

CORNING INC /NY  
Form 10-Q  
April 27, 2007

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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

For the quarterly period ended March 31, 2007

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 1-3247

CORNING INCORPORATED

(Exact name of Registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation or organization)

16-0393470  
(I.R.S. Employer Identification No.)

One Riverfront Plaza, Corning, New York  
(Address of principal executive offices)

14831  
(Zip Code)

Registrant's telephone number, including area code 607-974-9000



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## CORNING INCORPORATED AND SUBSIDIARY COMPANIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; in millions, except per share amounts)

	Three months ended	
	March 31, 2007	2006
Net sales	\$ 1,307	\$ 1,262
Cost of sales	716	689
Gross margin	591	573
Operating expenses:		
Selling, general and administrative expenses	214	223
Research, development and engineering expenses	130	124
Amortization of purchased intangibles	3	3
Restructuring, impairment and other charges (Note 2)		6
Asbestos settlement (Note 3)	110	185
Operating income	134	32
Interest income	37	24
Interest expense	(21)	(20)
Loss on repurchase of debt	(15)	
Other income, net	32	20
Income before income taxes	167	56
(Provision) benefit for income taxes (Note 5)	(56)	2
Income before minority interests and equity earnings	111	58
Minority interests		(1)
Equity in earnings of affiliated companies, net of impairments (Note 9)	216	200
Net income	\$ 327	\$ 257
Basic earnings per common share (Note 6)	\$ 0.21	\$ 0.17
Diluted earnings per common share (Note 6)	\$ 0.20	\$ 0.16

The accompanying notes are an integral part of these consolidated financial statements.

## CORNING INCORPORATED AND SUBSIDIARY COMPANIES

## CONSOLIDATED BALANCE SHEETS

(Unaudited; in millions, except per share amounts)

	March 31,  2007	December 31,  2006
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,123	\$ 1,157
Short-term investments, at fair value	1,765	2,010
Total cash, cash equivalents and short-term investments	2,888	3,167
Trade accounts receivable, net of doubtful accounts and allowances - \$23 and \$21	781	746
Inventories (Note 8)	685	639
Deferred income taxes (Note 5)	38	47
Other current assets	237	199
Total current assets	4,629	4,798
Investments (Note 9)	2,588	2,522
Property, net of accumulated depreciation - \$4,235 and \$4,087	5,281	5,193
Goodwill and other intangible assets, net (Note 10)	314	316
Deferred income taxes (Note 5)	116	114
Other assets	233	122
<b>Total Assets</b>	<b>\$ 13,161</b>	<b>\$ 13,065</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 20	\$ 20
Accounts payable	551	631
Other accrued liabilities (Notes 3 and 11)	1,660	1,668
Total current liabilities	2,231	2,319
Long-term debt (Note 4)	1,466	1,696
Postretirement benefits other than pensions	740	739
Other liabilities (Notes 3 and 11)	1,034	1,020
Total liabilities	5,471	5,774
Commitments and contingencies (Note 3)		
Minority interests	46	45
Shareholders' equity:		
Common stock - Par value \$0.50 per share; Shares authorized: 3.8 billion; Shares issued: 1,586 million and 1,582 million	793	791
Additional paid-in capital	12,071	12,008
Accumulated deficit	(4,668)	(4,992)
Treasury stock, at cost; Shares held: 18 million and 17 million	(222)	(201)
Accumulated other comprehensive loss (Note 15)	(330)	(360)

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Total shareholders' equity	7,644	7,246
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$13,161</b>	<b>\$13,065</b>

The accompanying notes are an integral part of these consolidated financial statements.

## CORNING INCORPORATED AND SUBSIDIARY COMPANIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in millions)

	Three months ended	
	March 31, 2007	2006
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 327	\$ 257
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	150	141
Amortization of purchased intangibles	3	3
Asbestos settlement	110	185
Restructuring, impairment and other charges		6
Loss on repurchases of debt	15	
Stock compensation charges	36	32
Undistributed earnings of affiliated companies	(67)	(70)
Deferred tax benefit		(62)
Restructuring payments	(11)	(4)
Customer deposits, net of (credits) issued	(33)	(8)
Employee benefit payments (in excess of) less than expense	(92)	15
Changes in certain working capital items:		
Trade accounts receivable	(28)	(65)
Inventories	(42)	(46)
Other current assets	(57)	(8)
Accounts payable and other current liabilities, net of restructuring payments	(121)	(195)
Other, net	3	
<b>Net cash provided by operating activities</b>	<b>193</b>	<b>181</b>
<b>Cash Flows from Investing Activities:</b>		
Capital expenditures	(262)	(280)
Net increase in long-term investments and other long-term assets		(77)
Short-term investments acquisitions	(553)	(858)
Short-term investments liquidations	798	735
<b>Net cash used in investing activities</b>	<b>(17)</b>	<b>(480)</b>
<b>Cash Flows from Financing Activities:</b>		
Net repayments of short-term borrowings and current portion of long-term debt	(8)	(4)
Retirements of long-term debt	(238)	
Proceeds from issuance of common stock, net	4	6
Proceeds from the exercise of stock options	22	219
Other, net		(2)
<b>Net cash (used in) provided by financing activities</b>	<b>(220)</b>	<b>219</b>
Effect of exchange rates on cash	10	
Net decrease in cash and cash equivalents	(34)	(80)
Cash and cash equivalents at beginning of period	1,157	1,342
<b>Cash and cash equivalents at end of period</b>	<b>\$ 1,123</b>	<b>\$ 1,262</b>

The accompanying notes are an integral part of these statements.

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**CORNING INCORPORATED AND SUBSIDIARY COMPANIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. Significant Accounting Policies**

*Basis of Presentation*

In these notes, the terms "Corning," "Company," "we," "us," or "our" mean Corning Incorporated and subsidiary companies.

The accompanying unaudited consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been omitted or condensed. These interim consolidated financial statements should be read in conjunction with Corning's consolidated financial statements and notes thereto included in its Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Form 10-K).

The unaudited consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of operations, financial position and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature. The results for interim periods are not necessarily indicative of results which may be expected for any other interim period or for the full year.

*New Accounting Standards*

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in applying generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies whenever an entity is measuring fair value under other accounting pronouncements that require or permit fair value measurement. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. Corning is currently evaluating the impact of SFAS 157 on its consolidated results of operations and financial condition.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115" (SFAS 159). This Statement allows all entities a one-time election to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value (the "fair value option"). SFAS 159 is effective for fiscal years beginning after November 15, 2007. Corning is currently evaluating the impact of SFAS 159 on its consolidated results of operations and financial condition.

In March 2007, the FASB ratified Emerging Issues Task Force (EITF) Issue No. 06-10 Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements (EITF 06-10). EITF 06-10 requires that an employer recognize a liability for the postretirement benefit obligation related to a collateral assignment arrangement in accordance with SFAS No. 106 Employers Accounting for Postretirement Benefits Other Than Pensions (SFAS 106) (if deemed part of a postretirement plan) or Accounting Principles Board Opinion 12 Omnibus Opinion-1967 (APB 12) (if not part of a plan). The consensus is applicable if, based on the substantive agreement with the employee, the employer has agreed to (a) maintain a life insurance policy during the postretirement period or (b) provide a death benefit. The EITF also reached a consensus that an employer should recognize and measure the associated asset on the basis of the terms of the collateral assignment arrangement. Corning is required to adopt EITF 06-10 effective January 1, 2008. Corning is currently assessing the impact of this EITF Issue.

**2. Restructuring, Impairment, and Other Charges**

*2007 Actions*

In the first quarter of 2007, Corning did not incur any restructuring, impairment, or other charges.

The following table summarizes amounts related to existing restructuring reserves as of and for the three months ended March 31, 2007 (in millions):

	Reserve at January 1, 2007	Cash payments	Reserve at March 31, 2007
Restructuring activity:			
Employee related costs	\$ 40	\$ (8)	\$ 32
Other charges	36	(3)	33
Total restructuring activity	\$ 76	\$ (11)	\$ 65

*2006 Actions*

In the first quarter of 2006, we recorded a \$7 million charge for a revision to an existing restructuring plan for a German location in our Telecommunications segment.

The following table details the charges, credits, and balances of the restructuring reserves as of and for the three months ended March 31, 2006 (in millions):

	January 1, 2006	Revisions to existing plans	Net charges/ (reversals)	Cash payments in 2006	Reserve at March 31, 2006
Restructuring charges:					
Employee related costs	\$ 36	\$ 7	\$ 7	\$ (2)	\$ 41
Other charges	49	(1)	(1)	(2)	46
Total restructuring charges	\$ 85	\$ 6	\$ 6	\$ (4)	\$ 87

Cash payments for employee-related costs will be substantially completed by the end of 2008, while payments for other charges will be substantially completed by the end of 2010.

**3. Commitments and Contingencies**

*Asbestos Settlement*

On March 28, 2003, Corning announced that it had reached agreement with the representatives of asbestos claimants for the settlement of all current and future asbestos claims against it and Pittsburgh Corning Corporation (PCC), which might arise from PCC products or operations (the PCC Plan). The proposed settlement, if the PCC Plan is approved and becomes effective, will require Corning to relinquish its equity interest in PCC, contribute its equity interest in Pittsburgh Corning Europe N.V. (PCE), a Belgian corporation, and contribute 25 million shares of Corning common stock. Corning also agreed to pay a total of \$140 million in six annual installments (present value \$131 million at March 2003), beginning one year after the PCC Plan becomes effective, with 5.5 percent interest from June 2004, and to assign certain insurance policy proceeds from its primary insurance and a portion of its excess insurance at the time of settlement.

The PCC Plan received a favorable vote from creditors in March 2004. Hearings to consider objections to the PCC Plan were held in the Bankruptcy Court in May 2004. In February 2006, the Bankruptcy Court requested that the PCC Plan proponents delete references to Section 105(a) of the Bankruptcy Code and resubmit the PCC Plan. The final round of oral argument was held on July 21, 2006.

On December 21, 2006, the Bankruptcy Court issued an order denying confirmation of the PCC Plan for reasons it set out in a memorandum opinion. Several parties, including Corning, filed motions for reconsideration. These motions were argued on March 5, 2007, and the Bankruptcy Court reserved decision.

If the Bankruptcy Court does not approve the PCC Plan in its current form, changes to the PCC Plan are reasonably likely to occur. The outcome of these proceedings is uncertain, and confirmation of the current PCC Plan or any amended PCC Plan is subject to a number of contingencies. However, apart from the quarterly mark-to-market adjustment in the value of the components of the settlement, management believes that the likelihood of a material adverse impact to Corning's financial statements is remote.

Two of Corning's primary insurers and several excess insurers have commenced litigation for a declaration of the rights and obligations of the parties under insurance policies, including rights that may be affected by the settlement arrangement described above. Corning is vigorously contesting these cases. Management is unable to predict the outcome of this insurance litigation.

In the first quarter of 2007, Corning recorded asbestos settlement expense of \$110 million, including \$101 million reflecting the increase in the value of Corning's common stock from December 31, 2006 to March 31, 2007, and \$9 million to adjust the estimated fair value of the other components of the proposed asbestos settlement.

In the first quarter of 2006, Corning recorded asbestos settlement expense of \$185 million, including \$182 million reflecting the increase in the value of Corning's common stock from December 31, 2005 to March 31, 2006, and \$3 million to adjust the estimated fair value of the other components of the proposed asbestos settlement.

If the book value of the assets to be contributed in the asbestos settlement remains lower than the carrying value of the settlement liability, a gain would be recognized at the time of settlement.

Since March 28, 2003, we have recorded total net charges of \$927 million to reflect the initial settlement liability and subsequent adjustments for the change in the fair value of the components of the liability.

The fair value of the liability expected to be settled by contribution of our investment in PCE, 25 million shares of our common stock and assigned insurance proceeds (in aggregate totaling \$764 million at March 31, 2007) is recorded in other accrued liabilities in our consolidated balance sheets. As the timing of this obligation's settlement will depend on future judicial rulings (i.e., controlled by a third party and not Corning), this portion of the PCC liability is considered a due on demand obligation. Accordingly, this portion of the obligation has been classified as a current liability even though it is possible that the contribution could be made beyond one year. The remaining portion of the settlement liability (totaling \$163 million at March 31, 2007), representing the net present value of the cash payments, is recorded in the other liabilities component in our consolidated balance sheets.

#### *Other Commitments and Contingencies*

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In the normal course of our business, we do not routinely provide significant third-party guarantees. When provided, these guarantees have various terms, and none of these guarantees are individually significant. Generally, third party guarantees provided by Corning are limited to certain financial guarantees including stand-by letters of credit and performance bonds, and the incurrence of contingent liabilities in the form of purchase price adjustment related to attainment of milestones.

We have also agreed to provide a credit facility to Dow Corning Corporation (Dow Corning). The funding of the Dow Corning \$150 million credit facility is subject to events connected to the Dow Corning Bankruptcy Plan. Refer to Note 8 (Investments) to the consolidated financial statements in our 2006 Form 10-K for a discussion of contingent liabilities associated with Dow Corning.

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As of March 31, 2007, contingent guarantees totaled a notional value of \$329 million, compared with \$334 million at December 31, 2006. We also were contingently liable for purchase obligations of \$244 million and \$261 million, at March 31, 2007 and December 31, 2006, respectively. We believe a significant majority of these guarantees and contingent liabilities will expire without being funded.

Product warranty liability accruals for the quarter ended March 31, 2007 and 2006 were \$27 million and \$28 million, respectively, approximately the same balances as the preceding year ends.

Corning is a defendant in various lawsuits, including environmental, product-related suits, the Dow Corning and PCC matters discussed in Note 8 (Investments) to the consolidated financial statements in our 2006 Form 10-K, and is subject to various claims which arise in the normal course of business. In the opinion of management, the likelihood that the ultimate disposition of these matters will have a material adverse effect on Corning's consolidated financial position, liquidity, or results of operations, is remote.

Corning has been named by the Environmental Protection Agency (the Agency) under the Superfund Act, or by state governments under similar state laws, as a potentially responsible party for 18 active hazardous waste sites. Under the Superfund Act, all parties who may have contributed any waste to a hazardous waste site, identified by such Agency, are jointly and severally liable for the cost of cleanup unless the Agency agrees otherwise. It is Corning's policy to accrue for its estimated liability related to Superfund sites and other environmental liabilities related to property owned by Corning based on expert analysis and continual monitoring by both internal and external consultants. At March 31, 2007, and December 31, 2006, Corning had accrued approximately \$14 million (undiscounted) and \$16 million (undiscounted), respectively, for the estimated liability for environmental cleanup and related litigation. Based upon the information developed to date, management believes that the accrued reserve is a reasonable estimate of the Company's liability and that the risk of an additional loss in an amount materially higher than that accrued is remote.

#### 4. Debt

In the first quarter of 2007, we paid \$238 million to redeem \$223 million principal amount of our 6.25% Euro notes due 2010. We recognized a loss of \$15 million upon the early redemption of these notes.

#### 5. Income Taxes

Our provision for income taxes and the related tax rates follow (in millions):

	Three months ended March 31,	
	2007	2006
Provision (benefit) for income taxes	\$ 56	\$ (2)
Effective tax (benefit) rate	33.5%	(3.6%)

For the three months ended March 31, 2007, the effective tax rate reflected the following items:

The impact of not recording tax benefits (expenses) on losses (income) generated in the U.S. until an appropriate level of profitability is reached and sustained in the U.S.

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The benefit of tax holidays and investment credits in Taiwan.

The impact of discrete items for which no tax benefit was recorded, including asbestos settlement expense of \$110 million and a loss on the repurchase of debt of \$15 million. Refer to Notes 3 (Commitments and Contingencies) and 4 (Debt) for additional information. Discrete items increased our effective tax rate by 14.3 percentage points.



For the three months ended March 31, 2006, the effective tax rate reflected the following items:

The impact of not recording tax benefits (expenses) on losses (income) generated in the U.S. until an appropriate level of profitability is reached and sustained in the U.S.

The benefit of tax holidays and investment credits in Taiwan and China.

The release of a \$38 million valuation allowance on a portion of our German tax benefits because we achieved an appropriate level of profitability in certain of our German operations leading us to conclude that it is more likely than not that tax benefits are realizable and the impact of discrete items for which no tax benefit was recorded, including asbestos settlement expense of \$185 million. Refer to Note 3 (Commitments and Contingencies) for additional information about this item. The net impact of the release of the valuation allowance and other discrete items reduced our effective tax rate by 18.5 percentage points.

As more fully described in Note 7 (Income Taxes) to the consolidated financial statements in the 2006 Form 10-K, all of our U.S. deferred tax assets had full valuation allowances at December 31, 2006 and this continues to be the case at March 31, 2007. We will maintain this valuation allowance until an appropriate level of profitability is sustained or we are able to develop tax planning strategies that enable us to conclude that it is more likely than not that our U.S. deferred tax assets are realizable. Until then, we will not record tax benefits (expenses) on losses (income) generated in the U.S.

Certain foreign subsidiaries in China and Taiwan are operating under tax holiday arrangements. The nature and extent of such arrangements vary. The benefits of such arrangements phase out in various years (2006 through 2011) according to the specific terms and schedules of the relevant taxing jurisdictions. The impact of the tax holidays on our effective tax rate is a reduction in the rate of 8 percentage points and 38 percentage points for the three months ended March 31, 2007 and 2006, respectively.

We adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) effective January 1, 2007. As a result of the implementation of FIN 48, we recognized a \$25 million increase in the liability for unrecognized tax benefits and a decrease to the January 1, 2007 balance of retained earnings of \$4 million. The amount of unrecognized tax benefits at January 1, 2007 is \$56 million of which \$38 million would impact the Company's effective tax rate, if recognized.

We recognized accrued interest and penalties associated with uncertain tax positions as part of tax expense. As of January 1, 2007, we had \$4 million of accrued interest and penalties.

Corning Incorporated as the common parent company and all 80%-or-more-owned U.S. subsidiaries join in the filing of consolidated U.S. federal income tax returns. All such returns for periods ended through December 31, 2004 have been audited by and settled with the Internal Revenue Service (IRS). We expect the IRS to begin the examination of our consolidated U.S. federal income tax returns for the years ended December 31, 2005 and December 31, 2006 in the fourth quarter of 2007.

Corning Incorporated and U.S. subsidiaries file income tax returns on a combined, unitary or stand-alone basis in multiple state and local jurisdictions, which generally have statutes of limitations ranging from 3 to 5 years. Various state income tax returns are currently in the process of examination, administrative appeals or litigation.

Our foreign subsidiaries file income tax returns in the countries in which they have operations. Generally, these countries have statutes of limitations ranging from 3 to 7 years. Years still open to examination by foreign tax authorities in major jurisdictions include Japan (2000

onward), and Taiwan (2005 onward).

While we expect the amount of unrecognized tax benefits to change in the next 12 months, we do not expect the change to have a significant impact on the results of operations or our financial position.

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**6. Earnings per Common Share**

The reconciliation of the amounts used in the basic and diluted earnings per common share computations follows (in millions, except per share amounts):

	Three months ended March 31, 2007			2006		
	Net income	Weighted- Average Shares	Per Share Amount	Net Income	Weighted- Average Shares	Per Share Amount
Basic earnings per common share	\$ 327	1,563	\$ 0.21	\$ 257	1,541	\$ 0.17
Effect of dilutive securities: Stock options and other dilutive securities		37			51	
Diluted earnings per common share	\$ 327	1,600	\$ 0.20	\$ 257	1,592	\$ 0.16

The following potential common shares were excluded from the calculation of diluted earnings per common share due to their anti-dilutive effect or, in the case of stock options, because their exercise price was greater than the average market price for the periods presented (in millions):

	Three months ended March 31,	
	2007	2006
Stock options and other dilutive securities excluded from the calculation of diluted earnings per common share	35	27

**7. Significant Customer**

On October 1, 2006, AU Optronics Corporation (AUO), a customer of the Display Technologies segment, completed its previously announced merger with Quanta Display Inc. (QDI), another customer of Corning's Display Technologies segment. In addition, through two separate transactions, AUO now holds a 49% equity stake in Toppan CFI, a subsidiary of Toppan Printing Co., Ltd., also a customer of the Display Technologies segment.

For the three months ended March 31, 2007 and 2006, Corning's combined sales to AUO, QDI and Toppan represented 10% and 14%, respectively, of the company's consolidated net sales.

**8. Inventories**

Inventories comprise the following (in millions):

	March 31, 2007	December 31, 2006
Finished goods	\$ 128	\$ 139

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Work in process	265	233
Raw materials and accessories	142	125
Supplies and packing materials	150	142
Total inventories	\$ 685	\$ 639

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**9. Investments**

Investments comprise the following (in millions):

	Ownership	March 31,	December 31,
	Interest	2007	2006
Affiliated companies accounted for by the equity method			
Samsung Corning Precision Glass Co., Ltd.	50%	\$ 1,337	\$ 1,380
Dow Corning Corporation	50%	782	683
Samsung Corning Co., Ltd.	50%	249	254
All other	25%-50% (1)	216	202
		2,584	2,519
Other investments		4	3
Total		\$ 2,588	\$ 2,522

(1) Amounts reflect Corning's direct ownership interests in the respective affiliated companies. Corning does not control any of these entities.

Related party information for these investments in affiliates follows (in millions):

	Three months ended March 31,	
	2007	2006
Related Party Transactions:		
Corning sales to affiliates	\$ 8	\$ 3
Corning purchases from affiliates	\$ 5	\$ 27
Dividends received from affiliates	\$ 149	\$ 129
Royalty income from affiliates	\$ 31	\$ 19
Corning transfers of assets, at cost, to affiliates	\$ 28	\$ 13
	March 31,	December 31,
	2007	2006
Related Party Amounts:		
Balances due from affiliates	\$ 56	\$ 26
Balances due to affiliates	\$ 3	\$ 8

We have contractual agreements with several of our equity affiliates which include sales, purchasing, licensing and technology agreements.

Summarized results of operations for our three significant investments accounted for by the equity method follow:

*Samsung Corning Precision Glass Co., Ltd. (Samsung Corning Precision)*

Samsung Corning Precision is a South Korea-based manufacturer of liquid crystal display glass for flat panel displays.

Samsung Corning Precision's results of operations follow (in millions):

	Three months ended March 31,	
	2007	2006
Statement of Operations		
Net sales	\$ 484	\$ 495
Gross profit	\$ 333	\$ 362
Net income	\$ 236	\$ 285
Corning's equity in earnings of Samsung Corning Precision	\$ 113	\$ 140
Related Party Transactions:		
Corning purchases from Samsung Corning Precision	\$ 1	\$ 17
Dividends received from Samsung Corning Precision	\$ 143	\$ 126
Royalty income from Samsung Corning Precision	\$ 29	\$ 19
Corning transfers of machinery and equipment to Samsung Corning Precision at cost (1)	\$ 28	\$ 13

- (1) Corning purchases machinery and equipment on behalf of Samsung Corning Precision to support its capital expansion initiatives. The machinery and equipment are transferred to Samsung Corning Precision at our cost basis, resulting in no revenue or gain being recognized on the transaction.

Corning and the Samsung Group each own 50% of the common stock of Samsung Corning Precision Glass Co., Ltd.

As of March 31, 2007, balances due to and due from Samsung Corning Precision were \$1 million and \$52 million, respectively. As of December 31, 2006, balances due to and from Samsung Corning Precision were \$2 million and \$19 million, respectively.

As of April 2007, Samsung Corning Precision and Samsung Corning Co., Ltd. are two of approximately thirty co-defendants in a lawsuit filed by Seoul Guarantee Insurance Co. and 14 other creditors. Refer to the Samsung Corning Co., Ltd. section of this note for additional information.

In February 2006, Corning made a capital contribution to Samsung Corning Precision in the amount of 75 billion Korean won (approximately \$77 million). Our ownership percentage was not affected by this capital contribution.

*Dow Corning Corporation (Dow Corning)*

Dow Corning is a U.S. based manufacturer of silicone products. Dow Corning's results of operations follow (in millions):

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	Three months ended March 31,	
	2007	2006
Statement of Operations		
Net sales	\$ 1,178	\$ 1,027
Gross profit	\$ 431	\$ 352
Net income	\$ 184	\$ 138
Corning's equity in earnings of Dow Corning	\$ 92	\$ 69
Related Party Transactions:		
Corning purchases from Dow Corning	\$ 3	\$ 3

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Balances due to Dow Corning were \$1 million as of March 31, 2007 and December 31, 2006.

Corning and The Dow Chemical Company (Dow Chemical) each own 50% of the common stock of Dow Corning. In May 1995, Dow Corning filed for bankruptcy protection to address pending and claimed liabilities arising from many thousands of breast implant product lawsuits. On June 1, 2004, Dow Corning emerged from Chapter 11 with a Plan of Reorganization (the Plan) which provided for the settlement or other resolution of implant claims. The Plan also includes releases for Corning and Dow Chemical as shareholders in exchange for contributions to the Plan.

Under the terms of the Plan, Dow Corning has established and is funding a Settlement Trust and a Litigation Facility to provide a means for tort claimants to settle or litigate their claims. Inclusive of insurance, Dow Corning has paid approximately \$1.5 billion to the Settlement Trust. As of March 31, 2007, Dow Corning had recorded a reserve for breast implant litigation of \$1.7 billion and anticipates insurance receivables of \$171 million. As a separate matter arising from the bankruptcy proceedings, Dow Corning is defending claims asserted by a number of commercial creditors who claim additional interest at default rates and enforcement costs, during the period from May 1995 through June 2004. On July 26, 2006, the U.S. Court of Appeals vacated the judgment of the District Court fixing the interest component, ruled that default interest and enforcement costs may be awarded subject to equitable factors to be determined, and directed that the matter be remanded for further proceedings. Dow Corning filed a petition for rehearing by the Court of Appeals, which was denied. It has filed a petition of writ of certiorari with the U.S. Supreme Court, which has also been denied. As of March 31, 2007, Dow Corning has estimated the interest payable to commercial creditors to be within the range of \$69 million to \$212 million. As Dow Corning management believes no single amount within the range appears to be a better estimate than any other amount within the range, Dow Corning has recorded the minimum liability within the range. Should Dow Corning not prevail in this matter, Corning's equity earnings would be reduced by its 50% share of the amount in excess of \$69 million, net of applicable tax benefits. There are a number of other claims in the bankruptcy proceedings against Dow Corning awaiting resolution by the U.S. District Court, and it is reasonably possible that Dow Corning may record bankruptcy-related charges in the future. There are no remaining tort claims against Corning, other than those that will be channeled by the Plan into facilities established by the Plan or otherwise defended by the Litigation Facility.

In 1995, Corning fully impaired its investment in Dow Corning after it filed for bankruptcy protection. Corning did not recognize net equity earnings from the second quarter of 1995 through the end of 2002. Corning began recognizing equity earnings in the first quarter of 2003 when management concluded that Dow Corning's emergence from bankruptcy was probable. Corning considers the \$249 million difference between the carrying value of its investment in Dow Corning and its 50% share of Dow Corning's equity to be permanent.



*Samsung Corning Co., Ltd. (Samsung Corning)*

Samsung Corning is a South Korea-based manufacturer of glass panels and funnels for cathode ray tube (CRT) television and display monitors.

Samsung Corning's results of operations follow (in millions):

	Three months ended March 31,	
	2007	2006
Statement of Operations		
Net sales	\$ 161	\$ 185
Gross profit	\$ 9	\$ 8
Net loss	\$ (3)	\$ (44)
Corning's equity in losses of Samsung Corning	\$ (1)	\$ (22)
Related Party Transactions:		
Royalty income from Samsung Corning	\$ 2	

Corning and the Samsung Group each own 50% of the common stock of Samsung Corning Co., Ltd.

As of December 31, 2006, the balance due from Samsung Corning was \$4 million.

In the first quarter of 2006, Corning reduced its investment in Samsung Corning by \$21 million due to an impairment of long-lived assets incurred by Samsung Corning. The charge also reduced Corning's equity earnings from Samsung Corning by \$21 million.

In 2003, 2005, and 2006, Samsung Corning recorded significant fixed asset and other impairment charges. As the conventional television glass market will be negatively impacted by strong growth in the LCD glass market, it is reasonably possible that Samsung Corning may incur additional restructuring or impairment charges or operating losses in the foreseeable future. Samsung Corning is currently investing in several developing businesses which Samsung Corning management believes will offset the decline in conventional television glass market over time. Should these new businesses not achieve expected results, additional operating losses, asset impairments and restructuring charges are likely to occur and Samsung Corning's long-term financial viability may come into question. These events could result in Corning incurring an impairment of its investment in Samsung Corning. Corning management believes it is more likely than not that an impairment of our investment will occur in the foreseeable future. Corning's investment in Samsung Corning was \$249 million at March 31, 2007.

Corning reviews the recoverability of all long-lived assets, including equity investments, when events or changes in circumstances occur that indicate that the carrying value of the asset or asset group may not be recoverable. As a result of the impairment events described above, Corning made an assessment of whether its investment in Samsung Corning had incurred an other-than-temporary impairment in the first quarter of 2007 and concluded that it had not. We will continue to monitor this investment.



Samsung Corning Precision Glass Co., Ltd. (Samsung Corning Precision) and Samsung Corning Co. Ltd. (Samsung Corning) were two of approximately thirty co-defendants in a lawsuit filed by Seoul Guarantee Insurance Co. and thirteen other creditors (SGI and Creditors) for alleged breach of an agreement that approximately thirty affiliates of the Samsung group entered into with SGI and Creditors in September 1999. The lawsuit is pending in the courts of Korea. According to the agreement, the Samsung affiliates agreed to sell 3.5 million shares of Samsung Life Insurance Co., Ltd. (SLI) by December 31, 2000, which were transferred to SGI and Creditors in connection with the petition for court receivership of Samsung Motor Inc. In the lawsuit, SGI and Creditors allege that, in the event that the proceeds of sale of the SLI shares is less than 2.45 trillion Korean won (approximately \$2.6 billion), the Samsung affiliates allegedly agreed to compensate SGI and Creditors for the shortfall, by other means, including the sale of an additional 500,000 SLI shares and Samsung affiliates' purchase of equity or subordinated debentures to be issued by SGI and Creditors. Any excess proceeds from the sale of the SLI shares are to be distributed to the Samsung affiliates. To our knowledge, the SLI shares have not been sold. The suit asks for total damages of 4.73 trillion Korean Won (approximately \$5.0 billion) plus penalty interest. Samsung Corning Precision and Samsung Corning combined guarantees should represent no more than 3.3% of the Samsung affiliates' total financial obligation. Although noting that the outcome of these matters is uncertain, Samsung Corning Precision and Samsung Corning have stated that these matters are not likely to result in a material ultimate loss to their financial statements. No claim in these matters has been asserted against Corning Incorporated or any of its affiliates.

#### *Variable Interest Entities*

Corning leases certain transportation equipment from a trust that qualifies as a variable interest entity under FIN 46R, *Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51, Revised* (FIN 46R). The sole purpose of this entity is leasing transportation equipment to Corning. Since Corning is the primary beneficiary of this entity, the financial statements of the entity are included in Corning's consolidated financial statements. The entity's assets are primarily comprised of fixed assets which are collateral for the entity's borrowings. These assets, amounting to approximately \$29 million as of March 31, 2007 and December 31, 2006, are classified as long-term assets in the consolidated balance sheet.

Corning leases certain transportation equipment from two additional trusts that qualify as variable interest entities under FIN 46R. The sole purpose of the entities is leasing transportation equipment to Corning. Corning has been involved with these entities as lessee since the inception of the trusts. Lease revenue generated by these trusts was \$2 million and \$1 million for the three months ended March 31, 2007 and 2006, respectively. Corning's maximum exposure to loss as a result of its involvement with the trusts is estimated at approximately \$15 million at March 31, 2007.

#### **10. Goodwill and Other Intangible Assets**

There were no changes in the carrying amount of goodwill for the three months ended March 31, 2007. Balances by segment are as follows (in millions):

	Telecom- munications	Display Technologies	Other (1)	Total
Balance at March 31, 2007	\$ 118	\$ 9	\$ 150	\$ 277

(1) This balance relates to our Specialty Materials operating segment.

Other intangible assets follow (in millions):

	March 31, 2007			December 31, 2006		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Amortized intangible assets:						
Patents and trademarks	\$ 148	\$ 115	\$ 33	\$ 147	\$ 112	\$ 35
Non-competition agreements	117	117		116	116	
Other	5	1	4	5	1	4
Total	\$ 270	\$ 233	\$ 37	\$ 268	\$ 229	\$ 39

Amortized intangible assets are primarily related to the Telecommunications segment.

Estimated amortization expense related to these intangible assets is \$10 million for 2007, \$11 million in 2008, \$11 million in 2009, and insignificant thereafter.

## 11. Customer Deposits

In 2005 and 2004, several of Corning's customers entered into long-term purchase and supply agreements in which Corning's Display Technologies segment will supply large-size glass substrates to these customers over periods of up to six years. As part of the agreements, these customers agreed to advance cash deposits to Corning for a portion of the contracted glass to be purchased. During the three month period ended March 31, 2007, we had no additional deposit payments against orders. During the three months ended March 31, 2006, we received a total of \$13 million of deposits against orders.

Upon receipt of the cash deposits made by customers, we record a customer deposit liability. This liability is reduced at the time of future product sales over the life of the agreements. As product is shipped to a customer, Corning recognizes revenue at the selling price and issues credit memoranda for an agreed amount of the customer deposit liability. The credit memoranda are applied against customer receivables resulting from the sale of product, thus reducing operating cash flows in later periods as these credits are applied for cash deposits received in earlier periods.

Customer deposits have been or will be received in the following periods (in millions):

	2004	2005	2006	Three months ended March 31, 2007	Remainder of 2007	Estimated 2008 and Beyond	Total
Customer deposits received	\$ 204	\$ 457	\$ 171	\$ 0	\$ 105	\$ 0	\$ 937

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In 2006 and 2005, we issued credit memoranda which totaled \$126 million and \$29 million for the years, respectively. During the three months ended March 31, 2007 and 2006, we issued \$33 million and \$21 million, respectively, in credit memoranda. These credits are not included in the above table.

Customer deposit liabilities were \$607 million and \$633 million at March 31, 2007 and December 31, 2006, respectively, of which \$207 million and \$213 million, respectively, were recorded in the current portion of other accrued liabilities in our consolidated balance sheets.

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In the event customers do not make all customer deposit installment payments or elect not to purchase the agreed upon quantities of product, subject to specific conditions outlined in the agreements, Corning may retain certain amounts of the customer deposits. If Corning does not deliver agreed upon product quantities, subject to specific conditions outlined in the agreements, Corning may be required to return certain amounts of customer deposits.

## 12. Employee Retirement Plans

The following table summarizes the components of net periodic benefit cost for Corning's defined benefit pension and postretirement health care and life insurance plans (in millions):

	Pension benefits Three months ended		Postretirement benefits Three months ended	
	March 31, 2007	2006	March 31, 2007	2006
Service cost	\$ 14	\$ 19	\$ 3	\$ 3
Interest cost	36	33	12	12
Expected return on plan assets	(45)	(41)		
Amortization of net loss	7	9	2	3
Amortization of prior service cost	3	2	(1)	(1)
Total expense	\$ 15	\$ 22	\$ 16	\$ 17

Corning and certain of its domestic subsidiaries offer postretirement plans that provide health care and life insurance benefits for retirees and eligible dependents. Certain employees may become eligible for such postretirement benefits upon reaching retirement age and service requirements. In response to rising health care costs, we changed our cost-sharing approach for retiree medical coverage. For current retirees (including surviving spouses) and active employees eligible for the salaried retiree medical program, we placed a cap on the amount we will contribute toward retiree medical coverage in the future. The cap equals 120% of our 2005 contributions toward retiree medical benefits. Once our contributions toward salaried retiree medical costs reach this cap, impacted retirees will have to pay the excess amount in addition to their regular contributions for coverage. Further, employees hired or rehired on or after January 1, 2007 will be eligible for Corning retiree medical upon retirement; however, these employees will pay 100% of the cost.

In the first quarter of 2007, we made a voluntary cash contribution of \$106 million to our domestic defined benefit pension plan.

## 13. Hedging Activities

We operate and conduct business in many foreign countries and as a result are exposed to movements in foreign currency exchange rates. Our exposure to exchange rate effects includes:

exchange rate movements on financial instruments and transactions denominated in foreign currencies which impact earnings, and  
exchange rate movements upon conversion of net assets in foreign subsidiaries for which the functional currency is not the U.S. dollar, which impact our net equity.

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Our most significant currency exposures relate to Japanese yen, Korean won, New Taiwanese dollar, and the Euro. We selectively enter into foreign exchange forward and option contracts with durations generally 18 months or less to hedge our exposure to exchange rate risk on foreign source income and purchases. The objective of these contracts is to reduce the impact of exchange rate movements on our operating results.

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We engage in foreign currency hedging activities to reduce the risk that changes in exchange rates will adversely affect the eventual net cash flows resulting from the sale of products to foreign customers and purchases from foreign suppliers. The hedge contracts reduce the exposure to fluctuations in exchange rates because the gains and losses associated with foreign currency balances and transactions are generally offset with gains and losses of the hedge contracts. Because the impact of movements in foreign exchange rates on the value of hedge contracts offsets the related impact on the underlying items being hedged, these financial instruments help alleviate the risk that might otherwise result from currency exchange rate fluctuations.

The following table summarizes the notional amounts and respective fair values of Corning's derivative financial instruments, which mature at varying dates, at March 31, 2007 (in millions):

	Notional	Fair
	Amount	Value
Foreign exchange forward contracts	\$ 902	\$ (2)
Foreign exchange option contracts	\$ 281	\$ 2

The forward and option contracts we use in managing our foreign currency exposures contain an element of risk in that the counterparties may be unable to meet the terms of the agreements. However, we minimize this risk by limiting the counterparties to a diverse group of highly-rated major domestic and international financial institutions with which we have other financial relationships. We are exposed to potential losses in the event of non-performance by these counterparties; however, we do not expect to record any losses as a result of counterparty default. We do not require and are not required to place collateral for these financial instruments.

Corning uses derivative instruments to limit the exposure to foreign currency fluctuations associated with certain monetary assets and liabilities. These derivative instruments are not designated as hedging instruments for accounting purposes and, as such, are referred to as undesignated hedges. Changes in the fair value of undesignated hedges are recorded in current period earnings in the other income, net component, along with the foreign currency gains and losses arising from the underlying monetary assets or liabilities, in the consolidated statement of operations. At March 31, 2007, the notional amount of the undesignated derivatives was \$548 million.

#### Cash Flow Hedges

Corning has cash flow hedges that are comprised of foreign exchange forward and option contracts. These contracts are designated and qualify as cash flow hedges under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), and are recorded in the consolidated financial statements at fair value. The effective portion of unrealized gain or loss on these contracts is deferred and reported as a component of accumulated other comprehensive income on the consolidated balance sheet, until such time as the hedged item impacts earnings. At that time, Corning reclassifies net gains and losses from cash flow hedges into the same line item of the consolidated statement of operations as where the effects of the hedged item are recorded, typically sales, cost of sales, or royalty income. At March 31, 2007, the amount of net gains expected to be reclassified into earnings within the next 12 months is \$4 million.

Corning reviews its cash flow hedges on a regular basis to ensure that each hedge relationship continues to be highly effective. In circumstances where a hedge becomes ineffective, any deferred gain or loss is immediately reclassified into current earnings. Corning has recorded no ineffectiveness for the quarter ended March 31, 2007.

#### Fair Value Hedges



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Corning records net gains and losses from fair value hedges into the same line item of the consolidated statement of operations as where the effects of the hedged item are recorded. There were no outstanding fair value hedges as of

March 31, 2007, or December 31, 2006.

### Net Investment in Foreign Operations

We have issued foreign currency denominated debt that has been designated as a hedge of the net investment in a foreign operation. The effective portion of the changes in fair value of the debt is reflected as a component of other accumulated comprehensive income as part of the foreign currency translation adjustment. Net loss included in the cumulative translation adjustment at March 31, 2007 and December 31, 2006 was \$139 million.

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## 14. Share-based Compensation

### Stock Compensation Plans

Effective January 1, 2006, the Company adopted SFAS 123(R). SFAS 123(R) requires the measurement and recognition of compensation cost for all share-based payment awards made to employees and directors, including grants of employee stock options and employee stock purchases related to the Worldwide Employee Share Purchase Plan (WESPP), based on estimated fair values. The Company elected to use the modified prospective transition method upon adoption of SFAS 123(R).

Share-based compensation cost recognized under SFAS 123(R) was approximately \$36 million and \$32 million for the three months ended March 31, 2007 and 2006, respectively, and included (1) employee stock options, (2) time-based restricted stock, (3) performance-based restricted stock, and (4) the WESPP. No tax benefits were attributed to the share-based compensation cost because a valuation allowance was maintained for substantially all net deferred tax assets.

### Stock Options

Our stock option plans provide non-qualified and incentive stock options to purchase authorized but unissued or treasury shares at the market price on the grant date and generally become exercisable in installments from one to five years from the grant date. The maximum term of non-qualified and incentive stock options is 10 years from the grant date.

The following table summarizes information concerning options outstanding including the related transactions under the options plans for the three months ended March 31, 2007:

	Number of Shares (in thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term in Years	Aggregate Intrinsic Value (in thousands)
Options Outstanding as of December 31, 2006	95,730	\$ 24.19		
Granted	2,019	\$ 20.01		
Exercised	(3,606)	\$ 6.84		
Forfeited and Expired	(455)	\$ 50.36		
Options Outstanding as of March 31, 2007	93,688	\$ 24.63	5.57	\$ 767,765
Options Exercisable as of March 31, 2007	78,982	\$ 25.59	5.00	\$ 702,132

The aggregate intrinsic value (market value of stock less option exercise price) in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price on March 30, 2007, which would have been received by the option holders had all option holders exercised their options as of that date.

As of March 31, 2007, there was approximately \$47 million of unrecognized compensation cost related to stock options granted under the Plan. The cost is expected to be recognized over a weighted-average period of 1.65 years. Compensation cost related to stock options was approximately \$18 million and \$19 million for the three months ended March 31, 2007 and 2006, respectively.

Proceeds received from the exercise of stock options were \$22 million for the three months ended March 31, 2007, and were included in financing activities on the Company's Consolidated Statements of Cash Flows. The total intrinsic value of options exercised for the three months ended March 31, 2007 and 2006 was approximately \$52 million and \$236 million, respectively, which is currently deductible for tax purposes. However, these tax benefits were not realized due to net operating loss carryforwards available to the Company. Refer to Note 5 (Income Taxes).

A lattice-based valuation model is used to estimate the fair values of option and restricted stock grants and incorporates the assumptions (including ranges of assumptions) noted in the table below. Expected volatility is based on the blended short-term volatility (the arithmetic average of the implied volatility and the short-term historical volatility), long-term historical volatility of Corning's stock, and other factors.

Corning also uses historical data to estimate future option exercise and employee termination within the valuation model. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected time to exercise of options granted is derived using a regression model and represents the period of time that options granted are expected to be outstanding. The range given below results from certain groups of employees exhibiting different behavior. The risk-free rates used in the lattice model are derived from the U.S. Treasury yield curve in effect from the grant date to the option's expiration date. Since period-by-period calculations are employed in the lattice model, Corning uses risk-free rates that apply from one period to the next, generally quarter to quarter. Such rates are typically referred to as forward rates. Being essentially marginal rates, forward rates both vary during the contractual term of the option and exhibit greater variation than the yield curve from which they are derived.

The following inputs for the lattice-based valuation model were used for option grants under our Stock Option Plans:

	Three months ended March 31, 2007	Three months ended March 31, 2006
Expected volatility	39-54%	38-53%
Weighted-average volatility	51%	50%
Expected dividends	0	0
Risk-free rate	4.6-5.2%	1.0-8.1%
Average risk-free rate	4.8%	4.6%
Expected time to exercise (in years)	2.2-5.4	3.0-3.8
Pre-vesting departure rate	1.6-2.5%	1-4%
Post vesting departure rate	3.8-6.7%	4-7%

### **Incentive Stock Plans**

The Corning Incentive Stock Plan permits stock grants, either determined by specific performance goals or issued directly, in most instances, subject to the possibility of forfeiture and without cash consideration. Shares under the Incentive Stock Plan are generally granted at-the-money, contingently vest over a period of 1 to 10 years, and have contractual lives of 1 to 10 years.

The fair value of each restricted stock grant under the Incentive Stock Plans was estimated on the date of grant for performance based grants assuming that performance goals will be achieved. The expected term for grants under the Incentive Stock Plans is 1 to 10 years.

### **Time-Based Restricted Stock:**

Time-based restricted stock is issued by the Company on a discretionary basis, and is payable in shares of the Company's common stock upon vesting. The fair value is based on the market price of the Company's stock on the grant date. Compensation cost is recognized over the requisite

vesting period and adjusted for actual forfeitures before vesting.

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The following table represents a summary of the status of the Company's nonvested time-based restricted stock as of December 31, 2006, and changes during the three months ended March 31, 2007:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested shares	(000 s)	
Nonvested shares at December 31, 2006	817	\$ 14.88
Granted	82	22.07
Vested	(15)	19.52
Forfeited	(22)	22.07
Nonvested shares at March 31, 2007	862	\$ 15.30

As of March 31, 2007, there was approximately \$5 million of unrecognized compensation cost related to non-vested time-based restricted stock compensation arrangements granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.26 years. Compensation cost related to time-based restricted stock was approximately \$1 million for each of the three months ended March 31, 2007 and 2006.

Performance-Based Restricted Stock:

Performance-based restricted stock is earned upon the achievement of certain targets, and is payable in shares of the Company's common stock upon vesting typically over a three-year period. The fair value is based on the market price of the Company's stock on the grant date and assumes that the target payout level will be achieved. Compensation cost is recognized over the requisite vesting period and adjusted for actual forfeitures before vesting. During the performance period, compensation cost may be adjusted based on changes in the expected outcome of the performance-related target.

The following table represents a summary of the status of the Company's nonvested performance-based restricted stock units as of December 31, 2006, and changes during the three months ended March 31, 2007:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested shares	(000 s)	
Nonvested shares at December 31, 2006	8,729	\$ 15.70
Granted	812	21.08
Vested	(2,083)	11.41
Forfeited	(60)	19.93
Nonvested shares at March 31, 2007	7,398	\$ 17.46

As of March 31, 2007, there was approximately \$85 million of unrecognized compensation cost related to non-vested performance-based restricted stock compensation arrangements granted under the Plan. The cost is expected to be recognized over a weighted-average period of 1.95 years. Compensation cost related to performance-based restricted stock was approximately \$15 million and \$11 million for the three months ended March 31, 2007 and 2006, respectively.

#### **Worldwide Employee Stock Purchase Plan**

In addition to the Stock Option Plan and Incentive Stock Plans, we have a Worldwide Employee Share Purchase Plan (WESPP). Under the WESPP, substantially all employees can elect to have up to 10% of their annual wages withheld to purchase our common stock. The purchase price of the stock was 85% of the lower of the beginning-of-quarter or end-of-quarter closing market price through September 30, 2006. Effective October 1, 2006, the purchase price of the stock is 85% of the end-of-quarter closing market price. Compensation cost related to the WESPP was approximately \$2 million for each of the three months ended March 31, 2007, and 2006. Shares purchased by employees was approximately 0.5 million and 0.4 million for the three months ended March 31, 2007 and 2006, respectively.

**15. Comprehensive Income**

Components of comprehensive income, on an after-tax basis where applicable, follow (in millions):

	Three months ended March 31,	
	2007 (a)	2006 (a)
Net income	\$ 327	\$ 257
Other comprehensive income:		
Change in unrealized gain on investments, net		1
Change in unrealized gain on derivative instruments, net	(37)	5
Reclassification adjustment relating to derivatives, net	28	(11)
Foreign currency translation adjustment, net	19	49
Amortization of prior pension costs, net	20	
Change in minimum pension liability		(4)
Total comprehensive income	\$ 357	\$ 297

- (a) Other comprehensive income items for the three months ended March 31, 2007 and 2006 include zero net tax effects. Refer to Note 5 (Income Taxes) for an explanation of Corning's tax paying position.

**16. Operating Segments**

Our reportable operating segments include Display Technologies, Telecommunications, Environmental Technologies, and Life Sciences. The Environmental Technologies reportable segment is an aggregation of our Automotive and Diesel operating segments, as these two segments share similar economic characteristics, products, customer types, production processes and distribution methods. The following provides a brief description of the products and markets served by each reportable segment:

Display Technologies - manufactures liquid crystal display glass for flat panel displays;

Telecommunications - manufactures optical fiber and cable, and hardware and equipment components for the telecommunications industry;

Environmental Technologies - manufactures ceramic substrates and filters for automobile and diesel applications; and

Life Sciences - manufactures glass and plastic consumables for pharmaceutical and scientific applications.

All other operating segments that do not meet the quantitative threshold for separate reporting have been grouped as All Other.



