UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 54906 / December 11, 2006

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2522 / December 11, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12501

In the Matter of

THOMAS F. GARBE,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted against Thomas F. Garbe ("Garbe" or "Respondent") pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act")**.**

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement of Thomas F. Garbe ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

In 2001, the PNC Financial Services Group, Inc. ("PNC") endeavored to remove certain loans and venture capital investments from its financial statements by transferring them to certain entities that were specially created to receive these assets. PNC made these transfers in order to reduce its exposure to loan losses and venture capital investment losses. PNC intended that the entities receiving these assets be regarded as "special purpose entities" ("SPEs") under generally accepted accounting principles ("GAAP") that would not have to be consolidated with PNC. For the second and third quarters of 2001, PNC filed financial statements with the Commission that did not consolidate these entities.

PNC's accounting with respect to these entities was improper under GAAP, and PNC made materially inaccurate statements in its filings with the Commission about its financial condition and performance, including, among other things, a material overstatement of its 2001 earnings. PNC's failure to account properly for these transactions, and its inaccurate disclosures, created a materially inaccurate picture that it was reducing its exposure to commercial lending and venture capital activities. Further, PNC's books and records were inaccurately maintained in connection with these transactions. Accordingly, PNC violated, among other provisions, reporting and recordkeeping provisions of the federal securities laws.[2]

Respondent Garbe failed to inquire adequately about facts and circumstances and was a cause of PNC's violations of the reporting and recordkeeping provisions of the federal securities laws. During 2001, Garbe was the head of PNC's Accounting Policy department, and, as such, had responsibility for ensuring that PNC's accounting for each of the three transactions described below was in conformity with GAAP. Garbe participated in discussions for the three transactions into which PNC entered with American International Group, Inc. ("AIG") during 2001, reviewed transaction-related documents, and researched and analyzed the proposed accounting treatment for those transactions. Garbe should have inquired further to determine if certain features of the transactions made nonconsolidation of the entities by PNC improper under GAAP. Most significantly, Garbe failed to adequately inquire whether the fees paid to AIG reduced AIG's investments in the SPEs below the point at which nonconsolidation would be appropriate under GAAP. Garbe, however, as head of PNC's Accounting Policy department, approved PNC's

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1 The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

2 The Commission previously brought settled proceedings against both PNC and AIG related to their roles in these matters. PNC Financial Services Group, Inc., Securities Act Release No. 8112, Exchange Act Release No. 46225, Accounting and Auditing Enforcement Release No. 1597 (July 18, 2002); SEC v. American International Group, Inc., No. 1:04CV02070 (GK) (D.D.C. judgment entered Dec. 7, 2004).

accounting for the three transactions and thereby was a cause of PNC's violation of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13.

B. RESPONDENT

Thomas F. Garbe, age 54, was the director of PNC's Accounting Policy department from December 2000 to December 2001. The Accounting Policy department followed and reported on relevant accounting literature and examined the accounting for all significant transactions at PNC to determine the proper accounting for them. In January 2002, Garbe became director of Financial Accounting at PNC. Garbe resides in Pittsburgh, Pennsylvania and is a certified public accountant licensed in North Carolina and Pennsylvania.

C. RELEVANT ENTITIES

1. **The PNC Financial Services Group, Inc.** is a Pennsylvania corporation with its principal place of business in Pittsburgh, Pennsylvania. PNC is a bank holding company that is regulated by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Cleveland (together the "Federal Reserve") and has a national bank subsidiary that is regulated by the Comptroller of the Currency.

2. **American International Group, Inc.** is a Delaware Corporation with its principal place of business in New York, New York. Through its subsidiaries, AIG is engaged in a broad range of insurance-related and asset management activities in the United States and abroad.

