PNC FINANCIAL SERVICES GROUP, INC.
Form 10-Q
August 02, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

or

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

For the transition period from to

Commission file number 001-09718

The PNC Financial Services Group, Inc.
(Exact name of registrant as specified in its charter)

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

The Tower at PNC Plaza, 300 Fifth Avenue, Pittsburgh, Pennsylvania 15222-2401
(Address of principal executive offices, including zip code)
(888) 762-2265
(Registrant's telephone number including area code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of July 20, 2018, there were 464,302,343 shares of the registrant’s common stock ($5 par value) outstanding.

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FINANCIAL REVIEW
THE PNC FINANCIAL SERVICES GROUP, INC.

This Financial Review, including the Consolidated Financial Highlights, should be read together with our unaudited Consolidated Financial Statements and unaudited Statistical Information included elsewhere in this Quarterly Report on Form 10-Q (the Report or Form 10-Q) and with Items 6, 7, 8 and 9A of our 2017 Annual Report on Form 10-K (2017 Form 10-K). We have reclassified certain prior period amounts to conform with the current period presentation, which we believe is more meaningful to readers of our consolidated financial statements. For information regarding certain business, regulatory and legal risks, see the following: the Risk Management section of this Financial Review and of Item 7 in our 2017 Form 10-K; Item 1A Risk Factors included in our 2017 Form 10-K; and the Legal Proceedings and Commitments Notes of the Notes To Consolidated Financial Statements included in Item 1 of this Report and Item 8 of our 2017 Form 10-K. Also, see the Cautionary Statement Regarding Forward-Looking Information section in this Financial Review and the Critical Accounting Estimates And Judgments section in this Financial Review and in our 2017 Form 10-K for certain other factors that could cause actual results or future events to differ, perhaps materially, from historical performance and from those anticipated in the forward-looking statements included in this Report. See Note 14 Segment Reporting in the Notes To Consolidated Financial Statements included in this Report for a reconciliation of total business segment earnings to total PNC consolidated net income as reported on a generally accepted accounting principles (GAAP) basis. In this Report, “PNC”, “we” or “us” refers to The PNC Financial Services Group, Inc. and its subsidiaries on a consolidated basis (except when referring to PNC as a public company, its common stock or other securities issued by PNC, which just refer to The PNC Financial Services Group, Inc.). References to The PNC Financial Services Group, Inc. or to any of its subsidiaries are specifically made where applicable.

Table 1: Consolidated Financial Highlights

Dollars in millions, except per share data Unaudited	Three months ended June 30		Six months ended June 30	
	2018	2017	2018	2017
Financial Results (a)				
Revenue				
Net interest income	$2,413	$2,258	$4,774	$4,418
Noninterest income	1,911	1,802	3,661	3,526
Total revenue	4,324	4,060	8,435	7,944
Provision for credit losses	80	98	172	186
Noninterest expense	2,584	2,479	5,111	4,881
Income before income taxes and noncontrolling interests	$1,660	$1,483	$3,152	$2,877
Net income	$1,356	$1,097	$2,595	$2,171
Less:				
Net income attributable to noncontrolling interests	10	10	20	27
Preferred stock dividends	55	55	118	118
Preferred stock discount accretion and redemptions	1	2	2	23
Net income attributable to common shareholders	1,290	1,030	$2,455	$2,003
Less:				
Dividends and undistributed earnings allocated to nonvested restricted shares	5	4	10	10
Impact of BlackRock earnings per share dilution	3	1	5	5
Net income attributable to diluted common shares	$1,282	$1,025	$2,440	$1,988
Diluted earnings per common share	$2.72	$2.10	$5.15	$4.05
Cash dividends declared per common share	$.75	$.55	$1.50	$1.10
Effective tax rate (b)	18.3 %	26.0 %	17.7 %	24.5 %
Performance Ratios				
Net interest margin (c)	2.96 %	2.84 %	2.94 %	2.81 %

Noninterest income to total revenue	44 %	44 %	43 %	44 %
Efficiency	60 %	61 %	61 %	61 %
Return on:				
Average common shareholders' equity	12.13 %	9.88 %	11.59 %	9.69 %
Average assets	1.45 %	1.19 %	1.39 %	1.19 %

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

(b) The effective income tax rates are generally lower than the statutory rate due to the relationship of pretax income to tax credits and earnings that are not subject to tax. Amounts for the 2018 periods reflected the change in the statutory federal income tax rate from 35% to 21%, effective as of January 1, 2018, as a result of the new federal tax legislation.

(c) Calculated as annualized taxable-equivalent net interest income divided by average earning assets. To provide more meaningful comparisons of net interest margins, we use net interest income on a taxable-equivalent basis in calculating net interest margin by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments. This adjustment is not permitted under GAAP in the Consolidated Income Statement. For additional information, see Reconciliation of Taxable-Equivalent Net Interest Income (Non-GAAP) in the Statistical Information (Unaudited) section in Item 1 of this Report.

Table 1: Consolidated Financial Highlights (Continued) (a)

Unaudited	June 30 2018	December 31 2017	June 30 2017
Balance Sheet Data (dollars in millions, except per share data)			
Assets	$380,711	$380,768	$372,190
Loans	$222,855	$220,458	$218,034
Allowance for loan and lease losses	$2,581	$2,611	$2,561
Interest-earning deposits with banks (b)	$21,972	$28,595	$22,482
Investment securities	$80,125	$76,131	$76,431
Loans held for sale	$1,325	$2,655	$2,030
Equity investments (c)	$12,430	$11,392	$10,819
Mortgage servicing rights	$2,045	$1,832	$1,867
Goodwill	$9,218	$9,173	$9,163
Other assets	$27,897	$27,894	$28,886
Noninterest-bearing deposits	$79,047	$79,864	$79,550
Interest-bearing deposits	$185,838	$185,189	$179,626
Total deposits	$264,885	$265,053	$259,176
Borrowed funds	$59,222	$59,088	$56,406
Total shareholders' equity	$46,904	$47,513	$46,084
Common shareholders' equity	$42,917	$43,530	$42,103
Accumulated other comprehensive income (loss)	$(940)	$(148)	$(98)
Book value per common share	$92.26	$91.94	$87.78
Period-end common shares outstanding (in millions)	465	473	480
Loans to deposits	84%	83%	84%
Client Assets (in billions)			
Discretionary client assets under management	$149	$151	$141
Nondiscretionary client assets under administration	130	131	125
Total client assets under administration	279	282	266
Brokerage account client assets	49	49	46
Total client assets	$328	$331	$312
Capital Ratios			
Basel III (d) (e) (f)			
Common equity Tier 1	9.5%	N/A	N/A
Tier 1 risk-based	10.7%	N/A	N/A
Total capital risk-based	12.6%	N/A	N/A
Leverage	9.4%	N/A	N/A
Supplementary leverage	7.8%	N/A	N/A
Fully Phased-In Basel III (Non-GAAP) (f) (g)			
Common equity Tier 1	N/A	9.8%	9.8%
2017 Transitional Basel III (d) (f)			
Common equity Tier 1	N/A	10.4%	10.3%
Tier 1 risk-based	N/A	11.6%	11.6%
Total capital risk-based	N/A	13.7%	13.7%
Leverage	N/A	9.9%	9.9%
Common shareholders' equity to total assets	11.3%	11.4%	11.3%
Asset Quality			
Nonperforming loans to total loans	.77%	.85%	.90%

Nonperforming assets to total loans, OREO, foreclosed and other assets	.83 %	.92 %	.99 %
Nonperforming assets to total assets	.49 %	.53 %	.58 %
Net charge-offs to average loans (for the three months ended) (annualized)	.20 %	.22 %	.20 %
Allowance for loan and lease losses to total loans	1.16 %	1.18 %	1.17 %
Allowance for loan and lease losses to total nonperforming loans	150 %	140 %	131 %
Accruing loans past due 90 days or more (in millions)	$586	$737	$674

(a) The Executive Summary and Consolidated Balance Sheet Review portions of this Financial Review provide information regarding items impacting the comparability of the periods presented.

(b) Amounts include balances held with the Federal Reserve Bank of Cleveland (Federal Reserve Bank) of $21.6 billion, $28.3 billion and $22.1 billion as of June 30, 2018, December 31, 2017 and June 30, 2017, respectively.

(c) Amounts include our equity interest in BlackRock. On January 1, 2018, $.6 billion of trading and available for sale securities, primarily money market funds, were reclassified to Equity investments in accordance with the adoption of Accounting Standards Update (ASU) 2016-01. See the Recently Adopted Accounting Standards portion of Note 1 Accounting Policies in the Notes To Consolidated Financial Statements in our first quarter 2018 Quarterly Report on Form 10-Q (First Quarter 2018 Form 10-Q) for additional detail on this adoption.

(d) All ratios are calculated using the regulatory capital methodology applicable to PNC during each period presented and calculated based on the standardized approach.

(e) The 2018 Basel III ratios for Common equity Tier 1 capital, Tier 1 risk-based capital, Leverage and Supplementary leverage reflect the full phase-in of all Basel III adjustments to these metrics applicable to PNC. The 2018 Basel III Total risk-based capital ratio includes $80 million of nonqualifying trust preferred capital securities that are subject to a phase-out period that runs through 2021.

(f) See Basel III Capital discussion in the Capital Management portion of the Risk Management section of this Financial Review and the capital discussion in the Banking Regulation and Supervision section of Item 1 Business and Item 1A Risk Factors in our 2017 Form 10-K. See also the Transitional Basel III and Fully Phased-In Basel III Common Equity Tier 1 Capital Ratios (Non-GAAP) – June 30, 2017 table in the Statistical Information (Unaudited) section of this Report for a reconciliation of the June 30, 2017 ratios.

(g) 2017 Fully Phased-in Basel III results are presented as Pro forma estimates.

EXECUTIVE SUMMARY

The PNC Financial Services Group, Inc. is one of the largest diversified financial services companies in the United States and is headquartered in Pittsburgh, Pennsylvania.

We have businesses engaged in retail banking, including residential mortgage, corporate and institutional banking and asset management, providing many of our products and services nationally. Our primary geographic markets are located in the Mid-Atlantic, Midwest and Southeast. We also provide certain products and services internationally.

Key Strategic Goals

At PNC we manage our company for the long term. We are focused on the fundamentals of growing customers, loans, deposits and revenue and improving profitability, while investing for the future and managing risk, expenses and capital. We continue to invest in our products, markets and brand, and embrace our commitments to our customers, shareholders, employees and the communities where we do business.

We strive to expand and deepen customer relationships by offering a broad range of deposit, credit and fee-based products and services. We are focused on delivering those products and services to our customers with the goal of addressing their financial objectives and putting customers' needs first. Our business model is built on customer loyalty and engagement, understanding our customers' financial goals and offering our diverse products and services to help them achieve financial well-being. Our approach is concentrated on organically growing and deepening client relationships across our businesses that meet our risk/return measures.

We are focused on our strategic priorities, which are designed to enhance value over the long term, and consist of:

- Expanding our leading banking franchise to new markets and digital platforms;
- Deepening customer relationships by delivering a superior banking experience and financial solutions; and
- Leveraging technology to innovate and enhance products, services, security and processes.

Our capital priorities are to support client growth and business investment, maintain appropriate capital in light of economic conditions and the Basel III framework and return excess capital to shareholders, in accordance with the currently effective capital plan included in our Comprehensive Capital Analysis and Review (CCAR) submission to the Board of Governors of the Federal Reserve System (Federal Reserve). For more detail, see the Capital Highlights portion of this Executive Summary and the Liquidity and Capital Management portion of the Risk Management section of this Financial Review and the Supervision and Regulation section in Item 1 Business of our 2017 Form 10-K.

Income Statement Highlights

Net income for the second quarter of 2018 increased 24% to $1.4 billion, or $2.72 per diluted common share, compared to $1.1 billion, or $2.10 per diluted common share, for the second quarter of 2017.

- Total revenue increased $264 million, or 7%, to $4.3 billion.
- Net interest income increased $155 million, or 7%, to $2.4 billion.
- Net interest margin increased to 2.96% compared to 2.84% for the second quarter of 2017.
- Noninterest income increased $109 million, or 6%, to $1.9 billion.
- Provision for credit losses was $80 million compared to $98 million for the second quarter of 2017.
- Noninterest expense increased $105 million, or 4%, to $2.6 billion.
- Income tax expense decreased to $304 million compared to $386 million for the second quarter of 2017.
- Federal tax reform legislation, the Tax Cuts and Jobs Act, lowered the statutory federal income tax rate for corporations to 21% from 35% effective January 1, 2018.

For additional detail, see the Consolidated Income Statement Review section in this Financial Review.

Balance Sheet Highlights

Our balance sheet was strong and well positioned at June 30, 2018 and December 31, 2017. In comparison to December 31, 2017:

- Total loans increased $2.4 billion, or 1%, to $222.9 billion.
- Total commercial lending grew $2.2 billion, or 1%.
- Total consumer lending increased $.2 billion.
- Total deposits declined $.2 billion to $264.9 billion.
- Investment securities increased $4.0 billion, or 5%, to $80.1 billion.
- Interest-earning deposits with banks decreased $6.6 billion, or 23%, to $22.0 billion.

For additional detail, see the Consolidated Balance Sheet Review section of this Financial Review.

Credit Quality Highlights

Overall credit quality remained strong.

- At June 30, 2018 compared to December 31, 2017:
- Nonperforming assets decreased $181 million, or 9%, to $1.9 billion.
- Overall loan delinquencies decreased $159 million, or 10%.
- Net charge-offs were $109 million in the second quarter of 2018 compared to $110 million for the second quarter of 2017.

For additional detail, see the Credit Risk Management portion of the Risk Management section of this Financial Review.

Capital Highlights

We maintained a strong capital position and continued to return capital to shareholders.

- The Basel III common equity Tier 1 capital ratio, which includes the full phase-in of all Basel III adjustments and became effective for PNC as of January 1, 2018, was 9.5% at June 30, 2018, compared with 9.8% at December 31, 2017, calculated on the same basis.
- In the second quarter of 2018, we returned $1.2 billion of capital to shareholders through repurchases of 5.7 million common shares for $.8 billion and dividends on common shares of $.4 billion.
- In June 2018, we announced share repurchase programs of up to $2.0 billion for the four-quarter period beginning in the third quarter of 2018, including repurchases of up to $.3 billion related to stock issuances under employee benefit plans.
- In July 2018, our board of directors raised the quarterly cash dividend on common stock to 95 cents per share, an increase of 20 cents per share, or 27%, effective with the August dividend.

See the Liquidity and Capital Management portion of the Risk Management section of this Financial Review for more detail on our 2018 liquidity and capital actions as well as our capital ratios.

Our ability to take certain capital actions, including plans to pay or increase common stock dividends or to repurchase shares under current or future programs, is subject to the results of the supervisory assessment of capital adequacy undertaken by the Federal Reserve as part of the CCAR process. For additional information, see the Supervision and Regulation section in Item 1 Business of our 2017 Form 10-K.

Business Outlook

Our forward-looking financial statements are based on our current view that U.S. economic growth will accelerate somewhat in 2018, in light of stimulus from corporate and personal income tax cuts passed in late 2017 that are expected to support business investment and consumer spending, respectively. We expect an increase in federal government spending will also support economic growth in 2018. Further gradual improvement in the labor market this year, including job gains and rising wages, is another positive for consumer spending. Other sources of growth for the U.S. economy in 2018 will be the global economic expansion and the housing market, although trade restrictions are a growing downside risk to the forecast. Although inflation slowed in 2017, it should pick up as the labor market continues to tighten. Short-term interest rates and bond yields are expected to rise throughout 2018; after the Federal Open Market Committee raised the federal funds rate in June, our baseline forecast is for one additional rate hike in September 2018, pushing the federal funds rate to a range of 2.00% to 2.25% by the end of the year. Longer-term rates are also expected to increase as the Federal Reserve slowly reduces the size of its balance sheet and the federal government borrows more. Long-term rates will rise more slowly than short-term rates, so we anticipate that the yield curve will flatten but not invert.

For the third quarter of 2018 compared to the second quarter of 2018, we expect:

- Modest loan growth;

- Net interest income to increase by low single digits, on a percentage basis;
- Fee income to increase by low single digits, on a percentage basis. Fee income consists of asset management, consumer services, corporate services, residential mortgage and service charges on deposits;
- Provision for credit losses to be between $100 million and $150 million; and
- Noninterest expense to be stable.

We expect the quarterly run rate for other noninterest income to be in the range of $225 million to $275 million, excluding net securities gains (losses) and Visa activity.

Our outlook for certain financial information for full year 2018 is compared to full year 2017 results as adjusted for the following fourth quarter 2017 tax legislation and significant items: $26 million in lower net interest income from the impact of tax legislation on leveraged leases; a total of $54 million of higher noninterest income, consisting of the flow through impact of tax legislation on our equity investment in BlackRock, Visa Class B derivative fair value adjustments, and the appreciation of BlackRock stock contributed to the PNC Foundation, partially offset by negative adjustments for residential mortgage servicing rights fair value assumption

updates; a total of $502 million of higher noninterest expense, consisting of a contribution to the PNC Foundation, charges for real estate dispositions and exits, and employee cash payments and pension account credits; and a $1.2 billion tax benefit recognized as a result of the federal tax legislation, primarily attributable to revaluation of net deferred tax liabilities and $230 million from the tax effect of the aforementioned significant items. For additional information on these fourth quarter 2017 items, see the Income Statement Highlights portion of the Executive Summary section in Item 7 of our 2017 Form 10-K.

For full year 2018 compared to full year 2017 on an adjusted basis, we expect:

- Loan growth to be up mid-single digits, on a percentage basis;
- Revenue to increase on the upper end of mid-single digits, on a percentage basis;
- Noninterest expense to increase on the lower end of mid-single digits, on a percentage basis; and
- The effective tax rate to be approximately 17%.

See the Cautionary Statement Regarding Forward-Looking Information section in this Financial Review and Item 1A Risk Factors in our 2017 Form 10-K for other factors that could cause future events to differ, perhaps materially, from those anticipated in these forward-looking statements.

CONSOLIDATED INCOME STATEMENT REVIEW

Our Consolidated Income Statement is presented in Part I, Item 1 of this Report.

Net income for the second quarter of 2018 was $1.4 billion, or $2.72 per diluted common share, an increase of 24% compared to $1.1 billion, or $2.10 per diluted common share, for the second quarter of 2017. For the first six months of 2018, net income was $2.6 billion, or $5.15 per diluted common share, an increase of 20% compared to $2.2 billion, or $4.05 per diluted common share, for the first six months of 2017.

Net income increased in both comparisons driven by an increase in revenue from higher net interest income and noninterest income and a lower effective tax rate, partially offset by an increase in noninterest expense.

