FIFTH THIRD BANCORP
Form 10-Q
November 04, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 September 30, 2005

Commission File Number 0-8076

(Exact name of Registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	31-0854434 (I.R.S. Employer Identification Number)

Fifth Third Center

Cincinnati, Ohio 45263

(Address of principal executive offices)

Registrant s telephone number, including area code: (513) 534-5300

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes x No ¨

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

Yes ¨ No x

There were 554,853,651 shares of the Registrant s Common Stock, without par value, outstanding as of October 31, 2005.

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This report may contain forward-looking statements about the Registrant and/or the company as combined with acquired entities within the meaning of Sections 27A of the Securities Act of 1933, as amended, and Rule 175 promulgated thereunder, and 21E of the Securities Exchange Act of 1934, as amended, and Rule 3b-6 promulgated thereunder, that involve inherent risks and uncertainties. This report may contain certain forward-looking statements with respect to the financial condition, results of operations, plans, objectives, future performance and business of the Registrant and/or the combined company including statements preceded by, followed by or that include the words or phrases such as believes, expects, anticipates, plans, trend, objective, continue, remain or similar expressions or future or conditional verbs such as should, could, might, can, may or similar expressions. There are a number of important factors that could cause future results to differ mater from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to: (1) competitive pressures among depository institutions increase significantly; (2) changes in the interest rate environment reduce interest margins; (3) prepayment speeds, loan origination and sale volumes, charge-offs and loan loss provisions; (4) general economic conditions, either national or in the states in which the Registrant, one or more acquired entities and/or the combined company do business, are less favorable than expected; (5) political developments, wars or other hostilities may disrupt or increase volatility in securities markets or other economic conditions; (6) changes and trends in the securities markets; (7) legislative or regulatory changes or actions, or significant litigation, adversely

affect the Registrant, one or more acquired entities and/or the combined company or the businesses in which the Registrant, one or more acquired entities and/or the combined company are engaged; (8) difficulties in combining the operations of acquired entities and (9) the impact of reputational risk created by the developments discussed above on such matters as business generation and retention, funding and liquidity. The Registrant undertakes no obligation to release revisions to these forward-looking statements or reflect events or circumstances after the date of this report.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (Item 2)

The following is management s discussion and analysis of certain significant factors that have affected Fifth Third Bancorp s (the Registrant or Fifth Third) financial condition and results of operations during the periods included in the Condensed Consolidated Financial Statements, which are a part of this filing.

TABLE 1: Selected Financial Data

	Three months ended September 30,		Percent Change	Nine months ended September 30,		Percent Change
($ in millions, except per share data)	**2005**	2004		**2005**	2004	
Income Statement Data						
Net interest income *(a)*	**$ 745**	766	(3)	**$ 2,262**	2,296	(1)
Noninterest income	**622**	611	2	**1,864**	1,986	(6)
Total revenue *(a)*	**1,367**	1,377	(1)	**4,126**	4,282	(4)
Provision for loan and lease losses	**69**	26	165	**197**	203	(3)
Noninterest expense	**732**	648	13	**2,164**	2,038	6
Net income	**395**	471	(16)	**1,217**	1,349	(10)
Common Share Data						
Earnings per share, basic	**$ .71**	.84	(15)	**$ 2.19**	2.40	(9)
Earnings per share, diluted	**.71**	.83	(14)	**2.18**	2.37	(8)
Cash dividends per common share	**.38**	.32	19	**1.08**	.96	13
Book value per share	**16.93**	16.11	5			
Dividend payout ratio	**53.5%**	38.6	39	**49.5%**	40.5	22
Financial Ratios						
Return on average assets	**1.51%**	1.95	(23)	**1.59%**	1.91	(17)
Return on average equity	**16.6**	21.1	(21)	**17.6**	20.6	(15)
Average equity as a percent of average assets	**9.11**	9.21	(1)	**9.04**	9.28	(3)
Net interest margin *(a)*	**3.16**	3.42	(8)	**3.27**	3.52	(7)
Efficiency *(a)*	**53.5**	47.0	14	**52.4**	47.6	10
Credit Quality						
Net losses charged off	**$ 64**	57	12	**$ 183**	187	(2)
Net losses charged off as a percent of average loans and leases	**.38%**	.40	(5)	**.37%**	.45	(18)
Allowance for loan and lease losses as a percent of loans and leases	**1.06**	1.23	(14)			
Allowance for credit losses as a percent of loans and leases *(b)*	**1.16**	1.35	(14)			
Nonperforming assets as a percent of loans, leases and other assets, including other real estate owned	**.51**	.48	6			
Underperforming assets as a percent of loans, leases and other assets, including other real estate owned	**.74**	.72	3			
Average Balances						
Loans and leases, including held for sale	**$ 68,556**	57,679	19	**$ 66,812**	56,236	19
Total securities and other short-term investments	**24,915**	31,413	(21)	**25,578**	30,891	(17)
Total assets	**103,699**	96,212	8	**102,501**	94,169	9
Demand deposits	**13,977**	12,537	11	**13,791**	12,065	14
Interest-bearing deposits	**50,403**	43,637	16	**50,010**	43,581	15
Short-term borrowings	**9,620**	13,274	(28)	**9,622**	14,322	(33)
Long-term debt	**16,914**	15,055	12	**16,528**	12,564	32
Shareholders equity	**9,451**	8,861	7	**9,262**	8,736	6
Regulatory Capital Ratios						
Tier 1 capital	**8.45%**	10.73	(21)			
Total risk-based capital	**10.57**	12.81	(17)			
Tier 1 leverage	**7.93**	9.13	(13)			

(a) Amounts presented on a fully taxable equivalent basis.

(b) The allowance for credit losses is the sum of the allowance for loan and lease losses and the reserve for unfunded commitments.

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OVERVIEW

This overview of management s discussion and analysis highlights selected information in the financial results of the Registrant and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources and critical accounting policies and estimates, you should carefully read this entire document. Each of these items could have an impact on the Registrant s financial condition and results of operations.

The Registrant is a diversified financial services company headquartered in Cincinnati, Ohio. At September 30, 2005, the Registrant had $104.6 billion in assets, operated 19 affiliates with 1,106 full-service Banking Centers including 125 Bank Mart® locations open seven days a week inside select grocery stores and 1,996 Jeanie® ATMs in Ohio, Kentucky, Indiana, Michigan, Illinois, Florida, Tennessee, West Virginia and Pennsylvania. During the third quarter of 2005, the Registrant divided its Florida affiliate into three independent affiliates, raising the total of number of affiliates to 19. The financial strength of the Registrant s largest banks, Fifth Third Bank and Fifth Third Bank (Michigan), continues to be recognized by rating agencies with deposit ratings of AA- and Aa1 from Standard & Poor s and Moody s, respectively. Additionally, the Registrant is recognized by Moody s with one of the highest senior debt ratings for any U.S. bank holding company of Aa2. The Registrant operates four main businesses: Commercial Banking, Retail Banking, Investment Advisors and Fifth Third Processing Solutions.

The Registrant s revenues are fairly evenly dependent on net interest income and noninterest income. For the three months ended September 30, 2005, net interest income, on a fully taxable equivalent (FTE) basis, and noninterest income provided 54% and 46% of total revenue, respectively. Changes in interest rates, credit quality, economic trends and the capital markets are primary factors that drive the performance of the Registrant. As discussed later in the Risk Management section, risk identification, measurement, monitoring, control and reporting are important to the management of risk and to the financial performance and capital strength of the Registrant.