**Operating Segments** (in millions)

	Display Technologies	Telecom- munications	Environmental Technologies	Life Sciences	All Other	Total
<b>Three months ended March 31, 2007</b>						
Net sales	\$ 524	\$ 439	\$ 179	\$ 76	\$ 89	\$ 1,307
Depreciation (1)	\$ 81	\$ 33	\$ 21	\$ 5	\$ 8	\$ 148
Amortization of purchased intangibles		\$ 3				\$ 3
Research, development and engineering expenses (2)	\$ 27	\$ 19	\$ 30	\$ 12	\$ 9	\$ 97
Income tax provision	\$ (41)	\$ (14)	\$ (4)			\$ (59)
Earnings (loss) before minority interest and equity earnings (3)	\$ 267	\$ 28	\$ 9		\$ (1)	\$ 303
Equity in earnings of affiliated companies	\$ 113	\$ 1			\$ 9	\$ 123
Net income	\$ 380	\$ 29	\$ 9		\$ 8	\$ 426
<b>Three months ended March 31, 2006</b>						
Net sales	\$ 547	\$ 397	\$ 155	\$ 72	\$ 91	\$ 1,262
Depreciation (1)	\$ 62	\$ 42	\$ 20	\$ 5	\$ 10	\$ 139
Amortization of purchased intangibles		\$ 3				\$ 3
Research, development and engineering expenses (2)	\$ 30	\$ 20	\$ 30	\$ 13	\$ 8	\$ 101
Restructuring, impairment and other charges and (credits) (before-tax and minority interest)		\$ 6				\$ 6
Income tax provision	\$ (29)	\$ (6)			\$ (3)	\$ (38)
Earnings (loss) before minority interest and equity earnings (loss) (3)	\$ 275	\$ (2)		\$ (5)	\$ 2	\$ 270
Minority interests		\$ 1			\$ (2)	\$ (1)
Equity in earnings (loss) of affiliated companies (4)	\$ 142	\$ 2	\$ (1)		\$ (13)	\$ 130
Net income (loss)	\$ 417	\$ 1	\$ (1)	\$ (5)	\$ (13)	\$ 399

- (1) Depreciation expense for Corning's reportable segments is recorded based on the assets of each segment and also includes an allocation of depreciation of corporate property not specifically identifiable to a segment.
- (2) Research, development, and engineering expenses includes direct project spending which is identifiable to a segment.
- (3) Many of Corning's administrative and staff functions are performed on a centralized basis. Where practicable, Corning charges these expenses to segments based upon the extent to which each business uses a centralized function. Other staff functions, such as corporate finance, human resources and legal are allocated to segments, primarily as a percentage of sales.
- (4) In the first quarter of 2006, equity in earnings (loss) of affiliated companies includes a charge of \$21 million for Corning's share of Samsung Corning's impairment of certain manufacturing assets and other charges.

A reconciliation of reportable segment net income to consolidated net income follows (in millions):

	Three months ended	
	March 31, 2007	2006
Net income of reportable segments	\$ 426	\$ 399
Unallocated amounts:		
Net financing costs (1)	8	(8)
Stock-based compensation expense	(36)	(32)
Exploratory research (2)	(28)	(21)
Corporate contributions	(14)	(8)
Equity in earnings of affiliated companies, net of impairments	93	70
Asbestos settlement (3)	(110)	(185)
Other corporate items (4)	(12)	42
Net income	\$ 327	\$ 257

- (1) Net financing costs include interest expense, interest income, and interest costs and investment gains associated with benefit plans.
- (2) Exploratory research includes \$10 million of spending in 2007 on development programs such as silicon on glass, green lasers and micro-reactors.
- (3) The asbestos settlement arrangement to be incorporated into the Pittsburgh Corning Corporation (PCC) reorganization plan, when the reorganization plan becomes effective, will require Corning to relinquish its equity interest in PCC, contribute its equity interest in Pittsburgh Corning Europe (PCE), and 25 million shares of Corning common stock to a trust. Corning also agreed to make cash payments over the six years from the effective date of the settlement and to assign certain insurance policy proceeds from its primary insurance and a portion of its excess insurance at the time of the settlement. The asbestos liability requires adjustment to fair value based upon movements in Corning's common stock price prior to contribution of the shares to the trust as well as change in the estimated fair value of the other components of the settlement offer. In the first quarter of 2007 and 2006, Corning recorded a charge of \$101 million and \$182 million, respectively, to reflect the movement in Corning's common stock price in each year and changes of \$9 million and \$3 million, respectively, to reflect changes in the estimated fair value of the other components of the settlement offer.
- (4) Other corporate items include the tax impact of the unallocated amounts. In addition, the following items are also included:

In the first quarter of 2007, loss of \$15 million from the repurchase of \$223 million principal amount of our 6.25% Euro notes due 2010.

In the first quarter of 2006, a \$38 million tax benefit from the release of our valuation allowance on Germany trade taxes.

The sales of each of our reportable operating segments are concentrated across a relatively small number of customers. In the first quarter of 2007, this small number of customers, which individually accounted for 10% or more of each segment's sales, represented the following concentration of segment sales:

In the Display segment, four customers accounted for 72% of total segment sales.

In the Telecommunications segment, three customers accounted for 33% of total segment sales.

In the Environmental Technologies segment, three customers accounted for 74% of total segment sales.

In the Life Sciences segment, one customer accounted for 48% of segment sales.

A significant amount of specialized manufacturing capacity for our Display Technologies segment is concentrated in Taiwan and Japan. It is at least reasonably possible that the use of a facility located outside of an entity's home country could be disrupted. Due to the specialized nature of the assets, it would not be possible to find replacement capacity quickly. Accordingly, loss of these facilities could produce a near-term severe impact to our display business and the Company as a whole.



ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**OVERVIEW**

Our key priorities for 2007 remain unchanged from the previous three years: protect our financial health, improve our profitability, and invest in the future. During the first quarter of 2007, we made the following progress against these priorities:

***Financial Health***

Our balance sheet remains strong, and we generated significant positive cash flows from operating activities.

In the first quarter, we repurchased \$223 million of our 6.25% Euro notes due in 2010.

Our debt to capital ratio declined from 19% at December 31, 2006, to 16% at March 31, 2007.

Operating cash flow in the first quarter of 2007 was \$193 million.

***Profitability***

For the three months ended March 31, 2007, we generated net income of \$327 million or \$0.20 per share compared to net income of \$257 million or \$0.16 per share for the same period in 2006. The improvement in net income was due largely to the following items:

Lower asbestos settlement expense of \$110 million in the first quarter of 2007 compared to expense of \$185 million for the same period last year resulting from the change in fair value of Corning's asbestos settlement liability. The change in fair value for the asbestos settlement liability was primarily attributable to the change in the value of 25 million shares of Corning's common stock to be contributed to the proposed settlement. For additional information on this matter, refer to Note 3 (Commitments and Contingencies) to the consolidated financial statements.

Higher sales and increased net income in the Telecommunications operating segment.

An increase in equity earnings primarily driven by the absence of an impairment charge for Samsung Corning which was recognized in the first quarter of last year.

Improvements in net income were offset somewhat by the absence of a \$38 million valuation allowance release for a portion of the Company's German deferred tax assets recorded in the first quarter of 2006.

***Investing in Our Future***

We continue to focus on the future and on what we do best—creating and making keystone components that enable high-technology systems. We remain committed to investing in research, development, and engineering to drive innovation and continue to work on technologies for glass substrates for active matrix liquid crystal display (LCD) glass substrates, diesel filters and substrates in response to tightening emissions control

standards, and the optical fiber and cable and hardware and equipment that enable fiber-to-the-premises.

Our research, development and engineering expenses for the three months ended March 31, 2007, increased by \$6 million when compared to the same period last year but remained constant as percentage of net sales. We believe our spending levels are adequate to support our technology and innovation strategies.

Capital spending totaled \$262 million and \$280 million in the first quarter of 2007 and 2006, respectively. We remain committed to investing in manufacturing capacity to match increased demand in our businesses. As a result, capital expenditures are heavily focused on expanding manufacturing capacity for LCD glass substrates in the Display Technologies segment and diesel products in the Environmental Technologies segment. We expect our 2007 capital spending to be in the range of \$1.1 billion to \$1.2 billion, of which approximately \$700 million will be directed toward our Display Technologies segment and approximately \$100 million will be directed toward our Environmental Technologies segment. In addition, in April 2007, we announced a \$300 million facility improvement plan for the Company's Sullivan Park Research and Development campus near Corning, New York. The expansion is expected to be completed over a six-year period.

**RESULTS OF OPERATIONS**

Selected highlights for the third quarter follow (dollars in millions):

	Three months ended March 31,		% Change
	2007	2006	07 vs. 06
Net sales	\$ 1,307	\$ 1,262	4%
Gross margin (gross margin %)	\$ 591 45%	\$ 573 45%	3%
Selling, general and administrative expenses (as a % of net sales)	\$ 214 16%	\$ 223 18%	(4)%
Research, development and engineering expenses (as a % of net sales)	\$ 130 10%	\$ 124 10%	5%
Restructuring, impairment and other charges (as a % of net sales)	\$ 0 0%	\$ 6 0%	(100)%
Asbestos settlement (as a % of net sales)	\$ 110 8%	\$ 185 15%	(41)%
Income before income taxes (as a % of net sales)	\$ 167 13%	\$ 56 4%	198%
(Provision) benefit for income taxes (as a % of net sales)	\$ (56) (4)%	\$ 2 0%	(2,900)%
Equity in earnings of affiliated companies, net of impairments (as a % of net sales)	\$ 216 17%	\$ 200 16%	8%
Net income (as a % of net sales)	\$ 327 25%	\$ 257 20%	27%

***Net Sales***

For the three months ended March 31, 2007, the net sales increase compared to the same period in 2006 was the result of year-over-year increased volumes in the Telecommunications and Environmental Technologies segments offset somewhat by lower sales in the Display Technologies segment. For Display Technologies, sales volume increases were more than offset by price declines. Movements in foreign exchange rates did not have a significant impact on sales for the first quarter of 2007 when compared with the first quarter of 2006.

***Cost of Sales***

The types of expenses included in the cost of sales line item are: raw materials consumption, including direct and indirect materials; salaries, wages and benefits; depreciation and amortization; production utilities; production-related purchasing; warehousing (including receiving and inspection); repairs and maintenance; inter-location inventory transfer costs; production and warehousing facility property insurance; rent for production facilities; and other production overhead.

***Gross Margin***

As a percentage of net sales, gross margin for the first quarter of 2007 was even with the same period last year. The improvement in overall gross margin dollars was due primarily to increased sales of the Telecommunications segment.

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***Selling, General and Administrative Expenses***

For the first quarter of 2007, selling, general, and administrative expenses decreased \$9 million when compared to the same period in 2006. As a percentage of sales, the decline equaled 2% for the first quarter of 2007 when compared to the first quarter of 2006. The decline in selling, general, administrative expenses was primarily due to lower compensation-related expenses in the first quarter of 2007 when compared to the first quarter of 2006.

The types of expenses included in the selling, general and administrative expenses line item are: salaries, wages and benefits; stock-based compensation expense; travel; sales commissions; professional fees; depreciation and amortization, utilities, and rent for administrative facilities.

***Research, Development and Engineering Expenses***

Research, development and engineering expenses increased by \$6 million in the first quarter of 2007 when compared to the same period last year but remained consistent as a percentage of net sales. Expenditures are currently focused on our Display Technologies, Environmental Technologies and Telecommunications segments as we strive to capitalize on the growth opportunities in those segments.

***Restructuring, Impairment and Other Charges***

There were no restructuring, impairment, and other charges recorded in the first quarter of 2007. In the first quarter of 2006, we recorded \$6 million of restructuring expenses for revisions to existing plans. Refer to Note 2 (Restructuring, Impairment and Other Charges) to the consolidated financial statements for additional information.

***Asbestos Settlement***

The asbestos settlement activity relates to changes in the estimated fair value of certain items to be contributed by Corning under the Pittsburgh Corning Corporation (PCC) asbestos settlement agreement if the PCC Plan of Reorganization receives judicial approval. For additional information on this matter, refer to Note 3 (Commitments and Contingencies) to the consolidated financial statements and Part II Other Information, Item 1. Legal Proceedings.

***Income Before Income Taxes***

In addition to the items identified above, the following items had an impact on the results of our income before income taxes:

	Three months ended March 31, 2007	2006
Loss on repurchases and retirement of debt, net	\$ (15)	
Movements in exchange rates		\$ (23)

***Provision for Income Taxes***

Our provision for income taxes and the related tax rates follow (in millions):



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	Three months ended March 31,	
	2007	2006
Provision (benefit) for income taxes	\$ 56	\$ (2)
Effective tax (benefit) rate	33.5%	(3.6)%

For the three months ended March 31, 2007, the effective tax rate reflected the following items:

The impact of not recording tax benefits (expenses) on losses (income) generated in the U.S. until an appropriate level of profitability is reached and sustained in the U.S.

The benefit of tax holidays and investment credits in Taiwan.

The impact of discrete items for which no tax benefit was recorded, including asbestos settlement expense of \$110 million and a loss on the repurchase of debt of \$15 million. Refer to Notes 3 (Commitments and Contingencies) and 4 (Debt) to the consolidated financial statements for additional information. Discrete items increased our effective tax rate by 14.3 percentage points.

For the three months ended March 31, 2006, the effective tax rate reflected the following items:

The impact of not recording tax benefits (expenses) on losses (income) generated in the U.S. until an appropriate level of profitability is reached and sustained in the U.S.

The benefit of tax holidays and investment credits in Taiwan and China.

The release of a \$38 million valuation allowance on a portion of our German tax benefits because we achieved an appropriate level of profitability in certain of our German operations leading us to conclude that it is more likely than not that tax benefits are realizable and the impact of discrete items for which no tax benefit was recorded, including asbestos settlement expense of \$185 million. Refer to Note 3 (Commitments and Contingencies) to the consolidated financial statements for additional information about this item. The net impact of the release of the valuation allowance and the other discrete items reduced our effective tax rate by 18.5 percentage points.

As more fully described in Note 7 (Income Taxes) to the consolidated financial statements in the 2006 Form 10-K, all of our U.S. deferred tax assets had full valuation allowances at December 31, 2006 and this continues to be the case at March 31, 2007. We will maintain this valuation allowance until an appropriate level of profitability is sustained or we are able to develop tax planning strategies that enable us to conclude that it is more likely than not that our U.S. deferred tax assets are realizable. Until then, we will not record tax benefits (expenses) on losses (income) generated in the U.S.

Certain foreign subsidiaries in China and Taiwan are operating under tax holiday arrangements. The nature and extent of such arrangements vary. The benefits of such arrangements phase out in various years (2006 through 2011) according to the specific terms and schedules of the relevant taxing jurisdictions. The impact of the tax holidays on our effective tax rate is a reduction in the rate of 8 percentage points and 38 percentage points for the three months ended March 31, 2007 and 2006, respectively.

We adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) effective January 1, 2007. As a result of the implementation of FIN 48, we recognized a \$25 million increase in the liability for unrecognized tax benefits and a decrease to the January 1, 2007 balance of retained earnings of \$4 million. The amount of unrecognized tax benefits at January 1, 2007 is \$56 million of which \$38 million would impact the Company's effective tax rate, if recognized.

Refer to Note 5 (Income Taxes) to the consolidated financial statements for additional information.

***Equity in Earnings of Affiliated Companies, Net of Impairments***

The following provides a summary of equity in earnings of associated companies (in millions):

	Three months ended March 31,	
	2007	2006
Samsung Corning Precision	\$ 113	\$ 140
Dow Corning Corporation	92	69
Samsung Corning	(1)	(22)
All other	12	13
Total equity earnings	\$ 216	\$ 200

Equity earnings for the first quarter of 2007 reflected earnings increases for Dow Corning Corporation and Samsung Corning, offset somewhat by a decline in equity earnings from Samsung Corning Precision, when compared to the same period in 2006. The decline in equity earnings for Samsung Corning Precision is explained in the discussion of the performance of our Display Technologies segment.

The improvement in equity earnings recognized from Dow Corning for the three months ended March 31, 2007, compared to the same period in 2006, was largely attributable to a 15% increase in sales volume and the impact of a lower effective tax rate.

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The improvement in Samsung Corning's equity earnings was primarily due to the absence of an impairment charge, which was recognized in the first quarter of last year. In the first quarter of 2006, Corning reduced its investment in Samsung Corning by \$21 million due to an impairment of long-lived assets incurred by Samsung Corning.

In 2003, 2005, and 2006, Samsung Corning recorded significant fixed asset and other impairment charges. As the conventional television glass market is expected to be negatively impacted by continued strong growth in the LCD glass market, it is reasonably possible that Samsung Corning may incur additional restructuring or impairment charges or operating losses in the foreseeable future. Samsung Corning is currently investing in several developing businesses which Samsung Corning management believes will offset the decline in conventional television glass market over time. Should these new businesses not achieve expected results, additional operating losses, asset impairments, and restructuring charges are likely to occur, and Samsung Corning's long-term financial viability may come into question. These events could result in Corning incurring an additional impairment of its investment in Samsung Corning. Corning's management believes it is more likely than not that an impairment of our investment will occur in the foreseeable future. Corning's investment in Samsung Corning was \$249 million at March 31, 2007.

Refer to Note 9 (Investments) to the consolidated financial statements for additional information relating to Samsung Corning Precision, Dow Corning, and Samsung Corning's operating results.

### **Net Income**

As a result of the above, our net income and per share data follow (in millions, except per share amounts):

	Three months ended March 31,	
	2007	2006
Net income	\$ 327	\$ 257
Basic earnings per common share	\$ 0.21	\$ 0.17
Diluted earnings per common share	\$ 0.20	\$ 0.16
Shares used in computing per share amounts		
Basic earnings per common share	1,563	1,541
Diluted earnings per common share	1,600	1,592

### **OPERATING SEGMENTS**

Our reportable operating segments include Display Technologies, Telecommunications, Environmental Technologies, and Life Sciences. The Environmental Technologies reportable segment is an aggregation of our Automotive and Diesel operating segments, as these two segments share similar economic characteristics, products, customer types, production processes and distribution methods. The following provides a brief description of the products and markets served by each reportable segment:

Display Technologies - manufactures liquid crystal display glass for flat panel displays;

Telecommunications - manufactures optical fiber and cable, and hardware and equipment components for the telecommunications industry;

Environmental Technologies - manufactures ceramic substrates and filters for automobile and diesel applications; and

Life Sciences - manufactures glass and plastic consumables for pharmaceutical and scientific applications.

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All other operating segments that do not meet the quantitative threshold for separate reporting have been grouped as All Other.

We prepared the financial results for our reportable segments on a basis that is consistent with the manner in which we internally disaggregate financial information to assist in making internal operating decisions. We included the earnings of equity affiliates that are closely associated with our operating segments in the respective segment's net income. We have allocated certain common expenses among segments differently than we would for stand-alone financial information prepared in accordance with GAAP. Segment net income may not be consistent with measures used by other companies. The accounting policies of our reportable segments are the same as those applied in the consolidated financial statements.

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**Display Technologies**

The following table provides net sales and other data for the Display Technologies segment (in millions):

	Three months ended March 31,		% Change
	2007	2006	07 vs. 06
Net sales	\$ 524	\$ 547	(4)%
Income before equity earnings	\$ 267	\$ 275	(3)%
Equity earnings of affiliated companies	\$ 113	\$ 142	(20)%
Net income	\$ 380	\$ 417	(9)%

The decrease in net sales for the first quarter of 2007 compared to the first quarter of 2006 reflects volume gains of 13% (measured in square feet of glass sold) which were more than offset by price declines. Year-over-year volume gains are driven by increased LCD monitor and TV market penetration, demand for larger-size substrates (generation 5 and above), and continued strong demand for glass for notebook computers. As demand for LCD television increases, we expect this business to become more seasonal. As expected, first quarter 2007 volume declined 12% from the seasonally strong fourth quarter of 2006. Although prices were down significantly compared to last year, prices declined only slightly compared to the fourth quarter of 2006 as we implemented a new pricing strategy at the beginning of 2007.

For the first quarter of 2007, large-size glass substrates accounted for 85% of total sales volumes, compared to 80% for the first quarter of 2006. Because the sales of the Display Technologies segment are denominated in Japanese yen, our sales are susceptible to movements in the U.S. dollar Japanese yen exchange rate. Sales in the first quarter of 2007 were not significantly impacted by movements in foreign exchange rates when compared to the first quarter of 2006.

For the three months ended March 31, 2007, income before equity earnings was down slightly resulting from a decrease in sales offset somewhat by lower manufacturing and operating expenses and an increase in royalty income from Samsung Corning Precision. Corning licenses certain of its patents to Samsung Corning Precision, as well as to third parties, which generate royalty income. Refer to Note 9 (Investments) to the consolidated financial statements for more information about related party transactions.

The decline in our equity earnings from Samsung Corning Precision for the first quarter of 2007 compared to the first quarter of 2006 was due to a decrease in sales. In the first quarter of 2007, net sales at Samsung Corning Precision reflected volume gains of 23%, which were more than offset by the impact of price declines when compared to the same period last year. First quarter 2007 volume declined 5%, and prices declined in the upper single digits (expressed as a percent) when compared to the fourth quarter of 2006. Equity earnings for the first quarter of 2007 were also impacted by an increase in manufacturing, operating, and royalty expenses. The impact of movements in foreign exchange rates was not significant during the first quarter of 2007 when compared to the same period last year. Equity earnings from Samsung Corning Precision are susceptible to movements in the U.S. dollar Japanese yen and U.S. dollar Korean won exchange rates.

The Display Technologies segment has a concentrated customer base comprised of LCD panel and color filter makers primarily located in Japan and Taiwan. On October 1, 2006, AU Optronics Corporation (AUO), a customer of the Display Technologies segment, completed its previously announced merger with Quanta Display Inc. (QDI), another customer of Corning's Display Technologies segment. In addition, through two recently announced transactions, AUO now holds a 49% equity stake in Toppan CFI, a subsidiary of Toppan Printing Co., Ltd., also a customer of the Display Technologies segment. As a result of these transactions, AUO, QDI, and Toppan CFI are considered to be a single customer reported as AUO. For the first quarter of 2007, AUO (including QDI and Toppan CFI), Chi Mei Optoelectronics Corporation, and Sharp Corporation, which individually accounted for more than 10% of segment net sales, accounted for 72% of segment sales when combined.

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In addition, Samsung Corning Precision's sales are concentrated across a small number of its customers. For the three months ended March 31, 2007, sales to two LCD panel makers located in Korea, Samsung Electronics Co., Ltd. and LG Phillips LCD Co., Ltd., accounted for approximately 93% of Samsung Corning Precision sales.

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In 2005 and 2004, Corning and several customers entered into long-term purchase and supply agreements in which the Display Technologies segment agreed to supply large-size glass substrates to the customers over periods of up to six years. As part of the agreements, these customers agreed to make advance cash deposits to Corning for a portion of the contracted glass to be purchased. In the first quarter of 2007, Corning did not receive any customer deposit payments and issued \$33 million in credit memoranda. In the first quarter of 2006, Corning received \$13 million of deposits and issued \$21 million in credit memoranda. Refer to Note 11 (Customer Deposits) to the consolidated financial statements for additional information.

In the event the customers do not make all customer deposit installment payments or elect not to purchase the agreed upon quantities of product, subject to specific conditions outlined in the agreements, Corning may retain certain amounts of the customer deposits. If Corning does not deliver agreed upon product quantities, subject to specific conditions outlined in the agreements, Corning may be required to return certain amounts of the customer deposits.

**Outlook:**

We expect to see a continuation of the overall industry growth and the trend toward large-size substrates driven by increased end market demand for LCD televisions. We have increased our estimates of volume growth in the LCD glass market to 35% to 40% in 2007. Our previous estimate was in the mid-30% range.

For the second quarter of 2007, we expect glass volumes of Corning's wholly owned business and Samsung Corning Precision to increase in the range of 8% to 12%, both individually and in the aggregate, when compared to the first quarter of 2007. Price declines in the second quarter of 2007 for Corning's wholly owned business are expected to be in the same range as the first quarter of 2007. Price declines at Samsung Corning are expected to mirror those of Corning's wholly-owned business.

Although we believe that end market demand for LCD televisions, monitors, and notebooks remains strong, we are cautious about the potential negative impact that economic conditions and political tensions could have on consumer demand. There is no assurance that the end-market rates of growth will continue at the rates experienced in recent years, that we will be able to pace our capacity expansions to actual demand, or that the rate of cost declines will offset price declines in any given period. While the industry has grown rapidly, consumer preferences for panels of differing sizes; prices; or other factors may lead to pauses in market growth. Therefore, it is possible that glass manufacturing capacity may exceed demand from time to time. In addition, changes in foreign exchange rates, principally the Japanese yen, will continue to impact the sales and profitability of this segment.

***Telecommunications***

The following table provides net sales and other data for the Telecommunications segment (in millions):

	Three months ended March 31,		% Change
	2007	2006	07 vs. 06
Net sales:			
Optical fiber and cable	\$ 211	\$ 205	3%
Hardware and equipment	228	192	19%
Total net sales	\$ 439	\$ 397	11%
Net income	\$ 29	\$ 1	2,800%



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For the three months ended March 31, 2007, increases in segment sales were driven by market growth for telecommunications products. Movements in foreign exchange rates, primarily the Euro, did not have a significant impact on sales for the three months ended March 31, 2007, when compared to the same periods last year.

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Effective April 1, 2006, Advance Cable Systems (ACS), an equity company affiliate, assumed responsibility for optical cable and hardware and equipment sales in Japan. Since April 1, 2006, ACS has been accounted for under the equity method and as a result, sales for the first quarter of 2007 are not comparable to sales for the first quarter of 2006. Sales of optical cable and hardware and equipment in Japan were \$23 million in the first quarter of 2006.

The increase in net income for the three months ended March 31, 2007, when compared to the same period last year was due largely to the same factors as described above. Movements in exchange rates did not significantly impact the results for this operating segment.

The Telecommunications segment has a concentrated customer base. For the first quarter of 2007, three customers of the Telecommunications segment, which individually accounted for more than 10% of segment sales, represented 33% of total segment sales when combined.

Outlook:

For the second quarter of 2007, we expect net sales to increase in the range of 10% to 15% when compared to the first quarter of 2007 driven by seasonality in the telecommunications business. In April 2007, we announced plans to re-open a portion of our Concord, N.C., optical fiber manufacturing facility as a result of volume growth in the optical fiber market, which has been greater than 15% over the past two years.

***Environmental Technologies***

The following table provides net sales and other data for the Environmental Technologies reportable operating segment (in millions):

	Three months ended March 31, 2007	2006	% Change 07 vs. 06
Net sales:			
Automotive	\$ 123	\$ 121	2%
Diesel	56	34	65%
Total net sales	\$ 179	\$ 155	15%
Net (loss) income	\$ 9	\$ (1)	1,000%

Increased sales of this segment for the first quarter of 2007 compared to the same period last year were due largely to improvements in the diesel product line. Diesel sales in the first quarter of 2007 reflect increased sales of heavy duty diesel products to meet the U.S. emissions regulations which went into effect on January 1, 2007. Movements in exchange rates did not have a significant impact on sales for this segment.

For the three months ended March 31, 2007, net income was up due to improvements in sales and manufacturing efficiencies when compared to the same period last year. Movements in foreign exchange rates did not have a significant impact on net income for the comparable periods.

The Environmental Technologies reportable operating segment sells to a concentrated customer base of manufacturers of catalyzers and emission control systems, who then sell to automotive and diesel engine manufacturers. Although our sales are to the emission control systems manufacturers, the use of our substrates and filters is generally required by the specifications of the automotive and diesel engine manufacturers.

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For the three months ended March 31, 2007, three customers of the Environmental Technologies segment, which individually accounted for more than 10% of segment sales, accounted for 74% of total segment sales.

### Outlook:

For the second quarter of 2007, we expect net sales of this segment to be up approximately 5% when compared to the first quarter of 2007. Diesel product sales are expected to increase as demand for heavy duty diesel products continues to increase.

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***Life Sciences***

The following table provides net sales and net (loss) income for the Life Sciences segment (in millions):

	Three months ended March 31,		% Change
	2007	2006	07 vs. 06
Net sales	\$ 76	\$ 72	6%
Net (loss) income		\$ (5)	100%

Net sales for the first quarter of 2007, were up when compared to the same period last year driven by market growth and higher prices. Movements in foreign exchange rates did not have a significant impact on the comparability of sales.

For the first quarter of 2007, the reduction in net loss compared to the same period in 2006 was due to increased sales and improved manufacturing performance.

In the Life Sciences segment, one customer accounted for approximately 48% of this segment's net sales for the three month periods ended March 31, 2007.

**Outlook:**

For the second quarter of 2007, we expect net sales to be up approximately 5% from the first quarter of 2007 due to seasonality in the life sciences market.

**LIQUIDITY AND CAPITAL RESOURCES**

***Financing Structure***

In the first quarter of 2007, we repurchased \$223 million of our 6.25% Euro notes due in 2010.

In the first quarter of 2006, we did not have any significant financing activities.

***Capital Spending***

Capital spending totaled \$262 million and \$280 million in the first quarter of 2007 and 2006, respectively. We remain committed to investing in manufacturing capacity to match increased demand in our businesses. As a result, capital expenditures are heavily focused on expanding

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manufacturing capacity for LCD glass substrates in the Display Technologies segment and diesel products in the Environmental Technologies segment. We expect our 2007 capital spending to be in the range of \$1.1 billion to \$1.2 billion, of which approximately \$700 million will be directed toward our Display Technologies segment and approximately \$100 million will be directed toward our Environmental Technologies segment. In addition, in April 2007, we announced a \$300 million facility improvement plan for the Company's Sullivan Park Research and Development campus near Corning, New York. The expansion is expected to be completed over a six-year period.

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**Customer Deposits**

Certain customers of our Display Technologies segment have entered into long-term supply agreements and agreed to make advance cash deposits to secure supply of large-size glass substrates. The deposits will be reduced through future product purchases, thus reducing operating cash flows in later periods as credits are applied for cash deposits received in earlier periods.

Customer deposits have been or will be received in the following periods (in millions):

	2004	2005	2006	Three months ended March 31, 2007	Remainder of 2007	Estimated 2008 and Beyond	Total
Customer deposits received	\$ 204	\$ 457	\$ 171	\$ 0	\$ 105	\$ 0	\$ 937

During the three months ended March 31, 2007, and 2006, we issued \$33 million and \$21 million in credit memoranda, respectively. These credits are not included in the above amounts.

In 2007, we expect to issue credits in the range of \$250 million to \$300 million. Based on the deposit arrangements currently in place, in 2007 and 2008, credits issued will exceed deposits received.

**Defined Benefit Pension Plans**

We have defined benefit pension plans covering certain domestic and international employees. Our funding policy has been to contribute, as necessary, an amount in excess of the minimum requirements in order to achieve the company's long-term funding targets. In the first quarter of 2007, we made a voluntary contribution of \$106 million to our domestic defined benefit pension plan.

**Key Balance Sheet Data**

Balance sheet and working capital measures are provided in the following table (dollars in millions):

	As of March 31, 2007	As of December 31, 2006
Working capital	\$ 2,398	\$ 2,479
Working capital, excluding cash, cash equivalents, and short-term investments	\$ (490)	\$ (688)
Current ratio	2.1:1	2.1:1
Trade accounts receivable, net of allowances	\$ 781	\$ 746
Days sales outstanding	54	48
Inventories	\$ 685	\$ 639
Inventory turns	4.4	4.6

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Days payable outstanding (1)	38	42
Long-term debt	\$ 1,466	\$ 1,696
Total debt to total capital	16%	19%

(1) Includes trade payables only.

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***Credit Rating***

Our credit ratings remain the same as those disclosed in our 2006 Annual Report on Form 10-K as follows:

RATING AGENCY Last Update	Rating Long-Term Debt	Outlook
Fitch April 26, 2006	BBB	Stable
Standard & Poor's April 10, 2006	BBB	Stable
Moody's July 17, 2006	Baa2	Stable

***Management Assessment of Liquidity***

Our major source of funding for 2007 and beyond will be our operating cash flow, our existing balances of cash, cash equivalents and short term investments, and proceeds from the exercise of employee stock options. From time to time, we may issue debt securities to refinance debt securities maturing in the next few years. We believe we have sufficient liquidity for the next several years to fund operations, restructuring, the asbestos settlement, research and development, capital expenditures, and scheduled debt repayments. Due to the significant increase in cash, cash equivalents and short term investments over the past few years, during 2007 we will continue to evaluate reductions in our debt, share repurchases, and dividends.

***Off Balance Sheet Arrangements***

There have been no material changes outside the ordinary course of business in off balance sheet arrangements disclosed in our 2006 Annual Report on Form 10-K under the caption Off Balance Sheet Arrangements.

***Contractual Obligations***

Other than the debt transactions described in Note 4 (Debt) to the consolidated financial statements, there have been no material changes outside the ordinary course of business in the contractual obligations disclosed in our 2006 Annual Report on Form 10-K under the caption Contractual Obligations.

**CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported therein. The estimates that required management's most difficult, subjective or complex judgments are described in our 2006 Annual Report on Form 10-K and remain unchanged through the first quarter of 2007.

**NEW ACCOUNTING STANDARDS**



In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in applying generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies whenever an entity is measuring fair value under other accounting pronouncements that require or permit fair value measurement. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. Corning is currently evaluating the impact of SFAS 157 on its consolidated results of operations and financial condition.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 (SFAS 159). This Statement allows all entities a one-time election to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value (the fair value option). SFAS 159 is effective for fiscal years beginning after November 15, 2007. Corning is currently evaluating the impact of SFAS 159 on its consolidated results of operations and financial condition.

In March 2007, the FASB ratified Emerging Issues Task Force (EITF) issue No. 06-10 Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements (EITF 06-10). EITF 06-10 requires that an employer recognize a liability for the postretirement benefit obligation related to a collateral assignment arrangement in accordance with SFAS 106 (if deemed part of a postretirement plan) or APB 12 (if not part of a plan). The consensus is applicable if, based on the substantive agreement with the employee, the employer has agreed to (a) maintain a life insurance policy during the postretirement period or (b) provide a death benefit. The EITF also reached a consensus that an employer should recognize and measure the associated asset on the basis of the terms of the collateral assignment arrangement. Corning is required to adopt EITF 06-10 effective January 1, 2008. Corning is currently assessing the impact of this EITF Issue.

## ENVIRONMENT

Corning has been named by the Environmental Protection Agency (the Agency) under the Superfund Act, or by state governments under similar state laws, as a potentially responsible party for 18 active hazardous waste sites. Under the Superfund Act, all parties who may have contributed any waste to a hazardous waste site, identified by such Agency, are jointly and severally liable for the cost of cleanup unless the Agency agrees otherwise. It is Corning's policy to accrue for its estimated liability related to Superfund sites and other environmental liabilities related to property owned by Corning based on expert analysis and continual monitoring by both internal and external consultants. At March 31, 2007, and December 31, 2006, Corning had accrued approximately \$14 million (undiscounted) and \$16 million (undiscounted), respectively, for the estimated liability for environmental cleanup and related litigation. Based upon the information developed to date, management believes that the accrued reserve is a reasonable estimate of the Company's liability and that the risk of an additional loss in an amount materially higher than that accrued is remote.

## FORWARD-LOOKING STATEMENTS

Many statements in this Quarterly Report Form 10-Q are forward-looking statements. These typically contain words such as believes, expects, anticipates, estimates, forecasts, and similar expressions. These forward-looking statements involve risks and uncertainties that may cause the actual outcome to be materially different. Such risks and uncertainties include, but are not limited to:

- global economic and political conditions;
- tariffs, import duties and currency fluctuations;
- product demand and industry capacity;
- competitive products and pricing;
- availability and costs of critical components and materials;
- new product development and commercialization;
- order activity and demand from major customers;
- fluctuations in capital spending by customers;
- possible disruption in commercial activities due to terrorist activity, armed conflict, political instability or major health concerns;
- facility expansions and new plant start-up costs;
- effect of regulatory and legal developments;
- ability to pace capital spending to anticipated levels of customer demand, which may fluctuate;
- credit rating and ability to obtain financing and capital on commercially reasonable terms;
- adequacy and availability of insurance;
- financial risk management;
- acquisition and divestiture activities;
- rate of technology change;
- level of excess or obsolete inventory;
- ability to enforce patents;
- adverse litigation;
- product and components performance issues;
- retention of key personnel;
- stock price fluctuations;
- customer acceptance of LCD televisions;
- a downturn in demand or decline in growth rates for LCD glass substrates;
- customer ability, most notably in the Display Technologies segment, to maintain profitable operations and obtain financing to fund their manufacturing expansions and ongoing operations;
- fluctuations in supply chain inventory levels;
- equity company activities, principally at Dow Corning Corporation, Samsung Corning Precision, and Samsung Corning;
- movements in foreign exchange rates, primarily the Japanese yen, Euro, and Korean won; and
- other risks detailed in Corning's SEC filings.



ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**Market Risk Disclosures**

There have been no material changes to our market risk exposures during the first three months of 2007. For a discussion of our exposure to market risk, refer to Item 7A, Quantitative and Qualitative Disclosures About Market Risks, contained in our 2006 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Corning carried out an evaluation, under the supervision and with the participation of Corning's management, including its chief executive officer and chief financial officer, of the effectiveness of the design and operation of Corning's disclosure controls and procedures as of March 31, 2007, the end of the period covered by this report. Based upon the evaluation, the chief executive officer and chief financial officer concluded that Corning's disclosure controls and procedures are effective to ensure that information required to be disclosed by Corning in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Corning's disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by Corning in the reports that it files or submits under the Exchange Act is accumulated and communicated to Corning's management, including its principal executive and principal financial officers, or other persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

During the fiscal quarter ended March 31, 2007, no change occurred in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II - Other Information

ITEM 1. LEGAL PROCEEDINGS

**Environmental Litigation.** Corning has been named by the Environmental Protection Agency (the Agency) under the Superfund Act, or by state governments under similar state laws, as a potentially responsible party at 18 active hazardous waste sites. Under the Superfund Act, all parties who may have contributed any waste to a hazardous waste site, identified by such Agency, are jointly and severally liable for the cost of cleanup unless the Agency agrees otherwise. It is Corning's policy to accrue for its estimated liability related to Superfund sites and other environmental liabilities related to property owned by Corning based on expert analysis and continual monitoring by both internal and external consultants. Corning has accrued approximately \$14 million (undiscounted) for its estimated liability for environmental cleanup and litigation at March 31, 2007. Based upon the information developed to date, management believes that the accrued reserve is a reasonable estimate of the Company's liability and that the risk of an additional loss in an amount materially higher than that accrued is remote.

**Dow Corning Bankruptcy.** Corning and Dow Chemical each own 50% of the common stock of Dow Corning. In May 1995, Dow Corning filed for bankruptcy protection to address pending and claimed liabilities arising from many thousands of breast implant product lawsuits. On June 1, 2004, Dow Corning emerged from Chapter 11 with a Plan of Reorganization (the Plan) which provided for the settlement or other resolution of implant claims. The Plan also includes releases for Corning and Dow Chemical as shareholders in exchange for contributions to the Plan.

Under the terms of the Plan, Dow Corning has established and is funding a Settlement Trust and a Litigation Facility to provide a means for tort claimants to settle or litigate their claims. Inclusive of insurance, Dow Corning has paid approximately \$1.5 billion to the Settlement Trust. As of March 31, 2007, Dow Corning had recorded a reserve for breast implant litigation of \$1.7 billion and anticipates insurance receivables of \$171 million. As a separate matter arising from the bankruptcy proceedings, Dow Corning is defending claims asserted by a number of commercial creditors who claim additional interest at default rates and enforcement costs, during the period from May 1995 through June 2004. On July 26, 2006, the U.S. Court of Appeals vacated the judgment of the District Court fixing the interest component, ruled that default interest and enforcement costs may be awarded subject to equitable factors to be determined, and directed that the matter be remanded for further proceedings. Dow Corning's petition for rehearing by the Court of Appeals and its petition for a writ of certiorari with the U.S. Supreme Court were both denied. As of March 31, 2007, Dow Corning has estimated the interest payable to commercial creditors to be within the range of \$69 million to \$212 million. As Dow Corning management believes no single amount within the range appears to be a better estimate than any other amount within the range, Dow Corning has recorded the minimum liability within the range. Should Dow Corning not prevail in this matter, Corning's equity earnings would be reduced by its 50% share of the amount in excess of \$69 million, net of applicable tax benefits. There are a number of other claims in the bankruptcy proceedings against Dow Corning awaiting resolution by the U.S. District Court, and it is reasonably possible that Dow Corning may record bankruptcy-related charges in the future. There are no remaining tort claims against Corning, other than those that will be channeled by the Plan into facilities established by the Plan or otherwise defended by the Litigation Facility.

**Pittsburgh Corning Corporation.** Corning and PPG Industries, Inc. (PPG) each own 50% of the capital stock of Pittsburgh Corning Corporation (PCC). Over a period of more than two decades, PCC and several other defendants have been named in numerous lawsuits involving claims alleging personal injury from exposure to asbestos. On April 16, 2000, PCC filed for Chapter 11 reorganization in the U.S. Bankruptcy Court for the Western District of Pennsylvania. As a result of PCC's bankruptcy filing, Corning recorded an after-tax charge of \$36 million in 2001 to fully impair its investment in PCC and discontinued recognition of equity earnings. At the time PCC filed for bankruptcy protection, there were approximately 12,400 claims pending against Corning in state court lawsuits alleging various theories of liability based on exposure to PCC's asbestos products and typically requesting monetary damages in excess of one million dollars per claim. Corning has defended those claims on the basis of the separate corporate status of PCC and the absence of any facts supporting claims of direct liability arising from PCC's asbestos products. Corning is also currently named in approximately 10,600 other cases (approximately 42,000 claims) alleging injuries from asbestos and similar amounts of monetary damages per claim. Those cases have been covered by insurance without

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material impact to Corning to date. Asbestos litigation is inherently difficult, and past trends in resolving these claims may not be indicators of future outcomes.

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In the bankruptcy court in April 2000, PCC obtained a preliminary injunction against the prosecution of asbestos actions arising from PCC's products against its two shareholders to afford the parties a period of time in which to negotiate a plan of reorganization for PCC (the PCC Plan).

On May 14, 2002, PPG announced that it had agreed with certain of its insurance carriers and representatives of current and future asbestos claimants on the terms of a settlement arrangement applicable to claims arising from PCC's products.

On March 28, 2003, Corning announced that it had reached agreement with the representatives of asbestos claimants for the settlement of all current and future asbestos claims against it and PCC, which might arise from PCC products or operations. The proposed settlement, if the PCC Plan is approved and becomes effective, would require Corning to relinquish its equity interest in PCC, contribute its equity interest in Pittsburgh Corning Europe N.V. (PCE), a Belgian corporation, and contribute 25 million shares of Corning common stock. Corning would also pay a total of \$140 million in six annual installments (present value \$131 million at March 2003), beginning one year after the PCC Plan becomes effective, with 5.5 percent interest from June 2004, and assign certain insurance policy proceeds from its primary insurance and a portion of its excess insurance at the time of settlement.

The PCC Plan received a favorable vote from creditors in March 2004. Hearings to consider objections to the PCC Plan were held in the Bankruptcy Court in May 2004. In February, 2006, the Bankruptcy Court requested that the PCC Plan proponents delete references to Section 105(a) of the Bankruptcy Code and resubmit the PCC Plan. The final round of oral argument was held on July 21, 2006.

On December 21, 2006, the Bankruptcy Court issued an order denying confirmation of the PCC Plan for reasons set out in a memorandum opinion. Several parties, including Corning, filed motions for reconsideration. These motions were argued on March 5, 2007, and the Bankruptcy Court reserved decision. If the Bankruptcy Court does not approve the PCC Plan in its current form, changes to the PCC Plan are reasonably likely to occur.

The outcome of these proceedings is uncertain, and confirmation of the current PCC Plan or any amended PCC Plan is subject to a number of contingencies. However, apart from the quarterly mark-to-market adjustment in the value of the components of the settlement, management believes that the likelihood of a material adverse impact to Corning's financial statements is remote.

Two of Corning's primary insurers and several excess insurers have commenced litigation for a declaration of the rights and obligations of the parties under insurance policies, including rights that may be affected by the settlement arrangement described above. Corning is vigorously contesting these cases. Management is unable to predict the outcome of this insurance litigation.

Since March 31, 2003, we have recorded total net charges of \$927 million to reflect the agreed settlement contributions and subsequent adjustments for the change in the fair value of the components.

The liability expected to be settled by contribution of our investment in PCE, assigned insurance proceeds, and the 25 million shares of our common stock (totaling \$764 million at March 31, 2007) is recorded in the other accrued liabilities component in our consolidated balance sheets. This portion of the PCC liability is considered a due on demand obligation. Accordingly, this portion of the obligation has been classified as a current liability even though it is possible that the contribution could be made beyond one year. The remaining portion of the settlement



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liability (totaling \$163 million at March 31, 2007), representing the net present value of the cash payments, is recorded in the other liabilities component in our consolidated balance sheets.

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**Seoul Guarantee Insurance Co. and other creditors against Samsung Group and affiliates.** As of April 2007, Samsung Corning Precision Glass Co., Ltd. (Samsung Corning Precision) and Samsung Corning Co. Ltd. (Samsung Corning) are two of approximately thirty co-defendants in a lawsuit filed by Seoul Guarantee Insurance Co. and thirteen other creditors (SGI and Creditors) for alleged breach of an agreement that approximately thirty affiliates of the Samsung group entered into with SGI and Creditors in September 1999. The lawsuit is pending in the courts of Korea. According to the agreement, the Samsung affiliates agreed to sell 3.5 million shares of Samsung Life Insurance Co., Ltd. (SLI) by December 31, 2000, which were transferred to SGI and Creditors in connection with the petition for court receivership of Samsung Motor Inc. In the lawsuit, SGI and Creditors allege that, in the event that the proceeds of sale of the SLI shares is less than 2.45 trillion Korean won (approximately \$2.6 billion), the Samsung affiliates allegedly agreed to compensate SGI and Creditors for the shortfall, by other means, including the sale of an additional 500,000 SLI shares and Samsung affiliates purchase of equity or subordinated debentures to be issued by SGI and Creditors. Any excess proceeds from the sale of the SLI shares are to be distributed to the Samsung affiliates. To our knowledge, the SLI shares have not been sold. The suit asks for total damages of 4.73 trillion Korean Won (approximately \$5.0 billion) plus penalty interest. Samsung Corning Precision and Samsung Corning combined guarantees should represent no more than 3.3% of the Samsung affiliates total financial obligation. Although noting that the outcome of these matters is uncertain, Samsung Corning Precision and Samsung Corning have stated that these matters are not likely to result in a material ultimate loss to their financial statements. No claim in these matters has been asserted against Corning Incorporated or any of its affiliates.

**Ellsworth Industrial Park, Downers Grove, IL Environmental Litigation.** In August 2005, Corning was named as a fourth party defendant in a class action, *Ann Muniz v. Rexnord Corp.*, filed in the U.S. District Court for the N.D. Illinois, claiming an unspecified amount of damages and asserting various personal injury and property damage claims against a number of corporate defendants. These claims allegedly arise from the release of solvents from the operations of several manufacturers at the Ellsworth Industrial Park into soil and ground water. On July 10, 2006, plaintiffs settled with a number of defendants and third-party defendants for \$15.75 million, and the settling defendants mediated allocation. In November 2006, Corning settled with three of the third-party defendants for a total of approximately \$99,000. The March 2007 trial date of the claim of the remaining third-party defendant was suspended and has not been rescheduled. Corning was also named as a third or fourth party defendant in two personal injury lawsuits and a cost-recovery action by the State of Illinois against a number of corporate defendants as a result of an alleged groundwater contamination at this industrial park site. In February 2007, Corning settled all claims in one of the personal injury lawsuits for \$60,000. Corning has a number of defenses to these claims, which management intends to contest vigorously. Management believes these matters are not likely to be material to the financial statements of Corning in any period.

**Astrium Insurance Litigation.** In February 2007, American Motorists Insurance Company and Lumbermens Mutual Casualty Company (collectively AMICO ) filed a declaratory judgment action against Corning, Corning NetOptix, Inc., OFC Corporation, Optical Filter Corporation, Galileo Electro-Optics Corporation, Galileo Corporation and Netoptix Corporation in the U.S. District Court for the Central District of California, seeking reimbursement for approximately \$14 million in defense costs incurred to defend all defendants, except Corning, in an underlying lawsuit entitled *Astrium S.A.S., et al. v. TRW, Inc., et al.* Defendants answers to the complaint were filed on March 5, 2007. Management believes that there are strong defenses to these claims and that the claims are not likely to be material to the financial statements of Corning.

#### ITEM 1A. RISK FACTORS

In addition to other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006 which could materially impact our business, financial condition or future results. Risks disclosed in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may materially adversely impact our business, financial condition or operating results.

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The information present below updates, and should be read in conjunction with, the risk factor information disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

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**Current or future litigation may harm our financial condition or results of operations**

Pending, threatened or future litigation is subject to inherent uncertainties. Our financial condition or results of operations may be adversely affected by unfavorable outcomes, expenses and costs exceeding amounts estimated or insured. In particular, we have been named as a defendant in numerous lawsuits alleging personal injury from exposure to asbestos. As described in Legal Proceedings, our negotiations with the representatives of asbestos claimants produced a tentative plan of settlement through a PCC Plan of Reorganization, but this Plan has not been confirmed by the Bankruptcy Court. The proponents of the Plan have moved for reconsideration of the order entered by the Court on December 21, 2006 denying Plan confirmation. It is reasonably possible that changes to the Plan may be negotiated, but the elements of the Plan and final approval are subject to a number of contingencies. Total charges of \$927 million have been recorded through March 31, 2007; however, additional charges or credits are possible due to the potential fluctuation in the price of our common stock, other adjustments in the proposed settlement, and other litigation factors.

If the December 21, 2006 ruling by the Bankruptcy Court, denying confirmation of the PCC Plan of Reorganization, is not reversed, a revised Plan may not include certain asbestos claims against the shareholders of PCC characterized as independent of the operations and products of PCC. We believe the total charges taken by Corning for asbestos matters is adequate to cover both a reduced contribution to a revised PCC Plan and these independent claims, as described in Legal Proceedings under Pittsburgh Corning. However, asbestos litigation is difficult to predict or estimate, and there are a number of uncertainties or risks that may affect the total costs actually incurred in resolving these claims.