Net Interest Income

Table 2: Summarized Average Balances and Net Interest Income (a)

Three months ended June 30 Dollars in millions	2018 Average Balances	Average Yields/ Rates	Interest Income/ Expense	2017 Average Balances	Average Yields/ Rates	Interest Income/ Expense
Assets						
Interest-earning assets						
Investment securities	$77,479	2.91 %	$564	$75,352	2.71 %	$511
Loans	222,684	4.23 %	2,367	216,373	3.82 %	2,077
Interest-earning deposits with banks	21,017	1.78 %	93	22,543	1.04 %	58
Other	6,905	4.98 %	87	9,748	3.38 %	82
Total interest-earning assets/interest income	$328,085	3.78 %	3,111	$324,016	3.35 %	2,728
Liabilities						
Interest-bearing liabilities						
Interest-bearing deposits	$184,357	.57 %	261	$179,012	.32 %	143
Borrowed funds	58,966	2.74 %	408	57,524	1.89 %	273
Total interest-bearing liabilities/interest expense	$243,323	1.10 %	669	$236,536	.70 %	416
Net interest margin/income (Non-GAAP)		2.96 %	2,442		2.84 %	2,312
Taxable-equivalent adjustments			(29)			(54)
Net interest income (GAAP)			$2,413			$2,258

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Six months ended June 30 Dollars in millions	2018 Average Balances	Average Yields/ Rates		Interest Income/ Expense	2017 Average Balances	Average Yields/ Rates		Interest Income/ Expense
Assets								
Interest-earning assets								
Investment securities	$76,075	2.85	%	$1,083	$75,800	2.69	%	$1,019
Loans	221,899	4.16	%	4,617	214,324	3.75	%	4,018
Interest-earning deposits with banks	23,329	1.64	%	191	23,363	.92	%	107
Other	7,402	4.52	%	167	9,076	3.46	%	156
Total interest-earning assets/interest income	$328,705	3.68	%	6,058	$322,563	3.29	%	5,300
Liabilities								
Interest-bearing liabilities								
Interest-bearing deposits	$183,900	.52	%	474	$177,947	.30	%	263
Borrowed funds	59,300	2.52	%	752	56,241	1.82	%	513
Total interest-bearing liabilities/interest expense	$243,200	1.01	%	1,226	$234,188	.66	%	776
Net interest margin/income (Non-GAAP)		2.94	%	4,832		2.81	%	4,524
Taxable-equivalent adjustments				(58)				(106)
Net interest income (GAAP)				$4,774				$4,418

(a) Interest income calculated as taxable-equivalent interest income. To provide more meaningful comparisons of interest income and yields for all interest-earning assets, as well as net interest margins, we use interest income on a taxable-equivalent basis in calculating average yields and net interest margins by increasing the interest income earned on tax-exempt assets to make it fully equivalent to interest income earned on taxable investments. This adjustment is not permitted under GAAP on the Consolidated Income Statement. For more information, see Reconciliation of Taxable-Equivalent Net Interest Income (Non-GAAP) in the Statistical Information (Unaudited) section of this Report.

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

Net interest income increased by $155 million, or 7%, and $356 million, or 8%, for the second quarter and first six months of 2018, respectively, compared to the same periods in 2017. The increase in both comparisons was driven by higher loans and securities yields, as well as loan growth, partially offset by increases in borrowing and deposit costs. Net interest margin increased in both comparisons reflecting the impact of higher interest rates.

Average investment securities increased $2.1 billion, or 3%, in the quarterly comparison and $.3 billion in the year-to-date comparison. Net purchase activity of U.S. Treasury and government agencies and agency residential mortgage-backed securities was offset by declines in commercial mortgage-backed, asset-backed and other securities. These comparisons included the impact of the January 1, 2018 reclassification of $.6 billion of available for sale securities to equity investments in accordance with the adoption of ASU 2016-01. See the Recently Adopted Accounting Standards portion of Note 1 Accounting Policies in the Notes To Consolidated Financial Statements in our First Quarter 2018 Form 10-Q for additional detail on this adoption.

Average investment securities increased to 24% of average interest-earning assets for the second quarter of 2018 compared to 23% for the second quarter of 2017 and both year-to-date periods.

Average loans grew $6.3 billion, or 3%, and $7.6 billion, or 4%, in the quarterly and year-to-date comparisons, respectively. Loan growth was driven by increases in average commercial lending of $5.5 billion and $7.0 billion in the respective comparisons reflecting broad-based growth in the Corporate Banking, Business Credit and Equipment Finance businesses in our Corporate & Institutional Banking segment.

Average consumer lending increased $.8 billion and $.6 billion in the quarterly and year-to-date comparisons, respectively. Growth in residential real estate, automobile and credit card loans was mostly offset by declines in home equity and education loans. Lower home equity loans reflected paydowns and payoffs exceeding new originated volume. In addition, run-off in the non-strategic consumer loan portfolios of brokered home equity and government guaranteed education loans contributed to the declines. Average loans represented 68% of average interest-earning assets for the second quarter and first six months of 2018 compared to 67% and 66% for the same periods of 2017, respectively.

Average interest-bearing deposits grew $5.3 billion, or 3%, and $6.0 billion, or 3%, in the respective quarterly and year-to-date comparisons, reflecting overall deposit and customer growth. Average savings deposits increased $9.0 billion and $9.2 billion,

respectively, due in part to a shift to relationship-based savings products from money market deposits, which decreased $6.0 billion and $5.7 billion in the respective comparisons. Additionally, average interest-bearing demand deposits grew $2.9 billion in both comparisons. Average interest-bearing deposits remained stable at 76% of average interest-bearing liabilities in both the quarterly and year-to-date comparisons.

Further details regarding average loans and deposits are included in the Business Segments Review section of this Financial Review.

Average borrowed funds increased $1.4 billion, or 3%, and $3.1 billion, or 5%, in the quarterly and year-to-date comparisons, respectively, primarily due to higher bank notes and senior debt, partially offset by a decline in subordinated debt. See the Consolidated Balance Sheet Review portion of this Financial Review for additional detail on the level and composition of borrowed funds.

Noninterest Income

Table 3: Noninterest Income

	Three months ended June 30				Six months ended June 30			
			Change				Change	
Dollars in millions	2018	2017	$	%	2018	2017	$	%
Noninterest income								
Asset management	$456	$398	$58	15 %	$911	$801	$110	14 %
Consumer services	381	360	21	6 %	738	692	46	7 %
Corporate services	487	466	21	5 %	916	880	36	4 %
Residential mortgage	84	104	(20)	(19)%	181	217	(36)	(17)%
Service charges on deposits	169	170	(1)	(1)%	336	331	5	2 %
Other	334	304	30	10 %	579	605	(26)	(4)%
Total noninterest income	$1,911	$1,802	$109	6 %	$3,661	$3,526	$135	4 %

Noninterest income as a percentage of total revenue was 44% for both the second quarters of 2018 and 2017. The comparable ratios for the year-to-date periods were 43% and 44%, respectively.

Growth in asset management revenue reflected higher earnings on our equity investment in BlackRock and stronger equity markets. PNC's discretionary client assets under management increased to $149 billion at June 30, 2018 compared with $141 billion at June 30, 2017.

Increases in consumer services revenue in the quarterly and year-to-date comparisons were primarily due to growth in debit and credit card fees totaling $12 million and $29 million, respectively, reflecting continued momentum in customer activity in both transaction trends and customer growth. Brokerage fees increased in both comparisons by $10 million and $20 million, respectively, as a result of growth in brokerage assets under management.

Higher corporate services revenue in both comparisons was primarily driven by growth in treasury management fees of $19 million and $34 million and merger and acquisition advisory fees of $11 million and $15 million, respectively. Additionally, the year-to-date comparison included a $12 million increase in operating lease income related to the commercial and vendor finance business acquired in the second quarter of 2017 and an $11 million lower benefit from commercial mortgage servicing rights valuation, net of economic hedge.

Residential mortgage revenue decreased due to loan sales revenue declines of $16 million and $28 million in the quarterly and year-to-date comparisons, as well as lower servicing revenue. The declines in loan sales revenue reflected increased competition in the marketplace and a shift in mix away from refinancing to purchases, which drove lower gain on sales margins.

Other noninterest income increased in the quarterly comparison reflecting a benefit from positive derivative fair value adjustments related to swap agreements with purchasers of Visa Class B common shares of $27 million in the second quarter of 2018, primarily due to developments relevant to the litigation, partially offset by a $16 million decline in net securities gains.

Other noninterest income decreased in the year-to-date comparison largely attributable to an $81 million decline in revenue from equity investments, which included the impact of first quarter 2017 positive valuation adjustments related to the Volcker Rule provisions of the Dodd-Frank Act. This decline was partially offset by a net $45 million benefit from derivative fair value adjustments related to Visa Class B common shares.

In the first quarter of 2018, and in connection with the commercial and vendor finance business we acquired in the second quarter of 2017, we reclassified operating lease income to corporate services noninterest income from other noninterest income on the

Consolidated Income Statement, including operating lease income of $31 million and $53 million for the three and six months ended June 30, 2017, respectively. Operating lease income was $31 million and $65 million for the three and six months ended June 30, 2018, respectively.

Provision For Credit Losses

The provision for credit losses decreased $18 million to $80 million in the second quarter of 2018 compared to the second quarter of 2017 and decreased $14 million to $172 million for the first six months of 2018 compared to the same period in 2017 reflecting a lower provision for commercial loans, partially offset by a higher provision for consumer loans.

The Credit Risk Management portion of the Risk Management section of this Financial Review includes additional information regarding factors impacting the provision for credit losses.

Noninterest Expense

Table 4: Noninterest Expense

	Three months ended June 30				Six months ended June 30			
			Change				Change	
Dollars in millions	2018	2017	$	%	2018	2017	$	%
Noninterest expense								
Personnel	$1,356	$1,276	$80	6 %	$2,710	$2,533	$177	7 %
Occupancy	203	202	1	—	421	424	(3)	(1)%
Equipment	281	281	—	—	554	532	22	4 %
Marketing	75	67	8	12%	130	122	8	7 %
Other	669	653	16	2 %	1,296	1,270	26	2 %
Total noninterest expense	$2,584	$2,479	$105	4 %	$5,111	$4,881	$230	5 %

Noninterest expense increased in both comparisons attributable to our ongoing business investments, including technology and staffing. The increases were primarily in higher personnel expense and were related to new initiatives, our announced increase in the minimum hourly pay rate for eligible employees and enhanced employee benefits. In addition, the year-to-date comparison reflects operating expense related to the second quarter 2017 acquisition of a commercial and vendor finance business.

PNC continued to focus on disciplined expense management. As of June 30, 2018, we were on track to achieve our full-year 2018 goal of $250 million in cost savings through our continuous improvement program, which we expect will fund a portion of our strategic investments.

Effective Income Tax Rate

The effective income tax rate was 18.3% in the second quarter of 2018 compared to 26.0% in the second quarter of 2017 and 17.7% in the first six months of 2018 compared to 24.5% in the same period of 2017. Both comparisons reflected the change in the statutory federal income tax rate from 35% to 21%, effective as of January 1, 2018, as a result of the new federal tax legislation.

CONSOLIDATED BALANCE SHEET REVIEW

Table 5: Summarized Balance Sheet Data

	June 30	December 31	Change	
Dollars in millions	2018	2017	$	%
Assets				
Interest-earning deposits with banks	$21,972	$28,595	$(6,623)	(23)%
Loans held for sale	1,325	2,655	(1,330)	(50)%
Investment securities	80,125	76,131	3,994	5%
Loans	222,855	220,458	2,397	1%
Allowance for loan and lease losses	(2,581)	(2,611)	30	1%
Mortgage servicing rights	2,045	1,832	213	12%
Goodwill	9,218	9,173	45	—
Other, net	45,752	44,535	1,217	3%
Total assets	$380,711	$380,768	$(57)	—
Liabilities				
Deposits	$264,885	$265,053	$(168)	—
Borrowed funds	59,222	59,088	134	—
Other	9,629	9,042	587	6%
Total liabilities	333,736	333,183	553	—
Equity				
Total shareholders’ equity	46,904	47,513	(609)	(1)%
Noncontrolling interests	71	72	(1)	(1)%
Total equity	46,975	47,585	(610)	(1)%
Total liabilities and equity	$380,711	$380,768	$(57)	—

The summarized balance sheet data in Table 5 is based upon our Consolidated Balance Sheet in Part 1, Item 1 of this Report.

Our balance sheet was strong and well positioned at both June 30, 2018 and December 31, 2017.

- Total assets were stable as higher investment securities and loan growth were funded by lower interest-earning deposits with banks;
- Total liabilities increased slightly;
- Total equity decreased slightly as share repurchases and lower accumulated other comprehensive income (AOCI) related to net unrealized securities losses were mostly offset by higher retained earnings driven by net income.

The following discussion provides additional information about the major components of our balance sheet. Information regarding our capital and regulatory compliance is included in the Liquidity and Capital Management portion of Risk Management in this Financial Review and in Note 18 Regulatory Matters in the Notes To Consolidated Financial Statements included in our 2017 Form 10-K.

Loans

Table 6: Loans

	June 30	December 31	Change	
Dollars in millions	2018	2017	$	%
Commercial lending				
Commercial	$113,367	$110,527	$2,840	3%
Commercial real estate	28,946	28,978	(32)	—
Equipment lease financing	7,323	7,934	(611)	(8)%

Total commercial lending	149,636	147,439	2,197	1 %
Consumer lending				
Home equity	27,219	28,364	(1,145)	(4)%
Residential real estate	17,805	17,212	593	3 %
Credit card	5,830	5,699	131	2 %
Other consumer				
Automobile	13,892	12,880	1,012	8 %
Education	4,057	4,454	(397)	(9)%
Other	4,416	4,410	6	—
Total consumer lending	73,219	73,019	200	—
Total loans	$222,855	$220,458	$2,397	1 %

Loan growth was driven by commercial lending as well as an increase in consumer lending balances.

Commercial loans increased primarily driven by growth from our Corporate Banking and Business Credit businesses within our Corporate & Institutional Banking segment. In Corporate Banking, commercial loans increased $1.7 billion, or 3%, largely due to strong growth in asset-backed finance securitizations as well as middle market and large corporate lending. In Business Credit, higher utilization and new production resulted in an increase in commercial loans of $1.0 billion, or 6%.

For commercial loans by industry and commercial real estate loans by geography, see Loan Portfolio Characteristics and Analysis in the Credit Risk Management portion of the Risk Management section in this Financial Review.

Consumer lending balances increased slightly as growth in automobile and residential real estate loans were mostly offset by lower home equity and education loans.

The growth in automobile loans was due in part to continued expansion in our Southeast markets. Residential real estate loans increased as a result of originations of nonconforming residential mortgage loans, both nationwide and within our branch network. Nonconforming residential mortgage loans are loans that do not meet government agency standards, such as a maximum loan amount, property type or credit requirements, among other factors. The growth in residential real estate loans was primarily due to nonconforming loans that exceeded agency conforming loan amount limits.

Home equity loans declined as paydowns and payoffs exceeded new originated volume. In addition, the declines in both home equity and education loans included the continued runoff in our non-strategic brokered home equity and government guaranteed education loan portfolios.

For information on home equity and residential real estate loans, including by geography, and automobile loans, see Loan Portfolio Characteristics and Analysis in the Credit Risk Management portion of the Risk Management section in this Financial Review.

See the Credit Risk Management portion of the Risk Management section of this Financial Review, Note 3 Asset Quality and Note 4 Allowance for Loan and Lease Losses in our Notes To Consolidated Financial Statements included in this Report, and Note 1 Accounting Policies in our 2017 Form 10-K for additional information regarding our loan portfolio.

Investment Securities

Table 7: Investment Securities

	June 30, 2018		December 31, 2017		Ratings (a) as of June 30, 2018				
Dollars in millions	Amortized Cost	Fair Value	Amortized Cost	Fair Value	AAA/ AA	A	BBB	BB and Lower	No Rating
U.S. Treasury and government agencies	$17,056	$16,944	$15,173	$15,286	100 %				
Agency residential mortgage-backed	44,337	43,321	40,037	39,847	100 %				
Non-agency residential mortgage-backed	2,333	2,655	2,610	2,932	11 %		4 %	66 %	19 %
Agency commercial mortgage-backed	2,131	2,049	2,367	2,315	100 %				
Non-agency commercial mortgage-backed (b)	3,101	3,080	3,141	3,161	84 %	6 %			10 %

Asset-backed (c)	5,601	5,653	5,531	5,598	85 %	3 %	6 %	6 %	
Other debt (d)	5,939	6,026	6,279	6,459	74 %	16%	7 %		3 %
Other (e)			587	585					
Total investment securities (f)	$80,498	$79,728	$75,725	$76,183	94 %	2 %	1 %	2 %	1 %

(a) Ratings percentages allocated based on amortized cost.
(b) Collateralized primarily by retail properties, office buildings, lodging properties and multi-family housing.
(c) Collateralized primarily by corporate debt, government guaranteed education loans and other consumer credit products.
(d) Includes state and municipal securities.
(e) On January 1, 2018, $.6 billion of available for sale securities, primarily money market funds, were reclassified to equity investments in accordance with the adoption of ASU 2016-01. See the Recently Adopted Accounting Standards portion of Note 1 Accounting Policies in our First Quarter 2018 Form 10-Q for additional detail on this adoption.
(f) Includes available for sale and held to maturity securities, which are recorded on our balance sheet at fair value and amortized cost, respectively.

Investment securities increased $4.0 billion to $80.1 billion at June 30, 2018 compared to December 31, 2017, driven by net purchase activity of agency residential mortgage-backed securities of $3.8 billion and U.S. Treasury and government agencies securities of $1.7 billion. These increases were partially offset by the reclassification of $.6 billion of available for sale securities, primarily money market funds, to equity investments as part of the adoption of ASU 2016-01. See the Recently Adopted Accounting Standards portion of Note 1 Accounting Policies in our First Quarter 2018 Form 10-Q for additional detail on the adoption of this ASU.

The level and composition of the investment securities portfolio fluctuates over time based on many factors including market conditions, loan and deposit growth, and balance sheet management activities. We manage our investment securities portfolio to optimize returns, while providing a reliable source of liquidity for our banking and other activities, considering the Liquidity Coverage Ratio (LCR) and other internal and external guidelines and constraints.

Table 7 presents the distribution of our investment securities portfolio by credit rating. We have included credit ratings information because we believe that the information is an indicator of the degree of credit risk to which we are exposed, which could affect our risk-weighted assets and, therefore, our risk-based regulatory capital ratios under the regulatory capital rules. Changes in credit ratings classifications could indicate increased or decreased credit risk and could be accompanied by a reduction or increase in the fair value of our investment securities portfolio.

At least quarterly, we conduct a comprehensive security-level impairment assessment on all securities. If economic conditions, including home prices, were to deteriorate from current levels, and if market volatility and liquidity were to deteriorate from current levels, or if market interest rates were to increase or credit spreads were to widen appreciably, the valuation of our investment securities portfolio would likely be adversely affected and we could incur additional other than temporary impairment (OTTI) credit losses that would impact our Consolidated Income Statement.

The duration of investment securities was 3.6 years at June 30, 2018. We estimate that at June 30, 2018 the effective duration of investment securities was 3.7 years for an immediate 50 basis points parallel increase in interest rates and 3.5 years for an immediate 50 basis points parallel decrease in interest rates.

Based on expected prepayment speeds, the weighted-average expected maturity of the investment securities portfolio (excluding other) was 5.7 years at June 30, 2018 compared to 5.2 years at December 31, 2017.

Table 8: Weighted-Average Expected Maturities of Mortgage and Other Asset-Backed Debt Securities

June 30, 2018	Years
Agency residential mortgage-backed	6.7
Non-agency residential mortgage-backed	6.4
Agency commercial mortgage-backed	3.6
Non-agency commercial mortgage-backed	3.1
Asset-backed	2.3

Additional information regarding our investment securities is included in Note 5 Investment Securities and Note 6 Fair Value in the Notes To Consolidated Financial Statements included in this Report.