D. FACTS

1. <u>Structure and Accounting Treatment of Special Purpose Entity Transactions</u>

During 2001, PNC entered into three transactions with AIG, "PAGIC I," "PAGIC II", and "PAGIC III," respectively. Each PAGIC transaction was intended to transfer certain loan or venture capital assets from PNC's balance sheet to a SPE. Each transaction involved the creation of two limited liability companies, one of which sold a substantial ownership interest to PNC and a minority ownership interest to AIG. With funds received in exchange for its shares, each PAGIC entity purchased loan or venture capital assets from PNC; some assets were acquired directly in exchange for shares. Many of the loan and other assets transferred by PNC were volatile, troubled or nonperforming.

In each of the second, third and fourth quarters of 2001, PNC entered into a PAGIC transaction. In its original financial reports filed with the Commission for the second and third quarters of 2001, PNC treated the loan and other assets transferred to the SPEs as if they were no longer assets of PNC. PNC intended that, as a result of the PAGIC transactions, PNC's balance sheet would reflect a reduction in exposure to troubled loans and volatile assets. PNC also intended, as a result of the PAGIC transactions, not to charge losses on the loans and other assets transferred to the SPEs against its income.

In sum, PNC transferred a total of approximately $762 million in loan and venture capital assets to the PAGIC SPEs, and PNC received preferred stock in exchange. PNC continued to service the loans and other assets transferred to the SPEs.

PNC's ability to treat the assets transferred to the PAGIC SPEs as no longer owned by PNC depended upon whether the transactions complied with the GAAP requirements for nonconsolidation of SPEs. As is discussed in greater detail below, at the time PNC entered into each of the PAGIC transactions, GAAP required, among other things, that an independent third party be the majority owner of each PAGIC SPE and that the independent third party provide a substantive capital investment in the SPE. Three percent was the minimally acceptable amount under GAAP to indicate a substantive capital investment sufficient for nonconsolidation. GAAP further provided that fees paid to the owner of the SPE for structuring the transaction were treated as a return of the owner's initial capital investment.

In fact, none of the PAGIC transactions complied with the GAAP requirements for nonconsolidation, in part because, in each transaction, AIG was to receive a fee that was in substance a structuring fee that eroded its minimum capital investment in the SPE. Therefore, PNC's second and third quarter 2001 financial statements included in the company's Forms 10-Q were not presented in conformity with GAAP. In short, PNC improperly treated the transfers of assets to the PAGIC SPEs as sales, when it should have consolidated the assets of the PAGIC entities in its financial statements. This failure to consolidate resulted in, among other things, (a) a material overstatement of PNC's earnings per share for the third quarter of 2001 by 21.4%, (b) material understatements of the amounts of PNC's nonperforming loans and nonperforming assets, and (c) material overstatements of the amounts of reductions in loans held for sale and overstatements in the amounts of securities available for sale.

2. <u>The PAGIC Transactions</u>

PAGIC I closed on June 28, 2001 (two days before the end of PNC's second quarter), PAGIC II closed on September 27, 2001 (three days before the end of PNC's third quarter), and PAGIC III closed on November 30, 2001 (during PNC's fourth quarter). In the PAGIC I and PAGIC II transactions, PNC transferred to the PAGIC entities loans and participations in loans ("loan assets") held by PNC's principal bank subsidiary, PNC Bank, N.A., and in the PAGIC III transaction, PNC transferred venture capital investments held by a non-bank subsidiary. In the PAGIC I transaction, PNC transferred $257.3 million in loan assets plus cash to a PAGIC entity, and in the PAGIC II transaction, PNC transferred $334.8 million in loan assets plus cash to a PAGIC entity. In the PAGIC III transaction, PNC transferred $169.6 million of venture capital assets plus cash to a PAGIC entity.

