PNC FINANCIAL SERVICES GROUP INC
Form 10-Q
May 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2007

or

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

For the transition period from to

Commission file number 001-09718

The PNC Financial Services Group, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania	**25-1435979**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One PNC Plaza,

249 Fifth Avenue,

Pittsburgh, Pennsylvania 15222-2707

(Address of principal executive offices)

(Zip Code)

(412) 762-2000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant 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 whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes __ No X

As of April 30, 2007, there were 344,919,068 shares of the registrant s common stock ($5 par value) outstanding.

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CONSOLIDATED FINANCIAL HIGHLIGHTS

THE PNC FINANCIAL SERVICES GROUP, INC.

Dollars in millions, except per share data Unaudited	Three months ended March 31 2007	2006
FINANCIAL PERFORMANCE (a)		
Revenue		
Net interest income, taxable-equivalent basis (b)	**$ 629**	$ 563
Noninterest income	**991**	1,185
Total revenue	**$ 1,620**	$ 1,748
Noninterest expense	**$ 944**	$ 1,162
Net income	**$ 459**	$ 354
Per common share		
Diluted earnings	**$ 1.46**	$ 1.19
Cash dividends declared (c)	**$ .55**	$ .50
SELECTED RATIOS		
Net interest margin	**2.95%**	2.95%
Noninterest income to total revenue (d)	**61**	68
Efficiency (e)	**58**	67
Return on		
Average common shareholders equity	**15.59%**	16.67%
Average assets	**1.73**	1.56

See page 34 for a glossary of certain terms used in this Report.

(a) The Executive Summary and Consolidated Income Statement Review Noninterest Income-Summary portions of the Financial Review section of this Report provide information regarding items impacting the comparability of the periods presented.

(b) The interest income earned on certain assets is completely or partially exempt from federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of yields and margins for all earning assets, we also provide revenue on a taxable-equivalent basis by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments. This adjustment is not permitted under GAAP in the Consolidated Income Statement.

The following is a reconciliation of net interest income as reported in the Consolidated Income Statement to net interest income on a taxable-equivalent basis (in millions):

	Three months ended March 31 2007	2006
Net interest income, GAAP basis	**$ 623**	$ 556
Taxable-equivalent adjustment	**6**	7
Net interest income, taxable-equivalent basis	**$ 629**	$ 563

(c) On April 5, 2007, our Board of Directors approved a quarterly cash dividend payable on April 24, 2007 of $.63 per common share, an increase of 15% from the previous dividend paid in the first quarter of 2007.

(d) Calculated as noninterest income divided by the sum of net interest income (GAAP basis) and noninterest income. Noninterest income for the first quarter 2006 included the impact of BlackRock on a consolidated basis, primarily consisting of asset management fees. First quarter 2007 noninterest income reflected income from our equity investment in BlackRock included in the Asset management line item.

(e) Calculated as noninterest expense divided by the sum of net interest income (GAAP basis) and noninterest income.

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Unaudited	**March 31 2007**	December 31 2006	March 31 2006
Balance Sheet Data (dollars in millions, except per share data) (a)			
Assets	**$ 122,563**	$ 101,820	$ 93,257
Loans, net of unearned income	**62,925**	50,105	49,521
Allowance for loan and lease losses	**690**	560	597
Securities	**26,475**	23,191	21,529
Loans held for sale	**2,382**	2,366	2,266
Goodwill and other intangibles	**8,668**	4,043	4,482
Equity investments (b)	**5,408**	5,330	1,387
Deposits	**77,367**	66,301	60,899
Borrowed funds	**20,456**	15,028	16,440
Shareholders equity	**14,739**	10,788	8,781
Common shareholders equity	**14,732**	10,781	8,774
Book value per common share	**42.63**	36.80	29.70
Common shares outstanding (millions)	**346**	293	295
Loans to deposits	**81%**	76%	81%
Assets Administered (billions)			
Managed (c)	**$ 76**	$ 54	$ 504
Nondiscretionary	**111**	86	87
Fund Assets Serviced (billions)			
Accounting/administration net assets	**$ 822**	$ 837	$ 750
Custody assets	**435**	427	383
Capital Ratios			
Tier 1 risk-based (d)	**8.6%**	10.4%	8.8%
Total risk-based (d)	**12.2**	13.5	12.5
Leverage (d)	**8.7**	9.3	7.6
Tangible common equity	**5.8**	7.4	5.2
Common shareholders equity to assets	**12.0**	10.6	9.4
Asset Quality Ratios			
Nonperforming loans to total loans	**.28%**	.29%	.37%
Nonperforming assets to total loans and foreclosed assets	**.32**	.34	.42
Nonperforming assets to total assets	**.17**	.17	.22
Net charge-offs to average loans (for the three months ended)	**.27**	.36	.15
Allowance for loan and lease losses to loans	**1.10**	1.12	1.21
Allowance for loan and lease losses to nonperforming loans	**388**	381	328

(a) Amounts at March 31, 2007 reflect the impact of our March 2, 2007 acquisition of Mercantile Bankshares Corporation (Mercantile).

(b) Amounts at March 31, 2007 and December 31, 2006 include our equity investment in BlackRock, Inc. (BlackRock).

(c) Amounts at March 31, 2007 and December 31, 2006 do not include BlackRock s assets under management as we deconsolidated BlackRock effective September 29, 2006.

(d) The regulatory minimums are 4.0% for Tier 1, 8.0% for Total, and 3.0% for Leverage ratios. The well-capitalized levels are 6.0% for Tier 1, 10.0% for Total, and 5.0% for Leverage ratios.

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Financial Review

The PNC Financial Services Group, Inc.

This Financial Review should be read together with our unaudited Consolidated Financial Statements and unaudited Statistical Information included elsewhere in this Report and with Items 6, 7, 8 and 9A of our 2006 Annual Report on Form 10-K (2006 Form 10-K). We have reclassified certain prior period amounts to conform with the current period presentation. For information regarding certain business and regulatory risks, see the Risk Management section in this Financial Review and Items 1A and 7 of our 2006 Form 10-K. Also, see the Cautionary Statement Regarding Forward-Looking Information and Critical Accounting Policies And Judgments sections in this Financial Review for certain other factors that could cause actual results or future events to differ, perhaps materially, from those anticipated in the forward-looking statements included in this Report or from historical performance. See Note 14 Segment Reporting in the Notes To Consolidated Financial Statements included in Part I, Item 1 of this Report for a reconciliation of total business segment earnings to total PNC consolidated net income as reported on a generally accepted accounting principles (GAAP) basis.

Executive Summary

The PNC Financial Services Group, Inc.

PNC is one of the largest diversified financial services companies in the United States based on assets, with businesses engaged in retail banking, corporate and institutional banking, asset management and global fund processing services. We provide many of our products and services nationally and others in our primary geographic markets located in Pennsylvania; New Jersey; Washington, DC; Maryland; Virginia; Ohio; Kentucky and Delaware. We also provide certain global fund processing services internationally.

Key Strategic Goals

Our strategy to enhance shareholder value centers on driving positive operating leverage by achieving growth in revenue from our diverse business mix that exceeds growth in expenses as a result of disciplined cost management. In each of our business segments, the primary drivers of revenue growth are the acquisition, expansion and retention of customer relationships. We strive to expand our customer base by providing convenient banking options, leading technological systems and a broad range of fee-based products and services. We also intend to grow revenue through appropriate and targeted acquisitions and, in certain businesses, by expanding into new geographical markets.