Funding Sources

Table 9: Details of Funding Sources

	June 30	December 31	Change	
Dollars in millions	2018	2017	$	%
Deposits				
Noninterest-bearing	$79,047	$79,864	$(817)	(1)%
Interest-bearing				
Money market	54,771	59,735	(4,964)	(8)%
Demand	61,853	61,213	640	1 %
Savings	51,974	46,980	4,994	11 %
Time deposits	17,240	17,261	(21)	—
Total interest-bearing deposits	185,838	185,189	649	—
Total deposits	264,885	265,053	(168)	—

Borrowed funds				
Federal Home Loan Bank (FHLB) borrowings	22,036	21,037	999	5 %
Bank notes and senior debt	27,596	28,062	(466)	(2)%
Subordinated debt	4,781	5,200	(419)	(8)%
Other	4,809	4,789	20	—
Total borrowed funds	59,222	59,088	134	—
Total funding sources	$324,107	$324,141	$(34)	—

Total deposits declined slightly in the comparison as growth in interest-bearing deposits was more than offset by a decrease in noninterest-bearing deposits.

Noninterest-bearing deposits decreased primarily due to seasonal declines in commercial deposits. Within interest-bearing deposits, savings deposits grew reflecting, in part, a shift from consumer money market to relationship-based savings products, as well as growth in commercial demand deposit balances.

Borrowed funds increased slightly in the comparison as issuances of FHLB borrowings were mostly offset by declines in bank notes and senior debt and subordinated debt. The level and composition of borrowed funds fluctuates over time based on many factors including market conditions, loan, investment securities and deposit growth, and capital considerations. We manage our borrowed funds to provide a reliable source of liquidity for our banking and other activities, considering LCR and other internal and external guidelines and constraints.

See the Liquidity and Capital Management portion of the Risk Management section of this Financial Review for additional information regarding our 2018 liquidity and capital activities.

Shareholders’ Equity

Total shareholders’ equity was $46.9 billion at June 30, 2018, a decrease of $.6 billion compared to December 31, 2017. The decrease resulted from common share repurchases of $1.5 billion, lower AOCI related to net unrealized securities losses of $.8 billion and common and preferred dividends of $.8 billion, partially offset by net income of $2.6 billion.

Common shares outstanding were 465 million and 473 million at June 30, 2018 and December 31, 2017, respectively, as repurchases of 10.5 million shares during the period were partially offset by share issuances from treasury stock related to warrants exercised and stock-based compensation activity.

BUSINESS SEGMENTS REVIEW

We have four reportable business segments:

- Retail Banking
- Corporate & Institutional Banking
- Asset Management Group
- BlackRock

Business segment results and a description of each business are included in Note 14 Segment Reporting included in the Notes To Consolidated Financial Statements in this Report. Certain amounts included in this Business Segments Review differ from those amounts shown in Note 14, primarily due to the presentation in this Financial Review of business net interest income on a taxable-equivalent basis.

Net interest income in business segment results reflects our internal funds transfer pricing methodology. Assets receive a funding charge and liabilities and capital receive a funding credit based on a transfer pricing methodology that incorporates product repricing characteristics, tenor and other factors.

Retail Banking
(Unaudited)

Table 10: Retail Banking Table

Six months ended June 30			Change	
Dollars in millions, except as noted	2018	2017	$	%
Income Statement				
Net interest income	$2,495	$2,260	$235	10 %
Noninterest income	1,313	1,248	65	5 %
Total revenue	3,808	3,508	300	9 %
Provision for credit losses	141	121	20	17 %
Noninterest expense	2,845	2,685	160	6 %
Pretax earnings	822	702	120	17 %
Income taxes	196	259	(63)	(24)%
Earnings	$626	$443	$183	41 %
Average Balance Sheet				
Loans held for sale	$640	$786	$(146)	(19)%
Loans				
Consumer				
Home equity	$24,391	$25,506	$(1,115)	(4)%
Automobile	13,375	12,185	1,190	10 %
Education	4,294	5,021	(727)	(14)%
Credit cards	5,674	5,129	545	11 %
Other	1,768	1,757	11	1 %
Total consumer	49,502	49,598	(96)	—
Commercial and commercial real estate	10,493	10,965	(472)	(4)%
Residential mortgage	13,570	11,804	1,766	15 %
Total loans	$73,565	$72,367	$1,198	2 %
Total assets	$88,879	$88,559	$320	—
Deposits				
Noninterest-bearing demand	$30,248	$29,285	$963	3 %
Interest-bearing demand	42,373	41,059	1,314	3 %
Money market	31,560	38,416	(6,856)	(18)%
Savings	45,139	36,851	8,288	22 %
Certificates of deposit	11,948	13,518	(1,570)	(12)%
Total deposits	$161,268	$159,129	$2,139	1 %
Performance Ratios				
Return on average assets	1.42 %	1.01 %		
Noninterest income to total revenue	34 %	36 %		
Efficiency	75 %	77 %		

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Six months ended June 30 Dollars in millions, except as noted	2018	2017	Change $	Change %
Supplemental Noninterest Income Information				
Consumer services	$553	$527	$26	5 %
Brokerage	$174	$154	$20	13 %
Residential mortgage	$181	$217	$(36)	(17)%
Service charges on deposits	$324	$317	$7	2 %
Residential Mortgage Information				
Residential mortgage servicing statistics (in billions, except as noted) (a)				
Serviced portfolio balance (b)	$124	$131	$(7)	(5)%
Serviced portfolio acquisitions	$4	$16	$(12)	(75)%
MSR asset value (b)	$1.3	$1.2	$.1	8 %
MSR capitalization value (in basis points) (b)	104	95	9	9 %
Servicing income: (in millions)				
Servicing fees, net (c)	$90	$96	$(6)	(6)%
Mortgage servicing rights valuation, net of economic hedge	$22	$23	$(1)	(4)%
Residential mortgage loan statistics				
Loan origination volume (in billions)	$3.7	$4.1	$(.4)	(10)%
Loan sale margin percentage	2.49 %	2.84 %		
Percentage of originations represented by:				
Purchase volume (d)	65 %	53 %		
Refinance volume	35 %	47 %		
Other Information (b)				
Customer-related statistics (average)				
Non-teller deposit transactions (e)	54 %	52 %		
Digital consumer customers (f)	65 %	61 %		
Credit-related statistics				
Nonperforming assets (g)	$1,141	$1,149	$(8)	(1)%
Net charge-offs	$212	$187	25	13 %
Other statistics				
ATMs	9,043	8,972	71	1 %
Branches (h)	2,404	2,481	(77)	(3)%
Brokerage account client assets (in billions) (i)	$49	$46	$3	7 %

(a) Represents mortgage loan servicing balances for third parties and the related income.
(b) Presented as of June 30, except for customer-related statistics, which are averages for the six months ended, and net charge-offs, which are for the six months ended.
(c) Servicing fees net of impact of decrease in MSR value due to passage of time, including the impact from both regularly scheduled loan prepayments and loans that were paid down or paid off during the period.
(d) Mortgages with borrowers as part of residential real estate purchase transactions.
(e) Percentage of total consumer and business banking deposit transactions processed at an ATM or through our mobile banking application.
(f) Represents consumer checking relationships that process the majority of their transactions through non-teller channels.
(g) Includes nonperforming loans of $1.1 billion at both June 30, 2018 and June 30, 2017.
(h) Excludes stand-alone mortgage offices and satellite offices (e.g., drive-ups, electronic branches and retirement centers) that provide limited products and/or services.
(i) Includes cash and money market balances.

Retail Banking earned $626 million in the first six months of 2018 compared with $443 million for the same period in 2017. The increase in earnings was driven by higher net interest income and noninterest income, partially offset by an increase in noninterest expense. Earnings in 2018 also benefited from the lower statutory federal income tax rate.

Net interest income increased primarily due to wider interest rate spreads on the value of deposits.

The increase in noninterest income reflected growth in brokerage, credit and debit card fees, higher service charges on deposits and positive derivative fair value adjustments related to swap agreements with purchasers of Visa Class B common shares. These increases were partially offset by lower residential mortgage noninterest income consisting of lower loan sales revenue, as well as lower servicing revenue. The decline in loan sales revenue reflected increased competition in the marketplace and a shift in mix away from refinancing to purchases, which drove lower gain on sales margins.

Higher noninterest expense primarily resulted from an increase in personnel expense, continued investments in technology, risk and compliance expense, and marketing activity.

Retail Banking continues to enhance the customer experience with refinements to product and service offerings that drive value for consumers and small businesses. We are focused on meeting the financial needs of our customers by providing a broad range of liquidity, banking and investment products.

The deposit strategy of Retail Banking is to remain disciplined on pricing and focused on growing and retaining relationship-based balances, executing on market-specific deposit growth strategies and providing a source of low-cost funding and liquidity to PNC. During the first six months of 2018, average total deposits increased compared to the same period a year ago, as both interest-bearing and noninterest-bearing demand deposits increased. Savings deposits grew, reflecting, in part, a shift from money market deposits to relationship-based savings products. Certificates of deposit declined due to the net runoff of maturing accounts.

Retail Banking average total loans increased in the first six months of 2018 compared with the same period in 2017.

- Average residential mortgages increased as a result of growth in nonconforming residential mortgage loans, both nationwide and within our branch network.
- Average automobile loans, which consisted of both direct and indirect auto loans, increased primarily due to strong new loan volumes, including in our Southeast markets.
- Average credit card balances increased as we continued to focus on our long-term objective of deepening penetration within our existing customer base.
- Average home equity loans decreased as paydowns and payoffs on loans exceeded new originated volume.
- Average commercial and commercial real estate loans declined as paydowns and payoffs on loans exceeded new volume.
- Average education loans decreased driven by a decline in the runoff portfolio of government guaranteed education loans.

Retail Banking continued to focus on its strategy of transforming the customer experience through transaction migration, branch network and home lending transformations and multi-channel engagement and service strategies.

- Approximately 65% of consumer customers used non-teller channels for the majority of their transactions in the first six months of 2018 compared with 61% in the first six months of 2017.
- Deposit transactions via ATM and mobile channels increased to 54% of total deposit transactions versus 52% in the comparison.
- Instant debit card issuance, which enables us to print a customer’s debit card in minutes, was available in 92% of our branch network as of June 30, 2018.
- In the second half of 2018, Retail Banking plans to launch its national retail digital strategy in markets where it does not have existing branches, with an initial focus on certain markets where PNC's Corporate & Institutional Banking has expanded its middle market banking business.

Retail Banking continued to make progress on its multi-year initiative to redesign the home lending process by integrating mortgage and home equity lending into a common platform to enhance product capability and improve speed of delivery and convenience. We implemented a new mortgage origination system in 2017 and converted home equity loans to the new servicing platform in the first quarter of 2018. Both residential mortgage and home equity loans are now serviced on a single platform.

Corporate & Institutional Banking
(Unaudited)

Table 11: Corporate & Institutional Banking Table

Six months ended June 30			Change	
Dollars in millions	2018	2017	$	%
Income Statement				
Net interest income	$1,782	$1,729	$53	3 %
Noninterest income	1,182	1,112	70	6 %
Total revenue	2,964	2,841	123	4 %
Provision for credit losses	56	112	(56)	(50)%
Noninterest expense	1,265	1,186	79	7 %
Pretax earnings	1,643	1,543	100	6 %
Income taxes	384	541	(157)	(29)%
Earnings	$1,259	$1,002	$257	26 %
Average Balance Sheet				
Loans held for sale	$890	$915	$(25)	(3)%
Loans				
Commercial	$101,767	$94,067	$7,700	8 %
Commercial real estate	26,723	27,334	(611)	(2)%
Equipment lease financing	7,669	7,550	119	2 %
Total commercial lending	136,159	128,951	7,208	6 %
Consumer	58	304	(246)	(81)%
Total loans	$136,217	$129,255	$6,962	5 %
Total assets	$152,769	$145,445	$7,324	5 %
Deposits				
Noninterest-bearing demand	$45,136	$46,872	$(1,736)	(4)%
Money market	23,118	21,204	1,914	9 %
Other	18,590	15,706	2,884	18 %
Total deposits	$86,844	$83,782	$3,062	4 %
Performance Ratios				
Return on average assets	1.66 %	1.39 %		
Noninterest income to total revenue	40 %	39 %		
Efficiency	43 %	42 %		
Other Information				
Consolidated revenue from: (a)				
Treasury Management (b)	$865	$731	$134	18 %
Capital Markets (b)	$541	$515	$26	5 %
Commercial mortgage banking activities				
Commercial mortgage loans held for sale (c)	$52	$51	$1	2 %
Commercial mortgage loan servicing income (d)	115	113	2	2 %
Commercial mortgage servicing rights valuation, net of economic hedge (e)	24	35	(11)	(31)%
Total	$191	$199	$(8)	(4)%
MSR asset value (f)	$748	$618	$130	21 %
Average Loans by C&IB business				
Corporate Banking	$58,191	$54,416	$3,775	7 %
Real Estate	37,336	37,730	(394)	(1)%
Business Credit	17,078	15,244	1,834	12 %
Equipment Finance	14,298	12,982	1,316	10 %

Commercial Banking	7,065	7,057	8	—
Other	2,249	1,826	423	23 %
Total average loans	$136,217	$129,255	$6,962	5 %
Credit-related statistics				
Nonperforming assets (f) (g)	$385	$586	$(201)	(34)%
Net charge-offs	$7	$42	$(35)	(83)%

(a) Represents consolidated amounts. See the additional revenue discussion regarding treasury management, capital markets-related products and services, and commercial mortgage banking activities in the Product Revenue section of this Corporate & Institutional Banking section.
(b) Includes amounts reported in net interest income and noninterest income.
(c) Includes other noninterest income for valuations on commercial mortgage loans held for sale and related commitments, derivative valuations, originations fees, gains on sale of loans held for sale and net interest income on loans held for sale.
(d) Includes net interest income and noninterest income (primarily in corporate service fees) from loan servicing net of reduction in commercial mortgage servicing rights due to amortization expense and payoffs. Commercial mortgage servicing rights valuation, net of economic hedge is shown separately.
(e) Amounts are reported in corporate service fees.
(f) As of June 30.
(g) Includes nonperforming loans of $.3 billion at June 30, 2018 and $.5 billion at June 30, 2017.

Corporate & Institutional Banking earned $1.3 billion in the first six months of 2018 compared to $1.0 billion for the same period in 2017. The increase was primarily due to the impact of the lower statutory federal income tax rate, higher revenue and a decrease in the provision for credit losses, partially offset by higher noninterest expense. We continue to focus on building client relationships where the risk-return profile is attractive.

Net interest income increased in the comparison, reflecting higher average loan and deposit balances, as well as wider interest rate spreads on the value of deposits, partially offset by narrower interest rate spreads on the value of loans.

Growth in noninterest income in the comparison was primarily driven by higher treasury management fees and capital markets-related revenue, including higher merger and acquisition advisory fees and revenue from customer-related derivative and foreign exchange services, partially offset by a lower benefit from commercial mortgage servicing rights valuation, net of economic hedge. Additionally, operating lease income increased, mainly due to the commercial and vendor finance business acquired in the second quarter of 2017.

Overall, credit quality remained strong, as nonperforming assets and net charge-offs declined in the comparison. The decrease in provision for credit losses in the comparison reflected lower specific loan reserves. Additionally, the prior year included an initial provision for the loan and lease portfolio obtained through the business acquired in the second quarter of 2017.

Noninterest expense increased in the comparison largely due to investments in strategic initiatives and variable costs associated with increased business activity.

Average loans increased in the comparison mostly due to strong growth in Corporate Banking, Business Credit and Equipment Finance businesses:

- Corporate Banking provides lending, treasury management and capital markets-related products and services to mid-sized and large corporations, and government and not-for-profit entities. Average loans for this business grew in the comparison reflecting increased lending to large and mid-sized corporate clients as well as strong production in asset backed financing.
- PNC Real Estate provides banking, financing and servicing solutions for commercial real estate clients across the country. Average loans for this business decreased primarily driven by project loan payoffs, partially offset by higher commercial mortgage originations.
- PNC Business Credit provides asset-based lending. The loan portfolio is relatively high yielding, with acceptable risk as the loans are mainly secured by short-term assets. Average loans for this business increased in the comparison as new originations and increased utilization were partially offset by payoffs.

- PNC Equipment Finance provides equipment financing solutions for clients throughout the U.S. and Canada. Average loans, including commercial loans and finance leases, and operating leases were $15.3 billion in the first six months of 2018, an increase of $1.5 billion in the year over year comparison due to strong new production and the impact of the acquired business.
- Commercial Banking provides lending, treasury management and capital markets-related products and services to smaller corporations and businesses. Average loans for this business were relatively unchanged.

The deposit strategy of Corporate & Institutional Banking is to remain disciplined on pricing and focused on growing and retaining relationship-based balances over time, executing on customer and segment-specific deposit growth strategies and continuing to provide funding and liquidity to PNC. Average total deposits increased in the comparison driven by growth in interest-bearing deposits reflecting, in part, a shift from noninterest-bearing deposits in the rising rate environment. We continue to monitor and balance the relationship between increases to rates paid and the overall profitability of our deposit balances.

Corporate & Institutional Banking is expanding its Corporate Banking business, focused on the middle market and larger sectors, into the Denver, Houston and Nashville markets in 2018. This follows offices opened in 2017 in Dallas, Kansas City and Minneapolis. These locations complement Corporate & Institutional Banking national businesses with a significant presence in these cities, and build on past successes in the markets where PNC's retail banking presence was limited, such as in the Southeast. We plan to offer our full suite of corporate and institutional products and services. We have also formalized plans to expand into the Boston and Phoenix markets in 2019.

Product Revenue

In addition to credit and deposit products for commercial customers, Corporate & Institutional Banking offers other services, including treasury management, capital markets-related products and services, and commercial mortgage banking activities, for customers of all business segments. On a consolidated basis, the revenue from these other services is included in net interest income, corporate service fees and other noninterest income. From a segment perspective, the majority of the revenue and expense related to these services is reflected in the Corporate & Institutional Banking segment results and the remainder is reflected in the results of other businesses. The Other Information section in Table 11 includes the consolidated revenue to PNC for these services. A discussion of the consolidated revenue from these services follows.

Treasury management revenue comprises fees from products and services and net interest income from customer deposit balances. Compared with the six months of 2017, treasury management revenue increased due to liquidity-related revenue associated with customer deposit balances, including interest rate spread expansion, and higher fee income.

Capital markets-related products and services include foreign exchange, derivatives, securities underwriting, loan syndications, mergers and acquisitions advisory and equity capital markets advisory related services. The increase in revenue in the comparison was broad based across most products and services and included higher merger and acquisition advisory, foreign exchange, derivative and securities underwriting fees, partially offset by lower revenue from credit valuations on customer-related derivative activities.

Commercial mortgage banking activities include revenue derived from commercial mortgage servicing (including net interest income and noninterest income) and revenue derived from commercial mortgage loans held for sale and related hedges. Total revenue from commercial mortgage banking activities decreased in the comparison due to a lower benefit from commercial mortgage servicing rights valuation, net of economic hedge.

