THE PNC FINANCIAL SERVICES GROUP, INC.<br>Quarterly Report on Form 10-Q/A, Amendment No. 1 For the quarterly period ended September 30, 2001

Page 1 represents a portion of the third quarter 2001 Financial Review which is not required by the Form 10-Q/A report and is not "filed" as part of the Form 10-Q/A.

The Quarterly Report on Form $10-Q / A$ and cross reference index is on page 41.

Consolidated Financial Highlights
THE PNC FINANCIAL SERVICES GROUP, INC.

By filing this amendment ("Amendment No. 1"), the registrant, The PNC Financial Services Group, Inc., hereby amends its Quarterly Report on Form $10-Q$ for the quarter ended September 30, 2001 ("September 2001 Form 10-Q") primarily for the items described in "Restatements" in the Overview section of the Financial Review and in the "Notes to Consolidated Financial Statements" of this Amendment No. 1 .

By this Amendment No. 1, the registrant is amending and restating its entire September 2001 Form 10-Q.

Dollars in millions, except per share data | Three months ended |
| :---: |
| September |
| N |

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DILUTED EARNINGS
Continuing operations
Discontinued operations
Before cumulative effect of accounting change
Cumulative effect of accounting change
Net income
Cash dividends declared
SELECTED RATIOS
FROM CONTINUING OPERATIONS
Return on
Average common shareholders' equity
Average assets
interest margin
Net
Noninterest income to total revenue
Efficiency (a)
FROM NET INCOME
Return on
(a) Excludes amortization and distributions on capital securities.
(b) Excludes amortization, distributions on capital securities and residential mortgage banking risk management activities.

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BALANCE SHEET DATA
Assets \$71,812
Earning assets ..... 57,546
Loans, net of unearned income ..... 42,140Securities11, 051
Loans held for sale ..... 2,242
Deposits ..... 44,918
Transaction deposits ..... 30,696Borrowed funds13, 046
Shareholders' equity ..... 6,773
Common shareholders' equity ..... 6,557
Book value per common share ..... 23.09
Loans to deposits ..... 94
CAPITAL RATIOS
Leverage ..... 8.1
Common shareholders' equity to total assets ..... 9.13
ASSET QUALITY RATIOS

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Nonperforming assets to total loans,<br>loans held for sale and foreclosed assets

THE PNC FINANCIAL SERVICES GROUP, INC.

This Financial Review should be read in conjunction with The PNC Financial Services Group, Inc. ("Corporation" or "PNC") unaudited Consolidated Financial Statements and Statistical Information included herein and the Financial Review and audited Consolidated Financial Statements included in the Corporation's 2000 Annual Report. Certain prior-period amounts have been reclassified to conform with the current year presentation. For information regarding certain business risks, see the Risk Management and Risk Factors sections in this Financial Review. Also, see the Forward-Looking Statements section in this Financial Review for certain other factors that could cause actual results to differ materially from forward-looking statements or historical performance.

## OVERVIEW

THE PNC FINANCIAL SERVICES GROUP, INC.
The Corporation is one of the largest diversified financial services companies in the United States, operating businesses engaged in regional community banking, corporate banking, real estate finance, asset-based lending, wealth management, asset management and global fund services. The Corporation provides certain products and services nationally and others in PNC's primary geographic markets in Pennsylvania, New Jersey, Delaware, Ohio and Kentucky. The Corporation also provides certain asset management and global fund services internationally.

PNC continues to aggressively pursue strategies to create a more diverse and valuable business mix designed to create shareholder value over time. PNC's focus is on increasing the contribution from more highly-valued businesses such as asset management and processing while improving the risk/return characteristics of traditional banking businesses. Earnings from asset management and processing businesses represented $27 \%$ of total business earnings for the first nine months of 2001 and consolidated noninterest income was $56 \%$ of total revenue for the first nine months of 2001 . At the same time, PNC sold its residential mortgage banking business and has been downsizing certain institutional lending portfolios resulting in an improvement of the loan to deposit ratio to $94 \%$ at September 30, 2001. Over the past three years, PNC has reduced loans by $\$ 15$ billion and unfunded commitments by $\$ 32$ billion. PNC continues to evaluate opportunities to reduce lending exposure and further improve the risk/return characteristics of its lending businesses. All of these actions have strengthened PNC's position in the most difficult operating environment since the early 1990's.

On January 31, 2001, PNC closed the sale of its residential mortgage banking business. The net loss on sale and income from operations included in the first nine months of 2001 resulted in income from discontinued operations of $\$ 5$ million or $\$ .02$ per diluted share. Certain closing date adjustments are currently in dispute between PNC and the buyer, Washington Mutual Bank, FA. The

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ultimate financial impact of the sale will not be determined until the disputed matters are finally resolved.

## RESTATEMENTS

Subsequent to December 31, 2001, PNC announced two changes that affected results for the nine months ended September 30, 2001.

In June and September 2001, the Corporation entered into certain transactions with subsidiaries of a third party financial institution (American International Group, Inc.) involving the sale of loans and the receipt of preferred interests in the subsidiaries. At the time of the transactions, the loans were removed from PNC's balance sheet and the preferred interests in the entities were recorded as securities available for sale in conformity with accounting guidance received from PNC's independent auditors. In January 2002, the Federal Reserve Board staff advised PNC that under generally accepted accounting principles the subsidiaries of the third party financial institution should be consolidated into the financial statements of PNC in preparing bank holding company reports. After considering all of the circumstances, PNC made the decision to restate its consolidated financial statements for the second and third quarters of 2001 to conform financial reporting with regulatory reporting requirements. This restatement reduced income from continuing operations and net income for the three and nine months ended September 30,2001 by $\$ 51$ million or $\$ .18$ per diluted share. Amounts appearing in this Amendment No. 1 reflect the consolidation of these entities.

Loans in these entities are included in the consolidated balance sheet as loans held for sale and are carried at the lower of cost or market value. Charges recorded at the dates the assets were sold into the entities were reflected as charge-offs on those loans in portfolio and as valuation adjustments in noninterest income on loans previously classified as held for sale. Subsequent charges to adjust the carrying value of the loans held for sale also reflected as valuation adjustments.

The amounts contained in this Amendment No. 1 also include the restatement of the results for the first quarter of 2001 to reflect the correction of an error related to the accounting for the sale of the residential mortgage banking business. This restatement reduced income from discontinued operations and net income for the nine months ended September 30,2001 by $\$ 35$ million or $\$ .12$ per diluted share. The consolidated balance sheet was not affected by this restatement as the impact of the error had been reflected in retained earnings at September 30, 2001. See "Restatements" in the Notes to Consolidated Financial Statements for additional information.

## SUMMARY FINANCIAL RESULTS

Consolidated net income for the first nine months of 2001 was $\$ 807$ million or $\$ 2.73$ per diluted share. Excluding the effect of adopting the new accounting standard for financial derivatives, net income was $\$ 812$ million or $\$ 2.75$ per diluted share compared with $\$ 945$ million or $\$ 3.18$ per diluted share for the first nine months of 2000 . These results include the negative impact of a $\$ 59$ million or $\$ .20$ per diluted share net loss from venture capital activities in 2001. Excluding this loss and the effect of the accounting change, results for the first nine months of 2001 were $\$ 871$ million or $\$ 2.95$ per diluted share.

Return on average common shareholders' equity was $16.50 \%$ and return on average assets was $1.51 \%$ for the first nine months of 2001 compared with $21.72 \%$ and 1. 67\%, respectively, for the first nine months of 2000 .

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The residential mortgage banking business, which was sold in January 2001, is reflected in discontinued operations throughout the Corporation's consolidated financial statements. Accordingly, the income and net assets of the residential mortgage banking business are shown separately on one line in the income statement and balance sheet, respectively, for all periods presented. The remainder of the discussion and information in this Financial Review reflects continuing operations, unless otherwise noted.

Taxable-equivalent net interest income of $\$ 1.696$ billion for the first nine months of 2001 increased $3 \%$ compared with the first nine months of 2000 . The increase was primarily due to the positive impact of transaction deposit growth and a lower rate environment that was partially offset by the impact of continued downsizing of the loan portfolio. The net interest margin widened 13 basis points to $3.76 \%$ for the first nine months of 2001 compared with $3.63 \%$ for the first nine months of 2000. The increase was primarily due to the impact of the lower rate environment and the benefit of growth in transaction deposits and downsizing of higher-cost, less valuable retail certificates and wholesale deposits.

The provision for credit losses was $\$ 235$ million for the first nine months of 2001 compared with $\$ 96$ million for the same period in 2000 . The increase was primarily related to loans in the communications and energy, metals and mining portfolios that PNC is downsizing. A $\$ 45$ million addition to unallocated reserves, given the deterioration in overall economic conditions, also contributed to the increase.

Noninterest income was $\$ 2.128$ billion for the first nine months of 2001 compared with $\$ 2.156$ billion for the same period in 2000 . Noninterest income for the first nine months of 2001 included $\$ 134$ million of net securities gains, $\$ 82$ million of equity management losses related to venture capital activities and charges of $\$ 86$ million for valuation adjustments on loans held for sale owned by the subsidiaries of a third party financial institution. See "Restatements" in the Notes to Consolidated Financial Statements for additional information.

Noninterest expense was $\$ 2.351$ billion for the first nine months of 2001 compared with $\$ 2.319$ billion for the first nine months of 2000 and the efficiency ratio remained essentially flat at $58 \%$ and $57 \%$ for the nine months ended 2001 and 2000, respectively.

Total assets were $\$ 71.8$ billion at September 30,2001 compared with $\$ 69.8$ billion at December 31, 2000. Average interest-earning assets were $\$ 59.7$ billion for the first nine months of 2001 compared with $\$ 60.1$ billion for the first nine months of 2000. A decline in loans and loans held for sale was partially offset by an increase in securities that are used for balance sheet and interest rate risk management activities.

Shareholders' equity totaled $\$ 6.8$ billion at September 30, 2001 and the regulatory capital ratios were $8.1 \%$ for leverage, $8.4 \%$ for tier I risk-based and $12.0 \%$ for total risk-based capital. During the first nine months of 2001, PNC repurchased 8.4 million shares of common stock.

Nonperforming assets were $\$ 526$ million at September 30,2001 compared with $\$ 372$ million at December 31, 2000. The ratio of nonperforming assets to total loans, loans held for sale and foreclosed assets was 1.18\% at September 30, 2001 compared with .71\% at December 31, 2000.

The allowance for credit losses was $\$ 720$ million and represented $1.71 \%$ of total loans and $199 \%$ of nonaccrual loans at September 30, 2001. The comparable amounts were $\$ 675$ million, $1.33 \%$ and $209 \%$, respectively, at December 31, 2000. Net charge-offs were $\$ 190$ million or $.55 \%$ of average loans for the first nine months of 2001 compared with $\$ 95$ million or $.25 \%$ for the same period in 2000 . The increase was primarily related to commercial loans in portfolios that PNC is

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downsizing.

Financial Review
THE PNC FINANCIAL SERVICES GROUP, INC.

## REVIEW OF BUSINESSES

PNC operates seven major businesses engaged in regional community banking, corporate banking, real estate finance, asset-based lending, wealth management, asset management and global fund services.

Business results are presented based on PNC's management accounting practices and the Corporation's management structure. There is no comprehensive, authoritative body of guidance for management accounting equivalent to generally accepted accounting principles; therefore, PNC's business results are not necessarily comparable with similar information for any other financial services institution. Financial results are presented, to the extent practicable, as if each business operated on a stand-alone basis.

The management accounting process uses various balance sheet and income statement assignments and transfers to measure performance of the businesses. Methodologies change from time to time as management accounting practices are enhanced and businesses change. Securities or borrowings and related net interest income are assigned based on the net asset or liability position of each business. Capital is assigned based on management's assessment of inherent risks and equity levels at independent companies providing similar products and services. The allowance for credit losses is allocated based on management's assessment of risk inherent in the loan portfolios. Support areas not directly aligned with the businesses are allocated primarily based on the utilization of services.

Total business financial results differ from consolidated results from continuing operations primarily due to differences between management accounting practices and generally accepted accounting principles, loan portfolios and businesses that were designated for downsizing during 1999, equity management activities, minority interests, residual asset and liability management activities, eliminations, unallocated reserves and unassigned items, the impact of which is reflected in the "Other" category. The operating results and financial impact of the disposition of the residential mortgage banking business, previously PNC Mortgage, are included in discontinued operations.

RESULTS OF BUSINESSES

|  | Revenue <br> (taxable-equivalent <br> basis) | Earnings |
| :---: | :---: | :---: |

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| Corporate Banking | 47 | 190 | 484 | 633 | 5 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Total PNC Bank | 572 | 620 | 2,169 | 2,130 | 19 |
| Secured Finance |  |  |  |  |  |
| PNC Real Estate Finance | 53 | 50 | 161 | 155 | 18 |
| PNC Business Credit | 39 | 37 | 98 | 86 | 32 |
| Total Secured Finance | 92 | 87 | 259 | 241 | 22 |
| Total Banking | 664 | 707 | 2,428 | 2,371 | 20 |
| Asset Management and Processing |  |  |  |  |  |
| PNC Advisors | 117 | 127 | 562 | 589 | 29 |
| BlackRock | 79 | 63 | 404 | 348 | 25 |
| PFPC | 49 | 31 | 556 | 505 | 31 |
| Total Asset Management and |  |  |  |  |  |
| Total business results Other | $\begin{gathered} 909 \\ (102) \end{gathered}$ | $\begin{aligned} & 928 \\ & (28) \end{aligned}$ | $\begin{array}{r} 3,950 \\ (126) \end{array}$ | $\begin{array}{r} 3,813 \\ \quad(13) \end{array}$ | 21 |
| Results from continuing operations Discontinued operations | $\begin{array}{r} 807 \\ 5 \end{array}$ | $\begin{array}{r} 900 \\ 45 \end{array}$ | 3,824 | 3,800 | 17 |
| Cumulative effect of accounting change | (5) |  |  |  |  |
| Total Consolidated | \$807 | \$945 | \$3,824 | \$3,800 | 17 |

REGIONAL COMMUNITY BANKING

| millions | 2001 | 2000 |
| :---: | :---: | :---: |
| INCOME STATEMENT |  |  |
| Net interest income | \$1,093 | \$1,058 |
| Other noninterest income | 507 | 443 |
| Net securities gains (losses) | 85 | ( 4 |
| Total revenue | 1,685 | 1,497 |
| Provision for credit losses | 35 | 33 |
| Noninterest expense | 827 | 796 |
| Pretax earnings | 823 | 668 |
| Income taxes | 298 | 238 |
| Earnings | \$525 | \$430 |

AVERAGE BALANCE SHEET
Loans
Consumer
Home equity $\quad \$ 6,219 \quad \$ 5,360$
Indirect automobile 853 1,281
$\begin{array}{ll}\text { Other consumer } & 870\end{array}$
Total consumer 7, 7,942 7,514
Commercial $3,5,588 \quad 36$

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| Residential mortgage | 8,691 | 11,538 |
| :---: | :---: | :---: |
| Vehicle leasing | 1,872 | 1,255 |
| Other | 135 | 142 |
| Total loans | 22,228 | 24,125 |
| Securities | 9,561 | 5,547 |
| Loans held for sale | 1,270 | 1,316 |
| Assigned assets and other assets | 7,129 | 7,576 |
| Total assets | \$40,188 | \$38,564 |
| Deposits |  |  |
| Noninterest-bearing demand | \$4,515 | \$4,570 |
| Interest-bearing demand | 5,602 | 5,408 |
| Money market | 12,020 | 9,994 |
| Total transaction deposits | 22,137 | 19,972 |
| Savings | 1,870 | 2,030 |
| Certificates | 12,292 | 13,641 |
| Total deposits | 36,299 | 35,643 |
| Other liabilities | 1,177 | 319 |
| Assigned capital | 2,712 | 2,602 |
| Total funds | \$40,188 | \$38,564 |
| PERFORMANCE RATIOS |  |  |
| Return on assigned capital | 26\% | 22\% |
| Noninterest income to total revenue | 35 | 29 |
| Efficiency | 47 | 51 |

Regional Community Banking provides deposit, branch-based brokerage, electronic banking and credit products and services to retail customers as well as deposit, credit, treasury management and capital markets products and services to small businesses primarily within PNC's geographic region.

Regional Community Banking's strategic focus is on driving sustainable revenue growth, aggressively managing the revenue/expense relationship and improving the risk/return dynamic of this business. Regional Community Banking utilizes knowledge-based marketing capabilities to analyze customer demographic information, transaction patterns and delivery preferences to develop customized banking packages focused on improving customer satisfaction and profitability.

Regional Community Banking has also invested heavily in building a sales culture and infrastructure while improving efficiency. Capital investments have been strategically directed towards the expansion of multi-channel distribution, consistent with customer preferences, as well as the delivery of relevant customer information to all distribution channels.

Regional Community Banking contributed 58\% of total business earnings for the first nine months of 2001 compared with $46 \%$ for the first nine months of 2000 . Earnings increased $\$ 95$ million or $22 \%$ to $\$ 525$ million for the first nine months of 2001 primarily due to business growth and net securities gains. Excluding net securities gains from the first nine months of 2001 and net securities losses from the first nine months of 2000, earnings increased approximately 10\% primarily driven by higher noninterest income, deposit growth and improved efficiency.

Total revenue increased $13 \%$ to $\$ 1.685$ billion for the first nine months of 2001 . Excluding net securities gains and losses from both periods, revenue increased $7 \%$ in the period-to-period comparison primarily due to higher consumer

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transaction activity in 2001 and residential mortgage loan securitization gains.

The provision for credit losses for the first nine months of 2001 was $\$ 35$ million compared with $\$ 33$ million for the same period in 2000.

Total loans decreased in the comparison as growth in home equity loans and vehicle leases was more than offset by the reduction of residential mortgage loans due to securitizations and the continued downsizing of the indirect automobile lending portfolio. The decrease in residential mortgage loans was offset by an increase in securities.

Total deposits grew $2 \%$ in the comparison driven by a $\$ 2.2$ billion increase in transaction deposits. The increase in money market deposits resulted from targeted consumer marketing initiatives to add new accounts and retain existing customers as funds shifted from savings and certificates of deposit.