In recent years, we have maintained a moderate risk profile characterized by strong credit quality and limited exposure to earnings volatility resulting from interest rate fluctuations and the shape of the interest rate yield curve. Our actions have created a balance sheet reflecting a strong capital position and investment flexibility to adjust, where appropriate, to changing interest rates and market conditions. We continue to invest capital in our businesses while returning a portion to shareholders through dividends and share repurchases.

Mercantile Bankshares Acquisition

We acquired Mercantile effective March 2, 2007 for approximately 53 million shares of PNC common stock and

$2.1 billion in cash. Total consideration paid was approximately $5.9 billion in stock and cash.

Mercantile has added banking and investment and wealth management services through 235 branches in Maryland, Virginia, the District of Columbia, Delaware and Southeastern Pennsylvania. This transaction has significantly expanded our presence in the mid-Atlantic region, particularly within the attractive Baltimore and Washington, DC markets.

The integration of Mercantile is on track and we are optimistic about the opportunities within our new region and customer base. We refer you to our Form 8-K filed March 8, 2007 for additional information on this transaction.

Key Factors Affecting Financial Performance

Our financial performance is substantially affected by several external factors outside of our control, including:

General economic conditions,
Loan demand and utilization of credit commitments,
Movement of customer deposits from lower to higher rate accounts or to investment alternatives,
The level of interest rates, and the shape of the interest rate yield curve,
The performance of the capital markets, and
Customer demand for other products and services.

In addition to changes in general economic conditions, including the direction, timing and magnitude of movement in interest rates and the performance of the capital markets, our success in the remainder of 2007 will depend, among other things, upon:

Further success in the acquisition, growth and retention of customers,
The successful integration of Mercantile,
Revenue growth,
A sustained focus on expense management and creating positive operating leverage,
Maintaining strong overall asset quality, and
Prudent risk and capital management.

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SUMMARY FINANCIAL RESULTS

In millions, except per share data	Three months ended Mar. 31, 2007	Mar. 31, 2006
Net income	**$ 459**	$ 354
Diluted earnings per share	**$ 1.46**	$ 1.19
Return on		
Average common shareholders equity	**15.59%**	16.67%
Average assets	**1.73%**	1.56%

Earnings for the first quarter of 2007 included the after-tax impact of the following items:

A gain of $53 million, or $.17 per diluted share, recognized in connection with the transfer of BlackRock shares to satisfy a portion of our 2002 BlackRock LTIP shares obligation,

A loss of $20 million, or $.06 per diluted share, from the net mark-to-market adjustment on our remaining BlackRock long-term incentive plan (LTIP) shares obligation, and

Acquisition integration costs related to the Mercantile acquisition and the 2006 BlackRock/MLIM transaction totaling $8 million, or $.03 per diluted share.

Our first quarter 2007 results included the following accomplishments consistent with our strategy:

We closed on the acquisition of Mercantile, increasing total assets to a record $123 billion.

Our business segments each grew earnings over the prior year first quarter. The rates of growth were 6% for Retail Banking, 29% for Corporate & Institutional Banking, 6% for BlackRock and 15% for PFPC.

We created positive operating leverage compared with the first quarter of 2006.

First quarter 2007 net interest income grew 12% compared with the first quarter of 2006. The net interest margin improved to 2.95% from 2.88% for the fourth quarter of 2006 and was unchanged from the first quarter of 2006.

Average loans increased $5.0 billion, or 10%, compared with the first quarter of 2006, largely due to the partial first quarter 2007 impact of Mercantile as well as growth in commercial loans.

Average deposits for the first quarter of 2007 increased $8.7 billion, or 14%, compared with the first quarter of 2006 due to growth in interest- and noninterest-bearing deposits and to the partial quarter impact of Mercantile.

Asset quality remained very strong. Nonperforming assets to total assets were .17% at March 31, 2007 compared with .22% at March 31, 2006.

BLACKROCK/MLIM TRANSACTION

As further described in our 2006 Form 10-K, on September 29, 2006 Merrill Lynch contributed its investment management business (MLIM) to BlackRock in exchange for 65 million shares of newly issued BlackRock common and preferred stock.

For the three months ended March 31, 2006, our Consolidated Income Statement included our former 69% ownership interest in BlackRock. However, our Consolidated Balance Sheet as of March 31, 2007 and December 31, 2006 reflected the September 29, 2006 deconsolidation of BlackRock s balance sheet amounts and recognized our approximate 34% ownership interest in BlackRock as an investment accounted for under the equity method. This accounting has resulted in a reduction in certain revenue and noninterest expense categories on our Consolidated Income Statement as our share of BlackRock s net income is now reported within asset management noninterest income. In addition, beginning with fourth quarter 2006, we recognize gain or loss each quarter-end on our then-remaining liability to provide shares of BlackRock common stock to help fund BlackRock LTIP programs as that liability is marked to market based on changes in BlackRock s common stock price. As in the first quarter of 2007, we will also recognize gains or losses on the future transfer of shares for payouts under such LTIP programs.

BALANCE SHEET HIGHLIGHTS

Total assets were $122.6 billion at March 31, 2007 compared with $101.8 billion at December 31, 2006. The increase compared with December 31, 2006 was primarily due to the addition of approximately $21 billion of assets related to Mercantile.

Total average assets were $107.4 billion for the first quarter of 2007 compared with $92.1 billion for the first quarter of 2006. This increase was primarily attributable to an $8.8 billion increase in average interest-earning assets and a $6.5 billion increase in average other noninterest-earning assets. An increase of $5.0 billion in loans, a $2.5 billion increase in securities, and a $1.6 billion increase in federal funds sold and resale agreements were the primary factors for the increase in average interest-earning assets.

The increase in average other noninterest-earning assets for the first quarter of 2007 reflected our equity investment in BlackRock, which averaged $3.8 billion for the first quarter of 2007 and which had been consolidated for the first quarter of 2006, and an increase in average goodwill of $1.4 billion related to the Mercantile acquisition.

Average total loans were $54.1 billion for the first quarter of 2007 and $49.1 billion in the first quarter of 2006. The increase in average total loans included the partial effect of the Mercantile acquisition during the quarter, and higher commercial loans. The increase in average total loans included growth in commercial real estate loans of approximately $2.5

billion and growth in commercial loans of approximately $1.9 billion. Loans represented 63% of average interest-earning assets for the first quarter of 2007 and 64% for the first quarter 2006.

Average securities totaled $23.4 billion for the first three months of 2007 and $20.9 billion for the first three months of 2006. The partial quarter impact of Mercantile contributed to the increase in average securities for 2007. By primary classification, the increase in average securities reflected a $5.4 billion increase in mortgage-backed and asset-backed securities, which was partially offset by a $3.1 billion decline in US Treasury and government agencies securities. Securities comprised 27% of average interest-earning assets for both the first quarter 2007 and the first quarter 2006.

Average total deposits were $69.7 billion for the first quarter of 2007, an increase of $8.7 billion over the first quarter of 2006. Average deposits grew from the prior year quarter primarily as a result of an increase in money market, noninterest-bearing demand deposits, retail certificates of deposit and the partial quarter impact of the Mercantile acquisition.

Average total deposits represented 65% of average total assets for the first quarter of 2007 and 66% for the first quarter of 2006. Average transaction deposits were $47.0 billion for the first quarter of 2007 compared with $40.8 billion for the first quarter of 2006.

Average borrowed funds were $16.8 billion for the first quarter of 2007 and $15.8 billion for the first quarter of 2006.

Shareholders equity totaled $14.7 billion at March 31, 2007, compared with $10.8 billion at December 31, 2006. The increase resulted primarily from the Mercantile acquisition completed in March 2007. See the Consolidated Balance Sheet Review section of this Financial Review for additional information.

