restricted stock is contingent upon the Company obtaining certain financial thresholds established on the grant date. Provided the incentive performance targets established in the year of grant are achieved, the performance-based restricted stock awards granted subsequent to 2002 will vest in a three-year period from the date of grant in an equal number of shares each year. Future vesting in all cases is subject generally to continued employment with MoneyGram. Holders of restricted stock and performance-based restricted stock have the right to receive dividends and vote the shares, but may not sell, assign, transfer, pledge or otherwise encumber the stock.

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Restricted stock awards are valued at the quoted market price of the Company s common stock on the date of grant and expensed using the straight-line method over the vesting or service period of the award. Following is a summary of restricted stock activity:

| | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Restricted stock outstanding at December 31, 2006 | 322,998 | $22.39 |
| Granted | 92,430 | 29.25 |
| Vested and issued | (169,528) | 19.32 |
| Forfeited | | |
| Restricted stock outstanding at June 30, 2007 | 245,900 | $26.69 |

Following is a summary of pertinent information related to the Company s stock-based awards:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in Thousands)* | **2007** | **2006** | **2007** | **2006** |
| Fair value of options vesting during period | | $ 68 | 2,595 | $ 5,627 |
| Fair value of restricted stock vesting during period | 163 | 1,731 | 5,118 | 13,338 |
| Expense recognized related to options | 1,052 | 599 | 2,098 | 1,180 |
| Expense recognized related to restricted stock | 605 | 528 | 1,153 | 1,128 |
| Intrinsic value of options exercised | 1,001 | 7,140 | 1,861 | 11,005 |
| Cash received from option exercises | 1,433 | 9,098 | 2,771 | 17,228 |
| Tax benefit realized for tax deductions from option exercises | (74) | 2,344 | 360 | 3,765 |

As of June 30, 2007, the Company s unvested stock-based awards had the following unrecognized compensation expense and remaining vesting periods:

| *(Amounts in Thousands)* | **Options** | **Restricted Stock** |
|---|---|---|
| Unrecognized compensation expense | $7,617 | $4,426 |
| Remaining weighted average vesting period | 1.92 years | 1.8 years |

As of June 30, 2007, the Company has remaining authorization to issue awards of up to 6,443,057 shares of common stock under its 2005 Omnibus Incentive Plan.

For the three and six months ended June 30, 2007, options to purchase 756,124 shares and 667,995 shares of common stock, respectively, were not included in the computation of diluted earnings per share because the effect would be antidilutive. For the three and six months ended June 30, 2006, options to purchase 351,029 shares and 236,290 shares of common stock, respectively, were not included in the computation of diluted earnings per share because the effect would be antidilutive. Options are generally antidilutive if the exercise price of the option is greater than the quoted market price of the Company s common stock for the period presented.

**12. Commitments and Contingencies**

At June 30, 2007, the Company had various reverse repurchase agreements, letters of credit and overdraft facilities totaling $2.1 billion to assist in the management of investments and the clearing of payment service obligations.

Included in this amount is an uncommitted reverse purchase agreement with one of the clearing banks totaling $1.0 billion. Overdraft facilities consist of $11.2 million of letters of credit, all of which are outstanding at June 30, 2007. Letters of credit totaling $1.1 million reduce amounts available under the revolving credit agreement. Fees on the letters of credit are paid in accordance with the terms of the revolving credit agreement.

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The Company has agreements with certain other co-investors to provide funds related to investments in limited partnership interests. As of June 30, 2007, the total amount of unfunded commitments related to these agreements was $1.4 million.

**13. New Accounting Pronouncements**

In February 2006, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 155, *Accounting for Certain Hybrid Instruments an amendment of FASB Statements No. 133 and 140.* SFAS No. 155 permits companies to measure any hybrid instrument in its entirety at fair value. Changes in fair value are recorded in income. Previously, hybrid instruments were required to be separated into two instruments, a derivative and host. Generally, the derivative instrument was recorded at fair value. The election to measure the hybrid instrument at fair value is made on an instrument-by-instrument basis and is irreversible. The standard also requires that beneficial interests in securitized financial assets be evaluated for freestanding or embedded derivatives. The Company adopted SFAS No. 155 on January 1, 2007 with no material impact to its Consolidated Financial Statements.

In July 2006, the FASB issued FASB Interpretation ( FIN ) No. 48. FIN No. 48 is an interpretation of SFAS No. 109, *Accounting for Income Taxes.* FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an entity s tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of tax positions. As discussed in Note 7, the Company adopted FIN No. 48 on January 1, 2007.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* This statement does not require any new fair value measurement, but it provides guidance on how to measure fair value under other accounting pronouncements. SFAS No. 157 also establishes a fair value hierarchy to classify the source of information used in fair value measurements. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad categories. This standard is effective for the Company on January 1, 2008. The Company is currently evaluating the impact of this pronouncement on its Consolidated Financial Statements.

In January 2007, the FASB issued SFAS No. 133 Implementation Issue No. B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets* ( DIG B40 ). DIG B40 provides the circumstances in which an embedded derivative of a securitized interest in a prepayable financial asset would not be subject to bifurcation. The Company adopted DIG B40 on January 1, 2007 with no material impact to its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The election to measure the financial instrument at fair value is made on an instrument-by-instrument basis for the entire instrument, with few exceptions, and is irreversible. SFAS No. 159 is effective for the Company on January 1, 2008. The Company is currently evaluating the impact of this pronouncement on its Consolidated Financial Statements.

In April 2007, the FASB issued FASB Staff Position ( FSP ) FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*. FIN 48 requires a tax position be measured or recognized based upon the outcomes that could be realized upon ultimate settlement with a tax authority. FSP FIN 48-1 amends FIN 48 to clarify when a tax position is effectively settled upon examination by a taxing authority. The Company adopted FSP FIN 48-1 as of January 1, 2007 with no material impact to its Consolidated Financial Statements.

In June 2007, the American Institute of Certified Public Accountants ( AICPA ) issued Statement of Position ( SOP ) 07-1, *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. SOP 07-1 provides specific guidance for determining whether an entity meets the definition of an investment company and should follow the AICPA Audit Accounting Guide *Investment Companies* (the Guide ). Entities that meet the definition of an investment company must apply the provisions of the Guide, which includes a requirement to carry investments at fair value. This standard is applicable for years beginning after December 15, 2007. The Company is currently evaluating the impact of this pronouncement, if any, on its Consolidated Financial Statements.

In June 2007, the Emerging Issues Task Force ( EITF ) approved EITF 06-11, *Accounting for Income Tax Benefits on Dividends on Share-Based Payment*. The EITF reached a final conclusion that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified restricted stock, restricted stock units and stock options should be recognized as an increase to additional paid-in-capital ( APIC ). Those tax benefits are considered excess tax benefits ( windfall ) under SFAS No. 123(revised 2004), *Share Based Payment*. The amount recognized in APIC for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb tax deficiencies. The guidance of this EITF will be adopted prospectively for the Company as of January 1, 2008. The Company is currently evaluating the impact of this pronouncement on its Consolidated Financial Statements.

**14. Minimum Commission Guarantees**

In limited circumstances, the Company may grant minimum commission guarantees as an incentive to new or renewing agents, for a specified period of time at a contractually specified amount. Under the guarantees, the Company will pay to the agent the difference between the contractually specified minimum commission and the actual commissions earned by the agent.

As of June 30, 2007, the liability for minimum commission guarantees is $4.1 million. As of June 30, 2007, the maximum amount that could be paid under commission guarantees is $28.3 million over a weighted average remaining term of 2.9 years. The maximum payment is calculated as the contractually guaranteed minimum commission times the remaining term of the contract and, therefore, assumes that the agent generates no money transfer transactions during the remainder of its contract. In fiscal 2006, the Company paid $3.0 million under these guarantees, or approximately 40 percent of the estimated maximum payment for the year.