Net interest income is the difference between interest income earned on assets such as loans, leases and securities, and interest expense paid on liabilities such as deposits and borrowings. Net interest income is affected by the general level of interest rates, the relative level of short-term and long-term interest rates, changes in interest rates and by changes in the amount and composition of interest-earning assets and interest-bearing liabilities. Generally, the rates of interest the Registrant earns on its assets and owes on its liabilities are established for a period of time. The change in market interest rates over time exposes the Registrant to interest rate risk that could result in potential adverse changes to net interest income. The Registrant manages this risk by continually analyzing and adjusting the composition of its assets and liabilities based on their payment streams and interest rates, the timing of their maturities and their sensitivity to changes in market interest rates. Additionally, in the ordinary course of business, the Registrant enters into certain derivative transactions as part of its overall strategy to manage its interest rate and prepayment risks.

The Registrant is also exposed to the risk of losses on its loan and lease portfolio as a result of changing expected cash flows caused by loan defaults or inadequate collateral, among other factors.

Noninterest income is derived primarily from electronic funds transfer (EFT) and merchant transaction processing fees, fiduciary and investment management fees, banking fees and service charges and mortgage banking revenue.

Net interest income, net interest margin, net interest rate spread and the efficiency ratio are presented in Management s Discussion and Analysis of Financial Condition and Results of Operations on an FTE basis. The FTE basis adjusts for the tax-favored status of income from certain loans and securities held by the Registrant that are not taxable for federal income tax purposes. The Registrant believes this presentation to be the preferred industry measurement of net interest income as it provides a relevant comparison between taxable and non-taxable amounts.

The Registrant completed its acquisition of Franklin Financial Corporation (Franklin Financial) in June of 2004 and has expanded its presence in the Nashville market. As of September 30, 2005, the Registrant has 18 banking centers within this market. On January 1, 2005, the Registrant completed its acquisition of First National Bankshares of Florida, Inc. (First National), a bank holding company with $5.6 billion in assets located primarily in Orlando, Tampa, Sarasota, Naples and Fort Myers. The Registrant completed its conversion activity associated with the First National acquisition in the first quarter. As of September 30, 2005, the Registrant s Florida affiliates have 84 full-service locations, of which 74 were acquired as part of the First National acquisition.

The Registrant s net income was $395 million in the third quarter of 2005, a 16% decrease compared to $471 million for the same period last year. Earnings per diluted share were $.71 for the third quarter, a 14% decrease from $.83 for the same period last year. The Registrant s quarterly dividend increased to $.38 per common share from $.32, an increase of 19% on a year-over-year basis.

Net interest income (FTE) decreased three percent compared to the same period last year. The net interest margin decreased from 3.29% in the second quarter of 2005 to 3.16% in the third quarter of 2005 primarily due to the continued flattening of the interest rate yield curve, the growth in loans relative to the growth in core deposits and mix shifts within the core deposit base. Noninterest income increased three percent, exclusive of a $9 million gain on certain third party merchant contracts sold in the third quarter of 2004, primarily due to a $35 million, or 23%, increase in electronic payment processing revenue; comparison being provided to supplement an understanding of fundamental revenue trends. Noninterest expense increased 13% versus the same period last year, primarily due to increases in marketing,

information technology, bankcard volume related costs and the significant investments in the sales force and retail distribution network. Since September 30, 2004, approximately 1,800 additional sales personnel have been added and 59 net new de-novo banking centers have opened, as well as the 74 remaining banking centers added from the acquisition of First National.

Credit quality metrics remained strong during the third quarter of 2005. Net charge-offs as a percent of average loans and leases held steady at .38% in the third quarter of 2005 compared to .34% in the second quarter of 2005 and .40% in the third quarter of 2004. At September 30, 2005, nonperforming assets as a percent of loans and leases were .51%, unchanged from June 30, 2005 and slightly increased from .48% at September 30, 2004. While credit quality metrics have remained strong throughout 2005, the Registrant does not expect this type of credit performance to continue indefinitely.

The Registrant s capital ratios exceed the well-capitalized guidelines as defined by the Board of Governors of the Federal Reserve System (FRB). As of September 30, 2005, the Tier 1 capital ratio was 8.45% and the total risk-based capital ratio was 10.57%. The Registrant s capital strength and financial stability have enabled the Registrant to maintain a Moody s credit rating that is equaled or surpassed by only four other U.S. bank holding companies.

The Registrant continues to invest in the geographic areas within its footprint that offer the best growth prospects, as it believes this is the most cost efficient method of expansion within its largest affiliate markets. During the first nine months of 2005, the Registrant opened its first three banking centers in Pittsburgh and has opened 42 new banking centers that did not involve the relocation or consolidation of existing facilities, with plans to continue adding banking centers in key markets in the fourth quarter of 2005 and throughout 2006 at levels similar to 2004.

RECENT ACCOUNTING STANDARDS

Note 2 of the Notes to Condensed Consolidated Financial Statements provides a complete discussion of the new accounting policies adopted by the Registrant during 2005 and 2004 and the expected impact of accounting policies issued but not yet required to be adopted.

CRITICAL ACCOUNTING POLICIES

Allowance for Loan and Lease Losses

The Registrant maintains an allowance to absorb probable loan and lease losses inherent in the portfolio. The allowance is maintained at a level the Registrant considers to be adequate and is based on ongoing quarterly assessments and evaluations of the collectibility and historical loss experience of loans and leases. Credit losses are charged and recoveries are credited to the allowance. Provisions for loan and lease losses are based on the Registrant s review of the historical credit loss experience and such factors that, in management s judgment, deserve consideration under existing economic conditions in estimating probable credit losses. In determining the appropriate level of the allowance, the Registrant estimates losses using a range derived from base and conservative estimates. The Registrant manages credit risk through a combination of conservative exposure limits significantly below legal lending limits and conservative underwriting, documentation and collections standards. The strategy also emphasizes diversification on a geographic, industry and customer level, regular credit examinations and quarterly management reviews of large credit exposures and loans experiencing deterioration of credit quality.

Larger commercial loans that exhibit probable or observed credit weaknesses are subject to individual review. Where appropriate, allowances are allocated to individual loans based on management s estimate of the borrower s ability to repay the loan given the availability of collateral, other sources of cash flow and legal options available to the Registrant. The review of individual loans includes those loans that are impaired as provided in Statement of Financial Accounting Standards (SFAS) No. 114, Accounting by Creditors for Impairment of a Loan. Any allowances for impaired loans are measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the underlying collateral. The Registrant evaluates the collectibility of both principal and interest when assessing the need for a loss accrual. Historical loss rates are applied to other commercial loans not subject to specific allowance allocations. The loss rates are derived from a migration analysis, which computes the net charge-off experience sustained on loans according to their internal risk grade. The Registrant utilizes two risk grading systems for commercial loans and leases. The current risk grading system utilized for allowance analysis purposes encompasses ten categories. The Registrant also maintains a dual risk grading system that provides for 13 probability of default grade categories and an additional six grade categories measuring loss factors given an event of default. The probability of default and loss given default analyses are not separated in the ten grade risk rating system. The Registrant is in the process of completing significant validation and testing of the dual risk rating system prior to implementation for allowance analysis purposes. The dual risk rating system is consistent with Basel II expectations and allows for more precision in the analysis of commercial credit risk.

Homogenous loans, such as consumer installment, residential mortgage loans and automobile leases are not individually risk graded. Rather, standard credit scoring systems and delinquency monitoring are used to assess credit risks. Allowances are established for each pool of loans based on the expected net charge-offs for one year. Loss rates are based on the average net charge-off history by loan category.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Historical loss rates for commercial and consumer loans may be adjusted for significant factors that, in management s judgment, reflect the impact of any current conditions on loss recognition. Factors that management considers in the analysis include the effects of the national and local economies, trends in the nature and volume of loans (delinquencies, charge-offs and nonaccrual loans), changes in mix, credit score migration comparisons, asset quality trends, risk management and loan administration, changes in the internal lending policies and credit standards, collection practices and examination results from bank regulatory agencies and the Registrant s internal credit examiners.