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| THE PNC FINANCIAL SERVICES GROUP, INC. |  |  |
| :---: | :---: | :---: |
| CORPORATE BANKING |  |  |
| Nine months ended September 30 - dollars in millions | 2001 | 2000 |
| INCOME STATEMENT |  |  |
| Credit-related revenue | \$211 | \$304 |
| Noncredit revenue | 273 | 329 |
| Total revenue | 484 | 633 |
| Provision for credit losses | 129 | 50 |
| Noninterest expense | 288 | 291 |
| Pretax earnings | 67 | 292 |
| Income taxes | 20 | 102 |
| Earnings | \$47 | \$190 |
| AVERAGE BALANCE SHEET |  |  |
| Loans |  |  |
| Middle market | \$5,834 | \$6,140 |
| Large corporate | 3,127 | 3,223 |
| Energy, metals and mining | 1,222 | 1,341 |
| Communications | 1,063 | 1,449 |
| Leasing | 2,264 | 1,768 |
| Other | 329 | 362 |
| Total loans | 13,839 | 14,283 |
| Other assets | 2,553 | 2,035 |
| Total assets | \$16,392 | \$16,318 |
| Deposits | \$4,764 | \$4,571 |
| Assigned funds and other liabilities | 10,399 | 10,523 |
| Assigned capital | 1,229 | 1,224 |
| Total funds | \$16,392 | \$16,318 |

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PERFORMANCE RATIOS

| Return on assigned capital | $5 \%$ | $21 \%$ |
| :--- | :---: | :---: |
| Noncredit revenue to total revenue | 56 | 52 |
| Efficiency | 59 | 46 |

Corporate Banking provides credit, equipment leasing, treasury management and capital markets products and services to large and mid-sized corporations, institutions and government entities primarily within PNC's geographic region.

The strategic focus for Corporate Banking is on the middle market with an emphasis on higher-margin noncredit products and services, especially treasury management and capital markets, and on improving the risk/return characteristics of its lending business. Approximately $35 \%$ of Corporate Banking's loan portfolio represents syndicated loans. These credits are generally large commitments that are shared by a number of financial institutions to reduce exposure to any one customer.

During the first quarter of 2001 , the Corporation announced the decision to downsize the communications portfolio and certain portions of the energy, metals and mining and large corporate portfolios. The designated loans are included in Corporate Banking business results in both periods presented. Management continues to aggressively evaluate opportunities to reduce lending exposure and improve the risk/return characteristics of this business. This strategy could lead to significant changes and write-downs in connection with the execution of further downsizing actions.

Corporate Banking contributed 5\% of total business earnings for the first nine months of 2001 compared with $21 \%$ for the first nine months of 2000 . Earnings declined to $\$ 47$ million for the first nine months of 2001 compared with $\$ 190$ million for the first nine months of 2000 primarily due to a higher provision for credit losses in 2001 related to portfolios that PNC is downsizing and lower noncredit revenue.

Total revenue of $\$ 484$ million for the first nine months of 2001 decreased $\$ 149$ million compared with the same period in 2000 . Credit related revenue for the nine months ended September 30, 2001 included a charge of $\$ 82$ million related to valuation adjustments on loans held for sale owned by the subsidiaries of a third party financial institution. See "Restatements" in the Notes to Consolidated Financial Statements for additional information. Average loans decreased in the period-to-period comparison primarily due to reductions in the large corporate, energy, metals and mining, communications and middle market portfolios, partially offset by the expansion of equipment leasing. Middle market loans declined in the period-to-period comparison primarily due to strategies to improve the risk profile of this portfolio.

Noncredit revenue includes noninterest income and the benefit of compensating balances received in lieu of fees. Noncredit revenue decreased $\$ 56$ million compared with the first nine months of 2000 primarily due to the impact of weak equity market conditions that resulted in lower capital markets fees and valuation losses associated with equity investments.

The provision for credit losses was $\$ 129$ million for the first nine months of 2001 compared with $\$ 50$ million for the first nine months of 2000 . The higher provision was primarily related to portfolios that are being downsized. A sustained weakness or further weakening of the economy, or other factors that adversely affect asset quality, could result in an increase in the number of delinquencies, bankruptcies or defaults, and a higher level of nonperforming assets, net charge-offs and provision for credit losses in future periods. See Credit Risk in the Risk Management section of this Financial Review for additional information regarding credit risk.

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Treasury management and capital markets products offered through Corporate Banking are sold by several businesses across the Corporation and related profitability is included in the results of those businesses. Consolidated revenue from treasury management was $\$ 251$ million for the first nine months of 2001 compared with $\$ 253$ million for the first nine months of 2000 . Increases in fee revenue were offset by lower income earned on customers' deposit balances resulting from the lower interest rate environment in 2001 and the impact of downsizing institutional lending. Consolidated revenue from capital markets was $\$ 89$ million for the first nine months of 2001 , a $\$ 10$ million decrease compared with the first nine months of 2000 due to weak equity market conditions as well as the impact of downsizing certain lending portfolios.

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PNC REAL ESTATE FINANCE


AVERAGE BALANCE SHEET
Loans

| Commercial - real estate related Commercial real estate | $\begin{array}{r} \$ 1,753 \\ 2,321 \end{array}$ | $\begin{array}{r} \$ 2,021 \\ 2,427 \end{array}$ |
| :---: | :---: | :---: |
| Total loans | 4,074 | 4,448 |
| Commercial mortgages held for sale | 220 | 180 |
| Other assets | 959 | 955 |
| Total assets | \$5,253 | \$5,583 |
| Deposits | \$466 | \$260 |
| Assigned funds and other liabilities | 4,392 | 4,940 |
| Assigned capital | 395 | 383 |
| Total funds | \$5,253 | \$5,583 |

PERFORMANCE RATIOS
Return on assigned capital 18\% 17\%
Noninterest income to total revenue 4544
Efficiency 58

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PNC Real Estate Finance provides credit, capital markets, treasury management, commercial mortgage loan servicing and other products and services to developers, owners and investors in commercial real estate. PNC's commercial real estate financial services platform provides processing services through Midland Loan Services, Inc., a leading third-party provider of loan servicing and technology to the commercial real estate finance industry, and Columbia Housing Partners, LP, ("Columbia") a national syndicator of affordable housing equity.

On October 17, 2001, PNC announced that it completed the acquisition of certain lending and servicing-related assets from TRI Acceptance Corporation. The acquisition will expand PNC Real Estate Finance's reach in multi-family finance, combining permanent loan capacity with PNC's traditional interim lending activities and Columbia's tax credit syndication capabilities.

Over the past three years, PNC Real Estate Finance has been strategically shifting to a more balanced and valuable revenue stream by focusing on real estate processing businesses and increasing the value of its lending business by selling more fee-based products. During the first nine months of $2001,45 \%$ of total revenue was generated by fee-based activities. Management continues to aggressively evaluate opportunities to reduce credit exposure and improve the risk/return characteristics of this business.

PNC Real Estate Finance contributed 6\% of total business earnings for the first nine months of 2001 compared with 5\% for the first nine months of 2000 . Earnings increased $\$ 3$ million or $6 \%$ in the period-to-period comparison primarily due to growth in processing services. Average loans decreased 8\% in the period-to-period comparison reflecting management's ongoing strategy to reduce balance sheet leverage.

Total revenue was $\$ 161$ million for the first nine months of 2001 compared with $\$ 155$ million for the first nine months of 2000 . The increase of $\$ 6$ million or $4 \%$ was primarily due to higher commercial mortgage loan servicing fees, reflecting a larger servicing portfolio. The increase in servicing fees was offset by higher amortization of servicing intangibles that resulted from the larger servicing portfolio as well as lower commercial mortgage-backed securitization gains. The commercial mortgage servicing portfolio increased $32 \%$ in the comparison to $\$ 66$ billion at September 30, 2001.

COMMERCIAL MORTGAGE SERVICING PORTFOLIO

| In billions | 2001 | 2000 |
| :---: | :---: | :---: |
| January 1 | \$ 51 | \$ 45 |
| Acquisitions/additions | 23 | 10 |
| Repayments/transfers | ( 8 ) | ( 5 ) |
| September 30 | \$66 | \$50 |

The provision for credit losses was $\$ 3$ million for the first nine months of 2001 and was primarily related to the sale of one nonperforming asset in the third quarter of 2001.

Noninterest expense was $\$ 117$ million for the first nine months of 2001 compared with $\$ 102$ million in the same period last year. The increase was primarily due to non-cash (passive) losses on affordable housing investments that were more than offset by related income tax credits.

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| Financial Review |  |  |
| :---: | :---: | :---: |
| PNC BUSINESS CREDIT |  |  |
| Nine months ended September 30 - dollars in millions | 2001 | 2000 |
| INCOME STATEMENT |  |  |
| Net interest income | \$77 | \$74 |
| Noninterest income | 21 | 12 |
| Total revenue | 98 | 86 |
| Provision for credit losses | 13 | 7 |
| Noninterest expense | 23 | 22 |
| Pretax earnings | 62 | 57 |
| Income taxes | 23 | 20 |
| Earnings | \$39 | \$37 |
| AVERAGE BALANCE SHEET |  |  |
| Loans | \$2,304 | \$2,158 |
| Other assets | 127 | 72 |
| Total assets | \$2,431 | \$2,230 |
| Deposits | \$81 | \$62 |
| Assigned funds and other liabilities | 2,189 | 2,020 |
| Assigned capital | 161 | 148 |
| Total funds | \$2,431 | \$2,230 |
| PERFORMANCE RATIOS |  |  |
| Return on assigned capital | 32\% | 33\% |
| Noninterest income to total revenue | 21 | 14 |
| Efficiency | 22 | 24 |



PNC Business Credit provides asset-based lending, capital markets and treasury management products and services to middle market customers nationally. PNC Business Credit's lending services include loans secured by accounts receivable, inventory, machinery and equipment, and other collateral, and its customers include manufacturing, wholesale, distribution, retailing and service industry companies.

PNC Business Credit's strategic focus is to build scale through portfolio acquisitions, expansion of existing offices as well as the addition of new marketing locations. The average loan portfolio grew $7 \%$ to $\$ 2.3$ billion for the first nine months of 2001 primarily as a result of this expansion. PNC Business Credit currently operates 15 offices in 13 states with a centralized back office to provide consistency to the control environment as well as cost efficiencies.

PNC Business Credit contributed 4\% of total business earnings for the first nine months of 2001 and 2000. Earnings increased $\$ 2$ million or $5 \%$ in the period-to-period comparison to $\$ 39$ million for the first nine months of 2001 as higher revenue was partially offset by an increase in the provision for credit losses.

Revenue was $\$ 98$ million for the first nine months of 2001 , a $\$ 12$ million or $14 \%$ increase compared with the first nine months of 2000 primarily due to higher

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noninterest income. The increase in noninterest income primarily resulted from gains on equity interests received as compensation in conjunction with lending relationships. Noninterest income for the nine months ended September 30, 2001 also included a charge of $\$ 4$ million related to valuation adjustments on loans held for sale owned by subsidiaries of a third party financial institution. See "Restatements" in the Notes to Consolidated Financial Statements for additional information.

The provision for credit losses increased $\$ 6$ million to $\$ 13$ million for the first nine months of 2001 as a result of declining credit conditions in a weaker economy. PNC Business Credit loans are secured loans to borrowers with a weaker financial condition. As a result, in a weaker economy, the provision for credit losses may be adversely affected. See Credit Risk in the Risk Management section of this Financial Review for additional information regarding credit risk.

Noninterest expense was $\$ 23$ million and the efficiency ratio improved to $22 \%$ for the first nine months of 2001 compared with $\$ 22$ million and $24 \%$ respectively, for the first nine months of 2000. The efficiency ratio improved in the comparison primarily due to higher noninterest income and economies of scale resulting from a centralized back office.

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PNC ADVISORS

Nine months ended September 30 - dollars in 20012000 millions

| INCOME STATEMENT |  |  |
| :---: | :---: | :---: |
| Net interest income | \$99 | \$102 |
| Noninterest income |  |  |
| Investment management and trust | 302 | 307 |
| Brokerage | 100 | 132 |
| Other | 61 | 48 |
| Total noninterest income | 463 | 487 |
| Total revenue | 562 | 589 |
| Provision for credit losses | 1 | 3 |
| Noninterest expense | 376 | 385 |
| Pretax earnings | 185 | 201 |
| Income taxes | 68 | 74 |
| Earnings | \$117 | \$127 |
| AVERAGE BALANCE SHEET |  |  |
| Loans |  |  |
| Commercial | \$543 | \$623 |
| Consumer | 1,098 | 960 |
| Residential mortgage | 884 | 969 |
| Other | 395 | 547 |
| Total loans | 2,920 | 3,099 |
| Other assets | 479 | 442 |
| Total assets | \$3,399 | \$3,541 |
| Deposits | \$2,078 | \$2,048 |
| Assigned funds and other liabilities | 774 | 943 |

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| Assigned capital | 547 | 550 |
| :---: | :---: | :---: |
| Total funds | \$3,399 | \$3,541 |
| PERFORMANCE RATIOS |  |  |
| Return on assigned capital | 29\% | 31\% |
| Noninterest income to total revenue | 82 | 83 |
| Efficiency | 66 | 65 |

PNC Advisors provides a full range of tailored investment products and services to affluent individuals and families including full-service brokerage through J.J.B. Hilliard, W.L. Lyons, Inc. ("Hilliard Lyons") and investment advisory services to the ultra-affluent through Hawthorn. PNC Advisors also serves as investment manager and trustee for employee benefit plans and charitable and endowment assets. PNC Advisors is focused on selectively expanding Hilliard Lyons and Hawthorn, increasing market share in PNC's primary geographic region and leveraging its expansive distribution platform.

PNC Advisors contributed $13 \%$ of total business earnings for the first nine months of 2001 compared with $14 \%$ for the first nine months of 2000 . Earnings of $\$ 117$ million for the first nine months of 2001 decreased 8\% compared with the same period last year due to the impact of weak equity markets.

Revenue decreased $\$ 27$ million in the period-to-period comparison primarily due to lower levels of retail investor trading activity and weak equity markets the impact of which was partially offset by investment management and trust revenue accrual adjustments of $\$ 15$ million. Management expects that revenues in this business will continue to be challenged at least until equity market conditions improve.

Noninterest expense decreased $\$ 9$ million in the period-to-period comparison primarily due to lower production-based compensation and expense management initiatives.

ASSETS UNDER MANAGEMENT (a)

| September 30 - in billions | 2001 | 2000 |
| :---: | :---: | :---: |
| Personal investment management and trust | \$46 | \$51 |
| Institutional trust | 13 | 15 |
| Total | \$59 | \$66 |

(a) Assets under management do not include brokerage assets administered.

Assets under management decreased $\$ 7$ billion as approximately $\$ 4$ billion of net new asset inflows during the past twelve months were more than offset by a decline in the value of the equity component of customers' portfolios. See Asset Management Performance in the Risk Factors section of this Financial Review for additional information regarding the potential impact of market conditions and asset management performance on PNC's revenue.

Brokerage assets administered by PNC Advisors were $\$ 26$ billion at September 30 , 2001, compared with $\$ 28$ billion at September 30,2000 and were also impacted by weak market conditions.

PNC Advisors will continue to focus on acquiring new customers and growing and expanding existing customer relationships while aggressively managing the revenue/expense relationship.


(a) Excludes the impact of fund administration and servicing costs - affiliates.

BlackRock is one of the largest publicly traded investment management firms in the United States with $\$ 226$ billion of assets under management at September 30, 2001. BlackRock manages assets on behalf of institutions and individuals through a variety of fixed income, liquidity, equity and alternative investment separate accounts and mutual funds, including its flagship fund families, BlackRock Funds and BlackRock Provident Institutional Funds. In addition, BlackRock provides risk management and technology services to a growing number of institutional investors under the BlackRock Solutions brand name.

BlackRock continues to focus on delivering superior investment performance to clients while pursuing strategies to build on core strengths and to selectively expand the firm's expertise and breadth of distribution.

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BlackRock contributed 9\% of total business earnings for the first nine months of 2001 compared with $7 \%$ for the first nine months of 2000 . Earnings increased $26 \%$ in the period-to-period comparison primarily due to an $18 \%$ increase in assets under management. New client mandates and additional funding from existing clients was $\$ 31$ billion or $89 \%$ of the increase in assets under management.

Total revenue for the first nine months of 2001 increased $\$ 56$ million or $16 \%$ compared with the first nine months of 2000 primarily due to new institutional business and strong fixed-income performance. The increase in operating expense in the period-to-period comparison supported revenue growth and business expansion.

| ASSETS UNDER MANAGEMENT September 30 - in billions | 2001 | 2000 |
| :---: | :---: | :---: |
| Separate accounts |  |  |
| Fixed income | \$119 | \$97 |
| Liquidity | 7 | 5 |
| Liquidity - securities lending | 8 | 11 |
| Equity | 8 | 7 |
| Alternative investment products | 5 | 3 |
| Total separate accounts | 147 | 123 |
| Mutual funds (a) |  |  |
| Fixed income | 14 | 14 |
| Liquidity | 56 | 38 |
| Equity | 9 | 16 |
| Total mutual funds | 79 | 68 |
| Total assets under management | \$226 | \$191 |

(a) Includes BlackRock Funds, BlackRock Provident Institutional Funds, BlackRock Closed End Funds, Short Term Investment Funds and BlackRock Global Series Funds.

BlackRock, Inc. is approximately 70\% owned by PNC and is listed on the New York Stock Exchange under the symbol BLK. Additional information about BlackRock is available in its filings with the Securities and Exchange Commission ("SEC") and may be obtained electronically at the SEC's home page at www.sec.gov.

