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**James S. Keller**
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July 13, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Notice of Proposed Rulemaking Concerning Trust Preferred
Securities and Related Matters – Docket No. R-1193

Dear Ms. Johnson:

The PNC Financial Services Group, Inc. ("PNC"), Pittsburgh, Pennsylvania, wishes to take this opportunity to comment on the notice of proposed rulemaking ("Proposal") of the Board of Governors of the Federal Reserve System ("Board") regarding the ongoing capital treatment of trust preferred securities ("TPS") (69 *Fed. Reg.* 28851 (May 19, 2004)). Uncertainty regarding the capital treatment of TPS has existed since the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46 in early 2003, as later revised in Interpretation No. 46R ("FIN 46R"). PNC appreciates the Board's efforts to resolve these issues and for the opportunity to provide suggestions for your consideration.

**INTRODUCTION**

PNC is one of the largest diversified financial organizations in the United States, with $74.1 billion in total assets as of March 31, 2004. Its major businesses include community banking, corporate banking, real estate finance, asset-based lending, wealth management, and global fund processing services. PNC's lead bank, PNC Bank, National Association, Pittsburgh, Pennsylvania, has branches in Indiana, Kentucky, New Jersey, Ohio, and Pennsylvania.

PNC currently has $1.2 billion of TPS outstanding. This includes three issuances totaling $850 million that were completed by PNC between 1996 and 1998. A fourth issuance for $300 million was completed in December 2003. An additional $46 million of TPS was assumed by PNC as of January 1, 2004, with the acquisition of United National Bancorp, Bridgewater, New Jersey.

PNC issued its various TPS in conformance with all applicable guidance in effect at the time of each issuance. At the most recent issue date, December 2003, PNC complied with the current quantitative guidelines and standards for inclusion of TPS in Tier 1 capital.

PNC has informally indicated its interest in pursuing voluntary implementation of the Advanced Internal Ratings Based Approach under BASEL II ("Advanced Method"), and we therefore assume the Board currently considers PNC, along with other institutions that may have indicated a similar interest, a candidate for the Advanced Method under the proposals for a new Basel accord ("Candidate Bank") for purposes of this Proposal. Under the Proposal, approximately $740 million, or 62 percent, of PNC's $1.2 billion of TPS would be excluded from PNC's Tier I capital. If PNC were not considered a Candidate Bank, only $100 million of the currently outstanding TPS would exceed the redefined 25 percent limitation.

The Proposal provides for a transition period of less than three years. During this period, bank holding companies with TPS exceeding the proposed quantitative limit would be required to consult with the Board on a plan to ensure no undue reliance on TPS and, where appropriate, to reduce such reliance. PNC believes that a three-year transition period would provide little practical value when dealing with 30-year instruments. Any "excess" TPS could be reduced only by market repurchases or the exercise of call options. Such significant reductions of TPS would likely be accomplished only by means of the payment of call premiums or unattractive repurchase terms, and would include the write-off of related issuance costs.

**RECOMMENDATIONS**

Below is a summary of PNC's recommendations, which are discussed in greater detail in the remainder of the letter:

(1) The Board should reconsider application of the more restrictive 15 percent quantitative limit to those institutions or Candidate Banks that opt in to the Advanced Method.

(2) If the Board should determine it is necessary that all banks utilizing the Advanced Method (whether required or by way of opt in) must consistently utilize the redefined 15 percent quantitative limit, then those banks that previously indicated an interest in opting in should be permitted to reconsider such intention.

(3) Alternatively, the Candidate Banks (if not all U.S. banks) should be provided relief through grandfathering or a much longer transition period.

(4) The Board should reconsider the application of a single quantitative limit to "restricted core capital elements" as defined in the Proposal, since a single limit does not reflect the significant differences in capital attributes.

**DISCUSSION**

In the Proposal, the Board describes at length the positive attributes of, and regulatory/industry experience with, TPS since their inception in 1996, which can be summarized as follows:

- TPS have long lives, which approach perpetuity.

- The five-year deferral right approaches "economic infinity."

- TPS are available to absorb losses on a broad basis throughout the consolidated holding company, and in this regard function at a level approaching common or non-cumulative preferred equity. The Board states that in numerous instances TPS have in practice functioned to absorb losses.

- TPS have been very successfully marketed to, and are well understood by, a large and diverse investor group. Over the last several years, this has provided even smaller institutions with a source of capital and market access not previously available to them through any other Tier I capital component.