**We may not have adequate insurance coverage for claims against us**

We face the risk of loss resulting from product liability, securities, fiduciary liability, intellectual property, antitrust, contractual, warranty, fraud and other lawsuits, whether or not such claims are valid. In addition, our product liability, fiduciary, directors and officers, property, natural catastrophe and comprehensive general liability insurance may not be adequate to cover such claims or may not be available to the extent we expect. Our insurance costs can be volatile and, at any time, can increase given changes in market supply and demand. We may not be able to obtain adequate insurance coverage in the future at acceptable costs. A successful claim that exceeds or is not covered by our policies could require us to pay substantial sums. Some of the carriers which have provided insurance in the past for our [excess] insurance programs are in liquidation and may not be able to respond if we should have claims. Unfavorable court decisions concerning matters of coverage, definition of occurrences or calculations of deductibles for asbestosis claims, for example, may also affect Corning's ability to recover significant sums from its insurance program. The financial health of other insurers may deteriorate. In addition, we may not be able to obtain adequate insurance coverage for certain risk such as political risk, terrorism or war.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

This table provides information about our purchases of our common stock during the fiscal first quarter of 2007:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (a)	Average Price Paid per Share (a)	Total Number of Shares Purchased as Part of Publicly Announced Plan (b)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan (b)
January 1-31, 2007	11,478	\$20.45	0	\$0
February 1-28, 2007	953,350	\$21.07	0	\$0
March 1-31, 2007	35,394	\$21.95	0	\$0
Total	533,455	\$21.09	0	\$0

(a) This column reflects the following transactions during the fiscal first quarter of 2007: (i) the deemed surrender to us of 245,132 shares of common stock to pay the exercise price and to satisfy tax withholding obligations in connection with the exercise of employee stock options, and (ii) the surrender to us of 755,090 shares of common stock to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees.

(b) During the quarter ended March 31, 2007, we did not have a publicly announced program for repurchase of shares of our common stock and did not repurchase our common stock in open-market transactions outside of such a program.

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit Number	Exhibit Name
10	Executive Supplemental Pension Plan as restated and signed April 10, 2007
12	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Exchange Act
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Exchange Act
32	Certification Pursuant to 18 U.S.C. Section 1350

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Corning Incorporated  
(Registrant)

April 27, 2007  
Date

/s/ JAMES B. FLAWS  
James B. Flaws  
Vice Chairman and Chief Financial Officer  
(Principal Financial Officer)

April 27, 2007  
Date

/s/ JANE D. POULIN  
Jane D. Poulin  
Chief Accounting Officer  
(Principal Accounting Officer)

April 27, 2007  
Date

/s/ KATHERINE A. ASBECK  
Katherine A. Asbeck  
Senior Vice President - Finance

EXHIBIT INDEX

Exhibit Number	Exhibit Name	Page
10	Executive Supplemental Pension Plan as restated and signed April 10, 2007	48
12	Computation of Ratio of Earnings to Fixed Charges	60
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Exchange Act	61
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Exchange Act	62
32	Certification Pursuant to 18 U.S.C. Section 1350	63



Exhibit 10

**CORNING INCORPORATED**

**EXECUTIVE SUPPLEMENTAL PENSION PLAN**

CORNING INCORPORATED (the Company ) hereby amends and restates the CORNING INCORPORATED EXECUTIVE SUPPLEMENTAL PENSION PLAN (the Plan ) for the benefit of eligible Employees. The terms of this restated Plan apply to eligible Employees who retire on or after December 6, 2006.

ARTICLE ONE

Definitions

1.1 Board means the Board of Directors of Corning Incorporated.

1.2 Change in Control means an event that is a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation within the meaning of Section 409A and that also falls within one of the following circumstances:

(i) an offeror (other than the Company) purchases shares of Corning Common Stock pursuant to a tender or exchange offer for such shares;

(ii) any person (as such term is used in Sections 13(d) and 14(d)(2) of the Securities Exchange Act of 1934) is or becomes the beneficial owner, directly or indirectly, of the Company's securities representing 50% or more of the combined voting power of Company's then outstanding securities;

(iii) the membership of the Company's Board of Directors changes as the result of a contested election or elections, such that within any 12 month period a majority of the individuals who are Directors at any particular time were initially placed on the Board of Directors as a result of such a contested election or elections; or

(iv) the consummation of a merger in which the Company is not the surviving corporation, consolidation, sale or disposition of all or substantially all of the Company's assets or a plan of partial or complete liquidation approved by the Company's shareholders.

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1.3 Code means the Internal Revenue Code of 1986, as amended from time to time.

1.4 Committee means the Compensation Committee of the Company's Board of Directors.

1.5 Company means Corning Incorporated.

1.6 Employee means any employee of a Participating Company who participates in the Qualified Plan and who is a management or highly compensated employee as such employees are defined in Title I of ERISA.

1.7 Normal Retirement Date means the first day of the month following the later of the Employee's 65th birthday or the date the Employee has five vesting years of service.

1.8 Participating Company means the Company and any related entity that meets the definition of Company in the Qualified Plan and which is approved by the Committee as a Participating Company under this Plan.

1.9 Plan means this Corning Incorporated Executive Supplemental Pension Plan.

1.10        **Qualified Plan** means The Corning Incorporated Pension Plan for Salaried Employees.

1.11        **Section 409A** means Section 409A of Code, and the Treasury regulations and other authoritative guidance issued thereunder.

1.12        **Total and Permanent Disability** shall mean, based upon medical evidence satisfactory to the Committee, the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long, continued and indefinite duration.

## ARTICLE TWO

### Purpose and Intent of Plan

2.1        The purpose of this Plan is to attract and retain a highly-motivated executive workforce by providing to eligible Employees retirement benefits in excess of those permitted under the Qualified Plan. The Plan is intended to constitute an unfunded plan of deferred compensation for a select group of management or highly-compensated employees as provided for in Title I of ERISA. This Plan is also intended to comply with the requirements of Section 409A and shall be interpreted consistent with that intent. The terms of this Plan shall supersede any and all other plans and documents that may have terms that are inconsistent with and/or are additional to the terms herein.

## ARTICLE THREE

### Eligible Employee

3.1        The Committee, in its sole discretion, shall designate those Employees who shall be eligible to participate in this Plan. All eligible Employees shall be identified in such records as the Committee deems appropriate to establish and maintain.

Notwithstanding any provision to the contrary, an otherwise eligible Employee shall be ineligible to participate and shall forfeit all rights to receive any benefit payment under this Plan if such employee:

- (a)        is terminated for cause, which determination shall be in the sole discretion of the Committee and this determination shall be final and binding on all persons;
- (b)        fails to comply with the terms of any noncompete, confidentiality and/or similar agreement(s) the eligible Employee has with the Company;
- (c)        solicits or encourages employees to leave the employ of the Company, as determined by the Committee in its sole discretion;

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- (d) works for or provides services to a third party, including competitors of the Company, which the Committee determines, in its sole discretion, may cause injury or harm to the Company; or
- (e) files or threatens legal action against the Company, either directly or indirectly through a third party company, including but not limited to threats or assertions of patent infringement, which the Committee determines, in its sole discretion, may cause injury or harm to the Company.

If the Committee, in its sole discretion, determines that an eligible Employee has failed to comply with the terms of any of paragraphs (b), (c), (d) or (e), the eligible Employee shall forfeit all future benefits under this Plan, and the eligible Employee shall promptly reimburse the Company for any Plan benefits that were paid to the eligible Employee.

An Employee who is designated as being eligible to receive benefits under this Plan shall not be entitled to any benefits under the Corning Incorporated Supplemental Pension Plan.

ARTICLE FOUR

Benefits

4.1 Benefit Amount. The benefit payable under this Plan is, as follows:

A. Except for the individuals listed in Exhibit A, eligible Employees shall accrue benefits under this Section 4.1A, subject to the vesting rule described in the following sentence. An eligible Employee shall vest in his right to receive a benefit under this Section 4.1A, if the eligible Employee: (i) terminates employment after both reaching age 50 and attaining 10 years of Credited Service; or (ii) was an eligible Employee who had attained age 55 as of December 5, 2006 and whose age plus years of Credited Service as of December 5, 2006 totaled at least 65. If an eligible Employee fails to vest in his benefit under the preceding sentence, he will receive the benefit set forth in Section 4.1C, rather than the benefit described in this Section 4.1A.

An eligible Employee's annual benefit under this Section 4.1A, calculated as of the Employee's Normal Retirement Date, is a straight life annuity equal to (a) less (b), where:

(a) equals the aggregate amount the eligible Employee would be entitled to receive under the following formula:

2% multiplied by the Employee's Credited Service multiplied by the Employee's Average Compensation, and

(b) equals the amount the eligible Employee is actually entitled to receive under the Qualified Plan.

For purposes of calculating (a) above:

(1) the term Compensation shall mean the total remuneration (before salary reduction, if any, under the Company's Management Deferral Plan, Supplemental Investment Plan, Investment Plan or any other Code section 125, 132(f) or 401(k) employee benefit plan) paid to an Employee by the Company for personal services actually rendered, including cash payments of GoalSharing awards, Performance Incentive Plan awards, Division Cash Awards, Individual Outstanding Contributor Awards and certain other eligible cash bonuses, but excluding any Company contributions paid under this Plan or any other employee benefit or deferred compensation plan, awards under the Company's Incentive Stock Plan, non-cash bonuses, awards under the Corporate Performance Plan, the value of stock purchase contracts, dividends or dividend equivalents thereon, reimbursed expenses, overseas allowances, cost-of-living allowances, death benefits, severance pay, signing bonuses, special achievement bonuses and other unusual payments determined by the Committee in a non-discriminatory manner. The Committee, in its sole discretion, may add to the items of includable compensation other compensatory payments or benefits earned by eligible Employees;

(2) the term Average Compensation shall mean the annualized equivalent of the average of an eligible Employee's Compensation in the highest 60 consecutive calendar months in the 120 calendar months immediately preceding the month after which the eligible Employee terminates employment, provided that such amount shall not exceed 300% of the Employee's annual full-time base compensation as of the date the eligible Employee terminates employment; and

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(3) the term Credited Service shall mean such service as defined in the Qualified Plan together with the modifications set forth in the Corning Incorporated Supplemental Pension Plan, provided that an Employee's Credited Service shall not exceed 25 years.

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An eligible Employee shall be entitled to receive an unreduced early retirement benefit if the Employee separates from service after: (i) attaining age 55 with at least 25 years of Credited Service; or (ii) attaining age 60 with at least 10 years of Credited Service. The following rules shall apply if an eligible Employee fails to satisfy these requirements:

(x) If an eligible Employee separates from service after attaining age 55 and commences benefits before attaining age 60, such Employee's early retirement benefit shall be the amount determined above, adjusted and reduced, at the rate of one-third of one percent for each month between the date benefits commence and the month following the month in which the Employee would attain age 60.

(y) If an eligible Employee incurs a Total and Permanent Disability, the eligible Employee shall be entitled to receive an unreduced early retirement benefit at the time specified in Section 4.2.

(z) If an eligible Employee separates from service before attaining age 55, such Employee's benefit shall commence within 60 days after attaining age 55 pursuant to Section 4.2 and his early retirement benefit shall be the amount determined above, adjusted and reduced by 50%.

B. This Section 4.1B shall only apply to an eligible Employee who is listed on Exhibit A. The eligible Employees listed on Exhibit A shall be vested in their Plan benefits under this Section 4.1B. An eligible Employee's annual benefit under this Section 4.1B, calculated as of the Employee's Normal Retirement Date, is a straight life annuity equal to (a) less (b), where:

(a) equals the aggregate amount the eligible Employee would be entitled to receive under the following formula:

1.5% multiplied by the Employee's Credited Service multiplied by the Employee's Average Compensation, and

(b) equals the amount the eligible Employee is actually entitled to receive under the Qualified Plan.

For purposes of calculating (a) above:

(1) the term Compensation shall mean the total remuneration (before salary reduction, if any, under the Company's Management Deferral Plan, Supplemental Investment Plan, Investment Plan or any other Code section 125, 132(f) or 401(k) employee benefit plan) paid to an Employee by the Company for personal services actually rendered, including cash payments of GoalSharing awards, Performance Incentive Plan awards, Division Cash Awards, Individual Outstanding Contributor Awards and certain other eligible cash bonuses, but excluding any Company contributions paid under this Plan or any other employee benefit or deferred compensation plan, awards under the Company's Incentive Stock Plan, non-cash bonuses, awards under the Corporate Performance Plan, the value of stock purchase contracts, dividends or dividend equivalents thereon, reimbursed expenses, overseas allowances, cost-of-living allowances, death benefits, severance pay, signing bonuses, special achievement bonuses and other unusual payments determined by the Committee in a non-discriminatory manner. The Committee in its sole discretion may add to the items of includable compensation other compensatory payments or benefits earned by eligible Employees;

(2) the term Average Compensation shall mean the annualized equivalent of the average of an eligible Employee's Compensation in the highest 60 consecutive calendar months in the 120 calendar months immediately preceding the month after which the eligible Employee terminates employment, provided that such amount shall not exceed 300% of the Employee's annual full-time base compensation as of the date the eligible Employee terminates employment; and



(3) the term Credited Service shall mean such service as defined in the Qualified Plan together with the modifications set forth in the Corning Incorporated Supplemental Pension Plan.

An eligible Employee shall be entitled to receive an unreduced early retirement benefit if the Employee separates from service after: (i) attaining age 55 with at least 25 years of Credited Service; or (ii) attaining age 60 with at least 10 years of Credited Service. The following rules shall apply if an eligible Employee fails to satisfy these requirements:

(x) If an eligible Employee separates from service after attaining age 55 and commences benefits before attaining age 60, such Employee's early retirement benefit shall be the amount determined above, adjusted and reduced, at the rate of one-third of one percent for each month between the date benefits commence and the month following the month in which the Employee would attain age 60.

(y) If an eligible Employee incurs a Total and Permanent Disability, the eligible Employee shall be entitled to receive an unreduced early retirement benefit at the time specified in Section 4.2.

(z) If an eligible Employee separates from service before attaining age 55, such Employee's benefit shall commence within 60 days after attaining age 55 pursuant to Section 4.2 and his early retirement benefit shall be the amount determined above, adjusted and reduced by 50%.

C. This Section 4.1C shall only apply to an eligible Employee who fails to vest in his benefit under Section 4.1A. The annual benefit payable to such an eligible Employee under this Plan shall be calculated as the benefit that would be paid to the eligible Employee under the benefit formula and terms and conditions (including the vesting provisions) set forth under the Corning Incorporated Supplemental Pension Plan with the following exception. Notwithstanding the provisions of the Corning Incorporated Supplemental Pension Plan, all benefits set forth in this Section 4.1C shall be paid in the form of an annuity, rather than a lump sum, except that a lump sum benefit shall be paid in the amounts and instances described in Section 4.3(a), (c) and Section 4.6.

D. Notwithstanding the foregoing, for purposes of calculating a particular Employee's benefit under the Plan, the Committee, in its sole discretion, may adjust an Employee's compensation, credited service or other factor used in calculating the Employee's benefit in any manner the Committee deems appropriate, provided such adjustment is memorialized in writing. The Committee may make such adjustment solely for a specified Employee or group of Employees and without regard to how other Employees are treated.

4.2 Commencement of Benefits. Except as set forth in Section 4.6, a Participating Company shall pay the nonforfeited benefits due under this Plan commencing within 60 days following the later of: (i) such Employee's separation from service within the meaning of Section 409A; or (ii) age 55. Notwithstanding the foregoing, benefit payments to a specified employee within the meaning of Section 409A (for this purpose, payments on account of death are not considered to be payments made on account of separation from service) may not commence until six months following the date of the specified employee's separation from service. Benefit payments that would otherwise have been paid to a specified employee in the absence of the previous sentence shall be held in suspense during the six month suspension period and paid to the specified employee in a lump sum payment as soon as administratively practicable after the date which is six months following the specified employee's separation from service.

4.3 Form of Payment. The default form of benefit payable under this Plan shall be a life annuity for unmarried Employees and a joint and 75 percent survivor annuity for married Employees. Employees may elect to receive their benefits in the form of a single life annuity or a joint and 50, 75 or 100 percent survivor annuity. Any election to change the form of benefit must be made under such procedure established by the Committee at least 12 months prior to the date the Employee separates from service; otherwise such change shall not be honored. The amount of the actual benefit paid from this Plan shall be the straight life annuity calculated under Section 4.1 adjusted as appropriate using the actuarial assumptions set forth in the career average formula under the Qualified Plan if a different form of annuity is paid. Any life annuity or joint and survivor annuity shall be paid in the form of the six year certain benefit described in Section 4.11 of the Qualified Plan (as of the date of this restatement). No actuarial adjustments shall be made for such six year certain benefit.

Notwithstanding the foregoing, the following special rules shall apply in lieu of the foregoing under the specified circumstances:

- (a) If an eligible Employee had accrued a benefit under the Corning Incorporated Supplemental Pension Plan before becoming eligible to receive a benefit under this Plan, the portion of such benefit that was earned under the cash balance formula of the Corning Incorporated Supplemental Pension Plan as of the date the Employee commenced participation in this Plan shall be paid in the form of lump sum benefit (rather than an annuity) and the annuity set forth in the preceding paragraph shall be offset by the value of such lump sum benefit. Such offset shall be calculated by converting the lump sum benefit into an actuarial equivalent straight life annuity using the actuarial assumptions set forth in the Qualified Plan for making such conversions.
- (b) Benefits payable under Section 4.6 shall be paid in the form of a lump sum payment and the actuarial assumptions used for calculating such amount shall be the applicable interest rate and applicable mortality table, in each case as defined in Section 417(e)(3) of the Code, for the last month of the quarter that second precedes the quarter of the determination.
- (c) In the event that the lump sum value of an Employee's benefit that would normally be paid in the form of an annuity or a death benefit described in Section 4.4 is less than \$20,000, such benefit shall be paid in the form of a lump sum payment, rather than an annuity. The actuarial assumptions used for calculating such amount shall be the applicable interest rate and applicable mortality table, in each case as defined in Section 417(e)(3) of the Code, for the last month of the quarter that second precedes the quarter of the determination.
- (d) Solely for the eligible Employee listed on Exhibit B, the Company shall provide such Employee's benefit by purchasing an annuity from MetLife (or its successor) after such Employee's separation from service.

4.4 Death Benefits. If an eligible Employee dies while still employed by a Participating Company but after becoming entitled to receive a vested benefit, the eligible Employee's spouse, if surviving, shall be entitled to a monthly lifetime benefit equal to 50 percent of the benefit the eligible Employee would have received under Section 4.1 at his Normal Retirement Date. Such benefit shall commence to the eligible Employee's spouse, if surviving, within 60 days of the date that the eligible Employee dies. Notwithstanding the foregoing, if the Employee's surviving spouse is more than 5 years younger than the deceased Employee, the benefit otherwise payable to the surviving spouse will be reduced by one-fifth of one percent times the number of months or major fractions thereof which is equal to the difference between (a) the age of the surviving spouse plus 60 months and (b) the age of the deceased Employee.

If an eligible Employee separates from service before attaining age 55, is entitled to receive a vested benefit under the Plan, but dies before commencing such benefit, such an eligible Employee's spouse, if surviving, shall be entitled to a monthly lifetime benefit equal to 50 percent of the benefit the eligible Employee would have received under Section 4.1 at his Normal Retirement Date adjusted and reduced by 50 percent. Such benefit shall commence to the eligible Employee's spouse, if surviving, within 60 days of the date that the eligible Employee would have attained age 55. Notwithstanding the foregoing, if the Employee's surviving spouse is more than 5 years younger than the deceased Employee, the benefit otherwise payable to the surviving spouse will be reduced by one-fifth of one percent times the number of months or major fractions thereof which is equal to the difference between (a) the age of the surviving spouse plus 60 months and (b) the age of the deceased Employee.

4.5 Unfunded Plan. All benefits payable to an eligible Employee under this Plan shall be paid by the Participating Company that employs the eligible Employee out of its general assets and shall not be funded. Although the Company does not intend, as of the effective date of restatement, to set aside any additional specific assets to meet its obligation to pay benefits under this Plan, the Company may, in its discretion, set aside assets for meeting its obligations, including, but not limited to, the establishment of a rabbi or other grantor trust. In the event such fund

or trust is established, each Participating Company shall be responsible for making contributions to provide for the benefits of its own eligible Employees. No Employee shall have any property rights in any such fund or trust or in any other assets held by a Participating Company. The right of an eligible Employee or his or her spouse or beneficiary to receive any of the benefits provided by this Plan shall be an unsecured claim against the general assets of a Participating Company.

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4.6 Change in Control. Notwithstanding any provision to the contrary but still subject to forfeiture provisions set forth in Section 3.1, in the event of a Change in Control, each eligible Employee shall become fully vested in the benefit payable under this Plan using the formula set forth in Section 4.1A (except that those eligible Employees listed on Exhibit A shall have their benefit calculated under the formula set forth in Section 4.1B). Such benefit shall be calculated assuming the Employee satisfied all requirements for receiving an unreduced early retirement benefit. If an eligible Employee has a separation from service within the meaning of Section 409A within 12 months of the Change in Control, such Employee shall receive his vested benefit under this Plan in the form of a single lump sum payment within 60 days of such separation, subject to the 6 month delay described in Section 4.2 (if applicable). In the case of a Change in Control and a termination of employment described above, an eligible Employee who has not at such time attained the age of 55 shall nevertheless be entitled to an immediate lump sum payment under this Plan equal to the then present value of the benefit that would have been payable at the time the Employee reached age 55 but determined on the basis of Compensation and Credited Service in effect on the date of the Employee's termination of employment.

## ARTICLE FIVE

### Administration

5.1 Committee as Administrator. This Plan shall be administered by the Committee in accordance with the Plan's terms.

The Committee shall determine the benefits due each Employee from this Plan and shall cause them to be paid by the Qualified Plan or by a Participating Company under this Plan accordingly.

The Committee shall inform each Employee of any elections which the Employee may possess and shall record such choices along with such other information as may be necessary to administer the Plan.

5.2 Consistency of Interpretation. Since this Plan is intended to operate in conjunction with the Qualified Plan, any questions concerning plan administration or the calculation of benefits that arise but are not specifically addressed by this Plan shall be considered in light of the Qualified Plan. In addition, unless the context requires otherwise, the terms used in this Plan shall have the same meaning as the same terms used in the Qualified Plan.

5.3 Committee Action Final. The Committee has sole discretion to determine eligibility to participate in this Plan, to determine the eligibility for and the amount of benefits, to interpret the Plan and to take any other action it deems appropriate to administer this Plan. The decisions made by and the actions taken by the Committee shall be final and conclusive on all persons.

Members of the Committee shall not be subject to individual liability with respect to their actions under this Plan. Notwithstanding the foregoing, the Company shall indemnify each member of the Committee who may incur financial liability for actions or failures to act with respect to the member's Committee responsibilities.

5.4 Claims Procedures.

(a) Claim for Benefits. The Committee, or its authorized delegate, shall maintain a procedure under which an Employee or his beneficiary (or an authorized representative acting on behalf of an Employee or his beneficiary) may assert a claim for benefits under the Plan. Any such claim shall be submitted to the Committee in writing. The Committee will generally notify the claimant of its decision within 90 days after it receives the claim. However, if the Committee determines that special circumstances require an extension of time to decide the claim, it may obtain an additional 90 days to decide the claim. Before obtaining this extension, the Committee will notify the claimant, in writing and before the end of the initial 90-day period, of the special circumstances requiring the extension and the date by which the Committee expects to render a decision.

(b) Claims Review Procedure. If the claimant's claim is denied in whole or in part, the Committee will provide the claimant, within the period described in Section 5.4(a), with a written or electronic notice which explains the reason or reasons for the decision, includes specific references to Plan provisions upon which the decision is based, provides a description of any additional material or information which might be helpful to decide the claim (including an explanation of why that information may be necessary), and describes the appeals procedures and applicable filing deadlines.

If a claimant disagrees with the decision reached by the Committee, the claimant may submit a written appeal requesting a review of the decision. The claimant's written appeal must be submitted within 60 days of receiving the initial adverse decision. The claimant's written appeal should clearly state the reason or reasons why the claimant disagrees with the Committee's decision. The claimant may submit written comments, documents, records and other information relating to the claim even if such information was not submitted in connection with the initial claim for benefits. Additionally, the claimant, upon request and free of charge, may have reasonable access and copies of all documents, records and other information relevant to the claim.

The Committee will generally decide a claimant's appeal at its next regularly scheduled meeting following receipt of the appeal, unless the Committee receives the appeal within 30 days of the meeting. In that case, the appeal would be reviewed at the second regularly scheduled meeting following receipt of the appeal. If special circumstances require an extension of time for reviewing the claim, the claimant will be notified in writing. The notice will be provided prior to the commencement of the extension, describe the special circumstances requiring the extension and set forth the date the Committee will decide the appeal. Such date will not be later than the third regularly scheduled meeting of the Committee following the receipt of the appeal. Once the Committee has made a decision, the claimant shall receive written or electronic notification of the decision within fifteen (15) days. In the case of an adverse decision, the notice will explain the reason or reasons for the decision, include specific references to Plan provisions upon which the decision is based, and indicate that the claimant is entitled to, upon request and free of charge, reasonable access to and copies of documents, records, and other information relevant to the claim.

A claimant may not commence a judicial proceeding against any person, including the Plan, the Plan administrator, a Participating Company, or any other person, with respect to a claim for benefits without first exhausting the claims procedures set forth in the preceding paragraph. A claimant who has exhausted these procedures and is dissatisfied with the decision on appeal of a denied claim may bring an action in an appropriate court to review the Committee's decision on appeal but only if such action is commenced no later than the earlier of (1) the applicable statute of limitations, or (2) the first anniversary of the Committee's decision on appeal.

## ARTICLE SIX

### Amendment and Termination

6.1 While the Company intends to maintain this Plan in conjunction with the Qualified Plan indefinitely, the Board reserves the right to amend or terminate it at any time for whatever reasons it may deem appropriate. The Board may delegate to a committee consisting of at least three employees of the Company the authority to make technical amendments to the Plan. Notwithstanding the foregoing, any amendment or termination of the Plan shall comply with the requirements of Section 409A.

Notwithstanding the preceding paragraph, however, the Company hereby makes a contractual commitment on behalf of itself, the other Participating Companies and their successors to pay, or to require the other Participating Companies to pay, the benefits accrued under this Plan prior to its amendment or termination to the extent it or the other Participating Companies are financially capable of meeting such obligation.





ARTICLE SEVEN

Miscellaneous

7.1 No Contract of Employment. Nothing contained in this Plan shall be construed as a contract of employment between a Participating Company and an Employee, or as a right of any Employee to be continued in the employment of a Participating Company, or as a limitation of the right of a Participating Company to discharge any of its Employees, with or without cause.

7.2 No Transferability. The rights of an Employee under this Plan shall not be transferable, voluntarily or involuntarily, other than by will or the laws of descent and distribution and are exercisable during the Employee's lifetime only by the Employee or the Employee's guardian or legal representative.

7.3 Taxation. The benefits payable under this Plan shall be subject to all federal, state and local income and employment taxes to which benefits of this type are normally subject.

7.4 Indemnification. To the fullest extent authorized or permitted by law, the Company shall indemnify any eligible Employee who brings an action or proceeding, whether civil or criminal, or who is made, or threatened to be made, a party to an action or proceeding, whether civil or criminal, by reason of the fact that he, his testator or intestate, is or shall be entitled to benefits under this Plan and the Company has failed to make payments hereunder when due or has otherwise failed to follow the terms of the Plan or such eligible Employee has reasonable cause to believe the Company shall fail or intends to fail to perform its future obligations hereunder arising within a reasonable time thereof, or with respect to any other matter directly or indirectly related to this Plan, unless a judgment or other final adjudication adverse to such eligible Employee establishes that the Company was or is legally entitled to fail to so perform its obligations hereunder. Without limitation of the foregoing, such indemnification shall include indemnification against all costs of whatever nature or kind, including attorneys' fees and costs of investigation or defense, incurred by any eligible Employee with respect to any such action or proceeding and any appeal therein, and which judgments, fines, amounts and expenses have not been recouped by him in any other manner. All expenses incurred by a person in connection with an actual or threatened action or proceeding with respect to which such person is or may be entitled to indemnification under this Section, shall, in the absence of a final adjudication adverse to such person as described above, be promptly paid by the Company to him, upon receipt of an undertaking by him to repay the portion of such advances, if any, to which he may finally be determined not to be entitled. The indemnification provided by this Section shall not be deemed exclusive of any other rights to which an eligible Employee may be entitled other than pursuant to this Section.

Notwithstanding the foregoing, there shall be no indemnification for persons who cease Plan participation and forfeit all benefits on account of termination for cause as described in Section 3.1(a) or the noncompete provision set forth in Section 3.1(c).

7.5 Successors. This Plan shall be binding on the Company's successors and assigns.

7.6 Section 409A. This Plan shall be governed by and subject to the requirements of Section 409A and shall be interpreted and administered in accordance with that intent. If any provision of this Plan would otherwise conflict with or frustrate this intent, that provision will be interpreted and deemed amended so as to avoid the conflict. The Committee reserves the right to take any action it deems appropriate or necessary to comply with the requirements of Section 409A and may take advantage of such transition rules under Section 409A as it deems necessary or appropriate. To the extent that this Plan has been amended in 2007 to change the time and form of payments, the amendment may apply only to amounts that would not otherwise be payable in 2007 and may not cause an amount to be paid in 2007 that would not otherwise be

payable in 2007.

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7.7 **Effective Date.** The original effective date of this Plan is January 1, 1986. The effective date of this restated plan document is December 6, 2006, and the terms of this restated Plan apply to eligible Employees who retire on or after December 6, 2006. Notwithstanding the foregoing, any provision of this restated Plan that is required to comply with the requirements of Section 409A is effective as of January 1, 2005. For benefits commencing to specified employees (as defined by Section 409A) prior to December 6, 2006, only the portion of the Employee's benefit that was earned or vested after December 31, 2004 was subject to the 6 month delay described in Section 4.2.

7.8 **Governing Law.** This Plan shall be interpreted and enforced in accordance with the laws of the State of New York.

IN WITNESS WHEREOF, the Company has caused this Plan document to be executed by its duly authorized officer this 10<sup>th</sup> day of April, 2007.

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### *Nonperforming Assets By Type*

	June 30	Dec. 31
	2010 (a)	2009
In millions		
Nonaccrual loans		
Commercial		
Retail/wholesale	\$ 242	\$ 231
Manufacturing	312	423
Real estate related (b)	405	419
Financial services	60	117
Health care	55	41
Other	619	575
Total commercial	1,693	1,806
Commercial real estate		
Real estate projects	1,661	1,754
Commercial mortgage	420	386
Total commercial real estate	2,081	2,140
Equipment lease financing	114	130
<b>TOTAL COMMERCIAL LENDING</b>	<b>3,888</b>	<b>4,076</b>
Consumer		
Home equity	405	356
Other	25	36
Total consumer	430	392
Residential real estate		
Residential mortgage	713	955
Residential construction	79	248
Total residential real estate	792	1,203
<b>TOTAL CONSUMER LENDING</b>	<b>1,222</b>	<b>1,595</b>
Total nonperforming loans	5,110	5,671
Foreclosed and other assets		

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Commercial lending	293	266
Consumer lending	501	379
Total foreclosed and other assets	794	645
Total nonperforming assets	\$ 5,904	\$ 6,316

(a) Certain information as of June 30, 2010 that we reported on a preliminary basis in connection with our July 22, 2010 earnings release has been revised for inclusion in this table.

(b) Includes loans related to customers in the real estate and construction industries.

**Change In Nonperforming Assets**

In millions	2010	2009
January 1	\$ 6,316	\$ 2,181
Transferred from accrual	2,785	4,368
Charge-offs and valuation adjustments	(1,152)	(811)
Principal activity including payoffs	(574)	(512)
Asset sales and transfers to held for sale	(685)	(311)
Returned to performing-TDRs	(329)	
Returned to performing-Other	(457)	(259)
June 30	\$ 5,904	\$ 4,656

Total nonperforming loans and nonperforming assets in the tables above are significantly lower than they would have been otherwise due to the accounting treatment for purchased impaired loans. This treatment also results in lower ratios of nonperforming loans to total loans and allowance for loan and lease losses to nonperforming loans. We recorded purchased impaired loans at estimated fair value of \$12.7 billion at

December 31, 2008, including an adjustment mark for life of loan credit losses. These loans are considered performing, even if contractually past due (or if we do not expect to receive payment in full based on the original contractual terms), as we are currently accreting interest income over the expected life of the loans. The accretible interest/yield represents the excess of the net present value of expected cash flows on the loans at the measurement date over the recorded investment. See Note 6 Purchased Impaired Loans Related to National City in the Notes To Consolidated Financial Statements in this Report for additional information on those loans.

At June 30, 2010, our largest nonperforming asset was approximately \$32 million and our average nonperforming loan associated with commercial lending was approximately \$1 million.

The amount of nonperforming loans that were current as to remaining principal and interest was \$1.3 billion at June 30, 2010 and \$1.7 billion at December 31, 2009.

We have a number of modification programs based upon our commitment to help eligible homeowners avoid foreclosure where appropriate. To date, we have provided approximately \$1.6 billion under the HARP and HAMP programs. The majority of our modifications that result in troubled debt restructurings (TDRs), as further discussed below, are due to a reduction of the interest rate under the original loan, either for the term of the modified loan or for a period of up to 24 months after which the interest rate reverts to that under the original loan. The impacts of these modifications are considered in our allowance for loan and lease losses when they become permanent.

Loans whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties where we do not receive adequate compensation are considered TDRs. TDRs typically result from our loss mitigation activities and could include rate reductions, principal forgiveness, forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. Total nonperforming loans included TDRs of \$500 million at June 30, 2010 and \$440 million at December 31, 2009. Purchased impaired loans are excluded from TDRs.

TDRs returned to performing (accrual) status totaled \$329 million at June 30, 2010 and are excluded from nonperforming loans. These loans have demonstrated a period of at least six months of performance under the modified terms. TDRs previously returned to performing status and now classified as nonperforming as they are no longer current under the modified terms were de minimus.

In addition, credit cards and certain small business and consumer credit agreements whose terms have been modified totaled \$290 million at June 30, 2010 and are excluded from



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TDRs and nonperforming loans. Our policy is to exempt these loans from being placed on nonaccrual status as permitted by regulatory guidance as these loans are directly charged off in the period that they become 180 days past due.

**Accruing Loans Past Due 30 To 89 Days (a) (b)**

	Amount		Percent of Outstandings	
	June 30	Dec. 31	June 30	Dec. 31
Dollars in millions	2010	2009	2010	2009
Commercial	\$ 501	\$ 684	.93%	1.26%
Commercial real estate	535	666	2.81	3.10
Equipment lease financing	21	128	.32	2.06
Consumer	419	438	.81	.87
Residential real estate	392	472	2.92	3.12
Total (c)	\$ 1,868	\$ 2,388	1.29	1.62

**Accruing Loans Past Due 90 Days Or More (a) (b)**

	Amount		Percent of Outstandings	
	June 30	Dec. 31	June 30	Dec. 31
Dollars in millions	2010	2009	2010	2009
Commercial	\$ 110	\$ 188	.20%	.35%
Commercial real estate	83	150	.44	.70
Equipment lease financing	4	6	.06	.10
Consumer	225	226	.43	.45
Residential real estate	177	314	1.51	2.07
Total (d)	\$ 599	\$ 884	.42	.60

(a) Excludes loans that are government insured/guaranteed, primarily residential mortgages.

(b) Certain information as of June 30, 2010 that we reported on a preliminary basis in connection with our July 22, 2010 earnings release has been revised for inclusion in this table.

(c) Excludes impaired loans acquired from National City totaling \$.5 billion at June 30, 2010 and \$.8 billion at December 31, 2009. These loans are excluded as they were recorded at estimated fair value when acquired and are currently considered performing loans due to the accretion of interest in purchase accounting.

(d) Excludes impaired loans acquired from National City totaling \$2.1 billion at June 30, 2010 and \$2.7 billion at December 31, 2009. These loans are excluded as they were recorded at estimated fair value when acquired and are currently considered performing loans due to the accretion of interest in purchase accounting.

Loans that are not included in nonperforming or past due categories and which we are uncertain about the borrower's ability to comply with existing repayment terms over the next six months totaled \$1.3 billion at June 30, 2010 and \$811 million at December 31, 2009. The increase compared with December 31, 2009 was driven by exposures in commercial real estate arising from the challenges of attracting tenants as construction projects near completion, or the loss of tenants/lease rate concessions on completed projects.

**Allowances for Loan and Lease Losses and Unfunded Loan Commitments and Letters of Credit**

We maintain an allowance for loan and lease losses to absorb losses from the loan portfolio. We determine the allowance

based on quarterly assessments of the estimated probable credit losses incurred in the loan portfolio. While we make allocations to specific loans and pools of loans, the total reserve is available for all loan and lease losses. There were no significant changes during the first six months of 2010 to the process and procedures we follow to determine our allowance of loan and lease losses.

As noted above, we establish an allowance for specific loans. Generally, the allowance is determined based upon the fair value of the collateral underlying the specific loan. The fair value of the collateral is based upon an appraisal or, if a recent appraisal is not available, the net book value of the asset from its most recent financial statements adjusted for loss given default collateral recovery

rates.

A portion of the allowance for loan and lease losses has been assigned to loan categories based on the relative specific, pool and purchased impaired loan allocation amounts to provide coverage for probable losses not covered in specific, pool and purchased impaired loan reserve methodologies related to qualitative and measurement factors. These factors include, but are not limited to, the following:

- industry concentrations and conditions,
- credit quality trends,
- recent loss experience in particular sectors of the portfolio,
- ability and depth of lending management,
- changes in risk selection and underwriting standards, and
- timing of available information.

At June 30, 2010, the portion of reserves for these factors was \$195 million.

We increased the allowance for loan and lease losses to \$5.3 billion at June 30, 2010 compared with \$5.1 billion at December 31, 2009. The increase was primarily due to consolidation of the securitized credit card portfolio. The allowance as a percent of nonperforming loans was 104% and as a percent of total loans was 3.46% at June 30, 2010. The comparable percentages at December 31, 2009 were 89% and 3.22%, respectively. Excluding the allowance for purchased impaired loans and consumer loans and lines of credit, not secured by residential real estate, of \$1.4 billion at June 30, 2010 and \$1.0 billion at December 31, 2009, respectively, the allowance as a percent of nonperforming loans was 77% at June 30, 2010 and 72% at December 31, 2009. The majority of the commercial portfolio is secured by collateral, including loans to asset-based lending customers that continue to show demonstrably lower loss given default. Further, the large high investment grade portion of the loan portfolio has performed well and has not been subject to significant deterioration. We continue to experience some pressure in the residential real estate and commercial real estate lending sectors consistent with the current slow and somewhat uncertain economic recovery.

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The allowance for loan and lease losses is significantly lower than it would have been otherwise due to the accounting treatment for purchased impaired loans. This treatment also results in a lower ratio of allowance for loan and lease losses to total loans. Loan loss reserves on the purchased impaired loans were not carried over on the date of acquisition. In addition, these loans were recorded net of \$9.2 billion of fair value adjustments as of December 31, 2008. As a result, the ratio of allowance for loan and lease losses to total loans is lower than it would be otherwise. Since acquisition date, additional reserves of \$9 billion have been provided for purchased impaired loans.

In addition to the allowance for loan and lease losses, we maintain an allowance for unfunded loan commitments and letters of credit. We report this allowance as a liability on our Consolidated Balance Sheet. We determine this amount using estimates of the probability of the ultimate funding and losses related to those credit exposures. This methodology is similar to the one we use for determining the adequacy of our allowance for loan and lease losses.

We refer you to Note 5 Asset Quality and Note 6 Purchased Impaired Loans Related to National City in the Notes To Consolidated Financial Statements in this Report regarding changes in the allowance for loan and lease losses and in the allowance for unfunded loan commitments and letters of credit.

We believe that our provision for credit losses in the second half of 2010 may be lower than the first half of 2010. Future provision levels will depend primarily on the level of nonperforming loans, our related coverage ratios, the pace of economic recovery and the nature of regulatory reforms.

**Charge-Offs And Recoveries**

Six months ended June 30			Net Charge-	Percent of
Dollars in millions	Charge-	Recoveries	offs	Average Loans
<b>2010</b>				
Commercial	\$ 586	\$ 81	\$ 505	1.85%
Commercial real estate	387	105	282	2.62
Equipment lease financing	79	25	54	1.78
Consumer	525	57	468	1.71
Residential real estate	235	13	222	2.36
<b>Total</b>	<b>\$ 1,812</b>	<b>\$ 281</b>	<b>\$ 1,531</b>	<b>1.97%</b>
<b>2009</b>				
Commercial	\$ 573	\$ 52	\$ 521	1.61%
Commercial real estate	230	15	215	1.70
Equipment lease financing	73	10	63	2.02
Consumer	437	55	382	1.47
Residential real estate	80	35	45	.41
<b>Total</b>	<b>\$ 1,393</b>	<b>\$ 167</b>	<b>\$ 1,226</b>	<b>1.44%</b>

Total net charge-offs are significantly lower than they would have been otherwise due to the accounting treatment for

purchased impaired loans. This treatment also results in a lower ratio of net charge-offs to average loans. Customer balances related to these impaired loans were reduced by the fair value adjustments of \$9.2 billion as of December 31, 2008. However, as a result of further credit deterioration on purchased impaired commercial loans, we recorded \$99 million of net charge-offs during the first six months of 2010. Net charge-offs were not recorded on purchased impaired consumer pools.

**CREDIT DEFAULT SWAPS**

From a credit risk management perspective, we buy and sell credit loss protection via the use of credit derivatives. When we buy loss protection by purchasing a credit default swap (CDS), we pay a fee to the seller, or CDS counterparty, in return for the right to receive a payment if a specified credit event occurs for a particular obligor or reference entity. We purchase CDSs to mitigate the



risk of economic loss on a portion of our loan exposures.

We also sell loss protection to mitigate the net premium cost and the impact of fair value accounting on the CDS in cases where we buy protection to hedge the loan portfolio. These activities represent additional risk positions rather than hedges of risk.

We approve counterparty credit lines for all of our CDS activities. Counterparty credit lines are approved based on a review of credit quality in accordance with our traditional credit quality standards and credit policies. The credit risk of our counterparties is monitored in the normal course of business. In addition, all counterparty credit lines are subject to collateral thresholds and exposures above these thresholds are secured.

CDSs are included in the Derivatives not designated as hedging instruments under GAAP table in the Financial Derivatives section of this Risk Management discussion.

### ***Liquidity Risk Management***

Liquidity risk is the risk of potential loss if we were unable to meet our funding requirements at a reasonable cost. We manage liquidity risk at the bank and parent company to help ensure that we can obtain cost-effective funding to meet current and future obligations under both normal business as usual and stressful circumstances.

Our largest source of liquidity on a consolidated basis is the deposit base that comes from our retail and corporate banking businesses. Other borrowed funds come from a diverse mix of short and long-term funding sources. Liquid assets and unused borrowing capacity from a number of sources are also available to maintain our liquidity position.

Liquid assets consist of short-term investments (Federal funds sold, resale agreements, trading securities, and interest-earning

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deposits with banks) and securities available for sale. At June 30, 2010, our liquid assets totaled \$54.0 billion, with \$25.2 billion pledged as collateral for borrowings, trust, and other commitments.

***Bank Level Liquidity***

Spot and forward funding gap analyses are the primary metrics used to measure and monitor bank liquidity risk. Funding gaps represent the difference in projected sources of liquidity available to offset projected uses. We calculate funding gaps for the overnight, thirty day, ninety day, one-hundred eighty day and one year time intervals. Risk limits are established within the Liquidity Risk policy. Compliance is regularly reviewed by management's Asset and Liability Committee.

PNC Bank, N.A. can borrow from the Federal Reserve Bank of Cleveland's (Federal Reserve Bank) discount window to meet short-term liquidity requirements. These borrowings are secured by securities and commercial loans. PNC Bank, N.A. is also a member of the Federal Home Loan Bank (FHLB)-Pittsburgh and as such has access to advances from FHLB-Pittsburgh secured generally by residential mortgage and other mortgage-related loans. At June 30, 2010, our unused secured borrowing capacity was \$23.4 billion with the Federal Reserve Bank and \$7.5 billion with FHLB-Pittsburgh.

Total FHLB borrowings were \$8.1 billion at June 30, 2010 compared with \$10.8 billion at December 31, 2009.

We can also obtain funding through traditional forms of borrowing, including Federal funds purchased, repurchase agreements, and short and long-term debt issuances. PNC Bank, N.A. has the ability to offer up to \$20 billion in senior and subordinated unsecured debt obligations with maturities of more than nine months. Through June 30, 2010, PNC Bank, N.A. had issued \$6.9 billion of debt under this program.

PNC Bank, N.A. also has the ability to offer up to \$3.0 billion of its commercial paper. As of June 30, 2010, there were no issuances outstanding under this program.

As of June 30, 2010, there were approximately \$6.5 billion of bank borrowings with maturities of less than one year.

***Parent Company Liquidity***

Our parent company's routine funding needs consist primarily of dividends to PNC shareholders, share repurchases, debt service, the funding of non-bank affiliates, and acquisitions.

Parent company liquidity guidelines are designed to help ensure that sufficient liquidity is available to meet these requirements over the succeeding 24-month period. Risk limits for parent company liquidity are established within the Enterprise Capital Management Policy. Compliance is reviewed by the Board of Directors' Joint Risk Committee.

The principal source of parent company cash flow is the dividends it receives from its subsidiary bank, which may be impacted by the following:

- Bank-level capital needs,
- Laws and regulations,
- Corporate policies,
- Contractual restrictions, and
- Other factors.

Also, there are statutory and regulatory limitations on the ability of national banks to pay dividends or make other capital distributions or to extend credit to the parent company or its non-bank subsidiaries. See Note 23 Regulatory Matters in the Notes To Consolidated Financial Statements in Item 8 of our 2009 Form 10-K for a further discussion of these limitations. Dividends may also be impacted by the bank's capital needs and by contractual restrictions. We provide additional information on certain contractual restrictions under the Perpetual Trust Securities, PNC Capital Trust E Trust Preferred Securities, and Acquired Entity Trust Preferred Securities sections of the Off-Balance Sheet Arrangements And Variable Interest Entities section of this Financial Review. The amount available for dividend payments to the parent company by PNC Bank, N.A. without prior regulatory approval was approximately \$1.4 billion at June 30, 2010.

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In addition to dividends from PNC Bank, N.A., other sources of parent company liquidity include cash and short-term investments, as well as dividends and loan repayments from other subsidiaries and dividends or distributions from equity investments. As of June 30, 2010, the parent company had approximately \$1.8 billion in funds available from its cash and short-term investments.

We can also generate liquidity for the parent company and PNC's non-bank subsidiaries through the issuance of securities in public or private markets.

Note 19 Equity in our 2009 Form 10-K describes our December 31, 2008 issuance of 75,792 shares of our Fixed Rate Cumulative Perpetual Preferred Shares, Series N (Series N Preferred Stock), related issuance discount and the warrant to purchase common shares to the US Treasury under the TARP Capital Purchase Program.

As approved by the Federal Reserve Board, US Treasury and our other banking regulators, on February 10, 2010, we redeemed all 75,792 shares of our Series N Preferred Stock held by the US Treasury totaling \$7.6 billion. We used the net proceeds from the first quarter 2010 common stock and senior notes offerings described in Note 28 Subsequent Events in our 2009 Form 10-K and other funds to redeem the Series N Preferred Stock.

In connection with the redemption of the Series N Preferred Stock, we accelerated the accretion of the remaining issuance discount on the Series N Preferred Stock and recorded a

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corresponding reduction in retained earnings of \$250 million during the first quarter of 2010. This resulted in a one-time, noncash reduction in net income attributable to common shareholders and related basic and diluted earnings per share.

Dividends of \$89 million were paid on February 10, 2010 when the Series N Preferred Stock was redeemed. PNC paid total dividends of \$421 million to the US Treasury while the Series N preferred shares were outstanding.

After exchanging its TARP Warrant for 16,885,192 warrants, each to purchase one share of PNC common stock, the US Treasury sold the warrants in a secondary public offering. The sale closed on May 5, 2010.

On May 19, 2010, PNC Funding Corp issued \$500 million of senior notes due May 2014. Interest will be paid semiannually at a fixed rate of 3.000%.

PNC Bank, N.A., through its subsidiary PNC Funding Corp, has the ability to offer up to \$3.0 billion of commercial paper to provide the parent company with additional liquidity. As of June 30, 2010, there were no issuances outstanding under this program.

We have effective shelf registration statements pursuant to which we can issue additional debt and equity securities, including certain hybrid capital instruments. As of June 30, 2010, there were approximately \$2.7 billion of parent company borrowings with maturities of less than one year.

**Status of Credit Ratings**

The cost and availability of short- and long-term funding, as well as collateral requirements for certain derivative instruments, is influenced by debt ratings. In general, rating agencies base their ratings on many quantitative and qualitative factors, including capital adequacy, liquidity, asset quality, business mix, level and quality of earnings, and the current legislative and regulatory environment, including implied government support. In addition, rating agencies themselves have been subject to scrutiny arising from the financial crisis and could make or be required to make substantial changes to their ratings policies and practices, particularly in response to legislative and regulatory changes, including as a result of provisions in Dodd-Frank. Potential changes in the legislative and regulatory environment and the timing of those changes could impact our ratings, which as noted above, could impact our liquidity and financial condition. A decrease, or potential decrease, in credit ratings could impact access to the capital markets and/or increase the cost of debt, and thereby adversely affect liquidity and financial condition.