PFPC

| Nine months ended September 30 - dollars in millions | 2001 | 2000 |
| :---: | :---: | :---: |
| INCOME STATEMENT |  |  |
| Fund servicing revenue | \$556 | \$505 |
| Operating expense | 396 | 380 |
| Amortization | 19 | 24 |
| Operating income | 141 | 101 |
| Nonoperating income (a) | 11 | 21 |
| Debt financing | 71 | 71 |
| Pretax earnings | 81 | 51 |

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| Income taxes | 32 | 20 |
| :---: | :---: | :---: |
| Earnings | \$49 | \$31 |
| AVERAGE BALANCE SHEET |  |  |
| Intangible assets | \$1,072 | \$1,110 |
| Other assets | 687 | 468 |
| Total assets | \$1,759 | \$1,578 |
| Deposits | \$79 | \$139 |
| Assigned funds and other liabilities | 1,472 | 1,231 |
| Assigned capital | 208 | 208 |
| Total funds | \$1,759 | \$1,578 |
| PERFORMANCE RATIOS |  |  |
| Operating margin | 25\% | 20\% |
| Return on assigned capital | 31 | 20 |

(a) Net of nonoperating expense.

PFPC is the largest full-service mutual fund transfer agent and second largest provider of mutual fund accounting and administration services in the United States, providing a wide range of fund services to the investment management industry. PFPC also provides customized processing solutions to the international marketplace through its Dublin, Ireland and Luxembourg operations.

To meet the growing needs of the European marketplace, PFPC continues its pursuit of offshore expansion. PFPC is also focusing technological resources on targeted Web-based initiatives and exploring strategic alliances.

PFPC contributed 5\% of total business earnings for the first nine months of 2001 and $3 \%$ for the first nine months of 2000. Earnings increased $\$ 18$ million or $58 \%$ in the period-to-period comparison and performance ratios improved significantly. The increase in earnings was primarily due to strong growth in transfer agency and sub-accounting revenue that resulted from an increase in shareholder accounts serviced. The first nine months of 2001 also benefited from focused expense control efforts and the comparative impact of Investor Services Group integration costs incurred in the prior-year period.

Revenue of $\$ 556$ million for the first nine months of 2001 increased $\$ 51$ million or $10 \%$ compared with the first nine months of 2000 . An increase in accounting/administration revenue, driven by new client growth, more than offset the impact of lower custody assets. Growth rates in this business are expected to slow as a result of lower market valuations and competitive pricing pressure. See Fund Servicing in the Risk Factors section of this Financial Review for additional information regarding matters that could impact fund servicing revenue.

Operating expense increased 4\% in the period-to-period comparison primarily due to business expansion partially offset by the comparative impact of one-time integration costs in the prior-year period.

SERVICING STATISTICS

| September 30 | 2001 | 2000 |
| :---: | :---: | :---: |
| Accounting/administration <br> assets (\$ in billions) (a) | \$500 | \$460 |
| Custody assets (\$ in billions) | 359 | 434 |
| Shareholder accounts (in millions) | 47 | 43 |

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(a) Includes net assets serviced offshore of approximately $\$ 16$ billion and $\$ 8$ billion at September 30, 2001 and 2000, respectively.

Financial Review
THE PNC FINANCIAL SERVICES GROUP, INC.

CONSOLIDATED INCOME STATEMENT REVIEW
NET INTEREST INCOME ANALYSIS

| Taxable-equivalent basis |  | age Bal |  | Inte | Incon | pens |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Nine months ended September 30 - dollars in millions | 2001 | 2000 | Change | 2001 | 2000 | Chang |
| Interest-earning assets |  |  |  |  |  |  |
| Loans held for sale | \$1,894 | \$2,681 | \$ (787) | \$92 | \$163 | \$(71 |
| Securities | 10,141 | 6,105 | 4,036 | 456 | 292 | 164 |
| Loans, net of unearned income Commercial | 20,144 | 21,878 | $(1,734)$ | 1,130 | 1,383 | (253 |
| Commercial real estate | 2,567 | 2,689 | (122) | 146 | 179 | (33 |
| Consumer | 9,095 | 9,210 | (115) | 563 | 589 | (26 |
| Residential mortgage | 9,616 | 12,519 | $(2,903)$ | 522 | 668 | (146 |
| Lease financing | 4,144 | 3,082 | 1,062 | 220 | 168 | 52 |
| Other | 478 | 670 | (192) | 25 | 42 | (17 |
| Total loans, net of unearned income | 46,044 | 50,048 | $(4,004)$ | 2,606 | 3,029 | (423 |
| Other | 1,637 | 1,278 | 359 | 93 | 71 | 22 |
| Total interest-earning assets/ interest income | $59,716$ | 60,112 | (396) | 3,247 | 3,555 | (308 |
| Noninterest-earning assets | $10,834$ | 8,874 | 1,960 |  |  |  |
| Total assets | \$70,550 | \$68,986 | \$1,564 |  |  |  |
| Interest-bearing liabilities Deposits |  |  |  |  |  |  |
| Demand and money market | \$20,994 | \$18,389 | \$2,605 | 419 | 472 | (53 |
| Savings | 1,927 | 2,088 | (161) | 15 | 27 | 12 |
| Retail certificates of deposit | 12,716 | 14,591 | $(1,875)$ | 516 | 603 | (87 |
| Other time | 534 | 633 | (99) | 26 | 31 | ( 5 |
| Deposits in foreign offices | 948 | 1,437 | (489) | 35 | 67 | (32 |
| Total interest-bearing deposits | 37,119 | 37,138 | (19) | 1,011 | 1,200 | (189 |
| Borrowed funds | 13,637 | 14,422 | (785) | 540 | 711 | (171 |
| Total interest-bearing liabilities/ interest expense | 50,756 | 51,560 | (804) | 1,551 | 1,911 | (360 |
| Noninterest-bearing liabilities, capital securities and shareholders' equity | 19,794 | 17,426 | 2,368 |  |  |  |
| Total liabilities, capital securities and shareholders' equity | \$70,550 | \$68,986 | \$1,564 |  |  |  |

Interest rate spread
Impact of noninterest-bearing sources
Net interest income/margin \$1,696 \$1,644 \$52

## NET INTEREST INCOME

Changes in net interest income and margin result from the interaction between the volume and composition of earning assets, related yields and associated funding costs. Accordingly, portfolio size, composition and yields earned and funding costs can have a significant impact on net interest income and margin.

Taxable-equivalent net interest income of $\$ 1.696$ billion for the first nine months of 2001 increased $3 \%$ compared with the first nine months of 2000 . The increase was primarily due to the positive impact of transaction deposit growth and a lower rate environment that was partially offset by the impact of continued downsizing of the loan portfolio. The net interest margin widened 13 basis points to $3.76 \%$ for the first nine months of 2001 compared with $3.63 \%$ for the first nine months of 2000. The increase was primarily due to the impact of the lower rate environment and the benefit of growth in transaction deposits and downsizing of higher-cost, less valuable retail certificates and wholesale deposits. See Interest Rate Risk in the Risk Management section of this Financial Review for additional information regarding interest rate risk.

Loans represented 77\% of average interest-earning assets for the first nine months of 2001 compared with $83 \%$ for the first nine months of 2000 . The decrease was primarily due to the continued downsizing of certain institutional lending portfolios and the securitization of residential mortgage loans during the first nine months of 2001.

Securities represented $17 \%$ of average interest-earning assets for the first nine months of 2001 compared with $10 \%$ for the first nine months of 2000 . The increase was primarily due to the securitization of residential mortgage loans as part of balance sheet and interest rate risk management activities.

Funding cost is affected by the volume and composition of funding sources as well as related rates paid thereon. Average deposits comprised $64 \%$ and $66 \%$ of total sources of funds for the first nine months of 2001 and 2000 , respectively, with the remainder primarily comprised of wholesale funding obtained at prevailing market rates.

Average demand and money market deposits increased $\$ 2.6$ billion or $14 \%$ compared with the first nine months of 2000, primarily reflecting the impact of strategic marketing initiatives to grow more valuable transaction accounts, while all other interest-bearing deposit categories decreased in the period-to-period comparison. Average borrowed funds for the first nine months of 2001 decreased $\$ 785$ million compared with the first nine months of 2000 as lower bank notes and senior debt were partially offset by increases in Federal Home Loan Bank borrowings and repurchase agreements.

PROVISION FOR CREDIT LOSSES
The provision for credit losses was $\$ 235$ million for the first nine months of 2001 compared with $\$ 96$ million for the first nine months of 2000 . The increase was primarily related to institutional lending portfolios that PNC is downsizing

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and a $\$ 45$ million addition to unallocated reserves, given the deterioration in economic conditions. See Credit Risk in the Risk Management section of this Financial Review for additional information regarding credit risk.

## NONINTEREST INCOME

Noninterest income was $\$ 2.128$ billion for the first nine months of 2001 compared with $\$ 2.156$ billion for the same period in 2000 . Noninterest income for the first nine months of 2001 included $\$ 134$ million of net securities gains, $\$ 82$ million of equity management losses related to venture capital activities and charges of $\$ 86$ million for valuation adjustments on loans held for sale owned by the subsidiaries of a third party financial institution. See "Restatements" in the Notes to Consolidated Financial Statements for additional information.

Asset management fees of $\$ 645$ million for the first nine months of 2001 increased $\$ 55$ million or $9 \%$ primarily driven by new institutional business and strong fixed-income performance at BlackRock. Consolidated assets under management were $\$ 270$ billion at September 30 , 2001 , a $13 \%$ increase compared with September 30, 2000. Fund servicing fees were $\$ 545$ million for the first nine months of 2001, a $\$ 58$ million or $12 \%$ increase compared with the first nine months of 2000 primarily driven by new client growth.

Service charges on deposits increased $7 \%$ to $\$ 160$ million for the first nine months of 2001 primarily due to an increase in transaction deposit accounts. Brokerage fees were $\$ 163$ million for the first nine months of 2001 compared with $\$ 192$ million for the first nine months of 2000 . The decrease was primarily due to a decline in equity markets activity. Consumer services revenue of \$171 million for the first nine months of 2001 increased $\$ 18$ million or $12 \%$ compared with the first nine months of 2000 primarily due to the expansion of PNC's ATM network and the increase in transaction deposit accounts.

Corporate services revenue was $\$ 149$ million for the first nine months of 2001 compared with $\$ 248$ million for the first nine months of 2000 . Higher commercial mortgage servicing revenue was more than offset by valuation adjustments of loans held for sale and other assets and lower capital markets revenue. Revenue in 2001 was adversely impacted by valuation adjustments of $\$ 86$ million related to loans held for sale owned by the subsidiaries of a third party financial institution. See "Restatements" in the Notes to Consolidated Financial Statements for additional information.

Equity management, which is comprised of venture capital activities, reflected a net loss of $\$ 82$ million for the first nine months of 2001 compared with $\$ 132$ million of income for the first nine months of 2000. The decrease primarily resulted from a decline in the estimated fair value of partnership investments. At September 30, 2001, equity management investments totaling approximately $\$ 683$ million, including net unrealized appreciation of $\$ 31$ million, were comprised of approximately $60 \%$ direct investments and $40 \%$ partnership investments. These valuations are subject to market conditions and may be volatile. PNC is currently evaluating strategies to mitigate the impact of the revenue volatility of this business.

Net securities gains were $\$ 134$ million for the first nine months of 2001 and were partially offset by valuation adjustments and write-downs of other assets and e-commerce investments totaling $\$ 35$ million that are reflected in corporate services and other noninterest income.

Other noninterest income was $\$ 243$ million for the first nine months of 2001 compared with $\$ 200$ million for the first nine months of 2000 . The increase was primarily due to higher revenue from trading activities and residential mortgage loan securitizations.

NONINTEREST EXPENSE
Noninterest expense was $\$ 2.351$ billion for the first nine months of 2001

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compared with $\$ 2.319$ billion for the first nine months of 2000 and the efficiency ratio remained essentially flat at 58\% and 57\% for the nine months ended 2001 and 2000, respectively. The increase in noninterest expense was primarily in businesses that have stronger revenue growth including the Regional Community Bank, BlackRock and PFPC. Average full-time equivalent employees totaled approximately 24,600 and 24,000 for the first nine months of 2001 and 2000, respectively. The increase was primarily in asset management and processing businesses.

Financial Review
THE PNC FINANCIAL SERVICES GROUP, INC.

CONSOLIDATED BALANCE SHEET REVIEW

LOANS
Loans were $\$ 42.1$ billion at September 30,2001 , a decrease of $\$ 8.5$ billion from year-end 2000 primarily due to residential mortgage loan securitizations and reductions in most commercial loan categories as a result of continuing efforts to reduce balance sheet leverage.

DETAILS OF LOANS

| In millions | September 30 | December 31 |
| :--- | ---: | ---: |
| 2001 | 2000 |  |


| Commercial |  |  |
| :---: | :---: | :---: |
| Manufacturing | \$4,567 | \$5,581 |
| Retail/wholesale | 4,293 | 4,413 |
| Service providers | 2,386 | 2,944 |
| Real estate related | 1,826 | 1,783 |
| Financial services | 1,608 | 1,726 |
| Communications | 934 | 1,296 |
| Health care | 658 | 722 |
| Other | 2,312 | 2,742 |
| Total commercial | 18,584 | 21,207 |
| Commercial real estate |  |  |
| Mortgage | 591 | 673 |
| Real estate project | 2,024 | 1,910 |
| Total commercial real estate | 2,615 | 2,583 |
| Consumer |  |  |
| Home equity | 6,883 | 6,228 |
| Automobile | 860 | 1,166 |
| Other | 1,378 | 1,739 |
| Total consumer | 9,121 | 9,133 |
| Residential mortgage | 6,815 | 13,264 |
| Lease financing | 5,663 | 4,845 |
| Other | 485 | 568 |
| Unearned income | $(1,143)$ | (999) |
| Total, net of unearned income | \$42,140 | \$50,601 |

Loan portfolio composition continued to be geographically diversified among

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numerous industries and types of businesses.

During 1999, total outstandings and exposure designated for downsizing totaled $\$ 3.7$ billion and $\$ 10.5$ billion, respectively. At September 30,2001 , remaining outstandings associated with this initiative were $\$ 321$ million, of which $\$ 271$ million were classified as loans with the remainder included in loans held for sale. Total remaining exposure related to this initiative was $\$ 1.3$ billion at September 30, 2001.

In addition, outstandings and exposure totaling approximately $\$ 2.5$ billion and $\$ 7.0$ billion, respectively, were designated for downsizing during the first quarter of 2001 , primarily consisting of the communications portfolio and certain portions of the energy, metals and mining and large corporate portfolios in Corporate Banking. At September 30, 2001 , remaining outstandings and exposure associated with this initiative were $\$ 1.6$ billion and $\$ 4.5$ billion, respectively.

At September 30, 2001, approximately $\$ 489$ million of loans held by the subsidiaries of a third party financial institution were classified in the consolidated financial statements as loans held for sale. Unfunded commitments and letters of credit related to the loans totaled approximately $\$ 111$ million at September 30, 2001.

NET UNFUNDED COMMITMENTS (a)

|  | September 30 | December 31 |
| :---: | :---: | :---: |
| In millions | 2001 | 2000 |
| Commercial | \$21,009 | \$24,253 |
| Commercial real estate | 969 | 1,039 |
| Consumer | 4,750 | 4,414 |
| Lease financing | 123 | 123 |
| Other | 150 | 173 |
| Total | \$27,001 | \$30,002 |

(a) Excludes unfunded commitments related to loans designated for downsizing in 1999 and 2001 and unfunded commitments related to loans held by the subsidiaries of a third party financial institution.

Commitments to extend credit represent arrangements to lend funds subject to specified contractual conditions. Commercial commitments are reported net of participations, assignments and syndications, primarily to financial institutions, and total $\$ 7.4$ billion at September 30,2001 and $\$ 7.2$ billion at December 31, 2000 .

Net outstanding letters of credit totaled $\$ 4.1$ billion and $\$ 4.0$ billion at September 30, 2001 and December 31, 2000, respectively, and consisted primarily of standby letters of credit that commit the Corporation to make payments on behalf of customers if specified future events occur. Unfunded commitments and letters of credit related to loans designated for downsizing in 2001 and 1999 totaled $\$ 3.9$ billion at September 30,2001 and $\$ 1.7$ billion at December 31, 2000 .

## SECURITIES

Total securities at September 30,2001 were $\$ 11.1$ billion compared with $\$ 5.9$ billion at December 31, 2000. Total securities represented $15 \%$ of total assets at September 30, 2001 compared with 8\% at December 31, 2000. The increase was primarily due to residential mortgage loan securitizations and purchases of asset-backed securities during the first nine months of 2001 . The expected weighted-average life of securities available for sale was 2 years and 11 months at September 30, 2001 compared with 4 years and 5 months at December 31, 2000.

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At September 30, 2001, the securities available for sale balance of $\$ 10.8$ billion included a net unrealized gain of $\$ 75$ million, which represented the difference between fair value and amortized cost. Securities available for sale at December 31, 2000 totaled $\$ 5.9$ billion and included a net unrealized loss of \$54 million. Net unrealized gains and losses in the securities available for sale portfolio are included in accumulated other comprehensive income or loss, net of tax or, for the portion attributable to a hedged risk as part of a fair value hedge strategy, in net income.

Securities designated as held to maturity are carried at amortized cost and are assets of subsidiaries of a third party financial institution, which are consolidated in PNC's financial statements. The expected weighted-average life of securities held to maturity was 19 years and 6 months at September 30, 2001. PNC had no securities held to maturity at December 31, 2000.

DETAILS OF SECURITIES

| In millions | Amortized Cost |  |
| :---: | :---: | :---: |
| SEPTEMBER 30, 2001 |  |  |
| SECURITIES AVAILABLE FOR SALE |  |  |
| Debt securities |  |  |
| U.S. Treasury and government agencies | \$1,053 | \$1,059 |
| Mortgage-backed | 6,509 | 6,561 |
| Asset-backed | 2,472 | 2,501 |
| State and municipal | 65 | 68 |
| Other debt | 73 | 74 |
| Corporate stocks and other | 533 | 517 |
| Total securities available for sale | \$10,705 | \$10,780 |
| SECURITIES HELD TO MATURITY |  |  |
| Debt securities |  |  |
| U.S. Treasury and government agencies | \$198 | \$206 |
| Other debt | 73 | 73 |
| Total securities held to maturity | \$271 | \$279 |
| DECEMBER 31, 2000 |  |  |
| Debt securities |  |  |
| U.S. Treasury and government agencies | \$313 | \$313 |
| Mortgage-backed | 4,037 | 4,002 |
| Asset-backed | 902 | 893 |
| State and municipal | 94 | 96 |
| Other debt | 73 | 73 |
| Corporate stocks and other | 537 | 525 |
| Total securities available for sale | \$5,956 | \$5,902 |

## FUNDING SOURCES

Total funding sources were $\$ 58.0$ billion at September 30, 2001 and decreased $\$ 1.4$ billion compared with December 31, 2000. Demand and money market deposits increased due to ongoing strategic marketing efforts to retain customers and increase money market balances as funds shifted from certificates of deposit. The change in the composition of borrowed funds reflected the impact of closing the sale of the residential mortgage banking business as well as a shift within categories to manage overall funding costs.