BUSINESS SEGMENT HIGHLIGHTS

Total business segment earnings increased 13%, to $416 million, for the first quarter of 2007 compared with the first quarter of 2006. We refer you to page 15 of this Report for a Results of Businesses Summary table. Highlights of results for the first quarter 2007 in comparison to the prior year period follow. Further analysis of business segment results for the first quarter 2007 is provided on pages 16 through 23.

We provide a reconciliation of total business segment earnings to total PNC consolidated net income as reported on a GAAP basis in Note 14 Segment Reporting in the Notes To Consolidated Financial Statements in this Report.

Retail Banking

Retail Banking earned $201 million for the first quarter of 2007 compared with $190 million for the same period in 2006. The 6% increase over the first quarter of 2006 was driven by the Mercantile acquisition, strong market related fees, and continued customer and balance sheet growth, partially offset by an increase in the provision for credit losses.

Corporate & Institutional Banking

Corporate & Institutional Banking earned $132 million in the first quarter of 2007 compared with $102 million in the first quarter of 2006. The 29% increase compared with the first quarter of 2006 was largely the result of a lower provision for credit losses, due to improving asset quality, and positive operating leverage.

BlackRock

Our BlackRock business segment earned $52 million for the first quarter of 2007 and $49 million for the first quarter of 2006. The higher earnings reflected our approximate 34% ownership interest in a larger BlackRock entity for the first quarter of 2007 compared with the first quarter of 2006.

PFPC

PFPC earned $31 million for the first quarter of 2007 compared with $27 million in the year-earlier period. The 15% earnings increase from the first quarter of 2006 reflected new business, organic growth and market appreciation, partly offset by client deconversions. Certain tax benefits

also contributed to the increase in earnings compared with the first three months of 2006.

Other

Other earnings for the first three months of 2007 totaled $43 million, while Other for the first three months of 2006 was a net loss of $14 million. The increase in Other in the comparison was primarily due to the impact of the $33 million after-tax net gain recognized during the first quarter of 2007 related to BlackRock LTIP activity, higher equity management gains in 2007 and a portion of the earnings contribution from Mercantile asset and liability management activities.

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CONSOLIDATED INCOME STATEMENT REVIEW

NET INTEREST INCOME AND NET INTEREST MARGIN

	Three months ended	
Dollars in millions	Mar. 31, 2007	Mar. 31, 2006
Taxable-equivalent net interest income	**$ 629**	$ 563
Net interest margin	**2.95%**	2.95%

We provide a reconciliation of net interest income as reported under GAAP to net interest income presented on a taxable-equivalent basis in the Consolidated Financial Highlights section on page 1 of this Report.

Changes in net interest income and margin result from the interaction of the volume and composition of interest-earning assets and related yields, interest-bearing liabilities and related rates paid, and noninterest-bearing sources of funding. See Statistical Information-Average Consolidated Balance Sheet And Net Interest Analysis included on pages 65 and 66 of this Report for additional information.

The 12% increase in taxable-equivalent net interest income for the first quarter of 2007 compared with the first quarter of 2006 was consistent with the $8.8 billion, or 12%, increase in average interest-earning assets over these periods. The reasons driving the higher interest-earning assets in this comparison are further discussed in the Balance Sheet Highlights portion of the Executive Summary section of this Report.

The net interest margin was 2.95% for both the first quarters of 2007 and 2006. The following factors offset each other in the comparison:

- The yield on interest-earning assets increased 59 basis points. Loans, the single largest component, increased 54 basis points.
- The impact of noninterest-bearing sources of funding increased 9 basis points for the first quarter of 2007 due to higher rates.
- These factors were offset by an increase in the rate paid on interest-bearing liabilities of 68 basis points. The rate paid on interest-bearing deposits, the single large component, increased 71 basis points.

During the first quarter of 2007, the average federal funds rate was 5.26% compared with 4.46% for the first quarter of 2006.

We believe that net interest margins for our industry will continue to be challenged if the yield curve remains flat or inverted, as competition for loans and deposits remains intense, as customers continue to migrate from lower rate to higher rate deposits or other products, and as the benefit of adding or repricing investment securities is diminished. However, we expect that taxable-equivalent net interest income for full year 2007 will grow in the mid-20% range compared with full year 2006 and the net interest margin will improve. These

expected increases are primarily due to the Mercantile acquisition as well as projected earning asset growth, funding composition and pricing, and interest rate changes.

PROVISION FOR CREDIT LOSSES

The provision for credit losses decreased $14 million, to $8 million, in the first quarter of 2007 compared with the first quarter of 2006. The decrease in the quarterly comparison was primarily the result of improving overall asset quality.

We do not expect to sustain asset quality at its current level. However, based on the assets we currently hold and current business trends and activities, we believe that overall asset quality will remain strong by historical standards for the near term. We anticipate that the provision will be higher for the second quarter of 2007 compared with the first quarter of 2007. To the extent actual outcomes differ from our estimates, additional provision for credit losses may be required that would reduce future earnings. See the Credit Risk Management portion of the Risk Management section of this Financial Review for additional information regarding factors that impact the provision for credit losses.

NONINTEREST INCOME

Summary

Noninterest income was $991 million for the first quarter of 2007 compared with $1.185 billion for the first quarter of 2006. In 2007, we refined our accounting and reporting of PFPC s distribution fee revenue and related expense amounts. Due to this change, amounts for these items for the

first quarter of 2007 are lower than as reported in conjunction with our first quarter 2007 earnings release. These amounts, which offset each other entirely and which have no impact on earnings, were previously shown on a gross basis within the fund servicing fee component of noninterest income and within other noninterest expense. This change was made on a prospective basis, effective January 1, 2007.

Total noninterest income for the first quarter of 2007 and first quarter 2006 included the following items:

- First quarter 2007 included a net gain related to our equity investment in BlackRock of $52 million, representing an $82 million gain recognized in connection with our transfer of BlackRock shares to satisfy a portion of our 2002 LTIP shares obligation, partially offset by a net mark-to-market adjustment totaling $30 million on our remaining BlackRock LTIP shares obligation, and
- First quarter of 2006 noninterest income included the impact of BlackRock on a consolidated basis in the amount of $406 million. Had BlackRock been on the equity method for the first quarter of 2006, BlackRock s reported noninterest income would have been $52 million for that quarter, or lower by $354 million.

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Apart from the impact of these items, noninterest income increased $108 million, or 13%, compared with the first quarter of 2006 largely as a result of organic growth and the acquisition of Mercantile.

Additional Analysis

Asset management fees totaled $165 million in the first quarter of 2007, a decrease of $296 million compared with the first quarter of 2006. Our equity income from BlackRock was included in asset management fees for the first quarter of 2007, while asset management fees in the prior year quarter reflected the impact of BlackRock s revenue on a consolidated basis.

Assets managed at March 31, 2007 totaled $76 billion compared with $504 billion at March 31, 2006. BlackRock s assets under management, which were no longer included in assets managed by us at March 31, 2007 due to our deconsolidation of BlackRock effective September 29, 2006, were included in the March 31, 2006 totals. We refer you to the Retail Banking section of the Business Segments Review section of this Report for further discussion of our assets under management.

Fund servicing fees of $203 million for the first quarter of 2007 represented an $18 million decrease from the prior year period. Included in these amounts were out-of-pocket revenue amounts at PFPC totaling $14 million for the first three months of 2007 and distribution/out-of-pocket revenue amounts of $37 million for the first three months of 2006. These revenue amounts are passed through to PFPC s customers, and therefore their impact was offset by expenses in the same amounts each year.