Credit ratings as of June 30, 2010 for PNC and PNC Bank, N.A. follow:

	Moody's	Standard & Poor's	Fitch
<b>The PNC Financial Services Group, Inc.</b>			
Senior debt	A3	A	A+
Subordinated debt	Baa1	A-	A
Preferred stock	Baa3	BBB	A
<b>PNC Bank, N.A.</b>			
Subordinated debt	A2	A	A
Long-term deposits	A1	A+	AA-
Short-term deposits	P-1	A-1	F1+
<b>Commitments</b>			

The following tables set forth contractual obligations and various other commitments as of June 30, 2010 representing required and potential cash outflows.

**Contractual Obligations**

June 30, 2010 in millions	Total
Remaining contractual maturities of time deposits	\$ 46,013
Borrowed funds	40,427
Minimum annual rentals on noncancellable leases	2,571
Nonqualified pension and postretirement benefits	539
Purchase obligations (a)	557
Total contractual cash obligations	\$ 90,107

(a) Includes purchase obligations for goods and services covered by noncancellable contracts and contracts including cancellation fees.

At June 30, 2010, the liability for uncertain tax positions, excluding associated interest and penalties, was \$215 million. This liability represents an estimate of tax positions that we have taken in our tax returns which may ultimately not be sustained upon examination by taxing authorities. Since the ultimate amount and timing of any future cash settlements cannot be predicted with reasonable certainty, this estimated liability has been excluded from the contractual obligations table. See Note 15 Income Taxes in the Notes To Consolidated Financial Statements of this Report for additional information.

**Other Commitments (a)**

June 30, 2010 in millions	Total Amounts Committed
Net unfunded credit commitments	\$ 95,775
Standby letters of credit (b)	9,930
Reinsurance agreements (c)	4,080
Other commitments (d)	825
Total commitments	\$ 110,610

(a) Other commitments are funding commitments that could potentially require performance in the event of demands by third parties or contingent events. Loan commitments are reported net of participations, assignments and syndications.

(b) Includes \$6.4 billion of standby letters of credit that support remarketing programs for customers' variable rate demand notes.

(c) Reinsurance agreements are with third-party insurers related to insurance sold to our customers.

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- (d) Includes unfunded commitments related to private equity investments of \$406 million and other investments of \$23 million which are not on our Consolidated Balance Sheet. Also includes commitments related to tax credit investments of \$375 million and other direct equity investments of \$21 million which are included in Other liabilities on our Consolidated Balance Sheet.

**MARKET RISK MANAGEMENT OVERVIEW**

Market risk is the risk of a loss in earnings or economic value due to adverse movements in market factors such as interest rates, credit spreads, foreign exchange rates, and equity prices.

**MARKET RISK MANAGEMENT INTEREST RATE RISK**

Interest rate risk results primarily from our traditional banking activities of gathering deposits and extending loans. Many factors, including economic and financial conditions, movements in interest rates, and consumer preferences, affect the difference between the interest that we earn on assets and the interest that we pay on liabilities and the level of our noninterest-bearing funding sources. Due to the repricing term mismatches and embedded options inherent in certain of these products, changes in market interest rates not only affect expected near-term earnings, but also the economic values of these assets and liabilities.

Asset and Liability Management centrally manages interest rate risk within limits and guidelines set forth in our risk management policies approved by management's Asset and Liability Committee and the Joint Risk Committee of the Board.

Sensitivity results and market interest rate benchmarks for the second quarters of 2010 and 2009 follow:

**Interest Sensitivity Analysis**

	Second Quarter 2010	Second Quarter 2009
<b>Net Interest Income Sensitivity Simulation</b>		
Effect on net interest income in first year from gradual interest rate change over following 12 months of:		
100 basis point increase	1.1%	.9%
100 basis point decrease (a)	(1.6)%	(1.6)%
Effect on net interest income in second year from gradual interest rate change over the preceding 12 months of:		
100 basis point increase	.7%	1.6%
100 basis point decrease (a)	(5.4)%	(5.1)%
<b>Duration of Equity Model (a)</b>		
Base case duration of equity (in years):	(3.0)	(1.9)
<b>Key Period-End Interest Rates</b>		
One-month LIBOR	.35%	.31%
Three-year swap	1.33%	2.14%
(a) Given the inherent limitations in certain of these measurement tools and techniques, results become less meaningful as interest rates approach zero.		

In addition to measuring the effect on net interest income assuming parallel changes in current interest rates, we routinely simulate the effects of a number of nonparallel interest rate environments. The following Net Interest Income Sensitivity to Alternative Rate Scenarios table reflects the percentage change in net interest income over the next two 12-month periods assuming (i) the PNC Economist's most likely rate forecast, (ii) implied market forward rates, and (iii) a Two-Ten Slope decrease (a 200 basis point decrease between two-year and ten-year rates superimposed on current base rates) scenario.

**Net Interest Income Sensitivity to Alternative Rate Scenarios (Second Quarter 2010)**

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	PNC Economist	Market Forward	Two-Ten Slope
First year sensitivity	<b>1.9%</b>	<b>.9%</b>	<b>.5%</b>
Second year sensitivity	<b>(.4)%</b>	<b>1.5%</b>	<b>(1.2)%</b>

All changes in forecasted net interest income are relative to results in a base rate scenario where current market rates are assumed to remain unchanged over the forecast horizon. When forecasting net interest income, we make assumptions about interest rates and the shape of the yield curve, the volume and characteristics of new business, and the behavior of existing on- and off-balance sheet positions. These assumptions determine the future level of simulated net interest income in the base interest rate scenario and the other interest rate scenarios presented in the above table. These simulations assume that as assets and liabilities mature, they are replaced or repriced at then current market rates. The graph below presents the yield curves for the base rate scenario and each of the alternate scenarios one year forward.

The second quarter 2010 interest sensitivity analyses indicate that our Consolidated Balance Sheet is positioned to benefit from an increase in interest rates. We believe that we have the deposit funding base and balance sheet flexibility to adjust, where appropriate and permissible, to changing interest rates and market conditions.

**Table of Contents****MARKET RISK MANAGEMENT    TRADING RISK**

Our trading activities are primarily customer-driven trading in fixed income securities, equities, derivatives, and foreign exchange contracts. They also include the underwriting of fixed income and equity securities. Proprietary trading positions were essentially eliminated by the second quarter of 2010.

We use value-at-risk (VaR) as the primary means to measure and monitor market risk in trading activities. The Risk Committee of the Board establishes an enterprise-wide VaR limit on our trading activities.

During the first six months of 2010, our VaR ranged between \$4.1 million and \$8.8 million, averaging \$6.9 million. During the first six months of 2009, our VaR ranged between \$5.8 million and \$9.1 million, averaging \$6.9 million.

To help ensure the integrity of the models used to calculate VaR for each portfolio and enterprise-wide, we use a process known as backtesting. The backtesting process consists of comparing actual observations of trading-related gains or losses against the VaR levels that were calculated at the close of the prior day. Under typical market conditions, we would expect an average of two to three instances a year in which actual losses exceeded the prior day VaR measure at the enterprise-wide level. There were no such instances during the first half of either 2010 or 2009.

The following graph shows a comparison of enterprise-wide trading-related gains and losses against prior day VaR for the period.

**Trading Revenue**

Six months ended June 30

In millions	2010	2009
Net interest income	\$ 33	\$ 32
Noninterest income	78	80
<b>Total trading revenue</b>	<b>\$ 111</b>	<b>\$ 112</b>
Securities underwriting and trading (a)	\$53	\$39
Foreign exchange	45	41
Financial derivatives	13	32
<b>Total trading revenue (b)</b>	<b>\$ 111</b>	<b>\$ 112</b>

Three months ended June 30

In millions	2010	2009
Net interest income	\$ 17	\$ 13
Noninterest income	20	91
<b>Total trading revenue</b>	<b>\$ 37</b>	<b>\$ 104</b>
Securities underwriting and trading (a)	\$13	\$28
Foreign exchange	23	21
Financial derivatives	1	55
<b>Total trading revenue (b)</b>	<b>\$ 37</b>	<b>\$ 104</b>

(a) Includes changes in fair value for certain loans accounted for at fair value.

(b) Product trading revenue includes related hedged activity.

Trading revenue excludes the impact of economic hedging activities, which relate primarily to residential mortgage servicing rights, and residential and held-for-sale commercial real estate loans.



Trading revenue for second quarter of 2010 decreased \$67 million compared with the second quarter of 2009 primarily due to the increased impact of counterparty credit risk on valuations of customer derivative positions and, to a lesser extent, reduced customer-driven trading results.

***MARKET RISK MANAGEMENT EQUITY AND OTHER***

***INVESTMENT RISK***

Equity investment risk is the risk of potential losses associated with investing in both private and public equity markets.

***BlackRock***

PNC owns approximately 44 million common stock equivalent shares of BlackRock equity, accounted for under the equity method. Our investment in BlackRock was \$5.8 billion at June 30, 2010 and the market value of our investment in BlackRock was \$6.2 billion at that date (not including liquidity discount). The primary risk measurement, similar to other equity investments, is economic capital. Further information about BlackRock is included in the Business Segments Review section of this Financial Review.

***Tax Credit Investments***

Included in our equity investments are tax credit investments which are mostly accounted for under the equity method. These investments, as well as equity investments held by consolidated partnerships, totaled \$2.3 billion at June 30, 2010 and \$2.5 billion at December 31, 2009.

**Table of Contents*****Private Equity***

The private equity portfolio is an illiquid portfolio comprised of equity and mezzanine investments that vary by industry, stage and type of investment. Private equity investments carried at estimated fair value totaled \$1.3 billion at June 30, 2010 and \$1.2 billion at December 31, 2009. As of June 30, 2010, \$650 million was invested directly in a variety of companies and \$607 million was invested indirectly through various private equity funds. Included in direct investments are investment activities of two private equity funds that are consolidated for financial reporting purposes. The noncontrolling interests of these funds totaled \$193 million as of June 30, 2010. The indirect private equity funds are not redeemable, but PNC receives distributions over the life of the partnership from liquidation of the underlying investments by the investee.

Our unfunded commitments related to private equity totaled \$406 million at June 30, 2010 compared with \$453 million at December 31, 2009.

***Visa***

At June 30, 2010, our investment in Visa Class B common shares totaled approximately 23 million shares. In May 2010, Visa funded \$500 million to their litigation escrow account and reduced the conversion ratio of Visa B to A shares. We consequently recognized our estimated \$47 million share of the \$500 million as a reduction of our indemnification liability and a reduction of noninterest expense. Considering the adjustment to the conversion ratio, these shares would convert to approximately 12.9 million of publicly traded Visa Class A common shares. As of June 30, 2010, we had recognized \$456 million of our Visa ownership, which we acquired with National City, on our Consolidated Balance Sheet. Based on the June 30, 2010 closing price of \$70.75 for the Visa shares, the market value of our investment was \$915 million. The Visa Class B common shares we own generally will not be transferable, except under limited circumstances, until they can be converted into shares of the publicly traded class of stock, which cannot happen until the later of three years after the IPO or settlement of all of the specified litigation. It is expected that Visa will continue to adjust the conversion ratio of Visa Class B to Class A shares in connection with settlements in excess of any amounts then in escrow for that purpose and will also reduce the conversion ratio to the extent that it adds any funds to the escrow in the future.

Note 18 Commitments and Guarantees in our Notes To Consolidated Financial Statements of this Report and Note 25 Commitments and Guarantees in our Notes To Consolidated Financial Statements under Item 8 of our 2009 Form 10-K have further information on our Visa indemnification obligation.

***Other Investments***

We also make investments in affiliated and non-affiliated funds with both traditional and alternative investment

strategies. The economic values could be driven by either the fixed-income market or the equity markets, or both. At June 30, 2010, other investments totaled \$314 million compared with \$368 million at December 31, 2009. We recognized net gains related to these investments of \$26 million during the first six months of 2010, including \$8 million during the second quarter. We recognized net losses related to these investments of \$79 million during the first six months of 2009, including \$8 million during the second quarter. Given the nature of these investments, if market conditions affecting their valuation were to worsen, we could incur future losses.

Our unfunded commitments related to other investments totaled \$23 million at June 30, 2010 and \$66 million at December 31, 2009.

A summary of our equity investments follows:

In millions	June 30 2010	Dec. 31 2009
BlackRock	\$ 5,815	\$ 5,736
Tax credit investments	2,317	2,510
Private equity	1,257	1,184
Visa	456	456
Other	314	368
Total	\$ 10,159	\$ 10,254

*FINANCIAL DERIVATIVES*

We use a variety of financial derivatives as part of the overall asset and liability risk management process to help manage interest rate, market and credit risk inherent in our business activities. Substantially all such instruments are used to manage risk related to changes in interest rates. Interest rate and total return swaps, interest rate caps and floors, swaptions, options, forwards and futures contracts are the primary instruments we use for interest rate risk management.

Financial derivatives involve, to varying degrees, interest rate, market and credit risk. For interest rate swaps and total return swaps, options and futures contracts, only periodic cash payments and, with respect to options, premiums are exchanged. Therefore, cash requirements and exposure to credit risk are significantly less than the notional amount on these instruments. Further information on our financial derivatives is presented in Note 1 Accounting Policies in our Notes To Consolidated Financial Statements under Item 8 of our 2009 Form 10-K and in Note 12 Financial Derivatives in the Notes To Consolidated Financial Statements in this Report, which is incorporated here by reference.

Not all elements of interest rate, market and credit risk are addressed through the use of financial or other derivatives, and such instruments may be ineffective for their intended purposes due to unanticipated market changes, among other reasons.

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The following table provides the notional or contractual amounts and estimated net fair value of financial derivatives at June 30, 2010 and December 31, 2009.

**Financial Derivatives**

	June 30, 2010		December 31, 2009	
	Notional/ Contractual Amount	Estimated Net Fair Value	Notional/ Contractual Amount	Estimated Net Fair Value
In millions				
<b>Derivatives designated as hedging instrument under GAAP</b>				
Interest rate contracts (a)				
Asset rate conversion				
Receive fixed swaps	\$ 16,214	\$ 396	\$ 13,055	\$ (64)
Pay fixed swaps	436	(29)		
Forward purchase commitments	4,265	134	350	1
Liability rate conversion				
Receive fixed swaps	11,520	1,010	13,048	707
Total interest rate risk management	32,435	1,511	26,453	644
Total derivatives designated as hedging instruments (b)	\$ 32,435	\$ 1,511	\$ 26,453	\$ 644
<b>Derivatives not designated as hedging instruments under GAAP</b>				
<u>Derivatives used for residential mortgage banking activities:</u>				
Interest rate contracts				
Swaps	\$ 56,320	\$ 127	\$ 38,596	\$ (152)
Caps/floors Purchased	1,700	82	5,200	50
Futures	62,953		41,609	
Future options	84,600	46	18,580	28
Swaptions	12,430	(17)	24,145	(22)
Commitments related to residential mortgage assets	9,536	26	9,565	6
Total residential mortgage banking activities	\$ 227,539	\$ 264	\$ 137,695	\$ (90)
<u>Derivatives used for commercial mortgage banking activities:</u>				
Interest rate contracts				
Swaps (c)	\$ 1,894	\$ (65)	\$ 1,948	\$ (15)
Commitments related to commercial mortgage assets (c)	1,330	(8)	1,733	8
Credit contracts				
Credit default swaps	285	20	460	52
Total commercial mortgage banking activities	\$ 3,509	\$ (53)	\$ 4,141	\$ 45
<u>Derivatives used for customer-related activities:</u>				
Interest rate contracts				
Swaps (c)	\$ 91,150	\$ (123)	\$ 91,090	\$ (54)
Caps/floors				
Sold	2,908	(10)	3,457	(15)
Purchased	2,041	8	2,115	14
Swaptions	2,080	45	1,996	11
Futures	1,838		2,271	
Foreign exchange contracts	7,774	19	8,002	14
Equity contracts	333	1	351	
Credit contracts				
Risk participation agreements	2,840	1	2,819	1
Total customer-related	\$ 110,964	\$ (59)	\$ 112,101	\$ (29)
<u>Derivatives used for other risk management activities:</u>				
Interest rate contracts				
Swaps (c)	\$ 479	\$ (1)	\$ 4,667	\$ 3
Caps/floors Sold				
Swaptions			720	(9)
Futures	284		145	
Future options				
Commitments related to residential mortgage assets	510	3	50	
Foreign exchange contracts	37	4	41	1
Credit contracts				
Credit default swaps	882	7	1,128	(2)

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Other contracts (d)	209	(298)	211	(486)
Total other risk management	\$ 2,401	\$ (285)	\$ 6,962	\$ (493)
Total derivatives not designated as hedging instruments	\$ 344,413	\$ (133)	\$ 260,899	\$ (567)
Total Gross Derivatives	\$ 376,848	\$ 1,378	\$ 287,352	\$ 77

- (a) The floating rate portion of interest rate contracts is based on money-market indices. As a percent of notional amount, 57% were based on 1-month LIBOR and 43% on 3-month LIBOR at June 30, 2010 compared with 57% and 43%, respectively, at December 31, 2009.
- (b) Fair value amount includes net accrued interest receivable of \$156 million at June 30, 2010 and \$162 million at December 31, 2009.
- (c) The increases in the negative fair values from December 31, 2009 to June 30, 2010 for interest rate contracts, foreign exchange, equity contracts and other contracts were due to the changes in fair values of the existing contracts along with new contracts entered into during 2010 and contracts terminated.
- (d) Includes PNC's obligation to fund a portion of certain BlackRock LTIP programs.

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***INTERNAL CONTROLS AND DISCLOSURE CONTROLS AND PROCEDURES***

As of June 30, 2010, we performed an evaluation under the supervision and with the participation of our management, including the Chairman and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures and of changes in our internal control over financial reporting.

Based on that evaluation, our Chairman and Chief Executive Officer and our Executive Vice President and Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934, as amended) were effective as of June 30, 2010, and that there has been no change in PNC's internal control over financial reporting that occurred during the second quarter of 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

***GLOSSARY OF TERMS***

**Accretable net interest** (Accretable yield) The excess of cash flows expected to be collected on a purchased impaired loan over the carrying value of the loan. The accretable net interest is recognized into interest income over the remaining life of the loan using the constant effective yield method.

**Adjusted average total assets** Primarily comprised of total average quarterly (or annual) assets plus (less) unrealized losses (gains) on investment securities, less goodwill and certain other intangible assets (net of eligible deferred taxes).

**Annualized** Adjusted to reflect a full year of activity.

**Assets under management** Assets over which we have sole or shared investment authority for our customers/clients. We do not include these assets on our Consolidated Balance Sheet.

**Basis point** One hundredth of a percentage point.

**Cash recoveries** Cash recoveries used in the context of purchased impaired loans represent cash payments from customers that exceeded the recorded investment of the designated impaired loan.

**Charge-off** Process of removing a loan or portion of a loan from our balance sheet because it is considered uncollectible. We also record a charge-off when a loan is transferred to held for sale by reducing the loan carrying amount to the fair value of the loan, if fair value is less than carrying amount.

**Client-related noninterest income** Total noninterest income included on our Consolidated Income Statement less amounts

for net gains (losses) on sales of securities, net other-than-temporary impairments, and other noninterest income.

**Common shareholders' equity to total assets** Common shareholders' equity divided by total assets. Common shareholders' equity equals total shareholders' equity less the liquidation value of preferred stock.

**Credit derivatives** Contractual agreements, primarily credit default swaps, that provide protection against a credit event of one or more referenced credits. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency and failure to meet payment obligations when due. The buyer of the credit derivative pays a periodic fee in return for a payment by the protection seller upon the occurrence, if any, of a credit event.

**Credit spread** The difference in yield between debt issues of similar maturity. The excess of yield attributable to credit spread is often used as a measure of relative creditworthiness, with a reduction in the credit spread reflecting an improvement in the borrower's perceived creditworthiness.

**Derivatives** Financial contracts whose value is derived from publicly traded securities, interest rates, currency exchange rates or market indices. Derivatives cover a wide assortment of financial contracts, including but not limited to forward contracts, futures,

options and swaps.

Duration of equity An estimate of the rate sensitivity of our economic value of equity. A negative duration of equity is associated with asset sensitivity (*i.e.*, positioned for rising interest rates), while a positive value implies liability sensitivity (*i.e.*, positioned for declining interest rates). For example, if the duration of equity is +1.5 years, the economic value of equity declines by 1.5% for each 100 basis point increase in interest rates.

Earning assets Assets that generate income, which include: Federal funds sold; resale agreements; trading securities; interest-earning deposits with banks; loans held for sale; loans; investment securities; and certain other assets.

Economic capital Represents the amount of resources that a business segment should hold to guard against potentially large losses that could cause insolvency. It is based on a measurement of economic risk, as opposed to risk as defined by regulatory bodies. The economic capital measurement process involves converting a risk distribution to the capital that is required to support the risk, consistent with our target credit rating. As such, economic risk serves as a common currency of risk that allows us to compare different risks on a similar basis.

Effective duration A measurement, expressed in years, that, when multiplied by a change in interest rates, would

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approximate the percentage change in value of on- and off- balance sheet positions.

**Efficiency** Noninterest expense divided by the sum of net interest income (GAAP basis) and noninterest income.

**Fair value** The price that would be received to sell an asset or the price that would be paid to transfer a liability on the measurement date using the principal or most advantageous market for the asset or liability in an orderly transaction between willing market participants.

**Foreign exchange contracts** Contracts that provide for the future receipt and delivery of foreign currency at previously agreed-upon terms.

**Funds transfer pricing** A management accounting methodology designed to recognize the net interest income effects of sources and uses of funds provided by the assets and liabilities of a business segment. We assign these balances LIBOR-based funding rates at origination that represent the interest cost for us to raise/invest funds with similar maturity and repricing structures.

**Futures and forward contracts** Contracts in which the buyer agrees to purchase and the seller agrees to deliver a specific financial instrument at a predetermined price or yield. May be settled either in cash or by delivery of the underlying financial instrument.

**GAAP** Accounting principles generally accepted in the United States of America.

**Interest rate floors and caps** Interest rate protection instruments that involve payment from the protection seller to the protection buyer of an interest differential, which represents the difference between a short-term rate (e.g., three-month LIBOR) and an agreed-upon rate (the strike rate) applied to a notional principal amount.

**Interest rate swap contracts** Contracts that are entered into primarily as an asset/liability management strategy to reduce interest rate risk. Interest rate swap contracts are exchanges of interest rate payments, such as fixed-rate payments for floating-rate payments, based on notional principal amounts.

**Intrinsic value** The amount by which the fair value of an underlying stock exceeds the exercise price of an option on that stock.

**Investment securities** Collectively, securities available for sale and securities held to maturity.

**Leverage ratio** Tier 1 risk-based capital divided by adjusted average total assets.

**LIBOR** Acronym for London InterBank Offered Rate. LIBOR is the average interest rate charged when banks in the London wholesale money market (or interbank market) borrow unsecured funds from each other. LIBOR rates are used as a benchmark for interest rates on a global basis.

**Net interest income from loans and deposits** A management accounting assessment, using funds transfer pricing methodology, of the net interest contribution from loans and deposits.

**Net interest margin** Annualized taxable-equivalent net interest income divided by average earning assets.

**Nonaccretable difference** Contractually required payments receivable on a purchased impaired loan in excess of the cash flows expected to be collected.

**Nondiscretionary assets under administration** Assets we hold for our customers/clients in a non-discretionary, custodial capacity. We do not include these assets on our Consolidated Balance Sheet.

**Noninterest income to total revenue** Noninterest income divided by the sum of net interest income (GAAP basis) and noninterest income.



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Nonperforming assets Nonperforming assets include nonaccrual loans, troubled debt restructured loans, foreclosed assets and other assets. We do not accrue interest income on assets classified as nonperforming.

Nonperforming loans Nonperforming loans include loans to commercial, commercial real estate, equipment lease financing, consumer, and residential mortgage customers and construction customers as well as troubled debt restructured loans. Nonperforming loans do not include loans held for sale or foreclosed and other assets. We do not accrue interest income on loans classified as nonperforming. Nonperforming loans do not include purchased impaired loans as we are currently accreting interest income over the expected life of the loans.

Notional amount A number of currency units, shares, or other units specified in a derivatives contract.

Operating leverage The period to period dollar or percentage change in total revenue (GAAP basis) less the dollar or percentage change in noninterest expense. A positive variance indicates that revenue growth exceeded expense growth (*i.e.*, positive operating leverage) while a negative variance implies expense growth exceeded revenue growth (*i.e.*, negative operating leverage).

Options Contracts that grant the purchaser, for a premium payment, the right, but not the obligation, to either purchase or

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sell the associated financial instrument at a set price during a specified period or at a specified date in the future.

**Other-than-temporary impairment (OTTI)** When the fair value of a security is less than its amortized cost basis, an assessment is performed to determine whether the impairment is other-than-temporary. If we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, an other-than-temporary impairment is considered to have occurred. In such cases, an other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. Further, if we do not expect to recover the entire amortized cost of the security, an other-than-temporary impairment is considered to have occurred. However for debt securities, if we do not intend to sell the security and it is not more likely than not that we will be required to sell the security before its recovery, the other-than-temporary loss is separated into (a) the amount representing the credit loss, and (b) the amount related to all other factors. The other-than-temporary impairment related to credit losses is recognized in earnings while the amount related to all other factors is recognized in other comprehensive income, net of tax.

**Pretax, pre-provision earnings** Total revenue less noninterest expense.

**Purchase accounting accretion** Accretion of the discounts and premiums on acquired assets and liabilities. The purchase accounting accretion is recognized in net interest income over the weighted average life of the financial instruments using the constant effective yield method.

**Purchased impaired loans** Acquired loans determined to be credit impaired under FASB ASC 310-30 (AICPA SOP 03-3). Loans are determined to be impaired if there is evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected.

**Recorded investment** The initial investment of a purchased impaired loan plus interest accretion and less any cash payments and writedowns to date. The recorded investment excludes any valuation allowance which is included in our allowance for loan and lease losses.

**Recovery** Cash proceeds received on a loan that we had previously charged off. We credit the amount received to the allowance for loan and lease losses.

**Residential development loans** Project-specific loans to commercial customers for the construction or development of residential real estate including land, single family homes, condominiums and other residential properties. This would

exclude loans to commercial customers where proceeds are for general corporate purposes whether or not such facilities are secured.

**Residential mortgage servicing rights hedge gains / (losses), net** We have elected to measure acquired or originated residential mortgage servicing rights (MSRs) at fair value under GAAP. We employ a risk management strategy designed to protect the economic value of MSRs from changes in interest rates. This strategy utilizes securities and a portfolio of derivative instruments to hedge changes in the fair value of MSRs arising from changes in interest rates. These financial instruments are expected to have changes in fair value which are negatively correlated to the change in fair value of the MSR portfolio. Net MSR hedge gains/ (losses) represent the change in the fair value of MSRs, exclusive of changes due to time decay and payoffs, combined with the change in the fair value of the associated derivative instruments.

**Return on average assets** Annualized net income divided by average assets.

**Return on average capital** Annualized net income divided by average capital.

**Return on average common shareholders' equity** Annualized net income less preferred stock dividends, including preferred stock discount accretion, divided by average common shareholders' equity.

**Risk-weighted assets** Computed by the assignment of specific risk-weights (as defined by the Board of Governors of the Federal Reserve System) to assets and off-balance sheet instruments.

**Securitization** The process of legally transforming financial assets into securities.

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Servicing rights An intangible asset or liability created by an obligation to service assets for others. Typical servicing rights include the right to receive a fee for collecting and forwarding payments on loans and related taxes and insurance premiums held in escrow.

Swaptions Contracts that grant the purchaser, for a premium payment, the right, but not the obligation, to enter into an interest rate swap agreement during a specified period or at a specified date in the future.

Taxable-equivalent interest The interest income earned on certain 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 yields and margins for all interest-earning assets, we use interest income on a taxable-equivalent basis in calculating average yields and net interest margins by increasing the interest income earned on tax-exempt assets to

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make it fully equivalent to interest income earned on other taxable investments. This adjustment is not permitted under GAAP on the Consolidated Income Statement.

**Tier 1 common capital** Tier 1 risk-based capital, less preferred equity, less trust preferred capital securities, and less noncontrolling interests.

**Tier 1 common capital ratio** Tier 1 common capital divided by period-end risk-weighted assets.

**Tier 1 risk-based capital** Total shareholders' equity, plus trust preferred capital securities, plus certain noncontrolling interests that are held by others; less goodwill and certain other intangible assets (net of eligible deferred taxes relating to taxable and nontaxable combinations), less equity investments in nonfinancial companies less ineligible servicing assets and less net unrealized holding losses on available for sale equity securities. Net unrealized holding gains on available for sale equity securities, net unrealized holding gains (losses) on available for sale debt securities and net unrealized holding gains (losses) on cash flow hedge derivatives are excluded from total shareholders' equity for Tier 1 risk-based capital purposes.

**Tier 1 risk-based capital ratio** Tier 1 risk-based capital divided by period-end risk-weighted assets.

**Total equity** Total shareholders' equity plus noncontrolling interests.

**Total return swap** A non-traditional swap where one party agrees to pay the other the total return of a defined underlying asset (e.g., a loan), usually in return for receiving a stream of LIBOR-based cash flows. The total returns of the asset, including interest and any default shortfall, are passed through to the counterparty. The counterparty is therefore assuming the credit and economic risk of the underlying asset.

**Total risk-based capital** Tier 1 risk-based capital plus qualifying subordinated debt and trust preferred securities, other noncontrolling interest not qualified as Tier 1, eligible gains on available for sale equity securities and the allowance for loan and lease losses, subject to certain limitations.

**Total risk-based capital ratio** Total risk-based capital divided by period-end risk-weighted assets.

**Transaction deposits** The sum of interest-bearing money market deposits, interest-bearing demand deposits, and noninterest-bearing deposits.

**Troubled debt restructuring** A restructuring of a loan whereby the lender for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that the lender would not otherwise consider or for which the lender would not be adequately compensated.

**Value-at-risk (VaR)** A statistically-based measure of risk which describes the amount of potential loss which may be incurred due to severe and adverse market movements. The measure is of the maximum loss which should not be exceeded on 99 out of 100 days.

**Watchlist** A list of criticized loans, credit exposure or other assets compiled for internal monitoring purposes. We define criticized exposure for this purpose as exposure with an internal risk rating of other assets especially mentioned, substandard, doubtful or loss.

**Yield curve** A graph showing the relationship between the yields on financial instruments or market indices of the same credit quality with different maturities. For example, a normal or positive yield curve exists when long-term bonds have higher yields than short-term bonds. A flat yield curve exists when yields are the same for short-term and long-term bonds. A steep yield curve exists when yields on long-term bonds are significantly higher than on short-term bonds. An inverted or negative yield curve exists when short-term bonds have higher yields than long-term bonds.

***CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION***

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We make statements in this Report, and we may from time to time make other statements, regarding our outlook or expectations for earnings, revenues, expenses, capital levels, liquidity levels, asset quality and/or other matters regarding or affecting PNC that are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Forward-looking statements are typically identified by words such as believe, plan, expect, anticipate, intend, outlook, estimate, forecast, will, should, and other similar words and expressions.

Forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. Forward-looking statements speak only as of the date they are made. We do not assume any duty and do not undertake to update our forward-looking statements. Actual results or future events could differ, possibly materially, from those that we anticipated in our forward-looking statements, and future results could differ materially from our historical performance. Our forward-looking statements are subject to the following principal risks and uncertainties. We provide greater detail regarding some of these factors in our 2009 Form 10-K and elsewhere in this Report, including in the Risk Factors and Risk Management sections of those reports. Our forward-looking statements may also be subject to other risks and uncertainties, including those discussed elsewhere in this Report or in our other filings with the SEC.

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Our businesses and financial results are affected by business and economic conditions, both generally and specifically in the principal markets in which we operate. In particular, our businesses and financial results may be impacted by:

Changes in interest rates and valuations in the debt, equity and other financial markets.

Disruptions in the liquidity and other functioning of financial markets, including such disruptions in the markets for real estate and other assets commonly securing financial products.

Actions by the Federal Reserve and other government agencies, including those that impact money supply and market interest rates.

Changes in our customers', suppliers' and other counterparties' performance in general and their creditworthiness in particular.

A slowing or failure of the moderate economic recovery that began last year.

Continued effects of the aftermath of recessionary conditions and the uneven spread of the positive impacts of the recovery on the economy in general and our customers in particular, including adverse impact on loan utilization rates as well as delinquencies, defaults and customer ability to meet credit obligations.

Changes in levels of unemployment.

Changes in customer preferences and behavior, whether as a result of changing business and economic conditions, climate-related physical changes or legislative and regulatory initiatives, or other factors.

A continuation of turbulence in significant portions of the US and global financial markets, particularly if it worsens, could impact our performance, both directly by affecting our revenues and the value of our assets and liabilities and indirectly by affecting our counterparties and the economy generally.

We will be impacted by the extensive reforms enacted in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Further, as much of that Act will require the adoption of implementing regulations by a number of different regulatory bodies, the precise nature, extent and timing of many of these reforms and the impact on us is still uncertain.

Financial industry restructuring in the current environment could also impact our business and financial performance as a result of changes in the creditworthiness and performance of our counterparties and by changes in the competitive and regulatory landscape.

Our results depend on our ability to manage current elevated levels of impaired assets.

Given current economic and financial market conditions, our forward-looking financial statements are subject to the risk that these conditions will be substantially different than we are currently expecting. These

statements are based on our current expectations that interest rates will remain low in the second half of 2010 and our view that the moderate economic recovery that began last year will continue throughout the rest of 2010.

Legal and regulatory developments could have an impact on our ability to operate our businesses or our financial condition or results of operations or our competitive position or reputation. Reputational impacts, in turn, could affect matters such as business generation and retention, our ability to attract and retain management, liquidity, and funding. These legal and regulatory developments could include:

Changes resulting from legislative and regulatory responses to the current economic and financial industry environment.

Other legislative and regulatory reforms, including broad-based restructuring of financial industry regulation as well as changes to laws and regulations involving tax, pension, bankruptcy, consumer protection, and other aspects of the financial institution industry.

Unfavorable resolution of legal proceedings or other claims and regulatory and other governmental investigations or other inquiries. In addition to matters relating to PNC's business and activities, such matters may also include proceedings, claims, investigations, or inquiries relating to pre-acquisition business and activities of acquired companies such as National City.

The results of the regulatory examination and supervision process, including our failure to satisfy the requirements of agreements with governmental agencies.

Changes in accounting policies and principles.

Changes resulting from legislative and regulatory initiatives relating to climate change that have or may have a negative impact on our customers' demand for or use of our products and services in general and their creditworthiness in particular.

Changes to regulations governing bank capital, including as a result of the so-called Basel 3 initiatives.

Our business and operating results are affected by our ability to identify and effectively manage risks inherent in our businesses, including, where appropriate, through the effective use of third-party insurance, derivatives, and capital management techniques, and by our ability to meet evolving regulatory capital standards.

The adequacy of our intellectual property protection, and the extent of any costs associated with obtaining rights in intellectual property claimed by others, can impact our business and operating results.

Our ability to anticipate and respond to technological changes can have an impact on our ability to respond to customer needs and to meet competitive demands.



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Our ability to implement our business initiatives and strategies could affect our financial performance over the next several years.

Our expansion with our National City acquisition in geographic markets and into business operations in areas in which we did not have significant experience or presence prior to 2009 presents greater risks and uncertainties than were present for us in other recent acquisitions.

Competition can have an impact on customer acquisition, growth and retention, as well as on our credit spreads and product pricing, which can affect market share, deposits and revenues.

Our business and operating results can also be affected by widespread disasters, terrorist activities or international hostilities, either as a result of the impact on the economy and capital and other financial markets generally or on us or on our customers, suppliers or other counterparties specifically.

Also, risks and uncertainties that could affect the results anticipated in forward-looking statements or from historical performance relating to our equity interest in BlackRock, Inc. are discussed in more detail in BlackRock's filings with the SEC, including in the Risk Factors sections of BlackRock's reports. BlackRock's SEC filings are accessible on the SEC's website and on or through BlackRock's website at [www.blackrock.com](http://www.blackrock.com). This material is referenced for informational purposes only and should not be deemed to constitute a part of this Report.

We grow our business in part by acquiring from time to time other financial services companies. Acquisitions present us with risks in addition to those presented by the nature of the business acquired. These include risks and uncertainties related both to the acquisition transactions themselves and to the integration of the acquired businesses into PNC after closing.

Acquisitions may be substantially more expensive to complete (including unanticipated costs incurred in connection with the integration of the acquired company) and the anticipated benefits (including anticipated cost savings and strategic gains) may be significantly harder or take longer to achieve than expected. Acquisitions may involve our entry into new businesses or new geographic or other markets, and these situations also present risks resulting from our inexperience in those new areas.

As a regulated financial institution, our pursuit of attractive acquisition opportunities could be negatively impacted due to regulatory delays or other regulatory issues. Regulatory and/or legal issues relating to the pre-acquisition operations of an acquired business may cause reputational harm to PNC following the acquisition and integration of the acquired business into ours and may result in additional future costs or regulatory limitations arising as a result of those issues.



**Table of Contents****CONSOLIDATED INCOME STATEMENT**

THE PNC FINANCIAL SERVICES GROUP, INC.

<i>In millions, except per share data</i> <i>Unaudited</i>	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Interest Income</b>				
Loans	\$ 2,158	\$ 2,203	\$ 4,318	\$ 4,668
Investment securities	572	672	1,195	1,361
Other	143	125	265	230
Total interest income	2,873	3,000	5,778	6,259
<b>Interest Expense</b>				
Deposits	244	474	525	1,020
Borrowed funds	194	333	439	726
Total interest expense	438	807	964	1,746
Net interest income	2,435	2,193	4,814	4,513
<b>Noninterest Income</b>				
Asset management	243	208	502	397
Consumer services	315	329	611	645
Corporate services	261	264	529	509
Residential mortgage	179	245	326	676
Service charges on deposits	209	242	409	466
Net gains on sales of securities	147	182	237	238
Other-than-temporary impairments	(118)	(453)	(358)	(1,139)
Less: Noncredit portion of other-than-temporary impairments (a)	(24)	(298)	(148)	(835)
Net other-than-temporary impairments	(94)	(155)	(210)	(304)
Other	217	295	457	349
Total noninterest income	1,477	1,610	2,861	2,976
Total revenue	3,912	3,803	7,675	7,489
<b>Provision For Credit Losses</b>				
	823	1,087	1,574	1,967
<b>Noninterest Expense</b>				
Personnel	959	1,086	1,915	2,082
Occupancy	172	182	359	361
Equipment	168	174	340	352
Marketing	65	59	115	116
Other	638	991	1,386	1,739
Total noninterest expense	2,002	2,492	4,115	4,650
Income from continuing operations before income taxes and noncontrolling interests	1,087	224	1,986	872
Income taxes	306	29	557	157
Income from continuing operations before noncontrolling interests	781	195	1,429	715
Income from discontinued operations (net of income taxes of \$13, \$6, \$27, and \$11)	22	12	45	22
Net income	803	207	1,474	737
Less: Net income (loss) attributable to noncontrolling interests	(9)	9	(14)	13
Preferred stock dividends	25	119	118	170
Preferred stock discount accretion	1	14	251	29
Net income attributable to common shareholders	\$ 786	\$ 65	\$ 1,119	\$ 525
<b>Basic Earnings Per Common Share</b>				
Continuing operations	\$ 1.45	\$ .11	\$ 2.09	\$ 1.12
Discontinued operations	.04	.03	.09	.05
Net income	\$ 1.49	\$ .14	\$ 2.18	\$ 1.17
<b>Diluted Earnings Per Common Share</b>				
Continuing operations	\$ 1.43	\$ .11	\$ 2.06	\$ 1.11
Discontinued operations	.04	.03	.09	.05
Net income	\$ 1.47	\$ .14	\$ 2.15	\$ 1.16

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***Average Common Shares Outstanding***

Basic	<b>524</b>	451	<b>511</b>	447
Diluted	<b>527</b>	453	<b>514</b>	448

(a) Included in accumulated other comprehensive loss.  
See accompanying Notes To Consolidated Financial Statements.

**Table of Contents****CONSOLIDATED BALANCE SHEET**

THE PNC FINANCIAL SERVICES GROUP, INC.

*In millions, except par value*

<i>Unaudited</i>	<b>June 30 2010</b>	December 31 2009
<b>Assets</b>		
Cash and due from banks (June 30, 2010 includes \$3 for VIEs) (a)	\$ 3,558	\$ 4,288
Federal funds sold and resale agreements (includes \$915 and \$990 measured at fair value) (b)	2,209	2,390
Trading securities	882	2,124
Interest-earning deposits with banks (June 30, 2010 includes \$467 for VIEs) (a)	5,028	4,488
Loans held for sale (includes \$2,256 and \$2,062 measured at fair value) (b)	2,756	2,539
Investment securities (June 30, 2010 includes \$571 for VIEs) (a)	53,717	56,027
Loans (June 30, 2010 includes \$4,671 for VIEs) (includes \$109 and \$88 measured at fair value) (a) (b)	154,342	157,543
Allowance for loan and lease losses (June 30, 2010 includes \$(216) for VIEs) (a)	(5,336)	(5,072)
Net loans	149,006	152,471
Goodwill	9,410	9,505
Other intangible assets	2,728	3,404
Equity investments (June 30, 2010 includes \$1,420 for VIEs) (a)	10,159	10,254
Other (June 30, 2010 includes \$821 for VIEs) (includes \$298 and \$486 measured at fair value) (a) (b)	22,242	22,373
<b>Total assets</b>	<b>\$ 261,695</b>	<b>\$ 269,863</b>
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest-bearing	\$ 44,312	\$ 44,384
Interest-bearing	134,487	142,538
<b>Total deposits</b>	<b>178,799</b>	<b>186,922</b>
<b>Borrowed funds</b>		
Federal funds purchased and repurchase agreements	3,690	3,998
Federal Home Loan Bank borrowings	8,119	10,761
Bank notes and senior debt	12,617	12,362
Subordinated debt	10,184	9,907
Other (June 30, 2010 includes \$4,262 for VIEs) (a)	5,817	2,233
<b>Total borrowed funds</b>	<b>40,427</b>	<b>39,261</b>
Allowance for unfunded loan commitments and letters of credit	218	296
Accrued expenses (June 30, 2010 includes \$92 for VIEs) (a)	2,757	3,590
Other (June 30, 2010 includes \$800 for VIEs) (a)	8,504	7,227
<b>Total liabilities</b>	<b>230,705</b>	<b>237,296</b>
<b>Equity</b>		
Preferred stock (c)		
Common stock \$5 par value		
Authorized 800 shares, issued 535 and 471 shares	2,678	2,354
Capital surplus preferred stock	646	7,974
Capital surplus common stock and other	11,979	8,945
Retained earnings	14,073	13,144
Accumulated other comprehensive loss	(442)	(1,962)
Common stock held in treasury at cost: 10 and 9 shares	(557)	(513)
<b>Total shareholders equity</b>	<b>28,377</b>	<b>29,942</b>
Noncontrolling interests	2,613	2,625
<b>Total equity</b>	<b>30,990</b>	<b>32,567</b>
<b>Total liabilities and equity</b>	<b>\$ 261,695</b>	<b>\$ 269,863</b>

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- (a) Amounts represent the assets or liabilities of consolidated variable interest entities (VIEs).
- (b) Amounts represent items for which the Corporation has elected the fair value option.
- (c) Par value less than \$.5 million at each date.

See accompanying Notes To Consolidated Financial Statements.

**Table of Contents****CONSOLIDATED STATEMENT OF CASH FLOWS**

THE PNC FINANCIAL SERVICES GROUP, INC.

<i>In millions</i>	<b>Six months ended June 30</b>	
<i>Unaudited</i>	<b>2010</b>	<b>2009</b>
<b><i>Operating Activities</i></b>		
Net income	\$ 1,474	\$ 737
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for credit losses	1,574	1,967
Depreciation and amortization	442	505
Deferred income taxes	571	188
Net gains on sales of securities	(237)	(238)
Net other-than-temporary impairments	210	304
Net gains related to BlackRock LTIP shares adjustment		(103)
Undistributed earnings of BlackRock	(115)	(43)
Excess tax benefits from share-based payment arrangements	(1)	
Net change in		
Trading securities and other short-term investments	1,214	192
Loans held for sale	(330)	(664)
Other assets	(528)	3,671
Accrued expenses and other liabilities	(406)	(5,097)
Other	400	(69)
Net cash provided by operating activities	4,268	1,350
<b><i>Investing Activities</i></b>		
Sales		
Securities available for sale	14,123	8,060
Loans	926	170
Repayments/maturities		
Securities available for sale	3,904	3,629
Securities held to maturity	880	131
Purchases		
Securities available for sale	(13,111)	(15,615)
Securities held to maturity	(693)	(764)
Loans	(2,930)	(137)
Net change in		
Federal funds sold and resale agreements	189	17
Interest-earning deposits with banks	(549)	4,560
Loans	5,788	7,698
Net cash received from acquisition and divestiture activity	156	
Other (a)	593	(35)
Net cash provided by investing activities	9,276	7,714
<b><i>Financing Activities</i></b>		
Net change in		
Noninterest-bearing deposits	623	4,658
Interest-bearing deposits	(7,441)	(7,083)
Federal funds purchased and repurchase agreements	(305)	(1,253)
Federal Home Loan Bank short-term borrowings	(280)	
Other short-term borrowed funds	(60)	(1,848)
Sales/issuances		
Federal Home Loan Bank long-term borrowings		1,500
Bank notes and senior debt	2,528	1,960
Other long-term borrowed funds	2,219	90
Supervisory Capital Assessment Program common stock		624
Common and treasury stock	3,441	121

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Repayments/maturities		
Federal Home Loan Bank long-term borrowings	(2,313)	(4,836)
Bank notes and senior debt	(2,462)	(2,449)
Subordinated debt	28	(558)
Other long-term borrowed funds	(2,342)	(74)
Preferred stock TARP	(7,579)	
Excess tax benefits from share-based payment arrangements	1	
Acquisition of treasury stock	(116)	(82)
Preferred stock cash dividends paid	(118)	(170)
Common stock cash dividends paid	(98)	(338)
Net cash used by financing activities	(14,274)	(9,738)
<b>Net Decrease In Cash And Due From Banks</b>	<b>(730)</b>	<b>(674)</b>
Cash and due from banks at beginning of period	4,288	4,471
Cash and due from banks at end of period	\$ 3,558	\$ 3,797
<b>Supplemental Disclosures</b>		
Interest paid	\$ 921	\$ 1,816
Income taxes paid	339	50
Income taxes refunded	4	22
<b>Non-cash Items</b>		
Transfer from (to) loans to (from) loans held for sale, net	514	(195)
Transfer from loans to foreclosed assets	670	437

(a) Includes the impact of the consolidation of variable interest entities as of January 1, 2010. See accompanying Notes To Consolidated Financial Statements.

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## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

THE PNC FINANCIAL SERVICES GROUP, INC.

### ***Business***

PNC is one of the largest diversified financial services companies in the United States and is headquartered in Pittsburgh, Pennsylvania.

PNC has businesses engaged in retail banking, corporate and institutional banking, asset management, and residential mortgage banking, 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, Virginia, Missouri, Delaware, Washington, D.C., and Wisconsin.

### ***NOTE 1 ACCOUNTING POLICIES***

#### ***BASIS OF FINANCIAL STATEMENT PRESENTATION***

Our consolidated financial statements include the accounts of the parent company and its subsidiaries, most of which are wholly owned, and certain partnership interests and variable interest entities.

We prepared these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. We have eliminated intercompany accounts and transactions. We have also reclassified certain prior year amounts to conform with the 2010 presentation. These reclassifications did not have a material impact on our consolidated financial condition or results of operations.

The second quarter of 2010 included a \$105 million pretax adjustment primarily related to the recognition of \$64 million of additional interest income on purchased impaired loans, a \$29 million reduction of interest expense related to the accretion of the purchase accounting adjustment for borrowings assumed in the National City acquisition, and another miscellaneous item. This correction should have been recorded in 2009. Management believes that the impact of this correction is not material to any prior period, the current period, or the estimated 2010 full year consolidated financial statements.

See Note 2 Divestiture regarding our July 1, 2010 sale of PNC Global Investment Servicing Inc. The Consolidated Income Statement for all periods presented and related Notes To Consolidated Financial Statements reflect the global investment servicing business as discontinued operations.

In our opinion, the unaudited interim consolidated financial statements reflect all normal, recurring adjustments needed to present fairly our results for the interim periods. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period.

When preparing these unaudited interim consolidated financial statements, we have assumed that you have read the audited consolidated financial statements included in our 2009 Annual Report on Form 10-K (2009 Form 10-K). Reference is made to Note 1 Accounting Policies in the 2009 Form 10-K for a detailed description of significant accounting policies. There have been no significant changes to these policies in the first six months of 2010 other than as disclosed herein. These interim consolidated financial statements serve to update the 2009 Form 10-K and may not include all information and notes necessary to constitute a complete set of financial statements.

We have considered the impact on these consolidated financial statements of events occurring subsequent to June 30, 2010.

