PNC FINANCIAL SERVICES GROUP INC
Form 10-Q
August 10, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2009

or

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

For the transition period from to

Commission file number 001-09718

The PNC Financial Services Group, Inc.

(Exact name of registrant as specified in its charter)

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

One PNC Plaza, 249 Fifth Avenue, Pittsburgh, Pennsylvania 15222-2707

(Address of principal executive offices, including zip code)

(412) 762-2000

(Registrant s telephone number, including area code)

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

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

Yes x No ¨

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

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

Yes ¨ No x

As of July 31, 2009, there were 461,402,998 shares of the registrant s common stock ($5 par value) outstanding.

Table of Contents

The PNC Financial Services Group, Inc.

Cross-Reference Index to Second Quarter 2009 Form 10-Q

Table of Contents

FINANCIAL REVIEW

CONSOLIDATED FINANCIAL HIGHLIGHTS

THE PNC FINANCIAL SERVICES GROUP, INC.

Dollars in millions, except per share data	Three months ended June 30		Six months ended June 30	
Unaudited	**2009 (a)**	2008	**2009 (a)**	2008
FINANCIAL PERFORMANCE (b)				
Revenue				
Net interest income	**$ 2,182**	$ 977	**$ 4,487**	$ 1,831
Noninterest income	**1,805**	1,062	**3,371**	2,029
Total revenue	**3,987**	2,039	**7,858**	3,860
Noninterest expense	**2,658**	1,103	**4,986**	2,138
Pretax, pre-provision earnings	**$ 1,329**	$ 936	**$ 2,872**	$ 1,722
Provision for credit losses	**$ 1,087**	$ 186	**$ 1,967**	$ 337
Net income	**$ 207**	$ 517	**$ 737**	$ 901
Net income attributable to common shareholders	**$ 65**	$ 505	**$ 525**	$ 882
Diluted earnings per common share	**$ .14**	$ 1.45	**$ 1.16**	$ 2.54
Cash dividends declared per common share	**$ .10**	$ .66	**$ .76**	$ 1.29
Total preferred dividends declared	**$ 119**		**$ 170**	
TARP Capital Purchase Program preferred dividends	**$ 95**		**$ 142**	
Impact of TARP Capital Purchase Program preferred dividends per common share	**$ .21**		**$ .32**	
SELECTED RATIOS				
Net interest margin (c)	**3.60%**	3.47%	**3.70%**	3.28%
Noninterest income to total revenue	**45**	52	**43**	53
Efficiency (d)	**67**	54	**63**	55
Return on:				
Average common shareholders equity	**1.52%**	14.33%	**5.72%**	12.59%
Average assets	**.30**	1.47	**.53**	1.29

See page 56 for a glossary of certain terms used in this Report.

Certain prior period amounts have been reclassified to conform with the current period presentation, which we believe is more meaningful to readers of our consolidated financial statements.

(a) Results for the three months ended and six months ended June 30, 2009 include the impact of National City, which we acquired on December 31, 2008.
(b) The Executive Summary and Consolidated Income Statement Review portions of the Financial Review section of this Report provide information regarding items impacting the comparability of the periods presented.
(c) Calculated as annualized taxable-equivalent net interest income divided by average earning assets. The interest income earned on certain earning assets is completely or partially exempt from Federal income tax. As such, these tax-exempt instruments typically yield lower returns than taxable investments. To provide more meaningful comparisons of margins for all earning assets, 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. The taxable-equivalent adjustments to net interest income for the three months ended June 30, 2009 and June 30, 2008 were $16 million and $10 million, respectively. The taxable-equivalent adjustments to net interest income for the six months ended June 30, 2009 and June 30, 2008 were $31 million and $19 million, respectively.
(d) Calculated as noninterest expense divided by total revenue.

Table of Contents

CONSOLIDATED FINANCIAL HIGHLIGHTS (CONTINUED) (a)