PFPC provided fund accounting/administration services for $822 billion of net fund investment assets and provided custody services for $435 billion of fund investment assets at March 31, 2007, compared with $750 billion and $383 billion, respectively, at March 31, 2006. These increases were the result of new business attained, organic growth from current customers and market appreciation.

Service charges on deposits grew $4 million, to $77 million, in the first three months of 2007 compared with the first three months of 2006. This increase can be attributed primarily to the partial quarter impact of Mercantile and to customer growth.

Brokerage fees totaled $66 million in the first quarter of 2007 and $59 million in the first quarter of 2006. The increase was primarily due to higher annuity income and mutual fund related revenues, including a favorable impact from products related to the fee-based fund advisory business.

Consumer services fees grew $2 million, to $91 million, for the first three months of 2007 compared with the first three months of 2006. This increase reflected the partial quarter

impact of Mercantile, higher debit card revenues resulting from higher transaction volumes, and revenue from the credit card business that began in the latter part of 2006. These factors were partially offset by lower ATM surcharge revenue in the 2007 period compared with the prior year period as a result of changing customer behavior and a strategic decision to reduce the out-of-footprint ATM network.

Corporate services revenue totaling $159 million in the first quarter of 2007 represented a $24 million increase over the first quarter of 2006. Higher revenue from various sources, including treasury management and mergers and acquisitions advisory and related services, contributed to this increase.

Equity management (private equity) net gains on portfolio investments totaled $32 million for the first three months of 2007 compared with $7 million for the first three months of 2006. Based on the nature of private equity activities, net gains or losses may be volatile from period to period.

Noninterest revenue from trading activities, more than one-half of which is customer-related, was $52 million for the first quarter of 2007 compared with $57 million for the first quarter of 2006. We provide additional information on our trading activities under Market Risk Management Trading Risk in the Risk Management section of this Financial Review.

Other noninterest income of $97 million for the first three months of 2007 represented a $10 million increase compared with the first three months of 2006. Other noninterest income typically fluctuates from period to period depending on the nature and magnitude of transactions completed.

Due to the BlackRock/MLIM transaction, which resulted in a $2.1 billion pretax gain in 2006, we expect that total noninterest income will decline significantly for full year 2007 compared with full year 2006. Changes in noninterest income compared with the prior year also will be

impacted by the deconsolidation of BlackRock and balance sheet repositioning actions in 2006, and our BlackRock LTIP obligation. Our remaining noninterest income sources are expected to increase, in aggregate, by a low teens percentage for full year 2007 compared with 2006 as a result of organic growth and the Mercantile acquisition.

Product Revenue

In addition to credit products to commercial customers, Corporate & Institutional Banking offers treasury management and capital markets-related products and services, commercial loan servicing and equipment leasing products that are marketed by several businesses across PNC.

Treasury management revenue, which includes fees as well as net interest income from customer deposit balances, increased 9% to $110 million for the first quarter of 2007 from $101

million for the first quarter of 2006. The higher revenue reflected continued expansion and client utilization of commercial payment card services, strong revenue growth in various electronic payment and information services, and a steady increase in business-to-business processing volumes.

Revenue from capital markets-related products and services was $67 million for the first three months of 2007 compared with $64 million in the first three months of 2006, primarily driven by increased revenues from mergers and acquisitions advisory and related services.

Midland Loan Services offers servicing, real estate advisory and technology solutions for the commercial real estate finance industry. Midland s revenue, which includes servicing fees and net interest income from servicing portfolio deposit balances, totaled $54 million for first quarter of 2007 and $42 million for first quarter of 2006. The 29% revenue growth was primarily driven by growth in the commercial mortgage servicing portfolio and related services.

As a component of our advisory services to clients, we provide a select set of insurance products to fulfill specific customer financial needs. Primary insurance offerings include:

- Annuities,
- Life,
- Credit life,
- Health,
- Disability, and
- Commercial lines coverage.

Client segments served by these insurance products include those in Retail Banking and Corporate & Institutional Banking. Insurance products are sold by licensed PNC insurance agents and through licensed third-party arrangements. Revenue from these products was $18 million in the first quarter of 2007 and $17 million in the first quarter of 2006.

PNC, through subsidiary companies Alpine Indemnity Limited and PNC Insurance Corp., participates as a direct writer for its general liability, automobile liability, workers compensation, property and terrorism insurance programs.

In the normal course of business, Alpine Indemnity Limited and PNC Insurance Corp. maintain insurance reserves for reported claims and for claims incurred but not reported based on actuarial assessments. We believe these reserves were adequate at March 31, 2007.

NONINTEREST EXPENSE

Total noninterest expense was $944 million for the first quarter of 2007 and $1.162 billion for the first quarter of 2006.

As noted above under Noninterest Income, in 2007 we refined our accounting and reporting of PFPC s distribution fee revenue and related expense amounts. This change was made on a prospective basis, effective January 1, 2007.

Noninterest expense for the first quarter 2007 and first quarter 2006 included the following:

- Integration costs of $11 million in the first quarter of 2007 related to our acquisition of Mercantile; and
- First quarter 2006 noninterest expense included $291 million of expenses related to BlackRock, which was still consolidated during that time. In addition, noninterest expense for the first quarter 2006 included $6 million of BlackRock/MLIM transaction integration costs.

Apart from the impact of these items, noninterest expense increased $68 million, or 8%, compared with the first quarter of 2006 largely as a result of increased compensation expenses, investments in growth initiatives and the acquisition of Mercantile.

We expect total noninterest expense to decline for full year 2007 compared with full year 2006 due to the impact of the deconsolidation of BlackRock. Apart from this impact, we expect noninterest expense to grow by a low teens percentage for full year 2007 compared with 2006 primarily as a result of the Mercantile acquisition. In addition, we expect to continue to incur pretax integration costs related to Mercantile that are currently estimated to be $40 million for the remainder of 2007.

PERIOD-END EMPLOYEES

	March 31, 2007	December 31, 2006	March 31, 2006
Full-time	24,635	21,455	23,642
Part-time	3,060	2,328	2,003
Total	27,695	23,783	25,645

Of the numbers at March 31, 2007, approximately 3,000 full-time and approximately 700 part-time employees were added as a result of our acquisition of Mercantile. BlackRock employees were included in these numbers at March 31, 2006.

EFFECTIVE TAX RATE

Our effective tax rate for the first three months of 2007 was 30.7% compared with 32.5% for the first three months of 2006. The lower effective rate for first quarter of 2007 reflected the deconsolidation of BlackRock effective September 29, 2006 and certain tax adjustments. We expect our effective tax rate to increase to approximately 32% for the remainder of 2007 resulting from the Mercantile acquisition.

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CONSOLIDATED BALANCE SHEET REVIEW

SUMMARIZED BALANCE SHEET DATA

In millions	March 31 2007	December 31 2006
Assets		
Loans, net of unearned income	**$ 62,925**	$ 50,105
Securities available for sale	**26,475**	23,191
Loans held for sale	**2,382**	2,366
Equity investments	**5,408**	5,330
Goodwill and other intangible assets	**8,668**	4,043
Other	**16,705**	16,785
Total assets	**$ 122,563**	$ 101,820
Liabilities		
Funding sources	**$ 97,823**	$ 81,329
Other	**8,634**	8,818
Total liabilities	**106,457**	90,147
Minority and noncontrolling interests in consolidated entities	**1,367**	885
Total shareholders equity	**14,739**	10,788
Total liabilities, minority and noncontrolling interests, and shareholders equity	**$ 122,563**	$ 101,820

Our Consolidated Balance Sheet is presented in Part I, Item 1 on page 38 of this Report.

