KEYCORP /NEW/
Form 10-Q
August 04, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

**Form 10-Q**

[**Ö**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2011
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 1-11302
(Exact name of registrant as specified in its charter)

| **Ohio** | **34-6542451** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **127 Public Square, Cleveland, Ohio** | **44114-1306** |
| (Address of principal executive offices) | (Zip Code) |

**(216) 689-3000**
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

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

| Large accelerated filer þ | Accelerated filer o |
|---|---|
| Non-accelerated filer o (Do not check if a smaller reporting company) | Smaller reporting company o |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

| Common Shares with a par value of $1 each | 952,859,183 Shares |
|---|---|
| (Title of class) | (Outstanding at August 1, 2011) |

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EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

**Throughout the Notes to Consolidated Financial Statements (Unaudited) and Management s Discussion & Analysis of Financial Condition & Results of Operations, we use certain acronyms and abbreviations which are defined in Note 1 ( Basis of Presentation ), which begins on page 9.**



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**PART I. FINANCIAL INFORMATION**
**Item 1. Financial Statements**

**Consolidated Balance Sheets**

| cept per share data | June 30, 2011 | Decembe 3 201 |
|---|---|---|
| | (Unaudited) | |
| from banks | $ 853 | $ 27 |
| estments | 4,563 | 1,34 |
| nt assets | 769 | 98 |
| lable for sale | 18,680 | 21,93 |
| ity securities (fair value: $19, $17 and $19) | 19 | 1 |
| ents | 1,195 | 1,35 |
| unearned income of $1,460, $1,572 and $1,641 | 47,840 | 50,10 |
| ce for loan and lease losses | 1,230 | 1,60 |
| | 46,610 | 48,50 |
| sale | 381 | 46 |
| equipment | 919 | 90 |
| e assets | 453 | 50 |
| | 917 | 91 |
| le assets | 19 | 2 |
| ned life insurance | 3,208 | 3,16 |
| ets | 900 | 1,00 |
| ne and other assets (including $91 of consolidated LIHTC guaranteed funds VIEs, see Note 9)[a] | 2,968 | 3,87 |
| assets (including $3,134 of consolidated education loan securitization trust VIEs at fair value, see Note 9)[a] | 6,328 | 6,55 |
| | $ 88,782 | $ 91,84 |
| S | | |
| mestic offices: | | |
| ney market deposit accounts | $ 26,277 | $ 27,06 |
| its | 1,973 | 1,87 |
| deposit ($100,000 or more) | 4,939 | 5,86 |
| posits | 7,167 | 8,24 |
| bearing | 40,356 | 43,05 |
| earing | 19,318 | 16,65 |
| reign office interest-bearing | 736 | 90 |
| | 60,410 | 60,61 |
| purchased and securities sold under repurchase agreements | 1,668 | 2,04 |
| d other short-term borrowings | 511 | 1,15 |
| bilities | 991 | 1,14 |

| | | |
|---|---|---|
| nse and other liabilities | **1,518** | 1,93 |
| ot | **10,997** | 10,59 |
| iabilities (including $2,949 of consolidated education loan securitization trust VIEs at fair value, see Note 9)[(a)] | **2,950** | 2,99 |
| s | **79,045** | 80,46 |
| k, $1 par value, authorized 25,000,000 shares: | | |
| mulative Perpetual Convertible Preferred Stock, Series A, $100 liquidation preference; authorized 7,475,000 2,904,839, 2,904,839 and 2,904,839 shares | **291** | 29 |
| mulative Perpetual Preferred Stock, Series B, $100,000 liquidation preference; authorized and issued 25,000 | | 2,44 |
| es, $1 par value; authorized 1,400,000,000 shares; issued 1,016,969,905 946,348,435 and 946,348,435 shares | **1,017** | 94 |
| k warrant | | 8 |
| s | **4,191** | 3,71 |
| ngs | **5,926** | 5,55 |
| , at cost (63,147,538, 65,740,726 and 65,833,721) | **(1,815)** | (1,90 |
| other comprehensive income (loss) | **109** | (1 |
| ers equity | **9,719** | 11,11 |
| g interests | **18** | 25 |
| | **9,737** | 11,37 |
| s and equity | **$ 88,782** | $ 91,84 |

(a) The assets of the VIEs can only be used by the particular VIE and there is no recourse to Key with respect to the liabilities of the consolidated LIHTC or education loan securitization trust VIEs.

See Notes to Consolidated Financial Statements (Unaudited).

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**Consolidated Statements of Income (Unaudited)**

| *dollars in millions, except per share amounts* | Three months ended June 30, 2011 | 2010 | Six months ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| **INTEREST INCOME** | | | | |
| Loans | **$ 551** | $ 677 | **$ 1,121** | $ 1,387 |
| Loans held for sale | **3** | 5 | **7** | 9 |
| Securities available for sale | **149** | 154 | **315** | 304 |
| Held-to-maturity securities | **1** | | **1** | 1 |
| Trading account assets | **9** | 10 | **16** | 21 |
| Short-term investments | **1** | 2 | **2** | 4 |
| Other investments | **12** | 13 | **24** | 27 |
| Total interest income | **726** | 861 | **1,486** | 1,753 |
| **INTEREST EXPENSE** | | | | |
| Deposits | **100** | 188 | **210** | 400 |
| Federal funds purchased and securities sold under repurchase agreements | **2** | 2 | **3** | 3 |
| Bank notes and other short-term borrowings | **3** | 4 | **6** | 7 |
| Long-term debt | **57** | 50 | **106** | 101 |
| Total interest expense | **162** | 244 | **325** | 511 |
| **NET INTEREST INCOME** | **564** | 617 | **1,161** | 1,242 |
| Provision (credit) for loan and lease losses | **(8)** | 228 | **(48)** | 641 |
| Net interest income (expense) after provision for loan and lease losses | **572** | 389 | **1,209** | 601 |
| **NONINTEREST INCOME** | | | | |
| Trust and investment services income | **113** | 112 | **223** | 226 |
| Service charges on deposit accounts | **69** | 80 | **137** | 156 |
| Operating lease income | **32** | 43 | **67** | 90 |
| Letter of credit and loan fees | **47** | 42 | **102** | 82 |
| Corporate-owned life insurance income | **28** | 28 | **55** | 56 |
| Net securities gains (losses)[a] | **2** | (2) | **1** | 1 |
| Electronic banking fees | **33** | 29 | **63** | 56 |
| Gains on leased equipment | **5** | 2 | **9** | 10 |
| Insurance income | **14** | 19 | **29** | 37 |
| Net gains (losses) from loan sales | **11** | 25 | **30** | 29 |
| Net gains (losses) from principal investing | **17** | 17 | **52** | 54 |
| Investment banking and capital markets income (loss) | **42** | 31 | **85** | 40 |
| Other income | **41** | 66 | **58** | 105 |
| Total noninterest income | **454** | 492 | **911** | 942 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **NONINTEREST EXPENSE** | | | | | | | | |
| Personnel | | **380** | | 385 | | **751** | | 747 |
| Net occupancy | | **62** | | 64 | | **127** | | 130 |
| Operating lease expense | | **25** | | 35 | | **53** | | 74 |
| Computer processing | | **42** | | 47 | | **84** | | 94 |
| Business services and professional fees | | **44** | | 41 | | **82** | | 79 |
| FDIC assessment | | **9** | | 33 | | **38** | | 70 |
| OREO expense, net | | **(3)** | | 22 | | **7** | | 54 |
| Equipment | | **26** | | 26 | | **52** | | 50 |
| Marketing | | **10** | | 16 | | **20** | | 29 |
| Provision (credit) for losses on lending-related commitments | | **(12)** | | (10) | | **(16)** | | (12) |
| Other expense | | **97** | | 110 | | **183** | | 239 |
| Total noninterest expense | | **680** | | 769 | | **1,381** | | 1,554 |
| **INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES** | | **346** | | 112 | | **739** | | (11) |
| Income taxes | | **94** | | 11 | | **205** | | (71) |
| **INCOME (LOSS) FROM CONTINUING OPERATIONS** | | **252** | | 101 | | **534** | | 60 |
| Income (loss) from discontinued operations, net of taxes of ($6), ($17), ($12) and ($15) (see Note 11) | | **(9)** | | (27) | | **(20)** | | (25) |
| **NET INCOME (LOSS)** | | **243** | | 74 | | **514** | | 35 |
| Less: Net income (loss) attributable to noncontrolling interests | | **3** | | 4 | | **11** | | 20 |
| **NET INCOME (LOSS) ATTRIBUTABLE TO KEY** | **$** | **240** | $ | 70 | **$** | **503** | $ | 15 |
| Income (loss) from continuing operations attributable to Key common shareholders | **$** | **243** | $ | 56 | **$** | **427** | $ | (42) |
| Net income (loss) attributable to Key common shareholders | | **234** | | 29 | | **407** | | (67) |
| Per common share: | | | | | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | **$** | **.26** | $ | .06 | **$** | **.47** | $ | (.05) |
| Income (loss) from discontinued operations, net of taxes | | **(.01)** | | (.03) | | **(.02)** | | (.03) |
| Net income (loss) attributable to Key common shareholders | | **.25** | | .03 | | **.44** | | (.08) |
| Per common share assuming dilution: | | | | | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | **$** | **.26** | $ | .06 | **$** | **.46** | $ | (.05) |
| Income (loss) from discontinued operations, net of taxes | | **(.01)** | | (.03) | | **(.02)** | | (.03) |
| Net income (loss) attributable to Key common shareholders | | **.25** | | .03 | | **.44** | | (.08) |
| Cash dividends declared per common share | **$** | **.03** | $ | .01 | **$** | **.04** | $ | .02 |

| | | | | |
|---|---|---|---|---|
| Weighted-average common shares outstanding (000) [b] | **947,565** | 874,664 | **914,911** | 874,526 |
| Weighted-average common shares and potential common shares outstanding (000) | **952,133** | 874,664 | **920,162** | 874,526 |

(a) For the three months ended June 30, 2011, we did not have impairment losses related to securities. For the three months ended June 30, 2010, we had $4 million in impairment losses related to securities, which were recognized in earnings.

(b) Assumes conversion of stock options and/or Preferred Series A, as applicable.

See Notes to Consolidated Financial Statements (Unaudited).

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**Consolidated Statements of Changes in Equity (Unaudited)**

| | Key Shareholders Equity | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| millions, except per share amounts | Preferred Shares Outstanding (000) | Common Shares Outstanding (000) | Preferred Stock | Common Shares | Common Stock Warrant | Capital Surplus | Retained Earnings | Treasury Stock, at Cost | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests |
| **E AT DECEMBER 31, 2009** | 2,930 | 878,535 | $ 2,721 | $ 946 | $ 87 | $ 3,734 | $ 5,158 | $ (1,980) | $ (3) | $ 270 |
| e effect adjustment to beginning Retained Earnings | | | | | | | 45 | | | |
| e (loss) | | | | | | | 15 | | | 20 |
| prehensive income (loss): | | | | | | | | | | |
| ized gains (losses) on securities for sale, net of income taxes of $136 | | | | | | | | | 230 | |
| ized gains (losses) on derivative nstruments, net of income taxes of | | | | | | | | | (66) | |
| ution to noncontrolling interests | | | | | | | | | | (38) |
| rrency translation adjustments | | | | | | | | | (19) | |
| on and postretirement benefit costs, me taxes | | | | | | | | | 11 | |
| prehensive income (loss) | | | | | | | | | | |
| ompensation | | | | | | 9 | | | | |
| ends declared on common shares hare) | | | | | | | (18) | | | |
| ends declared on Noncumulative referred Stock ($3.875 per share) | | | | | | | (12) | | | |
| ends accrued on Cumulative referred Stock (5% per annum) | | | | | | | (62) | | | |
| on of discount on Series B Stock | | | 8 | | | | (8) | | | |
| hares reissued for stock options and oyee benefit plans | | 1,980 | | | | (42) | | 66 | | |
| **E AT JUNE 30, 2010** | 2,930 | 880,515 | $ 2,729 | $ 946 | $ 87 | $ 3,701 | $ 5,118 | $ (1,914) | $ 153 | $ 252 |
| **E AT DECEMBER 31, 2010** | 2,930 | 880,608 | $ 2,737 | $ 946 | $ 87 | $ 3,711 | $ 5,557 | $ (1,904) | $ (17) | $ 257 |
| e (loss) | | | | | | | **503** | | | |
| prehensive income (loss): | | | | | | | | | | |
| ized gains (losses) on securities for sale, net of income taxes of $61 | | | | | | | | | **103** | |
| ized gains (losses) on derivative nstruments, net of income taxes of | | | | | | | | | **7** | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| bution from noncontrolling interests | | | | | | | | | | **(239)** |
| urrency translation adjustments | | | | | | | | | **13** | |
| on and postretirement benefit costs, ome taxes | | | | | | | | | **3** | |
| prehensive income (loss) | | | | | | | | | | |
| compensation | | | | | | **(2)** | | | | |
| dends declared on common shares share) | | | | | | | **(38)** | | | |
| dends declared on Noncumulative Preferred Stock ($3.875 per share) | | | | | | | **(12)** | | | |
| dends accrued on Cumulative referred Stock (5% per annum) | | | | | | | **(31)** | | | |
| referred Stock TARP redemption | **(25)** | | **(2,451)** | | | | **(49)** | | | |
| se of common stock warrant | | | | | **(87)** | **17** | | | | |
| ion of discount on Series B Stock | | | **4** | | | | **(4)** | | | |
| shares issuance | | **70,621** | | **71** | | **533** | | | | |
| shares reissued for stock options and loyee benefit plans | | **2,593** | | | | **(68)** | | **89** | | |
| | | | **1** | | | | | | | |
| **E AT JUNE 30, 2011** | **2,905** | **953,822** | **$ 291** | **$ 1,017** | | **$ 4,191** | **$ 5,926** | **$ (1,815)** | **$ 109** | **$ 18** |

See Notes to Consolidated Financial Statements (Unaudited).

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**Consolidated Statements of Cash Flows (Unaudited)**

| *in millions* | Six months ended June 30, 2011 | 2010 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income (loss) | $ **514** | $ 35 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Provision (credit) for loan and lease losses | **(48)** | 641 |
| Depreciation and amortization expense | **143** | 173 |
| FDIC (payments) net of FDIC expense | **35** | 59 |
| Deferred income taxes | **157** | (66) |
| Net losses (gains) and writedown on OREO | **5** | 48 |
| Provision (credit) for customer derivative losses | **(12)** | 27 |
| Net losses (gains) from loan sales | **(30)** | (29) |
| Net losses (gains) from principal investing | **(52)** | (54) |
| Provision (credit) for losses on lending-related commitments | **(16)** | (12) |
| (Gains) losses on leased equipment | **(9)** | (10) |
| Net securities losses (gains) | **(1)** | (1) |
| Net decrease (increase) in loans held for sale excluding transfers from continuing operations | **140** | (48) |
| Net decrease (increase) in trading account assets | **216** | 195 |
| Other operating activities, net | **412** | 595 |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | **1,454** | 1,553 |
| **INVESTING ACTIVITIES** | | |
| Net decrease (increase) in short-term investments | **(3,219)** | (241) |
| Purchases of securities available for sale | **(619)** | (4,453) |
| Proceeds from sales of securities available for sale | **1,587** | 32 |
| Proceeds from prepayments and maturities of securities available for sale | **2,448** | 1,676 |
| Proceeds from prepayments and maturities of held-to-maturity securities | | 4 |
| Purchases of held-to-maturity securities | **(2)** | (2) |
| Purchases of other investments | **(104)** | (60) |
| Proceeds from sales of other investments | **43** | 88 |
| Proceeds from prepayments and maturities of other investments | **41** | 53 |
| Net decrease (increase) in loans, excluding acquisitions, sales and transfers | **1,775** | 3,882 |
| Proceeds from loan sales | **94** | 293 |
| Purchases of premises and equipment | **(74)** | (54) |
| Proceeds from sales of premises and equipment | | 1 |
| Proceeds from sales of other real estate owned | **94** | 79 |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | **2,064** | 1,298 |
| **FINANCING ACTIVITIES** | | |
| Net increase (decrease) in deposits | **(200)** | (3,196) |
| Net increase (decrease) in short-term borrowings | **(1,017)** | 1,573 |
| Net proceeds from issuance of long-term debt | **1,020** | 18 |
| Payments on long-term debt | **(684)** | (1,034) |
| Net proceeds from issuance of common stock | **604** | |

| | | | | |
|---|---|---|---|---|
| Series B Preferred Stock TARP redemption | | **(2,500)** | | |
| Repurchase of common stock warrant | | **(70)** | | |
| Cash dividends paid | | **(96)** | | (92) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | | **(2,943)** | | (2,731) |
| **NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS** | | **575** | | 120 |
| **CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD** | | **278** | | 471 |
| **CASH AND DUE FROM BANKS AT END OF PERIOD** | $ | **853** | $ | 591 |
| Additional disclosures relative to cash flows: | | | | |
| Interest paid | $ | **317** | $ | 528 |
| Income taxes paid (refunded) | | **(319)** | | (157) |
| Noncash items: | | | | |
| Loans transferred to held for sale from portfolio | $ | **54** | $ | 208 |
| Loans transferred to other real estate owned | | **23** | | 99 |

See Notes to Consolidated Financial Statements (Unaudited).