Asset Management Group
(Unaudited)

Table 12: Asset Management Group Table

Six months ended June 30			Change	
Dollars in millions, except as noted	2018	2017	$	%
Income Statement				
Net interest income	$146	$144	$2	1 %
Noninterest income	448	435	13	3 %
Total revenue	594	579	15	3 %
Provision for credit losses (benefit)	—	(9)	9	*
Noninterest expense	441	432	9	2 %
Pretax earnings	153	156	(3)	(2)%
Income taxes	36	57	(21)	(37)%
Earnings	$117	$99	$18	18 %
Average Balance Sheet				
Loans				
Consumer	$4,741	$5,101	$(360)	(7)%
Commercial and commercial real estate	738	719	19	3 %
Residential mortgage	1,539	1,218	321	26 %
Total loans	$7,018	$7,038	$(20)	—
Total assets	$7,484	$7,517	$(33)	—
Deposits				
Noninterest-bearing demand	$1,462	$1,519	$(57)	(4)%
Interest-bearing demand	3,494	3,766	(272)	(7)%
Money market	2,454	3,358	(904)	(27)%
Savings	4,651	3,769	882	23 %
Other	345	239	106	44 %
Total deposits	$12,406	$12,651	$(245)	(2)%
Performance Ratios				
Return on average assets	3.15 %	2.66 %		
Noninterest income to total revenue	75 %	75 %		
Efficiency	74 %	75 %		
Supplemental Noninterest Income Information				
Asset management fees	$442	$428	$14	3 %
Other Information				
Nonperforming assets (a) (b)	$51	$49	$2	4 %
Net charge-offs	$7	$2	$5	250 %
Client Assets Under Administration (in billions) (a) (c)				
Discretionary client assets under management	$149	$141	$8	6 %
Nondiscretionary client assets under administration	130	125	5	4 %
Total	$279	$266	$13	5 %
Discretionary client assets under management				
Personal	$92	$89	$3	3 %
Institutional	57	52	5	10 %
Total	$149	$141	$8	6 %

* - Not meaningful
(a) As of June 30.
(b) Includes nonperforming loans of $50 million at June 30, 2018 and $45 million at June 30, 2017.

(c) Excludes brokerage account client assets.

Asset Management Group earned $117 million through the first six months of 2018 compared with earnings of $99 million through the first six months of 2017. Higher earnings reflected the lower statutory federal income tax rate and higher revenue, partially offset by higher noninterest expense and the impact of a benefit from the provision for credit losses in the prior year period.

Higher revenue in the comparison was driven by growth in asset management fees, reflecting stronger average equity markets.

Noninterest expense increased in the comparison and was primarily attributable to increases in legal reserves and continued investments in technology.

The reduction in the benefit from the provision for credit losses in the comparison reflected higher reserves on home equity loans.

Asset Management Group's discretionary client assets under management increased in the comparison to the prior year, primarily attributable to higher equity markets as of June 30, 2018.

The Asset Management Group strives to be the leading relationship-based provider of investment, planning, banking and fiduciary services to wealthy individuals and institutions by proactively delivering value-added ideas and solutions and exceptional service.

Wealth Management and Hawthorn have nearly 100 offices operating in seven out of the ten most affluent states in the U.S. with a majority co-located with retail banking branches. The businesses provide customized investments, wealth planning, trust and estate administration and private banking solutions to affluent individuals and ultra-affluent families.

Institutional Asset Management provides advisory, custody, and retirement administration services to institutional clients such as corporations, unions, municipalities, non-profits, foundations, and endowments. The business also offers PNC proprietary mutual funds and investment strategies. Institutional Asset Management is strengthening its partnership with Corporate & Institutional Banking to drive growth and is focused on building retirement capabilities and expanding product solutions for all customers.

BlackRock

(Unaudited)

We hold an equity investment in BlackRock, a leading publicly-traded investment management firm. Information related to our equity investment in BlackRock follows:

Table 13: BlackRock Table

Six months ended June 30 Dollars in millions	2018	2017
Business segment earnings (a)	$392	$289
PNC's economic interest in BlackRock (b)	22 %	22 %

(a) Includes our share of BlackRock's reported GAAP earnings net of income taxes on those earnings incurred by us.

(b) At June 30.

In billions	June 30 2018	December 31 2017
Carrying value of our investment in BlackRock (c)	$7.9	$7.7
Market value of our investment in BlackRock (d)	$17.4	$17.9

(c) We account for our investment in BlackRock under the equity method of accounting, exclusive of a related deferred tax liability of $1.6 billion at both June 30, 2018 and December 31, 2017. Our voting interest in BlackRock common stock was approximately 21% at June 30, 2018.

(d) Does not include liquidity discount.

Earnings for our BlackRock segment increased compared with the first six months of 2017, and included the impact of the lower statutory federal income tax rate.

In addition to our investment in BlackRock reflected in Table 13, at June 30, 2018, we held 143,458 shares of BlackRock Series C Preferred Stock valued at $57 million, which are available to fund our obligation in connection with certain BlackRock long-term incentive plan (LTIP) programs.

Our 2017 Form 10-K and our First Quarter 2018 Form 10-Q include additional information about our investment in BlackRock.

RISK MANAGEMENT

The Risk Management section included in Item 7 of our 2017 Form 10-K describes our enterprise risk management framework including risk culture, enterprise strategy, risk governance and framework, risk identification, risk assessment, risk controls and monitoring, and risk aggregation and reporting. Additionally, our 2017 Form 10-K provides an analysis of our key areas of risk, which include but are not limited to credit, liquidity and capital, market, operational and compliance. Our use of financial derivatives as part of our overall asset and liability risk management process is also addressed within the Risk Management section.

The following information updates our 2017 Form 10-K risk management disclosures.

Credit Risk Management

See the Credit Risk Management portion of the Risk Management section in our 2017 Form 10-K for additional discussion regarding credit risk.

Loan Portfolio Characteristics and Analysis

Table 14: Details of Loans
In billions
We use several asset quality indicators, as further detailed in Note 3 Asset Quality, to monitor and measure our exposure to credit risk within our loan portfolio. The following provides additional information about our significant loan classes.

Commercial
Commercial loans comprised 51% and 50% of our total loan portfolio at June 30, 2018 and December 31, 2017, respectively. Most of our commercial loans are secured by collateral that provides a secondary source of repayment for the loan should the borrower experience cash generation difficulties. Examples of this collateral include short-term assets, such as accounts receivable, inventory and securities, and long-lived assets, such as equipment, real estate and other business assets.

We actively manage our commercial loans to assess any changes (both positive and negative) in the level of credit risk at both the borrower and portfolio level. To evaluate the level of credit risk, we assign an internal risk rating reflecting the borrower’s probability of default (PD) and loss given default (LGD). This two-dimensional credit risk rating methodology provides granularity in the risk monitoring process and is updated on an ongoing basis through our credit risk management processes. In addition to continual monitoring of the level of credit risk, we also monitor concentrations of credit risk pertaining to both specific industries and geography that may exist in our portfolio. Our portfolio remains stable and well-diversified as shown in the following table which provides a breakout of our commercial loans by industry classification (classified based on the North American Industry Classification System (NAICS)).

Table 15: Commercial Loans by Industry

	June 30, 2018		December 31, 2017	
Dollars in millions	Amount	% of Total	Amount	% of Total
Commercial				
Manufacturing	$21,667	19 %	$20,578	19 %
Retail/wholesale trade	19,299	17	17,846	16
Service providers	14,343	13	15,100	14
Real estate related (a)	12,688	11	12,496	11
Health care	9,564	8	9,739	9
Financial services	9,241	8	8,532	8
Transportation and warehousing	5,531	5	5,609	5
Other industries	21,034	19	20,627	18
Total commercial loans	$113,367	100%	$110,527	100%

(a) Includes loans to customers in the real estate and construction industries.

Commercial Real Estate

Commercial real estate loans comprised $14.9 billion of real estate project loans and $14.0 billion related to commercial mortgages as of June 30, 2018. Comparable amounts were $15.3 billion and $13.7 billion, respectively, as of December 31, 2017. Commercial real estate loan growth remains challenged as market pricing and structure is, at times, outside of our risk tolerance, and payoffs and maturities continue at a steady pace.

We monitor credit risk associated with our commercial real estate projects and commercial mortgages similar to commercial loans by analyzing PD and LGD. Additionally, risks associated with types of credit activities tend to be correlated to the loan structure, collateral location, project progress and business environment. These attributes are also monitored and utilized in assessing credit risk. The portfolio is geographically diverse due to the nature of our business involving clients throughout the U.S. The following table presents our commercial real estate loans by geographic market.

Table 16: Commercial Real Estate Loans by Geography

	June 30, 2018		December 31, 2017	
Dollars in millions	Amount	% of Total	Amount	% of Total
Geography				
California	$4,194	14 %	$4,192	14 %
Florida	2,240	8	2,221	8
Maryland	2,128	7	2,104	7
Virginia	1,641	6	1,609	5
Texas	1,593	5	1,639	6
Illinois	1,405	5	1,325	5
Pennsylvania	1,339	5	1,394	5
New York	1,171	4	1,163	4
Ohio	1,104	4	1,134	4
New Jersey	936	3	964	3
All other states	11,195	39	11,233	39
Total commercial real estate loans	$28,946	100%	$28,978	100%

Home Equity

Home equity loans comprised $16.1 billion of primarily variable-rate home equity lines of credit and $11.1 billion of closed-end home equity installment loans at June 30, 2018. Comparable amounts were $16.8 billion and $11.6 billion, respectively, as of December 31, 2017.

We track borrower performance monthly, including obtaining original loan-to-value ratios (LTV), updated FICO scores at least quarterly, updated LTVs at least semi-annually, and other credit metrics at least quarterly, including the historical performance of any related mortgage loans regardless of lien position that we do or do not hold. This information is used for internal reporting and risk management. For internal reporting and risk management we also segment the population into pools based on product type (e.g., home equity loans, brokered home equity loans, home equity lines of credit, brokered home equity lines of credit). As part of our overall risk analysis and monitoring, we also segment the portfolio based upon the loan delinquency, nonperforming status, modification and bankruptcy status, FICO scores, LTV, lien position and geographic concentration.

The portfolio is primarily originated within our primary geographic markets, with only 5% of the portfolio in states outside of those markets at both June 30, 2018 and December 31, 2017. The credit quality of newly originated loans over the last twelve months was strong overall as evidenced by a weighted-average LTV on originations of 67% and a weighted-average FICO score of 775.

The credit performance of the majority of the home equity portfolio where we hold the first lien position is superior to the portion of the portfolio where we hold the second lien position, but do not hold the first lien. Lien position information is generally based upon original LTV at the time of origination. We use a third-party service provider to obtain updated loan, lien and collateral data that is aggregated from public and private sources.

The following table presents our home equity loans by geographic market and lien type.

Table 17: Home Equity Loans by Geography and by Lien Priority

	June 30, 2018		December 31, 2017	
Dollars in millions	Amount	% of Total	Amount	% of Total
Geography				
Pennsylvania	$6,465	24 %	$6,792	24 %
New Jersey	4,114	15	4,252	15
Ohio	3,244	12	3,413	12
Illinois	1,723	6	1,801	6
Maryland	1,526	6	1,572	6
Michigan	1,395	5	1,442	5
Florida	1,235	5	1,255	4
North Carolina	1,214	4	1,266	5
Kentucky	1,088	4	1,138	4
Indiana	879	3	924	3
All other states	4,336	16	4,509	16
Total home equity loans	$27,219	100%	$28,364	100%
Lien type				
1st lien		58 %		58 %
2nd lien		42		42
Total		100%		100%

Residential Real Estate

Residential real estate loans primarily consisted of residential mortgage loans at both June 30, 2018 and December 31, 2017.

We track borrower performance of this portfolio monthly similar to home equity loans. This information is used for internal reporting and risk management. For internal reporting and risk management we also segment the mortgage portfolio into pools based on product type (e.g., Federal Housing Administration (FHA), conforming, etc.). As part of our overall risk analysis and monitoring, we also segment the portfolio based upon loan delinquency, nonperforming status, modification and bankruptcy status, FICO scores, LTV and geographic concentrations. Loan performance is evaluated by source originators and loan servicers.

The credit quality of newly originated loans that we retained on our balance sheet over the last twelve months was strong overall as evidenced by a weighted-average LTV on originations of 71% and a weighted-average FICO score of 769.

The following table presents our residential real estate loans by geographic market.

Table 18: Residential Real Estate Loans by Geography

	June 30, 2018		December 31, 2017	
Dollars in millions	Amount	% of Total	Amount	% of Total
Geography				
California	$4,110	23 %	$3,676	21 %
New Jersey	1,568	9	1,503	9
Florida	1,544	9	1,529	9
Illinois	1,190	6	1,230	7
Pennsylvania	976	5	962	5
New York	894	5	847	5
Maryland	888	5	902	5
North Carolina	840	5	821	5
Virginia	826	5	824	5
Ohio	671	4	684	4
All other states	4,298	24	4,234	25
Total residential real estate loans	$17,805	100%	$17,212	100%

We originate residential mortgage loans nationwide through our national mortgage business as well as within our branch network. Residential mortgage loans underwritten to government agency standards, including conforming loan amount limits, are typically sold with servicing retained by us. We also originate nonconforming residential mortgage loans that do not meet government agency standards, which we retain on our balance sheet. Growth in residential mortgage loans in the first six months of 2018 was primarily due to nonconforming loans that exceeded agency conforming loan limits. The nonconforming residential mortgage portfolio had strong credit quality at June 30, 2018 with an average original LTV of 70% and an average original FICO score of 772. Our portfolio of nonconforming residential mortgage loans totaled $11.5 billion at June 30, 2018, with 28% located in California.

Automobile

Within auto loans, $12.4 billion resided in the indirect auto portfolio while $1.5 billion were in the direct auto portfolio as of June 30, 2018. Comparable amounts as of December 31, 2017 were $11.4 billion and $1.4 billion, respectively, and also included $.1 billion of securitized loans. The indirect auto portfolio relates to loan applications generated from franchised automobile dealers. This business is strategically aligned with our core retail business.

We continue to focus on borrowers with strong credit profiles as evidenced by a weighted-average loan origination FICO score over the last twelve months of 740 for indirect auto loans and 764 for direct auto loans. The weighted-average term of loan originations over the last twelve months was 73 months for indirect auto loans and 62 months for direct auto loans. We offer both new and used automobile financing to customers through our various channels. At June 30, 2018, the portfolio was composed of 53% new vehicle loans and 47% used vehicle loans. Comparable amounts at December 31, 2017 were 54% and 46%, respectively.

The auto loan portfolio's performance is measured monthly, including updated collateral values that are obtained monthly and updated FICO scores that are obtained at least quarterly. For internal reporting and risk management, we analyze the portfolio by product channel and product type and regularly evaluate default and delinquency experience. As part of our overall risk analysis and monitoring, we segment the portfolio by loan structure, collateral attributes and credit metrics which include FICO score, LTV and term.

Nonperforming Assets and Loan Delinquencies

Nonperforming Assets

Nonperforming assets include nonperforming loans and leases for which ultimate collectability of the full amount of contractual principal and interest is not probable and include nonperforming troubled debt restructurings (TDRs), other real estate owned (OREO), foreclosed and other assets. Loans held for sale, certain government insured or guaranteed loans, purchased impaired loans and loans accounted for under the fair value option are excluded from nonperforming loans. Additional information regarding our nonperforming loans and nonaccrual policies is included in Note 1 Accounting Policies in the Notes To Consolidated Financial Statements in our 2017 Form 10-K. A summary of the major categories of nonperforming assets are presented in Table 19. See Note 3 Asset Quality in the Notes To Consolidated Financial Statements in this Report for further detail of nonperforming asset categories.

Table 19: Nonperforming Assets by Type

Dollars in millions	June 30, 2018	December 31, 2017	Change $	Change %
Nonperforming loans				
Commercial lending	$414	$554	$(140)	(25)%
Consumer lending (a)	1,305	1,311	(6)	—
Total nonperforming loans	1,719	1,865	(146)	(8)%
OREO, foreclosed and other assets	135	170	(35)	(21)%
Total nonperforming assets	$1,854	$2,035	$(181)	(9)%
Amount of TDRs included in nonperforming loans	$863	$964	$(101)	(10)%
Percentage of total nonperforming loans	50%	52%		
Nonperforming loans to total loans	.77%	.85%		
Nonperforming assets to total loans, OREO, foreclosed and other assets	.83%	.92%		
Nonperforming assets to total assets	.49%	.53%		
Allowance for loan and lease losses to total nonperforming loans	150%	140%		

(a) Excludes most consumer loans and lines of credit not secured by residential real estate, which are charged off after 120 to 180 days past due and are not placed on nonperforming status.

Table 20: Change in Nonperforming Assets

In millions	2018	2017
January 1	$2,035	$2,374
New nonperforming assets	525	766
Charge-offs and valuation adjustments	(282)	(302)
Principal activity, including paydowns and payoffs	(280)	(389)
Asset sales and transfers to loans held for sale	(63)	(100)
Returned to performing status	(81)	(196)
June 30	$1,854	$2,153

As of June 30, 2018, approximately 88% of total nonperforming loans were secured by collateral which lessened reserve requirements and is expected to reduce credit losses in the event of default. As of June 30, 2018, commercial lending nonperforming loans were carried at approximately 66% of their unpaid principal balance, due to charge-offs recorded to date, before consideration of the Allowance for loan and lease losses (ALLL).

Within consumer nonperforming loans, residential real estate TDRs comprise 75% of total residential real estate nonperforming loans at both June 30, 2018 and December 31, 2017. Home equity TDRs comprise 48% of home equity nonperforming loans at June 30, 2018, down from 50% at December 31, 2017. TDRs generally remain in nonperforming status until a borrower has made at least six consecutive months of both principal and interest payments under the modified terms or ultimate resolution occurs. Loans where borrowers have been discharged from personal liability through Chapter 7 bankruptcy and have not formally reaffirmed their loan obligations to us and loans to borrowers not currently obligated to make both principal and interest payments under the restructured terms are not returned to accrual status.

At June 30, 2018, our largest nonperforming asset was $38 million in the Wholesale Trade industry and the ten largest individual nonperforming assets represented 11% of total nonperforming assets.

Loan Delinquencies

We regularly monitor the level of loan delinquencies and believe these levels may be a key indicator of loan portfolio asset quality. Measurement of delinquency status is based on the contractual terms of each loan. Loans that are 30

days or more past due in terms of payment are considered delinquent. Loan delinquencies exclude loans held for sale and purchased impaired loans, but include government insured or guaranteed loans and loans accounted for under the fair value option.

Table 21: Accruing Loans Past Due (a)

Dollars in millions	Amount June 30 2018	Amount December 31 2017	Change $	Change %	Percentage of Total Loans Outstanding June 30 2018	Percentage of Total Loans Outstanding December 31 2017
Early stage loan delinquencies						
Accruing loans past due 30 to 59 days	$519	$ 545	$(26)	(5)%	.23 %	.25 %
Accruing loans past due 60 to 89 days	256	238	18	8 %	.11 %	.11 %
Total	775	783	(8)	(1)%	.35 %	.36 %
Late stage loan delinquencies						
Accruing loans past due 90 days or more	586	737	(151)	(20)%	.26 %	.33 %
Total	$1,361	$ 1,520	$(159)	(10)%	.61 %	.69 %

(a) Past due loan amounts include government insured or guaranteed loans of $.7 billion at June 30, 2018 and $.9 billion at December 31, 2017.