DETAILS OF FUNDING SOURCES

| In millions | $\begin{array}{r} \text { ember } 30 \\ 2001 \end{array}$ | December 31 2000 |
| :---: | :---: | :---: |
| Deposits |  |  |
| Demand and money market | \$30,696 | \$28,771 |
| Savings | 1,923 | 1,915 |
| Retail certificates of deposit | 11,577 | 14,175 |
| Other time | 495 | 567 |
| Deposits in foreign offices | 227 | 2,236 |
| Total deposits | 44,918 | 47,664 |
| Borrowed funds |  |  |
| Federal funds purchased | 1,904 | 1,445 |
| Repurchase agreements | 672 | 607 |
| Bank notes and senior debt | 5,344 | 6,110 |
| Federal Home Loan Bank borrowings | 2,457 | 500 |
| Subordinated debt | 2,368 | 2,407 |
| Other borrowed funds | 301 | 649 |
| Total borrowed funds | 13,046 | 11,718 |
| Total | \$57,964 | \$59,382 |

## CAPITAL

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, deposit insurance costs, and the level and nature of regulatory oversight depend, in large part, on a financial institution's capital strength. At September 30, 2001, the Corporation and each bank subsidiary were considered well capitalized based on regulatory capital ratio requirements.

RISK-BASED CAPITAL

| Dollars in millions | $\begin{array}{r} \text { ember } 30 \\ 2001 \end{array}$ | December 31 2000 |
| :---: | :---: | :---: |
| Capital components |  |  |
| Shareholders' equity |  |  |
| Common | \$6,557 | \$6,344 |
| Preferred | 216 | 312 |
| Trust preferred capital securities | 848 | 848 |
| Goodwill and other | $(2,192)$ | $(2,214)$ |
| Net unrealized securities (gains) losses | losses | 77 |
| Tier I risk-based capital | 5,376 | 5,367 |
| Subordinated debt | 1,616 | 1,811 |
| Minority interest | 29 |  |
| Eligible allowance for credit losses | 720 | 667 |
| Total risk-based capital | \$7,741 | \$7,845 |

Assets
Risk-weighted assets and off-balance-sheet instruments, and market risk equivalent assets \$64,345 \$62,430
Average tangible assets 66,809

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\author{

Capital ratios <br> Tier I risk-based 8.4\% 8.6\% <br> Total risk-based <br> Leverage <br> | 12.0 | 12.6 |
| ---: | ---: |
| 8.1 | 8.0 |

}

The capital position is managed through balance sheet size and composition, issuance of debt and equity instruments, treasury stock activities, dividend policies and retention of earnings.

On October 4, 2001, PNC redeemed all outstanding shares of Fixed/Adjustable Rate Noncumulative Preferred Stock Series F for approximately $\$ 205$ million.

On February 15, 2001, the Board of Directors authorized the Corporation to purchase up to 15 million shares of its common stock through February 28, 2002 . During the first nine months of 2001 , PNC repurchased 8.4 million shares of its common stock.

## RISK FACTORS

The Corporation is subject to a number of risks including, among others, those described below and in the Risk Management and Forward-Looking Statements sections of this Financial Review. These factors and others could impact the Corporation's business, financial condition and results of operations.

BUSINESS AND ECONOMIC CONDITIONS
The Corporation's business and results of operations are sensitive to general business and economic conditions in the United States. These conditions include the level and movement of interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, and the strength of the U.S. economy, in general, and the regional economies in which the Corporation conducts business. A sustained weakness or further weakening of the economy could decrease the demand for loans and other products and services offered by the Corporation, increase usage of unfunded commitments or increase the number of customers and counterparties who become delinquent, file for protection under bankruptcy laws or default on their loans or other obligations to the Corporation. An increase in the number of delinquencies, bankruptcies or defaults could result in a higher level of nonperforming assets, net charge-offs and provision for credit losses. Changes in interest rates could affect the value of certain on-balance-sheet and off-balance-sheet financial instruments of the Corporation. Higher interest rates would also increase the Corporation's cost to borrow funds and may increase the rate paid on deposits. Changes in interest rates could also affect the value of assets under management. In a period of rapidly rising interest rates, certain assets under management would likely be negatively impacted by reduced asset values and increased redemptions. Also, changes in equity markets could affect the value of equity investments and the net asset value of assets under management and administration. A decline or volatility in the equity markets could negatively affect noninterest revenues.

## TERRORIST ACTIVITIES

The impact of the September 11th terrorist attacks or any future terrorist activities and responses to such activities cannot be predicted at this time with respect to severity or duration. The impact could adversely affect the Corporation in a number of ways including, among others, an increase in delinquencies, bankruptcies or defaults that could result in a higher level of nonperforming assets, net charge-offs and provision for credit losses.

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The financial services industry is subject to various monetary and other policies and regulations of the United States government and its agencies, which include the Federal Reserve Board, the Office of the Comptroller of Currency and the Federal Deposit Insurance Corporation as well as state regulators. The Corporation is particularly affected by the policies of the Federal Reserve Board, which regulates the supply of money and credit in the United States. The Federal Reserve Board's policies influence the rates of interest that PNC charges on loans and pays on interest-bearing deposits and can also affect the value of on-balance-sheet and off-balance-sheet financial instruments. Those policies also influence, to a significant extent, the cost of funding for the Corporation.

## COMPETITION

PNC operates in a highly competitive environment, both in terms of the products and services offered and the geographic markets in which PNC conducts business. This environment could become even more competitive in the future. The Corporation competes with local, regional and national banks, thrifts, credit unions and non-bank financial institutions, such as investment banking firms, investment advisory firms, brokerage firms, investment companies, venture capital firms, mutual fund complexes and insurance companies, as well as other entities that offer financial services, and through alternative delivery channels such as the World Wide Web. Technological advances and new legislation, among other changes, have lowered barriers to entry and have made it possible for non-bank institutions to offer products and services that traditionally have been provided by banks. Many of the Corporation's competitors benefit from fewer regulatory constraints and lower cost structures, allowing for more competitive pricing of products and services.

The Gramm-Leach-Bliley Act ("the Act"), which was enacted on November 12, 1999, permits affiliations among banks, securities firms and insurance companies. The Act significantly changes the competitive environment in which the Corporation conducts business. This environment could result in expanded competition and a loss of customers and related revenue.

## DISINTERMEDIATION

Disintermediation is the process of eliminating the role of the intermediary in completing a transaction. For the financial services industry, this means eliminating or significantly reducing the role of banks and other depository institutions in completing transactions that have traditionally involved banks. Disintermediation could result in, among other things, the loss of customer deposits and decreases in transactions that generate fee income.

ASSET MANAGEMENT PERFORMANCE
Asset management revenue is primarily based on a percentage of the value of assets under management and performance fees expressed as a percentage of the returns realized on assets under management. A decline in the value of debt and equity instruments, among other things, could cause asset management revenue to decline.

Investment performance is an important factor for the level of assets under management. Poor investment performance could impair revenue and growth as existing clients might withdraw funds in favor of better performing products. Also, performance fees could be lower or nonexistent. Additionally, the ability to attract funds from existing and new clients might diminish.

## FUND SERVICING

Fund servicing fees are primarily based on the market value of the assets and the number of shareholder accounts administered by the Corporation for its clients. A rise in interest rates or a sustained weakness or further weakening

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or volatility in the debt and equity markets could influence an investor's decision to invest or maintain an investment in a mutual fund. As a result, fluctuations may occur in the level or value of assets that the Corporation has under administration. A significant investor migration from mutual fund investments could have a negative impact on the Corporation's revenues by reducing the assets and the number of shareholder accounts it administers. There has been and continues to be merger, acquisition and consolidation activity in the financial services industry. Mergers or consolidations of financial institutions in the future could reduce the number of existing or potential fund servicing clients.

## ACQUISITIONS

The Corporation expands its business from time to time by acquiring other financial services companies. Factors pertaining to acquisitions that could adversely affect the Corporation's business and earnings include, among others: - anticipated cost savings or potential revenue enhancements that may not be fully realized or realized within the expected time frame;

- key employee, customer or revenue loss following an acquisition that may be greater than expected; and
- costs or difficulties related to the integration of businesses that may be greater than expected.


## RISK MANAGEMENT

In the normal course of business, the Corporation assumes various types of risk, which include, among other things, credit risk, interest rate risk, liquidity risk, and risk associated with trading activities and financial derivatives. PNC has risk management processes designed to provide for risk identification, measurement and monitoring.

CREDIT RISK
Credit risk represents the possibility that a borrower, counterparty or insurer may not perform in accordance with contractual terms. Credit risk is inherent in the financial services business and results from extending credit to customers, purchasing securities and entering into off-balance-sheet financial derivative transactions. The Corporation seeks to manage credit risk through, among other things, diversification, limiting exposure to any single industry or customer, requiring collateral, selling participations to third parties, and purchasing credit-related derivatives.


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| Nonaccrual loans to total loans | $.86 \%$ | $.64 \%$ |
| :--- | :--- | :--- |
| Nonperforming assets to total loans, | 1.18 | .71 |
| $\quad$ loans held for sale and foreclosed | .73 | .53 |
| assets |  |  |
| Nonperforming assets to total assets | .73 |  |

(a) Includes $\$ 6$ million of a troubled debt restructured loan held for sale as of September 30, 2001.

The above table excludes $\$ 37$ million and $\$ 18$ million of equity management assets carried at estimated fair value at September 30, 2001 and December 31, 2000, respectively. The amount of nonperforming loans that were current as to principal and interest was $\$ 91$ million at September 30,2001 and $\$ 67$ million at December 31, 2000. At September 30, 2001, approximately 40\% of nonperforming assets were from portfolios that were designated for downsizing.

A sustained weakness or further weakening of the economy, or other factors that adversely affect asset quality, could result in an increase in the number of delinquencies, bankruptcies or defaults, and a higher level of nonperforming assets, net charge-offs and provision for credit losses in future periods. See the Forward-Looking Statements section of this Financial Review for additional factors that could cause actual results to differ materially from forward-looking statements or historical performance.

CHANGE IN NONPERFORMING ASSETS

| In millions | 2001 | 2000 |
| :---: | :---: | :---: |
| January 1 | \$372 | \$325 |
| Transferred from accrual | 589 | 291 |
| Returned to performing | (14) | (3) |
| Principal reductions | (159) | (125) |
| Sales | (25) | (31) |
| Charge-offs and other | (237) | (103) |
| September 30 | \$526 | \$354 |

ACCRUING LOANS PAST DUE 90 DAYS OR MORE

|  |  | unt | Percent | Loans |
| :---: | :---: | :---: | :---: | :---: |
| Sept | er 30 | December 31 | September | December 31 |
| Dollars in millions | 2001 | 2000 |  | 2000 |
| Commercial | \$37 | \$46 | . $20 \%$ | . $22 \%$ |
| Commercial real estate | 11 | 6 | . 42 | . 23 |
| Consumer | 23 | 24 | . 25 | . 26 |
| Residential mortgage | 42 | 36 | . 62 | . 27 |
| Lease financing | 2 | 1 | . 04 | . 03 |
| Total | \$115 | \$113 | . 27 | . 22 |

Loans not included in nonaccrual or past due categories, but where information about possible credit problems causes management to be uncertain about the borrower's ability to comply with existing repayment terms over the next six months totaled $\$ 146$ million at September 30, 2001.

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## ALLOWANCE FOR CREDIT LOSSES

In determining the adequacy of the allowance for credit losses, the Corporation makes specific allocations to impaired loans and to pools of watchlist and nonwatchlist loans for various credit risk factors. Allocations to loan pools are developed by business segment and risk rating and are based on historical loss trends and management's judgment concerning those trends and other relevant factors. Those factors may include, among other things, actual versus estimated losses, regional and national economic conditions, business segment and portfolio concentrations, industry competition and consolidation, and the impact of government regulations. Consumer and residential mortgage loan allocations are made at a total portfolio level based on historical loss experience adjusted for portfolio activity and economic conditions.

While PNC's pool reserve methodologies strive to reflect all risk factors, there continues to be a certain element of risk associated with, but not limited to, potential estimation or judgmental errors. Unallocated reserves are designed to provide coverage for such risks. While allocations are made to specific loans and pools of loans, the total reserve is available for all credit losses.

Senior management's Reserve Adequacy Committee provides oversight for the allowance evaluation process, including quarterly evaluations and methodology and estimation changes. The results of the evaluations are reported to the Credit Committee of the Board of Directors.

The provision for credit losses for the first nine months of 2001 and the evaluation of the allowance for credit losses as of September 30, 2001 reflected changes in loan portfolio composition, the net impact of downsizing credit exposure and changes in asset quality. The unallocated portion of the allowance for credit losses represented $20 \%$ of the total allowance and $.35 \%$ of total loans at September 30, 2001 compared with $20 \%$ and $.26 \%$, respectively, at December 31, 2000. During the third quarter of 2001, PNC added $\$ 45$ million to unallocated reserves given the deterioration in economic conditions.

ROLLFORWARD OF ALLOWANCE FOR CREDIT LOSSES

| In millions | 2001 | 2000 |
| :---: | :---: | :---: |
| January 1 | \$675 | \$674 |
| Charge-offs | (219) | (131) |
| Recoveries | 29 | 36 |
| Net charge-offs | (190) | (95) |
| Provision for credit losses | 235 | 96 |
| September 30 | \$720 | \$675 |

The allowance as a percent of nonaccrual loans and total loans was 199\% and $1.71 \%$ respectively, at September 30, 2001. The comparable year-end 2000 percentages were $209 \%$ and $1.33 \%$, respectively.

CHARGE-OFFS AND RECOVERIES

| Nine months ended September 30 |  |  | Net | Percent of Average Loans |
| :---: | :---: | :---: | :---: | :---: |
| Dollars in millions | Charge-offs | Recoveries | Charge-offs |  |
| 2001 |  |  |  |  |
| Commercial | \$165 | \$13 | \$152 | 1.01\% |
| Commercial real estate | 6 | 1 | 5 | . 26 |
| Consumer | 31 | 13 | 18 | . 26 |
| Residential mortgage | 1 |  | 1 | . 01 |
| Lease financing | 16 | 2 | 14 | . 45 |


| Total | \$219 | \$29 | \$190 | . 55 |
| :---: | :---: | :---: | :---: | :---: |
| 2000 |  |  |  |  |
| Commercial | \$86 | \$14 | \$72 | . $44 \%$ |
| Commercial real estate | 2 | 4 | (2) | (.10) |
| Consumer | 34 | 16 | 18 | . 26 |
| Residential mortgage | 4 | 1 | 3 | . 03 |
| Lease financing | 5 | 1 | 4 | . 17 |
| Total | \$131 | \$36 | \$95 | . 25 |

Net charge-offs were $\$ 190$ million or $.55 \%$ of average loans for the first nine months of 2001 compared with $\$ 95$ million or $.25 \%$ for the same period in 2000 . The increase was primarily related to loans in institutional lending portfolios that PNC is downsizing.

## CREDIT-RELATED INSTRUMENTS

Credit default swaps provide, for a fee, an assumption of a portion of the credit risk associated with the underlying financial instruments. The Corporation primarily uses such contracts to mitigate credit risk associated with commercial lending activities. At September 30,2001 , credit default swaps of $\$ 140$ million in notional value were used by the Corporation to hedge credit risk associated with commercial lending activities.

## INTEREST RATE RISK

Interest rate risk arises primarily through the Corporation's traditional business activities of extending loans and accepting deposits. Many factors, including economic and financial conditions, movements in interest rates and consumer preferences affect the spread between interest earned on assets and interest paid on liabilities. In managing interest rate risk, the Corporation seeks to minimize its reliance on a particular interest rate scenario as a source of earnings while maximizing net interest income and net interest margin. To further these objectives, the Corporation uses securities purchases and sales, short-term and long-term funding, financial derivatives and other capital markets instruments.

Interest rate risk is centrally managed by Asset and Liability Management. The Corporation actively measures and monitors components of interest rate risk including term structure or repricing risk, yield curve or nonparallel rate shift risk, basis risk and options risk. The Corporation measures and manages both the short-term and long-term effects of changing interest rates. An income simulation model is designed to measure the sensitivity of net interest income to changing interest rates over the next twenty-four month period. An economic value of equity model is designed to measure the sensitivity of the value of existing on-balance-sheet and off-balance-sheet positions to changing interest rates.

The income simulation model is the primary tool used to measure the direction and magnitude of changes in net interest income resulting from changes in interest rates. Forecasting net interest income and its sensitivity to changes in interest rates requires that the Corporation make assumptions about the volume and characteristics of new business and the behavior of existing positions. These business assumptions are based on the Corporation's experience, business plans and published industry experience. Key assumptions employed in the model include prepayment speeds on mortgage-related assets and consumer loans, loan volumes and pricing, deposit volumes and pricing, the expected life

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and repricing characteristics of nonmaturity loans and deposits, and management's financial and capital plans.

Because these assumptions are inherently uncertain, the model cannot precisely estimate net interest income or precisely predict the effect of higher or lower interest rates on net interest income. Actual results will differ from simulated results due to the timing, magnitude and frequency of interest rate changes, the difference between actual experience and the assumed volume and characteristics of new business and behavior of existing positions, and changes in market conditions and management strategies, among other factors.

The Corporation's interest rate risk management policies provide that net interest income should not decrease by more than $3 \%$ if interest rates gradually increase or decrease from current rates by 100 basis points over a twelve-month period. At September 30, 2001, if interest rates were to gradually increase by 100 basis points over the next twelve months, the model indicated that net interest income would decrease by . 3\%. If interest rates were to gradually decrease by 100 basis points over the next twelve months, the model indicated that net interest income would decrease by 1.8\%.