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## Notes to Consolidated Financial Statements (Unaudited)

### 1. Basis of Presentation

As used in these Notes, references to Key, we, our, us and similar terms refer to the consolidated entity consisting o KeyCorp and its subsidiaries. KeyCorp refers solely to the parent holding company, and KeyBank refers to KeyCorp s subsidiary, KeyBank National Association.

The acronyms and abbreviations identified below are used in the Notes to Consolidated Financial Statements (Unaudited) as well as Management s Discussion & Analysis of Financial Condition & Results of Operations. You may find it helpful to refer back to this page as you read the 10-Q.

References to our 2010 Annual Report on Form 10-K refer to our Annual Report on Form 10-K for the year ended December 31, 2010, which has been filed with the U.S. Securities and Exchange Commission and is available on its website (www.sec.gov) or on our website (www.key.com/ir), and list specific sections and page locations in our 2010 Annual Report on Form 10-K as filed with the U.S. Securities and Exchange Commission.

AICPA: American Institute of Certified Public Accountants.
ALCO: Asset/Liability Management Committee.
ALLL: Allowance for loan and lease losses.
A/LM: Asset/liability management.
AOCI: Accumulated other comprehensive income (loss).
APBO: Accumulated postretirement benefit obligation.
Austin: Austin Capital Management, Ltd.
BHCs: Bank holding companies.
CMO: Collateralized mortgage obligation.
Common Shares: Common Stock, $1 par value.
CPP: Capital Purchase Program of the U.S. Treasury.
DIF: Deposit Insurance Fund.
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
ERM: Enterprise risk management.
EVE: Economic value of equity.
FASB: Financial Accounting Standards Board.
FDIC: Federal Deposit Insurance Corporation.
Federal Reserve: Board of Governors of the Federal Reserve System.
FHLMC: Federal Home Loan Mortgage Corporation.
FNMA: Federal National Mortgage Association.
GAAP: U.S. generally accepted accounting principles.
GNMA: Government National Mortgage Association.
IRS: Internal Revenue Service.
ISDA: International Swaps and Derivatives Association.
KAHC: Key Affordable Housing Corporation.
NASDAQ: National Association of Securities Dealers Automated Quotation System.
N/M: Not meaningful.
NOW: Negotiable Order of Withdrawal.
NYSE: New York Stock Exchange.
OCC: Office of the Controller of the Currency.
OCI: Other comprehensive income (loss).
OREO: Other real estate owned.
OTTI: Other-than-temporary impairment.
PBO: Projected Benefit Obligation.
QSPE: Qualifying special purpose entity.
S&P: Standard and Poor s Ratings Services, a Division of The McGraw-Hill Companies, Inc.
SCAP: Supervisory Capital Assessment Program administered by the Federal Reserve.
SEC: U.S. Securities and Exchange Commission.
Series A Preferred Stock: KeyCorp s 7.750% Noncumulative Perpetual Convertible Preferred Stock, Series A.
Series B Preferred Stock: KeyCorp s Fixed-Rate Cumulative Perpetual Preferred Stock, Series B issued to the U.S. Treasury under the CPP.
SILO: Sale in, lease out transaction.
SPE: Special Purpose Entities.
TAG: Transaction Account Guarantee program of the FDIC.
TARP: Troubled Asset Relief Program.
TDR: Troubled debt restructuring.
TE: Taxable equivalent.

LIBOR: London Interbank Offered Rate.

LIHTC: Low-income housing tax credit.

LILO: Lease in, lease out transaction.

Moody s: Moody s Investors Service, Inc.

N/A: Not applicable.

TLGP: Temporary Liquidity Guarantee Program of the FDIC.

U.S. Treasury: United States Department of the Treasury.

VAR: Value at risk.

VEBA: Voluntary Employee Benefit Association.

VIE: Variable interest entity.

XBRL: eXtensible Business Reporting Language.

The consolidated financial statements include the accounts of KeyCorp and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Some previously reported amounts have been reclassified to conform to current reporting practices.

The consolidated financial statements include any voting rights entities in which we have a controlling financial interest. In accordance with the applicable accounting guidance for consolidations, we consolidate a VIE if we have: (i) a variable interest in the entity; (ii) the power to direct activities of the VIE that most significantly impact the entity s economic performance; and (iii) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE (i.e., we are considered to be the primary beneficiary). Variable interests can include equity interests, subordinated debt, derivative contracts, leases, service agreements, guarantees, standby letters of credit, loan commitments, and other contracts, agreements and financial instruments. See Note 9 ( Variable Interest Entities ) for information on our involvement with VIEs.

We use the equity method to account for unconsolidated investments in voting rights entities or VIEs if we have significant influence over the entity s operating and financing decisions (usually defined as a voting or economic interest of 20% to 50%, but not controlling). Unconsolidated investments in voting rights entities or VIEs in which we have a voting or economic interest of less than 20% generally are carried at cost. Investments held by our registered broker-dealer and investment company subsidiaries (primarily principal investments) are carried at fair value.

Effective January 1, 2010, we prospectively adopted new accounting guidance that changes the way we account for securitizations and SPEs by eliminating the concept of a QSPE and changing the requirements for derecognition of financial assets. In adopting this guidance, we had to analyze our existing QSPEs for possible consolidation. As a result, we consolidated our education loan securitization trusts. That consolidation added $2.8 billion in discontinued assets, and liabilities and equity to our balance sheet, of which $2.6 billion of the assets represented loans. Prior to January 1, 2010, QSPEs, including securitization trusts, established under the applicable accounting guidance for transfers of financial assets were not consolidated. For additional information related to the consolidation of our education loan securitization trusts, see Note 9 ( Variable Interest Entities ) and Note 11 ( Divestiture and Discontinued Operations ).

We believe that the unaudited consolidated interim financial statements reflect all adjustments of a normal recurring nature and disclosures that are necessary for a fair presentation of the results for the interim periods presented.

The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2010 Annual Report on Form 10-K.

In preparing these financial statements, subsequent events were evaluated through the time the financial statements were issued. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the SEC.

**Offsetting Derivative Positions**

In accordance with the applicable accounting guidance related to the offsetting of certain derivative contracts on the balance sheet, we take into account the impact of bilateral collateral and master netting agreements that allow us to settle all derivative contracts held with a single counterparty on a net basis, and to offset the net derivative position with the related collateral when recognizing derivative assets and liabilities. Additional information regarding derivative offsetting is provided in Note 7 ( Derivatives and Hedging Activities ).

**Accounting Guidance Adopted in 2011**

***Improving disclosures about fair value measurements.*** In January 2010, the FASB issued accounting guidance which requires new disclosures regarding certain aspects of an entity s fair value disclosures and clarifies existing fair value disclosure requirements. Most of these new disclosures were required for interim and annual reporting periods beginning after December 15, 2009 (effective January 1, 2010, for us), however, the disclosures regarding purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements are effective for interim and annual periods beginning after December 15, 2010 (effective January 1, 2011, for us). The required disclosures are provided in Note 5 ( Fair Value Measurements ).

***Credit quality disclosures.*** In July 2010, the FASB issued new accounting guidance that requires additional disclosures about the credit quality of financing receivables (i.e., loans) and the allowance for credit losses. Most of these additional disclosures were required for interim and annual reporting periods ending on or after December 15, 2010 (effective December 31, 2010, for us). Specific items regarding activity that occurred before the issuance of this accounting guidance,

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such as the allowance rollforward disclosures, are required for periods beginning after December 15, 2010 (January 1, 2011, for us). The required disclosures are provided in Note 4 ( Asset Quality ).

**Accounting Guidance Pending Adoption at June 30, 2011**

***Troubled debt restructurings.*** In April 2011, the FASB issued accounting guidance to assist creditors in evaluating whether a modification or restructuring of a loan is a TDR. It clarifies existing guidance on whether the creditor has granted a concession and whether the debtor is experiencing financial difficulties, which are the two criteria used to determine whether a modification or restructuring is a TDR. This accounting guidance also requires additional disclosures regarding TDRs. It is effective for the first interim or annual period beginning after June 15, 2011 (effective July 1, 2011, for us) and is applied retrospectively for all modifications and restructurings that have occurred from the beginning of the annual period of adoption (2011 for us). We do not expect the adoption of this accounting guidance to have a material effect on our financial condition or results of operations.

***Fair value measurement.*** In May 2011, the FASB issued accounting guidance that changes the wording used to describe many of the current accounting requirements for measuring fair value and disclosing information about fair value measurements. This accounting guidance clarifies the FASB s intent about the application of existing fair value measurement requirements. It is effective for the interim and annual periods beginning on or after December 15, 2011 (effective January 1, 2012, for us) with early adoption prohibited. We do not expect the adoption of this accounting guidance to have a material effect on our financial condition or results of operations.

***Presentation of comprehensive income.*** In June 2011, the FASB issued new accounting guidance that will require all nonowner changes in shareholders equity to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This new accounting guidance does not change any of the components that are currently recognized in net income or comprehensive income. It will be effective for public entities for interim and annual periods beginning after December 15, 2011 (effective January 1, 2012, for us) as well as interim and annual periods thereafter. Early adoption is permitted. Management is currently evaluating how comprehensive income will be presented after this new accounting guidance becomes effective.

***Repurchase agreements.*** In April 2011, the FASB issued accounting guidance that changed the accounting for repurchase agreements and other similar arrangements by eliminating the collateral maintenance requirement when assessing effective control in these transactions. This change could result in more of these transactions being accounted for as secured borrowings instead of sales. This accounting guidance will be effective for new transactions and transactions that are modified on or after the first interim or annual period beginning after December 15, 2011 (effective January 1, 2012, for us). Early adoption of this guidance is prohibited. We do not expect the adoption of this accounting guidance to have a material effect on our financial condition or results of operations since we do not account for these types of arrangements as sales.

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**2. Earnings Per Common Share**

Our basic and diluted earnings per Common Share are calculated as follows:

| *dollars in millions, except per share amounts* | **Three months ended June 30, 2011** | **Three months ended June 30, 2010** | **Six months ended June 30, 2011** | **Six months ended June 30, 2010** |
|---|---|---|---|---|
| **EARNINGS** | | | | |
| Income (loss) from continuing operations | **$ 252** | $ 101 | **$ 534** | $ 60 |
| Less: Net income (loss) attributable to noncontrolling interests | **3** | 4 | **11** | 20 |
| Income (loss) from continuing operations attributable to Key | **249** | 97 | **523** | 40 |
| Less: Dividends on Series A Preferred Stock | **6** | 6 | **12** | 12 |
| Cash dividends on Series B Preferred Stock | | 31 | **31** | 62 |
| Amortization of discount on Series B Preferred Stock[b] | | 4 | **53** | 8 |
| Income (loss) from continuing operations attributable to Key common shareholders | **243** | 56 | **427** | (42) |
| Income (loss) from discontinued operations, net of taxes[a] | **(9)** | (27) | **(20)** | (25) |
| Net income (loss) attributable to Key common shareholders | **$ 234** | $ 29 | **$ 407** | $ (67) |
| **WEIGHTED-AVERAGE COMMON SHARES** | | | | |
| Weighted-average common shares outstanding (000) | **947,565** | 874,664 | **914,911** | 874,526 |
| Effect of dilutive convertible preferred stock, common stock options and other stock awards (000) | **4,568** | | **5,251** | |
| Weighted-average common shares and potential common shares outstanding (000) | **952,133** | 874,664 | **920,162** | 874,526 |
| **EARNINGS PER COMMON SHARE** | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | **$ .26** | $ .06 | **$ .47** | $ (.05) |
| Income (loss) from discontinued operations, net of taxes[a] | **(.01)** | (.03) | **(.02)** | (.03) |
| Net income (loss) attributable to Key common shareholders[c] | **.25** | .03 | **.44** | (.08) |
| Income (loss) from continuing operations attributable to Key common shareholders assuming dilution | **$ .26** | $ .06 | **$ .46** | $ (.05) |

| | | | | |
|---|---|---|---|---|
| Income (loss) from discontinued operations, net of taxes [a] | **(.01)** | (.03) | **(.02)** | (.03) |
| Net income (loss) attributable to Key common shareholders assuming dilution [c] | **.25** | .03 | **.44** | (.08) |

(a) In September 2009, we decided to discontinue the education lending business conducted through Key Education Resources, the education payment and financing unit of KeyBank. In April 2009, we decided to wind down the operations of Austin, a subsidiary that specialized in managing hedge fund investments for institutional customers. As a result of these decisions, we have accounted for these businesses as discontinued operations. The loss from discontinued operations for the period ended June 30, 2011, was primarily attributable to fair value adjustments related to the education lending securitization trusts.

(b) March 31, 2011 includes a $49 million deemed dividend.

(c) EPS may not foot due to rounding.

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## 3. Loans and Loans Held for Sale

Our loans by category are summarized as follows:

| *in millions* | **June 30, 2011** | December 31, 2010 | June 30, 2010 |
|---|---|---|---|
| Commercial, financial and agricultural | $ **16,883** | $ 16,441 | $ 17,113 |
| Commercial real estate: | | | |
| Commercial mortgage | **8,069** | 9,502 | 9,971 |
| Construction | **1,631** | 2,106 | 3,430 |
| Total commercial real estate loans | **9,700** | 11,608 | 13,401 |
| Commercial lease financing | **6,105** | 6,471 | 6,620 |
| Total commercial loans | **32,688** | 34,520 | 37,134 |
| Residential prime loans: | | | |
| Real estate residential mortgage | **1,838** | 1,844 | 1,846 |
| Home equity: | | | |
| Key Community Bank | **9,431** | 9,514 | 9,775 |
| Other | **595** | 666 | 753 |
| Total home equity loans | **10,026** | 10,180 | 10,528 |
| Total residential prime loans | **11,864** | 12,024 | 12,374 |
| Consumer other Key Community Bank | **1,157** | 1,167 | 1,147 |
| Consumer other: | | | |
| Marine | **1,989** | 2,234 | 2,491 |
| Other | **142** | 162 | 188 |
| Total consumer other | **2,131** | 2,396 | 2,679 |
| Total consumer loans | **15,152** | 15,587 | 16,200 |
| Total loans (a) | $ **47,840** | $ 50,107 | $ 53,334 |

(a) Excludes loans in the amount of $6.3 billion, $6.5 billion and $6.6 billion at June 30, 2011, December 31, 2010 and June 30, 2010, respectively, related to the discontinued operations of the education lending business.