**15. Segment Information**

The Company s business is conducted through two reportable segments, Global Funds Transfer and Payment Systems, which are determined based upon factors such as the type of customers, the nature of products and services provided and the distribution channels used to provide those services. The Company s largest agent in the Global Funds Transfer segment, Wal-Mart, accounted for approximately 20 percent of total Company revenue for the three and six months ended June 30, 2007. The following table reconciles segment operating income to Income before income taxes as reported in the Consolidated Financial Statements:

| | **Three Months Ended June 30** | | **Six Months Ended June 30** | |
|---|---|---|---|---|
| ***(Amounts in Thousands)*** | **2007** | **2006** | **2007** | **2006** |
| Revenue: | | | | |
| Global Funds Transfer: | | | | |
| Money transfer, including bill payment | $209,190 | $161,917 | $399,294 | $306,905 |
| Retail money order | 37,900 | 40,121 | 74,432 | 78,120 |
| | 247,090 | 202,038 | 473,726 | 385,025 |
| Payment Systems: | | | | |
| Official check and payment processing | 78,657 | 83,045 | 154,825 | 155,987 |
| Other | 7,435 | 7,830 | 14,464 | 15,573 |
| | 86,092 | 90,875 | 169,289 | 171,560 |
| Other | 77 | | 295 | |
| Total revenue | $333,259 | $292,913 | $643,310 | $556,585 |
| Operating Income: | | | | |
| Global Funds Transfer | $ 40,792 | $ 40,801 | $ 78,343 | $ 80,708 |
| Payment Systems | 9,898 | 16,207 | 19,464 | 26,529 |
| | 50,690 | 57,008 | 97,807 | 107,237 |
| Interest expense | (1,983) | (1,975) | (3,941) | (3,922) |
| Other unallocated expenses | (827) | (3,215) | (1,895) | (5,808) |

| | | | | |
|---|---|---|---|---|
| Income before income taxes | $ 47,880 | $ 51,818 | $ 91,971 | $ 97,507 |

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The following table presents depreciation and amortization expense and capital expenditures by segment:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in Thousands)* | **2007** | **2006** | **2007** | **2006** |
| Depreciation and amortization: | | | | |
| Global Funds Transfer | $11,080 | $ 8,061 | $21,531 | $15,543 |
| Payment Systems | 1,131 | 1,284 | 2,360 | 2,234 |
| Total depreciation and amortization | $12,211 | $ 9,345 | $23,891 | $17,777 |
| Capital expenditures: | | | | |
| Global Funds Transfer | $13,379 | $13,645 | $26,788 | $30,788 |
| Payment Systems | 1,703 | 3,219 | 3,223 | 6,673 |
| Total capital expenditures | $15,082 | $16,864 | $30,011 | $37,461 |

The following table presents revenue by major geographic area:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in Thousands)* | **2007** | **2006** | **2007** | **2006** |
| United States | $256,239 | $234,676 | $500,258 | $448,430 |
| Foreign | 77,020 | 58,237 | 143,052 | 108,155 |
| Total revenue | $333,259 | $292,913 | $643,310 | $556,585 |

**ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with MoneyGram International, Inc. s ( MoneyGram, the Company, we, us and our ) consolidated financial statements and related notes. This discussion contains forward-looking statements that involve risks and uncertainties. MoneyGram s actual results could differ materially from those anticipated due to various factors discussed under Forward-Looking Statements and elsewhere in this Quarterly Report.

**Summary**

Following are significant items affecting operating results in the second quarter of 2007:

Our Global Funds Transfer segment revenue grew 22 percent over the second quarter of 2006, driven by 29 percent growth in both money transfer transaction volume and revenue.

The net investment margin of 2.28 percent (see Table 4) decreased from 2.71 percent in the second quarter of 2006, primarily due to reduced cash recoveries from previously impaired securities.

Fee and other revenue increased 24 percent from the second quarter of 2006 to $232.5 million, driven primarily by continued growth in money transfer transaction volume.

Expenses increased 17 percent, driven by increased headcount and infrastructure costs supporting the growth in money transfer.

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**Table 1 Results of Operations**

| *(Amounts in Thousands)* | Three Months Ended June 30 2007 | Three Months Ended June 30 2006 | 2007 vs. 2006 (%) | Six Months Ended June 30 2007 | Six Months Ended June 30 2006 | 2007 vs. 2006 (%) |
|---|---|---|---|---|---|---|
| Revenue: | | | | | | |
| Fee and other revenue | $232,533 | $186,837 | 24 | $445,666 | $355,968 | 25 |
| Investment revenue | 101,107 | 106,516 | (5) | 197,161 | 201,476 | (2) |
| Net securities gains (losses) | (381) | (440) | NM | 483 | (859) | NM |
| Total revenue | 333,259 | 292,913 | 14 | 643,310 | 556,585 | 16 |
| Fee commissions expense | 100,279 | 75,619 | 33 | 190,291 | 143,103 | 33 |
| Investment commissions expense | 65,320 | 63,036 | 4 | 127,568 | 121,825 | 5 |
| Total commissions expense | 165,599 | 138,655 | 19 | 317,859 | 264,928 | 20 |
| Net revenue | 167,660 | 154,258 | 9 | 325,451 | 291,657 | 12 |
| Expenses: | | | | | | |
| Compensation and benefits | 50,363 | 43,093 | 17 | 100,394 | 83,721 | 20 |
| Transaction and operations support | 44,238 | 39,210 | 13 | 83,852 | 71,296 | 18 |
| Depreciation and amortization | 12,211 | 9,345 | 31 | 23,891 | 17,777 | 34 |
| Occupancy, equipment and supplies | 10,985 | 8,817 | 25 | 21,402 | 17,434 | 23 |
| Interest expense | 1,983 | 1,975 | 0 | 3,941 | 3,922 | 0 |
| Total expenses | 119,780 | 102,440 | 17 | 233,480 | 194,150 | 20 |
| Income before income taxes | 47,880 | 51,818 | (8) | 91,971 | 97,507 | (6) |
| Income tax expense | 15,521 | 15,112 | 3 | 29,773 | 29,865 | (0) |
| Net income | $ 32,359 | $ 36,706 | (12) | $ 62,198 | $ 67,642 | (8) |

NM = Not meaningful

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**Table 2 Results of Operations as a Percentage of Total Revenue**

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in Thousands)* | **2007** | **2006** | **2007** | **2006** |
| Revenue: | | | | |
| Fee and other revenue | 70% | 64% | 69% | 64% |
| Investment revenue | 30% | 36% | 31% | 36% |
| Net securities gains (losses) | 0% | 0% | 0% | 0% |
| Total revenue | 100% | 100% | 100% | 100% |
| Fee commissions expense | 30% | 26% | 30% | 26% |
| Investment commissions expense | 20% | 22% | 20% | 22% |
| Total commissions expense | 50% | 47% | 50% | 48% |
| Net revenue | 50% | 53% | 50% | 52% |
| Expenses: | | | | |
| Compensation and benefits | 15% | 15% | 15% | 15% |
| Transaction and operations support | 13% | 13% | 13% | 13% |
| Depreciation and amortization | 4% | 3% | 4% | 3% |
| Occupancy, equipment and supplies | 3% | 3% | 3% | 3% |
| Interest expense | 1% | 1% | 1% | 1% |
| Total expenses | 36% | 35% | 36% | 35% |
| Income before income taxes | 14% | 18% | 14% | 17% |
| Income tax expense | 4% | 5% | 4% | 5% |
| Net income | 10% | 13% | 10% | 12% |

NM = Not meaningful

For the second quarter of 2007, total revenue and net revenue grew 14 percent and 9 percent, respectively, over the second quarter of 2006 due to transaction growth in the money transfer business, partially offset by a decline in investment revenue. Investment revenue in the second quarter of 2006 benefited from $8.6 million of pretax cash flow on previously impaired investments and income from limited partnership interests, compared to a nominal amount during the second quarter of 2007. Total expenses, excluding commissions, increased 17 percent over the second quarter of 2006 to support the expansion of the money transfer business. The increases were primarily due to increased headcount, depreciation and amortization and investment in compliance and technology infrastructure. Headcount was higher as we staffed our retail money transfer locations in France and Germany and continued to increase our support functions, particularly customer service. Depreciation and amortization increased due to the depreciation of signage and computer hardware and amortization of software developed to enhance the money transfer platform.

For the six months ended June 30, 2007, total revenue increased by 16 percent, net revenue by 12 percent and total expenses by 20 percent over the first half of 2006 for the same reasons as described above. Pretax cash flow on previously impaired investments and income from limited partnership interests was $12.4 million in the first half of 2006 compared to a nominal amount in 2007.



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**Table 3 Net Fee Revenue Analysis**

| *(Amounts in Thousands)* | Three Months Ended June 30 2007 | Three Months Ended June 30 2006 | 2007 vs. 2006 | Six Months Ended June 30 2007 | Six Months Ended June 30 2006 | 2007 vs. 2006 |
|---|---|---|---|---|---|---|
| Fee and other revenue | $ 232,533 | $186,837 | 24% | $ 445,666 | $ 355,968 | 25% |
| Fee commissions expense | (100,279) | (75,619) | 33% | (190,291) | (143,103) | 33% |
| Net fee revenue | $ 132,254 | $111,218 | 19% | $ 255,375 | $ 212,865 | 20% |
| Commissions as a % of fee and other revenue | 43.1% | 40.5% | | 42.7% | 40.2% | |

Fee and other revenue is comprised of fees on money transfers, money orders and official check transactions. It is a growing portion of our total revenue, increasing to 70 percent and 69 percent of total revenue for the three and six months ended June 30, 2007, respectively, from 64 percent for the same periods in 2006. Fee and other revenue for the three and six months ended June 30, 2007 increased by 24 percent and 25 percent, respectively, compared to the same periods in the prior year, primarily driven by the growth in the money transfer business. Growth in money transfer revenue (including urgent bill payment) continued to be in line with growth in money transfer transaction volume. We anticipate money transfer revenue and money transfer volume growth percentages to remain similar, subject to fluctuations in the Euro exchange rate, pricing initiatives and product mix. See further discussion under Table 7 Global Funds Transfer Segment.