Accruing loans past due 90 days or more decreased at June 30, 2018 compared to December 31, 2017 primarily driven by a decline in government insured residential real estate and government insured education loans within other consumer loans. Accruing loans past due 90 days or more are not included in nonperforming loans and continue to accrue interest because they are well secured by collateral and are in the process of collection, or are managed in homogeneous portfolios with specified charge-off timeframes adhering to regulatory guidelines, or are certain government insured or guaranteed loans.

Loan Modifications and Troubled Debt Restructurings

Consumer Loan Modifications

We modify loans under government and PNC-developed programs based upon our commitment to help eligible homeowners and borrowers avoid foreclosure, where appropriate. Initially, a borrower is evaluated for a modification under a government program. If a borrower does not qualify under a government program, the borrower is then evaluated under a PNC program. Our programs utilize both temporary and permanent modifications and typically reduce the interest rate, extend the term and/or defer principal. Loans that are either temporarily or permanently modified under programs involving a change to loan terms are generally classified as TDRs. Further, loans that have certain types of payment plans and trial payment arrangements which do not include a contractual change to loan terms may be classified as TDRs.

A temporary modification, with a term up to 24 months, involves a change in original loan terms for a period of time and reverts to a calculated exit rate for the remaining term of the loan as of a specific date. A permanent modification, with a term greater than 24 months, is a modification in which the terms of the original loan are changed. Permanent modification programs generally result in principal forgiveness, interest rate reduction, term extension, capitalization of past due amounts, interest-only period or deferral of principal.

We also monitor the success rates and delinquency status of our loan modification programs to assess their effectiveness in serving our borrowers' and servicing customers' needs while mitigating credit losses. Table 22 provides the number of accounts and unpaid principal balance of modified consumer real estate related loans as of each date presented.

Table 22: Consumer Real Estate Related Loan Modifications

Dollars in millions	June 30, 2018 Number of Accounts	June 30, 2018 Unpaid Principal	December 31, 2017 Number of Accounts	December 31, 2017 Unpaid Principal

		Balance		Balance
Temporary modifications	2,783	$ 192	3,033	$ 217
Permanent modifications	22,255	2,453	23,270	2,581
Total consumer real estate related loan modifications	25,038	$ 2,645	26,303	$ 2,798

Commercial Loan Modifications

Modifications of terms for commercial loans are based on individual facts and circumstances. Commercial loan modifications may involve reduction of the interest rate, extension of the loan term and/or forgiveness of principal. Modified commercial loans are usually already nonperforming prior to modification. We evaluate these modifications for TDR classification based upon whether we granted a concession to a borrower experiencing financial difficulties.

Troubled Debt Restructurings

A TDR is a loan whose terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulties. TDRs result from our loss mitigation activities and include rate reductions, principal forgiveness, postponement/reduction of scheduled amortization and extensions, which are intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Additionally, TDRs also result from court imposed concessions (e.g., a Chapter 7 bankruptcy where the debtor is discharged from personal liability to us and a court approved Chapter 13 bankruptcy repayment plan).

Table 23: Summary of Troubled Debt Restructurings (a)

Dollars in millions	June 30 2018	December 31 2017	Change $	Change %
Total commercial lending	$324	$ 409	$(85)	(21)%
Total consumer lending	1,544	1,652	(108)	(7)%
Total TDRs	$1,868	$ 2,061	$(193)	(9)%
Nonperforming	$863	$ 964	$(101)	(10)%
Accruing (b)	1,005	1,097	(92)	(8)%
Total TDRs	$1,868	$ 2,061	$(193)	(9)%

(a) Amounts in table represent recorded investment, which includes the unpaid principal balance plus net accounting adjustments, less any charge-offs. Recorded investment does not include any associated valuation allowance.

(b) Accruing loans include consumer credit card loans and loans that have demonstrated a period of at least six months of performance under the restructured terms and are excluded from nonperforming loans.

Excluded from TDRs are $1.1 billion and $1.2 billion of consumer loans held for sale, loans accounted for under the fair value option and pooled purchased impaired loans, as well as certain government insured or guaranteed loans at June 30, 2018 and December 31, 2017, respectively. Nonperforming TDRs represented approximately 50% and 52% of total nonperforming loans at June 30, 2018 and December 31, 2017, respectively, and 46% and 47% of total TDRs at June 30, 2018 and December 31, 2017, respectively. The remaining portion of TDRs represents TDRs that have been returned to accrual accounting after performing under the restructured terms for at least six consecutive months.

Allowances for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit

We maintain an ALLL to absorb losses from the loan and lease portfolio and determine this allowance based on quarterly assessments of the estimated probable credit losses incurred in the loan and lease portfolio. Our total ALLL of $2.6 billion at June 30, 2018 consisted of $1.6 billion and $1.0 billion established for the commercial lending and consumer lending categories, respectively. We maintain the ALLL at a level that we believe to be appropriate to absorb estimated probable credit losses incurred in the loan and lease portfolio as of the balance sheet date. The reserve calculation and determination process is dependent on the use of key assumptions. Key reserve assumptions and estimation processes react to and are influenced by observed changes in loan and lease portfolio performance experience, the financial strength of the borrower, and economic conditions. Key reserve assumptions and estimation processes are periodically updated.

Allowances are established for non-impaired commercial loan classes based primarily on PD and LGD.

Our commercial pool reserve methodology is sensitive to changes in key risk parameters such as PD and LGD. The results of these parameters are then applied to the loan balance and unfunded loan commitments and letters of credit to determine the amount of the respective reserves. The majority of the commercial portfolio is secured by collateral, including loans to asset-based lending customers, which generally demonstrate lower LGD compared to loans not secured by collateral. Our PDs and LGDs are primarily determined using internal commercial loan loss data. This internal data is supplemented with third-party data and management judgment, as deemed necessary. We continue to evaluate and enhance our use of internal commercial loss data and will periodically update our PDs and LGDs as well

as consider third-party data, regulatory guidance and management judgment.
Allowances for non-impaired consumer loan classes are primarily based upon transition matrices, including using a roll-rate model. The roll-rate model uses statistical relationships, calculated from historical data that estimate the movement of loan outstandings through the various stages of delinquency and ultimately charge-off.

We establish specific allowances for loans considered impaired using methods prescribed by GAAP. All impaired loans are subject to individual analysis, except leases and large groups of smaller-balance homogeneous loans which may include, but are not limited to, credit card, residential real estate secured and consumer installment loans. Specific allowances for individual loans (including commercial and consumer TDRs) are determined based on an analysis of the present value of expected future cash flows from the loans discounted at their effective interest rate, observable market price or the fair value of the underlying collateral.

A portion of the ALLL is related to qualitative measurement factors. These factors may include, but are not limited to, the following:

- Industry concentrations and conditions,
- Recent credit quality trends,
- Recent loss experience in particular portfolios,
- Recent macro-economic factors,
- Model imprecision,
- Changes in lending policies and procedures,
- Timing of available information, including the performance of first lien positions, and
- Limitations of available historical data.

Purchased impaired loans are initially recorded at fair value and applicable accounting guidance prohibits the carryover or creation of valuation allowances at acquisition. Because the initial fair values of these loans already reflect a credit component, additional reserves are established when performance is expected to be worse than our expectations as of the acquisition date. At June 30, 2018, we had established reserves of $.3 billion for purchased impaired loans. In addition, loans (purchased impaired and non-impaired) acquired after January 1, 2009 were recorded at fair value. No allowance for loan losses was carried over and no allowance was created at the date of acquisition.

In addition to the ALLL, we maintain an allowance for unfunded loan commitments and letters of credit. We report this allowance as a liability on our Consolidated Balance Sheet. We maintain the allowance for unfunded loan commitments and letters of credit at a level we believe is appropriate to absorb estimated probable losses on these unfunded credit facilities. We determine this amount using estimates of the probability of the ultimate funding and losses related to those credit exposures. Other than the estimation of the probability of funding, this methodology is very similar to the one we use for determining our ALLL.

See Note 1 Accounting Policies in our 2017 Form 10-K and Note 3 Asset Quality in the Notes To Consolidated Financial Statements in this Report for further information on certain key asset quality indicators that we use to evaluate our portfolios and establish the allowances.

Table 24: Allowance for Loan and Lease Losses

Dollars in millions	2018		2017	
January 1	$2,611		$2,589	
Total net charge-offs	(222	)	(228	)
Provision for credit losses	172		186	
Net decrease / (increase) in allowance for unfunded loan commitments and letters of credit	8		(3	)
Other	12		17	
June 30	$2,581		$2,561	
Net charge-offs to average loans (for the six months ended) (annualized)	.20	%	.21	%
Total allowance for loan and lease losses to total loans	1.16	%	1.17	%
Commercial lending net charge-offs	$(13	)	$(45	)
Consumer lending net charge-offs	(209	)	(183	)
Total net charge-offs	$(222	)	$(228	)
Net charge-offs to average loans (for the six months ended) (annualized)				
Commercial lending	.02	%	.06	%
Consumer lending	.58	%	.51	%

At June 30, 2018, total ALLL to total nonperforming loans was 150%. The comparable amount for December 31, 2017 was 140%. These ratios are 109% and 102% when excluding the $.7 billion of ALLL at both June 30, 2018 and

December 31, 2017 allocated to consumer loans and lines of credit not secured by residential real estate and purchased impaired loans. We have excluded these amounts from ALLL in these ratios as these asset classes are not included in nonperforming loans. See Table 19 within this Credit Risk Management section for additional information.

The ALLL balance increases or decreases across periods in relation to fluctuating risk factors, including asset quality trends, net charge-offs and changes in aggregate portfolio balances. During the first six months of 2018, overall credit quality remained strong, which resulted in an essentially flat ALLL balance as of June 30, 2018 compared to December 31, 2017.

The following table summarizes our loan charge-offs and recoveries.

Table 25: Loan Charge-Offs and Recoveries

Six months ended June 30 Dollars in millions	Gross Charge-offs	Recoveries	Net Charge-offs / (Recoveries)	Percent of Average Loans (Annualized)
2018				
Commercial	$ 52	$ 32	$ 20	.04 %
Commercial real estate	8	14	(6)	(.04)%
Equipment lease financing	4	5	(1)	(.03)%
Home equity	61	44	17	.12 %
Residential real estate	6	10	(4)	(.05)%
Credit card	109	12	97	3.44 %
Other consumer				
Automobile	77	35	42	.63 %
Education	17	4	13	.61 %
Other	52	8	44	2.02 %
Total	$ 386	$ 164	$ 222	.20 %
2017				
Commercial	$ 101	$ 44	$ 57	.11 %
Commercial real estate	3	15	(12)	(.08)%
Equipment lease financing	2	2		
Home equity	72	43	29	.20 %
Residential real estate	4	8	(4)	(.05)%
Credit card	92	11	81	3.18 %
Other consumer				
Automobile	58	28	30	.49 %
Education	16	4	12	.48 %
Other	44	9	35	1.58 %
Total	$ 392	$ 164	$ 228	.21 %

See Note 1 Accounting Policies in our 2017 Form 10-K and Note 4 Allowance for Loan and Lease Losses in the Notes To Consolidated Financial Statements in this Report for additional information on the ALLL.

Liquidity and Capital Management

Liquidity risk, including our liquidity monitoring measures and tools, is described in further detail in the Liquidity and Capital Management section of our 2017 Form 10-K.

One of the ways we monitor our liquidity is by reference to the Liquidity Coverage Ratio (LCR), a regulatory minimum liquidity requirement designed to ensure that covered banking organizations maintain an adequate level of liquidity to meet net liquidity needs over the course of a hypothetical 30-day stress scenario. The LCR is calculated by dividing the amount of an institution's high quality, unencumbered liquid assets (HQLA), as defined and calculated in accordance with the LCR rules, by its estimated net cash outflows, with net cash outflows determined by applying the assumed outflow factors in the LCR rules. The resulting quotient is expressed as a percentage. The minimum LCR that PNC and PNC Bank are required to maintain is 100% in 2018. PNC and PNC Bank calculate the LCR daily, and as of June 30, 2018, the LCR for PNC and PNC Bank exceeded the requirement of 100%.

We provide additional information regarding regulatory liquidity requirements and their potential impact on us in the Supervision and Regulation section of Item 1 Business and Item 1A Risk Factors of our 2017 Form 10-K.

Sources of Liquidity

Our largest source of liquidity on a consolidated basis is the customer deposit base generated by our banking businesses. These deposits provide relatively stable and low-cost funding. Total deposits decreased slightly to $264.9 billion at June 30, 2018 from $265.1 billion at December 31, 2017 as growth in interest-bearing deposits was more than offset by a decrease in noninterest-bearing deposits. See the Funding Sources portion of the Consolidated Balance Sheet Review section of this Financial Review for additional information related to our deposits. Additionally, certain assets determined by us to be liquid as well as unused borrowing capacity from a number of sources are also available to manage our liquidity position.

At June 30, 2018, our liquid assets consisted of short-term investments (Federal funds sold, resale agreements, trading securities and interest-earning deposits with banks) totaling $26.1 billion and securities available for sale totaling $60.3 billion. The level of liquid assets fluctuates over time based on many factors, including market conditions, loan and deposit growth and balance sheet management activities. Our liquid assets included $3.2 billion of securities available for sale and trading securities pledged as collateral to secure public and trust deposits, repurchase agreements and for other purposes. In addition, $4.8 billion of securities held to maturity were also pledged as collateral for these purposes.

We also obtain liquidity through various forms of funding, including long-term debt (senior notes, subordinated debt and FHLB borrowings) and short-term borrowings (securities sold under repurchase agreements, commercial paper and other short-term borrowings). See Note 10 Borrowed Funds in our 2017 Form 10-K and the Funding Sources section of the Consolidated Balance Sheet Review for additional information related to our borrowings.
Total senior and subordinated debt, on a consolidated basis, decreased due to the following activity:

Table 26: Senior and Subordinated Debt

In billions	2018
January 1	$33.3
Issuances	2.7
Calls and maturities	(3.2)
Other	(.4)
June 30	$32.4

Bank Liquidity

Under PNC Bank’s 2014 bank note program, as amended, PNC Bank may from time to time offer up to $40.0 billion aggregate principal amount outstanding at any one time of its unsecured senior and subordinated notes with maturity dates more than nine months (in the case of senior notes) and five years or more (in the case of subordinated notes) from their date of issue. At June 30, 2018, PNC Bank had $26.2 billion of notes outstanding under this program of which $23.0 billion were senior bank notes and $3.2 billion were subordinated bank notes.

The following table details issuances for the three months ended June 30, 2018.

Table 27: PNC Bank Notes Issued

Issuance Date	Amount	Description of Issuance
June 8, 2018	$750 million	Senior notes with a maturity date of June 8, 2023. Interest is payable semi-annually at a fixed rate of 3.50% per annum on June 8 and December 8 of each year, beginning December 8, 2018.

See Note 16 Subsequent Events for information on the July 2018 issuance of $750 million of subordinated notes by PNC Bank.

PNC Bank maintains additional secured borrowing capacity with the FHLB-Pittsburgh and through the Federal Reserve Bank discount window. The Federal Reserve Bank, however, is not viewed as a primary means of funding our routine business activities, but rather as a potential source of liquidity in a stressed environment or during a market disruption. At June 30, 2018, our unused secured borrowing capacity at the FHLB-Pittsburgh and the Federal Reserve Bank totaled $41.2 billion.

PNC Bank has the ability to offer up to $10.0 billion of its commercial paper to provide additional liquidity. As of June 30, 2018, there were no issuances outstanding under this program.

Parent Company Liquidity

In addition to managing liquidity risk at the bank level, we monitor the parent company's liquidity. The parent company's contractual obligations consist primarily of debt service related to parent company borrowings and funding non-bank affiliates. Additionally, the parent company maintains adequate liquidity to fund discretionary activities such as paying dividends to our shareholders, share repurchases and acquisitions.

As of June 30, 2018, available parent company liquidity totaled $5.5 billion. Parent company liquidity is primarily held in intercompany short-term investments, the terms of which provide for the availability of cash in 31 days or less. Investments with longer durations may also be acquired, but if so, the related maturities are aligned with scheduled cash needs, such as the maturity of parent company debt obligations.

The principal source of parent company liquidity is the dividends it receives from PNC Bank, which may be impacted by the following:

- Bank-level capital needs,
- Laws and regulations,
- Corporate policies,
- Contractual restrictions, and
- Other factors.

There are statutory and regulatory limitations on the ability of a national bank to pay dividends or make other capital distributions or to extend credit to the parent company or its non-bank subsidiaries. The amount available for dividend payments by PNC Bank to the parent company without prior regulatory approval was approximately $1.8 billion at June 30, 2018. See Note 18 Regulatory Matters in the Notes To Consolidated Financial Statements in our 2017 Form 10-K for a further discussion of these limitations.

In addition to dividends from PNC Bank, other sources of parent company liquidity include cash and investments, as well as dividends and loan repayments from other subsidiaries and dividends or distributions from equity investments. We can also generate liquidity for the parent company and PNC's non-bank subsidiaries through the issuance of debt and equity securities, including certain capital instruments, in public or private markets and commercial paper. The parent company has the ability to offer up to $5.0 billion of commercial paper to provide additional liquidity. As of June 30, 2018, there were no commercial paper issuances outstanding.

The parent company has an effective shelf registration statement pursuant to which we can issue additional debt, equity and other capital instruments.

Parent company senior and subordinated debt outstanding totaled $6.7 billion and $6.8 billion at June 30, 2018 and December 31, 2017, respectively.

Contractual Obligations and Commitments

We have contractual obligations representing required future payments on borrowed funds, time deposits, leases, pension and postretirement benefits and purchase obligations. See the Liquidity and Capital Management portion of the Risk Management section in our 2017 Form 10-K for more information on these future cash outflows. Additionally, in the normal course of business we have various commitments outstanding, certain of which are not included on our Consolidated Balance Sheet. We provide information on our commitments in Note 13 Commitments in the Notes To Consolidated Financial Statements of this Report.

Credit Ratings

PNC's credit ratings affect the cost and availability of short and long-term funding, collateral requirements for certain derivative instruments and the ability to offer certain products.

In general, rating agencies base their ratings on many quantitative and qualitative factors, including capital adequacy, liquidity, asset quality, business mix, level and quality of earnings, and the current legislative and regulatory environment, including implied government support. A decrease, or potential decrease, in credit ratings could impact access to the capital markets and/or increase the cost of debt, and thereby adversely affect liquidity and financial condition.

Table 28: Credit Ratings for PNC and PNC Bank

	June 30, 2018		
	Moody's	Standard & Poor's	Fitch
PNC			
Senior debt	A3	A-	A+

Subordinated debt	A3	BBB+	A
Preferred stock	Baa2	BBB-	BBB-
PNC Bank			
Senior debt	A2	A	A+
Subordinated debt	A3	A-	A
Long-term deposits	Aa2	A	AA-
Short-term deposits	P-1	A-1	F1+
Short-term notes	P-1	A-1	F1

Capital Management

Detailed information on our capital management processes and activities, including additional information on our previous CCAR submissions and capital plans, is included in the Capital Management portion of the Risk Management section in our 2017 Form 10-K.