Each of the PAGIC transactions provided for AIG to receive, in the first five years, total fees exceeding the amount that AIG contributed to the transaction. For PAGIC I, AIG was to receive fees exceeding the $11.6 million that it contributed; for PAGIC II, AIG was to receive fees exceeding the $16.9 million that it contributed; and for PAGIC III, AIG was to receive fees exceeding the $8 million that it contributed. In each transaction, a portion of the fees was paid by the PAGIC entity to AIG at the closing of the transaction, and the remainder was to be paid over the following four years. The agreements further provided that, if PNC liquidated its interest in the PAGIC entities, AIG would receive the present value of the remainder of the fees for the remainder of the five-year period.

3. PNC's Form 10-Q for the Quarter Ended June 30, 2001

In its Form 10-Q for the quarter ended June 30, 2001, filed with the Commission on August 14, 2001, PNC disclosed its financial performance and financial condition for the second quarter of 2001. PNC did not include on its balance sheet, as set forth in this Form 10-Q, the assets it transferred to the PAGIC I SPE but did include its holdings of the PAGIC I preferred stock on its balance sheet, in the line item entry for securities available for sale. Among other things, PNC stated in the Form 10-Q that (1) management was evaluating opportunities to reduce lending exposure, (2) loans at the end of the quarter were $44.2 billion, a $6.4 billion decrease from year-end 2000, and (3) PNC had $374 million in nonperforming loan assets and $390 million in total nonperforming assets. The figures on nonperforming loan assets and nonperforming assets did not include $84 million in nonperforming assets among the $257 million in loan assets that PNC had transferred to the PAGIC I SPE. PNC's Form 10-Q did not include any reference to the PAGIC I transaction.

4. PNC's Form 10-Q for the Quarter Ended September 30, 2001

In its Form 10-Q for the quarter ended September 30, 2001, filed on November 14, 2001, PNC reported that earnings per share for that quarter were $1.02 per share. PNC did not include on its balance sheet, as set forth in this Form 10-Q, the assets it transferred to the PAGIC I and PAGIC II SPEs but did include its holdings of the PAGIC I and PAGIC II preferred stock on its balance sheet, in the line item entry for securities available for sale. Among other things, PNC stated in the Form 10-Q that (1) loans at the end of the quarter were $42.1 billion, an $8.5 billion decrease from year-end 2000 and (2) PNC had $361 million in nonperforming loan assets and $374 million in total nonperforming assets. The figures on nonperforming loan assets and nonperforming assets did not include a total of $207 million in nonperforming assets among the $592 million of loan assets that PNC had transferred to the SPEs established for PAGIC I and PAGIC II. PNC's Form 10-Q also did not include any reference to the PAGIC I or PAGIC II transactions.

5. PNC's January 17, 2002 Press Release

On January 11, 2002, the Federal Reserve directed PNC to consolidate the entities created in the three PAGIC transactions in PNC's bank holding company regulatory reports for 2001.

On January 17, 2002, PNC issued a press release announcing its fourth quarter and full-year 2001 financial results. In this release, PNC stated that its earnings per share were $1.91, and that its fourth quarter loss would be ($1.15) per share. PNC also stated that it had reduced its institutional loan portfolio through, among other things, "sale of institutional loans to subsidiaries of a third party financial institution." The release reported PNC's results as though PNC did not consolidate the assets of the three PAGIC SPEs for financial reporting purposes.

6. PNC Announces a Restatement with Respect to PAGIC Entities and Files Restated Financial Results

On January 29, 2002, PNC announced that it would reverse the accounting for all three PAGIC transactions, restate its financial statements for the second and third quarters of 2001, and revise its previously announced fourth quarter and full-year 2001 financial results. The change in accounting and restatement resulted in, among other things, a $155 million charge to PNC's earnings and a $0.53 per share drop (equivalent to 38%) in PNC's previously reported earnings per share for 2001.

On March 29, 2002, PNC filed amended Forms 10-Q for the quarters ended June 30, 2001, and September 30, 2001, that included restated financial results. The amended Form 10-Q for the quarter ended September 30, 2001 set forth PNC's restated financial results for the third quarter of 2001, including, among other things, PNC's earnings per share for this quarter, which were $0.84 per share (approximately 18% less than the $1.02 per share reported in PNC's original Form 10-Q for this quarter).