Our Consolidated Balance Sheet at March 31, 2007 reflects the addition of approximately $21 billion of assets resulting from our Mercantile acquisition.

Various seasonal and other factors impact our period-end balances whereas average balances (discussed under the Balance Sheet Highlights section of this Financial Review above and included in the Statistical Information section of this Report on pages 63 and 64) are more indicative of underlying business trends.

An analysis of changes in certain balance sheet categories follows.

LOANS, NET OF UNEARNED INCOME

Loans increased $12.8 billion, to $62.9 billion, at March 31, 2007 compared with the balance at December 31, 2006. Our acquisition of Mercantile added $12.4 billion of loans including $5.8 billion of commercial real estate, $2.7 billion of commercial, $2.3 billion of residential mortgage and $1.6 billion of consumer loans.

Details Of Loans

In millions	**March 31 2007**	December 31 2006
Commercial		
Retail/wholesale	**$ 5,916**	$ 5,301
Manufacturing	**4,416**	4,189
Other service providers	**2,791**	2,186
Real estate related	**3,555**	2,825
Financial services	**1,499**	1,324
Health care	**949**	707
Other	**4,396**	4,052
Total commercial	**$ 23,522**	$ 20,584
Commercial real estate		
Real estate projects	**8,769**	2,716
Mortgage	**602**	816
Total commercial real estate	**9,371**	3,532
Equipment lease financing	**3,527**	3,556
Total commercial lending	**36,420**	27,672
Consumer		
Home equity	**14,263**	13,749
Automobile	**1,956**	1,135
Other	**1,769**	1,631
Total consumer	**17,988**	16,515
Residential mortgage	**9,158**	6,337
Other	**364**	376
Unearned income	**(1,005)**	(795)
Total, net of unearned income	**$ 62,925**	$ 50,105

Our total loan portfolio continued to be diversified among numerous industries and types of businesses. The loans that we hold are also concentrated in, and diversified across, our principal geographic markets.

Commercial lending outstandings in the table above are the largest category and are the most sensitive to changes in assumptions and judgments underlying the determination of the allowance for loan and lease losses. We have allocated approximately $477 million, or 69%, of the total allowance for loan and lease losses at March 31, 2007 to these loans. This allocation also considers other relevant factors such as:

- Actual versus estimated losses,
- Regional and national economic conditions,
- Business segment and portfolio concentrations,
- Industry conditions,
- The impact of government regulations, and
- Risk of potential estimation or judgmental errors, including the accuracy of risk ratings.

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Net Unfunded Credit Commitments

In millions	March 31 2007	December 31 2006
Commercial	**$ 33,613**	$ 31,009
Consumer	**11,525**	10,495
Commercial real estate	**3,855**	2,752
Other	**270**	579
Total	**$ 49,263**	$ 44,835

Unfunded commitments are concentrated in our primary geographic markets. Net unfunded commitments at March 31, 2007 include $5.0 billion related to our acquisition of Mercantile. Commitments to extend credit represent arrangements to lend funds or provide liquidity subject to specified contractual conditions. Commercial commitments are reported net of participations, assignments and syndications, primarily to financial institutions, totaling $8.5 billion at March 31, 2007 and $8.3 billion at December 31, 2006.

Unfunded liquidity facility commitments and standby bond purchase agreements totaled $6.0 billion at March 31, 2007 and $6.0 billion at December 31, 2006 and are included in the preceding table primarily within the Commercial and Consumer categories.

In addition to credit commitments, our net outstanding standby letters of credit totaled $4.8 billion at March 31, 2007 and $4.4 billion at December 31, 2006. Standby letters of credit commit us to make payments on behalf of our customers if specified future events occur.

Leases and Related Tax and Accounting Matters

The equipment lease portfolio totaled $3.5 billion at March 31, 2007. Aggregate residual value at risk on the lease portfolio at March 31, 2007 was $1.1 billion. We have taken steps to mitigate $.6 billion of this residual risk, including residual value insurance coverage with third parties, third party guarantees, and other actions. The portfolio included approximately $1.7 billion of cross-border leases at March 31, 2007. Cross-border leases are leveraged leases of equipment located in foreign countries, primarily in western Europe and Australia. We have not entered into cross-border lease transactions since 2003.

Upon completing an examination of our 1998-2000 and 2001-2003 consolidated federal income tax returns, the IRS provided us with examination reports which propose increases in our tax liability, principally arising from adjustments to the timing of tax deductions from our cross-border lease transactions.

While the situation with respect to these proposed adjustments remains unresolved, we believe our reserves for these exposures were appropriate at March 31, 2007.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction* (FSP 13-2). FSP 13-2 became effective January 1, 2007 and will require a recalculation of the timing of income recognition for actual or projected changes in the timing of tax benefits for leveraged leases. Any cumulative adjustment must be recognized through retained earnings upon adoption of FSP 13-2. See Note 1 Accounting Policies in the Notes To Consolidated Financial Statements in Part I, Item 1 of this Report and in Item 8 of our 2006 Form 10-K for additional information. Effective January 1, 2007, we recalculated our leases and recorded a cumulative adjustment to beginning retained earnings of $149 million, after-tax, as required by FSP 13-2. This adjustment was based on our best estimate as to the timing and amount of ultimate settlement of this exposure. Any immediate or future reductions in earnings from our adoption of FSP 13-2 would be recovered in subsequent years.

The adjustment includes amounts related to three lease-to-service contract transactions that we were party to that were structured as partnerships for tax purposes. The partnership tax returns, depending on the particular partnership, have either been examined or are under examination by the IRS. We do not believe that our exposure from these transactions is material to our consolidated results of operations or financial position.

Additional information on cross-border lease transactions is included under Leases and Related Tax and Accounting Matters in the Consolidated Balance Sheet Review section of Item 7 of our 2006 Form 10-K.

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SECURITIES

Details Of Securities (a)

In millions	Amortized Cost	Fair Value
March 31, 2007		
SECURITIES AVAILABLE FOR SALE		
Debt securities		
Residential mortgage-backed	**$ 19,594**	**$ 19,546**
Commercial mortgage-backed	**3,884**	**3,882**
Asset-backed	**2,049**	**2,043**
US Treasury and government agencies	**414**	**411**
State and municipal	**206**	**205**
Other debt	**36**	**36**
Corporate stocks and other	**352**	**352**
Total securities available for sale	**$ 26,535**	**$ 26,475**
December 31, 2006		
SECURITIES AVAILABLE FOR SALE		
Debt securities		
Residential mortgage-backed	$ 17,325	$ 17,208
Commercial mortgage-backed	3,231	3,219
Asset-backed	1,615	1,609
US Treasury and government agencies	611	608
State and municipal	140	139
Other debt	90	87
Corporate stocks and other	321	321
Total securities available for sale	$ 23,333	$ 23,191

(a) Securities held to maturity at March 31, 2007 and December 31, 2006 were less than $.5 million.

Securities represented 22% of total assets at March 31, 2007 and 23% of total assets at December 31, 2006. Our acquisition of Mercantile added approximately $3 billion of securities, of which approximately $1 billion we classified as trading and sold and the remainder of which we classified as securities available for sale.

We evaluate our portfolio of securities available for sale in light of changing market conditions and other factors and, where appropriate, take steps intended to improve our overall positioning.

At March 31, 2007, securities available for sale included a net unrealized loss of $60 million, which represented the difference between fair value and amortized cost. The comparable amount at December 31, 2006 was a net unrealized loss of $142 million. Net unrealized gains and losses in the securities available for sale portfolio are included in shareholders equity as accumulated other comprehensive income (loss), net of tax.