An unallocated allowance is maintained to recognize the imprecision in estimating and measuring loss when evaluating allowances for individual loans or pools of loans. Allowances on individual loans and historical loss rates are reviewed quarterly and adjusted as necessary based on changing borrower and/or collateral conditions and actual collection and charge-off experience.

Loans acquired by the Registrant through a purchased business combination are evaluated for possible credit impairment. Reduction to the carrying value of the acquired loans as a result of credit impairment is recorded as an adjustment to goodwill. The Registrant does not carry over the acquired company s allowance for loan and lease losses nor does the Registrant add to its existing allowance for the acquired loans.

The Registrant s primary market areas for lending are Ohio, Kentucky, Indiana, Michigan, Illinois, Florida, Tennessee, West Virginia and Pennsylvania. When evaluating the adequacy of allowances, consideration is given to this regional geographic concentration and the closely associated effect changing economic conditions have on the Registrant s customers.

In the current year, the Registrant has not substantively changed any aspect to its overall approach in the determination of allowance for loan and lease losses. There have been no material changes in assumptions or estimation techniques as compared to prior periods that impacted the determination of the current period allowance for loan and lease losses. Based on the procedures discussed above, the Registrant is of the opinion that the allowance of $727 million was adequate, but not excessive, to absorb estimated credit losses associated with the loan and lease portfolio at September 30, 2005.

Valuation of Securities

Securities are classified as held-to-maturity, available-for-sale or trading on the date of purchase. Only those securities classified as held-to-maturity, and which management has both the intent and ability to hold to maturity, are reported at amortized cost. Available-for-sale and trading securities are reported at fair value with unrealized gains and losses, net of related deferred income taxes, included in accumulated other comprehensive income on the Condensed Consolidated Balance Sheets and noninterest income in the Condensed Consolidated Statements of Income, respectively. The fair value of a security is determined based on quoted market prices. If quoted market prices are not available, fair value is determined based on quoted prices of similar instruments. Realized securities gains or losses are reported within noninterest income in the Condensed Consolidated Statements of Income. The cost of securities sold is based on the specific identification method. Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that security s performance, the creditworthiness of the issuer and the Registrant s intent and ability to hold the security. A decline in value that is considered to be other-than-temporary is recorded as a loss within noninterest income in the Condensed Consolidated Statements of Income. At September 30, 2005, 92% of the unrealized losses in the available-for-sale security portfolio were comprised of securities issued by U.S. Treasury and Government agencies, U.S. Government sponsored agencies and states and political subdivisions as well as agency mortgage-backed securities. The Registrant believes the price movements in these securities are dependent upon the movement in market interest rates particularly given the negligible inherent credit risk for these securities. The Registrant also maintains its intent and ability to hold these securities.

Valuation of Servicing Rights

When the Registrant sells loans through either securitizations or individual loan sales in accordance with its investment policies, it may retain servicing rights. Servicing rights resulting from loan sales are amortized in proportion to and over the period of estimated net servicing revenues. Servicing rights are assessed for impairment monthly, based on fair value, with temporary impairment recognized through a valuation allowance and permanent impairment recognized through a write-off of the servicing asset and related valuation reserve. Key economic assumptions used in measuring any potential impairment of the servicing rights include the prepayment speeds of the underlying loans, the weighted-average life of the loans, the discount rate, the weighted-average coupon and the weighted-average default rate, as applicable. The primary risk of material changes to the value of the servicing rights resides in the potential volatility in the economic assumptions used, particularly the prepayment speeds. The Registrant monitors this risk and adjusts its valuation allowance as necessary to adequately reserve for any probable impairment in the portfolio. For purposes of measuring impairment, the servicing rights are stratified based on the financial asset type and interest rates. In addition, the Registrant obtains an independent third-party valuation of the mortgage servicing rights (MSR) portfolio on a quarterly basis. Fees received for servicing loans owned by investors are based on a percentage of the

outstanding monthly principal balance of such loans and are included in noninterest income as loan payments are received. Costs of servicing loans are charged to expense as incurred.

At September 30, 2005, the change in the fair value of MSRs due to an immediate 10% and 20% adverse change in the current prepayment assumptions would be a decrease of approximately $14 million and $37 million, respectively, and due to an immediate 10% and 20% favorable change in the current prepayment assumption would be an increase of approximately $21 million and $44 million, respectively. The change in the fair value of the MSR portfolio at September 30, 2005, due to an immediate 10% and 20% adverse change in the discount rate assumptions would be a decrease of approximately $14 million and $27 million, respectively, and due to an immediate 10% and 20% favorable change in the discount rate assumption would be an increase of approximately $15 million and $30 million, respectively. Sensitivity analysis related to other consumer and commercial servicing rights is not material to the Registrant s Condensed Consolidated Financial Statements. These sensitivities are hypothetical and should be used with caution. As the figures indicate, change in fair value based on a 10% and 20% variation in assumptions typically cannot be extrapolated because the relationship of the change in assumptions to change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the retained interests is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

STATEMENTS OF INCOME ANALYSIS

Net Interest Income

Compared to the third quarter of 2004, net interest income (FTE) decreased three percent as a result of net interest margin contracting 26 basis points (bp). The decline in net interest margin occurred despite a five percent increase in average earning assets. In terms of mix between volume and yield, the impact of changes in interest rates on net interest income (FTE) was a decrease of eight percent. The decline in net interest margin was attributable to the $1.6 billion repurchase of common stock, the growth in loans relative to the growth in core deposits and the corresponding increase in wholesale funding, the change in mix within core deposits and the continued flattening of the interest rate yield curve. The Registrant expects net interest margin to remain reasonably stable with approximately four to six basis points of continuing combined contraction in the fourth quarter and the first quarter of 2006.

The growth in average loans and leases of $10.9 billion over the third quarter of 2004 outpaced the $5.9 billion growth in core deposits for the same period. Of the $5.0 billion funding shortfall, only $.5 billion was provided through additional higher cost wholesale funding, as the Registrant continues to reduce its reliance on wholesale funding. For the third quarter of 2005, wholesale funding represented 45% of interest-bearing liabilities, down from 47% for the same period in the prior year. The remaining loan and lease funding was provided through reductions in the available-for-sale securities portfolio. During the third quarter of 2005, the average securities portfolio represented 27% of interest-earning assets, down from 35% in last year s third quarter. During the remainder of 2005, the Registrant will continue to use sales and cash flows from its earning asset base to fund its loan and lease growth that is in excess of its core deposit growth.

During the third quarter of 2005, the Registrant continued a strategic shift in its deposit pricing strategy as it moved away from promotional rates and towards highly competitive daily rates. As part of this strategy, the Registrant aggressively increased deposit rates, including focusing on the relative pricing between the more and less liquid deposit products, and moved customers into the right products given their liquidity needs. The combined results of these actions have been a 17% increase (not annualized) in net new account additions compared to the second quarter and a migration of interest checking balances into money market and savings accounts. Additionally, the Registrant recently announced the roll out of its identity theft protection service, which gives Fifth Third checking account customers, with two other Fifth Third products, free access to their credit information from all three of the nation s leading credit bureaus.