The Corporation models additional interest rate scenarios covering a wider range of rate movements to identify yield curve, term structure and basis risk exposures. These scenarios are developed based on historical rate relationships or management's expectations regarding the future direction and level of interest rates. Depending on market conditions and other factors, these scenarios may be modeled more or less frequently. Such analyses are used to identify risk and develop strategies.

An economic value of equity model is used by the Corporation to value all current on-balance-sheet and off-balance-sheet positions under a range of instantaneous interest rate changes. The resulting change in the value of equity is a measure of overall long-term interest rate risk inherent in the Corporation's existing on-balance-sheet and off-balance-sheet positions. The Corporation uses the economic value of equity model to complement the net interest income simulation modeling process.

The Corporation's interest rate risk management policies provide that the economic value of equity should not decline by more than $1.5 \%$ of the book value of assets for a 200 basis point instantaneous increase or decrease in interest rates. Based on the results of the economic value of equity model at September 30,2001 , if interest rates were to instantaneously increase by 200 basis points, the model indicated that the economic value of existing on-balance-sheet and off-balance-sheet positions would decline by $1.3 \%$ of assets. If interest rates were to instantaneously decrease by 200 basis points, the model indicated that the economic value of existing on-balance-sheet and off-balance-sheet positions would increase by . $2 \%$ of assets.

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## LIQUIDITY RISK

Liquidity represents the Corporation's ability to obtain cost-effective funding to meet the needs of customers as well as the Corporation's financial obligations. Liquidity is centrally managed by Asset and Liability Management, with oversight provided by the Corporate Asset and Liability Committee and the Finance Committee of the Board of Directors.

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Access to capital markets funding sources is a key factor affecting liquidity management. Access to such markets is in part based on the Corporation's credit ratings, which are influenced by a number of factors including capital ratios, asset quality and earnings. Additional factors that impact liquidity include the maturity structure of existing assets, liabilities, and off-balance-sheet positions, the level of liquid securities and loans available for sale, and the Corporation's ability to securitize and sell various types of loans.

Liquidity can also be provided through the sale of liquid assets, which consist of short-term investments, loans held for sale and securities. At September 30, 2001, such assets totaled $\$ 14.9$ billion, with $\$ 6.4$ billion pledged as collateral for borrowings, trust and other commitments. Liquidity can also be obtained through secured advances from the Federal Home Loan Bank, of which PNC Bank, N.A., PNC's largest bank subsidiary, is a member. These borrowings are generally secured by residential mortgages, other real-estate related loans and mortgage-backed securities. At September 30, 2001, approximately $\$ 10.8$ billion of residential mortgages and other real-estate related loans were available as collateral for borrowings from the Federal Home Loan Bank. Funding can also be obtained through alternative forms of borrowing, including federal funds purchased, repurchase agreements and short-term and long-term debt issuances.

Liquidity for the parent company and subsidiaries is also generated through the issuance of securities in public or private markets and lines of credit. At September 30, 2001, the Corporation had unused capacity under effective shelf registration statements of approximately $\$ 4.3$ billion of debt and equity securities and $\$ 400$ million of trust preferred capital securities. On October 29, 2001, PNC issued $\$ 600$ million of Floating Rate Senior Notes due 2004 and $\$ 400$ million of $5.75 \%$ Senior Notes due 2006 , reducing unused shelf capacity to $\$ 3.3$ billion. In addition, the Corporation had an unused line of credit of $\$ 500$ million at September 30, 2001.

The principal source of parent company revenue and cash flow is dividends from subsidiary banks. PNC Bancorp, Inc. is a wholly-owned subsidiary of the parent company and is the holding company for all bank subsidiaries. There are legal limitations on the ability of bank subsidiaries to pay dividends and make other distributions to PNC Bancorp, Inc. and in turn to the parent company. Without regulatory approval, the amount available for dividend payments to PNC Bancorp, Inc. by all bank subsidiaries was $\$ 312$ million at September 30, 2001. Dividends may also be impacted by capital needs, regulatory requirements, corporate policies, contractual restrictions and other factors.

Management believes the Corporation has sufficient liquidity to meet current obligations to borrowers, depositors, debt holders and others. The impact of replacing maturing liabilities is reflected in the income simulation model in the overall asset and liability management process.

TRADING ACTIVITIES
Most of PNC's trading activities are designed to provide capital markets services to customers and not to position the Corporation's portfolio for gains from market movements. PNC participates in derivatives and foreign exchange trading as well as underwriting and "market making" in equity securities as an accommodation to customers. PNC also engages in trading activities as part of risk management strategies.

Risk associated with trading, capital markets and foreign exchange activities is managed using a value-at-risk approach that combines interest rate risk, foreign exchange rate risk, spread risk and volatility risk. Using this approach, exposure is measured as the potential loss due to a two standard deviation, one-day move in interest rates. The combined period-end value-at-risk of all trading operations using this measurement was estimated as less than \$1.2 million at September 30, 2001.

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FINANCIAL DERIVATIVES
The Corporation uses a variety of financial derivatives as part of the overall asset and liability risk management process to manage interest rate, market and credit risk inherent in the Corporation's business activities. Substantially all such instruments are used to manage risk related to changes in interest rates. Interest rate and total rate of return swaps, purchased interest rate caps and floors and futures contracts are the primary instruments used by the corporation for interest rate risk management.

Interest rate swaps are agreements with a counterparty to exchange periodic fixed and floating interest payments calculated on a notional amount. The floating rate is based on a money market index, primarily short-term LIBOR. Total rate of return swaps are agreements with a counterparty to exchange an interest rate payment for the total rate of return on a specified reference index calculated on a notional amount. Purchased interest rate caps and floors are agreements where, for a fee, the counterparty agrees to pay the corporation the amount, if any, by which a specified market interest rate exceeds or is less than a defined rate applied to a notional amount, respectively. Interest rate futures contracts are exchange-traded agreements to make or take delivery of a financial instrument at an agreed upon price and are settled in cash daily.

Financial derivatives involve, to varying degrees, interest rate, market and credit risk. For interest rate and total rate of return swaps, caps and floors and futures contracts, only periodic cash payments and, with respect to caps and floors, premiums, are exchanged. Therefore, cash requirements and exposure to credit risk are significantly less than the notional value.

Not all elements of interest rate, market and credit risk are addressed through the use of financial or other derivatives, and such instruments may be ineffective for their intended purposes due to unanticipated market characteristics among other reasons.

The following table sets forth changes, during the first nine months of 2001, in the notional value of financial derivatives used for risk management and designated as accounting hedges under Statement of Financial Accounting Standards ("SFAS") No. 133.

FINANCIAL DERIVATIVES ACTIVITY

| Dollars in millions | December 31 | January 1 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2000 | Adjustments (a) | 2001 | Additions | Maturitie |
| Interest rate risk management |  |  |  |  |  |
| Interest rate swaps |  |  |  |  |  |
| Receive fixed | \$4,756 | \$180 | \$4,936 | \$5,900 | \$(1,618 |
| Pay fixed | 1 | 248 | 249 | 247 |  |
| Basis swaps | 2,230 | $(1,773)$ | 457 | 190 |  |
| Interest rate caps | 308 | (243) | 65 | 44 |  |
| Interest rate floors | 3,238 | (238) | 3,000 | 60 |  |
| Futures contracts |  |  |  | 416 |  |
| Total interest rate risk management | 10,533 | $(1,826)$ | 8,707 | 6,857 | (1, 618 |

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| Commercial mortgage banking risk management |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Interest rate swaps | 311 |  | 311 | 846 |  |
| Total rate of return swaps | 75 |  | 75 | 225 | (125 |
| Total commercial mortgage |  |  |  |  |  |
| Student lending activities Forward contracts | 347 | (347) |  |  |  |
| Credit-related activities |  |  |  |  |  |
| Credit default swaps | 4,391 | $(4,391)$ |  |  |  |
| Total | \$15, 657 | \$ (6, 564 ) | \$9,093 | \$7,928 | \$ $(1,743$ |


| Dollars in millions | $\begin{array}{r} \text { September } 30 \\ 2001 \end{array}$ | Weighted- <br> Average Maturity |
| :---: | :---: | :---: |
| Interest rate risk management Interest rate swaps |  |  |
|  |  |  |
| Receive fixed | \$9,098 | 2 yrs. 10 mos |
| Pay fixed | 151 | 3 yrs. 5 mos. |
| Basis swaps | 167 | 3 yrs. 6 mos . |
| Interest rate caps | 25 | 4 yrs. 7 mos. |
| Interest rate floors | 12 | 2 yrs. 3 mos. |
| Futures contracts | 300 | 9 mos. |
| Total interest rate risk management | 9,753 |  |
| Commercial mortgage banking risk management |  |  |
| Interest rate swaps | 208 | 9 yrs. 3 mos. |
| Total rate of return swaps | 175 | 4 mos . |
| Total commercial mortgage banking risk management | 383 |  |
| Student lending activities Forward contracts |  |  |
| Credit-related activities Credit default swaps |  |  |
| Total | \$10,136 |  |

(a) Primarily consists of derivatives that are not designated as accounting hedges under SFAS No. 133 and instruments no longer considered financial derivatives under SFAS No. 133.

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The following table sets forth the notional value and the fair value of financial derivatives used for risk management and designated as accounting hedges under SFAS No. 133. Weighted-average interest rates presented are based on the implied forward yield curve at September 30, 2001.

FINANCIAL DERIVATIVES

September $30, ~ 2001$ - dollars in millions | Notional |
| ---: |
| Value |$\quad$ Fair Va

(a) The floating rate portion of interest rate contracts is based on money-market indices. As a percent of notional value, $76 \%$ were based on 1 -month LIBOR, $23 \%$ on 3 -month LIBOR and the remainder on other short-term indices.
(b) Interest rate caps with notional values of $\$ 15$ million require the counterparty to pay the Corporation the excess, if any, of $3-m o n t h$ LIBOR over a weighted-average strike of $6.40 \%$. In addition, interest rate caps with notional values of $\$ 6$ million require the counterparty to pay the excess, if any, of 1 -month LIBOR over a weighted-average strike of $6.00 \%$. At September 30, 2001, 3-month LIBOR was 2.59\%.
(c) Interest rate floors with notional values of $\$ 5$ million require the counterparty to pay the excess, if any, weighted-average strike of $5.50 \%$ over 1 -month LIBOR. In addition, interest rate floors with notional values of $\$ 5$ million require the counterparty to pay the excess, if any, weighted-average strike of $4.50 \%$ over 3 -month LIBOR. At September 30, 2001, 1 -month LIBOR was $2.63 \%$ and 3 -month LIBOR was $2.59 \%$.
NM- Not meaningful

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The following table sets forth the notional value and the estimated fair value of financial derivatives used for risk management. Weighted-average interest rates presented are based on the implied forward yield curve at December 31, 2000.

FINANCIAL DERIVATIVES

(a) The floating rate portion of interest rate contracts is based on money-market indices. As a percent of notional value, $62 \%$ were based on 1-month LIBOR, $36 \%$ on 3 -month LIBOR and the remainder on other short-term indices.
(b) Interest rate caps with notional values of $\$ 61$ million, $\$ 95$ million and $\$ 150$ million require the counterparty to pay the Corporation the excess, if any, of 3 -month LIBOR over a weighted-average strike of $6.00 \%$, 1 -month LIBOR over

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a weighted-average strike of $5.68 \%$ and Prime over a weighted-average strike of $8.76 \%$, respectively. At December 31, 2000 , 3 -month LIBOR was $6.40 \%$, 1 -month LIBOR was $6.56 \%$ and Prime was $9.50 \%$.
(c) Interest rate floors with notional values of $\$ 3.0$ billion, require the counterparty to pay the excess, if any, of the weighted-average strike of $4.63 \%$ over 3 -month LIBOR. At December 31, 2000 , 3 -month LIBOR was $6.40 \%$.
(d) Due to the structure of these contracts, they are no longer considered financial derivatives under SFAS No. 133.
NM- Not meaningful

OTHER DERIVATIVES
To accommodate customer needs, PNC enters into customer-related financial derivative transactions primarily consisting of interest rate swaps, caps, floors and foreign exchange contracts. Risk exposure from customer positions is managed through transactions with other dealers.

Additionally, the Corporation enters into other derivative transactions for risk management purposes that are not designated as accounting hedges.

OTHER DERIVATIVES

(a) Represents average for nine months ended September 30, 2001.

THIRD QUARTER 2001 VS. 2000

Earnings for the third quarter of 2001 were $\$ 247$ million or $\$ .84$ per diluted share compared with earnings of $\$ 299$ million or $\$ 1.01$ per diluted share for the third quarter of 2000. Excluding net losses from venture capital activities, third quarter 2001 earnings were $\$ .87$ per diluted share. Return on average common shareholders' equity was $14.83 \%$ and return on average assets was $1.42 \%$ for the third quarter of 2001 compared with $19.99 \%$ and $1.72 \%$ respectively, for the third quarter of 2000.

Taxable-equivalent net interest income of $\$ 568$ million for the third quarter of

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2001 increased $\$ 34$ million or $6 \%$ compared with the third quarter of 2000 . The increase was primarily due to the positive impact of transaction deposit growth and a lower rate environment that was partially offset by the impact of continued downsizing of the loan portfolio. The net interest margin widened 35 basis points to $3.89 \%$ primarily due to the impact of the lower rate environment and the benefit of growth in transaction deposits and downsizing of higher-cost, less valuable retail certificates and wholesale deposits.

The provision for credit losses was $\$ 110$ million for the third quarter of 2001 compared with $\$ 30$ million for the third quarter of 2000 . The increase in the provision was primarily due to a $\$ 45$ million addition to unallocated reserves given the deterioration in overall economic conditions. The remainder of the increase in the provision for credit losses primarily related to commercial loans in portfolios that are being downsized.

Noninterest income was $\$ 707$ million for the third quarter of 2001 compared with $\$ 700$ million for the prior-year quarter. Noninterest income for the third quarter of 2001 included $\$ 88$ million of net securities gains, $\$ 13$ million of equity management losses related to venture capital activities and $\$ 85$ million of charges for valuation adjustments on loans held for sale owned by the subsidiaries of a third party financial institution.

Asset management fees of $\$ 208$ million for the third quarter of 2001 remained flat compared with the prior-year quarter as growth in new institutional business at BlackRock was offset by the impact of weak equity markets on investment management and trust revenue in PNC Advisors. Fund servicing fees of $\$ 182$ million for the third quarter of 2001 increased $\$ 14$ million or $8 \%$ compared with the third quarter of 2000 primarily due to new client growth.

Service charges on deposits were $\$ 56$ million for the third quarter of 2001 , up 12\% compared with the same period last year primarily due to an increase in transaction deposit accounts. Brokerage fees decreased $\$ 7$ million or $11 \%$ compared with the third quarter of 2000 as the impact of a decline in equity markets activity was partially offset by an increase in annuity commissions at the Regional Community Bank. Consumer services revenue of $\$ 58$ million for the third quarter of 2001 increased $\$ 3$ million or $5 \%$ compared with the prior-year quarter primarily due to the expansion of PNC's ATM network and the increase in transaction deposit accounts.

Corporate services reflected net losses of $\$ 3$ million for the third quarter of 2001 compared with net gains of $\$ 86$ million for the third quarter of 2000 . The decrease was primarily due to $\$ 85$ million of valuation adjustments in the third quarter of 2001 related to loans held for sale owned by the subsidiaries of a third party financial institution and the impact of weaker capital market conditions.

Equity management reflected net losses of $\$ 13$ million for the third quarter of 2001 compared with $\$ 3$ million of net losses for the third quarter of 2000 . The increase in net losses primarily resulted from a decline in the estimated fair value of partnership investments.

Net securities gains were $\$ 88$ million for the third quarter of 2001 compared with $\$ 7$ million for the third quarter of 2000 . Other noninterest income was $\$ 77$ million for the third quarter of 2001 compared with $\$ 68$ million for the third quarter of 2000 .

Noninterest expense was $\$ 787$ million and the efficiency ratio was $58 \%$ in the third quarter of 2001 compared with $\$ 747$ million and $57 \%$, respectively, during the third quarter of 2000 . The increase in noninterest expense was primarily in businesses that had stronger revenue growth including the Regional Community Bank, BlackRock and PFPC.

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Total assets were $\$ 71.8$ billion at September 30,2001 compared with $\$ 69.9$ billion at September 30, 2000. Average interest-earning assets were $\$ 57.9$ billion for the third quarter of 2001 compared with $\$ 59.7$ billion for the third quarter of 2000 . The decrease was primarily due to a $\$ 2.5$ billion decrease in commercial loans related to initiatives to downsize certain higher-risk, non-strategic portfolios. Average securities increased by nearly $\$ 5$ billion and residential mortgage loans decreased by a corresponding amount due to the securitization of residential mortgage loans following the sale of PNC Mortgage.

Average deposits were $\$ 44.6$ billion and represented $65 \%$ of total sources of funds for the third quarter of 2001 compared with $\$ 45.9$ billion and 66\%, respectively, in the third quarter of 2000 . While total deposits decreased $\$ 1.3$ billion, an increase in transaction deposits of $\$ 2.8$ billion or $10 \%$ was more than offset by a $\$ 4.1$ billion decrease in higher-cost retail certificates and wholesale deposits.

Average borrowed funds declined $7 \%$ to $\$ 12.5$ billion for the third quarter of 2001 compared with $\$ 13.5$ billion for the third quarter of 2000 as PNC continues to reduce its reliance on wholesale funding.

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Nonperforming assets were $\$ 526$ million at September 30,2001 compared with $\$ 354$ million at September 30,2000 . The ratio of nonperforming assets to total loans, loans held for sale and foreclosed assets was 1.18\% at September 30, 2001 compared with . 68\% at September 30, 2000.

The allowance for credit losses was $\$ 720$ million and represented $1.71 \%$ of period-end loans and $199 \%$ of nonperforming loans at September 30, 2001. The comparable ratios were $1.36 \%$ and $219 \%$, respectively, at September 30, 2000. Net charge-offs were $\$ 65$ million or $.59 \%$ of average loans in the third quarter of 2001. The comparable amounts were $\$ 30$ million or $.24 \%$ respectively, in the third quarter of 2000. The increase in net charge-offs was primarily related to commercial loans in portfolios that PNC is downsizing.