Our loans held for sale are summarized as follows:

| *in millions* | **June 30, 2011** | December 31, 2010 | June 30, 2010 |
|---|---|---|---|
| Commercial, financial and agricultural | $ **80** | $ 196 | $ 255 |
| Real estate commercial mortgage | **198** | 118 | 235 |
| Real estate construction | **39** | 35 | 112 |
| Commercial lease financing | **6** | 8 | 16 |
| Real estate residential mortgage | **58** | 110 | 81 |

| | | | | | |
|---|---|---|---|---|---|
| Total loans held for sale | $ | **381** | $ | 467 (a) | $ 699 |

(a) Excludes loans in the amount of $15 million and $92 million at December 31, 2010, and June 30, 2010, respectively, related to the discontinued operations of the education lending business. There were no loans held for sale in the discontinued operations of the education lending business at June 30, 2011.

Our summary of changes in loans held for sale follows:

| *in millions* | **June 30, 2011** | **December 31, 2010** | **June 30, 2010** |
|---|---|---|---|
| Balance at beginning of period | **$ 426** | $ 637 | $ 556 |
| New originations | **914** | 1,053 | 812 |
| Transfers from held to maturity, net | **16** | | 65 |
| Loan sales | **(1,039)** | (1,174) | (712) |
| Loan draws (payments), net | **73** | (49) | (16) |
| Transfers to OREO / valuation adjustments | **(9)** | | (6) |
| Balance at end of period | **$ 381** | $ 467 | $ 699 |

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## 4. Asset Quality

We manage our exposure to credit risk by closely monitoring loan performance trends and general economic conditions. A key indicator of the potential for future credit losses is the level of nonperforming assets and past due loans.

Our nonperforming assets and past due loans were as follows:

| *in millions* | June 30, 2011 | December 31, 2010 | June 30, 2010 |
|---|---|---|---|
| Total nonperforming loans | **$ 842** | $ 1,068 | $ 1,703 |
| Nonperforming loans held for sale | **42** | 106 | 221 |
| OREO | **52** | 129 | 136 |
| Other nonperforming assets | **14** | 35 | 26 |
| Total nonperforming assets | **$ 950** | $ 1,338 | $ 2,086 |
| Impaired loans | **$ 706** | $ 881 | $ 1,435 |
| Impaired loans with a specifically allocated allowance | **488** | 621 | 1,099 |
| Specifically allocated allowance for impaired loans | **46** | 58 | 157 |
| Restructured loans included in nonperforming loans[a] | **$ 144** | $ 202 | $ 167 |
| Restructured loans with a specifically allocated allowance [b] | **19** | 57 | 65 |
| Specifically allocated allowance for restructured loans [c] | **5** | 18 | 15 |
| Accruing loans past due 90 days or more | **$ 118** | $ 239 | $ 240 |
| Accruing loans past due 30 through 89 days | **465** | 476 | 610 |

(a) Restructured loans (i.e., troubled debt restructurings) are those for which we, for reasons related to a borrower s financial difficulties, grant a concession that we would not otherwise have considered. To improve the collectability of the loan, typical concessions include reducing the interest rate, extending the maturity date or reducing the principal balance.

(b) Included in impaired loans with a specifically allocated allowance.

(c) Included in specifically allocated allowance for impaired loans.

Impaired loans totaled $706 million at June 30, 2011, compared to $881 million at December 31, 2010, and $1.4 billion at June 30, 2010. Impaired loans had an average balance of $718 million for the second quarter of 2011 and $1.6 billion for the second quarter of 2010.

Of total impaired loans, $488 million was reviewed to determine if a specifically allocated allowance was required at June 30, 2011 in accordance with our $2.5 million threshold for such loans. As a result, $166 million of these loans

had $46 million of specifically allocated allowance and $322 million had a zero specific allocation. Also, $218 million of impaired loans under the $2.5 million threshold were allocated an allowance of $81 million at June 30, 2011, for a total of $384 million of loans with an allowance of $127 million at June 30, 2011, as shown in the following table.

At June 30, 2011, aggregate restructured loans (accrual, nonaccrual, and held-for-sale loans) totaled $252 million while at December 31, 2010 total restructured loans totaled $297 million. Although we added $87 million in restructured loans during the first six months ended June 30, 2011, the overall decrease in restructured loans was primarily attributable to $132 million in payments and charge-offs.

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A further breakdown of impaired loans by loan category as of June 30, 2011 follows:

**June 30, 2011**

| *in millions* | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment |
|---|---|---|---|---|
| With no related allowance recorded: | | | | |
| Commercial, financial and agricultural | $ 233 | $ 116 | | $ 205 |
| Commercial real estate: | | | | |
| Commercial mortgage | 241 | 123 | | 269 |
| Construction | 257 | 83 | | 333 |
| Total commercial real estate loans | 498 | 206 | | 602 |
| Commercial lease financing | | | | |
| Total commercial loans | 731 | 322 | | 807 |
| Real estate residential mortgage | | | | |
| Home equity: | | | | |
| Key Community Bank | 2 | | | 2 |
| Other | | | | |
| Total home equity loans | 2 | | | 2 |
| Total loans with no related allowance recorded | 733 | 322 | | 809 |
| With an allowance recorded: | | | | |
| Commercial, financial and agricultural | 147 | 79 | $ 32 | 212 |
| Commercial real estate: | | | | |
| Commercial mortgage | 215 | 145 | 49 | 202 |
| Construction | 116 | 56 | 22 | 100 |
| Total commercial real estate loans | 331 | 201 | 71 | 302 |
| Commercial lease financing | 38 | 25 | 12 | 40 |
| Total commercial loans | 516 | 305 | 115 | 554 |
| Real estate residential mortgage | 45 | 33 | 4 | 47 |
| Home equity: | | | | |
| Key Community Bank | 22 | 22 | 7 | 21 |
| Other | | | | |
| Total Home Equity Loans | 22 | 22 | 7 | 21 |

| | | | | | |
|---|---|---|---|---|---|
| Consumer other | Key Community Bank | 25 | 24 | 1 | 25 |
| Total loans with an allowance recorded | | 608 | 384 | 127 | 647 |
| Total | | $ 1,341 | $ 706 | $ 127 | $ 1,456 |

Our policies for our commercial and consumer loan portfolios for determining past due loans, placing loans on nonaccrual, applying payments on nonaccrual loans and resuming accrual of interest are disclosed in Note 1 ( Summary of Significant Accounting Policies ) under the heading Impaired and Other Nonaccrual Loans on page 102 of our 2010 Annual Report on Form 10-K.

At June 30, 2011, approximately $46 billion, or 97% of our total loans are current. Total past due loans of $1.4 billion represent approximately 3% of total loans.

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The following aging analysis as of June 30, 2011 of past due and current loans provides an alternative view of Key s credit exposure.

**June 30, 2011**

| *in millions* | Current | 30 -59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Non Accrual (NPL) | Total Past Due | Total Loans |
|---|---|---|---|---|---|---|---|
| **LOAN TYPE** | | | | | | | |
| Commercial, financial and agricultural | $ 16,599 | $ 35 | $ 17 | $ 19 | $ 213 | $ 284 | $ 16,883 |
| Commercial real estate: | | | | | | | |
| Commercial mortgage | 7,743 | 34 | 51 | 11 | 230 | 326 | 8,069 |
| Construction | 1,437 | 11 | 24 | 28 | 131 | 194 | 1,631 |
| Total commercial real estate loans | 9,180 | 45 | 75 | 39 | 361 | 520 | 9,700 |
| Commercial lease financing | 5,983 | 20 | 40 | 21 | 41 | 122 | 6,105 |
| Total commercial loans | $ 31,762 | $ 100 | $ 132 | $ 79 | $ 615 | $ 926 | $ 32,688 |
| Real estate residential mortgage | $ 1,713 | $ 24 | $ 14 | $ 8 | $ 79 | $ 125 | $ 1,838 |
| Home equity: | | | | | | | |
| Key Community Bank | 9,216 | 66 | 32 | 16 | 101 | 215 | 9,431 |
| Other | 559 | 13 | 7 | 5 | 11 | 36 | 595 |
| Total home equity loans | 9,775 | 79 | 39 | 21 | 112 | 251 | 10,026 |
| Consumer other Key Community Bank | 1,129 | 14 | 4 | 7 | 3 | 28 | 1,157 |
| Consumer other: | | | | | | | |
| Marine | 1,898 | 42 | 14 | 3 | 32 | 91 | 1,989 |
| Other | 138 | 2 | 1 | | 1 | 4 | 142 |
| Total consumer other | 2,036 | 44 | 15 | 3 | 33 | 95 | 2,131 |
| Total consumer loans | $ 14,653 | $ 161 | $ 72 | $ 39 | $ 227 | $ 499 | $ 15,152 |
| Total loans | $ 46,415 | $ 261 | $ 204 | $ 118 | $ 842 | $ 1,425 | $ 47,840 |

At June 30, 2011, the approximate carrying amount of our commercial nonperforming loans outstanding represented 57% of their original contractual amount, and total nonperforming loans outstanding represented 64% of their original contractual amount owed and nonperforming assets in total were carried at 60% of their original contractual amount.
At June 30, 2011, our twenty largest nonperforming loans totaled $276 million, representing 33% of total loans on nonperforming status from continuing operations as compared to $306 million in nonperforming loans representing 29% of total loans at December 31, 2010 and $441 million in nonperforming loans representing 25% of total loans on nonperforming status at June 30, 2010.
The risk characteristic prevalent to both commercial and consumer loans is the risk of loss arising from an obligor s inability or failure to meet contractual payment or performance terms. Evaluation of this risk is stratified and monitored by the assigned loan risk rating grades for the commercial loan portfolios and the regulatory risk ratings assigned for the consumer loan portfolios. This risk rating stratification assists in the determination of the allowance for loan and lease losses. Loan grades are assigned at the time of origination, verified by credit risk management and periodically reevaluated thereafter.
Most extensions of credit are subject to loan grading or scoring. This risk rating methodology blends our judgment with quantitative modeling. Commercial loans generally are assigned two internal risk ratings. The first rating reflects the probability that the borrower will default on an obligation; the second reflects expected recovery rates on the credit facility. Default probability is determined based on, among other factors, the financial strength of the borrower, an assessment of the borrower s management, the borrower s competitive position within its industry sector and our view of industry risk within the context of the general economic outlook. Types of exposure, transaction structure and collateral, including credit risk mitigants, affect the expected recovery assessment.
Credit quality indicators for loans are updated on an ongoing basis. Bond rating classifications are indicative of the credit quality of our commercial loan portfolios and are determined by converting our internally assigned risk rating grades to bond rating categories. Payment activity and the regulatory classifications of pass, special mention and substandard, are indicators of the credit quality of our consumer loan portfolios.
Credit quality indicators for our commercial and consumer loan portfolios based on bond rating, regulatory classification and payment activity as of June 30, 2011 are as follows:

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**Commercial Credit Exposure**
**Credit Risk Profile by Creditworthiness Category** [(a)]

**June 30,**
*in millions*

| | Commercial, financial and agricultural | | RE | Commercial RE | Construction | | Commercial Lease | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| **RATING** [(b)] | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** |
| AAA AA | **$ 100** | $ 96 | **$ 2** | $ 2 | **3** | | **$ 655** | $ 625 | **$ 760** | $ 723 |
| A | **671** | 820 | **63** | 23 | **$ 1** | $ 7 | **1,245** | 1,184 | **1,980** | 2,034 |
| BBB BB | **13,546** | 11,655 | **5,553** | 6,336 | **747** | 1,116 | **3,590** | 3,878 | **23,436** | 22,985 |
| B | **955** | 1,418 | **941** | 1,236 | **262** | 768 | **343** | 564 | **2,501** | 3,986 |
| CCC C | **1,611** | 3,124 | **1,510** | 2,374 | **618** | 1,539 | **272** | 369 | **4,011** | 7,406 |
| Total | **$ 16,883** | $ 17,113 | **$ 8,069** | $ 9,971 | **$ 1,631** | $ 3,430 | **$ 6,105** | $ 6,620 | **$ 32,688** | $ 37,134 |

(a) Credit quality indicators are updated on an ongoing basis and reflect credit quality information as of the interim period ending June 30, 2011.

(b) Our bond rating to loan grade conversion system is as follows: AAA - AA = 1, A = 2, BBB - BB = 3 - 13, B = 14 - 16, and CCC - C = 17 - 20.

**Consumer Credit Exposure**
**Credit Risk Profile by Regulatory Classifications** [(a)]

**June 30,**
*in millions*

| | Residential | Prime |
|---|---|---|
| **GRADE** | **2011** | **2010** |
| Pass | **$ 11,644** | $ 12,122 |
| Special Mention | | |
| Substandard | **220** | 252 |
| Total | **$ 11,864** | $ 12,374 |

**Credit Risk Profile Based on Payment Activity** [(a)]

| Consumer Key Community Bank | | Consumer Marine | | Consumer Other | | Total | |
|---|---|---|---|---|---|---|---|
| **2011** | **2010** | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Performing | **$ 1,154** | $ 1,142 | **$ 1,957** | $ 2,450 | **$ 141** | $ 186 | **$ 3,252** | $ 3,778 |
| Nonperforming | **3** | 5 | **32** | 41 | **1** | 2 | **36** | 48 |
| Total | **$ 1,157** | $ 1,147 | **$ 1,989** | $ 2,491 | **$ 142** | $ 188 | **$ 3,288** | $ 3,826 |

(a) Credit quality indicators are updated on an ongoing basis and reflect credit quality information as of the interim period ending June 30, 2011.

We use the following three-step process to estimate the appropriate level of the allowance for loan and lease losses on at least a quarterly basis: (1) we apply historical loss rates to existing loans with similar risk characteristics as noted in the credit quality indicator table above; (2) we exercise judgment to assess the impact of factors such as changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets; and, (3) for all TDRs, regardless of size, as well as impaired loans with an outstanding balance greater than $2.5 million, we conduct further analysis to determine the probable loss content and assign a specific allowance to the loan if deemed appropriate. We estimate the extent of impairment by comparing the carrying amount of the loan with the estimated present value of its future cash flows, the fair value of its underlying collateral or the loan s observable market price. A specific allowance also may be assigned even when sources of repayment appear sufficient if we remain uncertain about whether the loan will be repaid in full. Additional information is provided in Note 1 ( Summary of Significant Accounting Policies ) under the heading Allowance for Loan and Lease Losses on page 102 of our 2010 Annual Report on Form 10-K. The allowance for loan and lease losses at June 30, 2011, represents our best estimate of the losses inherent in the loan portfolio at that date. While quantitative modeling factors such as default probability and expected recovery rates are constantly changing as the financial strength of the borrower and overall economic conditions change, there have been no changes to the accounting policies or methodology we used to estimate the allowance for loan and lease losses.

Commercial loans generally are charged off in full or charged down to the fair value of the underlying collateral when the borrower s payment is 180 days past due. Our charge-off policy for most consumer loans is similar but takes effect when payments are 120 days past due. Home equity and residential mortgage loans generally are charged down to the fair value of the underlying collateral when payment is 180 days past due.

At June 30, 2011, the allowance for loan and lease losses was $1.2 billion, or 2.57% of loans compared to $1.6 billion, or 3.20% of loans, at December 31, 2010, and $2.2 billion or 4.16% of loans at June 30, 2010. At June 30, 2011, the allowance for loan and lease losses was 146.08% of nonperforming loans compared to 130.30% at June 30, 2010.