#### ***USE OF ESTIMATES***

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We prepare the consolidated financial statements using financial information available at the time, which requires us to make estimates and assumptions that affect the amounts reported. Our most significant estimates pertain to our allowance for loan and lease losses, impaired loans, fair value measurements, including security valuations and residential mortgage servicing rights, and revenue recognition. Actual results may differ from the estimates and the differences may be material to the consolidated financial statements.

### *INVESTMENT IN BLACKROCK, INC.*

We account for our investment in the common stock, Series B and Series D Preferred Stocks of BlackRock (both deemed to be in substance common stock) under the equity method of accounting. On January 31, 2010, the Series D Preferred Stock was converted to Series B Preferred Stock. The investment in BlackRock is reflected on our Consolidated Balance Sheet in the caption Equity investments, while our equity in earnings of BlackRock is reported on our Consolidated Income Statement in the caption Asset management.

On February 27, 2009, PNC's obligation to deliver BlackRock common shares in connection with BlackRock's long-term incentive plan programs was replaced with an obligation to deliver shares of BlackRock's new Series C Preferred Stock. The 2.9 million shares of Series C Preferred Stock were acquired from BlackRock in exchange for common shares on that same date. Since these preferred shares were not deemed to be in substance common stock, we elected to account for these preferred shares at fair value and the changes in fair value will offset the impact of marking-to-market the obligation to deliver these shares to BlackRock. Our investment in the BlackRock Series C Preferred Stock is included on our Consolidated Balance Sheet in the caption Other assets.



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As noted above, we mark-to-market our obligation to transfer BlackRock shares related to certain BlackRock long-term incentive plan (LTIP) programs. This obligation is classified as a derivative not designated as a hedging instrument under GAAP as disclosed in Note 12 Financial Derivatives.

***EARNINGS PER COMMON SHARE***

Basic earnings per common share is calculated using the two-class method to determine income attributable to common stockholders. Unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are considered participating securities under the two-class method. Income attributable to common stockholders is then divided by the weighted-average common shares outstanding for the period.

Diluted earnings per common share is calculated under the more dilutive of either the treasury method or the two-class method. For the diluted calculation, we increase the weighted-average number of shares of common stock outstanding by the assumed conversion of outstanding convertible preferred stock and debentures from the beginning of the year or date of issuance, if later, and the number of shares of common stock that would be issued assuming the exercise of stock options and warrants and the issuance of incentive shares using the treasury stock method. These adjustments to the weighted-average number of shares of common stock outstanding are made only when such adjustments will dilute earnings per common share. See Note 13 Earnings Per Share for additional information.

***RECENT ACCOUNTING PRONOUNCEMENTS***

On January 1, 2010, we adopted ASU 2009-16 Transfers and Servicing (Topic 860) Accounting For Transfers of Financial Assets which is a codification of guidance issued in June 2009. This guidance removes the concept of a qualifying special-purpose entity. The guidance also establishes conditions for accounting and reporting of a transfer of a portion of a financial asset, modifies the asset sale/derecognition criteria, and changes how retained interests are initially measured.

On January 1, 2010, we adopted ASU 2009-17 Consolidations (Topic 810) Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities which is a codification of guidance issued in June 2009. This guidance removes the scope exception for qualifying special-purpose entities, contains new criteria for determining the primary beneficiary of a variable interest entity (VIE) and increases the frequency of required reassessments to determine whether an entity is the primary beneficiary of a VIE. VIEs are assessed for consolidation under Topic 810 when we hold variable interests in these entities. PNC consolidates VIEs when we are deemed to be the primary beneficiary. The primary beneficiary of a VIE is determined to be the party that meets both of the following

criteria: (1) has the power to make decisions that most significantly affect the economic performance of the VIE and (2) has the obligation to absorb losses or the right to receive benefits that in either case could potentially be significant to the VIE. Effective January 1, 2010, we consolidated Market Street Funding LLC (Market Street), a credit card securitization trust, and certain Low Income Housing Tax Credit (LIHTC) investments. We recorded consolidated assets of \$4.2 billion, consolidated liabilities of \$4.2 billion, and an after-tax cumulative effect adjustment to retained earnings of \$92 million upon adoption (see Note 3 Loan Sale and Servicing Activities and Variable Interest Entities).

In January 2010, the FASB issued ASU 2010-6, Fair Value Measurements and Disclosures (Topic 820), Improving Disclosures About Fair Value Measurements. This guidance requires new disclosures as follows: 1) transfers in and out of Levels 1 and 2 and the reasons for the transfers, 2) additional breakout of asset and liability categories and 3) purchases, sales, issuances and settlements to be reported separately in the Level 3 rollforward. This guidance was effective for PNC for first quarter 2010 reporting with the exception of item 3 which is effective beginning with first quarter 2011 reporting.

In April 2010, the FASB issued ASU 2010-18, Receivables (Topic 310), Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset. This ASU amends the accounting guidance related to loans that are accounted for within a pool under ASC 310-30. The new guidance clarifies that modifications of such loans do not result in the removal of those loans from the pool even if the modification of those loans would otherwise be considered a troubled debt restructuring. The amended guidance continues to require that an entity consider whether the pool of assets in which the loan is included is impaired if expected cash flows for the pool change. No additional disclosures are required as a result of this ASU. ASU 2010-18 is effective for modifications of loans accounted for within pools under ASC 310-30 occurring in the first interim or annual period ending on or after July 15, 2010 with early adoption permitted. PNC accounts for loans within pools consistent with the guidance in this ASU.

***NOTE 2 DIVESTITURE***

***SALE OF PNC GLOBAL INVESTMENT SERVICING***

On July 1, 2010, we sold PNC Global Investment Servicing Inc. (GIS), a leading provider of processing, technology and business intelligence services to asset managers, broker-dealers and financial advisors worldwide, for \$2.3 billion in cash pursuant to a definitive agreement entered into on February 2, 2010.

Results of operations of GIS are presented as Income from discontinued operations, net of income taxes, on our Consolidated Income Statement for all periods presented.

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Asset and liabilities of GIS at June 30, 2010 and December 31, 2009 follow.

***Investment in Discontinued Operations***

In millions	June 30, 2010	December 31, 2009
Interest-earning deposits with banks	\$ 185	\$ 255
Goodwill	1,233	1,243
Other intangible assets	49	51
Other	348	359
Total assets	\$ 1,815	\$ 1,908
Interest-bearing deposits	\$ 103	\$ 93
Accrued expenses	225	266
Other	851	1,009
Total liabilities	\$ 1,179	\$ 1,368
Net assets	\$ 636	\$ 540

***NOTE 3 LOAN SALE AND SERVICING ACTIVITIES AND VARIABLE INTEREST ENTITIES******LOAN SALE AND SERVICING ACTIVITIES***

We have transferred residential and commercial mortgage loans in securitization or sales transactions in which we have continuing involvement. These transfers have occurred through Agency securitization, Non-Agency securitization, and whole-loan sale transactions. In Agency securitizations, Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC) (collectively the Agencies) securitize our transferred loans into mortgage-backed securities for sale into the secondary market through Special Purpose Entities (SPEs) they sponsor. In Non-Agency securitizations, we have transferred loans into securitization SPEs. In other instances third-party investors have purchased (in whole-loan sale transactions) and subsequently sold our loans into securitization SPEs. Third-party investors have also purchased our loans in whole-loan sale transactions. Securitization SPEs, which are legal entities that are utilized in the Agency and Non-Agency securitization transactions, are VIEs.

Our continuing involvement in the Agency securitizations, Non-Agency securitizations, and whole-loan sale transactions generally consists of servicing, limited repurchases of previously transferred loans and loss share arrangements, and, in limited circumstances, holding of mortgage-backed securities issued by the securitization SPEs.

Depending on the transaction, we may act as the master, primary, and/or special servicer to the securitization SPEs or third-party investors. Servicing responsibilities typically consist of collecting and remitting monthly borrower principal and interest payments, maintaining escrow deposits, performing loss mitigation and foreclosure activities, and, in certain instances, funding of servicing advances. Servicing advances, which are reimbursable, are recognized in Other

assets at cost and are made for principal and interest and collateral protection. With respect to Agency securitizations, the Agencies are responsible for working out defaulted loans.

We earn servicing and other ancillary fees for our role as servicer and depending on the contractual terms of the servicing arrangement, we can be terminated as servicer with or without cause. At the consummation date of each type of loan transfer, we recognize a servicing asset at fair value. Servicing assets are recognized in Other intangible assets on our Consolidated Balance Sheet and are classified within Level 3 of the fair value hierarchy. See Note 8 Fair Value and Note 9 Goodwill and Other Intangible Assets for further discussion of our residential and commercial servicing assets.

Certain loans transferred to the Agencies contain removal of account provisions (ROAPs). Under these ROAPs, we hold an option to repurchase at par individual delinquent loans that meet certain criteria. When we have the unilateral ability to repurchase a delinquent loan, effective control over the loan has been regained and we recognize the loan and a corresponding liability on the balance sheet regardless of our intent to repurchase the loan. At June 30, 2010 and December 31, 2009, the balance of our ROAP asset and liability totaled \$315 million and \$577 million, respectively.

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We generally do not retain mortgage-backed securities issued by the Agency and Non-Agency securitization SPEs at the inception of the securitization transactions. Rather, our limited holdings of these securities occur through subsequent purchases in the secondary market. PNC does not retain any credit risk on its Agency mortgage-backed security positions as FNMA, FHLMC, and the U.S. Government (for GNMA) guarantee losses of principal and interest on the underlying mortgage loans. We generally hold a senior class of Non-Agency mortgage-backed securities.

We also have involvement with certain Agency and Non-Agency commercial securitization SPEs where we have not transferred commercial mortgage loans. These SPEs were sponsored by independent third-parties and the loans held by these entities were purchased exclusively from other third-parties. Generally, our involvement with these SPEs is as servicer with servicing activities consistent to those described above. In certain instances, we can be terminated as servicer in these commercial securitization structures without cause by the controlling class of mortgage-backed security holders of the SPE.

### ***RECOURSE RESERVES***

We recognize a liability for our loss exposure associated with contractual obligations to repurchase previously transferred loans due to breaches of representations and warranties and also for loss sharing arrangements with the Agencies. Inherent in all of our loan transfers are certain representation and warranties we make to cover defects that may have occurred

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during the underwriting and origination of the loans. We typically repurchase loans only when representation and warranty defects are identified and go uncured. At June 30, 2010, this repurchase liability totaled \$159 million and was related to residential mortgage loan transfers. We generally do not recognize a representation and warranty liability for commercial mortgage loan transfers as our historical repurchase activity has been minimal.

We also recognize a liability for certain commercial mortgage loan loss sharing arrangements for loan transfers to the Agencies. Our liability and total exposure to loss under these loss sharing arrangements was \$39 million and \$4.0 billion,

respectively, at June 30, 2010. Our representation and warranty and loss share liabilities (collectively recourse obligations) are recognized in Other liabilities on our Consolidated Balance Sheet and are evaluated quarterly based upon loss methodologies that utilize assumptions such as historical and projected repurchase activity, loss severity, and estimated defaults. Other than providing temporary liquidity under servicing advances and our loss exposure associated with our recourse obligations, we have not provided nor are we required to provide any type of credit support, guarantees, or commitments to the securitization SPEs or third-party investors in these transactions.

**Certain Financial Information and Cash Flows Associated with Loan Sale and Servicing Activities**

In millions	June 30, 2010		December 31, 2009	
	Residential Mortgages	Commercial Mortgages (a)	Residential Mortgages	Commercial Mortgages (a)
<b>FINANCIAL INFORMATION</b>				
Servicing portfolio (b)	\$ 137,399	\$ 167,380	\$ 146,050	\$ 185,167
Carrying value of servicing assets (c)	963	722	1,332	921
Servicing advances	539	381	599	383
Servicing deposits	2,373	3,568	3,118	3,774
Recourse liability (d)	159	39	229	71
Carrying value of mortgage-backed securities held (e)	1,836	1,907	2,011	1,905

In millions	Three Months Ended		Six Months Ended	
	June 30, 2010		June 30, 2010	
	Residential Mortgages	Commercial Mortgages (a)	Residential Mortgages	Commercial Mortgages (a)
<b>CASH FLOWS</b>				
Sales of loans (f)	\$ 2,296	\$ 636	\$ 4,226	\$ 978
Repurchases of previously transferred loans	465		1,206	
Contractual servicing fees received	107	71	216	126
Servicing advances recovered, net	174	57	60	2
Cash flows on mortgage-backed securities held (e)	148	167	290	204

(a) Represents financial and cash flow information associated with both commercial mortgage loan transfer and servicing activities.

(b) For our continuing involvement with residential mortgage loan transfers, amount represents outstanding balance of loans transferred and serviced. For commercial mortgages, amount represents the portion of the overall servicing portfolio in which loans have been transferred by us or third parties to VIEs. It does not include loans serviced by us that were originated by third parties and have not been transferred to a VIE.

(c) See Note 8 Fair Value and Note 9 Goodwill and Other Intangible Assets for further information.

(d) Represents liability for our loss exposure associated with loan repurchases for breaches of representations and warranties and our commercial mortgage loss share arrangements for our Residential Mortgage Banking and Corporate & Institutional Banking business segments, respectively. See Note 18 Commitments and Guarantees for further information.

(e) Represents securities held where PNC transferred and/or serviced loans to a securitization SPE and we hold securities issued by that SPE.

(f) There were no gains or losses recognized on the transaction date for sales of residential mortgage and certain commercial mortgage loans as these loans are recognized on the balance sheet at fair value. For transfers of commercial loans not recognized on the balance sheet at fair value, gains/losses recognized on sales of these loans were insignificant for the three months and six months ended June 30, 2010.

**VARIABLE INTEREST ENTITIES (VIEs)**

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We are involved with various entities in the normal course of business that are deemed to be VIEs. We assess VIEs for consolidation based upon the accounting policies described in Note 1 and effective January 1, 2010, we consolidated Market Street, a credit card securitization trust, and certain Low Income Housing Tax Credit (LIHTC) investments as a result of adopting ASU 2009-17 Consolidations (Topic 810).

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The following provides a summary of VIEs, including those that we have consolidated and those in which we hold variable interests but have not consolidated into our financial statements as of June 30, 2010 and December 31, 2009, respectively.

**Consolidated VIEs Carrying Value (a)****June 30, 2010**

In millions	Market Street	Credit Card Securitization Trust	Tax Credit Investments (b)	Credit Risk Transfer Transaction	Total
<b>Assets</b>					
Cash and due from banks			\$ 3		\$ 3
Interest-earning deposits with banks		\$ 463	4		467
Investment securities	\$ 571				571
Loans	2,036	2,165		\$ 470	4,671
Allowance for loan and lease losses		(210)		(6)	(216)
Equity investments			1,420		1,420
Other assets	299	9	503	10	821
<b>Total assets</b>	<b>\$ 2,906</b>	<b>\$ 2,427</b>	<b>\$ 1,930</b>	<b>\$ 474</b>	<b>\$ 7,737</b>
<b>Liabilities</b>					
Other borrowed funds	\$ 2,616	\$ 1,512	\$ 134		\$ 4,262
Accrued expenses			92		92
Other liabilities	290		510		800
<b>Total liabilities</b>	<b>\$ 2,906</b>	<b>\$ 1,512</b>	<b>\$ 736</b>		<b>\$ 5,154</b>

(a) Amounts represent carrying value on PNC's Consolidated Balance Sheet.

(b) Amounts reported primarily represent LIHTC investments.

**Consolidated VIEs**

In millions	Aggregate Assets (a)	Aggregate Liabilities (a)
<b>June 30, 2010</b>		
Market Street	\$ 3,468	\$ 3,477
Credit Card Securitization Trust	2,672	1,622
Tax Credit Investments (b)	1,954	804
Credit Risk Transfer Transaction	795	795

**December 31, 2009**

Tax Credit Investments (b)	\$ 1,933	\$ 808
Credit Risk Transfer Transaction	860	860

(a) Aggregate assets and aggregate liabilities differ from the consolidated carrying value of assets and liabilities due to elimination of intercompany assets and liabilities held by the consolidated VIE.

(b) Amounts reported primarily represent LIHTC investments.

**Non-Consolidated VIEs**

In millions	Aggregate Assets	Aggregate Liabilities	PNC Risk of Loss	Carrying Value of Assets	Carrying Value of Liabilities
<b>June 30, 2010</b>					
Tax Credit Investments (a)	\$ 3,583	\$ 1,873	\$ 830	\$ 830(c)	\$ 336(d)
Commercial Mortgage-Backed Securitizations (b)	79,238	79,238	2,080	2,080(e)	
Residential Mortgage-Backed Securitizations (b)	44,847	44,847	1,860	1,857(e)	3(d)
Collateralized Debt Obligations	23		2	2(c)	

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Total \$ 127,691 \$ 125,958 \$ 4,772 \$ 4,769 \$ 339

In millions	Aggregate Assets	Aggregate Liabilities	PNC Risk of Loss
<b>December 31, 2009</b>			
Market Street	\$ 3,698	\$ 3,718	\$ 6,155(f)
Tax Credit Investments (a)	1,786	1,156	743
Collateralized Debt Obligations	23		2
<b>Total</b>	<b>\$ 5,507</b>	<b>\$ 4,874</b>	<b>\$ 6,900</b>

- (a) Amounts reported primarily represent LIHTC investments. Aggregate assets and aggregate liabilities represent estimated balances due to limited availability of financial information associated with certain acquired National City partnerships.
- (b) Amounts reported reflect involvement with securitization SPEs where PNC transferred to and/or services loans for a SPE and we hold securities issued by that SPE. We also invest in other mortgage and asset-backed securities issued by third-party VIEs with which we have no continuing involvement. Further information on these securities is included in Note 7 Investment Securities and values disclosed represent our maximum exposure to loss for those securities holdings.



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- (c) Included in Equity investments on our Consolidated Balance Sheet.
- (d) Included in Other liabilities on our Consolidated Balance Sheet.
- (e) Included in Trading securities, Investment securities, Other intangible assets, and Other assets on our Consolidated Balance Sheet.
- (f) PNC's risk of loss consisted of off-balance sheet liquidity commitments to Market Street of \$5.6 billion and other credit enhancements of \$.6 billion at December 31, 2009.

**MARKET STREET**

Market Street is a multi-seller asset-backed commercial paper conduit that is owned by an independent third party. Market Street's activities primarily involve purchasing assets or making loans secured by interests in pools of receivables from US corporations that desire access to the commercial paper market. Market Street funds the purchases of assets or loans by issuing commercial paper and is supported by pool-specific credit enhancements, liquidity facilities and program-level credit enhancement. Generally, Market Street mitigates its potential interest rate risk by entering into agreements with its borrowers that reflect interest rates based upon its weighted average commercial paper cost of funds. During 2009 and the first six months of 2010, Market Street met all of its funding needs through the issuance of commercial paper.

PNC Bank, N.A. provides certain administrative services, the program-level credit enhancement and all of the liquidity facilities to Market Street in exchange for fees negotiated based on market rates. Through these arrangements, PNC has the power to direct the activities of the special purpose entity (SPE) that most significantly affect its economic performance and these arrangements expose PNC to expected losses or residual returns that are significant to Market Street.

The commercial paper obligations at June 30, 2010 and December 31, 2009 were supported by Market Street's assets. While PNC may be obligated to fund under the \$5.1 billion of liquidity facilities for events such as commercial paper market disruptions, borrower bankruptcies, collateral deficiencies or covenant violations, our credit risk under the liquidity facilities is secondary to the risk of first loss provided by the borrower such as by the over-collateralization of the assets or by another third party in the form of deal-specific credit enhancement. Deal-specific credit enhancement that supports the commercial paper issued by Market Street is generally structured to cover a multiple of expected losses for the pool of assets and is sized to generally meet rating agency standards for comparably structured transactions. In addition, PNC would be required to fund \$236 million of the liquidity facilities if the underlying assets are in default. Market Street creditors have no direct recourse to PNC.

PNC provides program-level credit enhancement to cover net losses in the amount of 10% of commitments, excluding explicitly rated AAA/Aaa facilities. PNC provides 100% of the enhancement in the form of a cash collateral account funded by a loan facility. This facility expires in March 2013.

At June 30, 2010, \$567 million was outstanding on this facility. This amount was eliminated in PNC's Consolidated Balance Sheet as of June 30, 2010 due to the consolidation of Market Street. We are not required to nor have we provided additional financial support to the SPE.

**CREDIT CARD SECURITIZATION TRUST**

We are the sponsor of several credit card securitizations facilitated through an SPE trust. This bankruptcy-remote SPE or VIE was established to purchase credit card receivables from the sponsor and to issue and sell asset-backed securities created by it to independent third-parties. The SPE was financed primarily through the sale of these asset-backed securities. These transactions were originally structured as a form of liquidity and to afford favorable capital treatment. At June 30, 2010, Series 2005-1, 2006-1, 2007-1, and 2008-3 issued by the SPE were outstanding.

Our continuing involvement in these securitization transactions consists primarily of holding certain retained interests and acting as the primary servicer. For each securitization series, our retained interests held are in the form of a pro-rata undivided interest, or sellers' interest, in the transferred receivables, subordinated tranches of asset-backed securities, interest-only strips, discount receivables, and subordinated interests in accrued interest and fees in securitized receivables. We consolidated the SPE as of January 1, 2010 as we are deemed the primary beneficiary of the entity based upon our level of continuing involvement. Our role as primary servicer gives us the power to direct the activities of the SPE that most significantly affect its economic performance and our holding of retained interests gives us the obligation to absorb or receive expected losses or residual returns that are significant to the SPE. Accordingly, all retained interests held in the credit card SPE are eliminated in consolidation. The underlying assets of the consolidated SPE are restricted only for payment of the beneficial interest issued by the SPE. We are not required to nor have we provided additional financial support to the SPE. Additionally, creditors of the SPE have no direct recourse to PNC.

**TAX CREDIT INVESTMENTS**

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We make certain equity investments in various limited partnerships or limited liability companies (LLCs) that sponsor affordable housing projects utilizing the LIHTC pursuant to Sections 42 and 47 of the Internal Revenue Code. The purpose of these investments is to achieve a satisfactory return on capital, to facilitate the sale of additional affordable housing product offerings and to assist us in achieving goals associated with the Community Reinvestment Act. The primary activities of the investments include the identification, development and operation of multi-family housing that is leased to qualifying residential tenants. Generally, these types of investments are funded through a combination of debt and equity. We typically invest in these partnerships as a limited partner or non-managing member.

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Also, we are a national syndicator of affordable housing equity (together with the investments described above, the LIHTC investments). In these syndication transactions, we create funds in which our subsidiaries are the general partner or managing member and sell limited partnership or non-managing member interests to third parties, and in some cases may also purchase a limited partnership or non-managing member interest in the fund and/or provide mezzanine financing to the fund. The purpose of this business is to generate income from the syndication of these funds, generate servicing fees by managing the funds, and earn tax credits to reduce our tax liability. General partner or managing member activities include selecting, evaluating, structuring, negotiating, and closing the fund investments in operating limited partnerships, as well as oversight of the ongoing operations of the fund portfolio.

Typically, the general partner or managing member will be the party that has the right to make decisions that will most significantly impact the economic performance of the entity. The primary sources of losses and benefits in LIHTC investments are the tax credits, tax benefits due to passive losses on the investments, and development and operating cash flows. We have consolidated LIHTC investments in which we are the general partner or managing member and have a limited partnership interest or non-managing member interest that could potentially absorb losses or receive benefits that are significant. The assets are primarily included in Equity investments and Other assets on our Consolidated Balance Sheet with the liabilities classified in Other liabilities and third party investors' interests included in the Equity section as Noncontrolling interests. Neither creditors nor equity investors in the LIHTC investments have any recourse to our general credit. There are no terms or conditions that have required or could require us, as the primary beneficiary, to provide financial support. Also, we have not provided nor do we intend to provide financial or other support to the limited partnership or LLC that we are not contractually obligated to provide. The consolidated aggregate assets and liabilities of these LIHTC investments are provided in the Consolidated VIEs table and reflected in the Other business segment.

We also have LIHTC investments in which we are not the general partner and do not have the right to make decisions that will most significantly impact the economic performance of the entity. Accordingly, we are not the primary beneficiary of these investments and thus they are not consolidated. These investments are disclosed in the Non-Consolidated VIEs table. The table also reflects our maximum exposure to loss. Our maximum exposure to loss is equal to our legally binding equity commitments adjusted for recorded impairment and partnership results. We use the equity method to account for our investment in these entities with the investments reflected in Equity investments on our Consolidated Balance Sheet. In addition, we increase our recognized investments and recognize a liability for all legally binding unfunded equity

commitments. These liabilities are reflected in Other liabilities on our Consolidated Balance Sheet.

***CREDIT RISK TRANSFER TRANSACTION***

National City Bank (which merged into PNC Bank, N.A. in November 2009) sponsored an SPE and concurrently entered into a credit risk transfer agreement with an independent third party to mitigate credit losses on a pool of nonconforming residential mortgage loans originated by its former First Franklin business unit. The SPE or VIE was formed with a small equity contribution and was structured as a bankruptcy-remote entity so that its creditors have no recourse to the sponsor. In exchange for a perfected security interest in the cash flows of the nonconforming mortgage loans, the SPE issued asset-backed securities to the sponsor in the form of senior, mezzanine, and subordinated equity notes.

The credit risk transfer agreement associated with this transaction is no longer outstanding as a result of certain actions taken by us and the independent third-party in 2009. Refer to our 2009 Form 10-K for further details of these actions. We continue to hold all asset-backed securities issued by the SPE and are also the depositor in this transaction. As a result, we are deemed the primary beneficiary of the SPE. Our rights as depositor give us the power to direct the activities of the SPE that most significantly affect its economic performance and our holding of all asset-backed securities gives us the obligation to absorb or receive expected losses or residual returns that are significant to the SPE. Accordingly, this SPE is consolidated and all of the entity's assets, liabilities, and equity associated with the securities held by us are intercompany balances and are eliminated in consolidation. The underlying assets of the consolidated SPE are restricted only for payment of the asset-backed securities issued by the SPE. We are not required to nor have we provided additional financial support to the SPE.

***RESIDENTIAL AND COMMERCIAL MORTGAGE-BACKED SECURITIZATIONS***

In connection with each Agency and Non-Agency securitization discussed above, we evaluate each SPE utilized in these transactions for consolidation. In performing these assessments, we evaluate our level of continuing involvement in these transactions as the magnitude of our involvement ultimately determines whether or not we hold a variable interest and/or are the primary beneficiary of the SPE. Factors we consider in our consolidation assessment include the significance of (1) our role as servicer, (2) our holdings of mortgage-backed securities issued by the securitization SPE, and (3) the rights of third-party variable interest holders.

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Our first step in our assessment is to determine whether we hold a variable interest in the securitization SPE. We hold a variable interest in an Agency and Non-Agency securitization SPE through our holding of mortgage-backed securities issued by the SPE and/or our recourse obligations. Each SPE in which we hold a variable interest is evaluated to determine

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whether we are the primary beneficiary of the entity. For Agency securitization transactions, our contractual role as servicer does not give us the power to direct the activities that most significantly affect the economic performance of the SPEs. Thus, we are not the primary beneficiary of these entities. For Non-Agency securitization transactions, we would be the primary beneficiary to the extent our servicing activities give us the power to direct the activities that most significantly affect the economic performance of the SPE and we hold a more than insignificant variable interest in the entity. At June 30, 2010, our level of continuing involvement in Non-Agency securitization SPEs did not result in PNC being deemed the primary beneficiary of any of these entities. Details about the Agency and Non-Agency securitization SPEs where we hold a variable interest and are not the primary beneficiary are included in the table above. Our maximum exposure to loss as a result of our involvement with these SPEs is the carrying value of the mortgage-backed securities, servicing assets, servicing advances, and our liabilities associated with our recourse obligations. Creditors of the securitization SPEs have no recourse to PNC's assets or general credit.

**NOTE 4 LOANS AND COMMITMENTS TO EXTEND CREDIT**

Loans outstanding were as follows:

In millions	June 30 2010	December 31 2009
Commercial	\$ 54,232	\$ 54,818
Commercial real estate	20,364	23,131
Consumer	55,279	53,582
Residential real estate	17,837	19,810
Equipment lease financing	6,630	6,202
Total loans (a)	\$ 154,342	\$ 157,543

(a) Net of unearned income, net deferred loan fees, unamortized discounts and premiums, and purchase discounts and premiums totaling \$2.8 billion and \$3.2 billion at June 30, 2010 and December 31, 2009, respectively.

Future accretable discounts related to purchased impaired loans are not included in loans outstanding.

At June 30, 2010, we pledged \$14.7 billion of loans to the Federal Reserve Bank and \$27.0 billion of loans to the Federal Home Loan Bank as collateral for the contingent ability to borrow, if necessary. The comparable amounts at December 31, 2009 were \$18.8 billion and \$32.6 billion, respectively.

Certain loans are accounted for at fair value with changes in the fair value reported in current period earnings. The fair value of these loans was \$110 million, or less than 1% of the total loan portfolio, at June 30, 2010.

**Net Unfunded Credit Commitments**

In millions	June 30 2010	December 31 2009
Commercial and commercial real estate (a) (b)	\$ 56,854	\$ 60,143
Home equity lines of credit	19,973	20,367
Consumer credit card line and other unsecured lines	17,833	18,800
Other	1,115	1,485
Total	\$ 95,775	\$ 100,795

(a) Amount related to purchased customer receivables totaled \$2.7 billion at June 30, 2010 due to the January 1, 2010 consolidation of Market Street.

(b) Amount related to Market Street totaled \$5.6 billion at December 31, 2009. This amount was eliminated as of June 30, 2010 due to the consolidation of Market Street.

Commitments to extend credit represent arrangements to lend funds or provide liquidity subject to specified contractual conditions. At June 30, 2010 commercial commitments are reported net of \$14.7 billion of participations, assignments and syndications,

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primarily to financial institutions. The comparable amount at December 31, 2009 was \$13.2 billion.

Commitments generally have fixed expiration dates, may require payment of a fee, and contain termination clauses in the event the customer's credit quality deteriorates. Based on our historical experience, most commitments expire unfunded, and therefore cash requirements are substantially less than the total commitment. Consumer home equity lines of credit accounted for 53% of consumer unfunded credit commitments at June 30, 2010.

**Table of Contents****NOTE 5 ASSET QUALITY**

The following amounts exclude purchased impaired loans acquired in connection with the December 31, 2008 National City acquisition. See Note 6 Purchased Impaired Loans Related to National City for further information.

**Nonperforming Assets**

Dollars in millions	June 30, 2010	December 31, 2009
<b>Nonaccrual loans</b>		
Commercial	\$ 1,693	\$ 1,806
Commercial real estate	2,081	2,140
Equipment lease financing	114	130
<b>TOTAL COMMERCIAL LENDING</b>	<b>3,888</b>	<b>4,076</b>
<b>Consumer</b>		
Home equity	405	356
Other	25	36
<b>Total consumer</b>	<b>430</b>	<b>392</b>
<b>Residential real estate</b>		
Residential mortgage	713	955
Residential construction	79	248
<b>Total residential real estate</b>	<b>792</b>	<b>1,203</b>
<b>TOTAL CONSUMER LENDING</b>	<b>1,222</b>	<b>1,595</b>
<b>Total nonaccrual/nonperforming loans</b>	<b>5,110</b>	<b>5,671</b>
<b>Foreclosed and other assets</b>		
Commercial lending	293	266
Consumer lending	501	379
<b>Total foreclosed and other assets</b>	<b>794</b>	<b>645</b>
<b>Total nonperforming assets</b>	<b>\$ 5,904</b>	<b>\$ 6,316</b>
<b>Nonperforming loans to total loans</b>	<b>3.31%</b>	<b>3.60%</b>
<b>Nonperforming assets to total loans and foreclosed and other assets</b>	<b>3.81</b>	<b>3.99</b>
<b>Nonperforming assets to total assets</b>	<b>2.26</b>	<b>2.34</b>

Loans whose contractual terms have been restructured in a manner which grants a concession to a borrower experiencing financial difficulties where we do not receive adequate compensation are considered troubled debt restructurings (TDRs). TDRs typically result from our loss mitigation activities and could include rate reductions, principal forgiveness, forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of collateral. Total nonperforming loans in the table above include TDRs of \$500 million at June 30, 2010 and \$440 million at December 31, 2009.

TDRs returned to performing (accrual) status totaled \$329 million at June 30, 2010 and are excluded from nonperforming loans. These loans have demonstrated a period of at least six months of performance under the modified terms.

In addition, credit cards and certain small business and consumer credit agreements whose terms have been modified totaled \$290 million at June 30, 2010 and are excluded from

TDRs and nonperforming loans. Our policy is to exempt these loans from being placed on nonaccrual status as permitted by regulatory guidance as these loans are directly charged off in the period that they become 180 days past due.

Net interest income less the provision for credit losses was \$3.2 billion for the first six months of 2010 compared with \$2.5 billion for the first six months of 2009. Comparable amounts for the second quarter of 2010 and the second quarter of 2009 were \$1.6 billion and \$1.1 billion, respectively.

**Rollforward of Allowance for Loan and****Lease Losses**

In millions	2010	2009
January 1	\$ 5,072	\$ 3,917
Charge-offs	(1,812)	(1,393)
Recoveries	281	167
Net charge-offs	(1,531)	(1,226)
Provision for credit losses	1,574	1,967
Acquired allowance (a)		(114)
Adoption of ASU 2009-17, <i>Consolidations</i>	141	
Other	2	
Net change in allowance for unfunded loan commitments and letters of credit	78	25
June 30	\$ 5,336	\$ 4,569

(a) Reflects adjustments to the National City allowance acquired December 31, 2008 due to additional impairment of loans effective at that date.

#### Rollforward of Allowance for Unfunded Loan

#### Commitments and Letters of Credit

In millions	2010	2009
January 1	\$ 296	\$ 344
Net change in allowance for unfunded loan commitments and letters of credit	(78)	(25)
June 30	\$ 218	\$ 319

Originated Impaired Loans exclude leases and smaller homogeneous type loans as well as purchased impaired loans related to our acquisition of National City, but include acquired loans that are impaired subsequent to acquisition. We did not recognize any interest income on Originated Impaired Loans while they were impaired in the first six months of 2010 or 2009. The following table provides further detail on Originated Impaired Loans individually evaluated for reserves and the associated allowance for loan losses:

#### Originated Impaired Loans (a)

In millions	June 30 2010	Dec. 31 2009
Impaired loans with an associated reserve	\$ 3,902	\$ 3,475
Impaired loans without an associated reserve	334	471
Total impaired loans	\$ 4,236	\$ 3,946
Specific allowance for credit losses	\$ 1,146	\$ 1,148
Average impaired loan balance (b)	\$ 4,304	\$ 2,909

(a) Purchased impaired loans related to our acquisition of National City are excluded from this table and are disclosed in Note 6 Purchased Impaired Loans Related to National City.

(b) Six-month average for 2010 and full-year average for 2009.



**Table of Contents****NOTE 6 PURCHASED IMPAIRED LOANS RELATED TO NATIONAL CITY**

As further described in Note 6 of the 2009 Form 10-K, at December 31, 2008, we identified certain loans related to the National City acquisition, for which there was evidence of credit quality deterioration since origination and it was probable that we would be unable to collect all contractually required principal and interest payments. GAAP requires these loans to be recorded at fair value at acquisition date and prohibits the carrying over or the creation of valuation allowances in the initial accounting for such loans acquired in a transfer.

**Purchased Impaired Loans**

In millions	June 30, 2010		December 31, 2009	
	Recorded Investment	Outstanding Balance	Recorded Investment	Outstanding Balance
Commercial (a)	\$ 391	\$ 599	\$ 558	\$ 1,016
Commercial real estate (a)	1,295	1,807	1,694	2,705
Consumer	3,277	4,635	3,457	5,097
Residential real estate	4,245	5,440	4,663	6,620
<b>Total</b>	<b>\$ 9,208</b>	<b>\$ 12,481</b>	<b>\$ 10,372</b>	<b>\$ 15,438</b>

(a) Includes purchased impaired loans held for sale. The recorded investment and outstanding balance of these loans was \$81 million and \$87 million, respectively, at June 30, 2010. Comparable balances at December 31, 2009 were \$85 million and \$200 million. The reduction in the outstanding balance at June 30, 2010 reflected loan sales and payoffs during 2010.

During the first six months of 2010, the amount of purchased impaired loans decreased by a net \$1.2 billion as a result of payments and other exit activities partially offset by accretion of purchase accounting discount.

The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretible yield and is recognized in interest income over the remaining life of the loan using the constant effective yield method. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretible difference. Changes in the expected cash flows of individual commercial or pooled consumer purchased impaired loans from the date of

acquisition will either impact the accretible yield or result in an impairment charge to the provision for credit losses in the period in which the changes become probable. Prepayments are treated as a reduction of cash flows expected to be collected and a reduction of projections of contractual cash flows such that the nonaccretible difference is not affected. Thus, for decreases in the net present value of cash flows expected to be collected resulting from prepayments, the effect will be to reduce the yield prospectively. Subsequent decreases to the net present value of expected cash flows will generally result in an impairment charge to the provision for credit losses, resulting in an increase to the allowance for loan and lease losses, and a reclassification from accretible yield to nonaccretible difference. During the first six months of 2010, \$402 million of provision and \$99 million of charge-offs were recorded on impaired loans. As of June 30, 2010, decreases in the net present value of expected cash flows of purchased impaired loans resulted in an allowance for loan and lease losses of \$859 million on \$7.1 billion of the impaired loans while the remaining \$2.1 billion of impaired loans required no allowance as net present value of expected cash flows improved or remained the same. Subsequent increases in the net present value of cash flows will result in a recovery of any previously recorded allowance for loan and lease losses, to the extent applicable, and a reclassification from nonaccretible difference to accretible yield. Disposals of loans, which may include sales of loans or foreclosures, result in removal of the loan from the purchased impaired loan portfolio at its carrying amount.

Activity for the accretible yield for the first six months of 2010 follows.

**Accretible Yield**

In millions	<b>2010</b>
January 1	<b>\$ 3,502</b>
Accretion (including cash recoveries)	<b>(762)</b>

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Net reclassifications from accretable to non-accretable	(276)
Disposals	(143)
June 30	\$ 2,321

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**Table of Contents****NOTE 7 INVESTMENT SECURITIES****Investment Securities Summary**

In millions	Amortized Cost	Unrealized Gains      Losses		Fair Value
<b>June 30, 2010</b>				
<b>SECURITIES AVAILABLE FOR SALE</b>				
Debt securities				
US Treasury and government agencies	\$ 7,849	\$ 245	\$ (1)	\$ 8,093
Residential mortgage-backed				
Agency	19,985	644	(50)	20,579
Non-agency	8,993	229	(1,587)	7,635
Commercial mortgage-backed				
Agency	1,293	49		1,342
Non-agency	1,757	37	(76)	1,718
Asset-backed				
State and municipal	1,785	28	(287)	1,526
Other debt	1,333	59	(58)	1,334
Total debt securities	3,044	90	(3)	3,131
Corporate stocks and other	46,039	1,381	(2,062)	45,358
Total securities available for sale	492			492
	\$ 46,531	\$ 1,381	\$ (2,062)	\$ 45,850
<b>SECURITIES HELD TO MATURITY</b>				
Debt securities				
Commercial mortgage-backed (non-agency)	\$ 4,174	\$ 203	\$ (1)	\$ 4,376
Asset-backed	3,684	93	(15)	3,762
Other debt	9	1		10
Total securities held to maturity	\$ 7,867	\$ 297	\$ (16)	\$ 8,148
December 31, 2009				
<b>SECURITIES AVAILABLE FOR SALE</b>				
Debt securities				
US Treasury and government agencies	\$ 7,548	\$ 20	\$ (48)	\$ 7,520
Residential mortgage-backed				
Agency	24,076	439	(77)	24,438
Non-agency	10,419	236	(2,353)	8,302
Commercial mortgage-backed				
Agency	1,299	10	(12)	1,297
Non-agency	4,028	42	(222)	3,848
Asset-backed				
State and municipal	2,019	30	(381)	1,668
Other debt	1,346	58	(54)	1,350
Total debt securities	1,984	38	(7)	2,015
Corporate stocks and other	52,719	873	(3,154)	50,438
Total securities available for sale	360			360
	\$ 53,079	\$ 873	\$ (3,154)	\$ 50,798
<b>SECURITIES HELD TO MATURITY</b>				
Debt securities				
Commercial mortgage-backed (non-agency)	\$ 2,030	\$ 195		\$ 2,225
Asset-backed	3,040	109	(13)	3,136
Other debt	159	1		160
Total securities held to maturity	\$ 5,229	\$ 305	\$ (13)	\$ 5,521



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The fair value of investment securities is impacted by interest rates, credit spreads, market volatility and liquidity conditions. Net unrealized gains and losses in the securities available for sale portfolio are included in shareholders' equity as accumulated other comprehensive income or loss, net of tax, unless credit-related.

In March 2010, we transferred \$2.2 billion of available for sale commercial mortgage-backed non-agency securities to the held to maturity portfolio. The reclassification was made at fair value at the date of transfer. Net pretax unrealized gains in accumulated other comprehensive loss totaled \$92 million at the transfer date and will be accreted over the remaining life of the related securities as an adjustment of yield in a manner consistent with the amortization of premium on the same transferred securities, resulting in no impact on net income.

The following table presents gross unrealized loss and fair value of securities available for sale at June 30, 2010 and December 31, 2009. The securities are segregated between investments that have been in a continuous unrealized loss position for less than twelve months and twelve months or more based on the point in time the fair value declined below the amortized cost basis. The table includes debt securities where a portion of OTTI has been recognized in accumulated other comprehensive loss. The gross unrealized loss on debt securities held to maturity was \$16 million at June 30, 2010 and \$13 million at December 31, 2009 with the majority of positions in a continuous loss position for less than 12 months.

**Gross Unrealized Loss and Fair Value of Securities Available for Sale**

In millions	Unrealized loss position less than 12 months		Unrealized loss position 12 months or more		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
<b>June 30, 2010</b>						
Securities available for sale						
Debt securities						
US Treasury and government agencies			\$ (1)	\$ 52	\$ (1)	\$ 52
Residential mortgage-backed						
Agency	\$ (34)	\$ 2,117	(16)	261	(50)	2,378
Non-agency	(6)	43	(1,581)	6,385	(1,587)	6,428
Commercial mortgage-backed						
Non-agency	(17)	238	(59)	412	(76)	650
Asset-backed	(6)	191	(281)	798	(287)	989
State and municipal	(1)	87	(57)	268	(58)	355
Other debt			(3)	12	(3)	12
Total	\$ (64)	\$ 2,676	\$ (1,998)	\$ 8,188	\$ (2,062)	\$ 10,864
<b>December 31, 2009</b>						
Securities available for sale						
Debt securities						
US Treasury and government agencies	\$ (48)	\$ 4,015			\$ (48)	\$ 4,015
Residential mortgage-backed						
Agency	(76)	6,960	(1)	56	(77)	7,016
Non-agency	(7)	79	(2,346)	7,223	(2,353)	7,302
Commercial mortgage-backed						
Agency	(12)	779			(12)	779
Non-agency	(3)	380	(219)	1,353	(222)	1,733
Asset-backed	(1)	142	(380)	1,153	(381)	1,295
State and municipal	(1)	49	(53)	285	(54)	334
Other debt	(3)	299	(4)	18	(7)	317
Total	\$ (151)	\$ 12,703	\$ (3,003)	\$ 10,088	\$ (3,154)	\$ 22,791

**Evaluating Investments for Other-than-Temporary Impairments**

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For the securities in the above table, as of June 30, 2010 we do not intend to sell and have determined it is not more likely than not we will be required to sell the security prior to recovery of the amortized cost basis.

On at least a quarterly basis, we conduct a comprehensive security-level assessment on all securities in an unrealized loss

position to determine if OTTI exists. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. An OTTI loss must be recognized for a debt security in an unrealized loss position if we intend to sell the security or it is more likely than not we will be required to sell the security prior to recovery of its amortized cost basis. In this situation, the amount of loss recognized in income is equal to the difference between the fair value and the amortized cost basis of the security. Even if

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we do not expect to sell the security, we must evaluate the expected cash flows to be received to determine if we believe a credit loss has occurred. In the event of a credit loss, only the amount of impairment associated with the credit loss is recognized in income. The portion of the unrealized loss relating to other factors, such as liquidity conditions in the market or changes in market interest rates, is recorded in accumulated other comprehensive loss.

Equity securities are also evaluated to determine whether the unrealized loss is expected to be recoverable based on whether evidence exists to support a realizable value equal to or greater than the amortized cost basis. If it is probable that we will not recover the amortized cost basis, taking into consideration the estimated recovery period and our ability to hold the equity security until recovery, OTTI is recognized in earnings equal to the difference between the fair value and the amortized cost basis of the security.

The security-level assessment is performed on each security, regardless of the classification of the security as available for sale or held to maturity. Our assessment considers the security structure, recent security collateral performance metrics if applicable, external credit ratings, failure of the issuer to make scheduled interest or principal payments, our judgment and expectations of future performance, and relevant independent industry research, analysis and forecasts. We also consider the severity of the impairment and the length of time the security has been impaired in our assessment. Results of the periodic assessment are reviewed by a cross-functional senior management team representing Asset & Liability Management, Finance, and Balance Sheet Risk Management. The senior management team considers the results of the assessments, as well as other factors, in determining whether the impairment is other-than-temporary.

For debt securities, a critical component of the evaluation for OTTI is the identification of credit-impaired securities, where management does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. The paragraphs below describe our process for identifying credit impairment for our most significant categories of securities not backed by the US government or its agencies.

***Non-Agency Residential Mortgage-Backed Securities and Asset-Backed Securities Collateralized by First-Lien and Second-Lien Residential Mortgage Loans***

To measure credit losses for these securities, we compile relevant collateral details and performance statistics on a security-by-security basis. The securities are then processed

through a series of pre-established filters based upon ratings, collateral performance, projected losses, market prices and judgment to identify bonds that have the potential to be credit impaired.

Securities not passing all of the filters are subjected to further analysis. Cash flows are projected for the underlying collateral and are applied to the securities according to the deal structure using a third-party default model. Collateral cash flows are estimated using assumptions for prepayment rates, future defaults, and loss severity rates. The assumptions are security specific and are based on collateral characteristics, historical performance, and future expected performance. Based on the results of the cash flow analysis, we determine whether we will recover the amortized cost basis of our security.

***Credit Impairment Assessment Assumptions Non-Agency Residential Mortgage-Backed and Asset-Backed Securities (a)***

June 30, 2010	Range	Weighted-average (b)
Long-term prepayment rate		
(annual CPR)		
Prime	7-15%	12%
Alt-A	7-15	9
Remaining collateral expected to default		
Prime	0-100%	19%
Alt-A	3-82	44
Loss severity		

Prime	15-68%	42%
Alt-A	25-74	57

(a) Collateralized by first and second-lien residential mortgage loans.

(b) Calculated by weighting the relevant assumption for each individual security by the current outstanding cost basis of the security.

***Non-Agency Commercial Mortgage-Backed Securities***

Credit losses on these securities are measured using property-level cash flow projections and forward-looking property valuations. Cash flows are projected using a detailed analysis of net operating income (NOI) by property type which, in turn, is based on the analysis of NOI performance over the past several business cycles combined with PNC's economic outlook for the current cycle. Loss severities are based on property price projections, which are calculated using capitalization rate projections. The capitalization rate projections are based on a combination of historical capitalization rates and expected capitalization rates implied by current market activity, our outlook and relevant independent industry research, analysis and forecast. Securities exhibiting weaker performance within the model are subject to further analysis. This analysis is performed at the loan level, and includes assessing local market conditions, reserves, occupancy, rent rolls and master/special servicer details.



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During the second quarter and first six months of 2010 and 2009, the OTTI credit losses recognized in noninterest income related to estimated credit losses on securities that we do not expect to sell were as follows:

**Summary of OTTI Credit Losses Recognized in Earnings**

In millions	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Available for sale securities:				
Non-agency residential mortgage-backed	\$ (81)	\$ (131)	\$ (154)	\$ (248)
Commercial mortgage-backed	(3)	(1)	(3)	(6)
Asset-backed	(10)	(23)	(53)	(42)
Other debt				(4)
Marketable equity securities				(4)
<b>Total</b>	<b>\$ (94)</b>	<b>\$ (155)</b>	<b>\$ (210)</b>	<b>\$ (304)</b>

**Summary of OTTI Noncredit Losses Included in Accumulated Other Comprehensive Loss**

In millions	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
<b>Total</b>	<b>\$ (24)</b>	<b>\$ (298)</b>	<b>\$ (148)</b>	<b>\$ (835)</b>

The following table presents a rollforward of the cumulative OTTI credit losses recognized in earnings for all debt securities for which a portion of an OTTI loss was recognized in accumulated other comprehensive loss:

**Rollforward of Cumulative OTTI Credit Losses Recognized in Earnings**

In millions	Non-agency residential mortgage-backed	Commercial mortgage-backed	Asset-backed	Other debt	Total
<b>For the three months ended June 30, 2010</b>					
March 31, 2010	\$ (540)	\$ (6)	\$ (188)	\$ (12)	\$ (746)
Loss where impairment was not previously recognized	(14)	(3)	(6)		(23)
Additional loss where credit impairment was previously recognized	(67)		(4)		(71)
<b>June 30, 2010</b>	<b>\$ (621)</b>	<b>\$ (9)</b>	<b>\$ (198)</b>	<b>\$ (12)</b>	<b>\$ (840)</b>

In millions	Non-agency residential mortgage-backed	Commercial mortgage-backed	Asset-backed	Other debt	Total
<b>For the three months ended June 30, 2009</b>					
March 31, 2009	\$ (153)	\$ (5)	\$ (52)	\$ (4)	\$ (214)
Loss where impairment was not previously recognized	(37)	(1)	(16)		(54)
Additional loss where credit impairment was previously recognized	(94)		(7)		(101)
<b>June 30, 2009</b>	<b>\$ (284)</b>	<b>\$ (6)</b>	<b>\$ (75)</b>	<b>\$ (4)</b>	<b>\$ (369)</b>

In millions	Non-agency residential mortgage-backed	Commercial mortgage-backed	Asset-backed	Other debt	Total
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<u>For the six months ended June 30, 2010</u>					
December 31, 2009	\$	(479)	\$	(6)	\$ (145) \$ (12) \$ (642)
Loss where impairment was not previously recognized		(26)		(3)	(11) (40)
Additional loss where credit impairment was previously recognized		(128)		(42)	(170)
Reduction due to credit impaired securities sold		12			12
<b>June 30, 2010</b>	<b>\$</b>	<b>(621)</b>	<b>\$</b>	<b>(9)</b>	<b>\$ (198) \$ (12) \$ (840)</b>

In millions		Non-agency residential mortgage-backed	Commercial mortgage-backed	Asset-backed	Other debt	Total
<u>For the six months ended June 30, 2009 (a)</u>						
December 31, 2008	\$	(35)		\$ (34)		\$ (69)
Loss where impairment was not previously recognized		(155)	\$ (6)	(34)	\$ (4)	(199)
Additional loss where credit impairment was previously recognized		(94)		(7)		(101)
June 30, 2009	\$	(284)	\$ (6)	\$ (75)	\$ (4)	\$ (369)

(a) Excludes OTTI credit losses related to equity securities totaling \$4 million.