In the third quarter of 2005, the cost of interest-bearing core deposits was 2.24%, up from 1.17% in the third quarter of 2004. Despite more aggressive increases in deposit rates in the third quarter of 2005 as compared to prior periods, the relative cost advantage of interest-bearing core deposits compared to wholesale funding increased by 42 bp from the third quarter of 2004 to 128 bp and is relatively stable compared to the second quarter of 2005. Within interest-bearing core deposits, the money market and other time deposit balances combined to represent 33% of the total in the third quarter of 2005 compared to 27% in the third quarter of 2004. Money market and other time deposit balances generally receive a higher rate of interest than interest checking and savings balances. The combined rate paid on money market and other time deposit balances was 3.02% in the third quarter of 2005 compared to the combined rate of 1.86% on interest checking and savings balances in the prior year. Net interest rate spread declined 46 bp from 3.12% in the third quarter of 2004 to 2.66% in the third quarter of 2005 due largely to the flattening interest rate yield curve and the impact of changing funding mix and deposit strategies highlighted above. The average interest rate spread between the 3-month Treasury bill and the 10-year Treasury note compressed from 279 bp in the third quarter of 2004 to 123 bp in the second quarter of 2005 and to 78 bp in the third quarter of 2005 illustrating the relative pressure between shorter-term and longer-term funding costs and general security portfolio re-investment opportunities.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Interest income (FTE) from loans and leases increased $296 million, or 41%, compared to the third quarter of 2004. The increase resulted from the growth in average loans and leases of $10.9 billion, or 19%, for the third quarter of 2005 over the comparable period in 2004 as well as a 91 bp increase in average rates. The increase in average loans and leases included growth in commercial loans and leases of $6.6 billion, or 22%, compared to the third quarter of 2004. The yield on commercial loans was 6.05% for the third quarter of 2005, an increase of 117 bp from 4.88% for the prior year s quarter. Average consumer loans and leases increased by $4.3 billion, or 15%, compared to the third quarter of 2004, with an increase in yield of 62 bp to 5.73%.

Interest income (FTE) from investment securities and short-term investments decreased $57 million to $271 million for the third quarter of 2005 compared to the same period in 2004 due to the reduction of the investment securities portfolio primarily as a result of the balance sheet initiative undertaken in the fourth quarter of 2004 to reduce risks associated with increasing interest rates. These balance sheet initiatives included: (i) the sale of approximately $6.4 billion in the available-for-sale securities portfolio with a weighted-average coupon of 3.2%; (ii) the early retirement of approximately $2.8 billion of long-term debt with a weighted-average coupon of 5.4%; (iii) the termination of $2.8 billion in notional of receive-fixed/pay-variable interest rate swaps; and (iv) reductions in certain other wholesale borrowings. The average yield on taxable securities increased by only 14 bp due to the relative stability in longer-term interest rates.

TABLE 2: Consolidated Average Balance Sheets and Analysis of Net Interest Income (FTE)

For the three months ended September 30,	**2005**			2004			Attribution of Change in Net Interest Income *(a)*		
($ in millions)	**Average Balance**	**Revenue/ Cost**	**Average Yield/ Rate**	Average Balance	Revenue/ Cost	Average Yield/ Rate	Volume	Yield/Rate	Total
Assets									
Interest-earning assets:									
Loans and leases *(b)*	**$ 68,556**	**$ 1,020**	**5.90%**	$ 57,679	$ 724	4.99%	$ 149	147	296
Securities:									
Taxable	**24,013**	**255**	**4.22**	30,241	310	4.08	(66)	11	(55)
Exempt from income taxes *(b)*	**787**	**15**	**7.42**	890	17	7.56	(2)		(2)
Other short-term investments	**115**	**1**	**3.49**	282	1	1.51	(1)	1	
Total interest-earning assets	**93,471**	**1,291**	**5.48**	89,092	1,052	4.70	80	159	239
Cash and due from banks	**2,742**			2,265					
Other assets	**8,207**			5,603					
Allowance for loan and lease losses	**(721)**			(748)					
Total assets	**$ 103,699**			$ 96,212					
Liabilities									
Interest-bearing liabilities:									
Interest checking	**$ 18,498**	**$ 86**	**1.84%**	$ 19,570	$ 47	.94%	$ (3)	42	39
Savings	**9,939**	**48**	**1.90**	8,212	16	.76	4	28	32
Money market	**5,154**	**37**	**2.82**	3,542	10	1.11	6	21	27
Other time deposits	**8,730**	**68**	**3.14**	6,539	39	2.40	15	14	29
Certificates $100,000 and over	**4,156**	**34**	**3.28**	2,459	15	2.40	12	7	19
Foreign office deposits	**3,925**	**34**	**3.41**	3,315	12	1.45	3	19	22
Federal funds purchased	**4,001**	**35**	**3.50**	4,847	17	1.42	(3)	21	18
Short-term bank notes				1,275	5	1.46	(5)		(5)
Other short-term borrowings	**5,619**	**41**	**2.92**	7,152	23	1.27	(6)	24	18
Long-term debt	**16,914**	**163**	**3.80**	15,055	102	2.71	15	46	61
Total interest-bearing liabilities	**76,936**	**546**	**2.82**	71,966	286	1.58	38	222	260
Demand deposits	**13,977**			12,537					
Other liabilities	**3,335**			2,848					

Total liabilities	**94,248**			87,351					
Shareholders equity	**9,451**			8,861					
Total liabilities and shareholders equity	**$ 103,699**			$ 96,212					
Net interest income margin (taxable equivalent)		**$ 745**	**3.16%**		$ 766	3.42%	$ 42	(63)	(21)
Net interest rate spread (taxable equivalent)			**2.66%**			3.12%			
Interest-bearing liabilities to interest-earning assets			**82.31%**			80.77%			

(a) Changes in interest not solely due to volume or yield/rate are allocated in proportion to the absolute dollar amount of change in volume and yield/rate.

(b) The net taxable equivalent adjustment amounts included in the above table are $8 million and $9 million for the three months ended September 30, 2005 and 2004, respectively.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

The interest on core deposits increased $127 million, or 113%, in the third quarter of 2005 over the comparable period in 2004 due to increases in short-term interest rates and increasing average balances. Average core deposits increased $5.9 billion, or 12%, compared to the third quarter of 2004. The growth in noninterest-bearing funds and other core deposits is a critical component in the growth of net interest income. For the third quarter of 2005, the benefit to net interest margin of free funding increased to 50 bp from 30 bp in the third quarter of 2004. A key focus of the Registrant continues to be growing its transaction deposit products, such as checking, savings and money market accounts, in order to reduce its reliance on other sources to fund the expected growth in the balance sheet.

The interest on wholesale funding and long-term debt increased by $133 million, or 43%, in the third quarter over the comparable period in 2004 primarily due to increases in short-term rates. Average wholesale funding and short-term bank notes decreased $1.3 billion, or 7%, while average long-term debt increased $1.9 billion, or 11%, in the third quarter of 2005 over the comparable period in 2004.

TABLE 3: Consolidated Average Balance Sheets and Analysis of Net Interest Income (FTE)

For the nine months ended September 30,	**2005**			2004			Attribution of Change in Net Interest Income *(a)*		
($ in millions)	**Average Balance**	**Revenue/ Cost**	**Average Yield/ Rate**	Average Balance	Revenue/ Cost	Average Yield/ Rate	Volume	Yield/Rate	Total
Assets									
Interest-earning assets:									
Loans and leases *(b)*	**$ 66,812**	**$ 2,829**	**5.66%**	$ 56,236	$ 2,081	4.94%	$ 424	324	748
Securities:									
Taxable	**24,569**	**789**	**4.30**	29,696	925	4.16	(164)	28	(136)
Exempt from income taxes *(b)*	**819**	**46**	**7.35**	935	52	7.47	(6)		(6)
Other short-term investments	**190**	**3**	**2.35**	260	2	1.15	(1)	2	1
Total interest-earning assets	**92,390**	**3,667**	**5.31**	87,127	3,060	4.69	253	354	607
Cash and due from banks	**2,728**			2,140					
Other assets	**8,101**			5,625					
Allowance for loan and lease losses	**(718)**			(723)					
Total assets	**$ 102,501**			$ 94,169					
Liabilities									
Interest-bearing liabilities:									
Interest checking	**$ 19,240**	**$ 220**	**1.53%**	$ 19,464	$ 118	.81%	$ (1)	103	102
Savings	**9,660**	**109**	**1.51**	7,771	36	.62	11	62	73
Money market	**4,900**	**90**	**2.46**	3,220	23	.94	16	51	67
Other time deposits	**8,271**	**182**	**2.94**	6,049	117	2.59	47	18	65
Certificates $100,000 and over	**3,883**	**89**	**3.05**	2,502	35	1.88	25	29	54
Foreign office deposits	**4,056**	**89**	**2.94**	4,575	39	1.12	(5)	55	50
Federal funds purchased	**4,040**	**89**	**2.96**	6,238	52	1.12	(24)	61	37
Short-term bank notes	**332**	**6**	**2.60**	941	9	1.24	(8)	5	(3)
Other short-term borrowings	**5,250**	**102**	**2.60**	7,143	56	1.02	(18)	64	46
Long-term debt	**16,528**	**429**	**3.47**	12,564	279	2.98	99	51	150
Total interest-bearing liabilities	**76,160**	**1,405**	**2.47**	70,467	764	1.45	142	499	641
Demand deposits	**13,791**			12,065					
Other liabilities	**3,288**			2,901					
Total liabilities	**93,239**			85,433					
Shareholders equity	**9,262**			8,736					
Total liabilities and shareholders equity	**$ 102,501**			$ 94,169					
Net interest income margin (taxable equivalent)		**$ 2,262**	**3.27%**		$ 2,296	3.52%	$ 111	(145)	(34)
Net interest rate spread (taxable equivalent)			**2.84%**			3.24%			
Interest-bearing liabilities to interest-earning assets			**82.43%**			80.88%			