Fee commissions consist primarily of fees paid to our third-party agents for the money transfer service. For the three and six months ended June 30, 2007, fee commissions expense increased 33 percent compared to the same periods in 2006, primarily driven by higher money transfer transaction volume and tiered commissions. Tiered commissions are commission rates that are adjusted upward, subject to certain caps, as an agent s transaction volume grows. We use tiered commission rates as an incentive for select agents to grow transaction volume by paying for performance and allowing them to participate in adding market share for MoneyGram.

Net fee revenue increased 19 percent and 20 percent for the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006. The increase in net fee revenue is primarily driven by the increase in money transfer transactions. Growth in net fee revenue was less than fee and other revenue growth primarily due to tiered commissions.

**Table 4 Net Investment Revenue Analysis**

| *(Amounts in Thousands)* | Three Months Ended June 30 2007 | Three Months Ended June 30 2006 | 2007 vs. 2006 | Six Months Ended June 30 2007 | Six Months Ended June 30 2006 | 2007 vs. 2006 |
|---|---|---|---|---|---|---|
| Components of net investment revenue: | | | | | | |
| Investment revenue | $ 101,107 | $ 106,516 | -5% | $ 197,161 | $ 201,476 | -2% |
| Investment commissions expense (1) | (65,320) | (63,036) | 4% | (127,568) | (121,825) | 5% |
| Net investment revenue | $ 35,787 | $ 43,480 | -18% | $ 69,593 | $ 79,651 | -13% |
| Average balances: | | | | | | |
| Cash equivalents and investments | $6,298,881 | $6,430,475 | -2% | $6,246,056 | $6,386,878 | -2% |
| Payment service obligations (2) | 4,792,377 | 4,904,676 | -2% | 4,727,577 | 4,848,801 | -3% |

| Average yields earned and rates paid (3): | | | | | | |
|---|---|---|---|---|---|---|
| Investment yield | 6.44% | 6.64% | -0.20% | 6.37% | 6.36% | 0.01% |
| Investment commission rate | 5.47% | 5.16% | 0.31% | 5.44% | 5.07% | 0.37% |
| Net investment margin | 2.28% | 2.71% | -0.43% | 2.25% | 2.51% | -0.26% |

(1) Investment commissions expense includes payments made to financial institution customers based on short-term interest rate indices on the outstanding balances of official checks sold by that financial institution, as well as costs associated with swaps and the sale of receivables program.

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(2) Commissions are paid to financial institution customers based upon average outstanding balances generated by the sale of official checks only. The average balance in the table reflects only the payment service obligations for which commissions are paid and does not include the average balance of the sold receivables ($369.7 million and $374.8 million for the second quarter of 2007 and 2006, respectively, and $369.9 million and $383.8 million for the six months ended June 30, 2007 and 2006, respectively) as these are not recorded in the Consolidated Balance Sheets.

(3) Average yields/rates are calculated by dividing the

applicable amount shown in the Components of net investment revenue section by the applicable amount shown in the Average balances section, divided by the number of days in the period presented and multiplied by the number of days in the year. The Net investment margin is calculated by dividing Net investment revenue by the Cash equivalents and investments average balance, divided by the number of days in the period presented and multiplied by the number of days in the year.

Investment revenue decreased five percent and two percent in the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006 primarily due to lower levels of cash recoveries from previously impaired investments. Investment revenue for the three and six months ended June 30, 2006 included $8.6 million and $12.4 million, respectively, of cash flows from previously impaired investments and income from limited partnership interests compared to a nominal amount during the three and six months ended June 30, 2007. We anticipate that our average investable balances will be in the range of $6.0 billion to $6.3 billion for the year.

Investment commissions expense increased four percent and five percent in the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006 as rising short-term rates resulted in higher commissions paid to financial institution customers. The Company had $1.8 billion of outstanding swaps with an average fixed pay rate of 4.3 percent at June 30, 2007, compared to $2.6 billion with an average fixed pay rate of 4.3 percent at December 31, 2006. Approximately $475.0 million and $375.0 million of swaps matured in the first and second quarter of 2007, respectively, with an average fixed pay rate of 5.0 percent and 3.7 percent, respectively. Additional swaps of $300.0 million and $50.0 million with an average fixed pay rate of 3.9 percent and 5.6 percent will mature in the third and fourth quarters of 2007, respectively. We expect any replacement swaps to be at higher average rates than maturing swaps.

Net investment revenue decreased 18 percent and 13 percent in the three and six months ended June 30, 2007, respectively, compared to the same periods in the prior year. The net investment margin decreased to 2.28 percent and 2.25 percent for the three and six months ended June 30, 2007, respectively. This was due to lower cash recoveries from previously impaired securities and lower average investable balances, partially offset by higher yields.

**Table 5 Summary of Gains, Losses and Impairments**

| | Three Months Ended June 30 | | 2007 vs. | Six Months Ended June 30 | | 2007 vs. |
|---|---|---|---|---|---|---|
| ***(Amounts in Thousands)*** | **2007** | **2006** | **2006** | **2007** | **2006** | **2006** |
| Gross realized gains | $ 136 | $ 1,210 | $(1,074) | $ 3,929 | $ 2,848 | $1,081 |
| Gross realized losses | | (3) | 3 | (1,951) | (1,268) | (683) |
| Other-than-temporary impairments | (517) | (1,647) | 1,130 | (1,495) | (2,439) | 944 |
| Net securities gains (losses) | $(381) | $ (440) | $ 59 | $ 483 | $ (859) | $1,342 |

The Company had a net securities loss of $0.4 million and a net securities gain of $0.5 million in the three and six months ended June 30, 2007, respectively, compared to net securities losses of $0.4 million and $0.9 million in the three and six months ended June 30, 2006, respectively. Impairments in the three and six months ended June 30, 2007 related to investments backed by home equity loans, while impairments in the three and six months ended June 30, 2006 related primarily to investments backed by automobile, aircraft and manufactured housing collateral.

**Expenses**

*Compensation and benefits* Compensation and benefits includes salaries and benefits, management incentive programs and other employee related costs. Compensation and benefits increased 17 percent and 20 percent for the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006 due to higher headcount supporting the growth of the money transfer business. As of June 30, 2007, the number of employees increased 15 percent over the second quarter of 2006 as we staffed our retail locations in Western Europe and increased our support functions, particularly customer service. We expect compensation and benefits to increase in the remainder of 2007 compared to 2006 at a rate similar to what we have experienced in the first six months of 2007 due to additional headcount to support the growth of the money transfer business and annual merit increases.

*Transaction and operations support* Transaction and operations support expenses include marketing costs, professional fees and other outside service costs, telecommunications and forms expense related to our products. Transaction and operations support costs increased 13 percent and 18 percent for the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006, due to higher costs related to the expansion of the money transfer business and the global network. Professional fees increased 14 percent and 24 percent from the three and six months ended June 30, 2006, respectively, to support compliance activities and enhancements to our technology systems. The Company also experienced higher provisions for loss in the three and six months ended June 30, 2007 over the same periods in 2006.

*Depreciation and amortization* Depreciation and amortization includes depreciation on point of sale equipment, agent signage, computer hardware and software (including capitalized software development costs), office furniture, equipment and leasehold improvements and amortization of our intangible assets. Depreciation and amortization expense for the three and six months ended June 30, 2007 increased 31 percent and 34 percent, respectively, over the same periods in 2006, primarily due to the depreciation of signage and computer hardware, amortization of capitalized software acquired and/or developed in prior periods to enhance our support functions and amortization of acquired intangible assets.

The Company is currently implementing a new system to provide improved connections between our agents and our marketing, sales, customer service and accounting functions. The new system and associated processes are intended to increase the flexibility of our back office, thereby improving operating efficiencies. As we continue to invest in the infrastructure for future growth, we expect depreciation and amortization expense to increase.

*Occupancy, equipment and supplies* Occupancy, equipment and supplies includes facilities rent and maintenance costs, software and equipment maintenance costs, freight and delivery costs and supplies. Occupancy, equipment and supplies expense for the three and six months ended June 30, 2007 increased 25 percent and 23 percent, respectively, over the same periods in 2006. Office rent increased due to normal annual increases and expanded locations. Software expense and maintenance increases relate primarily to purchased licenses to support our growth and compliance initiatives. Freight and delivery and supplies expenses have increased in connection with the growth in our agent locations.

*Interest expense* Interest expense for the three and six months ended June, 30, 2007 was flat compared to the same periods in 2006 as receipts under our cash flow hedges offset rising interest rates.

*Income taxes* The effective tax rate was 32.4 percent for the three and six months ended June 30, 2007 compared to 29.2 percent and 30.6 percent for the three and six months ended June 30, 2006, respectively. The increase in the effective rate is due to tax exempt investment income declining as a percentage of total pre-tax income. We expect our effective tax rate to be around 31 percent for the full year.

**Acquisitions**

*Money Express* On May 31, 2006, MoneyGram completed the acquisition of Money Express, the Company s former super agent in Italy. In connection with the acquisition, the Company formed MoneyGram Payment Systems Italy, a wholly-owned subsidiary, to operate the former Money Express network. The acquisition provides the Company with the opportunity for further network expansion and more control of marketing and promotional activities in the region. MoneyGram acquired Money Express for $15.0 million. The acquisition cost includes $1.3 million of transaction costs and the forgiveness of $0.7 million of liabilities. The Company has finalized its purchase price allocation, which resulted in a decrease of $0.3 million to goodwill during the second quarter of 2007. Purchased intangible assets of $7.7 million, consisting primarily of agent contracts and a non-compete agreement, will be amortized over useful lives ranging from three to five years. Goodwill of $16.7 million was recorded and assigned to the Company s Global Funds Transfer segment.