Unaudited	June 30 2009 (b)	December 31 2008 (b)	June 30 2008
BALANCE SHEET DATA (dollars in millions, except per share data)			
Assets	**$ 279,754**	$ 291,081	$ 142,771
Loans	**165,009**	175,489	73,040
Allowance for loan and lease losses	**4,569**	3,917	988
Investment securities	**49,969**	43,473	31,032
Loans held for sale	**4,662**	4,366	2,288
Goodwill and other intangible assets	**12,890**	11,688	9,928
Equity investments	**8,168**	8,554	6,376
Deposits	**190,439**	192,865	84,689
Borrowed funds	**44,681**	52,240	32,472
Shareholders equity	**27,294**	25,422	15,108
Common shareholders equity	**19,363**	17,490	14,602
Accumulated other comprehensive loss	**3,101**	3,949	1,227
Book value per common share	**42.00**	39.44	42.17
Common shares outstanding (millions)	**461**	443	346
Loans to deposits	**87%**	91%	86%
ASSETS ADMINISTERED (billions)			
Managed	**$ 98**	$ 103	$ 67
Nondiscretionary	**124**	125	110
FUND ASSETS SERVICED (billions)			
Accounting/administration net assets	**$ 774**	$ 839	$ 988
Custody assets	**399**	379	471
CAPITAL RATIOS			
Tier 1 risk-based (c)	**10.5%**	9.7%	8.2%
Tier 1 common	**5.3**	4.8	5.7
Total risk-based (c)	**14.1**	13.2	11.9
Leverage (c) (d)	**9.1**	17.5	7.3
Common shareholders equity to assets	**6.9**	6.0	10.2
ASSET QUALITY RATIOS			
Nonperforming loans to total loans	**2.44%**	.95%	.95%
Nonperforming assets to total loans and foreclosed and other assets	**2.74**	1.24	1.00
Nonperforming assets to total assets	**1.62**	.75	.51
Net charge-offs to average loans (for the three months ended)	**1.89**	1.09	.62
Allowance for loan and lease losses to total loans	**2.77**	2.23	1.35
Allowance for loan and lease losses to nonperforming loans	**113**	236	142

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

(b) Includes the impact of National City, which we acquired on December 31, 2008.

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

(d) The ratio as of December 31, 2008 did not reflect any impact of National City on PNC s adjusted average total assets.

Table of Contents

FINANCIAL REVIEW

THE PNC FINANCIAL SERVICES GROUP, INC.

This Financial Review should be read together with our unaudited Consolidated Financial Statements and unaudited Statistical Information included elsewhere in this Report and with Items 6, 7, 8 and 9A of our 2008 Annual Report on Form 10-K (2008 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 and regulatory risks, see the Risk Management section in this Financial Review and Items 1A and 7 of our 2008 Form 10-K and Item 1A included in Part II of this Report. Also, see the Cautionary Statement Regarding Forward-Looking Information and Critical Accounting Policies And Judgments sections in this Financial Review for certain other factors that could cause actual results or future events to differ, perhaps materially, from historical performance and those anticipated in the forward-looking statements included in this Report. See Note 19 Segment Reporting in the Notes To Consolidated Financial Statements included in Part I, Item 1 of this Report for a reconciliation of total business segment earnings to total PNC consolidated net income as reported on a generally accepted accounting principles (GAAP) basis.

Effective July 1, 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. (SFAS) 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (FASB ASC 105-10, Generally Accepted Accounting Principles). The FASB Accounting Standards Codification™ (FASB ASC) will be the single source of authoritative nongovernmental US GAAP. The FASB ASC will be effective for financial statements that cover interim and annual periods ending after September 15, 2009. Other than resolving certain minor inconsistencies in current GAAP, the FASB ASC is not intended to change GAAP, but rather to make it easier to review and research GAAP applicable to a particular transaction or specific accounting issue. Technical references to GAAP included in this Report are provided under the new FASB ASC structure with the prior terminology included parenthetically the first time it appears.

EXECUTIVE SUMMARY

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.

As further described in Note 2 Acquisitions and Divestitures in our 2008 Form 10-K, on December 31, 2008, PNC acquired National City Corporation (National City). Our consolidated financial statements for the second quarter and first half of 2009 reflect the impact of National City.

PNC has businesses engaged in retail banking, corporate and institutional banking, asset management, residential mortgage banking and global investment servicing, providing many of its products and services nationally and others in PNC s primary geographic markets located in Pennsylvania, Ohio, New Jersey, Michigan, Maryland, Illinois, Indiana, Kentucky, Florida, Missouri, Virginia, Delaware, Washington, D.C., and Wisconsin. PNC also provides certain investment servicing internationally.

We expect to incur total merger and integration costs of approximately $1.2 billion pretax in connection with the acquisition of National City. This total includes $575 million pretax recognized in the fourth quarter of 2008 and $176 million pretax recognized in the first six months of 2009, including $125 million pretax in the second quarter. The transaction is expected to result in the reduction of approximately $1.2 billion of combined company annualized

noninterest expense through the elimination of operational and administrative redundancies.

We are in the process of integrating the businesses and operations of National City with those of PNC.

KEY STRATEGIC GOALS

We manage our company for the long term and are focused on returning to a moderate risk profile while maintaining strong capital and liquidity positions, investing in our markets and products, and embracing our corporate responsibility to the communities where we do business.