Changes in the allowance for loan and lease losses are summarized as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *in millions* | **2011** | 2010 | **2011** | 2010 |
| Balance at beginning of period continuing operations | $ **1,372** | $ 2,425 | $ **1,604** | $ 2,534 |
| Charge-offs | **(177)** | (492) | **(409)** | (1,049) |
| Recoveries | **43** | 57 | **82** | 92 |
| Net loans charged off | **(134)** | (435) | **(327)** | (957) |
| Provision for loan and lease losses from continuing operations | **(8)** | 228 | **(48)** | 641 |
| Foreign currency translation adjustment | | 1 | **1** | 1 |
| Balance at end of period continuing operations | $ **1,230** | $ 2,219 | $ **1,230** | $ 2,219 |

The changes in the ALLL by loan category from December 31, 2010 are as follows:

| *in millions* | December 31, 2010 | Provision | Charge-offs | Recoveries | June 30, 2011 |
|---|---|---|---|---|---|
| Commercial, financial and agricultural | $ 485 | $ **(22)** | $ **93** | $ **25** | $ **395** |
| Real estate commercial mortgage | 416 | **(18)** | **62** | **7** | **343** |
| Real estate construction | 145 | **15** | **62** | **8** | **106** |
| Commercial lease financing | 175 | **(53)** | **26** | **11** | **107** |
| Total commercial loans | 1,221 | **(78)** | **243** | **51** | **951** |
| Real estate residential mortgage | 49 | **7** | **17** | **2** | **41** |
| Home equity: | | | | | |
| Key Community Bank | 120 | **30** | **53** | **2** | **99** |
| Other | 57 | **4** | **26** | **2** | **37** |
| Total home equity loans | 177 | **34** | **79** | **4** | **136** |
| Consumer other Key Community Bank | 57 | **9** | **23** | **4** | **47** |
| Consumer other: | | | | | |
| Marine | 89 | **(14)** | **42** | **19** | **52** |
| Other | 11 | **(5)** | **5** | **2** | **3** |
| Total consumer other: | 100 | **(19)** | **47** | **21** | **55** |
| Total consumer loans | 383 | **31** | **166** | **31** | **279** |
| Total ALLL continuing operations | 1,604 | **(47)**[(a)] | **409** | **82** | **1,230** |

| | | | | | |
|---|---|---|---|---|---|
| Discontinued operations | 114 | **62** | **73** | **6** | **109** |
| Total ALLL including discontinued operations | $ 1,718 | **$ 15** | **$ 482** | **$ 88** | **$ 1,339** |

(a) Includes $1 million of foreign currency translation adjustment.

Our allowance for loan and lease losses decreased by $989 million, or 45%, since the second quarter of 2010. This contraction was associated with the improvement in credit quality of our loan portfolios, which has trended more favorably the past four quarters. Our asset quality metrics showed continued improvement and therefore has resulted in favorable risk rating migration and a reduction in our general allowance. Our general allowance encompasses the application of historical loss rates to our existing loans with similar risk characteristics and an assessment of factors such as changes in economic conditions and changes in credit policies or underwriting standards. Our delinquency trends improved throughout most of 2010 and into 2011. We attribute this improvement to a more moderate level of economic activity, more favorable conditions in the capital markets, improvement in client income statements and continued run off in our exit loan portfolio.

For continuing operations, the loans outstanding individually evaluated for impairment totaled $488 million, which had a corresponding allowance of $46 million at June 30, 2011. Loans outstanding collectively evaluated for impairment totaled $47 billion, with a corresponding allowance of $1.2 billion at June 30, 2011.

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A breakdown of the individual and collective allowance for loan and lease losses and the corresponding loan balances as of June 30, 2011 follows:

| | Allowance[a] | | | Outstanding[a] | |
|---|---|---|---|---|---|
| **June 30, 2011**<br>*in millions* | **Individually Evaluated for Impairment** | **Collectively Evaluated for Impairment** | **Loans** | **Individually Evaluated for Impairment** | **Collectively Evaluated for Impairment** |
| Commercial, financial and agricultural | $ 14 | $ 381 | $ 16,883 | $ 157 | $ 16,726 |
| Commercial real estate: | | | | | |
| Commercial mortgage | 21 | 322 | 8,069 | 213 | 7,856 |
| Construction | 11 | 95 | 1,631 | 116 | 1,515 |
| Total commercial real estate loans | 32 | 417 | 9,700 | 329 | 9,371 |
| Commercial lease financing | | 107 | 6,105 | | 6,105 |
| Total commercial loans | 46 | 905 | 32,688 | 486 | 32,202 |
| Real estate residential mortgage | | 41 | 1,838 | | 1,838 |
| Home equity: | | | | | |
| Key Community Bank | | 99 | 9,431 | 2 | 9,429 |
| Other | | 37 | 595 | | 595 |
| Total home equity loans | | 136 | 10,026 | 2 | 10,024 |
| Consumer other Key Community Bank | | 47 | 1,157 | | 1,157 |
| Consumer other: | | | | | |
| Marine | | 52 | 1,989 | | 1,989 |
| Other | | 3 | 142 | | 142 |
| Total consumer other | | 55 | 2,131 | | 2,131 |
| Total consumer loans | | 279 | 15,152 | 2 | 15,150 |
| Total ALLL continuing operations | 46 | 1,184 | 47,840 | 488 | 47,352 |
| Discontinued operations | | 109 | 6,261 | | 6,261 |
| Total ALLL including discontinued operations | $ 46 | $ 1,293 | $ 54,101 | $ 488 | $ 53,613 |

(a) There were no loans acquired with deteriorated credit quality at June 30, 2011.

The liability for credit losses inherent in lending-related commitments, such as letters of credit and unfunded loan commitments, is included in accrued expense and other liabilities on the balance sheet. We establish the amount of this reserve by considering both historical trends and current market conditions quarterly, or more often if deemed necessary. Our liability for credit losses on lending-related commitments has decreased since the second quarter of 2010 by $52 million to $57 million at June 30, 2011. When combined with our allowance for loan and lease losses, our total allowance for credit losses represented 2.69% of loans at June 30, 2011, compared to 4.36% at June 30, 2010.

Changes in the liability for credit losses on lending-related commitments are summarized as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *in millions* | **2011** | **2010** | **2011** | **2010** |
| Balance at beginning of period | **$ 69** | $ 119 | **$ 73** | $ 121 |
| Provision (credit) for losses on lending-related commitments | **(12)** | (10) | **(16)** | (12) |
| Balance at end of period | **$ 57** | $ 109 | **$ 57** | $ 109 |

At June 30, 2011, we did not have any significant commitments to lend additional funds to borrowers with loans on nonperforming status. The amount by which loans and loans held for sale, which were classified as nonperforming, reduced expected interest income was $5 million for the six months ended June 30, 2011 and $22 million for the year ended December 31, 2010.

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## 5. Fair Value Measurements

**Fair Value Determination**

As defined in the applicable accounting guidance for fair value measurements and disclosures, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in our principal market. We have established and documented our process for determining the fair values of our assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, we determine the fair value of our assets and liabilities using valuation models or third-party pricing services. Both of these approaches rely on market-based parameters, when available, such as interest rate yield curves, option volatilities and credit spreads, or unobservable inputs. Unobservable inputs may be based on our judgment, assumptions and estimates related to credit quality, liquidity, interest rates and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and our own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing is not indicative of the counterparty s credit quality. We make liquidity valuation adjustments to the fair value of certain assets to reflect the uncertainty in the pricing and trading of the instruments when we are unable to observe recent market transactions for identical or similar instruments. Liquidity valuation adjustments are based on the following factors:

- the amount of time since the last relevant valuation;
- whether there is an actual trade or relevant external quote available at the measurement date; and
- volatility associated with the primary pricing components.

We ensure that our fair value measurements are accurate and appropriate by relying upon various controls, including:

- an independent review and approval of valuation models;
- a detailed review of profit and loss conducted on a regular basis; and
- a validation of valuation model components against benchmark data and similar products, where possible.

We review any changes to our valuation methodologies to ensure they are appropriate and justified, and refine our valuation methodologies as more market-based data becomes available. We recognize transfers between levels of the fair value hierarchy at the end of the reporting period.

Additional information regarding our accounting policies for the determination of fair value is provided in Note 1 ( Summary of Significant Accounting Policies ) under the heading Fair Value Measurements on page 105 of our 2010 Annual Report on Form 10-K.

**Qualitative Disclosures of Valuation Techniques**

***Loans***. Most loans recorded as trading account assets are valued based on market spreads for identical assets since they are actively traded. Therefore, these loans are classified as Level 2 because the fair value recorded is based on observable market data for similar assets.

***Securities (trading and available for sale)***. We own several types of securities, requiring a range of valuation methods:

- Securities are classified as Level 1 when quoted market prices are available in an active market for the identical securities. Level 1 instruments include exchange-traded equity securities.
- Securities are classified as Level 2 if quoted prices for identical securities are not available, and we determine fair value using pricing models or quoted prices of similar securities. These instruments include municipal bonds; bonds backed by the U.S. government; corporate bonds; certain mortgage-backed securities; securities issued by the U.S. Treasury; money markets; and certain agency and corporate collateralized mortgage obligations. Inputs to the pricing models include actual trade data (i.e. spreads, credit ratings and interest rates) for comparable assets, spread tables, matrices, high-grade scales, option-adjusted spreads and standard inputs, such as yields, broker/dealer quotes, bids and offers.

- Securities are classified as Level 3 when there is limited activity in the market for a particular instrument. In such cases, we use internal models based on certain assumptions to determine fair value. Level 3 instruments include certain commercial mortgage-backed securities. Inputs for the Level 3 internal models include expected cash flows from the underlying loans, which take into account expected default and recovery percentages, market research and discount rates commensurate with current market conditions.

***Private equity and mezzanine investments***. Private equity and mezzanine investments consist of investments in debt and equity securities through our Real Estate Capital line of business. They include direct investments made in a property, as well as indirect investments made in funds that pool assets of many investors to invest in properties. There is not an active market in which to value these investments so we employ other valuation methods.

Direct investments in properties are initially valued based upon the transaction price. The carrying amount is then adjusted based upon the estimated future cash flows associated with the investments. Inputs used in determining future cash flows include the cost of build-out, future selling prices, current market outlook and operating performance of the particular investment. Indirect investments are valued using a methodology that is consistent with accounting guidance that allows us to use statements from the investment manager to calculate net asset value per share. A primary input used in estimating fair value is the most recent value of the capital accounts as reported by the general partners of the funds in which we invest. Private equity and mezzanine investments are classified as Level 3 assets since our judgment significantly influences the determination of fair value.

Investments in real estate private equity funds are included within private equity and mezzanine investments. The main purpose of these funds is to acquire a portfolio of real estate investments that provides attractive risk-adjusted returns and current income for investors. Certain of these investments do not have readily determinable fair values and represent our ownership interest in an entity that follows measurement principles under investment company accounting. The following table presents the fair value of the funds and related unfunded commitments at June 30, 2011:

| **June 30, 2011**<br>*in millions* | **Fair Value** | **Unfunded Commitments** |
|---|---|---|
| **INVESTMENT TYPE** | | |
| Passive funds [(a)] | $ 16 | $ 5 |
| Co-managed funds [(b)] | 17 | 9 |
| Total | $ 33 | $ 14 |

(a) We invest in passive funds, which are multi-investor private equity funds. These investments can never be redeemed. Instead, distributions are received through the liquidation of the underlying investments in the funds. Some funds have no restrictions on sale, while others require investors to remain in the fund until maturity. The funds will be liquidated over a period of one to seven years.

(b) We are a manager or co-manager of these funds. These investments can never be redeemed. Instead, distributions are received through the liquidation of the underlying investments in the funds. In addition, we receive management fees. We can sell or transfer our interest in any of these funds with the written consent of a majority of the fund s investors. In one instance, the other co-manager of the fund must consent to the sale or transfer of our interest in the fund. The funds will mature over a period of three to six years.

***Principal investments***. Principal investments consist of investments in equity and debt instruments made by our principal investing entities. They include direct investments (investments made in a particular company), as well as indirect investments (investments made through funds that include other investors). During the first half of 2011, employees who managed our various principal investments formed two independent entities that will serve as

investment managers of these investments going forward. Under this new arrangement which was mutually agreeable to both parties, these individuals will no longer be employees of Key. As a result of these changes, during the second quarter of 2011, we deconsolidated certain of these direct and indirect investments, totaling $234 million.

When quoted prices are available in an active market for the identical investment, we use the quoted prices in the valuation process, and the related investments are classified as Level 1 assets. However, in most cases, quoted market prices are not available for the identical investment, and we must perform valuations for direct investments based upon other sources and inputs, such as market multiples; historical and forecast earnings before interest, taxation, depreciation and amortization; net debt levels; and investment risk ratings.

Our indirect investments include primary and secondary investments in private equity funds engaged mainly in venture- and growth-oriented investing; these investments do not have readily determinable fair values. Indirect investments are valued using a methodology that is consistent with accounting guidance that allows us to estimate fair value based upon net asset value per share (or its equivalent, such as member units or an ownership interest in partners capital to which a proportionate share of net assets is attributed). A primary input used in estimating fair value is the most recent value of the capital accounts

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as reported by the general partners of the funds in which we invest. These investments are classified as Level 3 assets since our assumptions are not observable in the market place. The following table presents the fair value of the indirect funds and related unfunded commitments at June 30, 2011:

| **June 30, 2011** *in millions* | **Fair Value** | **Unfunded Commitments** |
|---|---|---|
| **INVESTMENT TYPE** | | |
| Private equity funds [(a)] | $ 463 | $ 143 |
| Hedge funds [(b)] | 7 | |
| Total | $ 470 | $ 143 |

(a) Consists of buyout, venture capital and fund of funds. These investments can never be redeemed with the investee funds. Instead, distributions are received through the liquidation of the underlying investments of the fund. An investment in any one of these funds can be sold only with the approval of the fund s general partners. We estimate that the underlying investments of the funds will be liquidated over a period of one to ten years.

(b) Consists of funds invested in long and short positions of stressed and distressed fixed income-oriented securities with the goal of producing attractive risk-adjusted returns. The investments can be redeemed quarterly with 45 days notice. However, the fund s general partners may impose quarterly redemption limits that may delay receipt of requested redemptions.

***Derivatives***. Exchange-traded derivatives are valued using quoted prices and, therefore, are classified as Level 1 instruments. However, only a few types of derivatives are exchange-traded, so the majority of our derivative positions are valued using internally developed models based on market convention that use observable market inputs, such as interest rate curves, yield curves, LIBOR discount rates and curves, index pricing curves, foreign currency curves and volatility surfaces (the three-dimensional graph of implied volatility against strike price and maturity). These derivative contracts, which are classified as Level 2 instruments, include interest rate swaps, certain options, cross currency swaps and credit default swaps. In addition, we have a few customized derivative instruments and risk participations that are classified as Level 3 instruments. These derivative positions are valued using internally developed models, with inputs consisting of available market data, such as bond spreads and asset values, as well as our assumptions, such as loss probabilities and proxy prices.

Market convention implies a credit rating of AA equivalent in the pricing of derivative contracts, which assumes all counterparties have the same creditworthiness. To reflect the actual exposure on our derivative contracts related to both counterparty and our own creditworthiness, we record a fair value adjustment in the form of a default reserve. The credit component is valued by individual counterparty based on the probability of default, and considers master netting and collateral agreements. The default reserve is considered to be a Level 3 input.