The operating results of Money Express subsequent to May 31, 2006 are included in the Company s Consolidated Statements of Income. The financial impact of the acquisition is not material to the Consolidated Balance Sheets or Consolidated Statements of Income.

*ACH Commerce* The Company purchased ACH Commerce in April 2005 for $8.5 million, of which $1.1 million was to be paid upon the second anniversary of the acquisition. Based on the terms of the acquisition agreement, the Company paid this amount during the second quarter of 2007.

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**Segment Performance**

We measure financial performance by our two business segments Global Funds Transfer and Payment Systems. The business segments are determined based upon factors such as the type of customers, the nature of products and services provided and the distribution channels used to provide those services. Through our agent network and retail locations, the Global Funds Transfer segment provides our retail consumers with money transfer services, domestic money orders and bill payment services. The Payment Systems segment provides official check services and money orders for financial institutions and controlled disbursements processing for our business customers. Segment pre-tax operating income and segment operating margin are used to evaluate performance and allocate resources.

We manage our investment portfolio on a consolidated level and the specific investment securities are not identifiable to a particular segment. However, average investable balances are allocated to our segments based upon the average balances generated by that segment s sale of payment instruments. The investment yield generally is allocated based upon the total average investment yield. Gains and losses are allocated based upon the allocation of average investable balances. Our derivatives portfolio is also managed on a consolidated level and the derivative instruments are not specifically identifiable to a particular segment. The total costs associated with our derivatives portfolio are allocated to each segment based upon the percentage of that segment s average investable balances to the total average investable balances. Other unallocated expenses represent pension and benefit obligation expense. Table 6 reconciles segment operating income to income before income taxes as reported in the financial statements.

**Table 6 Segment Information**

| | **Three Months Ended June 30** | | **2007 vs.** | **Six Months Ended June 30** | | **2007 vs.** |
|---|---|---|---|---|---|---|
| ***(Amounts in Thousands)*** | **2007** | **2006** | **2006** | **2007** | **2006** | **2006** |
| Operating income: | | | | | | |
| Global Funds Transfer | $40,792 | $40,801 | 0% | $78,343 | $ 80,708 | -3% |
| Payment Systems | 9,898 | 16,207 | -39% | 19,464 | 26,529 | -27% |
| Total segment operating income | 50,690 | 57,008 | -11% | 97,807 | 107,237 | -9% |
| Interest expense | 1,983 | 1,975 | 0% | 3,941 | 3,922 | 0% |
| Other unallocated expenses | 827 | 3,215 | -74% | 1,895 | 5,808 | -67% |
| Income before income taxes | $47,880 | $51,818 | -8% | $91,971 | $ 97,507 | -6% |

**Table 7 Global Funds Transfer Segment**

| | **Three Months Ended June 30** | | **2007 vs.** | **Six Months Ended June 30** | | **2007 vs.** |
|---|---|---|---|---|---|---|
| ***(Amounts in Thousands)*** | **2007** | **2006** | **2006** | **2007** | **2006** | **2006** |
| Money transfer revenue | $ 209,190 | $161,917 | 29% | $ 399,294 | $ 306,905 | 30% |
| Retail money orders and other | 37,900 | 40,121 | -6% | 74,432 | 78,120 | -5% |
| Total revenue | 247,090 | 202,038 | 22% | 473,726 | 385,025 | 23% |
| Commissions | (105,225) | (80,348) | 31% | (200,258) | (152,496) | 31% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net revenue | $ 141,865 | $121,690 | 17% | $ 273,468 | $ 232,529 | 18% |
| | | | | | | |
| Operating income | $ 40,792 | $ 40,801 | 0% | $ 78,343 | $ 80,708 | -3% |
| Operating margin | 16.5% | 20.2% | | 16.5% | 21.0% | |

Total revenue is comprised primarily of fees on money transfers, as well as fees on retail money orders and urgent bill payment products, investment revenue and securities gains and losses. Global Funds Transfer revenue increased 22 percent and 23 percent in the three and six months ended June 30, 2007, respectively, over the same periods in 2006. Total Global Funds Transfer segment revenue continues to be driven

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by the growth in the money transfer business. Growth in money transfer revenue (including urgent bill payment) was in line with growth in money transfer transaction volume at an increase of 29 percent over the prior year, primarily driven by our simplified pricing initiatives, pricing stability, product mix (money transfer transaction growth versus urgent bill payment transaction growth) and a benefit from the stronger Euro exchange rate. Our simplified pricing initiatives include reducing the number of pricing tiers or bands, and allows us to manage our price-volume dynamic while streamlining the point of sale process for our agents and customers. Our pricing philosophy continues to be to maintain a price point below our higher priced competitor but above the niche players in the market.

Domestic originated transactions (including urgent bill payment) increased 30 percent and 31 percent in the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006, with growth across all corridors. International, or transactions originated outside of North America, grew 35 percent in the three and six months ended June 30, 2007 compared to the same periods in 2006. Transaction volume to Mexico grew 10 percent and 11 percent in the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006 and represented 10 percent of our total transactions for the three and six months ended June 30, 3007. The growth in money transfer transactions is a result of our continued network expansions and targeted pricing initiatives to provide a strong consumer value proposition supported by targeted marketing efforts. The money transfer agent base grew 30 percent to approximately 125,000 agent locations in the second quarter of 2007 compared to the same period in 2006, primarily from the international markets, including the United Kingdom and India. As expected, retail money order transaction volume declined four percent for the three and six months ended June 30, 2007 compared to the same periods in 2006 due to trends in paper-based products.

Money transfer agents are located in the following geographic regions: 29,400 locations in North America; 20,600 locations in Latin America (including Mexico which represents 10,200 locations); 37,500 locations in Western Europe and the Middle East; 9,900 locations in the Indian subcontinent; 11,600 locations in Asia Pacific; 11,300 locations in Eastern Europe and 4,700 locations in Africa.

Investment revenue in Global Funds Transfer decreased three percent in the three and six months ended June 30, 2007 compared to the same periods in 2006, primarily due to reduced cash flow recoveries from previously impaired investments and lower average investable balances. Global Funds Transfer realized $1.9 million and $2.8 million of income from limited partnership interests and pretax cash flow recoveries from previously impaired investments in the three and six months ended June 30, 2006, respectively.

Commissions expense consists primarily of fees paid to our third-party agents for the money transfer service and costs associated with swaps and the sale of receivables program. Commissions expense for the three and six months ended June 30, 2007 increased 31 percent compared to the same periods in 2006, primarily driven by the transaction volume growth in money transfer, tiered commission rates paid to certain agents and increases in the Euro exchange rate. Tiered commissions are commission rates that are adjusted upward, subject to certain caps, as an agent s transaction volume grows. We use tiered commission rates as an incentive for select agents to grow transaction volume by paying the agents for performance and allowing the agent to participate in adding market share for MoneyGram. Tiered commissions did not have an impact until the third quarter of 2006.

Operating income of $40.8 million was flat for the second quarter of 2007 compared to the same period in 2006, resulting in an operating margin of 16.5 percent compared to 20.2 percent in the prior year. The decrease in operating margin reflects higher money transfer commissions, as well as increased headcount and investment in compliance and technology infrastructure to support the expansion of the money transfer business. Headcount was higher as we staffed our retail locations in Western Europe and continued to increase our support functions, particularly customer service, to support the expansion of the money transfer business. For the six months ended June 30, 2007, operating income decreased three percent from the same period in 2006 and reflected a decrease in operating margin to 16.5 percent from 21.0 percent in the prior year. Operating income for three and six months ended June 30, 2006 included $1.9 million and $2.8 million of cash flows from previously impaired investments and income from limited partnership interests, respectively. We expect our operating margin for the second half of 2007 to be in line with the first half of the year.