## FORWARD-LOOKING STATEMENTS

This report and other statements made by the Corporation may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act with respect to the outlook or expectations for earnings, revenues, asset quality, share repurchases, and other future financial or business performance, strategies and expectations. Forward-looking statements are typically identified by words or phrases such as "believe," "feel," "expect," "anticipate," "intend," "outlook," "estimate," "forecast," "position," "target," "mission," "assume," "achievable," "potential," "strategy," "goal," "objective," "plan," "aspiration," "outcome," "continue," "remain," "maintain," "seek," "strive," "trend" and variations of such words and similar expressions, or future or conditional verbs such as "will," "would," "should," "could," "might," "can," "may" or similar expressions.

The Corporation cautions that forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. Actual results could differ materially from those anticipated in forward-looking statements and future results could differ materially from historical performance. Forward-looking statements speak only as of the date they are made, and the Corporation assumes no duty to update forward-looking statements.

In addition to factors mentioned elsewhere in this report or previously disclosed in the Corporation's SEC reports (accessible on the SEC's website at

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www. sec.gov), the following factors, among others, could cause actual results to differ materially from forward-looking statements or historical performance:
(1) adjustments to recorded results of the sale of the residential mortgage banking business after disputes over certain closing date adjustments have been resolved;
(2) changes in political, economic or industry conditions, the interest rate environment or financial and capital markets, which could result in: a deterioration in credit quality and increased credit losses; an adverse effect on the allowance for loan losses; a reduction in demand for credit or fee-based products and services, net interest income, value of assets under management and assets serviced, value of debt and equity investments, or value of on-balance-sheet and off-balance-sheet assets; or changes in the availability and terms of funding necessary to meet PNC's liquidity needs;
(3) relative investment performance of assets under management;
(4) the introduction, withdrawal, success and timing of business initiatives and strategies, decisions regarding further reductions in balance sheet leverage, and PNC's inability to realize cost savings or revenue enhancements, implement integration plans and other consequences of mergers, acquisitions, restructurings and divestitures;
(5) customer borrowing, repayment, investment and deposit practices and their acceptance of PNC's products and services;
(6) the impact of increased competition;
(7) the means PNC chooses to redeploy available capital, including the extent and timing of any share repurchases and investments in PNC businesses;
(8) the inability to manage risks inherent in PNC's business;
(9) the unfavorable resolution of legal proceedings;
(10) the denial of insurance coverage for claims made by PNC;
(11) an increase in the number of customer or counterparty delinquencies, bankruptcies or defaults that could result in, among other things, increased credit and asset quality risk, a higher loan loss provision and reduced profitability;
(12) the impact, extent and timing of technological changes, the adequacy of intellectual property protection and costs associated with obtaining rights in intellectual property claimed by others;
(13) actions of the Federal Reserve Board and legislative and regulatory actions and reforms; and
(14) terrorist activities, including the September 11 terrorist attacks, which may adversely affect the general economy, financial and capital markets, specific industries, and PNC. The Corporation cannot predict the severity or duration of effects stemming from such activities or any actions taken in connection with them.

Some of the above factors are described in more detail in the Risk Factors section of this Financial Review and factors relating to credit risk, interest rate risk, liquidity risk, trading activities, and financial and other derivatives are discussed in the Risk Management section of this Financial Review. Other factors are described elsewhere in this report.

Consolidated Statement of Income
THE PNC FINANCIAL SERVICES GROUP, INC.
Three months ended
September 30


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| EARNINGS PER COMMON SHARE |  |  |
| :---: | :---: | :---: |
| Continuing operations |  |  |
| Basic | \$. 85 | \$1.02 |
| Diluted | . 84 | 1.01 |
| Net income |  |  |
| Basic | \$. 85 | \$1.10 |
| Diluted | . 84 | 1.09 |
| CASH DIVIDENDS DECLARED PER COMMON SHARE | . 48 | . 45 |
| AVERAGE COMMON SHARES OUTSTANDING |  |  |
| Basic | 286 | 289 |
| Diluted | 289 | 292 |

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheet
THE PNC FINANCIAL SERVICES GROUP, INC.
In millions, except par value ..... 20
ASSETS
Cash and due from banks ..... \$3,
Short-term investments
Loans held for sale
Securities
Loans, net of unearned income of $\$ 1,143$ and $\$ 999$ ..... 11,
Allowance for credit losses ..... 42 ,
Net loans ..... 41,
Goodwill and other amortizable assets Investment in discontinued operations Other ..... 9, 5
Total assets ..... \$71,
LIABILITIES
Deposits
Noninterest-bearing ..... \$8,
Interest-bearing ..... 36,
Total deposits ..... 44,Borrowed fundsFederal funds purchasedRepurchase agreementsBank notes and senior debtFederal Home Loan Bank borrowingsSubordinated debtOther borrowed funds


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```
Net change in loans
Repayment of securities
Sales
    Securities
    Loans
    Foreclosed assets
Purchases
    Securities
    Loans
Net cash received (paid) for acquisitions/divestitures
Other
    Net cash provided (used) by investing activities
FINANCING ACTIVITIES
Net change in
    Noninterest-bearing deposits
    Interest-bearing deposits
    Federal funds purchased
    Repurchase agreements
Sales/issuances
    Bank notes and senior debt
    Federal Home Loan Bank borrowings
    Subordinated debt
    Other borrowed funds
    Common stock
Repayments/maturities
    Bank notes and senior debt
    Federal Home Loan Bank borrowings
    Subordinated debt
    Other borrowed funds
Acquisition of treasury stock
Series F preferred stock tender offer
Cash dividends paid
    Net cash used by financing activities
(DECREASE) INCREASE IN CASH AND DUE FROM BANKS
    Cash and due from banks at beginning of year
    Cash and due from banks at end of period
CASH PAID FOR
    Interest
    Income taxes
NON-CASH ITEMS
    Transfer of residential mortgage loans to securities
    Transfer from loans to loans held for sale
    Transfer from loans to other assets
```

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements
THE PNC FINANCIAL SERVICES GROUP, INC.

BUSINESS
The PNC Financial Services Group, Inc. ("Corporation" or "PNC") is one of the largest diversified financial services companies in the United States, operating

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businesses engaged in regional community banking, corporate banking, real estate finance, asset-based lending, wealth management, asset management and global fund services. The Corporation provides certain products and services nationally and others in PNC's primary geographic markets in Pennsylvania, New Jersey, Delaware, Ohio and Kentucky. The Corporation also provides certain asset management and global fund services internationally. PNC is subject to intense competition from other financial services companies and is subject to regulation by various domestic and international authorities.

## ACCOUNTING POLICIES

## BASIS OF FINANCIAL STATEMENT PRESENTATION

The unaudited consolidated interim financial statements include the accounts of PNC and its subsidiaries, most of which are wholly owned. Such statements have been prepared in accordance with accounting principles generally accepted in the United States. All significant intercompany accounts and transactions have been eliminated.

In the opinion of management, the financial statements reflect all adjustments of a normal recurring nature necessary for a fair statement of results for the interim periods presented.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the amounts reported. Actual results will differ from such estimates and the differences may be material to the consolidated financial statements.

The consolidated financial statements and notes to consolidated financial statements reflect the residential mortgage banking business, which was sold on January 31, 2001, in discontinued operations, unless otherwise noted.

The notes included herein should be read in conjunction with the audited consolidated financial statements included in The PNC Financial Services Group, Inc.'s 2000 Annual Report.

FINANCIAL DERIVATIVES
The Corporation uses a variety of financial derivatives as part of the overall asset and liability risk management process to manage interest rate, market and credit risk inherent in the Corporation's business activities. Substantially all such instruments are used to manage risk related to changes in interest rates. Interest rate and total rate of return swaps, purchased interest rate caps and floors and futures contracts are the primary instruments used by the corporation for interest rate risk management.

Interest rate swaps are agreements with a counterparty to exchange periodic fixed and floating interest payments calculated on a notional amount. The floating rate is based on a money market index, primarily short-term LIBOR. Total rate of return swaps are agreements with a counterparty to exchange an interest rate payment for the total rate of return on a specified reference index calculated on a notional amount. Purchased interest rate caps and floors are agreements where, for a fee, the counterparty agrees to pay the corporation the amount, if any, by which a specified market interest rate exceeds or is less than a defined rate applied to a notional amount, respectively. Interest rate futures contracts are exchange-traded agreements to make or take delivery of a financial instrument at an agreed upon price and are settled in cash daily.

Financial derivatives involve, to varying degrees, interest rate, market and credit risk. The Corporation manages these risks as part of its asset and liability management process and through credit policies and procedures. The Corporation seeks to minimize the credit risk by entering into transactions with only a select number of high-quality institutions, establishing credit limits, requiring bilateral-netting agreements, and, in certain instances, segregated

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collateral.
CASH FLOW HEDGING STRATEGY
The Corporation enters into interest rate swap contracts to modify the interest rate characteristics of designated commercial loans from variable to fixed in order to reduce the impact of interest rate changes on future interest income. The fair value of the derivative is reported in other assets or other liabilities and offset in accumulated other comprehensive income for the effective portion of the derivative. Ineffectiveness of the strategy, as defined under Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137 and No. 138, if any, is reported in net interest income. Amounts reclassed into earnings, when the hedged transaction affects earnings, are included in net interest income.

FAIR VALUE HEDGING STRATEGIES
The Corporation enters into interest rate and total rate of return swaps, caps, floors and interest rate futures derivative contracts to hedge designated commercial mortgage loans held for sale, securities, commercial loans, bank notes, senior debt and subordinated debt for changes in fair value primarily due to changes in interest rates. Adjustments related to the ineffective portion of fair value hedging instruments are recorded in either net interest income or noninterest income depending on the hedged item.

Notes to Consolidated Financial Statements THE PNC FINANCIAL SERVICES GROUP, INC.

## CUSTOMER AND OTHER DERIVATIVES

To accommodate customer needs, PNC also enters into financial derivative transactions primarily consisting of interest rate swaps, caps, floors and foreign exchange contracts. Risk exposures from customer positions are managed through transactions with other dealers. Additionally, the Corporation enters into other derivative transactions for risk management purposes that are not designated as accounting hedges. The positions of customer and other derivatives are recorded at fair value and changes in value are included in noninterest income.

Effective January 1, 2001, the Corporation implemented SFAS No. 133. The statement requires the Corporation to recognize all derivative instruments as either assets or liabilities on the balance sheet at fair value. Financial derivatives are reported at fair value in other assets or other liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Corporation must designate the hedging instrument, based on the exposure being hedged, as either a fair value hedge, a cash flow hedge or a hedge of a net investment in a foreign operation.

For derivatives that are designated as fair value hedges (i.e., hedging the exposure to changes in the fair value of an asset or a liability attributable to a particular risk), the gain or loss on derivatives as well as the loss or gain on the hedged items are recognized in current earnings. For derivatives designated as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows), the effective portions of the gain or loss on derivatives are reported as a component of accumulated other comprehensive income in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivatives in excess of the hedged future cash flows, if any, is recognized in current earnings. For derivatives

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not designated as hedges, the gain or loss is recognized in current earnings.
FINANCIAL DERIVATIVES - PRE-SFAS NO. 133
Prior to January 1, 2001, interest rate swaps, caps and floors that modified the interest rate characteristics (such as from fixed to variable, variable to fixed, or one variable index to another) of designated interest-bearing assets or liabilities were accounted for under the accrual method. The net amount payable or receivable from the derivative contract was accrued as an adjustment to interest income or interest expense of the designated instrument. Premiums on contracts were deferred and amortized over the life of the agreement as an adjustment to interest income or interest expense of the designated instruments. Unamortized premiums were included in other assets.

Changes in the fair value of financial derivatives accounted for under the accrual method were not reflected in results of operations. Realized gains and losses, except losses on terminated interest rate caps and floors, were deferred as an adjustment to the carrying amount of the designated instruments and amortized over the shorter of the remaining original life of the agreements or the designated instruments. Losses on terminated interest rate caps and floors were recognized immediately in results of operations. If the designated instruments were disposed, the fair value of the associated derivative contracts and any unamortized deferred gains or losses were included in the determination of gain or loss on the disposition of such instruments. Contracts not qualifying for accrual accounting were marked to market with gains or losses included in noninterest income.

Credit default swaps were entered into to mitigate credit risk and lower the required regulatory capital associated with commercial lending activities. If the credit default swaps qualified for hedge accounting treatment, the premium paid to enter into the credit default swaps were recorded in other assets and deferred and amortized to noninterest expense over the life of the agreement. Changes in the fair value of credit default swaps qualifying for hedge accounting treatment were not reflected in the Corporation's financial position and had no impact on results of operations.

If the credit default swap did not qualify for hedge accounting treatment or if the Corporation was the seller of credit protection, the credit default swap was marked to market with gains or losses included in noninterest income.

Due to the particular structure of the Corporation's credit default swaps discussed in the preceding paragraphs, these instruments are not considered financial derivatives under the provisions of SFAS No. 133. Commencing January 1, 2001, the premiums paid to enter credit default swaps not considered to be derivatives are recorded in other assets and amortized to noninterest expense over the life of the agreement.

Notes to Consolidated Financial Statements
THE PNC FINANCIAL SERVICES GROUP, INC.

## RESTATEMENTS

In connection with the repositioning of its institutional lending businesses, PNC completed transactions in June 2001 and September 2001 in which assets were sold or transferred to subsidiaries of a third party financial institution with PNC receiving preferred interests in the subsidiaries. The transactions involved the sale of loan assets of $\$ 592$ million of which $\$ 132$ million were classified as nonperforming assets at the date of sale. Loan assets sold included loans previously held for sale and other loans that were reclassified from loans to loans held for sale and marked to the lower of cost or market prior to the sale. This resulted in charge-offs at the date transferred of $\$ 24$ million on loans and

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valuation adjustments of $\$ 4$ million for those loans that previously had been classified as held for sale. Including previous charge-offs and valuation adjustments, loans transferred had been charged down by approximately $\$ 108$ million prior to sale. In addition to the loan assets, PNC also transferred cash amounting to $\$ 320$ million. In return, PNC received one hundred percent of the Class A convertible preferred shares in each subsidiary. The Class A convertible preferred shares owned by PNC have no voting rights. PNC, as holder of the Class A convertible preferred shares, may convert such preferred shares to Class A common shares and cause the liquidation of the subsidiary. A noncumulative annual dividend may be paid on the preferred stock.

The third party financial institution formed each of the entities, contributed three percent equity in the form of cash and received one hundred percent of the Class B preferred shares and one hundred percent of the Class B common shares of each entity. The proceeds received by the applicable entity from the issuance of the Class A preferred and all of the Class B shares were used by each entity to fund certain operating expenses, future commitments under the loan agreements, investment in a managed asset account and to purchase U. S. Treasury zero coupon securities. The third party financial institution is the managing member of each of the entities and holds one hundred percent of the voting power. All management and operating decisions regarding the assets are at the discretion of the managing member. The managing member is paid an annual fee for its services. PNC is the servicer of the loans and is paid a servicing fee.

At the time of the transactions, the loans were removed from PNC's balance sheet and the preferred interests in the entities were recorded as securities available for sale in conformity with accounting guidance received from PNC's independent auditors. In January 2002, the Federal Reserve Board staff advised PNC that under generally accepted accounting principles the subsidiaries of the third party financial institution should be consolidated into the financial statements of $P N C$ in preparing bank holding company reports. After considering all the circumstances, PNC made the decision to restate its consolidated financial statements for the second and third quarters of 2001 to conform financial reporting with regulatory reporting requirements. This restatement reduced income from continuing operations and net income for the three and nine months ended September 30,2001 by $\$ 51$ million or $\$ .18$ per diluted share. The effects of the restatement on the consolidated financial statements for the third quarter of 2001 are included in this Amendment No. 1.

In consolidation, all loan assets of the third party subsidiaries are included in loans held for sale. Subsequent charges to adjust the carrying value of the loans held for sale were reflected as valuation adjustments. The following table summarizes the charges related to the assets in these entities for the first nine months of 2001.

| In millions | Third Quarter 2001 | Second Quarter 2001 | Total |
| :---: | :---: | :---: | :---: |
| At time of sale: |  |  |  |
| Charge-offs | \$9 | \$15 | \$24 |
| Valuation adjustments | 3 | 1 | 4 |
|  | 12 | 16 | 28 |
| Valuation adjustments subsequent to sale | 82 |  | 82 |
| Total | \$94 | \$16 | \$110 |

The amounts contained in this Amendment No. 1 also include the restatement of

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the results for the first quarter of 2001 to reflect the correction of an error related to the accounting for the sale of the residential mortgage banking business. This restatement reduced income from discontinued operations and net income for the nine months ended September 30, 2001 by $\$ 35$ million or $\$ .12$ per diluted share. The consolidated balance sheet was not affected by this restatement as the impact of the error had been reflected in retained earnings at September 30, 2001.

DISCONTINUED OPERATIONS
On January 31, 2001, PNC closed the sale of its residential mortgage banking business. Certain closing date adjustments are currently in dispute between PNC and the buyer, Washington Mutual Bank, FA. The ultimate financial impact of the sale will not be determined until the disputed matters are finally resolved.

The income and net assets of the residential mortgage banking business, which are presented on one line in the income statement and balance sheet, respectively, are as follows:

INCOME FROM DISCONTINUED OPERATIONS

| Nine months ended September 30 - in millions | 2001 | 2000 |
| :---: | :---: | :---: |
| Total income from operations after tax Net loss on disposal, after tax (a) | $\begin{gathered} \$ 15 \\ (10) \end{gathered}$ | \$45 |
| Total income from discontinued operations | \$5 | \$ 45 |

(a) Includes recognition of $\$ 35$ million of previously unrealized securities losses in accumulated other comprehensive income.

Notes to Consolidated Financial Statements THE PNC FINANCIAL SERVICES GROUP, INC.

INVESTMENT IN DISCONTINUED OPERATIONS

| December 31 - in millions | 2000 |
| :---: | :---: |
| Loans held for sale | \$3,003 |
| Securities available for sale | 3,016 |
| Loans, net of unearned income | 739 |
| Goodwill and other amortizable assets | 1,925 |
| All other assets | 1,168 |
| Total assets | 9,851 |
| Deposits | 1,150 |
| Borrowed funds | 7,601 |
| Other liabilities | 744 |
| Total liabilities | 9,495 |
| Net assets | \$356 |

RECENT ACCOUNTING PRONOUNCEMENTS
SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (a replacement of Financial Accounting Standards

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Board ("FASB") Statement No. 125) was issued in September 2000. Although SFAS No. 140 has changed many of the rules regarding securitizations, it continues to require an entity to recognize the financial and servicing assets it controls and the liabilities it has incurred and to derecognize financial assets when control has been surrendered in accordance with the criteria provided in the standard. As required, the Corporation began application of the new rules prospectively to transactions beginning in the second quarter of 2001 . SFAS No. 140 also requires certain disclosures pertaining to securitization transactions effective for fiscal years ended after December 15, 2000. PNC included these required disclosures in its December 31,2000 consolidated financial statements.

In July 2001, the FASB issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires the purchase method of accounting be used for all business combinations initiated or completed after June 30, 2001 and eliminates the pooling-of-interests method of accounting. The statement also addresses disclosure requirements for business combinations and initial recognition and measurement criteria for goodwill and other intangible assets as a result of purchase business combinations.

Also in July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets," which changes the accounting from amortizing goodwill to an impairment-only approach. The amortization of goodwill, including goodwill recognized relating to past business combinations, will cease upon adoption of the new standard. Impairment testing for goodwill at a reporting unit level will be required on at least an annual basis. The new standard also addresses other accounting matters, disclosure requirements and financial statement presentation issues relating to goodwill and other intangible assets. The Corporation will adopt SFAS No. 142 effective January 1, 2002. Assuming no impairment adjustments are necessary, no future business combinations and no other changes to goodwill, the Corporation expects net income to increase by approximately $\$ 94$ million in 2002 resulting from the cessation of goodwill amortization.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which requires that the fair value of a liability be recognized when incurred for the retirement of a long-lived asset and the value of the related asset be increased by that amount. The statement also requires that the liability be maintained at its present value in subsequent periods and outlines certain disclosures for such obligations. The adoption of this statement, which is effective January 1, 2003, is not expected to have a material impact on the Corporation's financial statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which replaces SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and for Assets to be Disposed Of." This statement primarily defines one accounting model for long-lived assets to be disposed of by sale, including discontinued operations, and addresses implementation issues regarding the impairment of long-lived assets. The adoption of this statement, which is effective January 1, 2002, is not expected to have a material impact on the Corporation's financial statements.

## CASH FLOWS

During the first nine months of 2001, divestiture activity that affected cash flows consisted of $\$ 383$ million of divested net assets and cash receipts of $\$ 503$ million. During the first nine months of 2000 , acquisition activity that affected cash flows consisted of $\$ 22$ million of acquired assets, $\$ 2$ million of acquired liabilities and cash payments of $\$ 3$ million.

## TRADING ACTIVITIES

Most of PNC's trading activities are designed to provide capital markets services to customers and not to position the Corporation's portfolio for gains from market movements. PNC participates in derivatives and foreign exchange trading as well as underwriting and "market making" in equity securities as an

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accommodation to customers. PNC also engages in trading activities as part of risk management strategies.

Net trading income for the first nine months of 2001 totaled $\$ 118$ million compared with $\$ 68$ million for the prior-year period and was included in noninterest income as follows:

| Nine months ended September 30 - in millions | 2001 | 2000 |
| :---: | :---: | :---: |
| Corporate services | \$5 | \$ 7 |
| Equity management |  | 2 |
| Other noninterest income |  |  |
| Securities trading (a) | 40 | 32 |
| Derivatives trading | 54 | 11 |
| Foreign exchange | 19 | 16 |
| Net trading income | \$118 | \$68 |

Notes to Consolidated Financial Statements
THE PNC FINANCIAL SERVICES GROUP, INC.

SECURITIES


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SECURITIES AVAILABLE FOR SALE
Debt securities
U.S. Treasury and government agencies
Mortgage-backed
Asset-backed
State and municipal
Other debt

Total securities at September 30,2001 was $\$ 11.1$ billion compared with $\$ 5.9$ billion at December 31, 2000. Total securities represented $15 \%$ of total assets at September 30, 2001 compared with $8 \%$ at December 31, 2000. The expected weighted-average life of securities available for sale was 2 years and 11 months at September 30,2001 compared with 4 years and 5 months at December 31, 2000.

At September 30,2001 , the securities available for sale balance of $\$ 10.8$ billion included a net unrealized gain of $\$ 75$ million, which represented the difference between fair value and amortized cost. Securities available for sale at December 31, 2000 totaled $\$ 5.9$ billion and included a net unrealized loss of $\$ 54$ million. Net unrealized gains and losses in the securities available for sale portfolio are included in accumulated other comprehensive income or loss, net of tax or, for the portion attributable to a hedged risk as part of a fair value hedge strategy, in net income.

Net securities gains associated with the disposition of securities available for sale were $\$ 134$ million for the first nine months of 2001 compared with $\$ 4$ million for the first nine months of 2000 . Net securities losses of $\$ 3$ million for the first nine months of 2001, and net securities gains of $\$ 2$ million for the first nine months of 2000, related to commercial mortgage banking activities, were included in corporate services revenue.

Securities designated as held to maturity are carried at amortized cost and are assets of subsidiaries of a third party financial institution, which are consolidated in PNC's financial statements. The expected weighted-average life of securities held to maturity was 19 years and 6 months at September 30, 2001. PNC had no securities held to maturity at December 31, 2000 .

NONPERFORMING ASSETS
Nonperforming assets were as follows:

|  | September 30 | December 31 |
| :---: | :---: | :---: |
| In millions | 2001 | 2000 |
| Nonaccrual loans | \$361 | \$323 |
| Nonperforming loans held for sale(a) | 152 | 33 |
| Foreclosed and other assets | 13 | 16 |
| Total nonperforming assets | \$526 | \$372 |

(a) Includes $\$ 6$ million of a troubled debt restructured loan held

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for sale as of September 30, 2001.

The above table excludes $\$ 37$ million and $\$ 18$ million of equity management assets carried at estimated fair value at September 30, 2001 and December 31, 2000, respectively.

ALLOWANCE FOR CREDIT LOSSES
Changes in the allowance for credit losses were as follows:

| In millions | 2001 | 2000 |
| :---: | :---: | :---: |
| Allowance at January 1 | \$675 | \$674 |
| Charge-offs |  |  |
| Commercial | (165) | (86) |
| Commercial real estate | (6) | (2) |
| Consumer | (31) | (34) |
| Residential mortgage | (1) | ( 4 ) |
| Lease financing | (16) | (5) |
| Total charge-offs | (219) | (131) |
| Recoveries |  |  |
| Commercial | 13 | 14 |
| Commercial real estate | 1 | 4 |
| Consumer | 13 | 16 |
| Residential mortgage |  | 1 |
| Lease financing | 2 | 1 |
| Total recoveries | 29 | 36 |
| Net charge-offs |  |  |
| Commercial | (152) | (72) |
| Commercial real estate | ( 5 ) | 2 |
| Consumer | (18) | (18) |
| Residential mortgage | (1) | (3) |
| Lease financing | (14) | ( 4 ) |
| Total net charge-offs | (190) | (95) |
| Provision for credit losses | 235 | 96 |
| Allowance at September 30 | \$720 | \$675 |

FINANCIAL DERIVATIVES
Effective January 1, 2001, the Corporation implemented SFAS No. 133. As a result of the adoption of this statement, the Corporation recognized, in the first quarter of 2001, an after-tax loss from the cumulative effect of a change in accounting principle of $\$ 5$ million reported in the consolidated income statement and an after-tax accumulated other comprehensive loss of $\$ 4$ million. The impact of the adoption of this standard related to the residential mortgage banking business that was sold is reflected in the results of discontinued operations.

Earnings adjustments resulting from cash flow and fair value hedge ineffectiveness were not significant to the results of operations of the Corporation during the first nine months of 2001.

During the next twelve months, the Corporation expects to reclassify to earnings $\$ 110$ million of pretax net gains on cash flow hedge derivatives currently reported in accumulated other comprehensive income. These net gains may result from anticipated net cash flows on receive fixed interest rate swaps and would offset reductions in net interest income recognized on the related floating rate commercial loans.

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At September 30, 2001 and December 31, 2000, the Corporation's exposure to credit losses with respect to financial derivatives was not material.

LEGAL PROCEEDINGS
The Corporation and persons to whom the Corporation may have indemnification obligations, in the normal course of business, are subject to various pending and threatened legal proceedings in which claims for monetary damages and other relief are asserted. Management, after consultation with legal counsel, does not at the present time anticipate the ultimate aggregate liability, if any, arising out of such legal proceedings will have a material adverse effect on the Corporation's financial condition. At the present time, management is not in a position to determine whether any such pending or threatened legal proceedings will have a material adverse effect on the corporation's results of operations in any future reporting period.

Notes to Consolidated Financial Statements THE PNC FINANCIAL SERVICES GROUP, INC.

COMPREHENSIVE INCOME
Comprehensive income from continuing operations was $\$ 459$ million for the third quarter of 2001 and $\$ 1.002$ billion for the first nine months of 2001 , compared with $\$ 345$ million and $\$ 940$ million, respectively, in 2000.

The Corporation's other comprehensive income consists of unrealized gains or losses on securities available for sale and cash flow hedge derivatives, foreign currency translation and minimum pension liability adjustments. The income effects allocated to each component of other comprehensive income are as follows:

\begin{tabular}{|c|c|c|c|}
\hline \begin{tabular}{l}
Nine months ended September 30, 2001 \\
In millions
\end{tabular} \& Pretax Amount \& ```
Tax
Benefit
(Expense)
``` \& After-tax Amount \\
\hline Unrealized securities gains Less: Reclassification adjustment for losses realized in net income \& \begin{tabular}{l}
\[
\$ 123
\] \\
(8)
\end{tabular} \& \$(44) \& \begin{tabular}{l}
\[
\$ 79
\] \\
(5)
\end{tabular} \\
\hline Net unrealized securities gains \& \& (47) \& 84 \\
\hline SFAS No. 133 transition adjustment \& (6) \& 2 \& (4) \\
\hline \begin{tabular}{l}
Unrealized gains on cash flow hedge derivatives \\
Less: Reclassification adjustment for losses realized in net income
\end{tabular} \& \[
149
\]
(27) \& \(52)\)