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Information relating to gross realized securities gains and losses from the sales of securities is set forth in the following table.

**Gains (Losses) on Sales of Securities Available for Sale**

Six months ended June 30	Gross Proceeds	Gross Gains	Gross Losses	Net Gains	Tax Expense
In millions					
<b>2010</b>	<b>\$ 14,164</b>	<b>\$ 297</b>	<b>\$ 60</b>	<b>\$ 237</b>	<b>\$ 83</b>
2009	7,993	241	3	238	83

The following table presents, by remaining contractual maturity, the amortized cost, fair value and weighted-average yield of debt securities at June 30, 2010.

**Contractual Maturity of Debt Securities**

June 30, 2010	1 Year or Less	After 1 Year through 5 Years	After 5 Years through 10 Years	After 10 Years	Total
Dollars in millions					
<b>SECURITIES AVAILABLE FOR SALE</b>					
US Treasury and government agencies	\$ 31	\$ 3,535	\$ 3,831	\$ 452	\$ 7,849
Residential mortgage-backed					
Agency		26	1,019	18,940	19,985
Non-agency			44	8,949	8,993
Commercial mortgage-backed					
Agency		221	1,048	24	1,293
Non-agency		59		1,698	1,757
Asset-backed		146	296	1,343	1,785
State and municipal	41	175	170	947	1,333
Other debt	6	2,565	274	199	3,044
Total debt securities available for sale	\$ 78	\$ 6,727	\$ 6,682	\$ 32,552	\$ 46,039
Fair value	\$ 80	\$ 6,877	\$ 6,943	\$ 31,458	\$ 45,358
Weighted-average yield, GAAP basis	3.35%	2.81%	3.52%	4.52%	4.12%
<b>SECURITIES HELD TO MATURITY</b>					
Commercial mortgage-backed (non-agency)		\$ 218	\$ 71	\$ 3,885	\$ 4,174
Asset-backed	\$ 100	2,756	459	369	3,684
Other debt		1	6	2	9
Total debt securities held to maturity	\$ 100	\$ 2,975	\$ 536	\$ 4,256	\$ 7,867
Fair value	\$ 100	\$ 3,075	\$ 550	\$ 4,423	\$ 8,148
Weighted-average yield, GAAP basis	2.20%	2.94%	1.73%	4.93%	3.92%

Based on current interest rates and expected prepayment speeds, the weighted-average expected maturity of mortgage and other asset-backed debt securities were as follows as of June 30, 2010:

**Weighted-Average Expected Maturity of Mortgage and Other Asset-Backed Debt Securities**

	<b>June 30, 2010</b>
Agency mortgage-backed securities	<b>4.0 years</b>
Non-agency mortgage-backed securities	<b>5.7 years</b>
Agency Commercial mortgage-backed securities	<b>6.1 years</b>

Non-agency Commercial mortgage-backed securities	<b>3.5 years</b>
Asset-backed securities	<b>2.8 years</b>

Weighted-average yields are based on historical cost with effective yields weighted for the contractual maturity of each security.

The following table presents the fair value of securities that have been either pledged to or accepted from others to collateralize outstanding borrowings.

*Fair Value of Securities Pledged and Accepted as Collateral*

In millions	June 30, 2010	December 31, 2009
Pledged to others	<b>\$ 25,223</b>	\$ 23,368
Accepted from others:		
Permitted by contract or custom to sell or repledge	<b>2,068</b>	2,357
Permitted amount repledged to others	<b>914</b>	1,283

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The securities pledged to others include positions held in our portfolio of investment securities, trading securities, and securities accepted as collateral from others that we are permitted by contract or custom to sell or repledge, and were used to secure public and trust deposits, repurchase agreements, and for other purposes. The securities accepted from others that we are permitted by contract or custom to sell or repledge are a component of Federal funds sold and resale agreements on our Consolidated Balance Sheet.

***NOTE 8 FAIR VALUE*****Fair Value Measurement**

Fair value is defined in GAAP as the price that would be received to sell an asset or the price paid to transfer a liability on the measurement date. The standard focuses on the exit price in the principal or most advantageous market for the asset or liability in an orderly transaction between willing market participants. GAAP establishes a fair value reporting hierarchy to maximize the use of observable inputs when measuring fair value and defines the three levels of inputs as noted below.

**Level 1**

Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities may include debt securities, equity securities and listed derivative contracts that are traded in an active exchange market and certain US government agency securities that are actively traded in over-the-counter markets.

**Level 2**

Observable inputs other than Level 1 such as: quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated to observable market data for substantially the full term of the asset or liability. Level 2 assets and liabilities may include debt securities, equity securities and listed derivative contracts with quoted prices that are traded in markets that are not active, and certain debt and equity securities and over-the-counter derivative contracts whose fair value is determined using a pricing model without significant unobservable inputs. This category generally includes agency residential and commercial mortgage-backed debt securities, asset-backed securities, corporate debt securities, residential mortgage loans held for sale, and derivative contracts.

**Level 3**

Unobservable inputs that are supported by minimal or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities may include financial instruments whose value is determined using pricing models with internally developed assumptions, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain available for sale and trading securities, commercial mortgage loans held for sale, private equity investments, residential mortgage servicing rights, BlackRock Series C Preferred Stock and certain

financial derivative contracts. The available for sale and trading securities within Level 3 include non-agency residential mortgage-backed securities, auction rate securities, certain private-issuer asset-backed securities and corporate debt securities. Nonrecurring items, primarily certain nonaccrual and other loans held for sale, commercial mortgage servicing rights, equity investments and other assets are also included in this category.

We characterize active markets as those where transaction volumes are sufficient to provide objective pricing information, with reasonably narrow bid/ask spreads and where dealer quotes received do not vary widely and are based on current information. Inactive markets are typically characterized by low transaction volumes, price quotations which vary substantially among market participants or are not based on current information, wide bid/ask spreads, a significant increase in implied liquidity risk premiums, yields, or performance indicators for observed transactions or quoted prices compared to historical periods, a significant decline or absence of a market for new issuance, or any combination of the above factors. We also consider nonperformance risks including credit risk as part of our valuation methodology for all assets and liabilities measured at fair value.

Any models used to determine fair values or to validate dealer quotes based on the descriptions below are subject to review and independent testing as part of our model validation and internal control testing processes. Our Model Validation Committee tests significant models on at least an annual basis. In addition, we have teams, independent of the traders, verify marks and assumptions used for valuations at each period end.

***Securities Available for Sale and Trading Securities***

Securities measured at fair value include both the available for sale and trading portfolios. We use prices obtained from pricing services, dealer quotes or recent trades to determine the fair value of securities. For 55% of our positions, we use prices obtained from pricing services provided by the Barclay's Capital Index and Interactive Data Corp. (IDC). For 16% of our positions, we use prices obtained from the pricing services as the primary input into the valuation process. Barclay's Capital Index prices are set with reference to market activity for highly liquid assets such as agency mortgage-backed securities, and matrix pricing for other assets, such as CMBS and asset-backed securities. IDC primarily uses pricing models considering adjustments for ratings, spreads, matrix pricing and prepayments for the instruments we value using this service, such as non-agency residential mortgage-backed

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securities, agency adjustable rate mortgage securities, agency CMOs and municipal bonds. Dealer quotes received are typically non-binding and corroborated with other dealer or market quotes, by reviewing valuations of comparable instruments, or by comparison to internal valuations. In circumstances where relevant market prices are limited or unavailable, valuations may require significant management judgments or adjustments to determine fair value. In these cases, the securities are classified as Level 3.

The valuation techniques used for securities classified as Level 3 include using a discounted cash flow approach or, in certain instances, identifying a proxy security, market transaction or index. For certain security types, primarily non-agency residential securities, the fair value methodology incorporates values obtained from a discounted cash flow model. The modeling process incorporates assumptions management believes willing market participants would use to value the security under current market conditions. The assumptions used include prepayment projections, credit loss assumptions, and discount rates, which include a risk premium due to liquidity and uncertainty that are based on both observable and unobservable inputs. We use the discounted cash flow analysis, in conjunction with other relevant pricing information obtained from either pricing services or broker quotes to establish the fair value that management believes is representative under current market conditions. For purposes of determining fair value at June 30, 2010, the relevant pricing service information was the predominant input.

In the proxy approach, the proxy selected generally has similar credit, tenor, duration, pricing and structuring attributes to the PNC position. The price, market spread, or yield on the proxy is then used to calculate an indicative market price for the security. Depending on the nature of the PNC position and its attributes relative to the proxy, management may make additional adjustments to account for market conditions, liquidity, and nonperformance risk, based on various inputs including recent trades of similar securities, single dealer quotes, and/or other observable and unobservable inputs.

***Financial Derivatives***

Exchange-traded derivatives are valued using quoted market prices and are classified as Level 1. However, the majority of derivatives that we enter into are executed over-the-counter and are valued using internal techniques. Readily observable market inputs to these models can be validated to external sources, including industry pricing services, or corroborated through recent trades, dealer quotes, yield curves, implied volatility or other market-related data. Certain derivatives, such as total rate of return swaps, are corroborated to the CMBX index. These derivatives are classified as Level 2. Derivatives priced using significant management judgment or assumptions are classified as Level 3.

The fair values of our derivatives are adjusted for nonperformance risk including credit risk as appropriate. Our

nonperformance risk adjustment is computed using new loan pricing and considers externally available bond spreads, in conjunction with internal historical recovery observations. The credit risk adjustment is not currently material to the overall derivatives valuation.

***Residential Mortgage Loans Held for Sale***

We have elected to account for certain residential mortgage loans originated for sale on a recurring basis at fair value. At December 31, 2009, all residential mortgage loans held for sale were at fair value. Residential mortgage loans are valued based on quoted market prices, where available, prices for other traded mortgage loans with similar characteristics, and purchase commitments and bid information received from market participants. These loans are regularly traded in active markets and observable pricing information is available from market participants. The prices are adjusted as necessary to include the embedded servicing value in the loans and to take into consideration the specific characteristics of certain loans that are priced based on the pricing of similar loans. These adjustments represent unobservable inputs to the valuation but are not considered significant to the fair value of the loans. Accordingly, residential mortgage loans held for sale are classified as Level 2.

***Residential Mortgage Servicing Rights***

Residential mortgage servicing rights (MSRs) are carried at fair value on a recurring basis. Currently, these residential MSRs do not trade in an active open market with readily observable prices. Although sales of servicing assets do occur, the precise terms and conditions typically would not be available. Accordingly, management determines the fair value of its residential MSRs using a discounted cash flow model incorporating assumptions about loan prepayment rates, discount rates, servicing costs, and other economic factors. As part of the pricing process, management compares its fair value estimates to third-party valuations on a quarterly basis to assess the reasonableness of the fair values calculated by its internal valuation models. Due to the nature of the valuation inputs, residential MSRs are classified as Level 3.

*Commercial Mortgage Loans Held for Sale*

We account for certain commercial mortgage loans classified as held for sale at fair value. The election of the fair value option aligns the accounting for the commercial mortgages with the related hedges. At origination, these loans were intended for securitization.

Due to inactivity in the CMBS securitization market in 2010 and 2009, we determine the fair value of commercial mortgage loans held for sale by using a whole loan methodology. Fair value is determined using assumptions that management believes a market participant would use in pricing the loans. When available, valuation assumptions included observable inputs based on whole loan sales. Adjustments are made to these assumptions to account for situations when uncertainties exist, including market



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conditions and liquidity. Credit risk is included as part of our valuation process for these loans by considering expected rates of return for market participants for similar loans in the marketplace. Based on the significance of unobservable inputs, we classified this portfolio as Level 3.

### ***Equity Investments***

The valuation of direct and indirect private equity investments requires significant management judgment due to the absence of quoted market prices, inherent lack of liquidity and the long-term nature of such investments. The carrying values of direct and affiliated partnership interests reflect the expected exit price and are based on various techniques including publicly traded price, multiples of adjusted earnings of the entity, independent appraisals, anticipated financing and sale transactions with third parties, or the pricing used to value the entity in a recent financing transaction. We value indirect investments in private equity funds based on net asset value as provided in the financial statements that we receive from their managers. Due to the time lag in our receipt of the financial information and based on a review of investments and valuation techniques applied, adjustments to the manager-provided value are made when available recent portfolio company information or market information indicates a significant change in value from that provided by the manager of the fund. These investments are classified as Level 3.

### ***Customer Resale Agreements***

We have elected to account for structured resale agreements, which are economically hedged using free-standing financial derivatives, at fair value. The fair value for structured resale agreements is determined using a model which includes observable market data such as interest rates as inputs. Readily observable market inputs to this model can be validated to external sources, including yield curves, implied volatility or other market-related data. These instruments are classified as Level 2.

### ***BlackRock Series C Preferred Stock***

We have elected to account for the 2.9 million shares of the BlackRock Series C Preferred Stock received in a stock exchange with BlackRock at fair value. The Series C Preferred Stock economically hedges the BlackRock LTIP liability that is accounted for as a derivative. The fair value of the Series C Preferred Stock is determined using a third-party modeling approach, which includes both observable and unobservable inputs. This approach considers expectations of a default/liquidation event and the use of liquidity discounts based on our inability to sell the security at a fair, open market price in a timely manner. Although dividends are equal to common shares and other preferred series, significant transfer restrictions exist on our Series C shares for any purpose other than to satisfy the LTIP obligation. Due to the significance of unobservable inputs, this security is classified as Level 3.

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Assets and liabilities measured at fair value on a recurring basis, including instruments for which PNC has elected the fair value option, follow.

**Fair Value Measurements Summary**

In millions	June 30, 2010			Total Fair Value	December 31, 2009			Total Fair Value
	Level 1	Level 2	Level 3		Level 1	Level 2	Level 3	
<b>Assets</b>								
Securities available for sale								
US Treasury and government agencies	\$ 7,540	\$ 553		\$ 8,093	\$ 7,026	\$ 494		\$ 7,520
Residential mortgage-backed								
Agency		20,579		20,579		24,433	\$ 5	24,438
Non-Agency			\$ 7,635	7,635			8,302	8,302
Commercial mortgage-backed								
Agency		1,342		1,342		1,297		1,297
Non-Agency		1,718		1,718		3,842	6	3,848
Asset-backed		376	1,150	1,526		414	1,254	1,668
State and municipal		1,097	237	1,334		1,084	266	1,350
Other debt		3,049	82	3,131		1,962	53	2,015
Total debt securities	7,540	28,714	9,104	45,358	7,026	33,526	9,886	50,438
Corporate stocks and other	276	169	47	492	230	83	47	360
Total securities available for sale	7,816	28,883	9,151	45,850	7,256	33,609	9,933	50,798
Financial derivatives (a) (b)								
Interest rate contracts	62	6,064	80	6,206	25	3,630	47	3,702
Other contracts		204	5	209	2	209	3	214
Total financial derivatives	62	6,268	85	6,415	27	3,839	50	3,916
Residential mortgage loans held for sale (c)		1,220		1,220		1,012		1,012
Trading securities (d)								
Debt (e)	447	320	73	840	1,690	299	89	2,078
Equity	42			42	46			46
Total trading securities	489	320	73	882	1,736	299	89	2,124
Residential mortgage servicing rights (f)			963	963			1,332	1,332
Commercial mortgage loans held for sale (c)			1,036	1,036			1,050	1,050
Equity investments								
Direct investments			650	650			595	595
Indirect investments (g)			618	618			593	593
Total equity investments			1,268	1,268			1,188	1,188
Customer resale agreements (h)		915		915		990		990
Loans (i)		110		110		107		107
Other assets								
BlackRock Series C Preferred Stock (j)			298	298			486	486
Other		422	7	429		207	23	230
Total other assets		422	305	727		207	509	716
Total assets	\$ 8,367	\$ 38,138	\$ 12,881	\$ 59,386	\$ 9,019	\$ 40,063	\$ 14,151	\$ 63,233
<b>Liabilities</b>								
Financial derivatives (b) (k)								
Interest rate contracts	\$ 16	\$ 4,515	\$ 51	\$ 4,582	\$ 2	\$ 3,185	\$ 18	\$ 3,205
BlackRock LTIP			298	298			486	486
Other contracts		151	6	157		146	2	148
Total financial derivatives	16	4,666	355	5,037	2	3,331	506	3,839
Trading securities sold short (l)								
Debt (e)	939			939	1,288	42		1,330
Equity					14			14
Total trading securities sold short	939			939	1,302	42		1,344

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Other liabilities			2		2		6		6
<b>Total liabilities</b>	<b>\$ 955</b>	<b>\$ 4,668</b>	<b>\$ 355</b>	<b>\$ 5,978</b>	<b>\$ 1,304</b>	<b>\$ 3,379</b>	<b>\$ 506</b>	<b>\$ 5,189</b>	

(a) Included in Other assets on our Consolidated Balance Sheet.

(b) Amounts at June 30, 2010 and December 31, 2009 are presented gross and are not reduced by the impact of legally enforceable master netting agreements that allow PNC to net positive and negative positions and cash collateral held or placed with the same counterparty. At June 30, 2010 and December 31, 2009, respectively, the net asset amounts were \$3.163 billion and \$2.047 billion and the net liability amounts were \$2.078 billion and \$1.733 billion.

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- (c) Included in Loans held for sale on our Consolidated Balance Sheet. PNC has elected the fair value option for certain commercial and residential mortgage loans held for sale.
- (d) Fair value includes net unrealized gains of \$4 million at June 30, 2010 and \$9 million at December 31, 2009.
- (e) Comprised primarily of US Treasury and government agencies securities.
- (f) Included in Other intangible assets on our Consolidated Balance Sheet.
- (g) The indirect equity funds are not redeemable, but PNC receives distributions over the life of the partnership from liquidation of the underlying investments by the investee.
- (h) Included in Federal funds sold and resale agreements on our Consolidated Balance Sheet. PNC has elected the fair value option for these items.
- (i) Included in Loans on our Consolidated Balance Sheet. PNC has elected the fair value option for residential mortgage loans originated for sale. Certain of these loans have been subsequently reclassified into portfolio loans.
- (j) PNC has elected the fair value option for these shares.
- (k) Included in Other liabilities on our Consolidated Balance Sheet.
- (l) Included in Other borrowed funds on our Consolidated Balance Sheet.

Reconciliations of assets and liabilities measured at fair value on a recurring basis using Level 3 inputs for the three months and six months ended June 30, 2010 and 2009 follow.

**Three Months Ended June 30, 2010**

Level 3 Instruments Only	March 31, 2010		Total realized / unrealized gains or losses (a)		Purchases, issuances, and settlements, net	Transfers into Level 3 (b)	Transfers out of Level 3 (b)	June 30, 2010		(*) Attributable to unrealized gains or losses related to assets and liabilities held at June 30, 2010
	In millions	Included in comprehensive earnings (*)	Included in other income							
<b>Assets</b>										
Securities available for sale										
Residential mortgage-backed non-agency	\$ 7,710	\$ (81)	\$ 57	\$ (49)			\$ (2)	\$ 7,635	\$ (81)	
Commercial mortgage-backed non-agency		3					(3)			
Asset-backed	1,187	(10)	19	(46)				1,150	(10)	
State and municipal	272	5	(11)	(29)				237		
Other debt	83		1	(2)				82		
Corporate stocks and other	47							47		
Total securities available for sale	9,302	(86)	66	(126)			(5)	9,151	(91)	
Financial derivatives	86	6		(7)				85	58	
Trading securities Debt	77	1		(5)				73		
Residential mortgage servicing rights	1,271	(288)		(20)				963	(291)	
Commercial mortgage loans held for sale	1,041	13		(18)				1,036	14	
Equity investments										
Direct investments	602	63		(15)				650	58	
Indirect investments	606	24		(12)				618	22	
Total equity investments	1,208	87		(27)				1,268	80	
Other assets										
BlackRock Series C Preferred Stock	452	(154)						298		
Other	9		(1)	(1)				7		
Total other assets	461	(154)	(1)	(1)				305		
Total assets	\$ 13,446	\$ (421)	\$ 65	\$ (204)			\$ (5)	\$ 12,881	\$ (230)	
Total liabilities (c)	\$ 494	\$ (159)		\$ 19	\$ 1			\$ 355	\$ 50	



**Table of Contents****Three Months Ended June 30, 2009**

Level 3 Instruments Only	March 31, 2009	Total realized / unrealized gains or losses (a)		Purchases, issuances, and settlements, net	Transfers into Level 3, net (b)	June 30, 2009	(*) Attributable to unrealized gains or losses related to assets and liabilities held at June 30, 2009
		Included in earnings (*)	Included in other comprehensive income				
In millions							
<b>Assets</b>							
Securities available for sale							
Residential mortgage-backed agency	\$ 6		\$ (1)			\$ 5	
Residential mortgage-backed non-agency	9,281	\$(131)	103	\$(239)		9,014	\$(131)
Commercial mortgage-backed non-agency	3,428	(1)	274	(43)		3,658	(1)
Asset-backed	1,319	(23)	(79)	(5)		1,212	(23)
State and municipal	291		1	(16)		276	
Other debt	51			2		53	
Corporate stocks and other	53		(3)			50	
Total securities available for sale	14,429	(155)	295	(301)		14,268	(155)
Financial derivatives	175	(52)		1	\$ 1	125	(50)
Trading securities							
Debt	87	3		12	(5)	97	3
Equity	25	3		3	(2)	29	1
Total trading securities	112	6		15	(7)	126	4
Residential mortgage servicing rights	1,052	417		(10)		1,459	408
Commercial mortgage loans held for sale	1,245	(20)		(46)		1,179	(19)
Equity investments	1,135	(14)		40	(1)	1,160	(6)
Other assets							
BlackRock Series C Preferred Stock	272	95				367	95
Other	38	2	(1)	(1)		38	2
Total other assets	310	97	(1)	(1)		405	97
Total assets	\$ 18,458	\$ 279	\$ 294	\$ (302)	\$ (7)	\$ 18,722	\$ 279
Total liabilities (c)	\$ 312	\$ 94	\$ 7	\$ 1		\$ 414	\$ 94

(a) Losses for assets are bracketed while losses for liabilities are not.

(b) PNC's policy is to recognize transfers in and transfers out as of the end of the reporting period.

(c) Financial derivatives.

**Table of Contents***Six Months Ended June 30, 2010*

Level 3 Instruments Only	December 31, 2009	Total realized / unrealized gains or losses (a)		Purchases, issuances, and settlements, net	Transfers		June 30, 2010	(*) Attributable to unrealized gains or losses related to assets and liabilities held at June 30, 2010	
		Included in earnings (*)	Included in other comprehensive income		into Level 3 (b)	out of Level 3 (b)			
In millions									
<b>Assets</b>									
Securities available for sale									
Residential mortgage-backed agency	\$ 5			\$ (5)					
Residential mortgage-backed non-agency	8,302	\$(182)	\$ (20)	(463)		\$ (2)	\$ 7,635	\$ (154)	
Commercial mortgage-backed non-agency	6					\$ 2	(8)		
Asset-backed	1,254	(53)	32	(83)			1,150	(53)	
State and municipal	266	5	(17)	(18)		1	237		
Other debt	53		4	(4)		29	82		
Corporate stocks and other	47		(1)	1			47		
Total securities available for sale	9,933	(230)	(2)	(572)		32	(10)	9,151	(207)
Financial derivatives	50	42		(7)				85	76
Trading securities Debt	89	(3)		(13)				73	(4)
Residential mortgage servicing rights	1,332	(323)		(46)				963	(324)
Commercial mortgage loans held for sale	1,050	22		(36)				1,036	20
<b>Equity investments</b>									
Direct investments	595	88		(33)				650	73
Indirect investments	593	41		(16)				618	33
Total equity investments	1,188	129		(49)				1,268	106
<b>Other assets</b>									
BlackRock Series C Preferred Stock	486	(184)		(4)				298	
Other	23		(4)	(12)				7	
Total other assets	509	(184)	(4)	(16)				305	
Total assets	\$ 14,151	\$(547)	\$ (6)	\$(739)	\$ 32	\$ (10)	\$ 12,881	\$ (333)	
Total liabilities (c)	\$ 506	\$(173)		\$ 21	\$ 1		\$ 355	\$ 48	

**Table of Contents***Six Months Ended June 30, 2009*

Level 3 Instruments Only	Dec. 31, 2008	National City Acquisition	Balance, January 1, 2009	Included in earnings (*)	Total realized / unrealized gains or losses (a)	Included in other comprehensive income	Purchases, issuances, and settlements, net	Transfers into Level 3, net (b)	June 30, 2009	(*) Attributable to unrealized gains or losses related to assets and liabilities held at June 30, 2009
<b>Assets</b>										
Securities available for sale										
Residential mortgage-backed agency		\$ 7	\$ 7			\$ (2)			\$ 5	
Residential mortgage-backed non-agency	\$ 3,304	899	4,203	\$ (248)	583	\$ (214)	\$ 4,690	9,014	\$ (248)	
Commercial mortgage-backed non-agency	337		337	(6)	325	(44)	3,046	3,658	(6)	
Asset-backed	833	59	892	(42)	(92)	(12)	466	1,212	(42)	
State and municipal	271	50	321		3	(22)	(26)	276		
Other debt	34	48	82	(3)	(3)	(23)		53	(3)	
Corporate stocks and other	58		58		(6)	(2)		50		
Total securities available for sale	4,837	1,063	5,900	(299)	808	(317)	8,176	14,268	(299)	
Financial derivatives	125	35	160	110		(149)	4	125	9	
Trading securities										
Debt	56	26	82	(2)			22	(5)	97	2
Equity	17	6	23	1			3	2	29	(2)
Total trading securities	73	32	105	(1)			25	(3)	126	
Residential mortgage servicing rights	6	1,019	1,025	419			15		1,459	403
Commercial mortgage loans held for sale	1,400	1	1,401	(78)		(144)			1,179	(72)
Equity investments	571	610	1,181	(79)		59	(1)	1,160	(74)	
Other assets										
BlackRock Series C Preferred Stock				156			211		367	156
Other		40	40	11	(12)	(1)			38	11
Total other assets		40	40	167	(12)	210			405	167
Total assets	\$ 7,012	\$ 2,800	\$ 9,812	\$ 239	\$ 796	\$ (301)	\$ 8,176	\$ 18,722	\$ 134	
Total liabilities (c)	\$ 22	\$ 16	\$ 38	\$ 155	\$ 1	\$ 220		\$ 414	\$ 158	

(a) Losses for assets are bracketed while losses for liabilities are not.

(b) PNC's policy is to recognize transfers in and transfers out as of the end of the reporting period.

(c) Financial derivatives.

Net losses (realized and unrealized) included in earnings relating to Level 3 assets and liabilities were \$374 million for the first six months of 2010 compared with net gains of \$84 million for the first six months of 2009. The net losses (realized and unrealized) for the second quarter of 2010 were \$262 million compared with net gains of \$185 million for the second quarter of 2009. These amounts included net unrealized losses of \$381 million and \$280 million, respectively, for the 2010 periods. The comparable amounts for the 2009 periods were net unrealized losses of \$24 million and net unrealized gains of \$185 million, respectively. These amounts were included in noninterest income on the Consolidated Income Statement.

During the first six months of 2010, no material transfers of assets or liabilities between the hierarchy levels occurred.



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During the first six months of 2009, securities transferred into Level 3 from Level 2 exceeded securities transferred out by \$8.2 billion. These primarily related to non-agency residential

and commercial mortgage-backed securities where management determined that the volume and level of market activity for these assets had significantly decreased. Other Level 3 assets include commercial mortgage loans held for sale, certain equity securities, auction rate securities, corporate debt securities, certain private-issuer asset-backed securities, private equity investments, certain derivative instruments, residential mortgage servicing rights and other assets.

Interest income earned from trading securities totaled \$25 million in both the first six months of 2010 and 2009. For the second quarter of 2010 and 2009, interest income related to trading securities totaled \$11 million and \$15 million, respectively. These amounts are included in other interest income on the Consolidated Income Statement.

### Nonrecurring Fair Value Changes

We may be required to measure certain other financial assets at fair value on a nonrecurring basis. These adjustments to fair value usually result from the application of

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lower-of-cost-or-fair value accounting or write-downs of individual assets due to impairment. The amounts below for nonaccrual loans represent the carrying value of loans for which adjustments are primarily based on the appraised value of collateral or the net book value of the asset from its most recent financial statements if no appraisal is available. If the net book value is utilized, LGD collateral recovery rates are employed, by collateral type, in calculating disposition costs to arrive at an adjusted fair value. If an appraisal is outdated due to changed project or market conditions, values based on the LGD recovery rates are used pending receipt of an updated appraisal. The amounts below for loans held for sale represent the carrying value of loans for which adjustments are primarily based on the appraised value of collateral or based on an observable market price, which often results in significant management assumptions

and input with respect to the determination of fair value. The fair value determination of the equity investment resulting in an impairment loss included below was based on observable market data for other comparable entities as adjusted for internal assumptions and unobservable inputs. The amounts below for commercial mortgage servicing rights reflect an impairment of one stratum at June 30, 2010 while no strata were impaired at December 31, 2009 and June 30, 2009. The fair value of commercial mortgage servicing rights is estimated by using an internal valuation model. The model calculates the present value of estimated future net servicing cash flows considering estimates of servicing revenue and costs, discount rates and prepayment speeds. Annually, this model is subject to an internal review process to validate controls and model results.

**Fair Value Measurements Nonrecurring (a)**

In millions	Fair Value		Gains (Losses)		Gains (Losses)	
	June 30	December 31	Three months ended	June 30	Six months ended	June 30
	2010	2009	June 30	2009	June 30	2009
<b>Assets</b>						
Nonaccrual loans	\$ 922	\$ 939	\$ 26	\$ (181)		\$ (249)
Loans held for sale	178	168	(78)	3	\$ (78)	(2)
Equity investments (b)	7	154		(12)		(55)
Commercial mortgage servicing rights (c)	195		(14)		(18)	
Other intangible assets	1	1				
Foreclosed and other assets	201	108	(35)	(24)	(58)	(40)
Long-lived assets held for sale	19	30	(4)	(1)	(13)	(1)
<b>Total assets</b>	<b>\$ 1,523</b>	<b>\$ 1,400</b>	<b>\$ (105)</b>	<b>\$ (215)</b>	<b>\$ (167)</b>	<b>\$ (347)</b>

(a) All Level 3 except \$2 million and \$5 million in loans held for sale which were Level 2 at June 30, 2010 and December 31, 2009, respectively.

(b) Includes LIHTC and other equity investments.

(c) One stratum at fair value at June 30, 2010 and no strata at fair value at December 31, 2009. During the first half of 2009, we recorded a \$35 million recovery of previous impairment on commercial mortgage servicing rights. Refer to Note 9 Goodwill and Other Intangible Assets for additional information.

**Fair Value Option**

Refer to the Fair Value Measurement section of this Note 8 regarding the fair value of commercial mortgage loans held for sale, residential mortgage loans held for sale, customer resale agreements, and BlackRock Series C Preferred Stock.

**Commercial Mortgage Loans Held for Sale**

Interest income on these loans is recorded as earned and reported on the Consolidated Income Statement in other interest income. The impact on earnings of offsetting economic hedges is not reflected in these amounts. Changes in fair value due to instrument-specific credit risk for both the second quarter and first six months of 2010 and the second quarter and first six months of

2009 were not material. The changes in fair value of these loans were partially offset by changes in the fair value of the related financial derivatives that economically hedged these loans.

Residential Mortgage Loans Held for Sale

Throughout 2010 and 2009, certain residential mortgage loans for which we elected the fair value option were subsequently reclassified to portfolio loans. Changes in fair value due to instrument-specific credit risk for the second quarter and first six months of 2010 and the second quarter and first six months of 2009 were not material.

Customer Resale Agreements

Interest income on structured resale agreements is reported on the Consolidated Income Statement in other interest income. Changes in fair value due to instrument-specific credit risk for both the second quarter and first six months of 2010 and the second quarter and first six months of 2009 were not material.

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The changes in fair value included in noninterest income for items for which we elected the fair value option follow.

**Fair Value Option Changes in Fair Value (a)**

In millions	Gains (Losses)		Gains (Losses)	
	Three months ended		Six months ended	
	June 30 2010	June 30 2009	June 30 2010	June 30 2009
<b>Assets</b>				
Customer resale agreements	\$ 7	\$ (18)	\$ 8	\$ (25)
Commercial mortgage loans held for sale	13	(20)	22	(78)
Residential mortgage loans held for sale	94	129	140	248
Residential mortgage loans portfolio	1	(1)	3	(4)
BlackRock Series C Preferred Stock	(154)	95	(184)	156

(a) The impact on earnings of offsetting hedged items or hedging instruments is not reflected in these amounts.

Fair values and aggregate unpaid principal balances of items for which we elected the fair value option follow.

**Fair Value Option Fair Value and Principal Balances**

In millions	Fair Value	Aggregate Unpaid Principal Balance	Difference
<b>June 30, 2010</b>			
Customer resale agreements	\$ 915	\$ 845	\$ 70
Residential mortgage loans held for sale			
Performing loans	1,199	1,176	23
Loans 90 days or more past due	20	28	(8)
Nonaccrual loans	1	5	(4)
Total	1,220	1,209	11
Commercial mortgage loans held for sale (a)			
Performing loans	1,010	1,192	(182)
Nonaccrual loans	26	40	(14)
Total	1,036	1,232	(196)
Residential mortgage loans portfolio			
Performing loans	35	37	(2)
Loans 90 days or more past due	56	57	(1)
Nonaccrual loans	18	31	(13)
Total	\$ 109	\$ 125	\$ (16)
<b>December 31, 2009</b>			
Customer resale agreements	\$ 990	\$ 925	\$ 65
Residential mortgage loans held for sale			
Performing loans	971	977	(6)
Loans 90 days or more past due	40	50	(10)
Nonaccrual loans	1	9	(8)
Total	1,012	1,036	(24)
Commercial mortgage loans held for sale (a)			
Performing loans	1,023	1,235	(212)
Nonaccrual loans	27	41	(14)
Total	1,050	1,276	(226)
Residential mortgage loans portfolio			
Performing loans	25	27	(2)
Loans 90 days or more past due	51	54	(3)

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Nonaccrual loans	12	23	(11)
Total	\$ 88	\$ 104	\$ (16)

(a) There were no loans 90 days or more past due within this category at June 30, 2010 or December 31, 2009.

**Table of Contents****ADDITIONAL FAIR VALUE INFORMATION RELATED TO FINANCIAL INSTRUMENTS**

In millions	June 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Assets</b>				
Cash and short-term assets	\$ 12,132	\$ 12,132	\$ 12,248	\$ 12,248
Trading securities	882	882	2,124	2,124
Investment securities	53,717	53,998	56,027	56,319
Loans held for sale	2,756	2,746	2,539	2,597
Net loans (excludes leases)	142,377	142,785	146,270	145,014
Other assets	4,445	4,445	4,883	4,883
Mortgage and other loan servicing rights	1,685	1,703	2,253	2,352
<b>Financial derivatives</b>				
Designated as hedging instruments under GAAP	1,540	1,540	739	739
Not designated as hedging instruments under GAAP	4,875	4,875	3,177	3,177
<b>Liabilities</b>				
Demand, savings and money market deposits	132,786	132,786	132,645	132,645
Time deposits	46,013	45,676	54,277	54,534
Borrowed funds	40,777	39,848	39,621	39,977
<b>Financial derivatives</b>				
Designated as hedging instruments under GAAP	29	29	95	95
Not designated as hedging instruments under GAAP	5,008	5,008	3,744	3,744
Unfunded loan commitments and letters of credit	207	207	290	290

The aggregate fair values in the table above do not represent the total market value of PNC's assets and liabilities as the table excludes the following:

- real and personal property,
- lease financing,
- loan customer relationships,
- deposit customer intangibles,
- retail branch networks,
- fee-based businesses, such as asset management and brokerage, and
- trademarks and brand names.

We used the following methods and assumptions to estimate fair value amounts for financial instruments.

**GENERAL**

For short-term financial instruments realizable in three months or less, the carrying amount reported on our Consolidated Balance Sheet approximates fair value. Unless otherwise stated, the rates used in discounted cash flow analyses are based on market yield curves.

**CASH AND SHORT-TERM ASSETS**

The carrying amounts reported on our Consolidated Balance Sheet for cash and short-term investments approximate fair values primarily due to their short-term nature. For purposes of this disclosure only, short-term assets include the following:

- due from banks,
- interest-earning deposits with banks,
- federal funds sold and resale agreements,

cash collateral (excluding cash collateral netted against derivative fair values),  
customers' acceptance liability, and  
accrued interest receivable.

*SECURITIES*

Securities include both the investment securities and trading portfolios. We use prices obtained from pricing services, dealer quotes or recent trades to determine the fair value of securities. For 55% of our positions, we use prices obtained from pricing services provided by the Barclays Capital Index and Interactive Data Corp. (IDC). For 16% of our positions, we use prices obtained from the pricing services as the primary input into the valuation process. Barclays Capital Index prices are set with reference to market activity for highly liquid assets such as agency mortgage-backed securities, and matrix pricing for other assets, such as CMBS and asset-backed securities. IDC primarily uses pricing models considering adjustments for ratings, spreads, matrix pricing and prepayments for the instruments we value using this service, such as non-agency residential mortgage-backed securities, agency adjustable rate mortgage securities, agency CMOs and municipal bonds. Dealer quotes received are typically non-binding and corroborated with other dealers' quotes, by reviewing valuations of comparable instruments, or by comparison to internal valuations.

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***NET LOANS AND LOANS HELD FOR SALE***

Fair values are estimated based on the discounted value of expected net cash flows incorporating assumptions about prepayment rates, net credit losses and servicing fees. For revolving home equity loans and commercial credit lines, this fair value does not include any amount for new loans or the related fees that will be generated from the existing customer relationships. Non-accrual loans are valued at their estimated recovery value. Also refer to the Fair Value Measurement and Fair Value Option sections of this Note 8 regarding the fair value of commercial and residential mortgage loans held for sale. Loans are presented net of the allowance for loan and lease losses and do not include future accretable discounts related to purchased impaired loans.

***OTHER ASSETS***

Other assets as shown in the accompanying table include the following:

- noncertificated interest-only strips,
- FHLB and FRB stock,
- equity investments carried at cost and fair value, and
- private equity investments carried at fair value.

Investments accounted for under the equity method, including our investment in BlackRock, are not included in the accompanying table.

The carrying amounts of private equity investments are recorded at fair value. The valuation procedures applied to direct investments include techniques such as multiples of adjusted earnings of the entity, independent appraisals, anticipated financing and sales transactions with third parties, or the pricing used to value the entity in a recent financing transaction. We value indirect investments in private equity funds based on net asset value as provided in the financial statements that we receive from their managers. Due to the time lag in our receipt of the financial information and based on a review of investments and valuation techniques applied, adjustments to the manager-provided value are made when available recent investment portfolio company or market information indicates a significant change in value from that provided by the general partner.

Fair value of the noncertificated interest-only strips is estimated based on the discounted value of expected net cash flows. The aggregate carrying value of our equity investments carried at cost and FHLB and FRB stock was \$2.5 billion at June 30, 2010 and \$2.6 billion as of December 31, 2009, both of which approximate fair value at each date.

***MORTGAGE AND OTHER LOAN SERVICING ASSETS***

Fair value is based on the present value of the estimated future cash flows, incorporating assumptions as to prepayment speeds, discount rates, escrow balances, interest rates, cost to service and other factors. We have controls in place intended to ensure that our fair values are appropriate. An independent model review group reviews our valuation models and validates them for their intended use.

The key valuation assumptions for commercial and residential mortgage loan servicing assets at June 30, 2010 and December 31, 2009 are included in Note 9 Goodwill and Other Intangible Assets.

***CUSTOMER RESALE AGREEMENTS***

Refer to the Fair Value Measurement section of this Note 8 regarding the fair value of customer resale agreements.

***DEPOSITS***

The carrying amounts of noninterest-bearing demand and interest-bearing money market and savings deposits approximate fair values. For time deposits, which include foreign deposits, fair values are estimated based on the discounted value of expected net cash flows assuming current interest rates.

***BORROWED FUNDS***



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The carrying amounts of Federal funds purchased, commercial paper, repurchase agreements, proprietary trading short positions, cash collateral (excluding cash collateral netted against derivative fair values), other short-term borrowings, acceptances outstanding and accrued interest payable are considered to be their fair value because of their short-term nature. For all other borrowed funds, fair values are estimated primarily based on dealer quotes.

### *UNFUNDED LOAN COMMITMENTS AND LETTERS OF CREDIT*

The fair value of unfunded loan commitments and letters of credit is our estimate of the cost to terminate them. For purposes of this disclosure, this fair value is the sum of the deferred fees currently recorded by us on these facilities and the liability established on these facilities related to their creditworthiness.

### *FINANCIAL DERIVATIVES*

For exchange-traded contracts, fair value is based on quoted market prices. For nonexchange-traded contracts, fair value is based on dealer quotes, pricing models or quoted prices for instruments with similar characteristics. Amounts for financial derivatives are presented on a gross basis.

**Table of Contents****NOTE 9 GOODWILL AND OTHER INTANGIBLE ASSETS**

Changes in goodwill by business segment during the first six months of 2010 follow:

**Changes in Goodwill by Business Segment (a)**

In millions	Asset						Total
	Retail Banking	Corporate & Institutional Banking	Management Group	Black-Rock	Residential Mortgage Banking	Other (b)	
January 1, 2010	\$ 5,369	\$ 2,756	\$ 68	\$ 26	\$ 43	\$ 1,243	\$ 9,505
Acquisition-related	(51)	(17)	(4)			(10)	(82)
BlackRock				(13)			(13)
<b>June 30, 2010</b>	<b>\$ 5,318</b>	<b>\$ 2,739</b>	<b>\$ 64</b>	<b>\$ 13</b>	<b>\$ 43</b>	<b>\$ 1,233</b>	<b>\$ 9,410</b>

(a) The Distressed Assets Portfolio business segment does not have any goodwill allocated to it.

(b) Represents goodwill related to GIS, which is no longer a reportable business segment. This goodwill was eliminated with the sale of GIS on July 1, 2010.

Changes in goodwill and other intangible assets during the first six months of 2010 follow:

**Summary of Changes in Goodwill and Other Intangible Assets**

In millions	Goodwill	Customer-Related	Servicing Rights
January 1, 2010	\$ 9,505	\$ 1,145	\$ 2,259
Additions/adjustments:			
Acquisition-related	(82)		
Mortgage and other loan servicing rights			(321)
BlackRock	(13)		
Sale of servicing rights			(192)
Impairment charge			(18)
Amortization		(106)	(39)
<b>June 30, 2010</b>	<b>\$ 9,410</b>	<b>\$ 1,039</b>	<b>\$ 1,689</b>

Assets and liabilities of acquired entities are recorded at estimated fair value as of the acquisition date and are subject to refinement as information relative to the fair values at the date of acquisition becomes available.

Our investment in BlackRock changes when BlackRock repurchases its shares in the open market or issues shares for an acquisition or pursuant to its employee compensation plans. We adjust goodwill when BlackRock repurchases its shares at an amount greater (or less) than book value per share which results in an increase (or decrease) in our percentage ownership interest.

The gross carrying amount, accumulated amortization and net carrying amount of other intangible assets by major category consisted of the following:

**Other Intangible Assets**

	<b>June 30</b>	December 31
In millions	<b>2010</b>	2009
<b>Customer-related and other intangibles</b>		
Gross carrying amount	<b>\$ 1,741</b>	\$ 1,742
Accumulated amortization	<b>(702)</b>	(597)
Net carrying amount	<b>\$ 1,039</b>	\$ 1,145
<b>Mortgage and other loan servicing rights</b>		
Gross carrying amount	<b>\$ 2,188</b>	\$ 2,729
Valuation allowance	<b>(18)</b>	
Accumulated amortization	<b>(481)</b>	(470)
Net carrying amount	<b>\$ 1,689</b>	\$ 2,259
<b>Total</b>	<b>\$ 2,728</b>	\$ 3,404

While certain of our other intangible assets have finite lives and are amortized primarily on a straight-line basis, certain core deposit intangibles are amortized on an accelerated basis.

For customer-related and other intangibles, the estimated remaining useful lives range from less than one year to 11 years, with a weighted-average remaining useful life of 10 years.

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Amortization expense on existing intangible assets, net of impairment reversal (charge) follows:

**Amortization Expense on Existing Intangible Assets**

In millions

<b>Six months ended June 30, 2010 (a)</b>	<b>\$ 125</b>
Six months ended June 30, 2009 (a)	146
Remainder of 2010	127
2011	242
2012	216
2013	211
2014	193
2015	176

(a) Amortization expense on intangible assets is net of impairment reversal (charge).

Changes in commercial mortgage servicing rights follow:

**Commercial Mortgage Servicing Rights**

In millions	2010	2009
January 1	<b>\$ 921</b>	\$ 864
Additions	<b>48</b>	60
Acquisition adjustment		(7)
Sale of servicing rights	<b>(192)</b>	
Impairment (charge) reversal	<b>(18)</b>	35
Amortization expense	<b>(37)</b>	(57)
June 30	<b>\$ 722</b>	\$ 895

We recognize as an other intangible asset the right to service mortgage loans for others. Commercial mortgage servicing rights are purchased in the open market and originated when loans are sold with servicing retained. Commercial mortgage servicing rights are initially recorded at fair value. These rights are subsequently measured using the amortization method. Accordingly, the commercial mortgage servicing rights are substantially amortized in proportion to and over the period of estimated net servicing income over a period of 5 to 10 years.

Commercial mortgage servicing rights are periodically evaluated for impairment. For purposes of impairment, the commercial mortgage servicing rights are stratified based on asset type, which characterizes the predominant risk of the underlying financial asset. If the carrying amount of any individual stratum exceeds its fair value, a valuation reserve is established with a corresponding charge to Corporate Services on our Consolidated Income Statement.

The fair value of commercial mortgage servicing rights is estimated by using an internal valuation model. The model calculates the present value of estimated future net servicing cash flows considering estimates on servicing revenue and costs, discount rates and prepayment speeds.

Changes in the residential mortgage servicing rights follow:

**Residential Mortgage Servicing Rights**

In millions	2010	2009
January 1	<b>\$ 1,332</b>	\$ 1,008

Additions:		
From loans sold with servicing retained	42	173
Changes in fair value due to:		
Time and payoffs (a)	(88)	(158)
Purchase accounting adjustments		17
Other (b)	(323)	419
June 30	\$ 963	\$ 1,459
Unpaid principal balance of loans serviced for others at June 30	\$ 137,399	\$ 161,849

(a) Represents decrease in mortgage servicing rights value due to passage of time, including the impact from both regularly scheduled loan principal payments and loans that paid down or paid off during the period.

(b) Represents mortgage servicing rights value changes resulting primarily from market-driven changes in interest rates.

We recognize mortgage servicing right assets on residential real estate loans when we retain the obligation to service these loans upon sale and the servicing fee is more than adequate compensation. Mortgage servicing rights are subject to declines in value principally from actual or expected prepayment of the underlying loans and defaults. We manage this risk by economically hedging the fair value of mortgage servicing rights with securities and derivative instruments which are expected to increase in value when the value of mortgage servicing rights declines.

The fair value of residential mortgage servicing rights is estimated by using third party software with internal valuation assumptions. The software calculates the present value of estimated future net servicing cash flows considering estimates on servicing revenue and costs, discount rates, prepayment speeds and future mortgage rates.

The fair value of residential and commercial MSRs and significant inputs to the valuation model as of June 30, 2010 are shown in the tables below. The expected and actual rates of mortgage loan prepayments are the most significant factors driving the fair value. Management uses internal proprietary models to estimate future loan prepayments. These models use empirical data drawn from the historical performance of our managed portfolio, as adjusted for current market conditions. Future interest rates are another important factor in the valuation of MSRs. Consistent with the pricing of capital market instruments, management utilizes market implied forward interest rates to estimate the future direction of mortgage and discount rates. Changes in the shape and slope of the forward curve in future periods may result in volatility in the fair value estimate.