We manage our funding and capital positions by making adjustments to our balance sheet size and composition, issuing or redeeming debt, issuing equity or other capital instruments, executing treasury stock transactions and capital redemptions or repurchases, and managing dividend policies and retaining earnings.

In the second quarter of 2018, we repurchased 5.7 million common shares for $.8 billion. We completed common stock repurchase programs of $2.4 billion, and repurchased shares for $.2 billion related to employee benefit plans, for the four quarter period ending June 30, 2018. We returned a total of $4.1 billion of capital to shareholders through repurchases of 18.4 million shares for $2.6 billion and dividends on common shares of $1.5 billion over the four quarter period, consistent with the capital plan accepted by the Federal Reserve as part of our 2017 CCAR submission.

In connection with the 2018 CCAR process, we submitted our capital plan, as approved by PNC's Board of Directors, to the Federal Reserve in April 2018. The Federal Reserve accepted the capital plan and did not object to our proposed capital actions. As provided in the 2018 capital plan, we announced new share repurchase programs of up to $2.0 billion for the four quarter period beginning in the third quarter of 2018, including repurchases of up to $.3 billion related to employee benefit plans.

We paid dividends on common stock of $.4 billion, or 75 cents per common share, during the second quarter of 2018. On July 5, 2018, the PNC Board of Directors raised the quarterly common stock cash dividend to 95 cents per share, an increase of 20 cents, or 27%, with a payment date of August 5, 2018.

See Note 16 Subsequent Events for information on the July 2018 issuance of $750 million of subordinated notes by PNC Bank.

Table 29: Basel III Capital

Dollars in millions	Basel III June 30, 2018 (a) (b)	Fully Phased-In Basel III (Non-GAAP) December 31, 2017 (c)	2017 Transitional Basel III December 31, 2017 (a)
Common equity Tier 1 capital			
Common stock plus related surplus, net of treasury stock	$6,656	$8,195	$8,195
Retained earnings	37,201	35,481	35,481
Accumulated other comprehensive income (loss) for securities currently and those transferred from available for sale	(268)	337	270
Accumulated other comprehensive income (loss) for pension and other postretirement plans	(489)	(544)	(436)
Goodwill, net of associated deferred tax liabilities	(9,026)	(8,988)	(8,988)
Other disallowed intangibles, net of deferred tax liabilities	(293)	(319)	(255)
Other adjustments/(deductions)	(167)	(141)	(138)
Total common equity Tier 1 capital before threshold deductions	33,614	34,021	34,129
Total threshold deductions (d)	(3,408)	(2,928)	(1,983)
Common equity Tier 1 capital	30,206	31,093	32,146
Additional Tier 1 capital			
Preferred stock plus related surplus	3,987	3,985	3,985
Other adjustments/(deductions)	(150)	(146)	(124)
Tier 1 capital	34,043	34,932	36,007
Additional Tier 2 capital			
Qualifying subordinated debt	3,205	3,433	3,482
Trust preferred capital securities	80		100
Eligible credit reserves includable in Tier 2 capital	2,870	2,907	2,907
Total Basel III capital	$40,198	$41,272	$42,496
Risk-weighted assets			
Basel III standardized approach risk-weighted assets (e)	$319,112	$316,120	$309,460
Basel III advanced approaches risk-weighted assets (f)	$280,883	$285,226	N/A
Average quarterly adjusted total assets	$363,573	$363,967	$364,999
Supplementary leverage exposure (g)	$434,135	$434,698	$435,731
Basel III risk-based capital and leverage ratios			
Common equity Tier 1 (i)	9.5 %	9.8 % (h)	10.4 %
Tier 1 (j)	10.7 %	11.1 % (h)	11.6 %
Total (k) (l) (m)	12.6 %	13.1 % (h)	13.7 %
Leverage (n)	9.4 %	9.6 %	9.9 %
Supplementary leverage ratio (o)	7.8 %	8.0 %	8.3 %

(a) All ratios are calculated using the regulatory capital methodology applicable to PNC during each period presented and calculated based on the standardized approach.

(b) The Basel III Common equity Tier 1 capital, Tier 1 risk-based capital, Leverage and Supplementary ratios as of June 30, 2018 reflect the full phase-in of all Basel III adjustments to these metrics applicable to PNC.

(c) 2017 Fully Phased-In Basel III results are presented as Pro forma estimates.

(d) Under the Basel III rules, certain items such as significant common stock investments in unconsolidated financial institutions (primarily BlackRock), mortgage servicing rights and deferred tax assets must be deducted from capital (subject to a phase-in schedule that ended December 31, 2017 and net of associated deferred tax liabilities) to the

extent they individually exceed 10%, or in the aggregate exceed 15%, of PNC's adjusted common equity Tier 1 capital.

(e) Includes credit and market risk-weighted assets.

(f) Basel III advanced approaches risk-weighted assets are calculated based on the Basel III advanced approaches rules, and include credit, market, and operational risk-weighted assets. During the parallel run qualification phase, PNC has refined the data, models, and internal processes used as part of the advanced approaches for determining risk-weighted assets. We anticipate additional refinements to this calculation through the parallel run qualification phase.

(g) Supplementary leverage exposure is the sum of Adjusted average assets and certain off-balance sheet exposures including undrawn credit commitments and derivative potential future exposures.

(h) Pro forma Fully phased-in Basel III capital ratios are based on Basel III standardized approach risk-weighted assets and rules.

(i) For comparative purposes only, the advanced approaches Basel III Common equity Tier 1 capital ratio for June 30, 2018 is 10.8% and for December 31, 2017 is 10.9% (estimated). This capital ratio is calculated using Common equity Tier 1 capital and dividing by Basel III advanced approaches risk-weighted assets.

(j) For comparative purposes only, the advanced approaches Basel III Tier 1 risk-based capital ratio for June 30, 2018 is 12.1% and for December 31, 2017 is 12.2% (estimated). This capital ratio is calculated using Tier 1 capital and dividing by Basel III advanced approaches risk-weighted assets.

(k) For comparative purposes only, the advanced approaches Basel III Total capital risk-based capital ratio for June 30, 2018 is 13.4% and for December 31, 2017 is 13.5% (estimated). This ratio is calculated using Total Basel III capital, which under the advanced approaches, Additional Tier 2 capital includes allowance for loan and lease losses in excess of Basel expected credit losses, if any, up to 0.6% of credit risk-weighted assets, and dividing by Basel III advanced approaches risk-weighted assets.

(l) The Basel III Total risk-based capital ratio includes $80 million of nonqualifying trust preferred capital securities that are subject to a phase-out period that runs through 2021.

(m) For comparative purposes only, as of June 30, 2018 the ratio would be 12.6%, assuming nonqualifying trust preferred capital securities are phased out.

(n) Leverage ratio is calculated based on Tier 1 capital divided by Average quarterly adjusted total assets.

(o) Supplementary leverage ratio is calculated based on Tier 1 capital divided by Supplementary leverage exposure. As advanced approaches banking organizations, PNC and PNC Bank became subject to a 3% minimum supplementary leverage ratio effective January 1, 2018.

The decline in our Basel III Common equity Tier 1 capital ratio at June 30, 2018 compared to December 31, 2017 reflected continued strong capital return to shareholders and a decline in AOCI largely related to the impact of higher interest rates on the valuation of our available for sale securities portfolio.

Because PNC remains in the parallel run qualification phase for the advanced approaches, our regulatory risk-based capital ratios in 2018 and 2017 are calculated using the standardized approach for determining risk-weighted assets. Under the standardized approach for determining credit risk-weighted assets, exposures are generally assigned a pre-defined risk weight. Exposures to high volatility commercial real estate, past due exposures and equity exposures are generally subject to higher risk weights than other types of exposures. Once we exit parallel run, our regulatory risk-based capital ratios will be the lower of the ratios calculated under the standardized approach and the advanced approaches.

Under the Basel III rules applicable to PNC, significant common stock investments in unconsolidated financial institutions (for PNC, primarily BlackRock), mortgage servicing rights and deferred tax assets must be deducted from capital (subject to a phase-in schedule that ended December 31, 2017 and net of associated deferred tax liabilities) to the extent they individually exceed 10%, or in the aggregate exceed 15%, of the institution's adjusted common equity Tier 1 capital. Also, Basel III regulatory capital includes (subject to a phase-in schedule that ended December 31, 2017) AOCI related to securities currently and those transferred from available for sale, as well as pension and other postretirement plans. With the exception of certain nonqualifiying trust preferred capital securities included in PNC’s Total risk-based capital, the transitions and multi-year phase-in of the definition of capital under the Basel III rules were complete as of January 1, 2018. Accordingly, we refer to the capital ratios calculated using the definition of capital in effect as of January 1, 2018 and, for the risk-based ratios, standardized approach risk-weighted assets, as the Basel III ratios. The Basel III Total risk-based capital includes trust preferred capital securities in the amount of $80 million that are subject to a phase-out that runs through 2021.We refer to the capital ratios calculated using the phased-in Basel III provisions in effect for 2017 and, for the risk-based ratios, standardized approach risk-weighted assets, as the 2017 Transitional Basel III ratios. All current period capital ratios are calculated using the regulatory capital methodology applicable to us during 2018.

Federal banking regulators have stated that they expect the largest U.S. bank holding companies (BHCs), including PNC, to have a level of regulatory capital well in excess of the regulatory minimum and have required the largest U.S. bank holding companies BHCs, including PNC, to have a capital buffer sufficient to withstand losses and allow them to meet the credit needs of their customers through estimated stress scenarios. We seek to manage our capital consistent with these regulatory principles, and believe that our June 30, 2018 capital levels were aligned with them.

At June 30, 2018, PNC and PNC Bank, our sole bank subsidiary, were both considered “well capitalized,” based on applicable U.S. regulatory capital ratio requirements. To qualify as “well capitalized”, PNC must have Basel III capital ratios of at least 6% for Tier 1 risk-based capital and 10% for Total risk-based capital, and PNC Bank must have Basel III capital ratios of at least 6.5% for Common equity Tier 1 risk-based capital, 8% for Tier 1 risk-based capital, 10% for Total risk-based capital and a Leverage ratio of at least 5%.

We provide additional information regarding regulatory capital requirements and some of their potential impacts on us in the Supervision and Regulation section of Item 1 Business, Item 1A Risk Factors and Note 18 Regulatory Matters in our 2017 Form 10-K. See the Statistical Information (Unaudited) section of this Report for details on our June 30, 2017 Transitional Basel III and Fully Phased-In Basel III Common equity Tier 1 capital ratios.

Market Risk Management

Market risk is the risk of a loss in earnings or economic value due to adverse movements in market factors such as interest rates, credit spreads, foreign exchange rates, commodity prices and equity prices. We are exposed to market risk primarily by our involvement in the following activities, among others:

- Traditional banking activities of gathering deposits and extending loans,
- Equity and other investments and activities whose economic values are directly impacted by market factors, and
- Fixed income securities, derivatives and foreign exchange activities, as a result of customer activities and securities underwriting.

We have established enterprise-wide policies and methodologies to identify, measure, monitor and report market risk. Market Risk Management provides independent oversight by monitoring compliance with established guidelines and reporting significant risks in the business to the Risk Committee of the Board of Directors.

Market Risk Management – Interest Rate Risk

Interest rate risk results primarily from our traditional banking activities of gathering deposits and extending loans. Many factors, including economic and financial conditions, movements in interest rates and consumer preferences, affect the difference between the interest that we earn on assets and the interest that we pay on liabilities and the level of our noninterest-bearing funding sources. Due to the repricing term mismatches and embedded options inherent in certain of these products, changes in market interest rates not only affect expected near-term earnings, but also the economic values of these assets and liabilities.

The interest rates that we pay on customer deposits have risen in recent quarters as a result of higher short-term market interest rates. The rates paid on commercial deposits have had a higher correlation to increases in short-term interest rates, as compared to the rates paid on consumer deposits. During the remainder of 2018, we anticipate that the rates paid on our consumer deposits will have a higher correlation to changes in short-term interest rates. The rates paid on customer deposits are also impacted by factors including the level of interest rates, competition for deposits, new product offerings, and changes in business strategies.

Our Asset and Liability Management group centrally manages interest rate risk as prescribed in our risk management policies, which are approved by management's Asset and Liability Committee and the Risk Committee of the Board of Directors.

Sensitivity results and market interest rate benchmarks for the second quarters of 2018 and 2017 follow:

Table 30: Interest Sensitivity Analysis

	Second Quarter 2018		Second Quarter 2017	
Net Interest Income Sensitivity Simulation (a)				
Effect on net interest income in first year from gradual interest rate change over the following 12 months of:				
100 basis point increase	2.0	%	2.8	%
100 basis point decrease	(2.5	)%	(3.3	)%
Effect on net interest income in second year from gradual interest rate change over the preceding 12 months of:				
100 basis point increase	4.1	%	5.4	%
100 basis point decrease	(6.5	)%	(8.7	)%
Duration of Equity Model (a)				
Base case duration of equity (in years)	(.1	)	(2.5	)
Key Period-End Interest Rates				
One-month LIBOR	2.09	%	1.22	%
Three-month LIBOR	2.34	%	1.30	%
Three-year swap	2.86	%	1.75	%

(a) Given the inherent limitations in certain of these measurement tools and techniques, results become less meaningful as interest rates approach zero.

In addition to measuring the effect on net interest income assuming parallel changes in current interest rates, we routinely simulate the effects of a number of nonparallel interest rate environments. Table 31 reflects the percentage change in net interest income over the next two 12-month periods assuming (i) the PNC Economist's most likely rate forecast, (ii) implied market forward rates and (iii) yield curve slope flattening (a 100 basis point yield curve slope flattening between one-month and ten-year rates superimposed on current base rates) scenario.

Table 31: Net Interest Income Sensitivity to Alternative Rate Scenarios

	June 30, 2018					
	PNC Economist		Market Forward		Slope Flattening	
First year sensitivity	.9	%	1.2	%	(.7	)%
Second year sensitivity	.3	%	.3	%	(3.2	)%

All changes in forecasted net interest income are relative to results in a base rate scenario where current market rates are assumed to remain unchanged over the forecast horizon.

When forecasting net interest income, we make assumptions about interest rates and the shape of the yield curve, the volume and characteristics of new business and the behavior of existing on- and off-balance sheet positions. These assumptions determine the future level of simulated net interest income in the base interest rate scenario and the other interest rate scenarios presented in Tables 30 and 31. These simulations assume that as assets and liabilities mature, they are replaced or repriced at then current market rates.

The following graph presents the LIBOR/Swap yield curves for the base rate scenario and each of the alternate scenarios one year forward.
Table 32: Alternate Interest Rate Scenarios: One Year Forward
The second quarter 2018 interest sensitivity analyses indicate that our Consolidated Balance Sheet is positioned to benefit from an increase in interest rates and an upward sloping interest rate yield curve. We believe that we have the deposit funding base and balance sheet flexibility to adjust, where appropriate and permissible, to changing interest rates and market conditions.

Market Risk Management – Customer-Related Trading Risk
We engage in fixed income securities, derivatives and foreign exchange transactions to support our customers' investing and hedging activities. These transactions, related hedges and the credit valuation adjustment related to our customer derivatives portfolio are marked-to-market daily and reported as customer-related trading activities. We do not engage in proprietary trading of these products.

We use value-at-risk (VaR) as the primary means to measure and monitor market risk in customer-related trading activities. VaR is used to estimate the probability of portfolio losses based on the statistical analysis of historical market risk factors. A diversified VaR reflects empirical correlations across different asset classes. We calculate a diversified VaR at a 95% confidence interval and the results for the first six months of 2018 and 2017 were within our acceptable limits.

See the Market Risk Management – Customer-Related Trading Risk section of our 2017 Form 10-K for more information on our models used to calculate VaR and our backtesting process.

Customer related trading revenue was $143 million for the six months ended June 30, 2018 compared to $129 million for the same period in 2017. The increase was primarily due to higher foreign exchange client sales revenues. For the quarterly period, customer related trading revenue was $66 million for the second quarter of 2018 compared to $61 million in 2017. The increase was primarily due to higher client related trading and foreign exchange client revenues, which was partially offset by the impact of changes in credit valuations for customer-related derivatives.

Market Risk Management – Equity And Other Investment Risk
Equity investment risk is the risk of potential losses associated with investing in both private and public equity markets. In addition to extending credit, taking deposits, underwriting securities and trading financial instruments, we make and manage direct investments in a variety of transactions, including management buyouts, recapitalizations and growth financings in a variety of industries. We also have investments in affiliated and non-affiliated funds that make similar investments in private equity. The economic and/or book value of these investments and other assets are directly affected by changes in market factors.

Various PNC business units manage our equity and other investment activities. Our businesses are responsible for making investment decisions within the approved policy limits and associated guidelines.

A summary of our equity investments follows:
Table 33: Equity Investments Summary

Dollars in millions	June 30 2018	December 31 2017	Change $	Change %
BlackRock	$7,753	$ 7,576	$177	2 %
Tax credit investments	2,178	2,148	30	1 %
Private equity and other	2,499	1,668	831	50%
Total	$12,430	$ 11,392	$1,038	9 %

BlackRock
We owned approximately 35 million common stock equivalent shares of BlackRock equity at June 30, 2018, accounted for under the equity method. The Business Segments Review section of this Financial Review includes additional information about BlackRock.

Tax Credit Investments
Included in our equity investments are direct tax credit investments and equity investments held by consolidated entities. These tax credit investment balances included unfunded commitments totaling $.8 billion at both June 30, 2018 and December 31, 2017. These unfunded commitments are included in Other liabilities on our Consolidated Balance Sheet.

Note 2 Loan Sale and Servicing Activities and Variable Interest Entities in the Notes To Consolidated Financial Statements in our 2017 Form 10-K has further information on Tax Credit Investments.

Private Equity and Other
The majority of our other equity investments consists of our private equity portfolio. The private equity portfolio is an illiquid portfolio consisting of mezzanine and equity investments that vary by industry, stage and type of investment. Private equity investments carried at estimated fair value totaled $1.4 billion and $1.3 billion at June 30, 2018 at December 31, 2017, respectively. As of June 30, 2018, $1.2 billion was invested directly in a variety of companies and $.2 billion was invested indirectly through various private equity funds. See Item 1 Business - Supervision and Regulation in our 2017 Form 10-K for discussion of the potential impacts of the Volcker Rule provisions of Dodd-Frank on our interests in and of private funds covered by the Volcker Rule.

Effective January 1, 2018, $.6 billion of available for sale securities were reclassified to equity investments as part of the adoption of ASU 2016-01. These securities were primarily money market funds.

Included in our other equity investments are Visa Class B common shares, which are recorded at cost. At June 30, 2018, the estimated value of our investment in Visa Class B common shares was approximately $759 million while our cost basis was not significant. Visa Class B common shares that we own are transferable only under limited circumstances until they can be converted into shares of the publicly-traded class of stock, which cannot happen until the settlement of the pending interchange litigation. See Note 6 Fair Value and Note 19 Legal Proceedings in the Notes To Consolidated Financial Statements in our 2017 Form 10-K for additional information regarding our Visa agreements.

We also have certain other equity investments, the majority of which represent investments in affiliated and non-affiliated funds with both traditional and alternative investment strategies. Net gains related to these investments were not significant at June 30, 2018 and June 30, 2017.