- TPS provide a cost-effective source of capital, promoting a competitive environment for U.S. banking organizations versus their foreign counterparts and competitors.

- The Board recognized the superior loss absorption and other qualitative capital attributes of TPS compared to those of REIT preferred and minority interests in non-bank affiliates (hereinafter collectively referred to as "REIT/NBMI").

- Because of market discipline, undue reliance on TPS by larger institutions has generally not been a concern. Also, those institutions historically considered "internationally active" have been aware of, and presumably have operated in conformance with, the Board's informal 15 percent "innovative instruments" standard since 1998.

Based on its experience with the TPS product, PNC agrees with the Board's observations regarding the positive capital attributes and industry experience. PNC acknowledges, however, that a quantitative limit on TPS should continue to exist to ensure that an appropriate level of common equity is represented within Tier I capital. The Proposal would amend the existing limit (the "Current 25 Percent Limit) in three primary ways:

1. The limit would apply to "restricted core capital elements," which include TPS, cumulative preferred stock, and REIT/NBMI;

2. Goodwill would be deducted from the base to which the limit applies; and

3. The limit would be reduced from 25 percent to 15 percent for "internationally active" banks and Candidate Banks.

PNC agrees that the inclusion of REIT/NBMI in Tier I capital should become subject to a quantitative limit. However, PNC believes that the Board should reconsider its proposed application of a single quantitative limit to TPS, cumulative preferred stock, and REIT/NBMI. Use of a single limit does not reflect the significant difference in capital attributes that the Board discussed at length in the Proposal. We recommend that two limits be considered: one for the total of TPS and cumulative preferred stock (reflecting their superior capital attributes), and a separate limitation on REIT/NBMI.

As noted above, the Proposal reduces the quantitative limit from 25 percent to 15 percent not only for the "internationally active" banks, but also the Candidate Banks. The effect of the definitional changes (inclusion of REIT/NBMI and the deduction of goodwill), and this reduction to a 15 percent limit, could be expected to have a disparate impact on the U.S. banking industry, as follows:

- The internationally active banks would be impacted only by the definitional changes, as they have been aware of, and presumably operated in conformance with, the informal 15 percent innovative instruments standard since 1998.

- Smaller institutions, and larger/midsize banks not considered Candidate Banks, would also be impacted only by the definitional changes, since the reduction from 25 percent to 15 percent would not apply to them.

- However, the Candidate Banks would be impacted by **both** the definitional changes and the reduction from a 25 percent to a 15 percent limit.

As discussed above, PNC issued its various TPS in conformance with all applicable guidance that existed at the time of each issuance. At the most recent issue date, December 2003, PNC complied with the Current 25 Percent Limit, and would have complied on a pro forma basis with the 15 percent innovative instruments standard. If PNC were not considered a Candidate Bank, only $100 million, rather than $740 million, of its currently outstanding $1.2 billion of TPS would exceed the redefined 25 percent limitation. We believe other institutions currently considered Candidate Banks could also be significantly impacted. PNC believes the Board should be encouraging banking organizations to become Candidate Banks by voluntarily implementing the Advanced Method rather than introducing a significant financial cost of doing so.

In the Proposal, the Board asks for comment regarding the proposed formal imposition of the 15 percent limit for internationally active banks, and if the Board should be more explicit in its definition of internationally active banks for purposes of the Proposal. PNC understands that one of the Board's overall objectives may be consistent treatment for all banks operating under the Advanced Method. However, we recommend the Board reconsider the effective application of the definition of internationally active and the more restrictive 15 percent quantitative limit to those institutions that opt in to the Advanced Method.

If the Board determines it is necessary that all banks utilizing the Advanced Method (whether required or by way of opt-in) must consistently utilize the redefined 15 percent quantitative limit, then those banks that previously indicated an interest in opting in should be permitted to reconsider. Such reconsideration by a Candidate Bank would incorporate the unexpected financial penalty of the reduction in TPS includable in Tier I capital caused by the definitional and quantitative changes.[1]

The Proposal provides for a transition period of less than three years. During this period, bank holding companies with TPS exceeding the proposed quantitative limit would be required to consult with the Board on a plan to ensure no undue reliance on TPS and, where appropriate, to reduce such reliance. PNC believes that a three-year transition period would prove of little consequence when dealing with 30-year instruments. TPS often have no-call periods for 10 years, significant call premiums thereafter, and issuance costs that are materially higher than for other capital instruments, such as subordinated debt. Any “excess” TPS could be reduced only by market repurchases or the exercise of call options, which on an industry-wide basis could involve a large amount of securities. Such significant reductions of TPS would likely be accomplished only by means of the payment of call premiums or unattractive repurchase terms, and would include the write-off of related issuance costs and, therefore, further reduce Tier 1 capital.