(a) Changes in interest not solely due to volume or yield/rate are allocated in proportion to the absolute dollar amount of change in volume and yield/rate.

(b) The net taxable equivalent adjustment amounts included in the above table are $24 million and $27 million for the nine months ended September 30, 2005 and 2004, respectively.

Provision for Loan and Lease Losses

The Registrant provides as an expense an amount for probable loan and lease losses within the loan portfolio that is based on the factors discussed in Critical Accounting Policies. The provision is recorded to bring the allowance for loan and lease losses to a level deemed appropriate by the Registrant. Actual credit losses on loans and leases are charged against the allowance for loan and lease losses. The amount of loans actually removed from the Condensed Consolidated Balance Sheets is referred to as charge-offs. Net charge-offs include current charge-offs, less recoveries in the current period on previously charged off assets.

The provision for loan and lease losses increased to $69 million in the third quarter of 2005 compared to $26 million in the same period last year. The comparison to last year is impacted by a reduction in the reserve for credit losses in the third quarter of 2004. The reduction in the reserve for credit losses resulted in a $27 million positive impact to earnings in 2004. In addition, average net loans and leases for the third quarter of 2005 increased 19% compared to the third quarter of 2004, and net charge-offs increased to $64 million compared to $57 million in the third quarter of 2004.

In the third quarter of 2005, net charge-offs as a percentage of average loans and leases decreased to .38% from .40% in the third quarter of 2004. The allowance for loan and lease losses as a percent of loans and leases declined to 1.06% from 1.23% at September 30, 2004. A portion of the decline in the allowance percentage is due to the acquisition of First National and its respective loan portfolio being recorded at fair value and not carrying over the previously existing allowance. Credit quality metrics and trends continued to remain stable at historically low levels for the Registrant. Refer to the Credit Risk Management section for further information on the provision for loan and lease losses, net charge-offs and other factors considered by the Registrant in assessing the credit quality of the loan portfolio and the allowance for loan and lease losses.

Noninterest Income

For the three and nine months ended September 30, 2005, noninterest income increased by two percent and decreased by six percent, respectively. The components of noninterest income for these periods are as follows:

TABLE 4: Noninterest Income

	For the three months ended September 30,		Percent Change	For the nine months ended September 30,		Percent Change
($ in millions)	**2005**	2004		**2005**	2004	
Electronic payment processing revenue	**$ 187**	152	23	**$ 535**	449	19
Service charges on deposits	**137**	134	2	**390**	389	
Mortgage banking net revenue	**45**	49	(8)	**132**	154	(14)
Investment advisory revenue	**89**	88	1	**269**	278	(3)
Operating lease revenue	**11**	35	(69)	**46**	129	(64)
Other noninterest income	**145**	137	6	**454**	545	(17)
Securities gains, net	**8**	16	(50)	**38**	42	(10)
Total noninterest income	**$ 622**	611	2	**$ 1,864**	1,986	(6)

Electronic payment processing revenue increased $35 million in the third quarter of 2005 compared to the same period last year. EFT revenue increased 22% and merchant processing revenue increased 23% compared to the same period in 2004. The Registrant continues to see strong trends in both merchant processing and financial institution volumes and corresponding impacts on processing volume. Fifth Third continues to see significant opportunities to attract new retailers and financial institution customers. The Registrant handles electronic processing for over 126,000 merchant locations and 1,500 financial institutions worldwide.

Service charges on deposits increased two percent in the third quarter of 2005 compared to the same period last year. Commercial deposit revenue declined one percent while consumer service charge revenue increased five percent. Net new consumer deposit account production increased by 17% (not annualized) in the third quarter. Despite growth in the number of relationships and overall activity, commercial service charges were negatively impacted compared to the third quarter last year by the increase in earnings credits on commercial customer demand deposit accounts due to the higher interest rate environment. Growth in the number of retail checking account relationships has improved consumer service charges and deposit generation continues to be a primary focus of the Registrant.

Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Mortgage banking net revenue declined to $45 million in the third quarter of 2005 from $49 million in the same period last year. The components of mortgage banking net revenue for the three and nine months ended September 30, 2005 and 2004 are as follows:

TABLE 5: Components of Mortgage Banking Net Revenue

	For the three months ended September 30,		For the nine months ended September 30,	
($ in millions)	**2005**	2004	**2005**	2004
Mortgage banking fees and loan sales	**$ 61**	45	**173**	177
Net valuation adjustments and amortization on mortgage servicing rights	**6**	(21)	**(27)**	(23)
Net (losses) gains and mark-to-market adjustments on both settled and outstanding free-standing derivative financial instruments	**(22)**	25	**(14)**	
Mortgage banking net revenue	**$ 45**	49	**132**	154

Mortgage banking fees and loan sales increased 36% over the third quarter of 2004. The increase was due to higher originations and corresponding mortgage sales, as mortgage originations increased to $2.9 billion in the third quarter of 2005 as compared to $1.7 billion in the same period last year.

The fluctuation and general rise in longer-term interest rates in the third quarter of 2005 and the corresponding general decrease in prepayment speeds led to the reversal of $27 million in temporary impairment on the MSR portfolio in the third quarter as compared to a reversal of temporary impairment of $3 million in the third quarter of 2004. Servicing rights are deemed impaired when a borrower s loan rate is distinctly higher than prevailing rates. The Registrant recognized a net loss of $23 million and a net gain of $23 million in the third quarter of 2005 and 2004, respectively, related to changes in fair value and settlement of free-standing derivatives purchased to economically hedge the MSR portfolio.

The Registrant maintains a non-qualifying hedging strategy to manage a portion of the risk associated with changes in impairment on the MSR portfolio. During the first nine months of 2005, the Registrant primarily used principal only swaps, interest rate swaps and swaptions to hedge the economic risk of the MSR portfolio as they were deemed to be the best available instruments for several reasons. Principal only swaps hedge the mortgage-LIBOR spread because they appreciate in value as a result of tightening spreads. They also provide prepayment protection by increasing in value when prepayment speeds increase, as opposed to MSRs that lose value in a faster prepayment environment. Swaptions are positive convexity hedges primarily used to hedge the negative convexity of the MSR portfolio. Receive fixed/pay floating interest rate swaps increase in value when interest rates do not increase as quickly as expected. Due to the increasing uncertainty as to the expected direction of longer-term interest rates, the Registrant increased the purchase of swaptions and receive fixed/pay floating derivatives used to economically hedge the MSR portfolio. As of September 30, 2005 and 2004, the Registrant held a combination of free-standing derivatives, including principal only swaps, swaptions and interest rate swaps with a net negative fair value of $10 million and a net positive fair value of $11 million, respectively, on outstanding notional amounts of $3.6 billion and $3.4 billion, respectively. In addition to the derivative positions used to economically hedge the MSR portfolio, the Registrant began to acquire various securities (primarily principal only strips) during the third quarter of 2005 as a supplement to its non-qualifying hedging strategy. Principal only strips increase in value as prepayments speeds increase, thus providing an economic hedge for the MSR portfolio. As of September 30, 2005, the Registrant s available-for-sale security portfolio included $178 million of securities related to the non-qualifying hedging strategy.