***Other assets and liabilities.*** The value of our repurchase and reverse repurchase agreements, trade date receivables and payables, and short positions is driven by the valuation of the underlying securities. The underlying securities may include equity securities, which are valued using quoted market prices in an active market for identical securities, resulting in a Level 1 classification. If quoted prices for identical securities are not available, fair value is determined by using pricing models or quoted prices of similar securities, resulting in a Level 2 classification. For the interest rate-driven products, such as government bonds, U.S. Treasury bonds and other products backed by the U.S. government, inputs include spreads, credit ratings and interest rates. For the credit-driven products, such as corporate bonds and mortgage-backed securities, inputs include actual trade data for comparable assets, and bids and offers.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

Certain assets and liabilities are measured at fair value on a recurring basis in accordance with GAAP. The following tables present these assets and liabilities at June 30, 2011 and December 31, 2010.

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| **June 30, 2011**<br>*in millions* | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| **ASSETS MEASURED ON A RECURRING BASIS** | | | | |
| Short-term investments: | | | | |
| Securities purchased under resale agreements | | $ 414 | | $ 414 |
| Trading account assets: | | | | |
| U.S. Treasury, agencies and corporations | | 403 | | 403 |
| States and political subdivisions | | 78 | | 78 |
| Collateralized mortgage obligations | | 79 | | 79 |
| Other mortgage-backed securities | | 61 | $ 1 | 62 |
| Other securities | $ 94 | 49 | | 143 |
| Total trading account securities | 94 | 670 | 1 | 765 |
| Commercial loans | | 4 | | 4 |
| Total trading account assets | 94 | 674 | 1 | 769 |
| Securities available for sale: | | | | |
| U.S. Treasury, agencies and corporations | | 9 | | 9 |
| States and political subdivisions | | 129 | | 129 |
| Collateralized mortgage obligations | | 17,609 | | 17,609 |
| Other mortgage-backed securities | | 917 | | 917 |
| Other securities | 9 | 7 | | 16 |
| Total securities available for sale | 9 | 18,671 | | 18,680 |
| Other investments: | | | | |
| Principal investments: | | | | |
| Direct | | | 270 | 270 |
| Indirect | | | 470 | 470 |
| Total principal investments | | | 740 | 740 |
| Equity and mezzanine investments: | | | | |
| Direct | | | 14 | 14 |
| Indirect | | | 33 | 33 |
| Total equity and mezzanine investments | | | 47 | 47 |
| Total other investments | | | 787 | 787 |
| Derivative assets: | | | | |
| Interest rate | | 1,527 | 81 | 1,608 |
| Foreign exchange | 83 | 95 | | 178 |
| Energy and commodity | | 295 | | 295 |
| Credit | | 26 | 8 | 34 |
| Equity | | 4 | | 4 |
| Derivative assets | 83 | 1,947 | 89 | 2,119 |
| Netting adjustments[a] | | | | (1,219) |

| | | | | |
|---|---|---|---|---|
| Total derivative assets | 83 | 1,947 | 89 | 900 |
| Accrued income and other assets | 7 | 21 | | 28 |
| Total assets on a recurring basis at fair value | $ 193 | $ 21,727 | $ 877 | $ 21,578 |
| **LIABILITIES MEASURED ON A RECURRING BASIS** | | | | |
| Federal funds purchased and securities sold under repurchase agreements: | | | | |
| Securities sold under repurchase agreements | | $ 369 | | $ 369 |
| Bank notes and other short-term borrowings: | | | | |
| Short positions | $ 1 | 449 | | 450 |
| Derivative liabilities: | | | | |
| Interest rate | | 1,181 | | 1,181 |
| Foreign exchange | 78 | 241 | | 319 |
| Energy and commodity | | 303 | | 303 |
| Credit | | 31 | | 31 |
| Equity | | 4 | | 4 |
| Derivative liabilities | 78 | 1,760 | | 1,838 |
| Netting adjustments[(a)] | | | | (847) |
| Total derivative liabilities | 78 | 1,760 | | 991 |
| Accrued expense and other liabilities | | 36 | | 36 |
| Total liabilities on a recurring basis at fair value | $ 79 | $ 2,614 | | $ 1,846 |

(a) Netting adjustments represent the amounts recorded to convert our derivative assets and liabilities from a gross basis to a net basis in accordance with the applicable accounting guidance related to the offsetting of certain derivative contracts on the balance sheet. The net basis takes into account the impact of bilateral collateral and master netting agreements that allow us to settle all derivative contracts with a single counterparty on a net basis and to offset the net derivative position with the related collateral. Total derivative assets and liabilities include these netting adjustments.

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| **December 31, 2010**<br>*in millions* | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| **ASSETS MEASURED ON A RECURRING BASIS** | | | | |
| Short term investments: | | | | |
| Securities purchased under resale agreements | | $ 373 | | $ 373 |
| Trading account assets: | | | | |
| U.S. Treasury, agencies and corporations | | 501 | | 501 |
| States and political subdivisions | | 66 | | 66 |
| Collateralized mortgage obligations | | 34 | | 34 |
| Other mortgage-backed securities | | 137 | $ 1 | 138 |
| Other securities | $ 145 | 69 | 21 | 235 |
| Total trading account securities | 145 | 807 | 22 | 974 |
| Commercial loans | | 11 | | 11 |
| Total trading account assets | 145 | 818 | 22 | 985 |
| Securities available for sale: | | | | |
| U.S. Treasury, agencies and corporations | | 8 | | 8 |
| States and political subdivisions | | 172 | | 172 |
| Collateralized mortgage obligations | | 20,665 | | 20,665 |
| Other mortgage-backed securities | | 1,069 | | 1,069 |
| Other securities | 13 | 6 | | 19 |
| Total securities available for sale | 13 | 21,920 | | 21,933 |
| Other investments: | | | | |
| Principal investments: | | | | |
| Direct | | | 372 | 372 |
| Indirect | | | 526 | 526 |
| Total principal investments | | | 898 | 898 |
| Equity and mezzanine investments: | | | | |
| Direct | | | 20 | 20 |
| Indirect | | | 30 | 30 |
| Total equity and mezzanine investments | | | 50 | 50 |
| Total other investments | | | 948 | 948 |
| Derivative assets: | | | | |
| Interest rate | | 1,691 | 75 | 1,766 |
| Foreign exchange | 92 | 88 | | 180 |
| Energy and commodity | | 317 | 1 | 318 |
| Credit | | 27 | 12 | 39 |
| Equity | | 1 | | 1 |
| Derivative assets | 92 | 2,124 | 88 | 2,304 |
| Netting adjustments [(a)] | | | | (1,298) |

| | | | | |
|---|---|---|---|---|
| Total derivative assets | 92 | 2,124 | 88 | 1,006 |
| Accrued income and other assets | 1 | 76 | | 77 |
| Total assets on a recurring basis at fair value | $ 251 | $ 25,311 | $ 1,058 | $ 25,322 |
| **LIABILITIES MEASURED ON A RECURRING BASIS** | | | | |
| Federal funds purchased and securities sold under repurchase agreements: | | | | |
| Securities sold under repurchase agreements | | $ 572 | | $ 572 |
| Bank notes and other short-term borrowings: | | | | |
| Short positions | | 395 | | 395 |
| Derivative liabilities: | | | | |
| Interest rate | | 1,335 | | 1,335 |
| Foreign exchange | $ 82 | 323 | | 405 |
| Energy and commodity | | 335 | | 335 |
| Credit | | 30 | $ 1 | 31 |
| Equity | | 1 | | 1 |
| Derivative liabilities | 82 | 2,024 | 1 | 2,107 |
| Netting adjustments [(a)] | | | | (965) |
| Total derivative liabilities | 82 | 2,024 | 1 | 1,142 |
| Accrued expense and other liabilities | | 66 | | 66 |
| Total liabilities on a recurring basis at fair value | $ 82 | $ 3,057 | $ 1 | $ 2,175 |

(a) Netting adjustments represent the amounts recorded to convert our derivative assets and liabilities from a gross basis to a net basis in accordance with the applicable accounting guidance related to the offsetting of certain derivative contracts on the balance sheet. The net basis takes into account the impact of bilateral collateral and master netting agreements that allow us to settle all derivative contracts with a single counterparty on a net basis and to offset the net derivative position with the related collateral. Total derivative assets and liabilities include these netting adjustments.

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**Changes in Level 3 Fair Value Measurements**

The following tables show the change in the fair values of our Level 3 financial instruments for the three and six months ended June 30, 2011 and 2010. We mitigate the credit risk, interest rate risk and risk of loss related to many of these Level 3 instruments by using securities and derivative positions classified as Level 1 or Level 2. Level 1 or Level 2 instruments are not included in the following tables. Therefore, the gains or losses shown do not include the impact of our risk management activities.

| | **Trading Account Assets** | | | **Other Investments** | | | | | **Derivative Instruments** | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | **Principal Investments** | | **Equity and Mezzanine Investments** | | | | | |
| *illions* | **Other Mortgage-Backed Securities** | **Other Securities** | **Commercial Loans** | **Direct** | **Indirect** | **Direct** | **Indirect** | **Accrued Income and Other Assets** | **Interest Rate** | **Energy and Commodity** | **Credit** |
| ance at ember 31, 0 | $ 1 | $ 21 | | $ 372 | $ 526 | $ 20 | $ 30 | | $ 75 | $ 1 | $ 11 |
| ns ses) included arnings | (b) | **3** (b) | (b) | **2** (c) | **43** (c) | **13** (c) | (c) | (c) | **14** (b) | **(1)** (b) | **(10** |
| chases | | | | **30** | **46** | | **9** | | **11** | | |
| es | | | | **(9)** | **(36)** | | | | **(20)** | | |
| ances lements | | **(24)** | | | | **(19)** | **(3)** | | | | **7** |
| nsfers into el 3 | | | | | | | | | **10** | | |
| nsfers out of el 3 | | | | **(125)** (d) | **(109)** (d) | | **(3)** | | **(9)** | | |
| ance at e 30, 2011 | **$ 1** | | | **$ 270** | **$ 470** | **$ 14** | **$ 33** | | **$ 81** | | **$ 8** |
| ealized gains ses) included arnings | (b) | **3** (b) | (b) | **$ 8** (c) | **$ 28** (c) | **$ 32** (c) | **$ (3)** (c) | (c) | (b) | (b) | |
| ance at ch 31, 2011 | $ **1** | $ | $ | $ **395** | $ **548** | $ **25** | $ **27** | $ | $ **81** | $ | $ **4** |
| ns ses) included arnings | (b) | **3** (b) | (b) | (c) | **10** (c) | **8** (c) | **1** (c) | (c) | **10** (b) | (b) | **(9** |
| chases | | | | **2** | **32** | | **7** | | **11** | | **6** |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| s<br>ances | | | | (2) | (11) | | | | (18) | | |
| lements | | (3) | | | | (19) | (2) | | | | 7 |
| nsfers into<br>el 3 | | | | | | | | | 3 | | |
| nsfers out of<br>el 3 | | | | (125) (d) | (109) (d) | | | | (6) | | |
| ance at<br>e 30, 2011 | $ 1 | | | $ 270 | $ 470 | $ 14 | $ 33 | | $ 81 | | $ 8 |
| ealized gains<br>ses) included<br>arnings | (b) | 3 (b) | (b) | $ 6 (c) | $ 4 (c) | $ 22 (c) | $ 1 (c) | (c) | (b) | (b) | |
| ance at<br>ember 31,<br>9 | $ 29 | $ 423 | $ 19 | $ 538 | $ 497 | $ 26 | $ 31 | | $ 99 | | $ 9 |
| ns<br>ses) included<br>arnings | 3 (b) | (b) | (1) (b) | 18 (c) | 36 (c) | 5 (c) | (4) (c) | (c) | (b) | (b) | 1 |
| chases, sales,<br>ances and<br>ements | (29) | (399) | (9) | (129) | (3) | (13) | 4 | $ 3 | (4) | | |
| transfers into<br>of) Level 3 | 1 | | | (8) | | 6 | | | (8) | | |
| ance at<br>e 30, 2010 | $ 4 | $ 24 | $ 9 | $ 419 | $ 530 | $ 24 | $ 31 | $ 3 | $ 87 | | $ 10 |
| ealized gains<br>ses) included<br>arnings | $ 2 (b) | (b) | $ (1) (b) | $ 2 (c) | $ 32 (c) | $ 41 (c) | $ (4) (c) | (c) | (b) | (b) | |
| ance at<br>ch 31, 2010 | $ 29 | $ 199 | $ 11 | $ 534 | $ 518 | $ 32 | $ 33 | $ 3 | $ 80 | | $ 10 |
| ns<br>ses) included<br>arnings | 3 (b) | (b) | (1) (b) | 3 (c) | 13 (c) | 3 (c) | (2) (c) | (c) | 9 (b) | (b) | |
| chases, sales,<br>ances and | (29) | (175) | (1) | (118) | (1) | (11) | | | (1) | | |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| ements transfers into of) Level 3 | 1 | | | | | | | | (1) | | |
| ance at e 30, 2010 | $ 4 | $ 24 | $ 9 | $ 419 | $ 530 | $ 24 | $ 31 | $ 3 | $ 87 | | $ 10 |
| ealized gains ses) included arnings | $ 2 (b) | (b) | (b) | $ (14) (c) | $ 13 (c) | $ 34 (c) | $ (2) (c) | (c) | (b) | $ (b) | |

(a) Amounts represent Level 3 derivative assets less Level 3 derivative liabilities.

(b) Realized and unrealized gains and losses on trading account assets and derivative instruments are reported in investment banking and capital markets income (loss) on the income statement.

(c) Realized and unrealized gains and losses on principal investments are reported in net gains (losses) from principal investments on the income statement. Realized and unrealized gains and losses on private equity and mezzanine investments are reported in investment banking and capital markets income (loss) on the income statement. Realized and unrealized gains and losses on investments included in accrued income and other assets are reported in other income on the income statement.

(d) Transfers out of Level 3 for principal investments represent investments that were deconsolidated during the second quarter of 2011 when employees who managed our various principal investments left Key and formed two independent entities that will serve as investment managers of these investments.

**Assets Measured at Fair Value on a Nonrecurring Basis**

Certain assets and liabilities are measured at fair value on a nonrecurring basis in accordance with GAAP. The adjustments to fair value generally result from the application of accounting guidance that requires assets and liabilities to be recorded at the lower of cost or fair value, or assessed for impairment. The following table presents our assets measured at fair value on a nonrecurring basis at June 30, 2011 and December 31, 2010:

| | June 30, 2011 | | | | December 31, 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| *in millions* | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| **ASSETS MEASURED ON A NONRECURRING BASIS** | | | | | | | | |
| Impaired loans | | | **$ 131** | **$ 131** | | | $ 219 | $ 219 |
| Loans held for sale [(a)] | | | **25** | **25** | | | 15 | 15 |
| Operating lease assets | | | | | | | | |
| Goodwill and other intangible assets | | | | | | | | |
| Accrued income and other assets | | **$ 19** | **13** | **32** | | $ 39 | 23 | 62 |
| Other investments | | | **1** | **1** | | | | |
| Total assets on a nonrecurring basis at fair value | | **$ 19** | **$ 170** | **$ 189** | | $ 39 | $ 257 | $ 296 |

(a) During the first half of 2011, we transferred $25 million of commercial and consumer loans from held-for-sale status to the held-to-maturity portfolio at their current fair value.

***Impaired loans***. We typically adjust the carrying amount of our impaired loans when there is evidence of probable loss and the expected fair value of the loan is less than its contractual amount. The amount of the impairment may be determined based on the estimated present value of future cash flows, the fair value of the underlying collateral or the loan s observable market price. Cash flow analysis considers internally developed inputs, such as discount rates, default rates, costs of foreclosure and changes in collateral values. The fair value of the collateral, which may take the form of real estate or personal property, is based on internal estimates, field observations and assessments provided by third-party appraisers. We perform or reaffirm appraisals of collateral-dependent impaired loans at least annually. Appraisals may occur more frequently if the most recent appraisal does not accurately reflect the current market, the debtor is seriously delinquent or chronically past due, or material deterioration in the performance of the project or condition of the property has occurred. Adjustments to outdated appraisals that result in an appraisal value less than the carrying amount of a collateral-dependent impaired loan are reflected in the allowance for loan and lease losses. Impaired loans with a specifically allocated allowance based on cash flow analysis or the underlying collateral are classified as Level 3 assets, while those with a specifically allocated allowance based on an observable market price that reflects recent sale transactions for similar loans and collateral are classified as Level 2. Current market conditions, including updated collateral values, and reviews of our borrowers financial condition impacted the inputs

used in our internal valuation analysis, resulting in write-downs of impaired loans during the first half of 2011.