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A sensitivity analysis of the hypothetical effect on the fair value of MSR to adverse changes in key assumptions is presented below. These sensitivities do not include the impact of the related hedging activities. Changes in fair value generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the MSR is calculated independently without changing any other assumption. In reality, changes in one factor may result in changes in another (for example, changes in mortgage interest rates, which drive changes in prepayment rate estimates, could result in changes in the interest rate spread), which could either magnify or counteract the sensitivities.

The following tables set forth the fair value of commercial and residential MSR and the sensitivity analysis of the hypothetical effect on the fair value of MSR to immediate adverse changes of 10% and 20% in those assumptions:

**Commercial Mortgage Loan Servicing Assets Key Valuation Assumptions**

Dollars in millions	June 30, 2010	Dec. 31, 2009
Fair value	\$ 740	\$ 1,020
Weighted-average life (years)	7.1	7.8
Weighted-average constant prepayment rate	5%-20%	6%-19%
Decline in fair value from 10% adverse change	\$ 7.3	\$ 9.7
Decline in fair value from 20% adverse change	\$ 14.2	\$ 18.8
Spread over forward interest rate swap rates	6%-9%	7%-9%
Decline in fair value from 10% adverse change	\$ 19.7	\$ 24.6
Decline in fair value from 20% adverse change	\$ 39.3	\$ 49.3

**Residential Mortgage Loan Servicing Assets Key Valuation Assumptions**

Dollars in millions	June 30, 2010	Dec. 31, 2009
Fair value	\$ 963	\$ 1,332
Weighted-average life (years)	3.2	4.5
Weighted-average constant prepayment rate	16.69%	19.92%
Decline in fair value from 10% adverse change	\$ 36	\$ 56
Decline in fair value from 20% adverse change	\$ 68	\$ 109
Spread over forward interest rate swap rates	12.20%	12.16%
Decline in fair value from 10% adverse change	\$ 37	\$ 55
Decline in fair value from 20% adverse change	\$ 72	\$ 106

Revenue from mortgage and other loan servicing comprised of contractually specified servicing fees, late fees, and ancillary fees follows:

**Revenue from Mortgage and Other Loan Servicing**

In millions	2010	2009
Six months ended June 30	\$ 356	\$ 426
Three months ended June 30	174	218

We also generate servicing revenue from fee-based activities provided to others.

Revenue from commercial mortgage servicing rights, residential mortgage servicing rights and other loan servicing are reported on our Consolidated Income Statement in the line items Corporate services, Residential mortgage, and Consumer services, respectively.

***NOTE 10 CAPITAL SECURITIES OF SUBSIDIARY TRUSTS AND PERPETUAL TRUST SECURITIES***

***CAPITAL SECURITIES OF SUBSIDIARY TRUSTS***

Our capital securities of subsidiary trusts are described in Note 14 Capital Securities of Subsidiary Trusts in our 2009 Form 10-K. All of these Trusts are wholly owned finance subsidiaries of PNC. In the event of certain changes or amendments to regulatory requirements or federal tax rules, the capital securities are redeemable. The financial statements of the Trusts are not included in PNC's consolidated financial statements in accordance with GAAP.

The obligations of the respective parent of each Trust, when taken collectively, are the equivalent of a full and unconditional guarantee of the obligations of such Trust under the terms of the capital securities. Such guarantee is subordinate in right of payment in the same manner as other junior subordinated debt. There are certain restrictions on PNC's overall ability to obtain funds from its subsidiaries. For additional disclosure on these funding restrictions, including an explanation of dividend and intercompany loan limitations, see Note 23 Regulatory Matters in our 2009 Form 10-K.

PNC is subject to restrictions on dividends and other provisions similar to or in some ways more restrictive than those potentially imposed under the Exchange Agreements with Trust II and Trust III, as described in Note 3 Variable Interest Entities in our 2009 Form 10-K.

***PERPETUAL TRUST SECURITIES***

We issue certain hybrid capital vehicles that qualify as capital for regulatory purposes.

In February 2008, PNC Preferred Funding LLC (the LLC), one of our indirect subsidiaries, sold \$375 million of 8.700% Fixed-to-Floating Rate Non-Cumulative Exchangeable

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Perpetual Trust Securities of PNC Preferred Funding Trust III (Trust III) to third parties in a private placement. In connection with the private placement, Trust III acquired \$375 million of Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Securities of the LLC (the LLC Preferred Securities). The sale was similar to the March 2007 private placement by the LLC of \$500 million of 6.113% Fixed-to-Floating Rate Non-Cumulative Exchangeable Trust Securities (the Trust II Securities) of PNC Preferred Funding Trust II (Trust II) in which Trust II acquired \$500 million of LLC Preferred Securities and to the December 2006 private placement by PNC REIT Corp. of \$500 million of 6.517% Fixed-to-Floating Rate Non-Cumulative Exchangeable Perpetual Trust Securities (the Trust I Securities) of PNC Preferred Funding Trust I (Trust I) in which Trust I acquired \$500 million of LLC Preferred Securities. PNC REIT Corp. owns 100% of LLC's common voting securities. As a result, LLC is an indirect subsidiary of PNC and is consolidated on our Consolidated Balance Sheet. Trust I, II and III's investment in LLC Preferred Securities is characterized as a noncontrolling interest on our Consolidated Balance Sheet since we are not the primary beneficiary of Trust I, Trust II and Trust III. This noncontrolling interest totaled \$1.3 billion at June 30, 2010.

Our 2009 Form 10-K includes additional information regarding the Trust I and Trust II Securities, including descriptions of replacement capital and dividend restriction covenants. The Trust III Securities include dividend restriction covenants similar to those described for Trust II Securities.

**NOTE 11 CERTAIN EMPLOYEE BENEFIT AND STOCK-BASED COMPENSATION PLANS****PENSION AND POSTRETIREMENT PLANS**

As described in Note 15 Employee Benefit Plans in our 2009 Form 10-K, we have a noncontributory, qualified defined benefit pension plan covering eligible employees. The plan derives benefits from cash balance formulas based on compensation levels, age and length of service. Pension contributions are based on an actuarially determined amount necessary to fund total benefits payable to plan participants.

Effective January 1, 2010, the pension plan has one design for all eligible employees. All new participants on or after January 1, 2010 will receive a fixed earnings credit of 3%. However, participants as of December 31, 2009 will be maintained at the earnings credit level they have attained as of that date going forward. The percentage will not increase in future years.

We also maintain nonqualified supplemental retirement plans for certain employees and provide certain health care and life insurance benefits for qualifying retired employees (postretirement benefits) through various plans. The nonqualified pension and postretirement benefit plans are unfunded. The Company reserves the right to terminate or

make plan changes at any time. Effective January 1, 2010, various benefit plans were amended to provide one plan design for all eligible employees.

The sale of GIS affected GIS participants in the pension and postretirement plans. At closing, all GIS participants were vested in their benefits under the pension plan and their active participation in such plan was terminated. However, certain GIS employees will continue to accrue service towards earning their retiree medical benefit. These changes will not have a significant impact on any of the plans.

The components of our net periodic pension and post-retirement benefit cost for the second quarter and first half of 2010 and 2009 were as follows:

**Net Periodic Pension and Postretirement Benefits Costs**

	Qualified Pension Plan		Nonqualified Retirement Plans		Postretirement Benefits	
Three months ended						
June 30						
In millions	<b>2010</b>	2009	<b>2010</b>	2009	<b>2010</b>	2009



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Net periodic cost consists of:						
Service cost	\$ 28	\$ 22			\$ 1	\$ 1
Interest cost	50	49	\$ 4	\$ 4	5	5
Expected return on plan assets	(71)	(64)				
Amortization of prior service cost	(2)					(1)
Amortization of actuarial losses	8	21	1			
Net periodic cost (benefit)	\$ 13	\$ 28	\$ 5	\$ 4	\$ 6	\$ 5

	Qualified Pension Plan		Nonqualified Retirement Plans		Postretirement Benefits	
Six months ended						
June 30						
In millions	2010	2009	2010	2009	2010	2009
Net periodic cost consists of:						
Service cost	\$ 51	\$ 45	\$ 1	\$ 1	\$ 2	\$ 2
Interest cost	102	103	7	7	10	10
Expected return on plan assets	(143)	(130)				
Amortization of prior service cost	(4)	(1)			(1)	(2)
Amortization of actuarial losses	17	42	2	1		
Net periodic cost (benefit)	\$ 23	\$ 59	\$ 10	\$ 9	\$ 11	\$ 10

**STOCK-BASED COMPENSATION PLANS**

As more fully described in Note 16 Stock-Based Compensation Plans in our 2009 Form 10-K, we have long-term incentive award plans (Incentive Plans) that provide for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, incentive shares/performance units, restricted stock, restricted share

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units, other share-based awards and dollar-denominated awards to executives and, other than incentive stock options, to non-employee directors. Certain Incentive Plan awards may be paid in stock, cash or a combination of stock and cash. We typically grant a substantial portion of our stock-based compensation awards during the first quarter of the year. As of June 30, 2010, no stock appreciation rights were outstanding.

Total compensation expense recognized related to all share-based payment arrangements during the first six months of 2010 and 2009 was \$48 million and \$26 million, respectively.

**NONQUALIFIED STOCK OPTIONS**

Options are granted at exercise prices not less than the market value of common stock on the grant date. Generally, options become exercisable in installments after the grant date. No option may be exercisable after 10 years from its grant date. Payment of the option exercise price may be in cash or shares

of common stock at market value on the exercise date. The exercise price may be paid in previously owned shares.

For purposes of computing stock option expense, we estimated the fair value of stock options primarily by using the Black-Scholes option-pricing model. Option pricing models require the use of numerous assumptions, many of which are very subjective.

**Stock Option Expense Option Pricing Models Assumptions**

Weighted-average for the six months ended

June 30	2010	2009
Risk-free interest rate	2.9%	1.9%
Dividend yield	0.7	3.6
Volatility	32.7	27.2
Expected life	6.0 yrs.	5.6 yrs.
<b>Grant-date fair value</b>	<b>\$ 19.58</b>	<b>\$ 5.56</b>

**Stock Option Information**

	PNC Options					
	PNC		Converted From National City		Total	
	Shares	Weighted-Average	Options	Weighted-Average	Shares	Weighted-Average
		Exercise Price		Exercise Price		Exercise Price
In thousands, except weighted-average data						
Outstanding at December 31, 2009	18,496	\$ 56.10	1,522	\$ 637.64	20,018	\$ 100.32
Granted	2,698	56.79			2,698	56.79
Exercised	(256)	45.83			(256)	45.83
Cancelled	(452)	57.31	(229)	509.42	(681)	209.22
<b>Outstanding at June 30, 2010</b>	<b>20,486</b>	<b>\$ 56.30</b>	<b>1,293</b>	<b>\$ 660.34</b>	<b>21,779</b>	<b>\$ 92.16</b>

**Exercisable at June 30, 2010** **12,608**   **\$ 62.26**   **1,293**   **\$ 660.34**   **13,901**   **\$ 117.89**

During the first six months of 2010 we issued 253,000 shares from treasury stock in connection with stock option exercise activity. As with past exercise activity, we currently intend to utilize treasury stock primarily for any future stock option exercises.

***INCENTIVE/PERFORMANCE UNIT SHARE AWARDS AND RESTRICTED STOCK/UNIT AWARDS***

The fair value of nonvested incentive/performance unit share awards and restricted stock/unit awards is initially determined based on prices not less than the market value of our common stock price on the date of grant. Incentive/performance unit share awards are subsequently valued subject to the achievement of one or more financial and other performance goals over a three-year period. The Personnel and Compensation Committee of the Board of Directors approves the final award payout with respect to incentive/performance unit share awards. Restricted stock/unit awards have various vesting periods generally ranging from 12 months to 60 months. There are no financial or performance goals associated with any of our restricted stock/unit awards. We recognize compensation expense for such awards ratably over the corresponding vesting and/or performance periods for each type of program.

***Summary of Nonvested Incentive/Performance Unit and Restricted Stock/Unit Shares Activity***

	Nonvested Incentive/ Performance Unit Shares	Weighted- Average Grant Date Fair Value	Nonvested Restricted Stock/ Unit Shares	Weighted- Average Grant Date Fair Value
Shares in thousands				
Dec. 31, 2009	285	\$ 66.45	2,213	\$ 53.45
<b>Granted</b>	189	53.78	620	54.51
<b>Vested/Released</b>	(128)	74.96	(449)	72.68
<b>Forfeited</b>	(3)	53.78	(44)	48.45
<b>June 30, 2010</b>	<b>343</b>	<b>\$ 56.43</b>	<b>2,340</b>	<b>\$ 50.14</b>

In the chart above, the unit shares and related weighted-average grant-date fair value of the incentive/performance awards exclude the effect of dividends on the underlying shares, as those dividends will be paid in cash.

At June 30, 2010, there was \$62 million of unrecognized deferred compensation expense related to nonvested share-based compensation arrangements granted under the Incentive Plans. This cost is expected to be recognized as expense over a period of no longer than five years.

**Table of Contents****LIABILITY AWARDS**

Beginning in 2008, we granted cash-payable restricted share units to certain members of management. The grants were made primarily as part of an annual bonus incentive deferral plan. While there are time-based, service-related vesting criteria, there are no market or performance criteria associated with these awards. Compensation expense recognized related to these awards was recorded in prior periods as part of annual cash bonus criteria. As of June 30, 2010, there were 489,184 of these cash-payable restricted share units outstanding.

During the third quarter of 2009, we entered into an agreement with certain of our executives regarding a portion of their salary to be payable in stock units. These units, which are cash-payable, have no future service, market or performance criteria and as such are fully expensed at grant date. These units will be settled in cash on March 31, 2011. We eliminated the granting of any future salary payable in stock units beginning March 2010. As of June 30, 2010, there were 280,174 of these units outstanding, with a current market value of \$16 million.

**Summary of Nonvested, Cash-Payable Restricted Share Unit Activity**

In thousands	Nonvested Cash-Payable	Aggregate Intrinsic Value
	Restricted Unit Shares	
Outstanding at December 31, 2009	1,001	
Granted	316	
Vested and Released	(181)	
Forfeited	(19)	
<b>Outstanding at June 30, 2010</b>	<b>1,117</b>	<b>\$ 63,126</b>

**NOTE 12 FINANCIAL DERIVATIVES**

We use derivative financial instruments (derivatives) primarily to help manage exposure to interest rate, market and credit risk and reduce the effects that changes in interest rates may have on net income, fair value of assets and liabilities, and cash flows. We also enter into derivatives with customers to facilitate their risk management activities.

Derivatives represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another type of asset to the other party based on a notional amount and an underlying as specified in the contract. Derivative transactions are often measured in terms of notional amount, but this amount is generally not exchanged and it is not recorded on the balance sheet. The notional amount is the basis to which the underlying is applied to determine required payments under the derivative contract. The underlying is a referenced interest rate, commonly LIBOR, security price, credit spread or other index. Certain contracts and commitments, such as residential and commercial real estate loan commitments associated with loans to be sold, also qualify as derivative instruments.

All derivatives are carried on our Consolidated Balance Sheet at fair value. Derivative balances are presented on a net basis taking into consideration the effects of legally enforceable master netting agreements. Cash collateral exchanged with counterparties is also netted against the applicable derivative fair values.

Further discussion on how derivatives are accounted for is included in Note 1 Accounting Policies in our 2009 Form 10-K.

**Derivatives Designated in Hedge Relationships**

Certain derivatives used to manage interest rate risk as part of our asset and liability risk management activities are designated as accounting hedges under GAAP. Derivatives hedging the risks associated with changes in the fair value of assets or liabilities are considered fair value hedges, while derivatives hedging the variability of expected future cash flows are considered cash flow hedges. Designating derivatives as accounting hedges allows for gains and losses on those derivatives, to the extent effective, to be

recognized in the income statement in the same period the hedged items affect earnings.

***Cash Flow Hedges***

We enter into receive-fixed, pay-variable interest rate swaps to modify the interest rate characteristics of designated commercial loans from variable to fixed in order to reduce the impact of changes in future cash flows due to market interest rate changes. For these cash flow hedges, any changes in the fair value of the derivatives that are effective in offsetting changes in the forecasted interest cash flows are recorded in accumulated other comprehensive income and are reclassified to interest income in conjunction with the recognition of interest receipts on the loans. In the 12 months that follow June 30, 2010, we expect to reclassify from the amount currently reported in accumulated other comprehensive income net derivative gains of \$274 million pretax, or \$178 million after-tax, in association with interest receipts on the hedged loans. This amount could differ from amounts actually recognized due to changes in interest rates, hedge dedesignations, and the addition of other hedges subsequent to June 30, 2010. The maximum length of time over which forecasted loan cash flows are hedged is 10 years. We use statistical regression analysis to assess the effectiveness of these hedge relationships at both the inception of the hedge relationship and on an ongoing basis.

We also periodically enter into forward purchase and sale contracts to hedge the variability of the consideration that will be paid or received related to the purchase or sale of debt securities classified as available for sale. The forecasted purchase or sale is consummated upon gross settlement of the forward contract itself. As a result, hedge ineffectiveness, if any, is typically minimal. Gains and losses on these forward contracts are recorded in accumulated other comprehensive income and are recognized in earnings when the hedged cash

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flows affect earnings. In the 12 months that follow June 30, 2010, we expect to reclassify from the amount currently reported in accumulated other comprehensive loss, net derivative gains of \$37 million pretax, or \$24 million after- tax, as adjustments of yield on securities available for sale. The maximum length of time we are hedging forecasted purchases is three months. There were no amounts in accumulated other comprehensive income related to the forecasted sale of securities at June 30, 2010.

There were no components of derivative gains or losses excluded from the assessment of hedge effectiveness related to either cash flow hedge strategy.

During the first six months of 2010 and 2009, there were no gains or losses from cash flow hedge derivatives reclassified to earnings because it became probable that the original forecasted transaction would not occur.

### ***Fair Value Hedges***

We enter into receive-fixed, pay-variable interest rate swaps to hedge changes in the fair value of outstanding fixed-rate debt and borrowings caused by fluctuations in market interest rates. The specific products hedged include bank notes, Federal Home Loan Bank borrowings, and senior and subordinated debt. We also enter into pay-fixed, receive- variable interest rate swaps to hedge changes in the fair value of fixed rate investment securities caused by fluctuations in market interest rates. The specific products hedged include US Treasury and government agency securities. For these hedge relationships, we use statistical regression analysis to assess hedge effectiveness at both the inception of the hedge relationship and on an ongoing basis. There were no components of derivative gains or losses excluded from the assessment of hedge effectiveness.

Further detail regarding the notional amounts, fair values and gains and losses recognized related to derivatives used in fair value and cash flow hedge strategies is presented in the tables that follow.

The ineffective portion of the change in value of our fair value and cash flow hedge derivatives resulted in net gains of \$4 million for the first six months of 2010 compared with net losses of \$3 million for the first six months of 2009.

### **Derivatives Not Designated in Hedge Relationships**

We also enter into derivatives which are not designated as accounting hedges under GAAP.

The majority of these derivatives are used to manage risk related to residential and commercial mortgage banking activities and are considered economic hedges. Although these derivatives are used to hedge risk, they are not designated as accounting hedges because the contracts they are hedging are typically also carried at fair value on the balance sheet, resulting in symmetrical accounting treatment for both the hedging instrument and the hedged item.

Our residential mortgage banking activities consist of originating, selling and servicing mortgage loans. Residential mortgage loans that will be sold in the secondary market, and the related loan commitments, which are considered derivatives, are accounted for at fair value. Changes in the fair value of the loans and commitments due to interest rate risk are hedged with forward loan sale contracts and Treasury and Eurodollar futures and options. Gains and losses on the loans and commitments held for sale and the derivatives used to economically hedge them are included in residential mortgage noninterest income on the Consolidated Income Statement.

We typically retain the servicing rights related to residential mortgage loans that we sell. Residential mortgage servicing rights are accounted for at fair value with changes in fair value influenced primarily by changes in interest rates. Derivatives used to hedge the fair value of residential mortgage servicing rights include interest rate futures, swaps and options, including purchased caps, floors, and swaptions, and forward contracts to purchase mortgage-backed securities. Gains and losses on residential mortgage servicing rights and the related derivatives used for hedging are included in residential mortgage noninterest income.

Commercial mortgage loans are also sold into the secondary market as part of our commercial mortgage banking activities and are accounted for at fair value. Commitments related to loans that will be sold are considered derivatives and are also accounted for at fair value. Derivatives used to economically hedge these loans and commitments from changes in fair value due to interest rate risk and credit risk include forward loan sale contracts, interest rate swaps, and credit default swaps. Gains and losses on the commitments, loans and derivatives are included in other noninterest income.

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The residential and commercial loan commitments associated with loans to be sold which are accounted for as derivatives are valued based on the estimated fair value of the underlying loan and the probability that the loan will fund within the terms of the commitment. The fair value also takes into account the fair value of the embedded servicing right.

We offer derivatives to our customers in connection with their risk management needs. These derivatives primarily consist of interest rate swaps, interest rate caps, floors, swaptions, and foreign exchange and equity contracts. We primarily manage our market risk exposure from customer transactions by entering into offsetting derivative transactions with third-party dealers. Gains and losses on customer-related derivatives are included in other noninterest income.

The derivatives portfolio also includes derivatives used for other risk management activities. These derivatives are entered into based on stated risk management objectives taking into consideration market expectations and the potential to benefit from price differentials between financial instruments and the market.

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This segment of the portfolio includes credit default swaps (CDS) used to mitigate the risk of economic loss on a portion of our loan exposure. We also sell loss protection to mitigate the net premium cost and the impact of mark-to-market accounting on CDS purchases to hedge the loan portfolio. The fair values of these derivatives typically are based on related credit spreads. Gains and losses on the derivatives entered into for other risk management are included in other noninterest income.

Included in the customer, mortgage banking risk management, and other risk management portfolios are written interest-rate caps and floors entered into with customers and for risk management purposes. We receive an upfront premium from the counterparty and are obligated to make payments to the counterparty if the underlying market interest rate rises above or falls below a certain level designated in the contract. At June 30, 2010, the fair value of the written caps and floors liability on our Consolidated Balance Sheet was \$10 million compared with \$15 million at December 31, 2009. Our ultimate obligation under written options is based on future market conditions and is only quantifiable at settlement.

Further detail regarding the derivatives not designated in hedging relationships is presented in the tables that follow.

### **Derivative Counterparty Credit Risk**

By purchasing and writing derivative contracts we are exposed to credit risk. We seek to minimize credit risk through credit approvals, limits, monitoring procedures, executing master netting agreements and collateral requirements. We generally enter into transactions with counterparties that carry high quality credit ratings. Nonperformance risk including credit risk is included in the determination of the estimated net fair value.

We generally have established agreements with our major derivative dealer counterparties that provide for exchanges of marketable securities or cash to collateralize either party's positions. At June 30, 2010, we held cash, US government securities and mortgage-backed securities totaling \$949 million under these agreements. We pledged cash of \$802

million under these agreements. To the extent not netted against derivative fair values under a master netting agreement, cash pledged is included in Other assets and cash held is included in Other borrowed funds on our Consolidated Balance Sheet.

The credit risk associated with derivatives executed with customers is essentially the same as that involved in extending loans and is subject to normal credit policies. We may obtain collateral based on our assessment of the customer's credit quality.

We periodically enter into risk participation agreements to share some of the credit exposure with other counterparties related to interest rate derivative contracts or to take on credit exposure to generate revenue. We will make/receive payments under these agreements if a customer defaults on its obligation to perform under certain derivative swap contracts. Risk participation agreements are included in the derivatives table that follows. Our exposure related to risk participations where we sold protection is discussed in the Credit Derivatives section below.

### **Contingent Features**

Some of PNC's derivative instruments contain provisions that require PNC's debt to maintain an investment grade credit rating from each of the major credit rating agencies. If PNC's debt ratings were to fall below investment grade, it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions.

The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position on June 30, 2010 was \$963 million for which PNC had posted collateral of \$798 million in the normal course of business. The maximum amount of collateral PNC would have been required to post if the credit-risk-related contingent features underlying these agreements had been triggered on June 30, 2010, would be an additional \$165 million.



**Table of Contents****Derivatives Total Notional or Contractual Amounts and Estimated Net Fair Values**

	Asset Derivatives				Liability Derivatives			
	June 30, 2010		December 31, 2009		June 30, 2010		December 31, 2009	
	Notional/ Contract Amount	Fair Value (a)	Notional/ Contract Amount	Fair Value (a)	Notional/ Contract Amount	Fair Value (b)	Notional/ Contract Amount	Fair Value (b)
In millions								
<b>Derivatives designated as hedging instruments under GAAP</b>								
Interest rate contracts:								
Cash flow hedges	\$ 20,479	\$ 530	\$ 6,394	\$ 32			\$ 7,011	\$ 95
Fair value hedges	11,520	1,010	13,048	707	\$ 436	\$ 29		
Total derivatives designated as hedging instruments	\$ 31,999	\$ 1,540	\$ 19,442	\$ 739	\$ 436	\$ 29	\$ 7,011	\$ 95
<b>Derivatives not designated as hedging instruments under GAAP</b>								
<u>Derivatives used for residential mortgage banking activities:</u>								
Residential mortgage servicing								
Interest rate contracts	\$ 148,374	\$ 1,550	\$ 88,593	\$ 651	\$ 68,647	\$ 1,284	\$ 42,874	\$ 766
Loan sales								
Interest rate contracts	6,747	53	4,251	39	3,771	55	1,977	14
Subtotal	\$ 155,121	\$ 1,603	\$ 92,844	\$ 690	\$ 72,418	\$ 1,339	\$ 44,851	\$ 780
<u>Derivatives used for commercial mortgage banking activities:</u>								
Interest rate contracts	\$ 1,328	\$ 77	\$ 2,128	\$ 67	\$ 1,896	\$ 150	\$ 1,553	\$ 74
Credit contracts:								
Credit default swaps	235	25	410	59	50	5	50	7
Subtotal	\$ 1,563	\$ 102	\$ 2,538	\$ 126	\$ 1,946	\$ 155	\$ 1,603	\$ 81
<u>Derivatives used for customer-related activities:</u>								
Interest rate contracts	\$ 48,855	\$ 2,978	\$ 51,270	\$ 2,193	\$ 51,162	\$ 3,058	\$ 49,659	\$ 2,237
Foreign exchange contracts	4,336	145	4,168	122	3,438	126	3,834	108
Equity contracts	212	19	195	16	121	18	156	16
Credit contracts:								
Risk participation agreements	1,245	4	1,091	3	1,595	3	1,728	2
Subtotal	\$ 54,648	\$ 3,146	\$ 56,724	\$ 2,334	\$ 56,316	\$ 3,205	\$ 55,377	\$ 2,363
<u>Derivatives used for other risk management activities:</u>								
Interest rate contracts	\$ 664	\$ 8	\$ 3,222	\$ 13	\$ 609	\$ 6	\$ 2,360	\$ 19
Foreign exchange contracts	37	4	39	1			2	
Credit contracts:								
Credit default swaps	451	12	516	13	431	5	612	15
Other contracts (c)					209	298	211	486
Subtotal	\$ 1,152	\$ 24	\$ 3,777	\$ 27	\$ 1,249	\$ 309	\$ 3,185	\$ 520
Total derivatives not designated as hedging instruments	\$ 212,484	\$ 4,875	\$ 155,883	\$ 3,177	\$ 131,929	\$ 5,008	\$ 105,016	\$ 3,744
Total Gross Derivatives	\$ 244,483	\$ 6,415	\$ 175,325	\$ 3,916	\$ 132,365	\$ 5,037	\$ 112,027	\$ 3,839
Less: Legally enforceable master netting agreements								
		2,508		1,600		2,508		1,600
Less: Cash collateral		744		269		451		506
Total Net Derivatives		\$ 3,163		\$ 2,047		\$ 2,078		\$ 1,733

(a) Included in Other Assets on our Consolidated Balance Sheet.

(b) Included in Other Liabilities on our Consolidated Balance Sheet.

(c) Includes PNC's obligation to fund a portion of certain BlackRock LTIP programs.



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Gains (losses) on derivative instruments and related hedged items follow:

**Derivatives Designated in GAAP Hedge Relationships Fair Value Hedges**

Six months ended In millions	Hedged Items	Location	June 30, 2010		June 30, 2009	
			Gain (Loss) on Derivatives Recognized in Income Amount	Gain (Loss) on Related Hedged Items Recognized in Income Amount	Gain (Loss) on Derivatives Recognized in Income Amount	Gain (Loss) on Related Hedged Items Recognized in Income Amount
Interest rate contracts	US Treasury Securities	Investment securities (interest income)	\$ (27)	\$ 26		
Interest rate contracts	Federal Home Loan Bank borrowings	Borrowed funds (interest expense)	(48)	47	\$ (54)	\$ 56
Interest rate contracts	Subordinated debt	Borrowed funds (interest expense)	260	(272)	(372)	364
Interest rate contracts	Bank notes and senior debt	Borrowed funds (interest expense)	214	(198)	(25)	28
<b>Total</b>			<b>\$ 399</b>	<b>\$ (397)</b>	<b>\$ (451)</b>	<b>\$ 448</b>

Three months ended In millions	Hedged Items	Location	June 30, 2010		June 30, 2009	
			Gain (Loss) on Derivatives Recognized in Income Amount	Gain (Loss) on Related Hedged Items Recognized in Income Amount	Gain (Loss) on Derivatives Recognized in Income Amount	Gain (Loss) on Related Hedged Items Recognized in Income Amount
Interest rate contracts	US Treasury Securities	Investment securities (interest income)	\$ (27)	\$ 26		
Interest rate contracts	Federal Home Loan Bank borrowings	Borrowed funds (interest expense)	(23)	23	\$ (27)	\$ 26
Interest rate contracts	Subordinated debt	Borrowed funds (interest expense)	200	(207)	(284)	273
Interest rate contracts	Bank notes and senior debt	Borrowed funds (interest expense)	172	(159)	(36)	37
<b>Total</b>			<b>\$ 322</b>	<b>\$ (317)</b>	<b>\$ (347)</b>	<b>\$ 336</b>

**Derivatives Designated in GAAP Hedge Relationships Cash Flow Hedges**

Six months ended In millions	Interest rate contracts	Gain (Loss) on Derivatives Recognized in OCI (Effective Portion)	Gain Reclassified from Accumulated OCI into Income (Effective Portion)		Gain Recognized in Income on Derivatives (Ineffective Portion)	
			Location	Amount	Location	Amount
<b>June 30, 2010</b>			<b>Interest income</b>		<b>Interest income</b>	
		\$725		\$ 175		\$ 2
			<b>Noninterest income</b>	25		

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June 30, 2009	Interest rate contracts	\$(208)	Interest income	\$ 145	Interest income	\$
Three months ended			Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Gain (Loss) Recognized in Income on Derivatives	
In millions			(Ineffective Portion)			
			Location	Amount	Location	Amount
<b>June 30, 2010</b>	<b>Interest rate contracts</b>	<b>\$485</b>	<b>Interest income</b>	<b>\$ 81</b>	<b>Interest income</b>	<b>\$ (1)</b>
			<b>Noninterest income</b>	<b>3</b>		
June 30, 2009	Interest rate contracts	\$(284)	Interest income	\$ 75	Interest income	\$

**Table of Contents****Derivatives Not Designated as Hedging Instruments under GAAP**

In millions	Three months		Six months ended	
	ended June 30 2010	2009	June 30 2010	2009
<b>Derivatives used for residential mortgage banking activities:</b>				
Residential mortgage servicing				
Interest rate contracts	\$ 351	\$ (328)	\$ 421	\$ (131)
Loan sales				
Interest rate contracts	(56)	10	(77)	7
Gains (losses) included in residential mortgage noninterest income	\$ 295	\$ (318)	\$ 344	\$ (124)
<b>Derivatives used for commercial mortgage banking activities:</b>				
Interest rate contracts	\$ (50)	\$ 58	\$ (71)	\$ 83
Credit contracts	(2)	(48)	(9)	1
Gains (losses) from commercial mortgage banking activities (a)	\$ (52)	\$ 10	\$ (80)	\$ 84
<b>Derivatives used for customer-related activities:</b>				
Interest rate contracts	\$ (21)	\$ 41	\$ (27)	\$ 18
Foreign exchange contracts	(7)	(11)	6	39
Equity contracts	2	2	1	(2)
Credit contracts	(1)	0	(2)	0
Gains (losses) from customer-related activities (a)	\$ (27)	\$ 32	\$ (22)	\$ 55
<b>Derivatives used for other risk management activities:</b>				
Interest rate contracts	\$ (15)	\$ 9	\$ (14)	\$ 18
Foreign exchange contracts	3	(6)	2	(6)
Credit contracts	0	(3)	4	(14)
Other contracts (b)	154	(95)	184	(58)
Gains (losses) from other risk management activities (a)	\$ 142	\$ (95)	\$ 176	\$ (60)
Total gains (losses) from derivatives not designated as hedging instruments	\$ 358	\$ (371)	\$ 418	\$ (45)

(a) Included in other noninterest income.

(b) Relates to BlackRock LTIP.

**CREDIT DERIVATIVES**

The credit derivative underlying is based on the credit risk of a specific entity, entities, or an index. As discussed above, we enter into credit derivatives, specifically credit default swaps and risk participation agreements, as part of our commercial mortgage banking hedging activities and for customer and other risk management purposes. Further detail regarding credit default swaps and risk participations sold follows:

**Credit Default Swaps**

Dollars in millions	June 30, 2010			December 31, 2009		
	Notional Amount	Estimated Net Fair Value	Weighted- Average Remaining Maturity In Years	Notional Amount	Estimated Net Fair Value	Weighted- Average Remaining Maturity In Years
<b>Credit Default Swaps Sold</b>						
Single name	\$ 60	\$ 2	3.16	\$ 85	\$ (4)	3.18
Index traded	357	(6)	7.16	457		6.12
Total	\$ 417	\$ (4)	6.58	\$ 542	\$ (4)	5.66
<b>Credit Default Swaps Purchased</b>						
Single name	\$ 465	\$ 5	3.15	\$ 586	\$ 1	3.69

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Index traded	<b>285</b>	<b>26</b>	<b>32.80</b>	460	53	35.89
Total	<b>\$ 750</b>	<b>\$ 31</b>	<b>14.42</b>	\$ 1,046	\$ 54	17.85
Total	<b>\$ 1,167</b>	<b>\$ 27</b>	<b>11.62</b>	\$ 1,588	\$ 50	13.69

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The notional amount of these credit default swaps by credit rating as of June 30, 2010 and December 31, 2009 follows:

**Credit Ratings of Credit Default Swaps**

Dollars in millions	June 30, 2010	December 31, 2009
<b>Credit Default Swaps Sold</b>		
Investment grade (a)	\$ 395	\$ 496
Subinvestment grade (b)	22	46
Total	\$ 417	\$ 542
<b>Credit Default Swaps Purchased</b>		
Investment grade (a)	\$ 598	\$ 894
Subinvestment grade (b)	152	152
Total	\$ 750	\$ 1,046

(a) Investment grade with a rating of BBB-/Baa3 or above based on published rating agency information.

(b) Subinvestment grade with a rating below BBB-/Baa3 based on published rating agency information.

The referenced/underlying assets for these credit default swaps as of June 30, 2010 and December 31, 2009 follow:

**Referenced/underlying Assets of Credit Default Swaps**

	Corporate Debt	Commercial mortgage- backed securities	Loans
<b>June 30, 2010</b>	<b>69%</b>	<b>24%</b>	<b>7%</b>
December 31, 2009	66%	29%	5%

We enter into credit default swaps under which we buy loss protection from or sell loss protection to a counterparty for the occurrence of a credit event related to a referenced entity or index. The maximum amount we would be required to pay under the credit default swaps in which we sold protection, assuming all referenced underlyings experience a credit event

at a total loss, without recoveries, was \$417 million at June 30, 2010 compared with \$542 million at December 31, 2009.

**Risk Participation Agreements**

We have entered into risk participation agreements sold with terms ranging from less than one year to 21 years. We will be required to make payments under these agreements if a customer defaults on its obligation to perform under certain derivative swap contracts with third parties.

**Risk Participation Agreements Sold**

Dollars in millions	Notional Amount	Estimated Net Fair Value	Weighted-Average Remaining Maturity In Years
<b>June 30, 2010</b>	<b>\$ 1,595</b>	<b>\$ (3)</b>	<b>1.73</b>
December 31, 2009	\$ 1,728	\$ (2)	2.03

Based on our internal risk rating process of the underlying swap counterparties, the percentages of the notional amount of risk participation agreements sold by internal credit rating as of June 30, 2010 and December 31, 2009 follow:

*Internal Credit Ratings of Risk Participation Agreements Sold*

	June 30, 2010	December 31, 2009
Pass (a)	<b>85%</b>	<b>94%</b>
Below pass (b)	<b>15%</b>	<b>6%</b>

(a) Indicates the expected risk of default is currently low.

(b) Indicates a higher degree of risk of default.

Assuming all underlying swap counterparties defaulted at June 30, 2010, the exposure from these agreements would be \$68 million based on the fair value of the underlying swaps compared with \$78 million at December 31, 2009.



**Table of Contents****NOTE 13 EARNINGS PER SHARE****Basic and Diluted Earnings per Common Share**

In millions, except per share data	Three months ended		Six months ended	
	2010	June 30 2009	2010	June 30 2009
<b>Basic</b>				
Net income from continuing operations	\$ 781	\$ 195	\$ 1,429	\$ 715
Less:				
Net income (loss) attributable to noncontrolling interests	(9)	9	(14)	13
Dividends distributed to common shareholders	53	45	98	336
Dividends distributed to preferred shareholders	25	119	118	170
Dividends distributed to nonvested restricted shares				1
Preferred stock discount accretion	1	14	251	29
Undistributed net income from continuing operations	\$ 711	\$ 8	\$ 976	\$ 166
Undistributed net income from discontinued operations	22	12	45	22
Undistributed net income	\$ 733	\$ 20	\$ 1,021	\$ 188
Percentage of undistributed income allocated to common shares	99.6%	99.7%	99.7%	99.7%
Undistributed income from continuing operations allocated to common shares	\$ 708	\$ 7	\$ 972	\$ 165
Plus: Common dividends	53	45	98	336
Net income from continuing operations attributable to basic common shares	\$ 761	\$ 52	\$ 1,070	\$ 501
Undistributed income from discontinued operations allocated to common shares	22	12	45	22
Net income attributable to basic common shares	\$ 783	\$ 64	\$ 1,115	\$ 523
Basic weighted-average common shares outstanding	524	451	511	447
Basic earnings per common share from continuing operations	\$ 1.45	\$ .11	\$ 2.09	\$ 1.12
Basic earnings per common share from discontinued operations	.04	.03	.09	.05
Basic earnings per common share	\$ 1.49	\$ .14	\$ 2.18	\$ 1.17
<b>Diluted</b>				
Net income from continuing operations attributable to basic common shares	\$ 761	\$ 52	\$ 1,070	\$ 501
Less: BlackRock common stock equivalents	6	2	8	3
Net income from continuing operations attributable to diluted common shares	\$ 755	\$ 50	\$ 1,062	\$ 498
Net income from discontinued operations attributable to diluted common shares	22	12	45	22
Net income attributable to diluted common shares	\$ 777	\$ 62	\$ 1,107	\$ 520
Basic weighted average common shares outstanding	524	451	511	447
Dilutive potential common shares (a) (b)	3	2	3	1
Diluted weighted-average common shares outstanding	527	453	514	448
Diluted earnings per common share from continuing operations	\$ 1.43	\$ .11	\$ 2.06	\$ 1.11
Diluted earnings per common share from discontinued operations	.04	.03	.09	.05
Diluted earnings per common share	\$ 1.47	\$ .14	\$ 2.15	\$ 1.16
(a) Excludes stock options considered to be anti-dilutive	11	16	12	17
(b) Excludes warrants considered to be anti-dilutive	22	22	22	22

**Table of Contents****NOTE 14 TOTAL EQUITY AND OTHER COMPREHENSIVE INCOME**

Activity in total equity for the first six months of 2010 follows. The par value of our preferred stock outstanding at June 30, 2010 totaled \$.3 million and is excluded from the table.

**Rollforward of Total Equity**

	Shares Outstanding		Shareholders' Equity				Treasury Stock	Noncontrolling Interests	Total Equity
	Common Stock	Common Stock	Capital Surplus Preferred Stock	Capital Surplus and Other	Retained Earnings	Accumulated Other Comprehensive Income (Loss)			
In millions, except per share data									
Balance at December 31, 2009	462	\$ 2,354	\$ 7,974	\$ 8,945	\$ 13,144	\$ (1,962)	\$ (513)	\$ 2,625	\$ 32,567
Cumulative effect of adopting ASU									
2009-17, Consolidations						(92)	(13)		(105)
Balance at January 1, 2010	462	\$ 2,354	\$ 7,974	\$ 8,945	\$ 13,052	\$ (1,975)	\$ (513)	\$ 2,625	\$ 32,462
Net income					1,488			(14)	1,474
Other comprehensive income (loss), net of tax									
Other-than-temporary impairment losses on debt securities						149			149
Net unrealized securities gains						939			939
Net unrealized gains on cash flow hedge derivatives							331		331
Pension, other postretirement and postemployment benefit plan adjustments						136			136
Other						(22)			(22)
Comprehensive income								(14)	3,007
Cash dividends declared									
Common (\$.20 per share)						(98)			(98)
Preferred						(118)			(118)
Redemption of Series N (TARP) Preferred Stock			(7,579)						(7,579)
Preferred stock discount accretion			251			(251)			
Common stock activity (a)	64	324		3,076					3,400
Treasury stock activity	(1)			(31)			(44)		(75)
Other				(11)				2	(9)
<b>Balance at June 30, 2010</b>	<b>525</b>	<b>\$ 2,678</b>	<b>\$ 646</b>	<b>\$ 11,979</b>	<b>\$ 14,073</b>	<b>\$ (442)</b>	<b>\$ (557)</b>	<b>\$ 2,613</b>	<b>\$ 30,990</b>

(a) Includes 63.9 million common shares issuance, the net proceeds of which were used together with other available funds to redeem the Series N (TARP) Preferred Stock, for a \$3.4 billion net increase in total equity.

Comprehensive income for the first six months of 2009 was \$1.7 billion.

**Change in Accumulated Other Comprehensive Income (Loss)**

Six months ended June 30, 2010

In millions	Tax (Expense)		
	Pretax	Benefit	After-tax
Change in net unrealized securities losses:			
Cumulative effect of adopting ASU 2009-17	\$ (20)	\$ 7	\$ (13)
Decrease in net unrealized losses for securities with OTTI charges	25	(9)	16
Less: OTTI losses realized in net income	(210)	77	(133)
Change in net unrealized losses on OTTI securities	235	(86)	149
Increase in net unrealized gains arising during the period for non-OTTI securities	1,734	(645)	1,089

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Less: Net gains realized in net income	237	(87)	150
Change in net unrealized gains on non-OTTI securities	1,497	(558)	939
Change in net unrealized securities losses	1,712	(637)	1,075
Change in net unrealized gains on cash flow hedge derivatives:			
Increase in net unrealized gains during the period on cash flow hedge derivatives	725	(268)	457
Less: Net gains realized in net income	200	(74)	126
Change in net unrealized gains on cash flow hedge derivatives	525	(194)	331
Change in pension, other postretirement and postemployment benefit plan adjustments	216	(80)	136
Change in other, net	(51)	29	(22)
Change in other comprehensive income (loss)	\$ 2,402	\$ (882)	\$ 1,520

**Accumulated Other Comprehensive Income (Loss) Components**

In millions	June 30, 2010		December 31, 2009	
	Pretax	After-tax	Pretax	After-tax
Net unrealized securities gains/(losses)	\$ 270	\$ 166	\$ (1,207)	\$ (760)
OTTI losses on debt securities	(1,061)	(667)	(1,296)	(816)
Net unrealized gains on cash flow hedge derivatives	788	497	263	166
Pension, other postretirement and postemployment benefit plan adjustments	(642)	(406)	(858)	(542)
Other, net	(78)	(32)	(27)	(10)
Accumulated other comprehensive loss	\$ (723)	\$ (442)	\$ (3,125)	\$ (1,962)

**Table of Contents****Repurchase of Outstanding TARP Preferred Stock and Sale by US Treasury of TARP Warrant**

Note 19 Equity in our 2009 Form 10-K describes our December 31, 2008 issuance of 75,792 shares of our Fixed Rate Cumulative Perpetual Preferred Shares, Series N (Series N Preferred Stock), related issuance discount and the warrant to purchase common shares to the US Treasury under the TARP Capital Purchase Program.

As approved by the Federal Reserve Board, US Treasury and our other banking regulators, on February 10, 2010, we redeemed all 75,792 shares of our Series N Preferred Stock held by the US Treasury totaling \$7.6 billion. We used the net proceeds from the common stock and senior notes offerings described in Note 28 Subsequent Events in our 2009 Form 10-K and other funds to redeem the Series N Preferred Stock.

In connection with the redemption of the Series N Preferred Stock, we accelerated the accretion of the remaining issuance discount on the Series N Preferred Stock and recorded a corresponding reduction in retained earnings of \$250 million during the first quarter of 2010. This resulted in a one-time, noncash reduction in net income attributable to common shareholders and related basic and diluted earnings per share.

Dividends of \$89 million were paid on February 10, 2010 when the Series N Preferred Stock was redeemed. PNC paid total dividends of \$421 million to the US Treasury while the Series N preferred shares were outstanding.

After exchanging its TARP Warrant for 16,885,192 warrants, each to purchase one share of PNC common stock, the US Treasury sold the warrants in a secondary public offering. The sale closed on May 5, 2010.

***NOTE 15 INCOME TAXES***

The net operating loss carryforwards and tax credit carryforwards at June 30, 2010 and December 31, 2009 follow:

***Net Operating Loss Carryforwards and Tax Credit Carryforwards***

In millions	June 30, 2010	December 31, 2009
<b><u>Net Operating Loss Carryforwards:</u></b>		
Federal	\$ 338	\$ 1,200
State	1,500	2,000
Valuation allowance State	31	31
<b><u>Tax Credit Carryforwards:</u></b>		
Federal	\$ 318	\$ 254
State	4	4

The majority of the federal net operating loss can be carried forward to future tax periods until 2029. We have established that no valuation allowance relating to the federal net operating losses is necessary based upon all available positive and negative evidence including PNC's forecast of future taxable income.

The state net operating loss carryforwards will expire from 2010 to 2029. We have established a valuation allowance of \$31 million relating to the state net operating losses at both June 30, 2010 and December 31, 2009.

The credit carryforwards will expire from 2012 to 2029. We have established that no valuation allowance relating to the tax credits is necessary based upon all available positive and negative evidence including PNC's forecast of future taxable income.

PNC's consolidated federal income tax returns through 2006 have been audited by the IRS and we have resolved these matters through the IRS Appeals Division. We expect the IRS to begin its examination of our 2007 and 2008 consolidated federal income tax returns during 2010.

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The consolidated federal income tax returns of National City through 2004 have been audited by the IRS. Included in the 2003 and 2004 examination were certain adjustments which are under review by the IRS Appeals Division. We do not anticipate any significant adverse impact to net income. The IRS has completed field examination of the 2005 through 2007 consolidated federal income tax returns of National City and a final report has been issued. National City has filed a protest with the IRS regarding the 2005 through 2007 audit cycle. The audit of the 2008 federal income tax return will commence in 2010. Also, in July 2010, we received a favorable IRS letter ruling resolving a tax position taken on a previous return which will result in a tax benefit of approximately \$89 million.

We had unrecognized tax benefits of \$215 and \$227 million at June 30, 2010 and December 31, 2009. At June 30, 2010, the amount of unrecognized tax benefits that if recognized would impact the effective tax rate was \$147 million.

It is reasonably possible that the liability for uncertain tax positions could increase or decrease in the next twelve months due to completion of tax authorities' exams or the expiration of statutes of limitations. Management estimates that the liability for uncertain tax positions could decrease by \$40 million within the next twelve months.

**Table of Contents****NOTE 16 SUMMARIZED FINANCIAL INFORMATION OF BLACKROCK****Summarized Consolidated Financial Information of BlackRock**

In millions	Six months ended June 30	
	2010	2009
Total revenue	\$ 4,027	\$ 2,016
Total expenses	2,676	1,484
Operating income	1,351	532
Non-operating income (expense)	(73)	(102)
Income before income taxes	1,278	430
Income tax expense	461	124
Net income	817	306
Less: net income (loss) attributable to non-controlling interests	(38)	4
Net income attributable to BlackRock	\$ 855	\$ 302

In millions	Three months ended June 30	
	2010	2009
Total revenue	\$ 2,032	\$ 1,029
Total expenses	1,335	768
Operating income	697	261
Non-operating income (expense)	(75)	77
Income before income taxes	622	338
Income tax expense	233	94
Net income	389	244
Less: net income (loss) attributable to non-controlling interests	(43)	26
Net income attributable to BlackRock	\$ 432	\$ 218

**NOTE 17 LEGAL PROCEEDINGS**

The disclosure below updates the description of legal proceedings in Note 24 Legal Proceedings in Part II, Item 8 of our 2009 Annual Report on Form 10-K and in Note 17 Legal Proceedings in Part I, Item 1 of our first quarter 2010 Quarterly Report on Form 10-Q (the "Prior Filings").

In accordance with ASC 450-20-25, we establish accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a liability is probable and that the amount of loss can be reasonably estimated. Any such accruals are adjusted thereafter if appropriate in light of changed circumstances. We cannot provide any assurance that any amounts already accrued will represent the ultimate loss to us from the legal proceeding in question.