The Registrant s total residential mortgage loans serviced at September 30, 2005 and 2004 was $31.9 billion and $29.9 billion, respectively, with $24.5 billion and $23.5 billion, respectively, of residential mortgage loans serviced for others.

Investment advisory revenues increased one percent in the third quarter of 2005 compared to the same period last year with relatively flat performance across all categories. The Registrant continues to focus its sales efforts on integrating services across business lines and working closely with retail and commercial team members to take advantage of a diverse and expanding customer base. The Registrant expects near and intermediate term revenue trends to be driven by the degree of success in continuing to grow the institutional money management business and in penetrating a large middle market commercial customer base with retirement and wealth planning services. The Registrant is one of the largest money managers in the Midwest and as of September 30, 2005 had over $189 billion in assets under care and $33 billion in assets under management.

Operating lease revenue results from the consolidation in the third quarter of 2003 of a special purpose entity (SPE) formed for the purpose of the sale and subsequent leaseback of leased automobiles. The consolidation was the result of the Registrant s implementation of Financial Accounting Standards Board s (FASB) Interpretation No. 46R (FIN46R), Consolidation of Variable Interest Entities an interpretation of ARB 51 (revised December 2003). The operating lease revenue declined $24 million from the third quarter of last year to $11 million and will continue to decline as the automobile leases mature.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

The major components of other noninterest income for the three and nine months ended September 30, 2005 and 2004 are as follows:

TABLE 6: Components of Other Noninterest Income

	For the three months ended September 30,		Percent Change	For the nine months ended September 30,		Percent Change
($ in millions)	**2005**	2004		**2005**	2004	
Cardholder fees	**$ 15**	13	15	**$ 44**	36	22
Consumer loan and lease fees	**9**	15	(40)	**37**	43	(14)
Commercial banking revenue	**50**	43	16	**146**	125	17
Bank owned life insurance income	**23**	15	53	**68**	44	55
Insurance income	**9**	8	13	**23**	23	
Gain on sale of certain merchant processing contracts		9	(100)		157	(100)
Other	**39**	34	15	**136**	117	16
Total other noninterest income	**$ 145**	137	6	**$ 454**	545	(17)

Comparisons to the prior year are impacted by the $9 million gain on the sale of certain third party merchant contracts in the third quarter of 2004. Exclusive of the impact of this transaction, other noninterest income increased by 13% in the third quarter of 2005 compared to the same period last year; comparison being provided to supplement an understanding of fundamental revenue trends. The increase was primarily attributable to strong growth in commercial banking revenue (including customer interest rate derivative sales and international service fees), bank-owned life insurance and cardholder fees. Comparisons to prior year are also impacted by the acquisition of First National.

Noninterest Expense

The Registrant continues to focus on efficiency initiatives as part of its core emphasis on operating leverage. These initiatives include increasing levels of process automation, the rationalization and reduction of non-core businesses as they relate to the Registrant s retail and middle market customer base and an increased emphasis on required returns on invested capital.

Operating expense levels are often measured using the efficiency ratio (noninterest expense divided by the sum of net interest income (FTE) and noninterest income), which was 53.5% and 47.0% for the third quarter of 2005 and 2004, respectively. The major components of noninterest expense for the three and nine months ended September 30, 2005 and 2004 are as follows:

TABLE 7: Noninterest Expense

	For the three months ended September 30,		Percent Change	For the nine months ended September 30,		Percent Change
($ in millions)	**2005**	2004		**2005**	2004	
Salaries, wages and incentives	**$ 285**	252	13	**$ 846**	752	13
Employee benefits	**70**	64	9	**218**	205	6

Equipment expense	**26**	22	18	**76**	61	25
Net occupancy expense	**54**	45	20	**162**	137	18
Operating lease expense	**8**	24	(67)	**34**	94	(64)
Other noninterest expense	**289**	241	20	**828**	789	5
Total noninterest expense	**$ 732**	648	13	**$ 2,164**	2,038	6

Total noninterest expense increased 13% in the third quarter of 2005 compared to the same period last year due to increases in marketing, information technology, bankcard volume related costs and the significant investments in the sales force and retail distribution network. Salaries, wages and incentives increased 13% for the current quarter compared to 2004 due to sales force expansion and the addition of First National employees. Net occupancy expenses increased 20% in the third quarter of 2005 over the same period last year due to the addition of 133 new banking centers that did not involve the relocation or consolidation of existing facilities, 74 of which resulted from the First National acquisition. Operating lease expense declined 67% from the third quarter last year and is expected to continue to decline as the automobile leases mature.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

The major components of other noninterest expense for the three and nine months ended September 30, 2005 and 2004 are as follows:

TABLE 8: Components of Other Noninterest Expense

	For the three months ended September 30,		Percent Change	For the nine months ended September 30,		Percent Change
($ in millions)	**2005**	2004		**2005**	2004	
Marketing and communications	**$ 36**	25	44	**$ 98**	76	29
Deposit insurance	**2**	2		**6**	13	(54)
Postal and courier	**13**	12	8	**37**	37	
Bankcard	**69**	52	33	**195**	160	22
Intangible amortization	**11**	7	57	**35**	22	59
Franchise and other taxes	**4**	10	(60)	**24**	29	(17)
Loan and lease	**25**	19	32	**63**	58	9
Printing and supplies	**9**	8	13	**27**	24	13
Travel	**13**	10	30	**40**	27	48
Information technology and operations	**30**	22	36	**82**	63	30
Other	**77**	74	4	**221**	280	(21)
Total other noninterest expense	**$ 289**	241	20	**$ 828**	789	5

Total other noninterest expense increased by $48 million from the third quarter of 2004 primarily due to increases in marketing and communications, bankcard volume related costs and information technology expenses. Marketing and communications increased 44% compared to the third quarter of 2004 primarily due to increased spending on deposit campaign initiatives through direct mailings and media advertising. Bankcard expense increased 33% compared to last year due to an increase in the number of merchant and retail customers as well as continuing organic growth in debit and credit card usage causing a corresponding increase in debit transaction costs and membership fees.

Applicable Income Taxes

The Registrant s income before income taxes, applicable income tax expense and effective tax rate for each of the periods indicated were:

TABLE 9: Applicable Income Taxes

	For the three months ended September 30,		For the nine months ended September 30,	
($ in millions)	**2005**	2004	**2005**	2004
Income before income taxes	**$ 558**	694	**1,741**	2,014
Applicable income taxes	**163**	223	**524**	665
Effective tax rate	**29.2 %**	32.1	**30.1**	33.0

Applicable income tax expense for all periods include the benefit from tax-exempt income, tax-advantaged investments and general business tax credits, partially offset by the effect of nondeductible expenses. In 2005, the effective tax rate includes certain favorable impacts resulting from statute expirations and the conclusion of certain tax examinations.

LINE OF BUSINESS RESULTS

The Registrant operates four main business segments, as described in Note 14 to the Condensed Consolidated Financial Statements. For acquisitions accounted for under the purchase method, management pools historical results to improve comparability with the current period. For the prior periods presented, the income and average assets of First National have been included in the respective segments and are then eliminated by the Acquisitions caption to agree to the prior period s reported results.