The fair value of securities available for sale generally decreases when market interest rates increase and vice versa. Consequently, increases in interest rates after March 31, 2007, could adversely impact the fair value of securities available for sale compared with March 31, 2007.

The expected weighted-average life of securities available for sale (excluding corporate stocks and other) was 3 years and 8 months at March 31, 2007 and December 31, 2006.

We estimate that at March 31, 2007 the effective duration of securities available for sale is 2.6 years for an immediate 50 basis points parallel increase in interest rates and 2.2 years for an immediate 50 basis points parallel decrease in interest rates. These estimates are unchanged from those at December 31, 2006.

LOANS HELD FOR SALE

Education loans held for sale totaled $1.5 billion at March 31, 2007 and $1.3 billion at December 31, 2006 and represented the majority of our loans held for sale at each date. We classify substantially all of our education loans as loans held for sale. Generally, we sell education loans when the loans are placed into repayment status. Gains on sales of education loans are reflected in the other noninterest income line item in our Consolidated Income Statement and in the results for the Retail Banking business segment.

FUNDING AND CAPITAL SOURCES

Details of Funding Sources

In millions	**March 31 2007**	December 31 2006
Deposits		
Money market	**$ 31,040**	$ 28,580
Demand	**21,121**	16,833
Retail certificates of deposit	**17,714**	14,725
Savings	**3,010**	1,864
Other time	**2,902**	1,326
Time deposits in foreign offices	**1,580**	2,973
Total deposits	**77,367**	66,301
Borrowed funds		
Federal funds purchased	**5,638**	2,711
Repurchase agreements	**2,586**	2,051
Bank notes and senior debt	**4,551**	3,633
Subordinated debt	**4,628**	3,962
Other	**3,053**	2,671
Total borrowed funds	**20,456**	15,028
Total	**$ 97,823**	$ 81,329

Total funding sources increased $16.5 billion at March 31, 2007 compared with the balance at December 31, 2006, as total deposits increased $11.1 billion and total borrowed funds increased $5.4 billion. Our acquisition of Mercantile added $12.5 billion of deposits and $2.1 billion of borrowed funds.

Capital

We manage our capital position by making adjustments to our balance sheet size and composition, issuing debt, equity or hybrid instruments, executing treasury stock transactions, maintaining dividend policies and retaining earnings.

Total shareholders equity increased $4.0 billion, to $14.7 billion, at March 31, 2007 compared with December 31, 2006.

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This increase reflected a $2.9 billion reduction in treasury stock and a $.9 billion increase in capital surplus, largely due to the Mercantile acquisition.

Common shares outstanding at March 31, 2007 were 346 million compared with 293 million at December 31, 2006. The increase in shares outstanding during the first quarter of 2007 reflected the issuance of approximately 53 million shares in connection with the Mercantile acquisition.

We purchased 1.4 million common shares under our common stock repurchase program during the first three months of 2007. Our current program, which permits us to purchase up to 20 million shares on the open market or in privately negotiated transactions, will remain in effect until fully utilized or until modified, superseded or terminated. As of March 31, 2007, remaining availability for purchases under this program was 13.1 million shares. The extent and timing of additional share repurchases under this program will depend on a number of factors including, among others, market and general economic conditions, economic and regulatory capital considerations, alternative uses of capital, regulatory limitations resulting from merger activity, and the potential impact on our credit rating. We expect to continue to be active in share repurchases.

Risk-Based Capital

Dollars in millions	**March 31 2007**	December 31 2006
Capital components		
Shareholders equity		
Common	**$14,732**	$10,781
Preferred	**7**	7
Trust preferred capital securities	**811**	965
Minority interest	**984**	494
Goodwill and other intangibles	**(8,170)**	(3,566)
Eligible deferred income taxes on intangible assets	**127**	26
Pension, other postretirement benefit plan adjustments	**142**	148
Net unrealized securities losses, after-tax	**38**	91
Net unrealized (gains) losses on cash flow hedge derivatives, after-tax	**(4)**	13
Equity investments in nonfinancial companies	**(37)**	(30)
Other, net	**(4)**	(5)
Tier 1 risk-based capital	**8,626**	8,924
Subordinated debt	**2,805**	1,954
Eligible allowance for credit losses	**811**	681
Total risk-based capital	**$12,242**	$11,559
Assets		
Risk-weighted assets, including off-balance sheet instruments and market risk equivalent assets	**$100,588**	$85,539
Adjusted average total assets	**99,377**	95,590
Capital ratios		
Tier 1 risk-based	**8.6%**	10.4%
Total risk-based	**12.2**	13.5
Leverage	**8.7**	9.3
Tangible capital		
Shareholders equity	**$14,732**	$10,781
Goodwill and other intangibles	**(8,170)**	(3,566)
Eligible deferred taxes	**127**	26
Tangible capital	**$6,689**	$7,241
Total assets excluding goodwill and other intangible assets, net of eligible deferred income taxes	**$114,520**	$98,280
Tangible common equity	**5.8%**	7.4%

The access to, and cost of, funding new business initiatives including acquisitions, the ability to engage in expanded business activities, the ability to pay dividends, the level of deposit insurance costs, and the level and nature of regulatory oversight depend, in part, on a financial

institution s capital strength. At March 31, 2007, each of our banking subsidiaries was considered well-capitalized based on regulatory capital ratio requirements, as indicated in the Capital Ratios section of Consolidated Financial Highlights on page 2 of this Report. We believe our bank subsidiaries will continue to meet these requirements during the remainder of 2007.

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OFF-BALANCE SHEET ARRANGEMENTS AND VARIABLE INTEREST ENTITIES

We engage in a variety of activities that involve unconsolidated entities or that are otherwise not reflected in our Consolidated Balance Sheet that are generally referred to as off-balance sheet arrangements. The following sections of this Report provide further information on these types of activities:

Commitments, including contractual obligations and other commitments, included within the Risk Management section of this Financial Review, and

Note 15 Commitments And Guarantees in the Notes To Consolidated Financial Statements included in Part I, Item 1 of this Report.

The following provides a summary of variable interest entities (VIEs), including those in which we hold a significant variable interest but have not consolidated and those that we have consolidated into our financial statements as of March 31, 2007 and December 31, 2006. Additional information on our partnership interests in low income housing projects is included in our 2006 Form 10-K under this same heading in Part I, Item 7 and Note 3 Variable Interest Entities in the Notes To Consolidated Financial Statements included in Part II, Item 8 of that report.

Non-Consolidated VIEs - Significant Variable Interests

In millions	Aggregate Assets	Aggregate Liabilities	PNC Risk of Loss
March 31, 2007			
Market Street	**$3,820**	**$3,819**	**$6,149**(a)
Collateralized debt obligations	**540**	**449**	**8**
Partnership interests in low income housing projects	**33**	**30**	**8**
Total	**$4,393**	**$4,298**	**$6,165**
December 31, 2006			
Market Street	$4,020	$4,020	$6,117(a)
Collateralized debt obligations	815	570	22
Partnership interests in low income housing projects	33	30	8
Total	$4,868	$4,620	$6,147

(a) PNC s risk of loss consists of off-balance sheet liquidity commitments to Market Street of $5.6 billion and other credit enhancements of $.5 billion at March 31, 2007. The comparable amounts at December 31, 2006 were $5.6 billion and $.6 billion, respectively.