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**Table 8 Payment Systems Segment**

| *(Amounts in Thousands)* | Three Months Ended June 30 2007 | Three Months Ended June 30 2006 | 2007 vs. 2006 | Six Months Ended June 30 2007 | Six Months Ended June 30 2006 | 2007 vs. 2006 |
|---|---|---|---|---|---|---|
| Official check and payment processing | $ 78,657 | $ 83,045 | -5% | $ 154,825 | $ 155,987 | -1% |
| Other revenue | 7,435 | 7,830 | -5% | 14,464 | 15,573 | -7% |
| Total revenue | 86,092 | 90,875 | -5% | 169,289 | 171,560 | -1% |
| Commissions | (60,374) | (58,307) | 4% | (117,602) | (112,431) | 5% |
| Net revenue | $ 25,718 | $ 32,568 | -21% | $ 51,687 | $ 59,129 | -13% |
| Operating income | $ 9,898 | $ 16,207 | -39% | $ 19,464 | $ 26,529 | -27% |
| Operating margin | 11.5% | 17.8% | | 11.5% | 15.5% | |
| Taxable equivalent basis (1) : | | | | | | |
| Revenue | $ 90,485 | $ 95,240 | -5% | $ 177,576 | $ 180,352 | -2% |
| Commissions | (60,374) | (58,307) | 4% | (117,602) | (112,431) | 5% |
| Operating income | 14,291 | 20,572 | -31% | 27,751 | 35,321 | -21% |
| Operating margin | 15.8% | 21.6% | | 15.6% | 19.6% | |

(1) The taxable equivalent basis numbers (commonly used by financial institutions) are non-GAAP measures that are used by the Company s management to evaluate the effect of tax-exempt securities on the Payment Systems segment. The tax-exempt investments in the investment portfolio have

lower pre-tax yields, but produce higher income on an after-tax basis than comparable taxable investments. An adjustment is made to present revenue and operating income resulting from amounts invested in tax-exempt securities on a taxable equivalent basis. The adjustment is calculated using a 35 percent tax rate and is $4.4 million for the second quarter of 2007 and 2006 and $8.3 million and $8.8 million for the six months ended June 30, 2007 and 2006, respectively. The presentation of taxable equivalent basis numbers is supplemental to results presented under GAAP and may not be comparable to similarly titled measures used by other companies. These non-GAAP measures should be used in

addition to, but not as a substitute for measures presented under GAAP.

Total revenue includes investment revenue, securities gains and losses, per-item fees charged to our official check financial institution customers and fees earned on our rebate processing business**.** Total revenue decreased five percent and one percent for the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006, primarily due to $6.7 million and $9.6 million of pretax income from limited partnership interests and cash flows from previously impaired securities earned in the three and six months ended June 30, 2006, respectively. The decrease in revenue also reflects lower average investable balances and was partially offset by higher yields on the investment portfolio.

Commissions expense includes payments made to financial institution customers based on official check average investable balances and short-term interest rate indices, as well as costs associated with swaps and the sale of receivables program. Commission expense increased four percent and five percent for the three and six months ended June 30, 2007, respectively, compared to the same periods in 2006, primarily due to higher short-term interest rates resulting in higher commissions paid to financial institution customers.

Operating margin for the three and six months ended June 30, 2007 was 11.5 percent (15.8 percent and 15.6 percent, respectively, on a taxable equivalent basis) as compared to 17.8 percent and 15.5 percent, respectively (21.6 percent and 19.6 percent, respectively, on a taxable equivalent basis) for the same periods in 2006. The operating margin for the three and six months ended June 30, 2006 benefited by 6.5 percentage points and 5.0 percentage points, respectively, from pretax cash flows from previously impaired securities and income from limited partnership interests.

**Liquidity and Capital Resources**

One of our primary financial goals is to maintain adequate liquidity to manage the fluctuations in the balances of payment service assets and obligations resulting from sales of official checks, money orders and other payment instruments, the timing of the collections of receivables and the timing of the presentment of such instruments for payment. In addition, we strive to maintain adequate liquidity for capital expenditures and other normal operating cash needs.

At June 30, 2007, we had cash and cash equivalents of $987.9 million, net receivables of $1.8 billion and investments of $5.7 billion, all substantially restricted for payment service obligations. We rely on the funds from ongoing sales of payment instruments and portfolio cash flows to settle payment service obligations as they are presented. Due to the continuous nature of the sales and settlement of our payment instruments, we are able to invest in securities with a longer term than the average life of our payment instruments.

We are regulated by various state agencies which generally require us to maintain liquid assets and investments with an investment rating of A or higher in an amount generally equal to the payment service obligation for those regulated payment instruments, namely teller checks, agent checks, money orders and money transfers. Consequently, a significant amount of cash and cash equivalents, receivables and investments are restricted to satisfy the liability to pay the face amount of regulated payment service obligations upon presentment. We are not regulated by state agencies for our payment service obligations resulting from outstanding cashier s checks. However, we restrict a portion of the funds related to these payment instruments due to contractual arrangements and Company policy. Assets restricted for regulatory or contractual reasons are not available to satisfy working capital or other financing requirements. The regulatory and contractual requirements do not require the Company to specify individual assets held to meet our payment service obligations, nor is the Company required to deposit specific assets into a trust, escrow or other special account. Rather, the Company must maintain a pool of liquid assets. No third party places limitations, legal or otherwise, on the Company regarding the use of its individual liquid assets. The Company is able to withdraw, deposit and sell its individual liquid assets at will, with no prior notice or penalty, provided the Company maintains a total pool of liquid assets sufficient to meet the regulatory and contractual requirements.

As of June 30, 2007 and December 31, 2006, we had unrestricted cash and cash equivalents, receivables and investments to the extent those assets exceed all payment service obligations as summarized in Table 9. These amounts are generally available. However, management considers a portion of these amounts as providing additional assurance that regulatory requirements are maintained during the normal fluctuations in the value of investments.

**Table 9 Unrestricted Assets**

| *(Amounts in Thousands)* | **June 30, 2007** | **December 31, 2006** |
|---|---|---|
| Cash and cash equivalents | $ 987,918 | $ 973,931 |
| Receivables, net | 1,775,431 | 1,758,682 |
| Trading investments | 121,200 | 145,500 |
| Available for sale investments | 5,624,054 | 5,690,600 |
| | 8,508,603 | 8,568,713 |
| Amounts restricted to cover payment service obligations | (8,211,535) | (8,209,789) |
| Unrestricted assets | $ 297,068 | $ 358,924 |

The decrease in unrestricted assets is primarily due to fluctuations in the market value of our investments and changes in our working capital resulting from repurchases of our common stock, capital expenditures and payment of dividends, partially offset by the timing of normal operating activities.

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**Table 10 Cash Flows Used In Operating Activities**

| *(Amounts in Thousands)* | Three Months Ended June 30 2007 | Three Months Ended June 30 2006 | Six Months Ended June 30 2007 | Six Months Ended June 30 2006 |
|---|---|---|---|---|
| Net income | $ 32,359 | $ 36,706 | $ 62,198 | $ 67,642 |
| Total adjustments to reconcile net income | 30,790 | 13,009 | 39,280 | 17,077 |
| Net cash provided by operating activities before changes in payment service assets and obligations | 63,149 | 49,715 | 101,478 | 84,719 |
| Change in cash and cash equivalents (substantially restricted) | 291,451 | 185,091 | (4,905) | 54,785 |
| Change in trading investments, net (substantially restricted) | (14,200) | (16,775) | 24,300 | 88,925 |
| Change in receivables, net (substantially restricted) | (177,820) | (158,175) | (20,701) | (190,987) |
| Change in payment service obligations | 81,778 | 94,751 | 1,746 | 23,162 |
| Net change in payment service assets and obligations | 181,209 | 104,892 | 440 | (24,115) |
| Net cash used in operating activities | $ 244,358 | $ 154,607 | $101,918 | $ 60,604 |

Table 10 summarizes the net cash flows used in operating activities. Operating activities provided net cash of $244.4 million and $154.6 million during the three months ended June 30, 2007 and 2006, respectively, for an increase in cash provided of $89.8 million. This increase is primarily due to $89.5 million of additional working capital from normal operating activities impacting our payment service assets and obligations, other assets and accounts payable and other liabilities. The remaining increase is due to changes in non-cash expenses, including depreciation and amortization and provision of uncollectible receivables.

Operating activities provided net cash of $101.9 million and $60.6 million during the six months ended June 30, 2007 and 2006, respectively, for an increase in cash provided of $41.3 million. This increase is primarily due to $37.8 million of additional working capital from normal operating activities impacting our payment service assets and obligations, other assets and accounts payable and other liabilities. The remaining increase is due to changes in non-cash expenses, including depreciation and amortization and provision of uncollectible receivables.

To understand the cash flow activity of our business, the cash provided by (used in) operating activities relating to the payment service assets and obligations should be reviewed in conjunction with the cash provided by (used in) investing activities related to our investment portfolio.

**Table 11 Cash Flows Provided By Investing Activities**

| *(Amounts in Thousands)* | Three Months Ended June 30 2007 | Three Months Ended June 30 2006 | Six Months Ended June 30 2007 | Six Months Ended June 30 2006 |
|---|---|---|---|---|
| Net investment activity | $(206,684) | $(115,585) | $(32,073) | $ 7,051 |
| Purchases of property and equipment | (15,082) | (19,428) | (30,011) | (40,025) |

| | | | | |
|---|---|---|---|---|
| Cash paid for acquisitions | (1,061) | (12,414) | (1,116) | (13,052) |
| Net cash used in investing activities | $(222,827) | $(147,427) | $(63,200) | $(46,026) |

Table 11 summarizes the net cash provided by investing activities. Investing activities primarily consist of activity within our investment portfolio. Other investing activity consisted of the use of cash of $15.1 million and $19.4 million in the three months ended June 30, 2007 and 2006, respectively, and $30.0 million and $40.0 million in the six months ended June 30, 2007 and 2006, respectively, for the purchase of property and equipment related to our continued investment in the money transfer platform and compliance activities.

In the second quarter of 2006, the Company acquired MoneyExpress, its former super agent in Italy. In addition, we acquired a 50 percent interest in a corporate aircraft in the first half of 2006.