9 \& 97
(18) <br>
\hline Net unrealized gains on cash flow hedge derivatives \& 170 \& (59) \& 111 <br>
\hline Other comprehensive income from continuing operations \& \$301 \& \$ (106) \& \$195 <br>
\hline
\end{tabular}

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| Year ended December 31, 2000 In millions | Pretax Amount | ```Tax Benefit (Expense)``` | After-tax Amount |
| :---: | :---: | :---: | :---: |
| Unrealized securities gains Less: Reclassification adjustment for losses realized in net income | $\$ 127$ (3) | $\$(41)$ $1$ | $\$ 86$ <br> (2) |
| Net unrealized securities gains <br> Minimum pension liability adjustment | $\begin{array}{r} 130 \\ 2 \end{array}$ | (42) (1) | 88 1 |
| Other comprehensive income from continuing operations | \$132 | \$ (43) | \$89 |

The accumulated balances related to each component of other comprehensive income (loss) are as follows:

| In millions S | $\begin{array}{r} \text { September } 30 \\ 2001 \end{array}$ | $\begin{array}{r} \text { December } 31 \\ 2000 \end{array}$ |
| :---: | :---: | :---: |
| Net unrealized securities gains (losses) | ) $\$ 52$ | \$ (32) |
| Net unrealized gains on cash flow hedge derivatives | 111 |  |
| Minimum pension liability adjustment Accumulated other comprehensive income (loss) from continuing operations | (11) \$152 | (11) \$ (43) |

[^0]In millions, except share and per share data
CALCULATION OF BASIC EARNINGS PER COMMON SHARE
Income from continuing operations
Less: Preferred dividends declared
Income from continuing operations applicable to basic earnings per common share
Income from discontinued operations applicable to basic earnings per common share
Cumulative effect of accounting change applicable to basic earnings per common share

| Net income applicable to basic earnings per common share | \$244 |
| :---: | :---: |
| Basic weighted-average common shares outstanding (in thousands) | 286,282 |
| Basic earnings per common share from continuing operations | \$. 85 |
| Basic earnings per common share from discontinued operations |  |
| Basic earnings per common share from cumulative effect of accounting change |  |
| Basic earnings per common share | \$. 85 |
| CALCULATION OF DILUTED EARNINGS PER COMMON SHARE |  |
| Income from continuing operations | \$247 |
| Less: Dividends declared on nonconvertible preferred stock Series F | 3 |
| Income from continuing operations applicable to diluted earnings per common share | 244 |
| Income from discontinued operations applicable to diluted earnings per common share |  |
| Cumulative effect of accounting change applicable to diluted earnings per common share |  |
| Net income applicable to diluted earnings per common share | \$244 |
| Basic weighted-average common shares outstanding (in thousands) | 286,282 |
| Weighted-average common shares to be issued using average market price and assuming: |  |
| Conversion of preferred stock Series A and B | 103 |
| Conversion of preferred stock Series C and D | 861 |
| Conversion of debentures | 17 |
| Exercise of stock options | 1,530 |
| Incentive share awards | 421 |
| Diluted weighted-average common shares outstanding (in thousands) | 289,214 |
| Diluted earnings per common share from continuing operations | \$. 84 |
| Diluted earnings per common share from discontinued operations |  |
| Diluted earnings per common share from cumulative effect of accounting change |  |
| Diluted earnings per common share | \$. 84 |

Notes to Consolidated Financial Statements
THE PNC FINANCIAL SERVICES GROUP, INC.

SEGMENT REPORTING
PNC operates seven major businesses engaged in regional community banking, corporate banking, real estate finance, asset-based lending, wealth management, asset management and global fund services.

Business results are presented based on PNC's management accounting practices and the Corporation's management structure. There is no comprehensive, authoritative body of guidance for management accounting equivalent to generally accepted accounting principles; therefore, PNC's business results are not necessarily comparable with similar information for any other financial services institution. Financial results are presented, to the extent practicable, as if each business operated on a stand-alone basis.

The management accounting process uses various balance sheet and income statement assignments and transfers to measure performance of the businesses.

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Methodologies change from time to time as management accounting practices are enhanced and businesses change. Securities or borrowings and related net interest income are assigned based on the net asset or liability position of each business. Capital is assigned based on management's assessment of inherent risks and equity levels at independent companies providing similar products and services. The allowance for credit losses is allocated based on management's assessment of risk inherent in the loan portfolios. Support areas not directly aligned with the businesses are allocated primarily based on the utilization of services.

Total business financial results differ from consolidated results from continuing operations primarily due to differences between management accounting practices and generally accepted accounting principles, loan portfolios and businesses that were designated for downsizing during 1999, equity management activities, minority interests, residual asset and liability management activities, eliminations, unallocated reserves and unassigned items, the impact of which is reflected in the "Other" category.

## BUSINESS SEGMENT PRODUCTS AND SERVICES

Regional Community Banking provides deposit, branch-based brokerage, electronic banking and credit products and services to retail customers as well as deposit, credit, treasury management and capital markets products and services to small businesses primarily within PNC's geographic region.

Corporate Banking provides credit, equipment leasing, treasury management and capital markets products and services to large and mid-sized corporations, institutions and government entities primarily within PNC's geographic region.

PNC Real Estate Finance provides credit, capital markets, treasury management, commercial mortgage loan servicing and other products and services to developers, owners and investors in commercial real estate. PNC's commercial real estate financial services platform provides processing services through Midland Loan Services, Inc., a leading third-party provider of loan servicing and technology to the commercial real estate finance industry, and columbia Housing Partners, LP, a national syndicator of affordable housing equity.

PNC Business Credit provides asset-based lending, capital markets and treasury management products and services to middle market customers nationally. PNC Business Credit's lending services include loans secured by accounts receivable, inventory, machinery and equipment, and other collateral, and its customers include manufacturing, wholesale, distribution, retailing and service industry companies.

PNC Advisors provides a full range of tailored investment products and services to affluent individuals and families including full-service brokerage through J.J.B. Hilliard, W.L. Lyons, Inc. and investment advisory services to the ultra-affluent through Hawthorn. PNC Advisors also serves as investment manager and trustee for employee benefit plans and charitable and endowment assets.

BlackRock is one of the largest publicly traded investment management firms in the United States with $\$ 226$ billion of assets under management at September 30 , 2001. BlackRock manages assets on behalf of institutions and individuals through a variety of fixed income, liquidity, equity and alternative investment separate accounts and mutual funds, including its flagship fund families, BlackRock Funds and BlackRock Provident Institutional Funds. In addition, BlackRock provides risk management and technology services to a growing number of institutional investors under the BlackRock Solutions brand name.

PFPC is the largest full-service mutual fund transfer agent and second largest provider of mutual fund accounting and administration services in the United States, providing a wide range of fund services to the investment management industry. PFPC also provides customized processing solutions to the

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international marketplace through its Dublin, Ireland and Luxembourg operations.