Market Street

Market Street Funding LLC (Market Street), is a multi-seller asset-backed commercial paper conduit that is owned by an independent third party. Market Street s activities are limited to the purchasing of assets or making of loans secured by interests primarily in pools of receivables from US corporations that desire access to the commercial paper

market. Market Street funds the purchases or loans by issuing commercial paper which has been rated A1/P1 by Standard & Poor s and Moody s, respectively, and is supported by pool-specific credit enhancement, liquidity facilities and program-level credit enhancement.

PNC Bank, National Association (PNC Bank, N.A.) provides certain administrative services, a portion of the program-level credit enhancement and the majority of liquidity facilities to Market Street in exchange for fees negotiated based on market rates. All of Market Street s assets at March 31, 2007 and December 31, 2006 collateralize the commercial paper obligations. PNC views its credit exposure for the Market Street transactions as limited. Facilities requiring PNC to fund for defaulted assets totaled $890 million at March 31, 2007. For 84% of the liquidity facilities at March 31, 2007, PNC is not required to fund if the assets are in default. PNC may be liable for funding under liquidity facilities for events such as borrower bankruptcies, collateral deficiencies or covenant violations. Additionally, PNC s obligations under the liquidity facilities are secondary to the risk of first loss provided by the borrower or another third party in the form of deal-specific credit enhancement for example, by the over collateralization of the assets. Deal-specific credit enhancement that supports the commercial paper issued by Market Street is generally structured to cover a multiple of the expected historical losses for the pool of assets and is sized to generally meet rating agency standards for comparably structured transactions. Credit enhancement is provided in part by PNC Bank, N.A. in the form of a cash collateral account that is funded by a loan facility that expires March 23, 2012. See Note 15 Commitments And Guarantees included in Part I, Item 1 of this Report for additional information. Neither creditors nor equity investors in Market Street have any recourse to our general credit. PNC recognized program administrator fees and commitment fees related to PNC s portion of the liquidity facilities of $2.9 million and $1 million, respectively, for the quarter ended March 31, 2007.

As more fully described in our 2006 Form 10-K, Market Street was restructured as a limited liability company in October 2005 and entered into a subordinated Note Purchase Agreement (Note) with an unrelated third party.

The Note provides first loss coverage whereby the investor absorbs losses up to the amount of the Note, which was $6.0 million as of March 31, 2007. Proceeds from the issuance of the Note are held by Market Street in a first loss reserve account that will be used to reimburse any losses incurred by Market Street, PNC Bank, N.A. or other providers under the liquidity facilities and the credit enhancement arrangements.

As a result of the Note issuance, we reevaluated the design of Market Street, its capital structure and relationships among the variable interest holders under the provisions of FASB Interpretation No. 46, (Revised 2003) Consolidation of

Variable Interest Entities (FIN 46R). Based on this analysis, we determined that we were no longer the primary beneficiary as defined by FIN 46R and deconsolidated Market Street from our Consolidated Balance Sheet effective October 17, 2005. There have been no events or changes in the contractual terms of the Note since that date that would change this conclusion.

The aggregate assets and liabilities of VIEs that we have consolidated in our financial statements are as follows:

Consolidated VIEs PNC Is Primary Beneficiary

In millions	Aggregate Assets	Aggregate Liabilities
Partnership interests in low income housing projects		
March 31, 2007	**$ 780**	**$ 780**
December 31, 2006	$ 834	$ 834

Investment Company Accounting Deferred Application

We also have subsidiaries that invest in and act as the investment manager for private equity funds organized as limited partnerships as part of our equity management activities. The funds invest in private equity investments to generate capital appreciation and profits. As permitted by FIN 46R, we have deferred applying the provisions of the interpretation for these entities pending further action by the FASB. These entities are not consolidated into our financial statements as of March 31, 2007 or December 31, 2006. Information on these entities follows:

In millions	Aggregate Assets	Aggregate Equity	PNC Risk of Loss
Private Equity Funds			
March 31, 2007	**$ 110**	**$ 110**	**$ 102**
December 31, 2006	$ 102	$ 102	$ 104

PNC s risk of loss in the table above includes both the value of our equity investments and any unfunded commitments to the respective entities. These equity investments are included in our private equity portfolio discussed under Market Risk Management Equity and Other Investment Risk in this Financial Review.

Perpetual Trust Securities

We issue certain hybrid capital vehicles that qualify as capital for regulatory and rating agency purposes.

In December 2006, one of our indirect subsidiaries, PNC REIT Corp., sold $500 million of 6.517% Fixed-to-Floating Rate Non-Cumulative Exchangeable Perpetual Trust Securities (the Trust Securities) of PNC Preferred Funding Trust I (Trust I), in a private placement. PNC REIT Corp. had previously acquired the Trust Securities from the trust in exchange for an equivalent amount of Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Securities (the LLC Preferred Securities), of PNC Preferred Funding LLC (the LLC), held by PNC REIT Corp. The LLC s initial material

assets consist of indirect interests in mortgages and mortgage-related assets previously owned by PNC REIT Corp. Our 2006 Form 10-K includes additional information regarding the Perpetual Trust Securities, including descriptions of replacement capital and dividend restriction covenants.

In March 2007, PNC Preferred Funding LLC sold $500 million of 6.113% Fixed-to-Floating Rate Non-Cumulative Exchangeable Perpetual Trust Securities of PNC Preferred Funding Trust II (Trust II), in a private placement. In connection with the private placement, Trust II acquired $500 million of LLC Preferred Securities.

PNC REIT Corp. owns 100% of the LLC s common voting securities. As a result, the LLC is an indirect subsidiary of PNC and is consolidated on our Consolidated Balance Sheet. Trust I and Trust II s investment in the LLC Preferred Securities is characterized as a minority interest on our Consolidated Balance Sheet since we are not the primary beneficiary of Trust I and Trust II. This minority interest totaled approximately $981 million at March 31, 2007.

Each Trust II Security is automatically exchangeable into a share of Series I Non-Cumulative Perpetual Preferred Stock of PNC (the Series I Preferred Stock) under certain conditions relating to the capitalization or the financial condition of PNC Bank, N.A. and upon the direction of the Office of the Comptroller of the Currency.

Simultaneously with the closing of the Trust II Securities sale, we entered into a replacement capital covenant (the Covenant) for the benefit of holders of a specified series of our long-term indebtedness (the Covered Debt). As of March 31, 2007, Covered Debt consists of our $200 million Floating Rate Junior Subordinated Notes issued on June 9, 1998. We agreed in the Covenant that until March 29, 2017, neither we nor our subsidiaries would purchase or redeem the Trust Securities, the LLC Preferred Securities or the Series I Preferred Stock (collectively, the Covenant Securities) unless: (i) we have received the prior approval of the Federal Reserve Board, if such approval is then required by the Federal Reserve Board and (ii) during the 180-day period prior to the date of purchase, PNC, PNC Bank, N.A. or PNC Bank, N.A. s subsidiaries, as applicable, have received proceeds from the sale of Qualifying Securities in the amounts specified in the Covenant (which amounts will vary based on the type of securities sold). Qualifying Securities means debt and equity securities having terms and provisions specified in the Covenant and that, generally described, are intended to contribute to our capital base in a manner that is similar to the contribution to our capital base made by the Covenant Securities. We filed a copy of the Covenant with the SEC as Exhibit 99.1 to PNC s Form 8-K filed on March 30, 2007.