Financial Derivatives

We use a variety of financial derivatives as part of the overall asset and liability risk management process to help manage exposure to market and credit risk inherent in our business activities. Substantially all such instruments are used to manage risk related to changes in interest rates. Interest rate swaps, interest rate caps and floors, swaptions, options, forwards and futures contracts are the primary instruments we use for risk management. We also enter into derivatives with customers to facilitate their risk management activities.

Financial derivatives involve, to varying degrees, market and credit risk. Periodic cash payments are exchanged for interest rate swaps, options and futures contracts. Premiums are also exchanged for options contracts. Therefore, cash requirements and exposure to credit risk are significantly less than the notional amount on these instruments.

Further information on our financial derivatives is presented in Note 1 Accounting Policies and Note 6 Fair Value in our Notes To Consolidated Financial Statements in our 2017 Form 10-K and in Note 6 Fair Value and Note 9 Financial Derivatives in the Notes To Consolidated Financial Statements in this Report.

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

RECENT REGULATORY DEVELOPMENTS

On March 15, 2018, the U.S. Court of Appeals for the Fifth Circuit, in U.S. Chamber of Commerce v. U.S. Department of Labor, vacated the regulation issued by the U.S. Department of Labor (the “DOL Fiduciary Rule”) that had generally taken effect in June 2017 expanding the definition of “investment advice” for retirement and certain other types of accounts. A petition for rehearing en banc was denied, and the DOL did not timely seek review of the decision by the U.S. Supreme Court. As a result, the Fifth Circuit issued its mandate on June 21, 2018, making the DOL Fiduciary Rule null and void as of that date. With the DOL Fiduciary Rule now vacated, the law will revert to a five-part test to determine whether investment-related activities constitute fiduciary investment advice, a test that was in place before the adoption of the DOL Fiduciary Rule.

The Securities and Exchange Commission (SEC) on May 9, 2018 proposed Regulation Best Interest, which would impose a new standard of conduct on SEC-registered broker-dealers when making recommendations to retail customers, as well as new and amended rules and forms that would mandate summary disclosure to retail customers describing their relationship with and services offered by registered broker-dealers and investment advisers. Together with the vacation of the DOL Fiduciary Rule, these developments primarily affect aspects of our Retail Banking and Asset Management Group segments, which will continue to focus on the best interest of our customers. While we do not anticipate material impact resulting from these changes, we note that retirement investors continue to be a focus of regulators at the federal and state level.

On May 24, 2018, the President signed the Economic Growth, Regulatory Relief and Consumer Protection Act (Relief Act), into law. The Relief Act, among other things, makes several changes to the enhanced prudential standards provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). For BHCs with total consolidated assets of $250 billion or more, the Relief Act requires that the Federal Reserve tailor the application of its enhanced prudential standards regulations based on risk-related factors, such as the BHC’s capital structure, risk profile, complexity, activities and size. In addition, the Relief Act generally exempts BHCs with less than $100 billion in total consolidated assets from the Dodd-Frank Act enhanced prudential standards and provides the Federal Reserve 18 months to determine, by rule or order, whether to continue applying any or all of those requirements to BHCs with total consolidated assets of $100 billion or more but less than $250 billion. The Relief Act also makes changes to the regulatory capital and liquidity rules by limiting the scope of commercial real estate exposures that receive a heightened risk weight under the U.S. Standardized Approach regulatory capital rules and requiring that the banking agencies amend the LCR rules to expand the definition of high-quality liquid assets under those rules to include certain high-quality municipal securities.

Also in May, the U.S. banking agencies, SEC and Commodity Futures Trading Commission jointly requested comment on proposed changes to the final regulations implementing the Volcker Rule. The proposal would tailor application of the Volcker Rule to banking entities based on a threshold of trading assets and liabilities (excluding trading assets and liabilities involving U.S. government and agency obligations). Firms below a $10 billion and above a $1 billion threshold, like PNC, may adopt streamlined compliance programs and rely on clearer and simplified requirements for engaging in risk-mitigating hedging activities; however, these firms would need to continue to satisfy the annual CEO attestation requirement under the current final regulations. The proposal introduces a new requirement for identifying positions deemed to be held in a trading account, which, if adopted as proposed, could have a negative impact on the ability of banking entities (including PNC) to effectively manage risks, make longer-term investments, and seed new funds. The proposal does not propose any changes to the covered fund provisions under the final regulations or otherwise impact the conformance relief the Federal Reserve has granted to qualifying illiquid funds. The 60-day public comment period on the proposal closes September 17, 2018.

On June 14, 2018, the Federal Reserve finalized rules to implement the single-counterparty credit limit (SCCL) under section 165(e) of the Dodd-Frank Act. Under the final SCCL rules, the net credit exposure of a BHC with total consolidated assets of $250 billion or more (covered BHC), including its subsidiaries, to any single, unaffiliated counterparty is subject to an aggregate limit. For a covered BHC that is not identified as a global systemically important BHC under applicable Federal Reserve rules, such as PNC, the applicable limit is 25% of the BHC's tier 1 capital and must be calculated at the end of each business day. The limit covers credit exposure resulting from, among other transactions, extensions of credit, repurchase and reverse repurchase transactions, purchases or investments in securities, and derivative transactions. For PNC, compliance with the final rules is required starting July 1, 2020. PNC is in the process of obtaining guidance from the Federal Reserve on how investments accounted for under the equity method, such as its investment in BlackRock, should be treated for purposes of the SCCL. At present, we do not expect the SCCL will have a material impact on PNC.

In June 2018, the California legislature passed the California Consumer Privacy Act of 2018 (Act), which is scheduled to take effect on January 1, 2020. The Act, which covers businesses that obtain or access personal information on California resident consumers, grants consumers enhanced privacy rights and control over their personal information. Among other things, the Act provides consumers with the right to request information from a business concerning the types of data the business collects on them, the source

of that information, the purposes for which it is used, and the types of entities with which the business shares the information. Subject to some exceptions, consumers may also request to have their information deleted. The Act requires the California Attorney General to solicit public comment on regulations implementing the Act including with regard to establishing certain exceptions to allow compliance with other state and federal laws.

On July 2, 2018, the Federal Reserve and the Federal Deposit Insurance Corporation announced that the filing deadline for the next resolution plan pursuant to Section 165(d) of the Dodd-Frank Act and the agencies' joint regulations was extended for PNC and 13 other domestic BHCs to December 31, 2019.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

Note 1 Accounting Policies of our 2017 Form 10-K describes the most significant accounting policies that we use to prepare our consolidated financial statements. Certain of these policies require us to make estimates or economic assumptions that may vary under different assumptions or conditions and such variations may significantly affect our reported results and financial position for the period or in future periods.

The following critical accounting policies and judgments are described in more detail in Critical Accounting Estimates and Judgments in Item 7 of our 2017 Form 10-K:

- Fair Value Measurements
- Allowances for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit
- Goodwill
- Residential and Commercial Mortgage Servicing Rights
- Income Taxes
- Legal Contingencies

Fair Value Measurements

The following table summarizes the assets and liabilities measured at fair value on a recurring basis at June 30, 2018 and December 31, 2017, respectively, and the portions of such assets and liabilities that are classified within Level 3 of the valuation hierarchy. Level 3 assets and liabilities are those where the fair value is estimated using significant unobservable inputs.

Table 34: Fair Value Measurements – Summary

	June 30, 2018		December 31, 2017	
Dollars in millions	Total Fair Value	Level 3	Total Fair Value	Level 3
Total assets	$71,936	$6,474	$69,673	$6,475
Total assets at fair value as a percentage of consolidated assets	19 %		18 %	
Level 3 assets as a percentage of total assets at fair value		9 %		9 %
Level 3 assets as a percentage of consolidated assets		2 %		2 %
Total liabilities	$3,768	$438	$4,233	$531
Total liabilities at fair value as a percentage of consolidated liabilities	1 %		1 %	
Level 3 liabilities as a percentage of total liabilities at fair value		12 %		13 %
Level 3 liabilities as a percentage of consolidated liabilities		<1 %		<1 %

The majority of assets recorded at fair value are included in the securities available for sale portfolio. The majority of Level 3 assets represent non-agency residential mortgage-backed securities in the available for sale portfolio, mortgage servicing rights and equity investments. For further information on fair value, see Note 6 Fair Value in the Notes To Consolidated Financial Statements in this Report.

Income Taxes

See the Critical Accounting Estimates and Judgments section in Item 7 of our 2017 Form 10-K for information on our accounting of certain income tax effects of the Tax Cuts and Jobs Act enacted on December 22, 2017. Where certain income tax effects could be reasonably estimated, these were included as provisional amounts as of December 31, 2017. During the measurement period, which will end in December 2018, these estimates may be adjusted upon obtaining or analyzing additional information about facts and circumstances or clarifications of uncertain aspects of the newly enacted tax law, which if known would have affected the initially reported provisional amounts. No changes were made to these provisional amounts during the first six months of 2018.

Recently Issued Accounting Standards

Accounting Standards Update (ASU)	Description	Financial Statement Impact
Leases - ASU 2016-02 Issued February 2016	• Required effective date of January 1, 2019.[(a)] • Requires lessees to recognize a right-of-use asset and related lease liability for all leases with lease terms of more than 12 months. • Recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or operating lease. • Targeted changes have been made to the lessor accounting model to align the guidance with the new lessee model and revenue recognition guidance. • May be adopted using a modified retrospective approach through a cumulative-effect adjustment. • Financial Accounting Standards Board approved an amendment which would permit the option to adopt the new standard prospectively as of the effective date, without adjusting comparative periods presented.	• We plan to adopt the guidance in the first quarter of 2019. • Implementation efforts are ongoing, including the deployment of a lease accounting software solution. • We are currently evaluating the impact of various accounting policy elections and the impact of new disclosure requirements. We are also currently evaluating the incremental borrowing rate to discount our future minimum lease payments in calculating the lease liabilities and corresponding right-of-use assets. • We are substantially complete with the evaluation of our initial lease population. We will continue to review service contracts through the effective date and may identify additional leases embedded within those arrangements that are within the scope of the ASU. • We expect, at a minimum, to recognize lease liabilities and corresponding right-of-use assets commensurate with the present value of the future minimum payments. Future minimum lease payments under operating leases totaled $2.6 billion as of December 31, 2017 as disclosed in Note 8 Premises, Equipment and Leasehold Improvements in our 2017 Form 10-K. • We do not expect a material change to the timing of our expense recognition. • Given the limited changes to lessor accounting, we do not expect material changes to recognition or measurement, but we are currently evaluating the impact. Implementation efforts are ongoing, including the deployment of a lessor accounting software solution.
Credit Losses - ASU 2016-13 Issued June 2016	• Required effective date of January 1, 2020.[(a)] • Requires the use of an expected credit loss methodology; specifically, current expected credit losses (CECL) for the remaining life of the asset will be recognized at the time of origination or acquisition. • Methodology will apply to loans, debt securities, and other financial assets and net investment in leases not accounted for at fair value through net income. It will also apply to off-balance sheet credit exposures except for unconditionally cancellable commitments.	• We do not plan to adopt the standard at its early adoption date in the first quarter of 2019. • We established a company-wide, cross-functional governance structure in the third quarter of 2016, which oversees overall strategy for implementation of Topic 326. • We continue to make progress towards design and development of CECL estimation methodologies, technological solutions, data requirements and future state processes. • We continue to believe that the adoption of the standard will result in an overall increase in the allowance for loan losses to cover credit losses over the estimated life of the financial assets. However, the magnitude of the increase in our allowance for loan losses at the adoption date will depend upon the nature and characteristics of the portfolio

	• In-scope assets will be presented at the net amount expected to be collected after deducting the allowance for credit losses from the amortized cost basis of the assets. • Requires enhanced credit quality disclosures including disaggregation of credit quality indicators by vintage. • Requires a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. • Required effective date of January 1, 2020.(a)	at the adoption date, as well as macroeconomic conditions and forecasts at that date.
Goodwill - ASU 2017-04 Issued January 2017	• Eliminates Step 2 from the goodwill impairment test to simplify the subsequent measurement of goodwill under which a loss was recognized only if the estimated implied fair value of the goodwill is below its carrying value. • Requires impairment to be recognized if the carrying amount exceeds the reporting unit's fair value.	• We plan to adopt the standard on its effective date and we do not expect the adoption of this standard to impact our consolidated results of operations or our consolidated financial position.

(a) Early adoption is permitted.

Recently Adopted Accounting Standards

See Note 1 Accounting Policies in the Notes To Consolidated Financial Statements in this Report regarding the impact of new accounting pronouncements.

OFF-BALANCE SHEET ARRANGEMENTS AND VARIABLE INTEREST ENTITIES

We engage in a variety of activities that involve entities that are not consolidated or otherwise reflected in our Consolidated Balance Sheet that are generally referred to as off-balance sheet arrangements. Additional information on these types of activities is included in our 2017 Form 10-K and in Note 2 Loan Sale and Servicing Activities and Variable Interest Entities and Note 13 Commitments in the Notes To Consolidated Financial Statements included in this Report.

A summary of variable interest entities (VIEs), including those in which we hold variable interests but have not consolidated into our financial statements, is included in Note 2 in our 2017 Form 10-K.

Trust Preferred Securities and REIT Preferred Securities

See Note 10 Borrowed Funds and Note 15 Equity in the Notes To Consolidated Financial Statements in our 2017 Form 10-K for additional information on trust preferred securities issued by PNC Capital Trust C including information on contractual limitations potentially imposed on payments (including dividends) with respect to PNC's equity securities and for additional information on the 2017 redemption of the REIT preferred securities issued by PNC Preferred Funding Trust I and PNC Preferred Funding Trust II.

INTERNAL CONTROLS AND DISCLOSURE CONTROLS AND PROCEDURES

As of June 30, 2018, we performed an evaluation under the supervision of and with the participation of our management, including the Chairman, President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures and of changes in our internal control over financial reporting.

Based on that evaluation, our Chairman, President and Chief Executive Officer and our Executive Vice President and Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) were effective as of June 30, 2018, and that there has been no change in PNC’s internal control over financial reporting that occurred during the second quarter of 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

GLOSSARY OF TERMS

For a glossary of terms commonly used in our filings, please see the glossary of terms included in our 2017 Form 10-K.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

We make statements in this Report, and we may from time to time make other statements, regarding our outlook for earnings, revenues, expenses, tax rates, capital and liquidity levels and ratios, asset levels, asset quality, financial position, and other matters regarding or affecting us and our future business and operations that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Forward-looking statements are typically identified by words such as “believe,” “plan,” “expect,” “anticipate,” “see,” “look,” “intend,” “outlook,” “project,” “f “estimate,” “goal,” “will,” “should” and other similar words and expressions. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time.

Forward-looking statements speak only as of the date made. We do not assume any duty to update forward-looking statements. Actual results or future events could differ, possibly materially, from those anticipated in forward-looking statements, as well as from historical performance.

Our forward-looking statements are subject to the following principal risks and uncertainties.

- Our businesses, financial results and balance sheet values are affected by business and economic conditions, including the following:
  - Changes in interest rates and valuations in debt, equity and other financial markets.
  - Disruptions in the U.S. and global financial markets.

- Actions by the Federal Reserve Board, U.S. Treasury and other government agencies, including those that impact money supply and market interest rates.
- Changes in customer behavior due to newly enacted tax legislation, changing business and economic conditions or legislative or regulatory initiatives.
- Changes in customers', suppliers' and other counterparties' performance and creditworthiness.
- Impact of tariffs and other trade policies of the U.S. and its global trading partners.
- Slowing or reversal of the current U.S. economic expansion.
- Commodity price volatility.
- Our forward-looking financial statements are subject to the risk that economic and financial market conditions will be substantially different than those we are currently expecting and do not take into account potential legal and regulatory contingencies. These statements are based on our current view that the U.S. economic growth will accelerate somewhat in

2018, in light of stimulus from corporate and personal income tax cuts passed in late 2017 that are expected to support business investment and consumer spending, respectively. We expect an increase in federal government spending will also support economic growth in 2018. Further gradual improvement in the labor market this year, including job gains and rising wages, is another positive for consumer spending. Other sources of growth for the U.S. economy in 2018 will be the global economic expansion and the housing market, although trade restrictions are a growing downside risk to the forecast. Although inflation slowed in 2017, it should pick up as the labor market continues to tighten. Short-term interest rates and bond yields are expected to rise throughout 2018; after the Federal Open Market Committee raised the federal funds rate in June, our baseline forecast is for one additional rate hike in September 2018, pushing the rate to a range of 2.00 to 2.25% by the end of the year. Longer-term rates are also expected to increase as the Federal Reserve slowly reduces the size of its balance sheet and the federal government borrows more. Long-term rates will rise more slowly than short-term rates, so we anticipate that the yield curve will flatten but not invert.

- Our ability to take certain capital actions, including returning capital to shareholders, is subject to review by the Federal Reserve Board as part of our comprehensive capital plan for the applicable period in connection with the Federal Reserve Board’s CCAR process and to the acceptance of such capital plan and non-objection to such capital actions by the Federal Reserve Board.
- Our regulatory capital ratios in the future will depend on, among other things, the company’s financial performance, the scope and terms of final capital regulations then in effect (particularly those implementing the international regulatory capital framework developed by the Basel Committee on Banking Supervision (Basel Committee), and management actions affecting the composition of our balance sheet. In addition, our ability to determine, evaluate and forecast regulatory capital ratios, and to take actions (such as capital distributions) based on actual or forecasted capital ratios, will be dependent at least in part on the development, validation and regulatory approval of related models.
- Legal and regulatory developments could have an impact on our ability to operate our businesses, financial condition, results of operations, competitive position, reputation, or pursuit of attractive acquisition opportunities. Reputational impacts could affect matters such as business generation and retention, liquidity, funding, and ability to attract and retain management. These developments could include:
  - Changes resulting from legislative and regulatory reforms, including changes affecting oversight of the financial services industry, consumer protection, pension, bankruptcy and other industry aspects, and changes in accounting policies and principles.
  - Changes to regulations governing bank capital and liquidity standards.
  - Unfavorable resolution of legal proceedings or other claims and regulatory and other governmental investigations or other inquiries. These matters may result in monetary judgments or settlements or other remedies, including fines, penalties, restitution or alterations in our business practices, and in additional expenses and collateral costs, and may cause reputational harm to us.
  - Results of the regulatory examination and supervision process, including our failure to satisfy requirements of agreements with governmental agencies.
  - Impact on business and operating results of any costs associated with obtaining rights in intellectual property claimed by others and of adequacy of our intellectual property protection in general.
- Business and operating results are affected by our ability to identify and effectively manage risks inherent in our businesses, including, where appropriate, through effective use of systems and controls, third-party insurance, derivatives, and capital management techniques, and to meet evolving regulatory capital and liquidity standards.
- Business and operating results also include impacts relating to our equity interest in BlackRock, Inc. and rely to a significant extent on information provided to us by BlackRock. Risks and uncertainties that could affect BlackRock are discussed in more detail by BlackRock in its SEC filings.
- We grow our business in part through acquisitions. Acquisition risks and uncertainties include those presented by the nature of the business acquired, including in some cases those associated with our entry into new businesses or new geographic or other markets and risks resulting from our inexperience in those new areas, as well as risks and uncertainties related to the acquisition transactions themselves, regulatory issues, and the integration of the acquired

businesses into PNC after closing.