The Company purchased ACH Commerce in April 2005 for $8.5 million, of which $1.1 million was to be paid upon the second anniversary of the acquisition. Based on the terms of the acquisition agreement, the Company paid this amount during the second quarter of 2007.

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**Table 12 Cash Flows Used in Financing Activities**

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| *(Amounts in Thousands)* | **2007** | **2006** | **2007** | **2006** |
| Proceeds and tax benefit from exercise of share-based compensation | $ 1,359 | $ 11,442 | $ 3,131 | $ 20,993 |
| Purchase of treasury stock | (18,777) | (15,198) | (33,510) | (28,734) |
| Cash dividends paid | (4,113) | (3,424) | (8,339) | (6,837) |
| Net cash used in financing activities | $(21,531) | $ (7,180) | $(38,718) | $(14,578) |

Table 12 summarizes the net cash flows used in financing activities. Sources of cash relate primarily to the exercise of share-based compensation, which provided $1.4 million and $9.1 million during the three months ended June 30, 2007 and 2006, respectively, and $2.8 million and $17.2 million during the six months ended June 30, 2007 and 2006, respectively. The exercise of share-based compensation generated no tax benefits and $2.3 million of tax benefits in the three months ended June 30, 2007 and 2006, respectively, and $0.4 million and $3.8 million in the six months ended June 30, 2007 and 2006, respectively. Cash used by financing activities relate primarily to our purchase of $18.8 million and $15.2 million of treasury stock during the three months ended June 30, 2007 and 2006, respectively, and $33.5 million and $28.7 million during the six months ended June 30, 2007 and 2006, respectively. In addition, we paid $4.1 million and $3.4 million in dividends during the three months ended June 30, 2007 and 2006, respectively, and $8.3 million and $6.8 million during the six months ended June 30, 2007 and 2006, respectively.

**Other Funding Sources and Requirements**

We have a bank credit facility providing $350.0 million in the form of a $250.0 million four-year revolving credit facility and a $100.0 million term loan. At June 30, 2007, we had outstanding borrowings under the credit facility consisting of $50.0 million under the revolving credit facility and a $100.0 million term loan. The maturity date of the credit facility and term loan is June 2010. The credit facility may be increased to $500.0 million under certain circumstances. The interest rate applicable to both the credit facility and the term loan is LIBOR plus 50 basis points, subject to adjustment in the event of a change in the credit rating of our senior unsecured debt. The usage fees on the facility range from 0.080 percent to 0.250 percent, depending on the credit rating of our senior unsecured debt. At June 30, 2007, the interest rate under the bank credit facility was 5.86 percent, exclusive of the effect of commitment fees and other costs, and the facility fee was 0.125 percent.

The remaining availability under the bank credit facility may be used for general corporate purposes and to support letters of credit. Loans under the bank credit facility are guaranteed on an unsecured basis by our material domestic subsidiaries. Borrowings under the bank credit facilities are subject to various covenants, including interest coverage ratio, leverage ratio and consolidated total indebtedness ratio. The interest coverage ratio of earnings before interest and taxes to interest expense must not be less than 3.5 to 1.0. The leverage ratio of total debt to total capitalization must be less than 0.5 to 1.0. The consolidated total indebtedness ratio of total debt to earnings before interest, taxes, depreciation and amortization must be less than 3.0 to 1.0. At June 30, 2007, we were in compliance with all of the covenants under the bank credit facility.

At June 30, 2007 and December 31, 2006, the interest rate debt swaps used to hedge the cash flows of the Company s variable rate debt had an average fixed pay rate of 4.3 percent and an average variable receive rate of 4.7 percent and 4.6 percent, respectively. See Note 5 to the Consolidated Financial Statements for further information regarding the Company s portfolio of derivative financial instruments.

At June 30, 2007, we had various reverse repurchase agreements, letters of credit and overdraft facilities totaling $2.1 billion to assist in the management of investments and the clearing of payment service obligations. Included in this amount is an uncommitted reverse repurchase agreement with one of the clearing banks totaling $1.0 billion. Overdraft facilities consist of $11.2 million of letters of credit, all of which are outstanding at June 30, 2007. Letters

of credit totaling $1.1 million reduce amounts available under the revolving credit agreement. Fees on the letters of credit are paid in accordance with the terms of the revolving credit agreement.
The Company has agreements with certain other co-investors to provide funds related to investments in limited partnership interests. As of June 30, 2007, the total amount of unfunded commitments related to these agreements was $1.4 million.

**Table 13 Contractual Obligations**

| | | Payments due by period | | | |
|---|---|---|---|---|---|
| *(Amounts in Thousands)* | Total | Less than 1 year | 2-3 years | 4-5 years | More than 5 years |
| Debt, including interest payments | $176,370 | $ 8,790 | $17,580 | $150,000 | $ |
| Operating leases | 53,759 | 9,736 | 17,218 | 13,878 | 12,927 |
| Derivative financial instruments | 24,860 | 11,203 | 11,101 | 2,556 | |
| Other obligations | 1,410 | 1,410 | | | |
| Total contractual cash obligations | $256,399 | $31,139 | $45,899 | $166,434 | $12,927 |

Debt consists of principal amounts outstanding under the revolving credit facility and term loan at June 30, 2007, as well as related interest payments. As described above, interest payments on our outstanding debt are based on a floating interest rate indexed to LIBOR. For disclosure purposes, the interest rate for future periods has been assumed to be 5.86 percent, which is the rate in effect on June 30, 2007. Operating leases consist of various leases for buildings and equipment used in our business. Derivative financial instruments represent the net payable (receivable) under our interest rate swap agreements. Other obligations are unfunded capital commitments related to limited partnership interests included in our investment portfolio.

The Company has funded, noncontributory pension plans. Our funding policy is to contribute at least the minimum contribution required by applicable regulations. MoneyGram did not make a contribution to the funded pension plans during the first half of 2007. There are no required contributions for the funded pension plan in 2007; however, the Company may choose to make contributions during the remainder of 2007. The Company also has certain unfunded pension and postretirement plans that require benefit payments over extended periods of time. During the three and six months ended June 30, 2007, we paid benefits totaling $1.1 million and $2.0 million, respectively, related to these unfunded plans. Benefit payments under these unfunded plans are expected to be $2.1 million in the remainder of 2007. Expected contributions and benefit payments under these plans are not included in the table above.

As a result of the adoption of the provisions of Financial Accounting Standards Board ( FASB ) Interpretation ( FIN ) No. 48, *Accounting for Uncertainty in Income Taxes,* on January 1, 2007 we recorded a liability for unrecognized tax benefits of $39.1 million, which is included in Accounts payable and other liabilities in the Consolidated Balance Sheets. Of the $39.1 million, $31.4 million could affect the effective tax rate if recognized. As of June 30, 2007, the liability for unrecognized tax benefits is $40.7 million. This amount is not reflected in the table above.

In limited circumstances, the Company may grant minimum commission guarantees as an incentive to new or renewing agents, for a specified period of time at a contractually specified amount. Under the guarantees, the Company will pay to the agent the difference between the contractually specified minimum commission and the actual commissions earned by the agent. As of June 30, 2007, the minimum commission guarantees had a maximum payment of $28.3 million over a weighted average remaining term of 2.9 years. The maximum payment is calculated as the contractually guaranteed minimum commission times the remaining term of the contract and, therefore, assumes that the agent generates no money transfer transactions during the remainder of its contract. As of June 30, 2007, the liability for minimum commission guarantees is $4.1 million. Minimum commission guarantees are not reflected in the table above.

Although no assurance can be given, we expect operating cash flows and short-term borrowings to be sufficient to finance our ongoing business, maintain adequate capital levels and meet debt and clearing agreement covenants and investment grade rating requirements. Should financing requirements exceed such sources of funds, we believe we have adequate external financing sources available to cover any shortfall, including unused commitments under our credit facilities.

The Company has an effective universal shelf registration on file with the Securities and Exchange Commission. The universal shelf registration provides for the issuance of up to $500.0 million of our securities, including common

stock, preferred stock and debt securities. The securities may be sold from time to time in one or more series. The terms of the securities and any offering of the securities will be determined at the time of the sale. The shelf registration is intended to provide the Company with additional funding sources for general corporate purposes, including working capital, capital expenditures, debt payment and the financing of possible acquisitions or stock repurchases.

**Stockholders Equity**

On May 9, 2007, the Company s Board of Directors approved an increase of the Company s current authorization to purchase shares of common stock by an additional 5,000,000 shares to a total of 12,000,000 shares. For the three and six months ended June 30, 2007, we purchased 650,000 shares and 1,150,000 shares of our common stock at an average price of $28.89 and $29.14 per share, respectively. As of June 30, 2007, the Company had remaining authorization to purchase up to 5,675,000 shares of its common stock.

Subsequent to June 30, 2007, we purchased 470,000 shares of our common stock at an average price of $26.56.