Results of the Registrant s business segments are presented based on its management structure and management accounting practices. The structure and practices are specific to the Registrant; therefore, the financial results of the Registrant s business segments are not necessarily comparable with similar information for other financial institutions. The Registrant refines its methodologies from time to time as management accounting practices are improved and businesses change. Revisions to the Registrant s methodologies are applied on a retroactive basis.

The Registrant manages interest rate risk centrally at the corporate level by employing a funds transfer pricing (FTP) methodology. This methodology insulates the business segments from interest rate risk, enabling them to focus on servicing customers through loan originations and deposit taking. The FTP system assigns charge and credit rates to classes of assets and liabilities, respectively, based on expected duration. The Registrant has not changed the conceptual application of FTP during 2004 or 2005. The net impact of the FTP methodology is included in Other/Eliminations.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

The financial results of the business segments include allocations for shared services and headquarters expenses. Even with these allocations, the financial results are not necessarily indicative of the business segments financial condition and results of operations as if they were to exist as independent entities. Additionally, the business segments form synergies by taking advantage of cross-sell opportunities and when funding operations by accessing the capital markets as a collective unit. Net income by business segment is summarized as follows:

TABLE 10: Business Segment Results

	For the three months ended September 30,		For the nine months ended September 30,	
($ in millions)	**2005**	2004	**2005**	2004
Commercial Banking	**$ 197**	184	**583**	521
Retail Banking	**266**	271	**822**	809
Investment Advisors	**30**	29	**95**	90
Processing Solutions	**27**	34	**94**	180
Other/Eliminations	**(125)**	(39)	**(377)**	(222)
Acquisitions		(8)		(29)
Net income	**$ 395**	471	**1,217**	1,349

Commercial Banking

Commercial Banking provides a comprehensive range of financial services and products to large and middle-market businesses, governments and professional customers. In addition to the traditional lending and depository offerings, Commercial Banking products and services include, among others, cash management, foreign exchange and international trade finance, derivatives and capital markets services, asset-based lending, real estate finance, public finance, commercial leasing and syndicated finance.

Net income increased $13 million, or seven percent, compared to the third quarter of 2004 largely as a result of loan and deposit growth and success in customer interest rate and foreign exchange derivative sales. Average loans and leases included in the commercial banking segment increased 12% to $30.3 billion over the prior year third quarter, with strong results in commercial construction. Despite average demand deposits remaining flat from the prior year third quarter due to lower compensating balance requirements, average core deposits increased to $14.8 billion in the third quarter of 2005 from $12.5 billion in 2004, an 18% increase. The increase in average core deposits and loans and the related FTP impact led to a $42 million increase in net interest income compared to the same period last year.

Noninterest income increased $17 million, or 17%, compared to the same quarter last year largely due to an increase in customer interest rate derivative sales and international service revenue. Revenue from customer interest rate derivatives sales increased $8 million, or 266%, over the same period in 2004 and international service revenue, which includes letters of credit and foreign currency services, increased $3 million, or 11%. Increases in these categories were partially offset by a decline in service charges on commercial customer demand deposit accounts as higher short-term interest rates increased the earnings credits on these accounts.

Noninterest expense increased $38 million, or 25%, for the three months ended September 30, 2005 compared to the third quarter of 2004. The investment in sales personnel throughout 2004 and in 2005 primarily contributed to the increase in noninterest expense as total full-time equivalent sales employees increased 27% to 1,397 from 1,102 at the end of the third quarter of 2004.

Retail Banking

Retail Banking provides a full range of deposit and loan and leases products to individuals and small businesses, and includes the branch network, consumer finance and mortgage banking. Through 1,106 banking centers, Retail Banking offers depository and loan products, such as checking and savings accounts, home equity lines of credit, credit cards and loans for automobile and other personal financing needs, as well as products designed to meet the specific needs of small businesses, including cash management services. Consumer finance services generally include the Registrant s indirect lending activities, which include loans to consumers through dealers and federal and private student education loans, as well as the Registrant s financing of inventory for automobile and marine dealers. Mortgage banking activities include the origination, retention and servicing of mortgage loans, sales and securitizations of mortgage loans or pools of mortgage loans and all associated hedging activities.

Net income decreased $5 million, or two percent, compared to the third quarter of 2004 as an increase in net interest income was offset by a decline in noninterest income and by higher loan loss provision and noninterest expenses. Average loans and leases increased 13% compared to the third quarter of 2004 as a result of 14% increases in both direct and indirect installment loans and a 16% increase in residential mortgage. Average core deposits increased two percent over the third quarter of 2004 with double digit increases in savings, money market, demand deposits and consumer time deposits mitigated by an 18% decrease in interest checking. As a result of the growth in average loans and core deposits and the related net FTP impact, net interest income increased $56 million compared to the same period last year.

Third quarter 2004 earnings were positively impacted by a decrease in the provision for loan and lease losses. The reduced provision for loan and lease losses in the prior year quarter is the primary reason for the $15 million increase in provision in the current quarter as the provision for loan and lease losses returns to more normal levels.

Noninterest income declined six percent from the third quarter of 2004. Increases in electronic payment processing revenue from small business customers, up 37% over the third quarter of 2004, were offset by decreases in mortgage banking net revenue and operating lease revenue.

Noninterest expense increased eight percent compared to the third quarter of 2004 as lower operating lease expenses partially offset the increased employee related expenses and net occupancy costs resulting from banking centers opening as part of the de-novo growth effort. Since the third quarter of 2004, 59 new banking centers that did not involve relocation or consolidation of existing facilities have been opened due to de-novo growth. The Registrant continues to position itself for sustained long-term growth through new banking center additions in key markets.

Investment Advisors

Investment Advisors provides a full range of investment alternatives for individuals, companies and not-for-profit organizations. Investment Advisors primary services include trust, institutional, retirement, private client, asset management and broker-dealer services. Fifth Third Securities, Inc., an indirect wholly-owned subsidiary of the Registrant, offers full service retail brokerage services to individual clients. Fifth Third Asset Management, Inc., an indirect wholly-owned subsidiary of the Registrant, provides asset management services and also advises the Registrant s proprietary family of mutual funds, Fifth Third Funds.*

Net income increased $1 million, or three percent, in the third quarter of 2005 compared to the same period last year. This increase resulted from a 23% improvement in net interest income due to strong loan growth. Average loans and leases increased to $2.7 billion, a 22% increase from the third quarter last year. Noninterest income was relatively flat from the third quarter of last year and noninterest expense increased 10% as a result of increased sales force and information technology investments. In order to capitalize on an expanding customer base and additional growth opportunities, 134 full-time equivalent sales employees have been added since the third quarter of 2004, including 101 net new sales hires during 2005.

Processing Solutions

Fifth Third Processing Solutions provides electronic funds transfer, debit, credit and merchant transaction processing, operates the Jeanie® ATM network and provides other data processing services to affiliated and unaffiliated customers.

Net income decreased $7 million, or 20%, compared to the third quarter of 2004 largely due to the $9 million pretax gain resulting from the sale of certain third party contracts in the prior year. Excluding the impact of the sale, net income decreased by approximately seven percent; comparison being provided to supplement an understanding of the fundamental trends. EFT revenue was up 21% over the third quarter of last year primarily due to new customer additions. Merchant revenue increased 23% due to increased volume at existing customers and new customer additions. The strong increase in noninterest income was mitigated by a 28% increase in noninterest expense. Noninterest expense was up due to headcount additions, investment in information technology and volume-related network costs. The Registrant continues to see significant opportunities to attract new financial institution customers and retailers within this business segment.

Other/Eliminations

Other/Eliminations includes the unallocated portion of the investment portfolio, certain non-core deposit funding, unassigned equity and certain support activities and other items not attributed to the business segments.