7. Garbe's Role in the PAGIC Transactions

In late May or early June 2001, Garbe learned from others that PNC was contemplating entering into the first of the PAGIC transactions. PNC senior management asked Garbe, as head of PNC's Accounting Policy department, to review PNC's accounting for the proposed transaction. Garbe participated in internal meetings with other PNC personnel in which the terms of the transactions were discussed. He discussed the transaction with personnel from Ernst & Young, LLP, PNC's auditor. Garbe was also present for certain conversations between PNC and AIG personnel during which certain transaction terms were discussed, and he reviewed transaction documents. Prior to the closing of PAGIC I, Ernst & Young provided to PNC and Garbe a draft "Guidance Letter," which opined that nonconsolidation of the PAGIC SPE conformed with GAAP. This letter, however, made no mention of the fee paid to AIG. A similar Guidance Letter was provided by Ernst &Young to PNC for PAGIC II and PAGIC III. Garbe subsequently reviewed and approved a memorandum prepared by PNC's Accounting Policy department for each PAGIC transaction that analyzed the accounting for the transaction and mentioned the fee paid to AIG, but without analyzing the accounting implications of such a fee. These memos concluded that PNC's nonconsolidation of the PAGIC entities was the appropriate accounting treatment under GAAP.

Throughout the relevant period, Garbe received information that should have prompted him to inquire further to determine whether PNC's nonconsolidation of the PAGIC entities was proper under GAAP. Most significantly, he should have known that, although the final transaction documents referred to AIG's fee as "fee to the managing member" and "management fee," the fee was in fact a structuring fee that would cause AIG's investment to be reduced below the 3% minimally acceptable amount required for nonconsolidation under GAAP. In connection with the PAGIC I transaction, Garbe knew that AIG initially proposed that PNC directly pay

AIG a fee at the closing of the transaction. Garbe rejected that proposal because such a fee would be viewed as a structuring fee. The manner in which the fee would be paid to AIG was thereafter renegotiated. As subsequently renegotiated, a PAGIC entity would pay AIG's fee. For the first five years, AIG would receive a fixed annual fee that, in total, exceeded the amount that AIG invested in the transaction. AIG would receive the present value of this fee even if PNC liquidated its interest in the PAGIC entities during the five-year period, and AIG would receive the same amount regardless of what took place with respect to the value or disposition of the loan assets that PNC contributed in the transaction.[3] The facts relating to the funding and payment of the fee were understood by Garbe.

Garbe further knew that PNC would be the servicer of the loan assets that it transferred to the PAGIC entities. PNC would retain the relevant loan records and establish bank accounts for loan collections. As the loan servicer, PNC would receive payments, would be responsible for valuing the loans annually and for developing action plans for managing the workout of the loans, which would be reviewed by AIG periodically. AIG's actual management of the PAGIC entities was limited, at best. For its role as servicer of the loan assets, PNC was to receive a servicing fee paid by a PAGIC entity separately from the fee that the PAGIC entity paid to AIG. The servicing fee paid to PNC, however, was significantly less than the fee paid to AIG, and, unlike the fee paid to AIG for the first five years, varied based on the value of the loan assets that PNC transferred in the transaction.[4] This and other information that arose during the course of the negotiations with AIG presented Garbe with reasons to evaluate whether AIG's fee for management services was actually a structuring fee that would reduce AIG's investment below the required 3% minimum and accordingly would cause the accounting for the transaction not to be in conformity with GAAP. Consequently, Garbe should have made further inquiry into the nature of AIG's fee. Nevertheless, Garbe, as head of PNC's Accounting Policy department, approved PNC's nonconsolidation of the SPE established for the PAGIC I transaction without making such an inquiry.