The Company paid cash dividends of $0.10 per share of common stock during the six months ended June 30, 2007. On May 9, 2007, the Company s Board of Directors declared a cash dividend of $0.05 per share of common stock, which was paid on July 2, 2007. Any future determination to pay dividends on MoneyGram common stock will be at the discretion of our Board of Directors and will depend on our financial condition, results of operations, cash requirements, prospects and such other factors as our Board of Directors may deem relevant. Subject to Board approval, the Company intends to continue paying a quarterly dividend, which will be funded through cash generated from operating activities.

**Off-Balance Sheet Arrangements**

The Finance and Investment Committee of the Board of Directors generally approves any transactions and strategies, including any potential off-balance sheet arrangements, which materially affect investment results and cash flows.

We have an agreement to sell, on a periodic basis, undivided percentage ownership interests in certain receivables, primarily from our money order agents, in an amount not to exceed $400.0 million. These receivables are sold to commercial paper conduits (trusts) sponsored by a financial institution and represent a small percentage of the total assets in these conduits. Our rights and obligations are limited to the receivables transferred, and are accounted for as sales transactions under Statement of Financial Accounting Standards ( SFAS No. 140 ), *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* The assets and liabilities associated with these conduits, including our sold receivables, are not recorded or included in our financial statements. In the fourth quarter of 2006, the Company extended the agreement through December 2007. The business purpose of this arrangement is to accelerate cash flow for investment. The receivables are sold at a discount based upon short-term interest rates. Executive management regularly reviews performance under the terms of the agreement. On average we sold receivables totaling $369.7 million and $369.9 million during the three and six months ended June 30, 2007, for a total discount of $5.1 and $10.4 million, respectively.

**Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( GAAP ) requires estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities in the consolidated financial statements. Actual results could differ from those estimates. On a regular basis, management reviews the accounting policies, assumptions and estimates to ensure that our financial statements are presented fairly and in accordance with GAAP.

Critical accounting policies are those policies that management believes are most important to the portrayal of a company s financial position and results of operations, and that require management to make estimates that are difficult, subjective or complex. There were no changes to our critical accounting policies during the second quarter of 2007. For further information regarding our critical accounting policies, refer to Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

**Recent Accounting Developments**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Instruments an amendment of FASB Statements No. 133 and 140.* SFAS No. 155 permits companies to measure any hybrid instrument in its entirety at fair value. Changes in fair value are recorded in income. Previously, hybrid instruments were required to be separated into two instruments, a derivative and host. Generally, the derivative instrument was recorded at fair value. The election to measure the hybrid instrument at fair value is made on an instrument-by-instrument basis and is irreversible. The standard also requires that beneficial interests in securitized financial assets be evaluated for

freestanding or embedded derivatives. The Company adopted SFAS No. 155 on January 1, 2007 with no material impact to its Consolidated Financial Statements.

In July 2006, the FASB issued FIN No. 48. FIN No. 48 is an interpretation of SFAS No. 109, *Accounting for Income Taxes.* FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in an entity s tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition of tax positions. As discussed in Note 7, the Company adopted FIN No. 48 on January 1, 2007.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* This statement does not require any new fair value measurement, but it provides guidance on how to measure fair value under other accounting pronouncements. SFAS No. 157 also establishes a fair value hierarchy to classify the source of information used in fair value measurements. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad categories. This standard is effective for the Company on January 1, 2008. The Company is currently evaluating the impact of this pronouncement on its Consolidated Financial Statements.

In January 2007, the FASB issued SFAS No. 133 Implementation Issue No. B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets* ( DIG B40 ). DIG B40 provides the circumstances in which an embedded derivative of a securitized interest in a prepayable financial asset would not be subject to bifurcation. The Company adopted DIG B40 on January 1, 2007 with no material impact to its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The election to measure the financial instrument at fair value is made on an instrument-by-instrument basis for the entire instrument, with few exceptions, and is irreversible. SFAS No. 159 is effective for the Company on January 1, 2008. The Company is currently evaluating the impact of this pronouncement on its Consolidated Financial Statements.

In April 2007, the FASB issued FASB Staff Position ( FSP ) FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48*. FIN 48 requires a tax position be measured or recognized based upon the outcomes that could be realized upon ultimate settlement with a tax authority. FSP FIN 48-1 amends FIN 48 to clarify when a tax position is effectively settled upon examination by a taxing authority. The Company adopted FSP FIN 48-1 as of January 1, 2007 with no material impact to its Consolidated Financial Statements.

In June 2007, the American Institute of Certified Public Accountants ( AICPA ) issued Statement of Position ( SOP ) 07-1, *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. SOP 07-1 provides specific guidance for determining whether an entity meets the definition of an investment company and should follow the AICPA Audit Accounting Guide *Investment Companies* (the Guide ). Entities that meet the definition of an investment company must apply the provisions of the Guide, which includes a requirement to carry investments at fair value. This standard is applicable for years beginning after December 15, 2007. The Company is currently evaluating the impact of this pronouncement, if any, on its Consolidated Financial Statements.

In June 2007, the Emerging Issues Task Force ( EITF ) approved EITF 06-11, *Accounting for Income Tax Benefits on Dividends on Share-Based Payment*. The EITF reached a final conclusion that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified restricted stock, restricted stock units and stock options should be recognized as an increase to additional paid-in-capital ( APIC ). Those tax benefits are considered excess tax benefits ( windfall ) under SFAS No. 123(revised 2004) *Share-Based Payment*. The amount recognized in APIC for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb tax deficiencies. The guidance of this EITF will be adopted prospectively for MGI as of January 1, 2008. The Company is currently evaluating the impact of this pronouncement on its Consolidated Financial Statements.

**Forward Looking Statements**

This Quarterly Report on Form 10-Q may contain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of MoneyGram International, Inc. and its subsidiaries. Statements preceded by, followed by or that include words such as may, will, expect, anticipate, continue, estimate, project, believes or similar expressions are intended to identify some of the forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and are included, along with this statement, for purposes of complying with the safe harbor provisions of that Act. These forward-looking statements involve risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the risks and uncertainties described in Part I, Item 1A Risk Factors of the Company s Annual Report on Form 10-K for the year ended December 31, 2006, as well as the various factors

described below. Since it is not possible to foresee all such factors, you should not consider these factors to be a complete list of all risks or uncertainties.

*Agent Retention.* We may be unable to renew material retail agent and financial institution customer contracts, or we may experience a loss of business from significant agents or customers.



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*Development of New and Enhanced Products and Related Investment.* We may be unable to successfully and timely implement new or enhanced technology, delivery methods and product and service offerings and we may invest in new products or services that are not successful.

*Intellectual Property.* The loss of intellectual property protection, the inability to secure or enforce intellectual property protection or to successfully defend against an intellectual property infringement action could harm our business and prospects.

*Competition.* We may be unable to compete against our large competitors, niche competitors or new competitors that may enter the markets in which we operate.

*U.S. and International Regulation.* Failure by us or our agents to comply with the laws and regulatory requirements in the United States and abroad, or changes in laws, regulations or other industry practices and standards could have an adverse effect on our results of operations.

*Operation in Politically Volatile Areas.* Offering money transfer transactions through agents in regions that are politically volatile and/or, in a limited number of cases, are subject to certain OFAC restrictions could cause contravention of U.S. law or regulations, subject us to fines and penalties and cause us reputational harm.

*Network and Data Security.* If we face system interruptions and system failures due to defects in our software, development delays and installation difficulties, or we suffer a material security breach of our systems, our business could be harmed.

*Business Interruption.* In the event of a breakdown, catastrophic event, security breach, improper operation or any other event impacting our systems or processes or our vendors systems or processes, or improper action by our employees, agents, customer financial institutions or third party vendors, we could suffer financial loss, loss of customers, regulatory sanctions and damage to our reputation.

*Agent Credit and Fraud Risks.* We may face credit and fraud exposure if we are unable to collect funds from our agents who receive the proceeds from the sale of our payment instruments.

*Third Party Fraud.* Fraudulent activity using our services could lead to reputational damage to our brand and could reduce the use and acceptance of our services.

*Litigation or Investigations.* Our business and results of operations may be materially adversely affected by lawsuits or investigations which could result in material settlements, fines or penalties.

*Investment Portfolio Credit Risk.* If an issuer of securities in our investment portfolio defaulted on its payment obligations, the value of our securities would decline, adversely affecting the value of our investment portfolio.

*Interest Rate Fluctuations.* Fluctuations in interest rates may materially adversely affect revenue derived from investment of funds received from the sale of our payment instruments and commissions paid to financial institution customers.

*Market Value of Securities.* Material changes in the market value of securities we hold may materially adversely affect our results of operation and financial condition.

*New Retail Locations and Acquisitions.* Opening new Company owned retail locations and/or acquiring businesses may cause a diversion of capital and management s attention from our core business and subjects us

to new risks.

*International Migration Patterns.* Changes in immigration laws or other circumstances that discourage international migration could adversely affect our money transfer remittance volume or growth rate.

*Liquidity.* Material changes in our need for and the availability of liquid assets may affect our ability to meet our payment service obligations and may materially adversely affect our results of operation and financial condition.

*Banking Relationships.* Inability by us or our agents to maintain existing or establish new banking relationships could adversely affect our business, results of operations and our financial condition.

*International.* Our business and results of operations may be adversely affected by political, economic or other instability in countries in which we have material agent relationships.