We have also entered into an Exchange Agreement with Trust II in which we have agreed that if full dividends are not paid

in a dividend period on the Trust II Securities and the LLC Preferred Securities held by Trust II, PNC will not declare or pay dividends with respect to, or redeem, purchase or acquire, any of its equity capital securities during the next succeeding dividend period, other than: (i) purchases, redemptions or other acquisitions of shares of capital stock of PNC in connection with any employment contract, benefit plan or other similar arrangement with or for the benefit of employees, officers, directors or consultants, (ii) purchases of shares of common stock of PNC pursuant to a contractually binding requirement to buy stock existing prior to the commencement of the extension period, including under a contractually binding stock repurchase plan, (iii) any dividend in connection with the implementation of a shareholders rights plan, or the redemption or repurchase of any rights under any such plan, (iv) as a result of an exchange or conversion of any class or series of PNC s capital stock for any other class or series of PNC s capital stock, (v) the purchase of fractional interests in shares of PNC capital stock pursuant to the conversion or exchange provisions of such stock or the security being converted or exchanged or (vi) any stock dividends paid by PNC where the dividend stock is the same stock as that on which the dividend is being paid. We filed a copy of the Exchange Agreement with the SEC as Exhibit 4.16 to PNC s Form 8-K filed on March 30, 2007.

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BUSINESS SEGMENTS REVIEW

We have four major businesses engaged in providing banking, asset management and global fund processing products and services. Business segment results, including inter-segment revenues, and a description of each business are included in Note 14 Segment Reporting included in the Notes To Consolidated Financial Statements under Part I, Item 1 of this Report.

Results of individual businesses are presented based on our management accounting practices and our management structure. There is no comprehensive, authoritative body of guidance for management accounting equivalent to GAAP; therefore, the financial results of individual businesses are not necessarily comparable with similar information for any other company. We refine our methodologies from time to time as our management accounting practices are enhanced and our businesses and management structure change. Financial results are presented, to the extent practicable, as if each business, with the exception of our BlackRock segment, operated on a stand-alone basis. As permitted under GAAP, we have aggregated the business results for certain operating segments for financial reporting purposes.

Assets receive a funding charge and liabilities and capital receive a funding credit based on a transfer pricing methodology that incorporates product maturities, duration and other factors. Capital is intended to cover unexpected losses and is assigned to the banking and processing businesses using our risk-based economic capital model. We have assigned to Retail Banking capital equal to 6% of funds to reflect the capital required for well-capitalized banks and to approximate market comparables for this business. The capital assigned for PFPC reflects its legal entity shareholders equity.

BlackRock business segment results for the three months ended March 31, 2006 reflected our majority ownership in BlackRock during that period. Subsequent to the September 29, 2006 BlackRock/MLIM transaction closing, which had the effect of reducing our ownership interest to approximately 34%, our investment in BlackRock has been accounted for under the equity method but continues to be a separate reportable business segment of PNC.

We have allocated the allowances for loan and lease losses and unfunded loan commitments and letters of credit based on our assessment of risk inherent in the loan portfolios. Our allocation of the costs incurred by operations and other support areas not directly aligned with the businesses is primarily based on the use of services.

Total business segment financial results differ from total consolidated results. The impact of these differences is reflected in the Other category. Other includes residual activities that do not meet the criteria for disclosure as a separate reportable business, such as gains or losses related to BlackRock transactions including LTIP distributions and obligations, Mercantile and BlackRock/MLIM acquisition integration costs, asset and liability management activities, net securities gains or losses, certain trading activities, equity management activities and minority interest in income of BlackRock for the first quarter of 2006, differences between business segment performance reporting and financial statement reporting (GAAP), intercompany eliminations, and most corporate overhead.

Employee data as reported by each business segment in the tables that follow reflects staff directly employed by the respective business and excludes corporate and shared services employees.

Results Of Businesses - Summary

(Unaudited)

	Earnings		Revenue (a)		Average Assets (b)	
Three months ended March 31 - dollars in millions	**2007**	2006	**2007**	2006	**2007**	2006
Retail Banking	**$ 201**	$ 190	**$ 839**	$ 753	**$ 34,449**	$ 29,369
Corporate & Institutional Banking	**132**	102	**370**	335	**26,498**	23,788
BlackRock (c) (d)	**52**	49	**68**	410	**3,870**	1,841

PFPC (e)	**31**	27	**200**	196	**2,378**	2,385
Total business segments	**416**	368	**1,477**	1,694	**67,195**	57,383
Other (c)	**43**	(14)	**143**	54	**40,227**	34,746
Total consolidated	**$ 459**	$ 354	**$ 1,620**	$ 1,748	**$ 107,422**	$ 92,129

(a) Business segment revenue is presented on a taxable-equivalent basis. A reconciliation of total consolidated revenue on a book (GAAP) basis to total consolidated revenue on a taxable-equivalent basis follows:

Three months ended March 31 - (in millions)	**2007**	2006
Total consolidated revenue, book (GAAP) basis	**$ 1,614**	$ 1,741
Taxable-equivalent adjustment	**6**	7
Total consolidated revenue, taxable-equivalent basis	**$ 1,620**	$ 1,748

(b) Period-end balances for BlackRock and PFPC. BlackRock was an equity investment at March 31, 2007 and was consolidated at March 31, 2006.

(c) For our segment reporting presentation, our share of pretax BlackRock/MLIM transaction integration costs totaling $2 million and $6 million for the three months ended March 31, 2007 and March 31, 2006 have been reclassified from BlackRock to Other. Other for the first three months of 2007 also includes $11 million of pretax Mercantile acquisition integration costs.

(d) For the first quarter of 2007, revenue represents our equity income from BlackRock. For the first quarter of 2006, revenue represents the sum of total operating revenue and nonoperating income.

(e) PFPC revenue represents the sum of servicing revenue and nonoperating income (expense) less debt financing costs. Prior period servicing revenue amounts have been reclassified to conform with the current period presentation.

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RETAIL BANKING

Three months ended March 31

Taxable-equivalent basis

Dollars in millions	**2007**	2006
INCOME STATEMENT		
Net interest income	**$452**	$408
Noninterest income		
Asset management	**100**	87
Service charges on deposits	**75**	71
Brokerage	**63**	58
Consumer services	**88**	86
Other	**61**	43
Total noninterest income	**387**	345
Total revenue	**839**	753
Provision for credit losses	**23**	9
Noninterest expense	**496**	440
Pretax earnings	**320**	304
Income taxes	**119**	114
Earnings	**$201**	$190
AVERAGE BALANCE SHEET		
Loans		
Consumer		
Home equity	**$13,881**	$13,778
Indirect	**1,480**	987
Other consumer	**1,490**	1,248
Total consumer	**16,851**	16,013
Commercial	**8,201**	5,433
Floor plan	**952**	970
Residential mortgage	**1,781**	1,648
Other	**233**	236
Total loans	**28,018**	24,300
Goodwill and other intangible assets	**2,942**	1,582
Loans held for sale	**1,562**	1,880
Other assets	**1,927**	1,607
Total assets	**$34,449**	$29,369
Deposits		
Noninterest-bearing demand	**$8,871**	$7,777
Interest-bearing demand	**8,354**	8,025
Money market	**15,669**	14,644
Total transaction deposits	**32,894**	30,446
Savings	**2,243**	2,183
Certificates of deposit	**15,738**	13,115
Total deposits	**50,875**	45,744
Other liabilities	**708**	560
Capital	**3,287**	2,943
Total funds	**$54,870**	$49,247
PERFORMANCE RATIOS		
Return on average capital	**25%**	26%
Noninterest income to total revenue	**46**	46
Efficiency	**59**	58
OTHER INFORMATION, INCLUDING MERCANTILE (a) (b)		
Other statistics:		

Full-time employees	**11,645**	9,725
Part-time employees		