For accounting purposes, the PAGIC II and PAGIC III transactions were substantially similar to the PAGIC I transaction. In each case, Garbe should have made further inquiry to determine if the fees paid to AIG in the PAGIC II and PAGIC III transactions also were structuring fees that reduced AIG's investments in those transactions below the 3% level. Nevertheless, Garbe approved PNC's nonconsolidation accounting for the PAGIC II and PAGIC III transactions without making such inquiry.

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[3] During the first five years, AIG could not liquidate the PAGIC entities without PNC's consent. To help ensure that AIG would receive its fee, the agreements further provided that, with one minor exception, the first monies received in connection with the loan assets would be deposited into a "Management Fee Account" until that account had a sufficient amount to pay AIG the fee when it became due.

[4] After the first five years, AIG's fee would vary based on the value of both the loan assets and the value of a zero-coupon Treasury security purchased with some of the cash that PNC had contributed in the transaction.

E. DISCUSSION

Section 13(a) of the Exchange Act requires issuers of registered securities to file periodic reports with the Commission containing information prescribed by specific Commission rules. Rule 13a-1 requires the filing of annual reports on Form 10-K. Rule 13a-13 requires the quarterly filing of a Form 10-Q. Rule 12b-20 requires, in addition to information required by Commission rules to be included in periodic reports, such further material information as may be necessary to make the required statements not misleading. These reports are required to be complete and accurate.[5] Under the federal securities laws,[6] PNC is, and was at all relevant times, required to comply with GAAP in its filings with the Commission.

Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." "A company's 'books and records' include not only general ledgers and accounting entries, but also memoranda and internal corporate reports."[7]

1. PNC Violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13

PNC's accounting for the PAGIC transactions was not in conformity with GAAP. Among other things, the transactions did not satisfy the requirement that the majority owner (in this case AIG) make a substantive capital investment. Because AIG's fees were structuring fees, they should have been treated under GAAP as a return of AIG's investment in the transaction, which reduced that investment below the 3% threshold. Because the PAGIC transactions did not satisfy the criteria for nonconsolidation, PNC should have consolidated the PAGIC entities in its financial statements.

The failure to account properly for the PAGIC transactions resulted in a material overstatement of PNC's earnings for the third quarter of 2001, among other things, and in inaccurate disclosures in the company's Forms 10-Q for the second and third quarters of 2001. Those disclosures, described above, created a materially inaccurate picture of the extent to which PNC was reducing its exposure to commercial lending activities and the risks attendant thereto. Thus, for example, the amounts of nonperforming loans, nonperforming assets, and reductions in loans held for sale, were all materially inaccurate, in that they were improperly recorded on the assumption that the assets transferred to PAGIC I and PAGIC II had been removed from PNC's financial statements. In fact, PNC's nonperforming assets and loans were materially greater than disclosed, because they should have included certain assets transferred to PAGIC I and PAGIC II, and its reductions in loans were materially overstated. As a result of PNC's improper accounting

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5 See SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979).

6 17 CFR § 210.4-01(a)(1).

7 Gibson Greetings, Inc., Exchange Act Release No. 36357, 60 SEC Docket 1401 (Oct. 11, 1995).

for the PAGIC transactions for the second and third quarters of 2001 and the resulting misleading disclosures in the company's Forms 10-Q for those periods, PNC violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13.

2. Garbe Was a Cause of PNC's Violations

For the reasons discussed above, Garbe should have known that the fee paid to AIG in each PAGIC transaction was a structuring fee and that PNC's nonconsolidation of the PAGIC entities did not comply with GAAP. Garbe, as head of PNC's Accounting Policy department, had responsibility for ensuring that the accounting for each of the PAGIC transactions was in conformity with GAAP. By his actions described above, Garbe was a cause of PNC's violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that**:**

Respondent Garbe cease and desist from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act, and Exchange Act Rules 12b-20 and 13a-13.

By the Commission.

Nancy M. Morris
Secretary