Rather than the proposed three-year transition period, we believe that the Board should consider a grandfathering approach, such as:

- For each TPS issued prior to May 6, 2004 (the date of the Proposal), the Current 25 Percent Limit should apply up until five years before the scheduled maturity date of the underlying junior subordinated debt, or until otherwise called or repurchased. When within five years of scheduled maturity of the underlying junior subordinated debt, TPS would be reclassified from Tier 1 capital to Tier 2 capital and subject to the same risk-based capital limitations as subordinated debt. Any TPS issued subsequent to May 5, 2004, would not qualify for the Current 25 Percent Limit. This would apply to all U.S. banks except those historically considered internationally active under the Board’s informal 1998 innovative instruments standard.

- For internationally active banks, the 15 percent innovative instruments standard (before the definitional changes set forth in the Proposal) would similarly be grandfathered.

PNC believes that a grandfathering approach such as the above, which extends to scheduled maturity, is appropriate given the long-term nature and structure of TPS and that the industry as a whole issued these securities in good faith based on specific regulatory guidance or standards.

However, another approach would be for the grandfathering to extend, for each TPS issue, until the greater of: (1) the date as of which any “excess” TPS is callable at par, or (2) 15 years from

[1] Also, the bank regulatory agencies have subsequently announced their intention to amend the 1998 BASEL I accord for the ongoing use by the vast majority of U.S. banking organizations. When the Candidate Banks indicated their interest in voluntarily opting in to the Advanced Method, their only alternative was to continue operating under the existing 1998 accord. The plan to amend the BASEL I accord may result in an improved alignment of capital requirements with risk, yet do so in a less complicated manner than BASEL II, thus providing an alternative that would be less costly to implement and operate going forward, which the Candidate Banks should have an opportunity to study, evaluate and comment upon.

the date of issuance to allow all TPS to be included in Tier I capital for at least half their original 30-year term (in consideration of the often significant issuance costs that had been incurred).

With regard to the definitional changes of the Proposal, PNC acknowledges that the proposed deduction of goodwill would result in more consistency among institutions that in the past have recorded acquisitions using either of the permitted purchase or pooling of interests methods of accounting. The Proposal would result in the quantitative limit applying to tangible capital, which would eliminate the historical inconsistencies resulting from the permitted use of these two accounting methods until the pooling method was eliminated by FASB's Statement No. 141 in 2001. The deduction of goodwill for purposes of the quantitative limits would also be consistent with the long-standing definition of Tier I capital.

However, we expect the impact of this change would be more significant for the internationally active and large- to mid-size regional banks that have been most active in the industry consolidation process. The Board states in its Proposal that some smaller institutions that have participated in trust issuance pools have over relied on TPS, and that one of the objectives of the Proposal is to eliminate such over reliance. PNC believes that the proposed deduction of goodwill will have the least impact on these smaller institutions, which, presumably, have had less participation in the ongoing industry consolidation process.

The Board also requested comment on the proposed continuation of the current requirement for a call option on TPS no later than ten years from the date of issuance. PNC believes that this call option requirement is inconsistent with one of the primary characteristics necessary for Tier I capital treatment, which is that the life of the security be perpetual. (In the case of TPS, the minimum 30-year term is considered as approaching economic perpetuity.) Lack of a call option would not impact the loss absorption qualities of TPS. PNC therefore recommends that the requirement for any call option, for treatment of TPS as Tier I capital, be eliminated. We believe, however, that even in this event the majority of newly issued TPS would continue to incorporate a call option feature due to the long term flexibility such a call option provides.

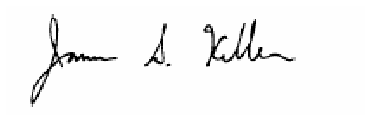
**CONCLUSION**

In conclusion, we believe that the Board should give careful consideration to the fact that a number of banking organizations, placing good faith reliance on the rules and guidance in place at the time, could be significantly and adversely impacted by the Proposal.

* * *

Thank you for considering the views expressed in this letter. If you have any questions, please feel free to contact me.

Sincerely yours,



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