The results of Other/Eliminations were primarily impacted by the decrease in interest income from investment securities and the increased cost of non-core deposit funding. Due to the balance sheet repositioning in the fourth quarter of 2004 and the continued run-off of the securities portfolio in 2005, interest income on the securities portfolio decreased $57 million from the third quarter of 2004. Interest expense on non-core deposit funding increased $132 million from the third quarter of 2004. This increase in interest expense resulted from an increase in the average interest rate on non-core deposit funding, which rose from 2.03% in the third quarter of 2004 to 3.52% in the third quarter of 2005. Additionally, the Registrant s increased reliance on longer-term funding also impacted the increase in interest expense.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

B ALANCE SHEET ANALYSIS

Loans

The table below summarizes the end of period commercial and consumer loans and leases, including loans held for sale, by major category:

TABLE 11: Components of Loans and Leases (including held for sale)

	September 30, 2005		December 31, 2004		September 30, 2004	
($ in millions)	**Balance**	**Percent of Total**	Balance	Percent of Total	Balance	Percent of Total
Commercial loans and leases:						
Commercial	**$ 18,596**	**27**	$ 16,058	26	$ 15,271	26
Mortgage	**9,138**	**13**	7,636	13	7,644	13
Construction	**5,880**	**8**	4,348	7	4,077	7
Leases	**3,619**	**5**	3,426	6	3,357	6
Total commercial loans and leases	**37,233**	**53**	31,468	52	30,349	52
Consumer loans and leases:						
Installment	**21,002**	**30**	18,094	30	17,838	30
Mortgage and construction	**9,213**	**13**	7,911	13	7,283	13
Credit card	**805**	**1**	843	1	809	1
Leases	**1,738**	**3**	2,051	4	2,209	4
Total consumer loans and leases	**32,758**	**47**	28,899	48	28,139	48
Total loans and leases	**$ 69,991**	**100**	$ 60,367	100	$ 58,488	100

Total loans and leases increased 20% over the third quarter of 2004 and 17% on an annualized basis over the second quarter. The Registrant has experienced double-digit loan growth in both the consumer and commercial categories as well as at the majority of its affiliates. The Registrant expects low double-digit loan growth rates to continue in the near term.

Commercial loan and lease outstandings, including loans held for sale, have exhibited continued strength and increased 18% compared to December 31, 2004 and 23% compared to September 30, 2004. The mix of commercial loans was essentially unchanged from prior periods. The increase in commercial loans and leases was impacted by the acquisition of $2.8 billion of commercial loans obtained in the First National transaction in the first quarter of 2005. Excluding the impact of the acquisition, commercial loans and leases increased 13% compared to September 30, 2004; comparison being provided to supplement an understanding of the fundamental lending trends.

Consumer loan and lease outstandings, including loans held for sale, increased 13% compared to December 31, 2004 and 16% compared to September 30, 2004. Consumer loan comparisons to the prior periods are impacted by the $1.1 billion of consumer loans obtained in the First National acquisition. Exclusive of the acquired loans, consumer loans and leases increased 12% compared to September 30, 2004; comparison being provided to supplement an understanding of the fundamental lending trends. The Registrant is continuing to devote significant focus on producing retail loan originations given the strong credit performance and attractive yields available in these products. Residential mortgage and construction loans, including held for sale, increased 16% compared to December 31, 2004 and increased 27% compared to September 30, 2004. Exclusive of the impact of the acquisition, residential mortgage and construction loans increased 16% compared to September 30, 2004; comparison being provided to supplement an understanding of the fundamental lending trends. Comparisons to prior periods are dependent upon

the volume and timing of originations as well as the timing of loan sales. Residential mortgage originations totaled $2.9 billion in the third quarter of 2005 compared to $2.0 billion in the fourth quarter of 2004 and $1.7 billion during the third quarter of 2004. Consumer lease balances decreased 15% from December 31, 2004 and 21% compared to September 30, 2004 largely resulting from continued competition from captive finance companies offering promotional lease rates. The acquisition of First National did not have a material impact on consumer lease balances.

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TABLE 12: Components of Average Loans and Leases

	September 30, 2005		December 31, 2004		September 30, 2004	
($ in millions)	**Balance**	**Percent of Total**	Balance	Percent of Total	Balance	Percent of Total
Commercial loans and leases:						
Commercial	**$ 18,203**	**27**	$ 15,565	26	$ 15,068	26
Mortgage	**9,095**	**13**	7,617	13	7,582	13
Construction	**5,700**	**8**	4,247	7	3,963	7
Leases	**3,537**	**5**	3,333	6	3,300	6
Total commercial loans and leases, including held for sale	**36,535**	**53**	30,762	52	29,913	52
Consumer loans and leases:						
Installment	**20,570**	**30**	17,995	30	17,707	31
Mortgage and construction	**8,895**	**13**	7,724	13	6,983	12
Credit card	**778**	**1**	827	1	797	1
Leases	**1,778**	**3**	2,132	4	2,279	4
Total consumer loans and leases, including held for sale	**32,021**	**47**	28,678	48	27,766	48
Total loans and leases, including held for sale	**$ 68,556**	**100**	$ 59,440	100	$ 57,679	100
Total loans and leases, excluding held for sale	**$ 67,539**		$ 58,714		$ 57,160	

On an average basis, commercial loans and leases increased $6.6 billion, or 22%, compared to the third quarter 2004 with the Registrant experiencing double-digit growth in the majority of its affiliate markets, including 20% or greater growth in Lexington, Chicago and Ohio Valley. The increase in average commercial loans and leases was primarily driven by strong growth in commercial construction loans, commercial and industrial loans and commercial mortgages, which increased 44%, 21% and 20%, respectively, over third quarter 2004. Excluding the impact of the First National acquisition, average commercial loans and leases increased $3.8 billion, or 13%, compared to the third quarter 2004; comparison being provided to supplement an understanding of the fundamental lending trends.

On an average basis, consumer loans and leases increased $4.3 billion, or 15%, compared to the third quarter 2004 with the Registrant experiencing double-digit growth in the majority of its affiliate markets, including 15% or greater growth in Florida, Nashville, Cleveland, Cincinnati and Northern Michigan. The growth in average consumer loans and leases was a result of double-digit growth in residential mortgage and construction loans and consumer installment loans mitigated by decreases in consumer leases and credit card loans. Excluding the impact of the First National acquisition, average consumer loans and leases increased $3.1 billion, or 11%, compared to the third quarter 2004; comparison being provided to supplement an understanding of the fundamental lending trends.

Investment Securities

Total investment securities were $23.0 billion, $25.0 billion and $31.9 billion at September 30, 2005, December 31, 2004 and September 30, 2004, respectively. Increasing long-term interest rates during the third quarter of 2005 resulted in an increase in the net unrealized loss on the available-for-sale securities portfolio from $167 million at June 30, 2005 to $456 million at September 30, 2005. At September 30, 2005, 16% of the debt securities in the available-for-sale portfolio were adjustable-rate instruments, compared to 14% at December 31, 2004 and 15% at September 30, 2004. The estimated average life of the debt securities in the available-for-sale portfolio at September 30, 2005 and December 21, 2004 was 4.4 years compared to 4.3 years at September 30, 2004. This slight increase from prior periods was primarily due to the change in prepayment expectations, which decelerated based on the increases in longer-term interest rates during the quarter.

Information presented in Table 13 is on a weighted-average life basis, anticipating future prepayments. Yield information is presented on an FTE basis and is computed utilizing historical cost balances. Maturity and yield calculations for the total available-for-sale portfolio exclude equity

securities that have no stated yield or maturity.

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TABLE 13: Characteristics of Available-for-Sale Securities

As of September 30, 2005 ($ in millions)	Amortized Cost	Fair Value	Weighted-Average Life (in years)	Weighted-Average Yield
U.S. Treasury and Government agencies:				
Average life of one year or less	$ 1	$ 1	0.8	7.01%
Average life 1 5 years				
Average life 5 10 years				