- Competition can have an impact on customer acquisition, growth and retention and on credit spreads and product pricing, which can affect market share, deposits and revenues. Our ability to anticipate and respond to technological changes can also impact our ability to respond to customer needs and meet competitive demands.
- Business and operating results can also be affected by widespread natural and other disasters, pandemics, dislocations, terrorist activities, system failures, security breaches, cyberattacks or international hostilities through impacts on the economy and financial markets generally or on us or our counterparties specifically.

We provide greater detail regarding these as well as other factors in our 2017 Form 10-K, our First Quarter 2018 Form 10-Q, and elsewhere in this Report, including in the Risk Factors and Risk Management sections and the Legal Proceedings and Commitments Notes of the Notes To Consolidated Financial Statements in those reports. Our forward-looking statements may also be subject to other risks and uncertainties, including those discussed elsewhere in this Report or in our other filings with the SEC.

CONSOLIDATED INCOME STATEMENT
THE PNC FINANCIAL SERVICES GROUP, INC.

Unaudited	Three months ended June 30		Six months ended June 30	
In millions, except per share data	2018	2017	2018	2017
Interest Income				
Loans	$2,345	$2,040	$4,573	$3,944
Investment securities	557	495	1,069	988
Other	180	139	358	262
Total interest income	3,082	2,674	6,000	5,194
Interest Expense				
Deposits	261	143	474	263
Borrowed funds	408	273	752	513
Total interest expense	669	416	1,226	776
Net interest income	2,413	2,258	4,774	4,418
Noninterest Income				
Asset management	456	398	911	801
Consumer services	381	360	738	692
Corporate services	487	466	916	880
Residential mortgage	84	104	181	217
Service charges on deposits	169	170	336	331
Other	334	304	579	605
Total noninterest income	1,911	1,802	3,661	3,526
Total revenue	4,324	4,060	8,435	7,944
Provision For Credit Losses	80	98	172	186
Noninterest Expense				
Personnel	1,356	1,276	2,710	2,533
Occupancy	203	202	421	424
Equipment	281	281	554	532
Marketing	75	67	130	122
Other	669	653	1,296	1,270
Total noninterest expense	2,584	2,479	5,111	4,881
Income before income taxes and noncontrolling interests	1,660	1,483	3,152	2,877
Income taxes	304	386	557	706
Net income	1,356	1,097	2,595	2,171
Less: Net income attributable to noncontrolling interests	10	10	20	27
Preferred stock dividends	55	55	118	118
Preferred stock discount accretion and redemptions	1	2	2	23
Net income attributable to common shareholders	$1,290	$1,030	$2,455	$2,003
Earnings Per Common Share				
Basic	$2.74	$2.12	$5.19	$4.10
Diluted	$2.72	$2.10	$5.15	$4.05
Average Common Shares Outstanding				
Basic	469	484	471	486
Diluted	472	488	474	491

See accompanying Notes To Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
THE PNC FINANCIAL SERVICES GROUP, INC.

Unaudited In millions	Three months ended June 30		Six months ended June 30	
	2018	2017	2018	2017
Net income	$1,356	$1,097	$2,595	$2,171
Other comprehensive income (loss), before tax and net of reclassifications into Net income:				
Net unrealized gains (losses) on non-OTTI securities	(155)	151	(801)	220
Net unrealized gains (losses) on OTTI securities	3	62	17	97
Net unrealized gains (losses) on cash flow hedge derivatives	(113)	(10)	(306)	(87)
Pension and other postretirement benefit plan adjustments	6	45	69	(17)
Other	(35)	22	(8)	26
Other comprehensive income (loss), before tax and net of reclassifications into Net income	(294)	270	(1,029)	239
Income tax benefit (expense) related to items of other comprehensive income	53	(89)	231	(72)
Other comprehensive income (loss), after tax and net of reclassifications into Net income	(241)	181	(798)	167
Comprehensive income	1,115	1,278	1,797	2,338
Less: Comprehensive income (loss) attributable to noncontrolling interests	10	10	20	27
Comprehensive income attributable to PNC	$1,105	$1,268	$1,777	$2,311

See accompanying Notes To Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEET
THE PNC FINANCIAL SERVICES GROUP, INC.

Unaudited In millions, except par value	June 30 2018	December 31 2017
Assets		
Cash and due from banks	$5,425	$5,249
Interest-earning deposits with banks	21,972	28,595
Loans held for sale (a)	1,325	2,655
Investment securities – available for sale	60,275	57,618
Investment securities – held to maturity	19,850	18,513
Loans (a)	222,855	220,458
Allowance for loan and lease losses	(2,581)	(2,611)
Net loans	220,274	217,847
Equity investments (b)	12,430	11,392
Mortgage servicing rights	2,045	1,832
Goodwill	9,218	9,173
Other (a)	27,897	27,894
Total assets	$380,711	$380,768
Liabilities		
Deposits		
Noninterest-bearing	$79,047	$79,864
Interest-bearing	185,838	185,189
Total deposits	264,885	265,053
Borrowed funds		
Federal Home Loan Bank borrowings	22,036	21,037
Bank notes and senior debt	27,596	28,062
Subordinated debt	4,781	5,200
Other (c)	4,809	4,789
Total borrowed funds	59,222	59,088
Allowance for unfunded loan commitments and letters of credit	289	297
Accrued expenses and other liabilities	9,340	8,745
Total liabilities	333,736	333,183
Equity		
Preferred stock (d)		
Common stock ($5 par value, Authorized 800 shares, issued 542 shares)	2,710	2,710
Capital surplus	16,250	16,374
Retained earnings	37,201	35,481
Accumulated other comprehensive income (loss)	(940)	(148)
Common stock held in treasury at cost: 77 and 69 shares	(8,317)	(6,904)
Total shareholders' equity	46,904	47,513
Noncontrolling interests	71	72
Total equity	46,975	47,585
Total liabilities and equity	$380,711	$380,768

(a) Our consolidated assets included the following for which we have elected the fair value option: Loans held for sale of $1.2 billion, Loans of $.8 billion and Other assets of $.2 billion at June 30, 2018 and Loans held for sale of $1.7 billion, Loans of $.9 billion and Other assets of $.3 billion at December 31, 2017.

(b)

Amounts include our equity interest in BlackRock. Effective for the first quarter of 2018, $.6 billion of trading and available for sale securities, primarily money market funds, were reclassified to Equity investments on January 1, 2018 in accordance with the adoption of Accounting Standards Update 2016-01, Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities.

(c) Our consolidated liabilities at both June 30, 2018 and December 31, 2017 included Other borrowed funds of $.1 billion for which we have elected the fair value option.

(d) Par value less than $.5 million at each date.

See accompanying Notes To Consolidated Financial Statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
THE PNC FINANCIAL SERVICES GROUP, INC.

Unaudited In millions	Six months ended June 30 2018	 2017
Operating Activities		
Net income	$2,595	$2,171
Adjustments to reconcile net income to net cash provided (used) by operating activities		
Provision for credit losses	172	186
Depreciation and amortization	567	568
Deferred income taxes	167	80
Changes in fair value of mortgage servicing rights	(76)	153
Undistributed earnings of BlackRock	(268)	(198)
Net change in		
Trading securities and other short-term investments	161	(1,076)
Loans held for sale	1,322	450
Other assets	(1,708)	451
Accrued expenses and other liabilities	1,563	(364)
Other	44	(201)
Net cash provided (used) by operating activities	$4,539	$2,220
Investing Activities		
Sales		
Securities available for sale	$5,189	$3,504
Loans	761	776
Repayments/maturities		
Securities available for sale	4,478	5,389
Securities held to maturity	1,254	1,269
Purchases		
Securities available for sale	(13,776)	(6,634)
Securities held to maturity	(2,663)	(2,788)
Loans	(299)	(315)
Net change in		
Federal funds sold and resale agreements	434	(353)
Interest-earning deposits with banks	6,623	3,229
Loans	(3,472)	(7,080)
Net cash paid for acquisition		(1,323)
Other	(988)	(443)
Net cash provided (used) by investing activities	$(2,459)	$(4,769)

(continued on following page)

CONSOLIDATED STATEMENT OF CASH FLOWS
THE PNC FINANCIAL SERVICES GROUP, INC.
(continued from previous page)

Unaudited In millions	Six Months Ended June 30 2018	2017
Financing Activities		
Net change in		
Noninterest-bearing deposits	$(862)	$(663)
Interest-bearing deposits	649	2,692
Federal funds purchased and repurchase agreements	511	440
Federal Home Loan Bank borrowings	2,500	
Commercial paper	(100)	
Other borrowed funds	(225)	485
Sales/issuances		
Federal Home Loan Bank borrowings	1,500	6,000
Bank notes and senior debt	2,738	4,063
Other borrowed funds	256	162
Common and treasury stock	40	68
Repayments/maturities		
Federal Home Loan Bank borrowings	(3,001)	(4,510)
Bank notes and senior debt	(2,850)	(1,000)
Subordinated debt	(324)	(1,908)
Other borrowed funds	(264)	(88)
Redemption of noncontrolling interests		(1,000)
Acquisition of treasury stock	(1,641)	(1,374)
Preferred stock cash dividends paid	(118)	(118)
Common stock cash dividends paid	(713)	(540)
Net cash provided (used) by financing activities	$(1,904)	$2,709
Net Increase (Decrease) In Cash And Due From Banks	176	160
Cash and due from banks at beginning of period	5,249	4,879
Cash and due from banks at end of period	$5,425	$5,039
Supplemental Disclosures		
Interest paid	$1,182	$793
Income taxes paid	$102	$30
Income taxes refunded	$461	$11
Non-cash Investing and Financing Items		
Transfer from loans to loans held for sale, net	$294	$233
Transfer from loans to foreclosed assets	$100	$112

See accompanying Notes To Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THE PNC FINANCIAL SERVICES GROUP, INC.
Unaudited

BUSINESS

The PNC Financial Services Group, Inc. (PNC) is one of the largest diversified financial services companies in the United States and is headquartered in Pittsburgh, Pennsylvania.

We have businesses engaged in retail banking, including residential mortgage, corporate and institutional banking and asset management, providing many of our products and services nationally. Our primary geographic markets are located in the Mid-Atlantic, Midwest and Southeast. We also provide certain products and services internationally.

NOTE 1 ACCOUNTING POLICIES

Basis of Financial Statement Presentation

Our consolidated financial statements include the accounts of the parent company and its subsidiaries, most of which are wholly-owned, certain partnership interests and variable interest entities.

We prepared these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). We have eliminated intercompany accounts and transactions. We have also reclassified certain prior year amounts to conform to the current period presentation, which did not have a material impact on our consolidated financial condition or results of operations.

In our opinion, the unaudited interim consolidated financial statements reflect all normal, recurring adjustments needed to present fairly our results for the interim periods. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period.

We have also considered the impact of subsequent events on these consolidated financial statements.

When preparing these unaudited interim consolidated financial statements, we have assumed that you have read the audited consolidated financial statements included in our 2017 Form 10-K. Reference is made to Note 1 Accounting Policies in our 2017 Form 10-K for a detailed description of significant accounting policies. There have been no significant changes to our accounting policies as disclosed in our 2017 Form 10-K, except for those accounting policies included in this Note 1 as a result of the adoption of new accounting standards that were effective in the first quarter of 2018. See our first quarter 2018 Quarterly Report on Form 10-Q (First Quarter 2018 Form 10-Q) for more detail on these new accounting standards. These interim consolidated financial statements serve to update our 2017 Form 10-K and may not include all information and Notes necessary to constitute a complete set of financial statements.

Use of Estimates

We prepared these consolidated financial statements using financial information available at the time of preparation, which requires us to make estimates and assumptions that affect the amounts reported. Our most significant estimates pertain to our fair value measurements and allowances for loan and lease losses and unfunded loan commitments and letters of credit. Actual results may differ from the estimates and the differences may be material to the consolidated financial statements.

Revenue Recognition

We earn interest and noninterest income from various sources, including:

- Lending,
- Securities portfolio,
- Asset management,
- Customer deposits,
- Loan sales, loan securitizations, and servicing,
- Brokerage services,
- Sale of securities,
- Certain private equity activities, and
- Securities, derivatives and foreign exchange activities.

In addition, we earn fees and commissions from:

- Issuing loan commitments, standby letters of credit and financial guarantees,
- Deposit account services,
- Merchant services,
- Selling various insurance products,
- Providing treasury management services,
- Providing merger and acquisition advisory and related services
- Debit and credit card transactions, and
- Participating in certain capital markets transactions.

Our Asset management noninterest income also includes our share of the earnings of BlackRock recognized under the equity method of accounting.

We record private equity income or loss based on changes in the valuation of the underlying investments or when we dispose of our interest.

We recognize gain/(loss) on changes in the fair value of certain financial instruments where we have elected the fair value option. These financial instruments include certain commercial and residential mortgage loans originated for sale, certain residential mortgage portfolio loans, resale agreements and our investment in BlackRock Series C preferred stock. We also recognize gain/(loss) on changes in the fair value of residential and commercial mortgage servicing rights (MSRs).

We recognize revenue from servicing residential mortgages, commercial mortgages and other consumer loans as earned based on the specific contractual terms. These revenues are reported on the Consolidated Income Statement in the line items Residential mortgage, Corporate services and Consumer services. We recognize revenue from securities, derivatives and foreign exchange customer-related trading, as well as securities underwriting activities, as these transactions occur or as services are provided. We generally recognize gains from the sale of loans upon receipt of cash. Mortgage revenue recognized is reported net of mortgage repurchase reserves.

For the fee-based revenue within the scope of ASC Topic 606 - Revenue from Contracts with Customers (Topic 606), revenue is recognized when or as those services are transferred to the customer. See Note 15 Fee-based Revenue from Contracts with Customers for additional information related to revenue within the scope of Topic 606.

Equity Securities and Partnership Interests

We account for equity securities and equity investments other than BlackRock and private equity investments under one of the following methods:

- Equity securities that have a readily determinable fair value are included in Equity investments on our Consolidated Balance Sheet. Both realized and unrealized gains and losses are included in Noninterest income. Dividend income on these equity securities is included in Other interest income on our consolidated income statement.
- For investments in limited partnerships, limited liability companies and other investments that are not required to be consolidated, we use either the equity method of accounting or the practicability exception to fair value. We use the equity method for general and limited partner ownership interests and limited liability companies in which we are considered to have significant influence over the operations of the investee. Under the equity method, we record our equity ownership share of net income or loss of the investee in Noninterest income and any dividends received on equity method investments are recorded as a reduction to the investment balance. When an equity investment experiences an other-than-temporary decline in value, we may be required to record a loss on the investment.
- We generally use the practicability exception to fair value for all other investments. When we elect this alternative measurement method, the carrying value is adjusted for impairment, if any, plus or minus changes in value resulting from observable price changes in orderly transactions for identical or similar instruments of the same issuer. These

investments are written down to fair value if a qualitative assessment indicates impairment and the fair value is less than the carrying value. The amount of the write-down is accounted for as a loss included in Noninterest income. Distributions received on these investments are included in Noninterest income.

Investments described above are included in Equity investments on our Consolidated Balance Sheet.

See Note 1 Accounting Policies of our 2017 Form 10-K for a discussion on our accounting for our investment in BlackRock and private equity investments.

Derivative Instruments and Hedging Activities

We use a variety of financial derivatives as part of our overall asset and liability risk management process to help manage exposure to interest rate, market and credit risk inherent in our business activities. Interest rate and total return swaps, swaptions, interest rate caps

and floors, options, forwards, and futures contracts are the primary instruments we use for risk management. Financial derivatives involve, to varying degrees, interest rate, market and credit risk. We manage these risks as part of our asset and liability management process and through credit policies and procedures.

We recognize all derivative instruments at fair value as either Other assets or Other liabilities on the Consolidated Balance Sheet and the related cash flows in the Operating Activities section of the Consolidated Statement of Cash Flows. Adjustments for counterparty credit risk are included in the determination of fair value. 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 cash flow or net investment hedging relationship. For all other derivatives, changes in fair value are recognized in earnings.

We utilize a net presentation for derivative instruments on the Consolidated Balance Sheet taking into consideration the effects of legally enforceable master netting agreements. Cash collateral exchanged with counterparties is also netted against the applicable derivative exposures by offsetting obligations to return, or general rights to reclaim, cash collateral against the fair values of the net derivatives being collateralized.

For those derivative instruments that are designated and qualify as accounting hedges, we designate the hedging instrument, based on the exposure being hedged, as a fair value hedge, a cash flow hedge or a hedge of the net investment in a foreign operation.

We formally document the relationship between the hedging instruments and hedged items, as well as the risk management objective and strategy, before undertaking an accounting hedge. To qualify for hedge accounting, the derivatives and related hedged items must be designated as a hedge at inception of the hedge relationship. In addition, a derivative must be highly effective at reducing the risk associated with the exposure being hedged. For accounting hedge relationships, we formally assess, both at the inception of the hedge and on an ongoing basis, if the derivatives are highly effective in offsetting designated changes in the fair value or cash flows of the hedged item. If it is determined that the derivative instrument is not highly effective, hedge accounting is discontinued. We assess effectiveness using statistical regression analysis. Where the critical terms of the derivative and hedged item match, effectiveness may be assessed qualitatively.

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, such as changes in LIBOR), changes in the fair value of the hedging instrument are recognized in earnings and offset by also recognizing in earnings the changes in the fair value of the hedged item attributable to the hedged risk. To the extent the change in fair value of the derivative does not offset the change in fair value of the hedged item, the difference is reflected in the Consolidated Income Statement in the same income statement line as the hedged item.

For derivatives designated as cash flow hedges (i.e., hedging the exposure to variability in expected future cash flows), the gain or loss on derivatives is reported as a component of Accumulated other comprehensive income (AOCI) and subsequently reclassified to income in the same period or periods during which the hedged cash flows affect earnings and recorded in the same income statement line item as the hedged cash flows. For derivatives designated as a hedge of net investment in a foreign operation, the gain or loss on the derivatives are reported as a component of AOCI.

We discontinue hedge accounting when it is determined that the derivative no longer qualifies as an effective hedge; the derivative expires or is sold, terminated or exercised; or the derivative is de-designated as a fair value or cash flow hedge or, for a cash flow hedge, it is no longer probable that the forecasted transaction will occur by the end of the originally specified time period.

We purchase or originate financial instruments that contain an embedded derivative. For financial instruments not measured at fair value with changes in fair value reported in earnings, we assess, at inception of the transaction, if the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the host contract and whether a separate instrument with the same terms as the embedded derivative would be a derivative. If the embedded derivative is not clearly and closely related to the host contract and meets the definition of a derivative, the embedded derivative is recorded separately from the host contract with changes in fair value recorded in earnings, unless we elect to account for the hybrid instrument at fair value.

We have elected, on an instrument-by-instrument basis, fair value measurement for certain financial instruments with embedded derivatives.

We enter into commitments to originate residential and commercial mortgage loans for sale. We also enter into commitments to purchase or sell commercial and residential real estate loans. These commitments are accounted for as free-standing derivatives which are recorded at fair value in Other assets or Other liabilities on the Consolidated Balance Sheet. Any gain or loss from the change in fair value after the inception of the commitment is recognized in Noninterest income.

Recently Adopted Accounting Standards

We did not adopt any new accounting standards that had a significant impact during the second quarter of 2018.