In our experience, legal proceedings are inherently unpredictable, and in many legal proceedings various factors exacerbate this inherent unpredictability, including where the damages sought are unsubstantiated or indeterminate, it is unclear whether a case brought as a class action will be allowed to proceed on that basis, discovery is not complete, the proceeding is not yet in its final stages, the matters present

legal uncertainties, there are significant facts in dispute, there are a large number of parties (including where it is uncertain how liability, if any, will be shared among multiple defendants), or there is a wide range of potential results. As a result, in many cases (including all of those described below and in our Prior Filings to the extent still pending), we cannot provide a meaningful estimate of the unrecognized possible loss or range of loss, including any possible loss in addition to amounts, if any, already accrued.

**National City Matters**

*Derivative Cases.*

Commencing in January 2008, a series of shareholder derivative complaints were filed in the United States District Court for the Northern District of Ohio, the Chancery Court for the State of Delaware and the Cuyahoga County, Ohio, Court of Common Pleas against certain officers and directors of National City. Subsequently, the complaints filed in Delaware were voluntarily dismissed and the complaints filed in Ohio state court were consolidated and stayed pending resolution of the Ohio federal court derivative litigation. A consolidated complaint was filed in the federal court. These suits made substantially similar allegations against certain officers and directors of National City for, among other things, breaches of fiduciary duty, waste of corporate assets, unjust enrichment and (in the federal court case) violations of the Securities Exchange Act of 1934, based on claims, among others, that National City issued inaccurate information to investors about the status of its business and prospects, and that the defendants caused National City to repurchase shares of its stock at artificially inflated prices. The complaints sought unspecified money damages and equitable relief (including restitution and certain corporate governance changes) against the individual defendants on behalf of National City, as well as attorneys' fees and costs. In October 2009, the federal district court entered an order dismissing the federal consolidated complaint for lack of standing. As a result of the voluntary dismissal of the remaining acquisition-related litigation referred to below, the remaining derivative cases are no longer pending.

*Securities and State Law Fiduciary Cases.*

In April 2008, a lawsuit was filed in the Cuyahoga County, Ohio, Court of Common Pleas against National City, certain officers and directors of National City, and its auditor, Ernst & Young, LLP. (Ernst & Young was subsequently dropped as a defendant in this lawsuit.) The complaint was brought as a class action on behalf of all current and former National City employees who acquired stock pursuant to and/or traceable to a December 1, 2006 registration statement filed in connection with the acquisition of Harbor Federal Savings Bank and who were participants in the Harbor Bank Employees Stock Ownership Plan and the Harbor Bank Stock Incentive Plan. The plaintiffs alleged that the

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registration statement contained false and misleading statements and omissions in violation of the federal securities laws. The parties entered into a settlement agreement in April 2010. The court approved the settlement in June 2010. The amount of the settlement is not material to PNC.

In the lawsuit filed in December 2008 in the United States District Court for the Northern District of Ohio against National City and some of its officers and directors on behalf of the purchasers of National City's 4.0% Convertible Senior Notes Due 2011, in July 2010, the parties reached a tentative settlement, which is subject, among other things, to final documentation, notice to the proposed class, and court approval. The amount of the settlement would not be material to PNC.

***National City Acquisition-Related Litigation***

National City was a defendant in numerous lawsuits filed in and after October 2008 as class actions on behalf of National City stockholders. These lawsuits were pending in the Delaware Chancery Court (all of which were consolidated into a single lawsuit), the United States District Court for the Northern District of Ohio and the Cuyahoga County, Ohio, Court of Common Pleas. The consolidated Delaware case and most of the Ohio cases included PNC as a defendant. All of these lawsuits also named as defendants National City's directors and one of the Ohio federal lawsuits named National City officers as defendants.

The complaints in these cases alleged that the National City directors breached their fiduciary duties to the stockholders of National City in connection with the proposed transaction with PNC. The lawsuits generally alleged that National City directors breached their fiduciary duties by, among other things, causing National City to enter into the proposed transaction at an allegedly inadequate and unfair price, engaging in self-dealing and acting with divided loyalties, and failing to disclose material information to the stockholders. Some lawsuits alleged violations of the federal securities laws. In the cases naming PNC as a defendant, PNC was alleged to have aided and abetted the other defendants' breaches of fiduciary duties. The various complaints sought, among other remedies, an accounting, imposition of a constructive trust, unspecified damages, rescission, costs of suit, and attorneys' fees.

In addition, the plaintiffs in one of the [pending] derivative lawsuits against the National City directors in the Cuyahoga County Court of Common Pleas referred to above moved to amend their complaint to add merger-related claims, including claims that National City's directors agreed to sell National City in order to extinguish their own personal liability in derivative litigation pending against them. PNC was not named as a defendant in the proposed amended complaint.

The parties to the Delaware lawsuit and to certain of the Ohio state court lawsuits entered into a stipulation of settlement in

February 2009 to resolve the Delaware lawsuit, one of the Ohio state court lawsuits and the acquisition-related claim proposed to be filed in the derivative lawsuit pending in Ohio state court. In February 2009, the Court of Chancery preliminarily approved a class of all persons who were National City common stockholders during the period from the close of business on October 23, 2008 through (and including) December 31, 2008. In July 2009, the Court of Chancery approved the settlement. In addition, in connection with the settlement, the Court of Chancery awarded attorneys' fees and expenses to plaintiffs' counsel to be paid by PNC. In September 2009, objectors to the settlement filed appeals of the approval to the Delaware Supreme Court. In addition, the plaintiffs cross-appealed the size of the award of attorneys' fees and costs. The Delaware Supreme Court affirmed the Chancery Court's approval of the settlement in April 2010. Subsequently, the Delaware Supreme Court granted reconsideration en banc of the appeal. Upon such reconsideration, in July 2010, the Supreme Court affirmed again the Chancery Court's approval. This settlement resolves and releases all claims in all actions that were or could have been brought challenging any aspect of the merger, the merger agreement, and any disclosure made in connection therewith. All of the other pending federal and state litigation referred to above under this heading have been voluntarily dismissed. Other than the payment of attorneys' fees and expenses, these cases have been resolved without any payments by PNC.

***Adelphia***

In the case being prosecuted by the Adelphia Recovery Trust in the United States District Court for the Southern District of New York, the court has scheduled argument on the pending motions for summary judgment in August 2010 and scheduled the trial on the remaining claims in October 2010.

***CBNV Mortgage Litigation***

In the case pending in North Carolina state court, in June, 2010, the North Carolina Supreme Court reversed the North Carolina Court of Appeals with respect to the jurisdictional issue and remanded the matter to the Court of Appeals for consideration on the merits.



***Overdraft Litigation***

Beginning in October 2009, PNC Bank and National City Bank have been named in five lawsuits brought as class actions relating to the manner in which they charged overdraft fees on ATM and debit transactions to customers. Three lawsuits naming PNC Bank and one naming National City Bank, along with similar lawsuits against numerous other banks, have been consolidated for pre-trial proceedings in the United States District Court for the Southern District of Florida (the MDL Court ). The first of these cases was originally filed against PNC Bank in October 2009 in the United States District Court for the District of New Jersey, and an amended complaint was filed in June 2010 in the MDL Court. The class sought to be certified in this case is limited to customers with accounts in New Jersey branches. The other cases that have been consolidated were filed in June 2010 in

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the United States District Court for the Southern District of Florida and seek to certify national classes of customers for common law claims, and subclasses of PNC Bank customers with accounts in Pennsylvania branches in one case, PNC Bank customers with accounts in Pennsylvania and Illinois branches in another case, and National City Bank customers with accounts in Illinois branches in the third case, in each situation for purposes of claims under those states' consumer protection statutes. No class periods are stated in any of the complaints, other than for the applicable statutes of limitations, which vary by state and cause of action.

The fifth lawsuit is pending against National City Bank in the United States District Court for the District of Columbia. The class sought to be certified in this case is a national class of National City Bank customers with subclasses of customers with accounts in Michigan and Ohio branches for purposes of claims under those states' consumer protection statutes. In July 2010, the parties reached a tentative settlement of the lawsuit pending in the District of Columbia, which is subject, among other things, to notice to the proposed class, and court approval. The amount of the settlement would not be material to PNC. There is a motion pending before the Judicial Panel on Multidistrict Litigation to determine whether this matter should be transferred to the MDL Court, which was referred to the Panel on July 29, 2010 for disposition. No decision has yet been rendered. The plaintiffs and National City Bank have opposed the transfer. If approved, the transfer could have an impact on the tentative settlement.

The complaints in each of these lawsuits allege that the banks engaged in unlawful practices in assessing overdraft fees arising from electronic point-of-sale and ATM debits. The principal practice challenged in these lawsuits is the banks' purportedly common policy of posting debit transactions on a daily basis from highest amount to lowest amount, thereby allegedly inflating the number of overdraft fees assessed. Other practices challenged include the failure to decline to honor debit card transactions where the account has insufficient funds to cover the transactions.

In the cases in the MDL Court, the plaintiffs assert claims for breach of the covenant of good faith and fair dealing; unconscionability; conversion, unjust enrichment; and violation of the consumer protection statutes of Pennsylvania, Illinois and New Jersey. The action against National City pending in the District of Columbia adds claims under the Ohio and Michigan consumer protection statutes and the federal Electronic Funds Transfer Act. Plaintiffs seek restitution of overdraft fees paid, unspecified monetary damages, punitive damages, pre-judgment interest, costs and reasonable attorneys' fees, and declaratory relief finding the overdraft policies to be unfair and unconscionable. These cases are in early stages, with no responsive pleadings or motions having yet been filed.

**NOTE 18 COMMITMENTS AND GUARANTEES****EQUITY FUNDING AND OTHER COMMITMENTS**

Our unfunded commitments at June 30, 2010 included private equity investments of \$406 million and other investments of \$23 million.

**STANDBY LETTERS OF CREDIT**

We issue standby letters of credit and have risk participations in standby letters of credit and bankers' acceptances issued by other financial institutions, in each case to support obligations of our customers to third parties, such as remarketing programs for customers' variable rate demand notes. Net outstanding standby letters of credit and internal credit ratings were as follows:

**Net Outstanding Standby Letters of Credit**

	<b>June 30</b>	December 31
Dollars in billions	<b>2010</b>	2009
Net outstanding standby letters of credit	<b>\$ 9.9</b>	\$ 10.0
Internal credit ratings (as percentage of portfolio):		
Pass (a)	<b>88%</b>	86%
Below pass (b)	<b>12%</b>	14%

(a) Indicates that expected risk of loss is currently low.

(b) Indicates a higher degree of risk of default.

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If the customer fails to meet its financial or performance obligation to the third party under the terms of the contract or there is a need to support a remarketing program, then upon the request of the guaranteed party, we would be obligated to make payment to them. The standby letters of credit and risk participations in standby letters of credit and bankers' acceptances outstanding on June 30, 2010 had terms ranging from less than 1 year to 9 years. The aggregate maximum amount of future payments PNC could be required to make under outstanding standby letters of credit and risk participations in standby letters of credit and bankers' acceptances was \$12.8 billion at June 30, 2010, of which \$6.4 billion support remarketing programs.

As of June 30, 2010, assets of \$2.0 billion secured certain specifically identified standby letters of credit. Recourse provisions from third parties of \$2.9 billion were also available for this purpose as of June 30, 2010. In addition, a portion of the remaining standby letters of credit and letter of credit risk participations issued on behalf of specific customers is also secured by collateral or guarantees that secure the customers' other obligations to us. The carrying amount of the liability for our obligations related to standby letters of credit and risk participations in standby letters of credit and bankers' acceptances was \$252 million at June 30, 2010.

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*STANDBY BOND PURCHASE AGREEMENTS AND OTHER LIQUIDITY FACILITIES*

We enter into standby bond purchase agreements to support municipal bond obligations. At June 30, 2010, the aggregate of our commitments under these facilities was \$400 million. We also enter into certain other liquidity facilities to support individual pools of receivables acquired by commercial paper conduits. At June 30, 2010 our total commitments under these facilities were \$145 million.

*INDEMNIFICATIONS*

As further described in our 2009 Form 10-K, we are a party to numerous acquisition or divestiture agreements under which we have purchased or sold, or agreed to purchase or sell, various types of assets. These agreements generally include indemnification provisions under which we indemnify the third parties to these agreements against a variety of risks to the indemnified parties as a result of the transaction in question. When PNC is the seller, the indemnification provisions will generally also provide the buyer with protection relating to the quality of the assets we are selling and the extent of any liabilities being assumed by the buyer. Due to the nature of these indemnification provisions, we cannot quantify the total potential exposure to us resulting from them.

We provide indemnification in connection with securities offering transactions in which we are involved. When we are the issuer of the securities, we provide indemnification to the underwriters or placement agents analogous to the indemnification provided to the purchasers of businesses from us, as described above. When we are an underwriter or placement agent, we provide a limited indemnification to the issuer related to our actions in connection with the offering and, if there are other underwriters, indemnification to the other underwriters intended to result in an appropriate sharing of the risk of participating in the offering. Due to the nature of these indemnification provisions, we cannot quantify the total potential exposure to us resulting from them.

In the ordinary course of business, we enter into certain types of agreements that include provisions for indemnifying third parties. We also enter into certain types of agreements, including leases, assignments of leases, and subleases, in which we agree to indemnify third parties for acts by our agents, assignees and/or sublessees, and employees. We also enter into contracts for the delivery of technology service in which we indemnify the other party against claims of patent and copyright infringement by third parties. Due to the nature of these indemnification provisions, we cannot calculate our aggregate potential exposure under them.

We engage in certain insurance activities which require our employees to be bonded. We satisfy this bonding requirement by issuing letters of credit which were insignificant at June 30, 2010.

In the ordinary course of business, we enter into contracts with third parties under which the third parties provide services on behalf of PNC. In many of these contracts, we agree to indemnify the third party service provider under certain circumstances. The terms of the indemnity vary from contract to contract and the amount of the indemnification liability, if any, cannot be determined.

We are a general or limited partner in certain asset management and investment limited partnerships, many of which contain indemnification provisions that would require us to make payments in excess of our remaining funding commitments. While in certain of these partnerships the maximum liability to us is limited to the sum of our unfunded commitments and partnership distributions received by us, in the others the indemnification liability is unlimited. As a result, we cannot determine our aggregate potential exposure for these indemnifications.

Pursuant to their bylaws, PNC and its subsidiaries provide indemnification to directors, officers and, in some cases, employees and agents against certain liabilities incurred as a result of their service on behalf of or at the request of PNC and its subsidiaries. PNC and its subsidiaries also advance on behalf of covered individuals costs incurred in connection with certain claims or proceedings, subject to written undertakings by each such individual to repay all amounts advanced if it is ultimately determined that the individual is not entitled to indemnification. We generally are responsible for similar indemnifications and advancement obligations that companies we acquire had to their officers, directors and sometimes employees and agents at the time of acquisition. We advanced such costs on behalf of several such individuals with respect to pending litigation or investigations during the first six months of 2010. It is not possible for us to determine the aggregate potential exposure resulting from the obligation to provide this indemnity or to advance such costs.

In connection with the lending of securities facilitated by GIS as an intermediary on behalf of certain of its clients, we provide indemnification to those clients against the failure of the borrowers to return the securities. The market value of the securities lent is

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fully secured on a daily basis; therefore, the exposure to us is limited to temporary shortfalls in the collateral as a result of short-term fluctuations in trading

prices of the loaned securities. At June 30, 2010, the total maximum potential exposure as a result of these indemnity obligations was \$7.7 billion, although the collateral at the time exceeded that amount.

### *VISA INDEMNIFICATION*

Our payment services business issues and acquires credit and debit card transactions through Visa U.S.A. Inc. card association or its affiliates (Visa). Our 2009 Form 10-K has additional information regarding the October 2007 Visa restructuring, our involvement with judgment and loss sharing agreements with Visa and certain other banks, and other 2009 developments in this area.

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In May 2010, Visa funded \$500 million to their litigation escrow account and reduced the conversion ratio of Visa B to A shares. We consequently recognized our estimated \$47 million share of the \$500 million as a reduction of our indemnification liability and a reduction of noninterest expense.

Our Visa indemnification liability included on our Consolidated Balance Sheet at June 30, 2010 totaled \$146 million as a result of the indemnification provision in Section 2.05j of the Visa By-Laws and/or the indemnification provided through the judgment and loss sharing agreements. Any ultimate exposure to the specified Visa litigation may be different than this amount.

**RECOURSE AGREEMENTS**

We are authorized to originate, underwrite, close to fund and service commercial mortgage loans and then sell them to FNMA under FNMA's DUS program. We have similar arrangements with FHLMC.

Under these programs, we generally assume up to one-third of the risk of loss on unpaid principal balances through a loss share arrangement. At June 30, 2010, the potential exposure to loss was \$4.0 billion. Accordingly, we maintain a reserve for such potential losses. At June 30, 2010, the unpaid principal balance outstanding of loans sold as a participant in these programs was \$13.4 billion. The reserves for losses under these programs, totaled \$39 million as of June 30, 2010 and is included in Other liabilities on our Consolidated Balance Sheet. If payment is required under these programs, we would not have a contractual interest in the collateral underlying the mortgage loans on which losses occurred, although the value of the collateral is taken into account in determining our share of such losses. The serviced loans are not included on our Consolidated Balance Sheet.

We sell residential mortgage loans pursuant to agreements which contain representations concerning subjects such as credit information, loan documentation, collateral, and insurability. Prior to the acquisition, National City also sold home equity loans/lines of credit pursuant to such agreements. On a regular basis, investors may request PNC to indemnify them against losses on certain loans or to repurchase loans which the investors believe do not comply with applicable representations. During 2009 and the first six months of 2010 the frequency of such requests increased in relation to prior years. This increase was driven by higher loan delinquencies, resulting from deterioration in overall economic conditions and trends, particularly those impacting the residential housing sector.

Upon completion of its own investigation as to the validity of the claim, PNC will repurchase or provide indemnification on such loans. This may take the form of an outright repurchase of the loan or a settlement payment to the investor. If the loan is repurchased it is properly considered in our nonperforming loan disclosures and statistics.

Management maintains a liability for estimated losses on loans expected to be repurchased, or on which indemnification is expected to be provided, and regularly evaluates the adequacy of this recourse liability based on trends in repurchase and indemnification requests, actual loss experience, known and inherent risks in the loans, and current economic conditions. As part of its evaluation of the adequacy of this recourse liability, management considers estimated loss projections over the life of the subject loan portfolio.

At June 30, 2010 and December 31, 2009, the total liability for estimated losses on such repurchase and indemnification claims, including reserves related to the agency programs described above, were as follows:

**Estimated Losses on Repurchase and Indemnification Claims**

	June 30 2010	December 31 2009
Dollars in millions		
Residential Mortgage Banking	\$ 159	\$ 229
Distressed Assets Portfolio	56	44
Corporate & Institutional Banking	39	71
Retail Banking	2	2
Total	\$ 256	\$ 346

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These liabilities are reported in Other liabilities on our Consolidated Balance Sheet. The decrease in this reserve during the first half of 2010 was mainly due to loan repurchases and elimination of reserves, partially offset by additional provisions to the reserves.

### **REINSURANCE AGREEMENTS**

We have two wholly-owned captive insurance subsidiaries which provide reinsurance to third-party insurers related to insurance sold to our customers. These subsidiaries enter into various types of reinsurance agreements with third-party insurers where the subsidiary assumes the risk of loss through either an excess of loss or quota share agreement up to 100% reinsurance. In excess of loss agreements, these subsidiaries assume the risk of loss for an excess layer of coverage up to specified limits, once a defined first loss percentage is met. In quota share agreements, the subsidiaries and third-party insurers share the responsibility for payment of all claims.

Reserves recognized for probable losses on these policies and the aggregate maximum exposure up to the specified limits for all reinsurance contracts were as follows:

### **Reinsurance Agreements**

In millions except as noted	<b>June 30 2010</b>
Reserves for probable losses	<b>\$ 195</b>
Maximum exposure (billions)	<b>\$ 4.1</b>

The comparable amount of reserves for probable losses as of December 31, 2009 was \$220 million.

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### ***REPURCHASE AND RESALE AGREEMENTS***

We enter into repurchase and resale agreements where we transfer investment securities to/from a third party with the agreement to repurchase/resell those investment securities at a future date for a specified price. These transactions are accounted for as collateralized borrowings/financings.

### ***NOTE 19 SEGMENT REPORTING***

We have six reportable business segments:

- Retail Banking
- Corporate & Institutional Banking
- Asset Management Group
- Residential Mortgage Banking
- BlackRock
- Distressed Assets Portfolio

Results of individual businesses are presented based on our management accounting practices and management structure. There is no comprehensive, authoritative body of guidance for management accounting equivalent to GAAP; therefore, the financial results of our individual businesses are not necessarily comparable with similar information for any other company. We refine our methodologies from time to time as our management accounting practices are enhanced and our businesses and management structure change. As a result of its sale, GIS is no longer a reportable business segment.

Financial results are presented, to the extent practicable, as if each business operated on a stand-alone basis. As permitted under GAAP, we have aggregated the business results for certain similar operating segments for financial reporting purposes.

Assets receive a funding charge and liabilities and capital receive a funding credit based on a transfer pricing methodology that incorporates product maturities, duration and other factors. Capital is intended to cover unexpected losses and is assigned to the banking and servicing businesses using our risk-based economic capital model. We have assigned capital to Retail Banking equal to 6% of funds to approximate market comparables for this business.

We have allocated the allowances for loan and lease losses and unfunded loan commitments and letters of credit based on our assessment of risk inherent in each business segment's loan portfolio. Our allocation of the costs incurred by operations and other shared support areas not directly aligned with the businesses is primarily based on the use of services.

Total business segment financial results differ from consolidated income from continuing operations before noncontrolling interests and exclude the earnings and revenue attributable to GIS. The impact of these differences is reflected in the Other category in the business segment tables. Other includes residual activities that do not meet the criteria for disclosure as a separate reportable business, such

as gains or losses related to BlackRock transactions including LTIP share distributions and obligations, integration costs, asset and liability management activities including net securities gains or losses and certain trading activities, exited businesses, equity management activities, alternative investments, intercompany eliminations, most corporate overhead, and differences between business segment performance reporting and financial statement reporting (GAAP), including the presentation of net income attributable to noncontrolling interests. Assets, revenue and earnings attributable to foreign activities were not material in the periods presented for comparative purposes.

### ***BUSINESS SEGMENT PRODUCTS AND SERVICES***

***Retail Banking*** provides deposit, lending, brokerage, trust, investment management, and cash management services to consumer and small business customers within our primary geographic markets. Our customers are serviced through our branch network, call centers and the internet. The branch network is located primarily in Pennsylvania, Ohio, New Jersey, Michigan, Maryland, Illinois, Indiana, Kentucky, Florida, Virginia, Missouri, Delaware, Washington, D.C., and Wisconsin.

***Corporate & Institutional Banking*** provides lending, treasury management, and capital markets-related products and services to mid-sized corporations, government and not-for-profit entities, and selectively to large corporations. Lending products include secured and unsecured loans, letters of credit and equipment leases. Treasury management services include cash and investment



management, receivables management, disbursement services, funds transfer services, information reporting, and global trade services. Capital markets-related products and services include foreign exchange, derivatives, loan syndications, mergers and acquisitions advisory and related services to middle-market companies, our multi-seller conduit, securities underwriting, and securities sales and trading. Corporate & Institutional Banking also provides commercial loan servicing, and real estate advisory and technology solutions for the commercial real estate finance industry. Corporate & Institutional Banking provides products and services generally within our primary geographic markets, with certain products and services offered nationally.

**Asset Management Group** includes personal wealth management for high net worth and ultra high net worth clients and institutional asset management. Wealth management products and services include financial planning, customized investment management, private banking, tailored credit solutions and trust management and administration for individuals and their families. Institutional asset management provides investment management, custody, and retirement planning services. The institutional clients include corporations, foundations and unions and charitable endowments located primarily in our geographic footprint.

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**Residential Mortgage Banking** directly originates primarily first lien residential mortgage loans on a nationwide basis with a significant presence within the retail banking footprint and also originates loans through joint venture partners. Mortgage loans represent loans collateralized by one-to-four-family residential real estate. These loans are typically underwritten to government agency and/or third party standards, and sold, servicing retained, to primary mortgage market conduits FNMA, FHLMC, Federal Home Loan Banks and third-party investors, or are securitized and issued under the Government National Mortgage Association (GNMA) program. The mortgage servicing operation performs all functions related to servicing mortgage loans primarily those in first lien position for various investors and for loans owned by PNC. Certain loans originated through our joint ventures are serviced by a joint venture partner.

**BlackRock** is the largest publicly traded investment management firm in the world. BlackRock manages assets on

behalf of institutional and individual investors worldwide through a variety of equity, fixed income, multi-asset class, alternative and cash management separate accounts and funds, including iShares®, the global product leader in exchange traded funds. In addition, BlackRock provides market risk management, financial markets advisory and enterprise investment system services globally to a broad base of clients. At June 30, 2010, our share of BlackRock's earnings was 23%.

**Distressed Assets Portfolio** includes commercial residential development loans, cross-border leases, consumer brokered home equity loans, retail mortgages, non-prime mortgages, and residential construction loans. These loans require special servicing and management oversight given current market conditions. The majority of these loans are from acquisitions, primarily National City.

**Table of Contents****Results Of Businesses**

Three months ended June 30

In millions	Retail Banking	Corporate & Institutional Banking	Asset Management Group	Residential Mortgage Banking	BlackRock	Distressed Assets Portfolio	Other	Consolidated
<b>2010</b>								
<b>Income Statement</b>								
Net interest income	\$ 886	\$ 911	\$ 66	\$ 73		\$ 339	\$ 160	\$ 2,435
Noninterest income (expense)	508	296	154	182	\$ 99	(1)	239	1,477
Total revenue	1,394	1,207	220	255	99	338	399	3,912
Provision for (recoveries of) credit losses	280	97	14	(8)		404	36	823
Depreciation and amortization	59	37	10	1			71	178
Other noninterest expense	935	384	150	108		65	182	1,824
Earnings (loss) from continuing operations before income taxes	120	689	46	154	99	(131)	110	1,087
Income taxes (benefit)	35	246	17	62	22	(45)	(31)	306
Earnings (loss) from continuing operations before noncontrolling interests	\$ 85	\$ 443	\$ 29	\$ 92	\$ 77	\$ (86)	\$ 141	\$ 781
Inter-segment revenue		\$ 4	\$ 2	\$ 3	\$ 7	\$ (4)	\$ (12)	
Average Assets (a)	\$ 67,600	\$ 76,952	\$ 7,071	\$ 8,813	\$ 6,125	\$ 18,516	\$ 79,289	\$ 264,366
<b>2009</b>								
<b>Income Statement</b>								
Net interest income (expense)	\$ 902	\$ 879	\$ 75	\$ 87		\$ 295	\$ (45)	\$ 2,193
Noninterest income	564	397	151	245	\$ 67	39	147	1,610
Total revenue	1,466	1,276	226	332	67	334	102	3,803
Provision for credit losses	304	649	46	8		30	50	1,087
Depreciation and amortization	68	35	10	1			80	194
Other noninterest expense	997	432	157	175		55	482	2,298
Earnings (loss) from continuing operations before income taxes	97	160	13	148	67	249	(510)	224
Income taxes (benefit)	36	53	5	56	13	94	(228)	29
Earnings (loss) from continuing operations before noncontrolling interests	\$ 61	\$ 107	\$ 8	\$ 92	\$ 54	\$ 155	\$ (282)	\$ 195
Inter-segment revenue	\$ 1	\$ 2	\$ 5	\$ 1	\$ 4	\$ (5)	\$ (8)	
Average Assets (a)	\$ 65,177	\$ 86,904	\$ 7,427	\$ 8,591	\$ 4,383	\$ 23,778	\$ 84,595	\$ 280,855

Six months ended June 30

In millions	Retail Banking	Corporate & Institutional Banking	Asset Management Group	Residential Mortgage Banking	BlackRock	Distressed Assets Portfolio	Other	Consolidated
<b>2010</b>								
<b>Income Statement</b>								
Net interest income	\$ 1,757	\$ 1,780	\$ 130	\$ 153		\$ 677	\$ 317	\$ 4,814
Noninterest income (expense)	996	667	318	336	\$ 198	(2)	348	2,861
Total revenue	2,753	2,447	448	489	198	675	665	7,675
Provision for (recoveries of) credit losses	619	333	23	(24)		569	54	1,574
Depreciation and amortization	122	71	21	2			145	361
Other noninterest expense	1,847	795	296	228		123	465	3,754
Earnings (loss) from continuing operations before income taxes	165	1,248	108	283	198	(17)	1	1,986
Income taxes (benefit)	56	445	40	109	44	(3)	(134)	557
Earnings (loss) from continuing operations before noncontrolling interests	\$ 109	\$ 803	\$ 68	\$ 174	\$ 154	\$ (14)	\$ 135	\$ 1,429
Inter-segment revenue		\$ 20	\$ 6	\$ 5	\$ 11	\$ (7)	\$ (35)	
Average Assets (a)	\$ 67,782	\$ 78,227	\$ 7,094	\$ 8,834	\$ 6,125	\$ 19,009	\$ 78,678	\$ 265,749
<b>2009</b>								
<b>Income Statement</b>								
Net interest income (expense)	\$ 1,823	\$ 1,895	\$ 171	\$ 178		\$ 626	\$ (180)	\$ 4,513
Noninterest income	1,084	664	305	682	\$ 93	52	96	2,976
Total revenue	2,907	2,559	476	860	93	678	(84)	7,489
Provision for (recoveries of) credit losses	608	936	63	(1)		289	72	1,967
Depreciation and amortization	135	71	21	3			168	398

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Other noninterest expense	1,983	826	316	346	135	646	4,252
Earnings (loss) from continuing operations before income taxes	181	726	76	512	93	254	872
Income taxes (benefit)	70	260	29	193	16	96	157
Earnings (loss) from continuing operations before noncontrolling interests	\$ 111	\$ 466	\$ 47	\$ 319	\$ 77	\$ 158	\$ 715
Inter-segment revenue	\$ (1)	\$ 5	\$ 9	\$ 3	\$ 8	\$ (9)	\$ (15)
Average Assets (a)	\$ 65,397	\$ 89,005	\$ 7,442	\$ 7,909	\$ 4,383	\$ 24,295	\$ 280,853

(a) Period-end balances for BlackRock.

**Table of Contents****STATISTICAL INFORMATION (Unaudited)**

THE PNC FINANCIAL SERVICES GROUP, INC.

**Average Consolidated Balance Sheet And Net Interest Analysis**

Taxable-equivalent basis Dollars in millions	Six months ended June 30, 2010			Six months ended June 30, 2009		
	Average Balances	Interest Income/Expense	Average Yields/Rates	Average Balances	Interest Income/Expense	Average Yields/Rates
<b>Assets</b>						
Interest-earning assets:						
Investment securities						
Securities available for sale						
Residential mortgage-backed						
Agency	\$ 21,150	\$ 424	4.00%	\$ 22,030	\$ 543	4.93%
Non-agency	9,783	290	5.92	12,828	430	6.70
Commercial mortgage-backed	4,153	110	5.30	4,439	128	5.77
Asset-backed	1,843	43	4.66	2,008	71	7.02
U.S. Treasury and government agencies	8,104	121	2.98	2,711	40	2.97
State and municipal	1,360	40	5.88	1,351	37	5.53
Other debt	2,202	34	3.13	849	16	3.76
Corporate stocks and other	451		.12	422	2	.96
Total securities available for sale	49,046	1,062	4.33	46,638	1,267	5.43
Securities held to maturity						
Commercial mortgage-backed	3,193	91	5.67	1,983	63	6.34
Asset-backed	3,681	49	2.69	1,640	41	4.95
Other	90	5	11.70	9		6.50
Total securities held to maturity	6,964	145	4.17	3,632	104	5.71
Total investment securities	56,010	1,207	4.31	50,270	1,371	5.45
Loans						
Commercial	54,903	1,425	5.16	65,391	1,662	5.05
Commercial real estate	21,689	578	5.30	25,519	702	5.47
Equipment lease financing	6,105	156	5.12	6,298	156	4.97
Consumer	55,143	1,466	5.36	52,246	1,410	5.44
Residential mortgage	18,985	717	7.56	21,876	757	6.93
Total loans	156,825	4,342	5.54	171,330	4,687	5.47
Loans held for sale	2,561	153	12.02	4,640	127	5.52
Federal funds sold and resale agreements	1,933	19	1.95	1,668	22	2.58
Other	8,450	93	2.21	15,804	85	1.07
Total interest-earning assets/interest income	225,779	5,814	5.15	243,712	6,292	5.16
Noninterest-earning assets:						
Allowance for loan and lease losses	(5,124)			(4,240)		
Cash and due from banks	3,664			3,694		
Other	41,430			37,687		
Total assets	\$ 265,749			\$ 280,853		
<b>Liabilities and Equity</b>						
Interest-bearing liabilities:						
Interest-bearing deposits						
Money market	\$ 58,303	144	.50	\$ 54,153	346	1.29
Demand	24,814	20	.16	22,897	40	.35
Savings	6,850	7	.19	6,473	8	.24
Retail certificates of deposit	45,444	337	1.50	57,662	580	2.03
Other time	959	14	2.96	7,950	42	1.04
Time deposits in foreign offices	2,847	3	.21	3,588	4	.24
Total interest-bearing deposits	139,217	525	.76	152,723	1,020	1.35
Borrowed funds						
Federal funds purchased and repurchase agreements	4,251	7	.34	4,647	10	.41
Federal Home Loan Bank borrowings	9,086	36	.78	16,454	145	1.76
Bank notes and senior debt	12,641	133	2.08	13,537	253	3.72

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Subordinated debt	9,767	240	4.92	10,339	326	6.31
Other	5,969	25	.84	2,057	20	1.94
Total borrowed funds	41,714	441	2.11	47,034	754	3.20
Total interest-bearing liabilities/interest expense	180,931	966	1.07	199,757	1,774	1.78
Noninterest-bearing liabilities and equity:						
Noninterest-bearing deposits	43,474			39,734		
Allowance for unfunded loan commitments and letters of credit	273			336		
Accrued expenses and other liabilities	10,424			11,931		
Equity	30,647			29,095		
Total liabilities and equity	\$ 265,749			\$ 280,853		
Interest rate spread			4.08			3.38
Impact of noninterest-bearing sources			.21			.32
Net interest income/margin		\$ 4,848	4.29%		\$ 4,518	3.70%

Nonaccrual loans are included in loans, net of unearned income. The impact of financial derivatives used in interest rate risk management is included in the interest income/expense and average yields/rates of the related assets and liabilities. Basis adjustments related to hedged items are included in noninterest-earning assets and noninterest-bearing liabilities. Average balances of securities are based on amortized historical cost (excluding adjustments to fair value, which are included in other assets). Average balances for certain loans and borrowed funds accounted for at fair value, with changes in fair value recorded in trading noninterest income, are included in noninterest-earning assets and noninterest-bearing liabilities. The interest-earning deposits with the Federal Reserve are included in the Other interest-earning assets category.

**Table of Contents****Average Consolidated Balance Sheet And Net Interest Analysis (Continued)**

Second Quarter 2010			First Quarter 2010			Second Quarter 2009		
Average	Interest	Average	Average	Interest	Average	Average	Interest	Average
Balances	Income/ Expense	Yields/ Rates	Balances	Income/ Expense	Yields/ Rates	Balances	Income/ Expense	Yields/ Rates
\$20,382	\$ 196	3.83%	\$ 21,926	\$ 228	4.16%	\$ 21,007	\$ 257	4.89%
9,358	140	5.97	10,213	150	5.87	12,520	217	6.95
2,962	39	5.29	5,357	71	5.29	4,624	67	5.84
1,695	21	4.96	1,992	22	4.40	1,985	22	4.22
8,708	61	2.81	7,493	60	3.19	4,185	33	3.15
1,356	19	5.50	1,365	21	6.26	1,366	17	5.20
2,526	18	2.94	1,874	16	3.39	1,012	9	3.61
446		.13	457		.10	386	1	1.01
47,433	494	4.16	50,677	568	4.48	47,085	623	5.30
4,264	60	5.62	2,110	31	5.82	2,004	32	6.28
3,697	24	2.61	3,665	25	2.76	1,847	23	4.85
21		9.29	160	5	11.97	9		8.00
7,982	84	4.23	5,935	61	4.10	3,860	55	5.60
55,415	578	4.17	56,612	629	4.44	50,945	678	5.32
54,349	729	5.30	55,464	696	5.02	63,570	792	4.92
20,963	269	5.08	22,423	309	5.51	25,418	298	4.64
6,080	77	5.13	6,131	79	5.12	6,191	63	4.11
54,939	736	5.37	55,349	730	5.35	51,878	686	5.30
18,576	359	7.73	19,397	358	7.39	21,831	374	6.86
154,907	2,170	5.58	158,764	2,172	5.50	168,888	2,213	5.22
2,646	87	13.15	2,476	66	10.80	4,757	62	5.26
2,193	10	1.73	1,669	9	2.23	1,726	11	2.47
9,419	46	1.93	7,471	47	2.55	16,870	53	1.23
224,580	2,891	5.13	226,992	2,923	5.17	243,186	3,017	4.94
(5,113)			(5,136)			(4,385)		
3,595			3,735			3,558		
41,304			41,557			38,496		
\$264,366			\$ 267,148			\$ 280,855		
\$58,679	68	.46	\$ 57,923	76	.53	\$ 55,464	146	1.05
24,953	9	.14	24,672	11	.18	23,629	17	.30
7,075	4	.19	6,623	3	.19	6,678	4	.21
43,745	156	1.44	47,162	181	1.55	57,357	287	2.01
881	6	2.90	1,039	8	3.01	5,259	18	1.35
2,661	1	.21	3,034	2	.21	3,348	2	.22
137,994	244	.71	140,453	281	.81	151,735	474	1.25
4,159	3	.29	4,344	4	.39	4,283	5	.39
8,575	19	.83	9,603	17	.73	15,818	60	1.51
12,666	49	1.53	12,616	84	2.65	13,688	107	3.10
9,764	110	4.54	9,769	130	5.30	10,239	165	6.46
6,005	14	.92	5,934	11	.77	2,170	8	1.34
41,169	195	1.88	42,266	246	2.33	46,198	345	2.97

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179,163	439	.98	182,719	527	1.16	197,933	819	1.65
44,308			42,631			40,965		
251			295			328		
10,446			10,401			11,990		
30,198			31,102			29,639		
\$264,366			\$ 267,148			\$ 280,855		
		4.15			4.01			3.29
		.20			.23			.31
	\$ 2,452	4.35%		\$ 2,396	4.24%		\$ 2,198	3.60%

Loan fees for the six months ended June 30, 2010 and June 30, 2009 were \$88 million and \$78 million, respectively. Loan fees for the three months ended June 30, 2010, March 31, 2010, and June 30, 2009 were \$43 million, \$45 million, and \$34 million, respectively. Interest income includes the effects of taxable-equivalent adjustments using a marginal federal income tax rate of 35% to increase tax-exempt interest income to a taxable-equivalent basis. The taxable-equivalent adjustments to interest income for the six months ended June 30, 2010 and June 30, 2009 were \$37 million and \$31 million, respectively. The taxable-equivalent adjustments to interest income for the three months ended June 30, 2010, March 31, 2010, and June 30, 2009 were \$19 million, \$18 million, and \$16 million, respectively.



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***PART II OTHER INFORMATION***

***ITEM 1. LEGAL PROCEEDINGS***

See the information set forth in Note 17 Legal Proceedings in the Notes To Consolidated Financial Statements under Part I, Item 1 of this Report, which is incorporated by reference in response to this item.

***ITEM 1A. RISK FACTORS***

The following risk factor is added to the risk factors previously disclosed in PNC's 2009 Form 10-K in response to Part I, Item 1A. In general, each of these risk factors, including the one added below, presents the risk of a material impact on our results of operations or financial condition, in addition to other possible consequences described therein. These risk factors are also discussed further in other parts of our 2009 Form 10-K and in this Report.

**The regulatory environment for the financial services industry will be significantly impacted by the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act.**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) mandates the most wide-ranging overhaul of financial industry regulation in decades. Dodd-Frank was signed into law on July 21, 2010, and is now in the implementation stage. The law provides a regulatory framework and requires that regulators, some of which are new regulatory bodies created by Dodd-Frank, draft, review and approve more than 200 implementing regulations and conduct numerous studies that are likely to lead to more regulations.

The newly created regulatory bodies are the Consumer Financial Protection Bureau and the Financial Stability Oversight Council. The Consumer Financial Protection Bureau has been given authority to regulate all consumer financial products sold by banks and non-bank companies. The 10-member inter-agency Financial Stability Oversight Council has been charged with identifying systemic risks and strengthening the regulation of financial holding companies and certain non-bank companies deemed to be systemically important and could, in extraordinary cases, break up financial firms deemed too big to fail.

There are a number of reform provisions that are likely to significantly impact the ways in which banks and bank holding companies, including PNC, do business. For example, Dodd-Frank prohibits banks from engaging in some types of proprietary trading, restricts the ability of banks to sponsor or invest in private equity or hedge funds, and requires banks to move some derivatives business to separately capitalized subsidiaries of holding companies. The Federal Reserve will set debit card interchange fees. States will be allowed to impose consumer protection laws on national banks if the state

laws are stricter than federal laws, although the Comptroller of the Currency may preempt state laws if they prevent or significantly interfere with the business of banking. Other provisions of the legislation will affect oversight, holding company capital requirements, risk retention for securitizations, and residential mortgage products.

While much of how Dodd-Frank will operate depends on the specific regulatory changes adopted, it is clear that the reforms will have a significant effect on our entire industry. Although Dodd-Frank will affect a number of the areas in which we do business, it is not clear at this time what adjustments will be required and the extent to which we will be able to adjust our businesses. Although it is difficult to predict the magnitude and extent of these effects at this stage, we believe compliance with Dodd-Frank and its implementing regulations will negatively impact revenue and increase the cost of doing business, both in terms of transition expenses and on an ongoing basis and may limit our ability to pursue certain business opportunities.

***ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS***

(c) Details of our repurchases of PNC common stock during the second quarter of 2010 are included in the following table:

In thousands, except per share data

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2010 period	Total shares purchased	Average price paid per share	Total shares purchased as part of publicly announced programs (b)	Maximum number of shares that may yet be purchased under the programs (b)
April 1 - April 30	(a) 331	\$ 65.56		24,710
May 1 - May 31	225	\$ 64.19		24,710
June 1 - June 30	804	\$ 57.52		24,710
Total	1,360	\$ 60.54		

- (a) Reflects PNC common stock purchased in connection with our various employee benefit plans. No shares were purchased under the program referred to in note (b) to this table during the second quarter of 2010.
- (b) Our current stock repurchase program allows us to purchase up to 25 million shares on the open market or in privately negotiated transactions. This program was authorized on October 4, 2007 and will remain in effect until fully utilized or until modified, superseded or terminated.

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***ITEM 6. EXHIBITS***

The following exhibit index lists Exhibits filed, or in the case of Exhibits 32.1 and 32.2 furnished, with this Quarterly Report on Form 10-Q:

***EXHIBIT INDEX***

- 12.1 Computation of Ratio of Earnings to Fixed Charges
- 12.2 Computation of Ratio of Earnings to Fixed Charges and Preferred Stock Dividends
- 31.1 Certification of Chairman and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350
- 32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350

101 Interactive Data File (XBRL)

You can obtain copies of these Exhibits electronically at the SEC's website at [www.sec.gov](http://www.sec.gov) or by mail from the Public Reference Section of the SEC, 100 F Street, N.E., Washington, DC 20549 at prescribed rates. The Exhibits are also available as part of this Form 10-Q on or through PNC's corporate website at [www.pnc.com/secfilings](http://www.pnc.com/secfilings). Shareholders and bondholders may also receive copies of Exhibits, without charge, by contacting Shareholder Relations at 800-843-2206 or via e-mail at [investor.relations@pnc.com](mailto:investor.relations@pnc.com). The interactive data file (XBRL) exhibit is only available electronically.

***SIGNATURE***

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on August 9, 2010 on its behalf by the undersigned thereunto duly authorized.

**The PNC Financial Services Group, Inc.**

/s/ Richard J. Johnson  
Richard J. Johnson  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

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***CORPORATE INFORMATION***

THE PNC FINANCIAL SERVICES GROUP, INC.

***CORPORATE HEADQUARTERS***

The PNC Financial Services Group, Inc.

One PNC Plaza, 249 Fifth Avenue

Pittsburgh, Pennsylvania 15222-2707

412-762-2000

***STOCK LISTING*** The PNC Financial Services Group, Inc.'s common stock is listed on the New York Stock Exchange under the symbol PNC.

***INTERNET INFORMATION*** The PNC Financial Services Group, Inc.'s financial reports and information about its products and services are available on the internet at [www.pnc.com](http://www.pnc.com). We provide information for investors in portions of our corporate website, such as the Investor Events, Quarterly Earnings, SEC Filings, Financial Information, Financial Press Releases and Message from the Chairman areas that you can find under About PNC Investor Relations. In this section, we will from time to time post information that we believe may be important or useful to investors. We generally post the following shortly before or promptly following its first use or release: financially-related press releases (including earnings releases), various SEC filings, presentation materials associated with earnings and other investor conference calls or events, and access to live and taped audio from such calls or events. When warranted, we will also use our website to expedite public access to time-critical information regarding PNC in advance of distribution of a press release or a filing with the SEC disclosing the same information. You can also find the SEC reports and corporate governance information described in the sections below in the Investor Relations section of our website.

Where we have included web addresses in this Report, such as our web address and web addresses of the SEC and of BlackRock, we have included those web addresses as inactive textual references only. Except as specifically incorporated by reference into this Report, information on those websites is not part hereof.

***FINANCIAL INFORMATION*** We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (Exchange Act), and, in accordance with the Exchange Act, we file annual, quarterly and current reports, proxy statements, and other information with the SEC. You can obtain copies of these and other filings, including exhibits, electronically at the SEC's internet website at [www.sec.gov](http://www.sec.gov) or on or through PNC's corporate internet website at [www.pnc.com/secfilings](http://www.pnc.com/secfilings). Copies may also be obtained without charge by contacting Shareholder Services at 800-982-7652 or via the online contact form at [www.computershare.com/contactus](http://www.computershare.com/contactus) for copies without exhibits or by contacting Shareholder Relations at

800-843-2206 or via email at [investor.relations@pnc.com](mailto:investor.relations@pnc.com) for copies of exhibits. The interactive data file (XBRL) exhibit is only available electronically.

***CORPORATE GOVERNANCE AT PNC*** Information about our Board and its committees and corporate governance at PNC is available on PNC's corporate website at [www.pnc.com/corporategovernance](http://www.pnc.com/corporategovernance). Shareholders who would like to request printed copies of PNC's Code of Business Conduct and Ethics or our Corporate Governance Guidelines or the charters of our Board's Audit, Nominating and Governance, or Personnel and Compensation Committees (all of which are posted on the PNC corporate website) may do so by sending their requests to George P. Long, III, Chief Governance Counsel and Corporate Secretary, at corporate headquarters at the above address. Copies will be provided without charge to shareholders.

***INQUIRIES*** For financial services call 888-PNC-2265.

Individual shareholders should contact Shareholder Services at 800-982-7652.

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Analysts and institutional investors should contact William H. Callihan, Senior Vice President, Director of Investor Relations, at 412-762-8257 or via e-mail at [investor.relations@pnc.com](mailto:investor.relations@pnc.com).

News media representatives and others seeking general information should contact Brian E. Goerke, Director of External Communications, at 412-762-4550 or via e-mail at [corporate.communications@pnc.com](mailto:corporate.communications@pnc.com).

**COMMON STOCK PRICES/DIVIDENDS DECLARED** The table below sets forth by quarter the range of high and low sale and quarter-end closing prices for The PNC Financial Services Group, Inc. common stock and the cash dividends declared per common share.

	High	Low	Close	Cash Dividends Declared
<b>2010 Quarter</b>				
<b>First</b>	<b>\$ 61.80</b>	<b>\$ 50.46</b>	<b>\$ 59.70</b>	<b>\$ .10</b>
<b>Second</b>	<b>\$ 70.45</b>	<b>\$ 56.30</b>	<b>\$ 56.50</b>	<b>\$ .10</b>
Total				<b>\$ .20</b>
<b>2009 Quarter</b>				
First	\$ 50.42	\$ 16.20	\$ 29.29	\$ .66
Second	53.22	27.50	38.81	.10
Third	48.78	33.06	48.59	.10
Fourth	57.86	43.37	52.79	.10
Total				\$ .96

**DIVIDEND POLICY** Holders of PNC common stock are entitled to receive dividends when declared by the Board of Directors out of funds legally available for this purpose. Our Board of Directors may not pay or set apart dividends on the common

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stock until dividends for all past dividend periods on any series of outstanding preferred stock have been paid or declared and set apart for payment. The Board presently intends to continue the policy of paying quarterly cash dividends. The amount of any future dividends will depend on economic and market conditions, our financial condition and operating results, and other factors, including contractual restrictions and applicable government regulations and policies (such as those relating to the ability of bank and non-bank subsidiaries to pay dividends to the parent company).

***DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN***

The PNC Financial Services Group, Inc. Dividend Reinvestment and Stock Purchase Plan enables holders of our common and preferred stock to conveniently purchase additional shares of common stock. You can obtain a prospectus and enrollment form by contacting Shareholder Services at 800-982-7652.

***REGISTRAR AND STOCK TRANSFER AGENT***

Computershare Trust Company, N.A.

250 Royall Street

Canton, MA 02021

800-982-7652