



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 22, 2008

James S. Keller, Esq.
Chief Regulatory Counsel
The PNC Financial Services Group, Inc.
One PNC Plaza, 21st Floor
Pittsburgh, Pennsylvania 15222

Dear Mr. Keller:

This is in response to the request by The PNC Financial Services Group, Inc. ("PNC"), Pittsburgh, Pennsylvania, for temporary relief from the Board's risk-based and leverage capital guidelines for bank holding companies ("Capital Rules")¹ in connection with its proposal to acquire National City Corporation ("National City"), Cleveland, Ohio.

PNC has requested that the Board (i) grant PNC additional time to comply with the 15 percent limit ("15 percent limit") on including restricted core capital elements in tier 1 capital that will apply to internationally active banking organizations as of March 31, 2009;² (ii) allow PNC to include a greater amount of deferred tax assets that are dependent on future taxable income ("DTAs") in tier 1 capital than is permitted by the Capital Rules; and (iii) allow PNC to delay implementation of the Basel II advanced risk-based capital adequacy framework ("Advanced Approaches").³ The Board has broad authority to provide exemptions from the Capital Rules.⁴

¹ 12 CFR part 225, Appendices A and D.

² 70 Federal Register 11827 (March 10, 2005). Restricted core capital elements include qualifying cumulative perpetual preferred stock, certain forms of minority interest, and qualifying trust preferred securities. See 12 CFR part 225, Appendix A, § II.A.1.a.

³ 12 CFR part 225, Appendix G.

⁴ See 12 CFR part 225, Appendix A, § III.A; 12 CFR part 225, Appendix D, § II.b.; 12 CFR part 225 Appendix G, § 1(c).

Under the Capital Rules, cumulative perpetual preferred stock and trust preferred securities may not comprise more than 25 percent of a bank holding company's tier 1 capital. As of March 31, 2009, however, internationally active banking organizations will be subject to the 15 percent limit. The Capital Rules define an internationally active banking organization to include, among other things, a bank holding company with total consolidated assets of \$250 billion or more. After its acquisition of National City, PNC's total consolidated assets would exceed \$250 billion, and it would become an internationally active banking organization subject to the 15 percent limit. PNC has requested a four-year transition period before becoming subject to the 15 percent limit. PNC has represented that, until it entered into an agreement to acquire National City in the fall of 2008, it did not anticipate becoming an internationally active banking organization by March 31, 2009.

Although the Board understands that PNC did not anticipate being subject to the 15 percent limit until recently and would need some additional time to implement plans for compliance after its acquisition of National City, PNC has not provided sufficient support for its request for relief from the limit for a four-year period. After reviewing the facts and circumstances of PNC's request, the Board concludes that a one-year transition period would allow PNC to make adjustments to its capital policy and strengthen its capital position in anticipation of being subject to the new limit. The Board expects PNC to strengthen the components of its tier 1 capital base during this adjustment period and believes that a longer time frame for adjustment would weaken incentives to implement capital plans and policies that are based on compliance with the limit. Accordingly, the Board grants PNC relief from the 15 percent limit until March 31, 2010. After the consummation of its proposed acquisition of National City and until March 31, 2010, PNC must comply with the Capital Rules on the same basis as non-internationally active bank holding companies.

The Capital Rules limit the amount of DTAs that a bank holding company may include in tier 1 capital to the lesser of (i) 10 percent of tier 1 capital or (ii) the amount of DTAs that the bank holding company expects to realize within one year of the calendar quarter-end date based on projections of future taxable income for that year ("look-forward period").⁵ PNC has asked to be allowed to include all DTAs in its tier 1 capital for five years, with no limit, as part of its overall plan for orderly absorption of the assets and liabilities of National City.

The Board believes that granting a look-forward period of five years with no limit would inappropriately provide PNC immediate capital relief for DTAs based on projections of earnings so far into the future as to be largely speculative in nature.

⁵ See 12 CFR part 225, Appendix A, § II.A.4.a.

However, a more limited look-forward period of three years or less, while maintaining a DTA ceiling of 10 percent of tier 1 capital, would allow PNC to use a substantial portion of the large amount of DTAs to be generated from acquiring a banking organization with financial difficulties. At the same time, a look-forward period of three years or less would provide greater certainty that PNC would obtain capital relief only for those DTAs that it would be able to use based on actual future earnings. In accordance with these conclusions, the Board grants PNC's request in part. After consummation of its acquisition of National City and until January 1, 2010, PNC may include an aggregate amount of DTAs in tier 1 capital equal to the lesser of (i) 10 percent of tier 1 capital or (ii) the sum of (A) the amount of DTAs acquired as a result of its acquisition of National City that PNC expects to realize within three years of the calendar quarter-end date based on projections of future taxable income for those three years plus (B) the amount of DTAs not related to National City that PNC expects to realize within one year of the calendar quarter-end date based on projections of future taxable income for that year. From January 1, 2010, to January 1, 2011, PNC may apply a look-forward period of two years, rather than three years, in the manner described above for DTAs acquired as a result of its acquisition of National City. This temporary DTA relief will expire on January 1, 2011.

The Board concludes that the limited and temporary relief from the Capital Rules described above would permit PNC to implement its capital and integration plans for National City in a safe, sound, and orderly manner. The Board notes that PNC would be well capitalized (as defined in section 225.2 of the Board's Regulation Y⁶) on consummation of the acquisition of National City even without the regulatory capital relief provided by the exemptions. Furthermore, PNC has acknowledged to the Board that it must seek to augment capital during the period the relief applies, through retention of earnings or the issuance of common stock or other capital instruments.

On consummation of its acquisition of National City, PNC would become subject to the Advanced Approaches due to its asset size.⁷ PNC has requested that the Board permit it to delay application of the Advanced Approaches until six months after completion of its integration of National City. The Board notes that a great deal of flexibility is built into the implementation requirements of the Advanced Approaches that should accommodate PNC's adoption of them after it acquires National City. Under the Advanced Approaches, PNC would have until six months after the end of the year in which the acquisition is consummated to formulate an

⁶ 12 CFR 225.2(r).

⁷ See 12 CFR part 225, Appendix G, § 1(b)(1).

internal plan for implementation of the Advanced Approaches for consideration by its board of directors. In addition, PNC has up to three years from the end of the year in which the acquisition is consummated to complete its parallel run under the Advanced Approaches. Furthermore, the Federal Reserve may extend this timeframe, if appropriate, based on the facts and circumstances of PNC's implementation process. Accordingly, the Board declines to provide PNC an extension of the time period for implementation of the Advanced Approaches at this time.

These determinations are specifically conditioned on compliance by PNC with all the commitments and representations made to the Board in connection with the request for exemptions. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the requests and, as such, may be enforced in proceedings under applicable law. These determinations are based on the specific facts and circumstances of the existing and proposed relationships between PNC and National City. Any material change in those facts or circumstances or any failure by PNC to observe any of its commitments or representations may result in a different determination or in revocation of the exemptions.

Sincerely yours,

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Cleveland
Office of the Comptroller of the Currency
Federal Deposit Insurance Corporation