Our strategy to enhance shareholder value centers on driving pre-tax, pre-provision earnings that exceed credit costs by achieving growth in revenue from our balance sheet and diverse business mix that exceeds growth in expenses controlled through disciplined cost management. The primary drivers of revenue growth are the acquisition, expansion and retention of customer relationships. We strive to expand our customer base by offering convenient banking options and leading technology solutions, providing a broad range of fee-based and credit products and services, focusing on customer service, and through a significantly enhanced branding initiative. We may also grow revenue through appropriate and targeted acquisitions and, in certain businesses, by expanding into new geographical markets.

We are focused on our strategies for quality growth. We are committed to returning to a moderate risk profile characterized by disciplined credit management and limited

Table of Contents

exposure to earnings volatility resulting from interest rate fluctuations and the shape of the interest rate yield curve. Our actions have created a well-positioned and strong balance sheet, strong liquidity and investment flexibility to adjust, where appropriate and permissible, to changing interest rates and market conditions.

We also continue to be focused on building capital in the current environment characterized by economic and regulatory uncertainty. See the Funding and Capital Sources section of the Consolidated Balance Sheet Review section and the Liquidity Risk Management section of this Financial Review regarding certain restrictions on dividends and common share repurchases resulting from PNC s participation on December 31, 2008 in the US Department of the Treasury s Troubled Asset Relief Program (TARP) Capital Purchase Program and other regulatory restrictions on dividend capacity.

On March 1, 2009, our board of directors decided to reduce PNC s quarterly common stock dividend from $.66 to $.10 per share. Accordingly, the board of directors declared a quarterly common stock cash dividend of $.10 per share in April and July 2009. Our Board recognizes the importance of the dividend to our shareholders. While our overall capital and liquidity positions are strong, extreme economic and market deterioration and the changing regulatory environment drove this difficult but prudent decision. This proactive measure will help us build capital by approximately $1 billion annually, further strengthen our balance sheet and enable us to continue to serve our customers.

Supervisory Capital Assessment Program

(Stress tests)

On May 7, 2009, the Board of Governors of the Federal Reserve System announced the results of the stress tests conducted by banking regulators under the Supervisory Capital Assessment Program with respect to the 19 largest bank holding companies. As a result of this test, the Federal Reserve concluded that PNC was well capitalized but that, in order to provide a greater cushion against the risk that economic conditions over the next two years are worse than currently anticipated, PNC needed to augment the composition of its capital by increasing the common shareholders equity component of Tier 1 capital. In May 2009 we raised $624 million in new common equity at market prices through the issuance of 15 million shares of common stock. In connection with the Supervisory Capital Assessment Program, we submitted a capital plan which was accepted by the Federal Reserve.

Recent Market and Industry Developments

Since the middle of 2007 and with a heightened level of activity during the past 12 months, there has been unprecedented turmoil, volatility and illiquidity in worldwide financial markets, accompanied by uncertain prospects for the overall national economy, which is currently in the midst of a

severe recession. In addition, there have been dramatic changes in the competitive landscape of the financial services industry during this time.

Recent efforts by the Federal government, including the US Department of the Treasury, the Federal Reserve, the FDIC, and the Securities and Exchange Commission, to stabilize and restore confidence in the financial services industry have impacted and will likely continue to impact PNC and our stakeholders. These efforts, which will continue to evolve, include the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009, and other legislative, administrative and regulatory initiatives, including the US Treasury s TARP Capital Purchase Program, the FDIC s Temporary Liquidity Guarantee Program (TLGP) and the Federal Reserve s Commercial Paper Funding Facility (CPFF).

These programs, some of which are further described in Item 7 of our 2008 Form 10-K, include the following:

TARP Capital Purchase Program On December 31, 2008, PNC issued to the US Treasury $7.6 billion of preferred stock together with a related warrant to purchase shares of common stock of PNC, in accordance with the terms of the TARP Capital Purchase Program. Funds from this sale count as Tier 1 capital. Holders of this preferred stock are entitled to a cumulative cash dividend at the annual rate per share of 5% of the liquidation preference per year for the first five years after its issuance. After December 31, 2013, if these shares are still outstanding, the annual dividend rate will increase to 9% per year. We plan to redeem the US Treasury s investment as soon as appropriate in a shareholder-friendly manner, subject to approval by our banking regulators. We do not contemplate exchanging any of the shares of preferred stock issued to the US Treasury under the TARP Capital Purchase Program for shares of mandatorily convertible preferred stock.

Further information on these securities is included in Note 19 Shareholders Equity i