***Loans held for sale***. Through a quarterly analysis of our loan portfolios held for sale, which include both performing and nonperforming loans, we determined that adjustments were necessary to record some of the portfolios at the lower of cost or fair value in accordance with GAAP. Loans held for sale portfolios adjusted to fair value totaled $25 million at June 30, 2011 and $15 million at December 31, 2010. Current market conditions, including updated collateral values, and reviews of our borrowers financial condition impacted the inputs used in our internal models and other valuation methodologies, resulting in these adjustments.

Valuations of performing commercial mortgage and construction loans held for sale are conducted using internal models that rely on market data from sales or nonbinding bids on similar assets, including credit spreads, treasury rates, interest rate curves and risk profiles, as well as our own assumptions about the exit market for the loans and details about individual loans within the respective portfolios. Therefore, we have classified these loans as Level 3 assets. The inputs related to our assumptions and other internal loan data include changes in real estate values, costs of foreclosure, prepayment rates, default rates and discount rates.

Valuations of nonperforming commercial mortgage and construction loans held for sale are based on current agreements to sell the loans or approved discounted payoffs. If a negotiated value is not available, we use third-party appraisals, adjusted for current market conditions. Since valuations are based on unobservable data, these loans have been classified as Level 3 assets.

***Operating lease assets.*** The valuation of commercial finance and operating leases is performed using an internal model that relies on market data, such as swap rates and bond ratings, as well as our own assumptions about the exit market for the leases and details about the individual leases in the portfolio. These leases have been classified as Level 3 assets. The inputs

related to our assumptions include changes in the value of leased items and internal credit ratings. In addition, commercial leases may be valued using current nonbinding bids when they are available. The leases valued under this methodology are classified as Level 2 assets.

***Goodwill and other intangible assets***. On a quarterly basis, we review impairment indicators to determine whether we need to evaluate the carrying amount of the goodwill and other intangible assets assigned to Key Community Bank and Key Corporate Bank. We also perform an annual impairment test for goodwill. Fair value of our reporting units is determined using both an income approach (discounted cash flow method) and a market approach (using publicly traded company and recent transactions data), which are weighted equally. Inputs used include market-available data, such as industry, historical and expected growth rates, and peer valuations, as well as internally driven inputs, such as forecasted earnings and market participant insights. Since this valuation relies on a significant number of unobservable inputs, we have classified these assets as Level 3. For additional information on the results of recent goodwill impairment testing, see Note 10 ( Goodwill and Other Intangible Assets ) on page 135 of our 2010 Annual Report on Form 10-K.

The fair value of other intangible assets is calculated using a cash flow approach. While the calculation to test for recoverability uses a number of assumptions that are based on current market conditions, the calculation is based primarily on unobservable assumptions; therefore, the assets are classified as Level 3. We use various assumptions depending on the type of intangible asset being valued; our assumptions may include attrition rates, types of customers, revenue streams, prepayment rates, refinancing probabilities and credit defaults. There was no impairment of other intangible assets recorded during the quarter ended June 30, 2011.

***Other assets.*** OREO and other repossessed properties are valued based on inputs such as appraisals and third-party price opinions, less estimated selling costs. Generally, we classify these assets as Level 3. However, OREO and other repossessed properties for which we receive binding purchase agreements are classified as Level 2. Returned lease inventory is valued based on market data for similar assets and is classified as Level 2. Assets that are acquired through, or in lieu of, loan foreclosures are recorded initially as held for sale at the lower of the loan balance or fair value at the date of foreclosure. After foreclosure, valuations are updated periodically, and current market conditions may require the assets to be marked down further to a new cost basis.

**Fair Value Disclosures of Financial Instruments**

The carrying amount and fair value of our financial instruments at June 30, 2011 and December 31, 2010 are shown in the following table:

| | **June 30, 2011** | | **December 31, 2010** | |
|---|---|---|---|---|
| *in millions* | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| **ASSETS** | | | | |
| Cash and short-term investments [(a)] | $ **5,416** | $ **5,416** | $ 1,622 | $ 1,622 |
| Trading account assets [(e)] | **769** | **769** | 985 | 985 |
| Securities available for sale [(e)] | **18,680** | **18,680** | 21,933 | 21,933 |
| Held-to-maturity securities [(b)] | **19** | **19** | 17 | 17 |
| Other investments [(e)] | **1,195** | **1,195** | 1,358 | 1,358 |
| Loans, net of allowance [(c)] | **46,610** | **45,759** | 48,503 | 46,140 |

| | | | | |
|---|---|---|---|---|
| Loans held for sale [e] | **381** | **381** | 467 | 467 |
| Mortgage servicing assets [d] | **180** | **247** | 196 | 284 |
| Derivative assets [e] | **900** | **900** | 1,006 | 1,006 |
| **LIABILITIES** | | | | |
| Deposits with no stated maturity [a] | $ **47,568** | $ **47,568** | $ 45,598 | $ 45,598 |
| Time deposits [d] | **12,842** | **13,253** | 15,012 | 15,502 |
| Short-term borrowings [a] | **2,179** | **2,179** | 3,196 | 3,196 |
| Long-term debt [d] | **10,997** | **11,321** | 10,592 | 10,611 |
| Derivative liabilities [e] | **991** | **991** | 1,142 | 1,142 |

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Valuation Methods and Assumptions

(a) Fair value equals or approximates carrying amount. The fair value of deposits with no stated maturity does not take into consideration the value ascribed to core deposit intangibles.

(b) Fair values of held-to-maturity securities are determined by using models that are based on security-specific details, as well as relevant industry and economic factors. The most significant of these inputs are quoted market prices, interest rate spreads on relevant benchmark securities and certain prepayment assumptions. We review the valuations derived from the models to ensure they are reasonable and consistent with the values placed on similar securities traded in the secondary markets.

(c) The fair value of the loans is based on the present value of the expected cash flows. The projected cash flows are based on the contractual terms of the loans, adjusted for prepayments and use of a discount rate based on the relative risk of the cash flows, taking into account the loan type, maturity of the loan, liquidity risk, servicing costs, and a required return on debt and capital. In addition, an incremental liquidity discount is applied to certain loans, using historical sales of loans during periods of similar economic conditions as a benchmark. The fair value of loans includes lease financing receivables at their aggregate carrying amount, which is equivalent to their fair value.

(d) Fair values of servicing assets, time deposits and long-term debt are based on discounted cash flows utilizing relevant market inputs.

(e) Information pertaining to our methodology for measuring the fair values of derivative assets and liabilities is included in the sections entitled Qualitative Disclosures of Valuation Techniques and Assets Measured at Fair Value on a Nonrecurring Basis in this note.

We use valuation methods based on exit market prices in accordance with the applicable accounting guidance for fair value measurements. We determine fair value based on assumptions pertaining to the factors a market participant would consider in valuing the asset. A substantial portion of our fair value adjustments are related to liquidity. During the first half of 2011, the fair values of our loan portfolios improved primarily due to increasing liquidity in the loan markets. If we were to use different assumptions, the fair values shown in the preceding table could change significantly. If a nonexit price methodology was used for valuing our loan portfolio for continuing operations, it would result in a premium of 0.6%. Also, because the applicable accounting guidance for financial instruments excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements, the fair value amounts shown in the table above do not, by themselves, represent the underlying value of our company as a whole.

***Education lending business***. The discontinued education lending business consists of assets and liabilities (recorded at fair value) in the securitization trusts, which were consolidated as of January 1, 2010 in accordance with new consolidation accounting guidance, as well as loans in portfolio (recorded at carrying value with appropriate valuation reserves) and loans held for sale (prior to the second quarter of 2011), both of which are outside the trusts. The fair value of loans held for sale was identical to the aggregate carrying amount of the loans. All of these loans were excluded from the table above as follows:

- loans at carrying value, net of allowance, of $3.1 billion ($2.8 billion at fair value) at June 30, 2011 and $3.2 billion ($2.8 billion at fair value) at December 31, 2010;
- loans held for sale of $15 million at December 31, 2010. There were no loans held for sale at June 30, 2011; and
- loans in the trusts at fair value of $3.1 billion at June 30, 2011 and December 31, 2010.

Securities issued by the education lending securitization trusts, which are the primary liabilities of the trusts, totaling $2.9 billion in fair value at June 30, 2011 and $3.0 billion in fair value at December 31, 2010, are also excluded from the above table. Additional information regarding the consolidation of the education lending securitization trusts is provided in Note 11 ( Divestiture and Discontinued Operations ).

***Residential real estate mortgage loans.*** Residential real estate mortgage loans with carrying amounts of $1.8 billion at June 30, 2011 and December 31, 2010 are included in Loans, net of allowance in the above table.

***Short-term financial instruments.*** For financial instruments with a remaining average life to maturity of less than six months, carrying amounts were used as an approximation of fair values.



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## 6. Securities

***Securities available for sale.*** These are securities that we intend to hold for an indefinite period of time; they may, however be sold in response to changes in interest rates, prepayment risk, liquidity needs or other factors. Securities available for sale are reported at fair value. Unrealized gains and losses (net of income taxes) deemed temporary are recorded in equity as a component of AOCI on the balance sheet. Unrealized losses on equity securities deemed to be "other-than-temporary," and realized gains and losses resulting from sales of securities using the specific identification method are included in "net securities gains (losses)" on the income statement. Unrealized losses on debt securities deemed to be "other-than-temporary" are included in "net securities gains (losses)" on the income statement or AOCI in accordance with the applicable accounting guidance related to the recognition of OTTI of debt securities.

"Other securities" held in the available-for-sale portfolio are primarily marketable equity securities that are traded on a public exchange such as the NYSE or NASDAQ.

***Held-to-maturity securities.*** These are debt securities that we have the intent and ability to hold until maturity. Debt securities are carried at cost and adjusted for amortization of premiums and accretion of discounts using the interest method. This method produces a constant rate of return on the adjusted carrying amount.

"Other securities" held in the held-to-maturity portfolio consist of foreign bonds, capital securities and preferred equity securities.

The amortized cost, unrealized gains and losses, and approximate fair value of our securities available for sale and held-to-maturity securities are presented in the following tables. Gross unrealized gains and losses represent the difference between the amortized cost and the fair value of securities on the balance sheet as of the dates indicated. Accordingly, the amount of these gains and losses may change in the future as market conditions change.

| | June 30, 2011 | | | |
|---|---|---|---|---|
| *in millions* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| **SECURITIES AVAILABLE FOR SALE** | | | | |
| U.S. Treasury, agencies and corporations | **$ 9** | | | **$ 9** |
| States and political subdivisions | **126** | **$ 3** | | **129** |
| Collateralized mortgage obligations | **17,124** | **485** | | **17,609** |
| Other mortgage-backed securities | **845** | **72** | | **917** |
| Other securities | **13** | **3** | | **16** |
| Total securities available for sale | **$ 18,117** | **$ 563** | | **$ 18,680** |
| **HELD-TO-MATURITY SECURITIES** | | | | |
| States and political subdivisions | **$ 1** | | | **$ 1** |
| Other securities | **18** | | | **18** |
| Total held-to-maturity securities | **$ 19** | | | **$ 19** |

| | December 31, 2010 | | | |
|---|---|---|---|---|
| *in millions* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| **SECURITIES AVAILABLE FOR SALE** | | | | |
| U.S. Treasury, agencies and corporations | $ 8 | | | $ 8 |
| States and political subdivisions | 170 | $ 2 | | 172 |
| Collateralized mortgage obligations | 20,344 | 408 | $ 87 | 20,665 |
| Other mortgage-backed securities | 998 | 71 | | 1,069 |
| Other securities | 15 | 4 | | 19 |
| Total securities available for sale | $ 21,535 | $ 485 | $ 87 | $ 21,933 |
| **HELD-TO-MATURITY SECURITIES** | | | | |
| States and political subdivisions | $ 1 | | | $ 1 |
| Other securities | 16 | | | 16 |
| Total held-to-maturity securities | $ 17 | | | $ 17 |

| *in millions* | June 30, 2010<br>Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **SECURITIES AVAILABLE FOR SALE** | | | | |
| U.S. Treasury, agencies and corporations | $ 8 | | | $ 8 |
| States and political subdivisions | 75 | $ 3 | | 78 |
| Collateralized mortgage obligations | 17,817 | 473 | | 18,290 |
| Other mortgage-backed securities | 1,187 | 96 | | 1,283 |
| Other securities | 106 | 11 | $ 3 | 114 |
| Total securities available for sale | $ 19,193 | $ 583 | $ 3 | $ 19,773 |
| **HELD-TO-MATURITY SECURITIES** | | | | |
| States and political subdivisions | $ 3 | | | $ 3 |
| Other securities | 16 | | | 16 |
| Total held-to-maturity securities | $ 19 | | | $ 19 |

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The following table summarizes our securities available for sale that were in an unrealized loss position as of June 30, 2011, December 31, 2010, and June 30, 2010.

| | Duration of Unrealized Loss Position | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Longer | | Total | |
| *in millions* | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| **JUNE 30, 2011** | | | | | | |
| Securities available for sale: | | | | | | |
| Collateralized mortgage obligations | **$ 126** | | | | **$ 126** | |
| Total temporarily impaired securities | **$ 126** | | | | **$ 126** | |
| **DECEMBER 31, 2010** | | | | | | |
| Securities available for sale: | | | | | | |
| Collateralized mortgage obligations | $ 4,028 | $ 87 | | | $ 4,028 | $ 87 |
| Total temporarily impaired securities | $ 4,028 | $ 87 | | | $ 4,028 | $ 87 |
| **June 30, 2010** | | | | | | |
| Securities available for sale: | | | | | | |
| Other securities | $ 18 | $ 2 | $ 3 | $ 1 | $ 21 | $ 3 |
| Total temporarily impaired securities | $ 18 | $ 2 | $ 3 | $ 1 | $ 21 | $ 3 |

We had less than $1 million of gross unrealized losses at June 30, 2011 that related to five fixed-rate collateralized mortgage obligations, which we invested in as part of an overall A/LM strategy. Since these securities have fixed interest rates, their fair value is sensitive to movements in market interest rates. These securities have a weighted-average maturity of 4.6 years at June 30, 2011.

The unrealized losses within each investment category are considered temporary since we expect to collect all contractually due amounts from these securities. Accordingly, these investments have been reduced to their fair value through OCI, not earnings.

We regularly assess our securities portfolio for OTTI. The assessments are based on the nature of the securities, the underlying collateral, the financial condition of the issuer, the extent and duration of the loss, our intent related to the individual securities, and the likelihood that we will have to sell securities prior to expected recovery.

Debt securities identified to have OTTI are written down to their current fair value. For those debt securities that we intend to sell, or more-likely-than-not will be required to sell, prior to the expected recovery of the amortized cost, the entire impairment (i.e., the difference between amortized cost and the fair value) is recognized in earnings. For those debt securities that we do not intend to sell, or more-likely-than-not will not be required to sell, prior to expected recovery, the credit portion of OTTI is recognized in earnings, while the remaining OTTI is recognized in equity as a component of AOCI on the balance sheet. As shown in the following table, we did not have any impairment losses recognized in earnings for the three months ended June 30, 2011.