*Internal Controls.* Our inability to maintain compliance with the internal control provisions of Section 404 of the Sarbanes-Oxley Act of 2002 could have a material adverse effect on our business and stock price.

*Anti-Takeover Provisions.* Provisions in our charter documents and specific provisions of Delaware law may have the effect of delaying, deterring or preventing a merger or change in control of our Company.

*Other Factors.* Additional risk factors may be described in our other filings with the Securities and Exchange Commission from time to time.

Actual results may differ materially from historical and anticipated results. These forward-looking statements speak only as of the date on which such statements are made, and we undertake no obligation to update such statements to reflect events or circumstances arising after such date.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company believes that there have been no material changes in our market risk since December 31, 2006, except as set forth below. For further information on market risk, refer to Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Enterprise Risk Management in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

The Company uses Value-at-Risk ( VAR ) modeling and net investment revenue simulation analysis for measuring and analyzing consolidated interest rate risk. VAR is a risk assessment methodology that estimates the potential decline in the value of a security or portfolio under various market conditions. VAR quantifies the change in market value due to changes in volatility and interest rates over a given time horizon and given a certain level of confidence. The Company utilizes VAR to quantify the potential decline in the fair value of its investment portfolio using a 95 percent confidence level and a one-month time horizon. The Company uses a Monte Carlo model that derives the interest rate change from volatility assumptions, specified probability and time horizon. The model includes the Company s investment portfolio and interest rate derivative contracts.

At June 30, 2007, the VAR is $(20.6) million, given a 95 percent confidence level and a one-month time horizon. Accordingly, there is a five percent chance the loss on the investment portfolio over the next month will exceed the $(20.6) million. The high, low and average VAR for the three months ended June 30, 2007 was $(20.6) million, $(17.2) million and $(19.1) million, respectively. The high, low and average VAR for the six months ended June 30, 2007 was $(21.2) million, $(16.9) million and $(19.1) million, respectively.

The net investment revenue simulation analysis incorporates substantially all of the Company s interest sensitive assets and liabilities, together with forecasted changes in the balance sheet and assumptions that reflect the current interest rate environment. This analysis assumes the yield curve increases gradually over a one-year period. Table 14 summarizes the changes to our pre-tax income from continuing operations under various scenarios.

The modeling of our investment portfolio involves a number of assumptions including prepayments, interest rates and volatility. The VAR model and net investment revenue simulation analysis are risk analysis tools and do not purport to represent actual losses that will be incurred by the Company. While we believe that these assumptions are reasonable, different assumptions could produce materially different estimates.

**Table 14 Interest Rate Sensitivity Analysis**

| | Basis Point Change in Interest Rates | | | | | |
|---|---|---|---|---|---|---|
| *(Amounts in thousands)* | **Down 200** | **Down 100** | **Down 50** | **Up 50** | **Up 100** | **Up 200** |
| Pre-tax income from continuing operations | $4,260 | $3,769 | $2,239 | $(2,489) | $(4,474) | $(7,225) |
| Percent change | 2.6% | 2.3% | 1.4% | -1.5% | -2.7% | -4.4% |

**ITEM 4. CONTROLS AND PROCEDURES**

*Disclosure Controls and Procedures* As of the end of the period covered by this report (the Evaluation Date ), the Company carried out an evaluation, under the supervision and with the participation of management, including the

Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act ). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, the Company s disclosure controls and procedures were effective.



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*Changes in Internal Control over Financial Reporting* There were no changes in the Company s internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the fiscal quarter ended June 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are party to a variety of legal proceedings that arise in the normal course of our business. In these actions, plaintiffs may request punitive or other damages that may not be covered by insurance. We accrue for these items as losses become probable and can be reasonably estimated. While the results of these legal proceedings cannot be predicted with certainty, management believes that the final outcome of these proceedings will not have a material adverse effect on our consolidated results of operations or financial position.

### ITEM 1A. RISK FACTORS

There has been no material change in the risk factors set forth in the Company s Annual Report on Form 10-K for the year ended December 31, 2006. For further information, refer to Part I, Item IA, Risk Factors in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On November 18, 2004, our Board of Directors authorized a plan to repurchase, at our discretion, of up to 2,000,000 shares of MoneyGram common stock on the open market. On August 18, 2005, the Board of Directors increased its share buyback authorization by 5,000,000 shares to a total of 7,000,000 shares. On May 9, 2007, the Board of Directors increased its share buyback authorization by an additional 5,000,000 shares to a total of 12,000,000 shares. These authorizations were announced publicly in our press releases issued on November 18, 2004, August 18, 2005 and May 9, 2007, respectively. The repurchase authorization is effective until such time as the Company has repurchased 12,000,000 common shares. Shares of MoneyGram common stock tendered to the Company in connection with the exercise of stock options or vesting of restricted stock are not considered repurchased shares under the terms of the repurchase authorization. As of June 30, 2007, we have repurchased 6,325,000 shares of our common stock under this authorization and have remaining authorization to repurchase up to 5,675,000 shares.

The following table sets forth information in connection with purchases made by us, or on our behalf, of shares of our common stock during the quarterly period ended June 30, 2007. The total number of shares purchased includes shares surrendered to the Company in payment of individual income taxes in connection with the exercise of stock options or the vesting of restricted stock.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan or Program | Maximum Number of Shares that May Yet Be Purchased Under the Plan or Program |
|---|---|---|---|---|
| April 1 April 30, 2007 | 291,902 | $ 28.85 | 290,000 | 6,035,000 |
| May 1 May 31, 2007 | 330,000 | $ 28.80 | 330,000 | 5,705,000 |
| June 1 June 30, 2007 | 38,144 | $ 28.69 | 30,000 | 5,675,000 |

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**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The stockholders of the Company voted on two items at the Annual Meeting of Stockholders on May 9, 2007:

1. The election of four directors to a 3-year term.
2. The ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2007.

The Class III nominees for directors whose terms expire at the 2010 Annual Meeting were elected based on the following votes:

| Nominee | Votes For | Votes Withheld |
|---|---|---|
| Jess T. Hay | 78,061,982 | 230,047 |
| Linda Johnson Rice | 77,871,816 | 420,213 |
| Albert M. Teplin | 78,121,221 | 170,808 |
| Timothy R. Wallace | 78,109,559 | 182,470 |

In addition, the terms of the following directors continued after the Annual Meeting:

Class I directors with terms expiring in 2008 Monte E. Ford, Judith K. Hofer, Robert C. Krueger and Philip W. Milne, and

Class II directors with terms expiring in 2009 Donald E. Kiernan, Douglas L. Rock and Othón Ruiz Montemayor

The ratification of the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for 2007 was approved based on the following votes:

| | |
|---|---|
| For | 78,156,308 |
| Against | 67,120 |
| Abstain | 68,601 |

**ITEM 6. EXHIBITS**

Exhibits are filed with this Form 10-Q as listed in the accompanying Exhibit Index.

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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.

**MoneyGram International, Inc.**
(Registrant)

August 9, 2007

By: /s/ Jean C. Benson

Senior Vice President and Controller
(Chief Accounting Officer and
Authorized Officer)

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## EXHIBIT INDEX

| Exhibit Number | Description |
|---|---|
| +10.1 | MoneyGram International, Inc. Management and Line of Business Incentive Plan as amended and restated May 9, 2007 (incorporated herein by reference from Exhibit 99.01 to the Company s Current Report on Form 8-K filed May 14, 2007). |
| +10.2 | MoneyGram International, Inc. Performance Unit Incentive Plan as amended and restated May 9, 2007 (incorporated herein by reference from Exhibit 99.02 to the Company s Current Report on Form 8-K filed May 14, 2007). |
| +10.3 | MoneyGram International, Inc. Deferred Compensation Plan as amended and restated May 9, 2007 (incorporated herein by reference from Exhibit 99.03 to the Company s Current Report on Form 8-K filed May 14, 2007). |
| +10.4 | Form of MoneyGram International, Inc. 2005 Omnibus Incentive Plan Non-Qualified Stock Option Agreement as of May 8, 2007 (incorporated herein by reference from Exhibit 99.04 to the Company s Current Report on Form 8-K filed May 14, 2007). |
| +10.5 | Form of MoneyGram International, Inc. 2005 Omnibus Incentive Plan Restricted Stock Award Agreement as of May 8, 2007 (incorporated herein by reference from Exhibit 99.05 to the Company s Current Report on Form 8-K filed May 14, 2007). |
| +10.6 | Form of MoneyGram International, Inc. 2005 Omnibus Incentive Plan Performance Based Restricted Stock Award Agreement as of May 8, 2007 (incorporated herein by reference from Exhibit 99.06 to the Company s Current Report on Form 8-K filed May 14, 2007). |
| *31.1 | Section 302 Certification of Chief Executive Officer |
| *31.2 | Section 302 Certification of Chief Financial Officer |
| *32.1 | Section 906 Certification of Chief Executive Officer |
| *32.2 | Section 906 Certification of Chief Financial Officer |

+ Denotes form of management contract or compensatory plan or arrangement required to be filed as an exhibit to this report.

* Filed herewith.