RESULTS OF BUSINESSES

|  |  |  | PNC |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Three months ended September 30 In millions | Regional Community Banking | Corporate Banking | Real <br> Estate Finance | $\begin{array}{r} \text { PNC } \\ \text { Business } \\ \text { Credit } \end{array}$ | $\begin{array}{r} \text { PNC } \\ \text { Advisors } \end{array}$ | BlackR |
| 2001 |  |  |  |  |  |  |
| INCOME STATEMENT |  |  |  |  |  |  |
| Net interest income (a) | \$375 | \$117 | \$31 | \$26 | \$31 | \$2 |
| Noninterest income | 210 | (16) | 24 | 1 | 142 | 135 |
| Total revenue | 585 | 101 | 55 | 27 | 173 | 137 |
| Provision for credit losses | 15 | 41 | 5 | 5 |  |  |
| Depreciation and amortization | 20 | 3 | 5 | 1 | 5 |  |
| Other noninterest expense | 256 | 89 | 36 | 6 | 115 | 85 |
| Pretax earnings | 294 | (32) | 9 | 15 | 53 | 45 |
| Income taxes | 108 | (14) | (6) | 6 | 19 | 18 |
| Earnings | \$186 | \$ (18) | \$15 | \$ 9 | \$34 | \$27 |
| Inter-segment revenue | \$1 | \$1 |  |  | \$14 | \$ 5 |
| AVERAGE ASSETS | \$39,926 | \$15,947 | \$5,178 | \$2,433 | \$3,358 | \$ 644 |
| 2000 |  |  |  |  |  |  |
| INCOME STATEMENT |  |  |  |  |  |  |
| Net interest income (a) | \$355 | \$145 | \$28 | \$25 | \$34 | \$2 |
| Noninterest income | 151 | 68 | 24 | 4 | 157 | 127 |
| Total revenue | 506 | 213 | 52 | 29 | 191 | 129 |
| Provision for credit losses | 11 | 12 |  | 5 |  |  |
| Depreciation and amortization | 21 | 3 | 4 | 1 | 4 |  |
| Other noninterest expense | 241 | 92 | 31 | 7 | 123 | 86 |
| Pretax earnings | 233 | 106 | 17 | 16 | 64 | 38 |
| Income taxes | 84 | 36 |  | 5 | 23 | 15 |
| Earnings | \$149 | \$70 | \$17 | \$11 | \$ 41 | \$23 |
| Inter-segment revenue | \$1 | \$1 |  |  | \$21 | \$3 |
| AVERAGE ASSETS | \$39,320 | \$16,729 | \$5,541 | \$2,343 | \$3,470 | \$ 492 |
| Nine months ended September 30 |  |  |  |  |  |  |
| 2001 |  |  |  |  |  |  |
| INCOME STATEMENT |  |  |  |  |  |  |
| Net interest income (a) | \$1,093 | \$385 | \$88 | \$77 | \$99 | \$ 7 |
| Noninterest income | 592 | 99 | 73 | 21 | 463 | 404 |

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| Total revenue | 1,685 | 484 | 161 | 98 | 562 | 411 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for credit losses | 35 | 129 | 3 | 13 | 1 |  |
| Depreciation and amortization | 62 | 10 | 16 | 2 | 13 | 19 |
| Other noninterest expense | 765 | 278 | 101 | 21 | 363 | 258 |
| Pretax earnings | 823 | 67 | 41 | 62 | 185 | 134 |
| Income taxes | 298 | 20 | (12) | 23 | 68 | 55 |
| Earnings | \$525 | \$47 | \$53 | \$39 | \$117 | \$79 |
| Inter-segment revenue | \$3 | \$3 |  |  | \$49 | \$13 |
| AVERAGE ASSETS | \$40,188 | \$16,392 | \$5,253 | \$2,431 | \$3,399 | \$644 |
| 2000 |  |  |  |  |  |  |
| INCOME STATEMENT |  |  |  |  |  |  |
| Net interest income (a) | \$1,058 | \$417 | \$87 | \$74 | \$102 | \$4 |
| Noninterest income | 439 | 216 | 68 | 12 | 487 | 348 |
| Total revenue | 1,497 | 633 | 155 | 86 | 589 | 352 |
| Provision for credit losses | 33 | 50 |  | 7 | 3 |  |
| Depreciation and amortization | 63 | 10 | 14 | 2 | 11 | 15 |
| Other noninterest expense | 733 | 281 | 88 | 20 | 374 | 230 |
| Pretax earnings | 668 | 292 | 53 | 57 | 201 | 107 |
| Income taxes | 238 | 102 | 3 | 20 | 74 | 44 |
| Earnings | \$430 | \$190 | \$50 | \$37 | \$127 | \$63 |
| Inter-segment revenue | \$3 | \$3 |  |  | \$64 | \$9 |
| AVERAGE ASSETS | \$38,564 | \$16,318 | \$5,583 | \$2,230 | \$3,541 | \$492 |

(a) Taxable-equivalent basis

Statistical Information
THE PNC FINANCIAL SERVICES GROUP, INC.

CONSOLIDATED AVERAGE BALANCE SHEET AND NET INTEREST ANALYSIS

Nine months ended

2001

Taxable-equivalent basis
Dollars in millions

| 2001 |  |  |
| :---: | :---: | :---: |
| Average |  | Average |
| Balances | Interest | Yields/Rates |

ASSETS
Interest-earning assets
Loans held for sale
Securities


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```
Interest rate spread
    Impact of noninterest-bearing sources
Nonaccrual loans are included in loans, net of unearned income. The impact of financial derivatives used in interest rate risk management is included in the interest income/expense and average yields/rates of the related assets and liabilities. Average balances of securities are based on amortized historical cost (excluding SFAS No. 115 adjustments to fair value).
Loan fees for the nine months ended September 30, 2001 and September 30, 2000 were both \(\$ 89\) million. For each of the three months ended September 30, 2001, June 30, 2001 and September 30, 2000 loan fees were \(\$ 29\) million, \(\$ 30\) million and \$29 million, respectively.
```

3.15

| Taxable-equivalent basis Dollars in millions | Third Quarter 2001 |  |  | Se |
| :---: | :---: | :---: | :---: | :---: |
|  | Average Balances | Interest | Average Yields/Rates | Avera Balanc |
| ASSETS |  |  |  |  |
| Interest-earning assets | \$1,955 | \$24 | 4.83\% | \$1,7 |
| Loans held for sale |  |  |  |  |
| Securities |  |  |  |  |
| Securities available for sale |  |  |  |  |
| U.S. Treasury and government agencies and corporations | 3,908 | 56 | 5.69 | 3, 6 |
| Other debt | 6,538 | 97 | 5.93 | 7,9 |
| State, municipal and other | 91 | 1 | 7.75 |  |
| Total securities available for sale | 10,537 | 154 | 5.86 | 11,7 |
| Securities held to maturity | 92 | 2 | 6.92 |  |
| Total securities | 10,629 | 156 | 5.87 | 11,7 |
| Loans, net of unearned income |  |  |  |  |
| Commercial | 19,296 | 333 | 6.76 | 20,2 |
| Commercial real estate | 2,548 | 43 | 6.67 | 2,5 |
| Consumer | 9,102 | 181 | 7.86 | 9,0 |
| Residential mortgage | 7,771 | 138 | 7.11 | 8, |
| Lease financing | 4,381 | 75 | 6.76 | 4,1 |
| Other | 456 | 7 | 6.04 |  |
| Total loans, net of unearned income | 43,554 | 777 | 7.04 | 45,0 |
| Other | 1,725 | 30 | 6.86 | 1,5 |
| Total interest-earning assets/interest income | 57,863 | 987 | 6.75 | 59,9 |
| Noninterest-earning assets |  |  |  |  |
| Investment in discontinued operations |  |  |  |  |
| Allowance for credit losses | (678) |  |  | 6 |
| Cash and due from banks | 2,921 |  |  | 2,9 |
| Other assets | 8,870 |  |  | 8, |


| Total assets | \$68,976 |  |  | \$70,7 |
| :---: | :---: | :---: | :---: | :---: |
| LIABILITIES, CAPITAL SECURITIES AND SHAREHOLDERS' EQUITY |  |  |  |  |
| Interest-bearing liabilities |  |  |  |  |
| Interest-bearing deposits |  |  |  |  |
| Demand and money market | \$21,559 | 123 | 2.25 | \$20,9 |
| Savings | 1,925 | 4 | . 84 | 1,9 |
| Retail certificates of deposit | 11,785 | 142 | 4.79 | 12,6 |
| Other time | 501 | 8 | 6.26 |  |
| Deposits in foreign offices | 357 | 3 | 3.54 | 1,0 |
| Total interest-bearing deposits Borrowed funds | 36,127 | 280 | 3.07 | 37,1 |
| Federal funds purchased | 1,497 | 14 | 3.60 | 2,6 |
| Repurchase agreements | 893 | 7 | 2.90 |  |
| Bank notes and senior debt | 4,973 | 57 | 4.51 | 5,1 |
| Federal Home Loan Bank borrowings | 2,459 | 22 | 3.48 | 2,5 |
| Subordinated debt | 2,332 | 41 | 6.98 | 2 , 3 |
| Other borrowed funds | 373 | (2) | (1.93) |  |
| Total borrowed funds | 12,527 | 139 | 4.35 | 14,0 |
| Total interest-bearing liabilities/interest expense | 48,654 | 419 | 3.40 | 51,2 |
| Noninterest-bearing liabilities and shareholders' equity |  |  |  |  |
| Demand and other noninterest-bearing deposits | 8,448 |  |  | 8, 2 |
| Accrued expenses and other liabilities | 4,283 |  |  | 3,7 |
| Mandatorily redeemable capital securities of sibsidiary trusts | 848 |  |  |  |
| Shareholders' equity | 6,743 |  |  | 6,6 |
| Total liabilities, capital securities and shareholders' equity | \$68,976 |  |  | \$ 70,7 |
| Interest rate spread |  |  | 3.35 |  |
| Impact of noninterest-bearing sources |  |  | . 54 |  |
| Net interest income/margin |  | \$568 | $3.89 \%$ |  |

Third Quarter 2000
$\left.\begin{array}{lrl}\text { Taxable-equivalent basis } & \begin{array}{c}\text { Average } \\ \text { Dollars in millions }\end{array} & \begin{array}{c}\text { Average } \\ \text { Yalances }\end{array} \\ \text { Yields/Rat } \\ \text { Interest }\end{array}\right)$

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| Total securities available for sale Securities held to maturity | 6,179 | 99 | 6.41 |
| :---: | :---: | :---: | :---: |
| Total securities | 6,179 | 99 | 6.41 |
| Loans, net of unearned income |  |  |  |
| Commercial | 21,800 | 472 | 8.4 |
| Commercial real estate | 2,688 | 61 | 8.85 |
| Consumer | 9,174 | 201 | 8.72 |
| Residential mortgage | 12,405 | 222 | 7.16 |
| Lease financing | 3,238 | 58 | 7.2 |
| Other | 646 | 14 | 8.6 |
| Total loans, net of unearned income | 49,951 | 1,028 | 8.13 |
| Other | 1,445 | 30 | 8.05 |
| Total interest-earning assets/interest income | 59,726 | 1,204 | 7.98 |
| Noninterest-earning assets |  |  |  |
| Investment in discontinued operations | 515 |  |  |
| Allowance for credit losses | (680) |  |  |
| Cash and due from banks | 2,848 |  |  |
| Other assets | 6,689 |  |  |
| Total assets | \$69,098 |  |  |
| LIABILITIES, CAPITAL SECURITIES AND SHAREHOLDERS' EQUITY |  |  |  |
| Interest-bearing liabilities |  |  |  |
| Interest-bearing deposits |  |  |  |
| Demand and money market | \$18,914 | 175 | 3.68 |
| Savings | 2,020 | 9 | 1.81 |
| Retail certificates of deposit | 14,776 | 217 | 5.85 |
| Other time | 619 | 10 | 6.55 |
| Deposits in foreign offices | 1,342 | 23 | 6.50 |
| Total interest-bearing deposits | 37,671 | 434 | 4.58 |
| Borrowed funds |  |  |  |
| Federal funds purchased | 1,904 | 32 | 6.51 |
| Repurchase agreements | 846 | 14 | 5.8 |
| Bank notes and senior debt | 6,290 | 108 | 6.75 |
| Federal Home Loan Bank borrowings | 1,105 | 20 | 7.16 |
| Subordinated debt | 2,419 | 45 | 7.4 |
| Other borrowed funds | 954 | 17 | 7.18 |
| Total borrowed funds | 13,518 | 236 | 6.85 |
| Total interest-bearing liabilities/interest expense | 51,189 | 670 | 5.18 |
| Noninterest-bearing liabilities and shareholders' equity |  |  |  |
| Demand and other noninterest-bearing deposits | 8,239 |  |  |
| Accrued expenses and other liabilities | 2,637 |  |  |
| Mandatorily redeemable capital securities of subsidiary trusts | 848 |  |  |
| Shareholders' equity | 6,185 |  |  |
| Total liabilities, capital securities and shareholders' equity | \$69,098 |  |  |
| Interest rate spread <br> Impact of noninterest-bearing sources |  |  | 2.80 |
| Net interest income/margin |  | \$534 | 3.54 |

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Securities and Exchange Commission Washington, D.C. 20549

Quarterly Report pursuant to Section 13 or $15(d)$ of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2001.

Commission File Number 1-9718

THE PNC FINANCIAL SERVICES GROUP, INC.
Incorporated in the Commonwealth of Pennsylvania
IRS Employer Identification No. 25-1435979
Address: One PNC Plaza
249 Fifth Avenue
Pittsburgh, Pennsylvania 15222-2707
Telephone: (412) 762-2000

By filing this amendment ("Amendment No. 1"), the undersigned registrant hereby amends its Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 ("September 2001 Form 10-Q") primarily for the items described in "Restatements" in the Overview section of the Financial Review and in the "Notes to Consolidated Financial Statements" of this Amendment No. 1.

By this Amendment No. 1, the undersigned registrant is amending and restating its entire September 2001 Form 10-Q.

As of October 31, 2001 The PNC Financial Services Group, Inc. had 284,067,222 shares of common stock (\$5 par value) outstanding.

The PNC Financial Services Group, Inc. (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 and (2) has been subject to such filing requirements for the past 90 days.

The following sections of the Financial Review set forth in the cross-reference index are incorporated in the Quarterly Report on Form 10-Q/A, Amendment No. 1 .


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PART II OTHER FINANCIAL INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

The following exhibit index lists Exhibits filed with this Quarterly Report on Form 10-Q/A, Amendment No. 1:

```
*10.15 Forms of Second Amendment to Change in Control
    Severance Agreements
    12.1 Computation of Ratio of Earnings to Fixed Charges
    12.2 Computation of Ratio of Earnings to Fixed Charges and
    Preferred Stock Dividends
*99 The Corporation's Employee Stock Purchase Plan, as
    amended
```

* Previously filed with the Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 and incorporated herein by reference.

Copies of these Exhibits may be obtained electronically at the Securities and Exchange Commission's home page at www.sec.gov. Copies may also be obtained without charge by writing to Thomas F. Garbe, Director of Financial Accounting, at corporate headquarters, by calling (412) 762-1553 or via e-mail at financial.reporting@pnc.com.

The Corporation filed the following Report on Form 8-K since June 30, 2001:

Form 8-K dated as of July 25, 2001, reporting on entering into underwriting agreements with respect to the public offering of $\$ 450,000,000$ of floating Rate Senior Notes due 2003, and $\$ 700,000,000$ of $5.75 \%$ Senior Notes due 2006, and on the form of notes and related guarantees, filed pursuant to Item 5 .

Form 8-K dated as of October 29, 2001, reporting on entering into underwriting agreements with respect to the public offering of $\$ 600,000,000$ of Floating Rate Senior Notes due 2004, and $\$ 400,000,000$ of $5.75 \%$ Senior Notes due 2006 , and on the form of notes and related guarantees, filed pursuant to Item 5 .

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to be signed on March 29, 2002, on its behalf by the undersigned thereunto duly authorized.

THE PNC FINANCIAL SERVICES GROUP, INC.
By: /s/ Robert L. Haunschild
Robert L. Haunschild
Chief Financial Officer

Corporate Information
THE PNC FINANCIAL SERVICES GROUP, INC.

CORPORATE HEADOUARTERS

The PNC Financial Services Group, Inc.
One PNC Plaza
249 Fifth Avenue
Pittsburgh, Pennsylvania 15222-2707
(412) 762-2000

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## STOCK LISTING

The PNC Financial Services Group, Inc. common stock is listed on the New York Stock Exchange under the symbol PNC.

## INTERNET INFORMATION

The PNC Financial Services Group, Inc.'s financial reports and information about its products and services are available on the Internet at www.pnc.com.

## FINANCIAL INFORMATION

The Corporation's Annual Report on Form 10-K is filed with the Securities and Exchange Commission ("SEC"). Copies of this document and other filings, including Exhibits thereto, may be obtained electronically at the SEC's home page at www.sec.gov. Copies may also be obtained without charge by writing to Thomas F. Garbe, Director of Financial Accounting, at corporate headquarters, by calling (412) 762-1553 or via e-mail at financial.reporting@pnc.com.

## INQUIRIES

For financial services call 1-888-PNC-2265. Individual shareholders should contact Shareholder Relations at (800) 982-7652.

Analysts and institutional investors should contact William H. Callihan, Vice President, Investor Relations, at (412) 762-8257 or via e-mail at investor.relations@pnc.com.

News media representatives and others seeking general information should contact R. Jeep Bryant, Director of Corporate Communications, at (412) 762-8221 or via e-mail at corporate.communications@pnc.com.

COMMON STOCK PRICES/DIVIDENDS DECLARED
The table below sets forth by quarter the range of high and low sale and quarter-end closing prices for The PNC Financial Services Group, Inc. common stock and the cash dividends declared per common share.

| 2001 QUARTER | High | Low | Close | Cash <br> Dividends Declared |
| :---: | :---: | :---: | :---: | :---: |
| First | \$75.813 | \$56.000 | \$67.750 | \$. 48 |
| Second | 71.110 | 62.400 | 65.790 | . 48 |
| Third | 70.390 | 51.140 | 57.250 | . 48 |
| Total |  |  |  | \$1.44 |
| 2000 QUARTER |  |  |  |  |
| First | \$48.500 | \$36.000 | \$45.063 | \$. 45 |
| Second | 57.500 | 41.000 | 46.875 | . 45 |
| Third | 66.375 | 47.625 | 65.000 | . 45 |
| Fourth | 75.000 | 56.375 | 73.063 | . 48 |
| Total |  |  |  | \$1.83 |

DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN
The PNC Financial Services Group, Inc. Dividend Reinvestment and Stock Purchase Plan enables holders of common and preferred stock to purchase additional shares

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of common stock conveniently and without paying brokerage commissions or service charges. A prospectus and enrollment card may be obtained by writing to Shareholder Relations at corporate headquarters.

REGISTRAR AND TRANSFER AGENT
The Chase Manhattan Bank
85 Challenger Road
Ridgefield Park, New Jersey 07660
(800) 982-7652


[^0]:    EARNINGS PER SHARE
    The following table sets forth basic and diluted earnings per share calculations.