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| **Three months ended June 30, 2011** | |
|---|---|
| *in millions* | |
| **Balance at March 31, 2011** | $ 4 |
| Impairment recognized in earnings | |
| **Balance at June 30, 2011** | $ 4 |

Realized gains and losses related to securities available for sale were as follows:

| **Six months ended June 30, 2011** | |
|---|---|
| *in millions* | |
| Realized gains | $ 23 |
| Realized losses | (22) |
| Net securities gains (losses) | $ 1 |

At June 30, 2011, securities available for sale and held-to-maturity securities totaling $11.3 billion were pledged to secure securities sold under repurchase agreements, to secure public and trust deposits, to facilitate access to secured funding, and for other purposes required or permitted by law.

The following table shows securities by remaining maturity. Collateralized mortgage obligations and other mortgage-backed securities both of which are included in the securities available-for-sale portfolio are presented based on their expected average lives. The remaining securities, including all of those in the held-to-maturity portfolio, are presented based on their remaining contractual maturity. Actual maturities may differ from expected or contractual maturities since borrowers have the right to prepay obligations with or without prepayment penalties.

| | **Securities Available for Sale** | | **Held-to-Maturity Securities** | |
|---|---|---|---|---|
| **June 30, 2011** *in millions* | **Amortized Cost** | **Fair Value** | **Amortized Cost** | **Fair Value** |
| Due in one year or less | $ 323 | $ 331 | $ 5 | $ 5 |
| Due after one through five years | 17,620 | 18,166 | 14 | 14 |
| Due after five through ten years | 101 | 110 | | |
| Due after ten years | 73 | 73 | | |
| Total | $ 18,117 | $ 18,680 | $ 19 | $ 19 |

## 7. Derivatives and Hedging Activities

We are a party to various derivative instruments, mainly through our subsidiary, KeyBank. Derivative instruments are contracts between two or more parties that have a notional amount and an underlying variable, require a small or no net investment and allow for the net settlement of positions. A derivative s notional amount serves as the basis for the payment provision of the contract, and takes the form of units, such as shares or dollars. A derivative s underlying variable is a specified interest rate, security price, commodity price, foreign exchange rate, index or other variable. The interaction between the notional amount and the underlying variable determines the number of units to be exchanged between the parties and influences the fair value of the derivative contract.

The primary derivatives that we use are interest rate swaps, caps, floors and futures; foreign exchange contracts; energy derivatives; credit derivatives; and equity derivatives. Generally, these instruments help us manage exposure to interest rate risk, mitigate the credit risk inherent in the loan portfolio, hedge against changes in foreign currency exchange rates, and meet client financing and hedging needs. As further discussed in this note:

- interest rate risk represents the possibility that the EVE or net interest income will be adversely affected by fluctuations in interest rates;

- credit risk is the risk of loss arising from an obligor s inability or failure to meet contractual payment or performance terms; and

- foreign exchange risk is the risk that an exchange rate will adversely affect the fair value of a financial instrument.

Derivative assets and liabilities are recorded at fair value on the balance sheet, after taking into account the effects of bilateral collateral and master netting agreements. These agreements allow us to settle all derivative contracts held with a single counterparty on a net basis, and to offset net derivative positions with related collateral, where applicable. As a result, we could have derivative contracts with negative fair values included in derivative assets on the balance sheet and contracts with positive fair values included in derivative liabilities.

At June 30, 2011, after taking into account the effects of bilateral collateral and master netting agreements, we had $225 million of derivative assets and $115 million of derivative liabilities that relate to contracts entered into for hedging purposes. As of the same date, after taking into account the effects of bilateral collateral and master netting agreements and a reserve for potential future losses, we had derivative assets of $675 million and derivative liabilities of $876 million that were not designated as hedging instruments.

The recently enacted Dodd-Frank Act may limit the types of derivatives activities that KeyBank and other insured depository institutions may conduct. As a result, our use of one or more of the types of derivatives noted above may change in the future.

Additional information regarding our accounting policies for derivatives is provided in Note 1 ( Summary of Significant Accounting Policies ) under the heading Derivatives on page 104 of our 2010 Annual Report on Form 10-K.

### Derivatives Designated in Hedge Relationships

Net interest income and the EVE change in response to changes in interest rates and differences in the repricing and maturity characteristics of interest-earning assets and interest-bearing liabilities. We utilize derivatives that have been designated as part of a hedge relationship in accordance with the applicable accounting guidance for derivatives and hedging to minimize interest rate volatility, which then minimizes the volatility of net interest income and the EVE. The primary derivative instruments used to manage interest rate risk are interest rate swaps, which convert the contractual interest rate index of agreed-upon amounts of assets and liabilities (i.e., notional amounts) to another interest rate index.

We designate certain receive fixed/pay variable interest rate swaps as fair value hedges. These swaps are used primarily to modify our consolidated exposure to changes in interest rates. These contracts convert certain fixed-rate long-term debt into variable-rate obligations. As a result, we receive fixed-rate interest payments in exchange for making variable-rate payments over the lives of the contracts without exchanging the notional amounts.

Similarly, we designate certain receive fixed/pay variable interest rate swaps as cash flow hedges. These contracts effectively convert certain floating-rate loans into fixed-rate loans to reduce the potential adverse effect of interest rate

decreases on future interest income. Again, we receive fixed-rate interest payments in exchange for making variable-rate payments over the lives of the contracts without exchanging the notional amounts. We also designate certain pay

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fixed/receive variable interest rate swaps as cash flow hedges. These swaps convert certain floating-rate debt into fixed-rate debt.

We also use interest rate swaps to hedge the floating-rate debt that funds fixed-rate leases entered into by our Equipment Finance line of business. These swaps are designated as cash flow hedges to mitigate the interest rate mismatch between the fixed-rate lease cash flows and the floating-rate payments on the debt.

The derivatives used for managing foreign currency exchange risk are cross currency swaps. We have outstanding issuances of medium-term notes that are denominated in foreign currencies. The notes are subject to translation risk, which represents the possibility that the fair value of the foreign-denominated debt will change based on movement of the underlying foreign currency spot rate. It is our practice to hedge against potential fair value volatility caused by changes in foreign currency exchange rates and interest rates. The hedge converts the notes to a variable-rate U.S. currency-denominated debt, which is designated as a fair value hedge of foreign currency exchange risk.

**Derivatives Not Designated in Hedge Relationships**

On occasion, we enter into interest rate swap contracts to manage economic risks but do not designate the instruments in hedge relationships. The amount of these contracts at June 30, 2011 was not significant.

Like other financial services institutions, we originate loans and extend credit, both of which expose us to credit risk. We actively manage our overall loan portfolio and the associated credit risk in a manner consistent with asset quality objectives. This process entails the use of credit derivatives primarily credit default swaps. Credit default swaps enable us to transfer to a third party a portion of the credit risk associated with a particular extension of credit, and to manage portfolio concentration and correlation risks. Occasionally, we also provide credit protection to other lenders through the sale of credit default swaps. This objective is accomplished primarily through the use of an investment-grade diversified dealer-traded basket of credit default swaps. These transactions may generate fee income, and diversify and reduce overall portfolio credit risk volatility. Although we use credit default swaps for risk management purposes, they are not treated as hedging instruments as defined by the applicable accounting guidance for derivatives and hedging.

We also enter into derivative contracts for other purposes, including:

¨ interest rate swap, cap, floor and futures contracts entered into generally to accommodate the needs of commercial loan clients;

¨ energy swap and options contracts entered into to accommodate the needs of clients;

¨ interest rate derivatives and foreign exchange contracts used for proprietary trading purposes;

¨ positions with third parties that are intended to offset or mitigate the interest rate or market risk related to client positions discussed above; and

¨ foreign exchange forward contracts entered into to accommodate the needs of clients.

These contracts are not designated as part of hedge relationships.

**Fair Values, Volume of Activity and Gain/Loss Information Related to Derivative Instruments**

The following table summarizes the fair values of our derivative instruments on a gross basis as of June 30, 2011, December 31, 2010, and June 30, 2010. The change in the notional amounts of these derivatives by type from December 31, 2010 to June 30, 2011 indicates the volume of our derivative transaction activity during the first half of 2011. The notional amounts are not affected by bilateral collateral and master netting agreements. Our derivative instruments are included in derivative assets or derivative liabilities on the balance sheet, as indicated in the following table:

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| | June 30, 2011 | | | December 31, 2010 | | | June 30, 2010 | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Fair Value | | | Fair Value | | | Fair Value | |
| *in millions* | **Notional Amount** | **Derivative Assets** | **Derivative Liabilities** | **Notional Amount** | **Derivative Assets** | **Derivative Liabilities** | **Notional Amount** | **Derivative Assets** | **Derivative Liabilities** |
| Derivatives designated as hedging instruments: | | | | | | | | | |
| Interest rate | **$ 9,713** | **$ 459** | **$ 1** | $ 10,586 | $ 458 | $ 17 | $ 14,168 | $ 601 | $ 4 |
| Foreign exchange | **1,188** | | **150** | 1,093 | | 240 | 1,383 | 14 | 334 |
| Total | **10,901** | **459** | **151** | 11,679 | 458 | 257 | 15,551 | 615 | 338 |
| Derivatives not designated as hedging instruments: | | | | | | | | | |
| Interest rate | **46,355** | **1,149** | **1,180** | 48,344 | 1,308 | 1,319 | 65,173 | 1,624 | 1,611 |
| Foreign exchange | **6,001** | **178** | **169** | 5,946 | 180 | 164 | 7,617 | 183 | 163 |
| Energy and commodity | **1,896** | **295** | **303** | 1,827 | 318 | 335 | 2,031 | 344 | 364 |
| Credit | **2,934** | **34** | **31** | 3,375 | 39 | 31 | 3,640 | 47 | 37 |
| Equity | **32** | **4** | **4** | 20 | 1 | 1 | 18 | 1 | 1 |
| Total | **57,218** | **1,660** | **1,687** | 59,512 | 1,846 | 1,850 | 78,479 | 2,199 | 2,176 |
| Netting adjustments [(a)] | | **(1,219)** | **(847)** | | (1,298) | (965) | N/A | (1,661) | (1,193) |
| Total derivatives | **$ 68,119** | **$ 900** | **$ 991** | $ 71,191 | $ 1,006 | $ 1,142 | $ 94,030 | $ 1,153 | $ 1,321 |

(a) Netting adjustments represent the amounts recorded to convert our derivative assets and liabilities from a gross basis to a net basis in accordance with the applicable accounting guidance. The net basis takes into account the impact of bilateral collateral and master netting agreements that allow us to settle all derivative contracts with a single counterparty on a net basis and to offset the net derivative position with the related collateral.

***Fair value hedges.*** Instruments designated as fair value hedges are recorded at fair value and included in derivative assets or derivative liabilities on the balance sheet. The effective portion of a change in the fair value of an instrument designated as a fair value hedge is recorded in earnings at the same time as a change in fair value of the hedged item, resulting in no effect on net income. The ineffective portion of a change in the fair value of such a hedging instrument is recorded in other income on the income statement with no corresponding offset. During the six-month period ended June 30, 2011, we did not exclude any portion of these hedging instruments from the assessment of hedge effectiveness. While there is some ineffectiveness in our hedging relationships, all of our fair value hedges remained

highly effective as of June 30, 2011.

The following table summarizes the pre-tax net gains (losses) on our fair value hedges for the six month periods ended June 30, 2011 and 2010, and where they are recorded on the income statement.

| | **Six months ended June 30, 2011** | | | | | |
|---|---|---|---|---|---|---|
| *in millions* | **Income Statement Location of Net Gains (Losses) on Derivative** | **Net Gains (Losses) on Derivative** | **Hedged Item** | **Income Statement Location of Net Gains (Losses) on Hedged Item** | **Net Gains (Losses) on Hedged Item** | |
| Interest rate | Other income | **$ (12)** | Long-term debt | Other income | **$ 8** | (a) |
| Interest rate | Interest expense Long-term debt | **112** | | | | |
| Foreign exchange | Other income | **90** | Long-term debt | Other income | **(95)** | (a) |
| Foreign exchange | Interest expense Long-term debt | **5** | Long-term debt | Interest expense Long-term debt | **(8)** | (b) |
| Total | | **$ 195** | | | **$ (95)** | |

| | **Six months ended June 30, 2010** | | | | | |
|---|---|---|---|---|---|---|
| *in millions* | **Income Statement Location of Net Gains (Losses) on Derivative** | **Net Gains (Losses) on Derivative** | **Hedged Item** | **Income Statement Location of Net Gains (Losses) on Hedged Item** | **Net Gains (Losses) on Hedged Item** | |
| Interest rate | Other income | $ 184 | Long-term debt | Other income | $ (176) | (a) |
| Interest rate | Interest expense Long-term | 109 | | | | |

| | | | | | |
|---|---|---|---|---|---|
| | debt | | | | |
| Foreign exchange | Other income | (264) | Long-term debt | Other income | 258 [a] |
| | Interest expense | | | | |
| Foreign exchange | Long-term debt | 3 | Long-term debt | Interest expense Long-term debt | (7) [b] |
| Total | | $ 32 | | | $ 75 |

(a) Net gains (losses) on hedged items represent the change in fair value caused by fluctuations in interest rates.

(b) Net gains (losses) on hedged items represent the change in fair value caused by fluctuations in foreign currency exchange rates.

***Cash flow hedges.*** Instruments designated as cash flow hedges are recorded at fair value and included in derivative assets or derivative liabilities on the balance sheet. Initially, the effective portion of a gain or loss on a cash flow hedge is recorded as a component of AOCI on the balance sheet and is subsequently reclassified into income when the hedged transaction impacts earnings (e.g., when we pay variable-rate interest on debt, receive variable-rate interest on commercial loans or sell commercial real estate loans). The ineffective portion of cash flow hedging transactions is included in other income on the income statement. During the six-month period ended June 30, 2011, we did not exclude any portion of these

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hedging instruments from the assessment of hedge effectiveness. While there is some ineffectiveness in our hedging relationships, all of our cash flow hedges remained highly effective as of June 30, 2011.
The following table summarizes the pre-tax net gains (losses) on our cash flow hedges for the six-month periods ended June 30, 2011 and 2010, and where they are recorded on the income statement. The table includes the effective portion of net gains (losses) recognized in OCI during the period, the effective portion of net gains (losses) reclassified from OCI into income during the current period and the portion of net gains (losses) recognized directly in income, representing the amount of hedge ineffectiveness.

| | Six months ended June 30, 2011 | | | | |
|---|---|---|---|---|---|
| *in millions* | **Net Gains (Losses) Recognized in OCI (Effective Portion)** | **Income Statement Location of Net Gains (Losses) Reclassified From OCI Into Income (Effective Portion)** | **Net Gains (Losses) Reclassified From OCI Into Income (Effective Portion)** | **Income Statement Location of Net Gains (Losses) Recognized in Income (Ineffective Portion)** | **Net Gains (Losses) Recognized in Income (Ineffective Portion)** |
| Interest rate | $ 42 | Interest income Loans | $ 27 | Other income | |
| Interest rate | (9) | Interest expense Long-term debt | (5) | Other income | |
| Interest rate | | Net gains (losses) from loan sales | | Other income | |
| Total | $ 33 | | $ 22 | | |

| | Six months ended June 30, 2010 | | | | |
|---|---|---|---|---|---|
| *in millions* | **Net Gains (Losses) Recognized in OCI (Effective Portion)** | **Income Statement Location of Net Gains (Losses) Reclassified From OCI Into Income (Effective Portion)** | **Net Gains (Losses) Reclassified From OCI Into Income (Effective Portion)** | **Income Statement Location of Net Gains (Losses) Recognized in Income (Ineffective Portion)** | **Net Gains (Losses) Recognized in Income (Ineffective Portion)** |
| Interest rate | $ 42 | Interest income Loans | $ 134 | Other income | |

| | | | | | |
|---|---|---|---|---|---|
| Interest rate | (22) | Interest expense | Long-term debt | (10) | Other income |
| Interest rate | | Net gains (losses) from loan sales | | | Other income |
| Total | $ 20 | | | $ 124 | |

The after-tax change in AOCI resulting from cash flow hedges is as follows:

| in millions | December 31, 2010 | 2011 Hedging Activity | Reclassification of Gains to Net Income | June 30, 2011 |
|---|---|---|---|---|
| AOCI resulting from cash flow hedges | $ 8 | **$ 21** | **$ (14)** | **$ 15** |

Considering the interest rates, yield curves and notional amounts as of June 30, 2011, we would expect to reclassify an estimated $7 million of net losses on derivative instruments from AOCI to income during the next twelve months. In addition, we expect to reclassify approximately $13 million of net gains related to terminated cash flow hedges from AOCI to income during the next twelve months. The maximum length of time over which we hedge forecasted transactions is 17 years.

***Nonhedging instruments.*** Our derivatives that are not designated as hedging instruments are recorded at fair value in derivative assets and derivative liabilities on the balance sheet. Adjustments to the fair values of these instruments, as well as any premium paid or received, are included in investment banking and capital markets income (loss) on the income statement.

The following table summarizes the pre-tax net gains (losses) on our derivatives that are not designated as hedging instruments for the six-month periods ended June 30, 2011 and 2010, and where they are recorded on the income statement.

| in millions | Six months ended June 30, 2011 | 2010 |
|---|---|---|
| **NET GAINS (LOSSES)** [(a)] | | |
| Interest rate | **$ 6** | $ 7 |
| Foreign exchange | **20** | 20 |
| Energy and commodity | **2** | 4 |
| Credit | **(10)** | (9) |
| Total net gains (losses) | **$ 18** | $ 22 |

(a) Recorded in investment banking and capital markets income (loss) on the income statement.

### Counterparty Credit Risk

Like other financial instruments, derivatives contain an element of credit risk. This risk is measured as the expected positive replacement value of the contracts. We use several means to mitigate and manage exposure to credit risk on derivative contracts. We generally enter into bilateral collateral and master netting agreements that provide for the net settlement of all contracts with a single counterparty in the event of default. Additionally, we monitor counterparty credit risk exposure on each contract to determine appropriate limits on our total credit exposure across all product types. We review our collateral positions on a daily basis and exchange collateral with our counterparties in accordance with ISDA and other related agreements. We generally hold collateral in the form of cash and highly rated securities issued by the U.S. Treasury, government-sponsored enterprises or GNMA. The collateral netted against derivative assets on the balance sheet totaled $354 million at June 30, 2011, $331 million at December 31, 2010, and $469 million at June 30, 2010. The collateral netted against derivative liabilities totaled $19 million at June 30, 2011, $2 million at December 31, 2010, and $2 million at June 30, 2010.

The following table summarizes our largest exposure to an individual counterparty at the dates indicated.

| *in millions* | | **June 30, 2011** | | **December 31, 2010** | | **June 30, 2010** |
|---|---|---|---|---|---|---|
| Largest gross exposure (derivative asset) to an individual counterparty | $ | **147** | $ | 168 | $ | 219 |
| Collateral posted by this counterparty | | **33** | | 25 | | 33 |
| Derivative liability with this counterparty | | **250** | | 275 | | 320 |
| Collateral pledged to this counterparty | | **137** | | 141 | | 154 |
| Net exposure after netting adjustments and collateral | | **2** | | 9 | | 20 |

The following table summarizes the fair value of our derivative assets by type. These assets represent our gross exposure to potential loss after taking into account the effects of bilateral collateral and master netting agreements and other means used to mitigate risk.

| *in millions* | | **June 30, 2011** | | **December 31, 2010** | | **June 30, 2010** |
|---|---|---|---|---|---|---|
| Interest rate | **$** | **1,026** | $ | 1,134 | $ | 1,434 |
| Foreign exchange | | **110** | | 104 | | 94 |
| Energy and commodity | | **105** | | 84 | | 74 |
| Credit | | **10** | | 14 | | 19 |
| Equity | | **3** | | 1 | | 1 |
| Derivative assets before collateral | | **1,254** | | 1,337 | | 1,622 |
| Less: Related collateral | | **354** | | 331 | | 469 |
| Total derivative assets | **$** | **900** | $ | 1,006 | $ | 1,153 |

We enter into derivative transactions with two primary groups: broker-dealers and banks, and clients. Since these groups have different economic characteristics, we have different methods for managing counterparty credit exposure

and credit risk.
We enter into transactions with broker-dealers and banks for various risk management purposes and proprietary trading purposes. These types of transactions generally are high dollar volume. We generally enter into bilateral collateral and master netting agreements with these counterparties. At June 30, 2011, after taking into account the effects of bilateral collateral and master netting agreements, we had gross exposure of $804 million to broker-dealers and banks. We had net exposure of $211 million after the application of master netting agreements and collateral; our net exposure to broker-dealers and banks at June 30, 2011, was reduced to $21 million with $190 million of additional collateral held in the form of securities.
We enter into transactions with clients to accommodate their business needs. These types of transactions generally are low dollar volume. We generally enter into master netting agreements with these counterparties. In addition, we mitigate our overall portfolio exposure and market risk by buying and selling U.S. Treasuries and Eurodollar futures, and entering into offsetting positions and other derivative contracts. Due to the smaller size and magnitude of the individual contracts with clients, collateral generally is not exchanged in connection with these derivative transactions. To address the risk of default associated with the uncollateralized contracts, we have established a default reserve (included in derivative assets ) in the amount of $32 million at June 30, 2011, which we estimate to be the potential future losses on amounts due from client counterparties in the event of default. At December 31, 2010, the default reserve was $48 million. At June 30, 2011, after taking into account the effects of master netting agreements, we had gross exposure of $779 million to client counterparties. We had net exposure of $689 million on our derivatives with clients after the application of master netting agreements, collateral and the related reserve.


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**Credit Derivatives**

We are both a buyer and seller of credit protection through the credit derivative market. We purchase credit derivatives to manage the credit risk associated with specific commercial lending and swap obligations. We also sell credit derivatives, mainly index credit default swaps, to diversify the concentration risk within our loan portfolio.

The following table summarizes the fair value of our credit derivatives purchased and sold by type. The fair value of credit derivatives presented below does not take into account the effects of bilateral collateral or master netting agreements.

| | **June 30, 2011** | | | **December 31, 2010** | | | **June 30, 2010** | | |
|---|---|---|---|---|---|---|---|---|---|
| *in millions* | **Purchased** | **Sold** | **Net** | **Purchased** | **Sold** | **Net** | **Purchased** | **Sold** | **Net** |
| Single name credit default swaps | **$ (10)** | **$ 9** | **$ (1)** | $ (8) | $ 9 | $ 1 | $ 12 | $ (4) | $ 8 |
| Traded credit default swap indices | | **2** | **2** | | 2 | 2 | 1 | (2) | (1) |
| Other | **3** | | **3** | 5 | | 5 | 5 | (2) | 3 |
| Total credit derivatives | **$ (7)** | **$ 11** | **$ 4** | $ (3) | $ 11 | $ 8 | $ 18 | $ (8) | $ 10 |

Single name credit default swaps are bilateral contracts whereby the seller agrees, for a premium, to provide protection against the credit risk of a specific entity (referred to as the reference entity ) in connection with a specific debt obligation. The protected credit risk is related to adverse credit events, such as bankruptcy, failure to make payments, and acceleration or restructuring of obligations, identified in the credit derivative contract. As the seller of a single name credit derivative, we would be required to pay the purchaser the difference between the par value and the market price of the debt obligation (cash settlement) or receive the specified referenced asset in exchange for payment of the par value (physical settlement) if the underlying reference entity experiences a predefined credit event. For a single name credit derivative, the notional amount represents the maximum amount that a seller could be required to pay. In the event that physical settlement occurs and we receive our portion of the related debt obligation, we will join other creditors in the liquidation process, which may result in the recovery of a portion of the amount paid under the credit default swap contract. We also may purchase offsetting credit derivatives for the same reference entity from third parties that will permit us to recover the amount we pay should a credit event occur.

A traded credit default swap index represents a position on a basket or portfolio of reference entities. As a seller of protection on a credit default swap index, we would be required to pay the purchaser if one or more of the entities in the index had a credit event. For a credit default swap index, the notional amount represents the maximum amount that a seller could be required to pay. Upon a credit event, the amount payable is based on the percentage of the notional amount allocated to the specific defaulting entity.

The majority of transactions represented by the other category shown in the above table are risk participation agreements. In these transactions, the lead participant has a swap agreement with a customer. The lead participant (purchaser of protection) then enters into a risk participation agreement with a counterparty (seller of protection), under which the counterparty receives a fee to accept a portion of the lead participant s credit risk. If the customer defaults on the swap contract, the counterparty to the risk participation agreement must reimburse the lead participant for the counterparty s percentage of the positive fair value of the customer swap as of the default date. If the customer swap has a negative fair value, the counterparty has no reimbursement requirements. The notional amount represents the maximum amount that the seller could be required to pay. If the customer defaults on the swap contract and the seller fulfills its payment obligations under the risk participation agreement, the seller is entitled to a pro rata share of

the lead participant s claims against the customer under the terms of the swap agreement.

The following table provides information on the types of credit derivatives sold by us and held on the balance sheet at June 30, 2011, December 31, 2010, and June 30, 2010. Except as noted, the payment/performance risk assessment is based on the default probabilities for the underlying reference entities debt obligations using a Moody s credit ratings matrix known as Moody s Idealized Cumulative Default Rates. The payment/performance risk shown in the table represents a weighted-average of the default probabilities for all reference entities in the respective portfolios. These default probabilities are directly correlated to the probability that we will have to make a payment under the credit derivative contracts.

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| | June 30, 2011 | | | | December 31, 2010 | | | | June 30, 2010 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | Notional Amount | Average Term (Years) | Payment / Performance Risk | | Notional Amount | Average Term (Years) | Payment / Performance Risk | | Notional Amount | Average Term (Years) | Payment / Performance Risk | |
| Single name credit default swaps | **$ 844** | **2.40** | **4.45** | **%** | $ 942 | 2.42 | 3.93 | % | $ 1,102 | 2.45 | 4.10 | % |
| Traded credit default swap indices | **318** | **3.88** | **3.47** | | 369 | 3.86 | 6.68 | | 344 | 4.00 | 8.08 | |
| Other | **17** | **5.56** | **9.04** | | 48 | 2.00 | Low | (a) | 46 | 3.09 | 7.70 | |
| Total credit derivatives sold | **$ 1,179** | | | | $ 1,359 | | | | $ 1,492 | | | |

(a) The other credit derivatives were not referenced to an entity s debt obligation. We determined the payment/performance risk based on the probability that we could be required to pay the maximum amount under the credit derivatives. We have determined that the payment/performance risk associated with the other credit derivatives was low (i.e., less than or equal to 30% probability of payment).

**Credit Risk Contingent Features**

We have entered into certain derivative contracts that require us to post collateral to the counterparties when these contracts are in a net liability position. The amount of collateral to be posted is based on the amount of the net liability and thresholds generally related to our long-term senior unsecured credit ratings with Moody s and S&P. Collateral requirements also are based on minimum transfer amounts, which are specific to each Credit Support Annex (a component of the ISDA Master Agreement) that we have signed with the counterparties. In a limited number of instances, counterparties also have the right to terminate their ISDA Master Agreements with us if our ratings fall below a certain level, usually investment-grade level (i.e., Baa3 for Moody s and BBB- for S&P). At June 30, 2011, KeyBank s ratings with Moody s and S&P were A3 and A-, respectively, and KeyCorp s ratings with Moody s and S& were Baa1 and BBB+, respectively. If there was a downgrade of our ratings, we could be required to post additional collateral under those ISDA Master Agreements where we are in a net liability position. As of June 30, 2011, the aggregate fair value of all derivative contracts with credit risk contingent features (i.e., those containing collateral posting or termination provisions based on our ratings) held by KeyBank that were in a net liability position totaled $867 million, which includes $531 million in derivative assets and $1.4 billion in derivative liabilities. We had $861 million in cash and securities collateral posted to cover those positions as of June 30, 2011.

The following table summarizes the additional cash and securities collateral that KeyBank would have been required to deliver had the credit risk contingent features been triggered for the derivative contracts in a net liability position as of June 30, 2011, December 31, 2010, and June 30, 2010. The additional collateral amounts were calculated based on scenarios under which KeyBank s ratings are downgraded one, two or three ratings as of June 30, 2011, and take into account all collateral already posted. At June 30, 2011, KeyCorp did not have any derivatives in a net liability position that contained credit risk contingent features.

| | June 30, 2011 | | December 31, 2010 | | June 30, 2010 | |
|---|---|---|---|---|---|---|
| *in millions* | Moody s | S&P | Moody s | S&P | Moody s | S&P |

| KeyBank s long-term senior unsecured credit ratings | **A3** | **A-** | A3 | A- | A2 | A- |
|---|---|---|---|---|---|---|
| One rating downgrade | $ **11** | $ **11** | $ 16 | $ 16 | $ 28 | $ 22 |
| Two rating downgrades | **16** | **16** | 27 | 27 | 51 | 25 |
| Three rating downgrades | **16** | **16** | 32 | 32 | 59 | 30 |

If KeyBank s ratings had been downgraded below investment grade as of June 30, 2011, payments of up to $17 million would have been required to either terminate the contracts or post additional collateral for those contracts in a net liability position, taking into account all collateral already posted. KeyBank s long-term senior unsecured credit rating currently is four ratings above investment grade at Moody s and S&P.

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## 8. Mortgage Servicing Assets

We originate and periodically sell commercial mortgage loans but continue to service those loans for the buyers. We also may purchase the right to service commercial mortgage loans for other lenders. A servicing asset is recorded if we purchase or retain the right to service loans in exchange for servicing fees that exceed the going market rate. Changes in the carrying amount of mortgage servicing assets are summarized as follows:

| | Six months ended June 30, | | | |
|---|---|---|---|---|
| *in millions* | | **2011** | | 2010 |
| Balance at beginning of period | **$** | **196** | $ | 221 |
| Servicing retained from loan sales | | **11** | | 3 |
| Purchases | | **2** | | 7 |
| Amortization | | **(29)** | | (22) |
| Balance at end of period | **$** | **180** | $ | 209 |
| Fair value at end of period | **$** | **247** | $ | 307 |

The fair value of mortgage servicing assets is determined by calculating the present value of future cash flows associated with servicing the loans. This calculation uses a number of assumptions that are based on current market conditions. The primary economic assumptions used to measure the fair value of our mortgage servicing assets at June 30, 2011 and 2010, are:

- prepayment speed generally at an annual rate of 0.00% to 25.00%;
- expected credit losses at a static rate of 2.00% to 3.00%;
- residual cash flows discount rate of 7.00% to 15.00%; and
- value assigned to escrow funds at an interest rate of 2.50% to 7.18%.

Changes in these economic assumptions could cause the fair value of mortgage servicing assets to change in the future. The volume of loans serviced, expected credit losses, and the value assigned to escrow deposits are critical to the valuation of servicing assets. At June 30, 2011, a 1.00% decrease in the value assigned to the escrow deposits would cause a $32 million decrease in the fair value of our mortgage servicing assets; and an increase in the assumed default rate of commercial mortgage loans of 1.00% would cause a $8 million decrease in the fair value of our mortgage servicing assets.

Contractual fee income from servicing commercial mortgage loans totaled $48 million and $37 million for the six-month periods ended June 30, 2011 and 2010, respectively. We have elected to remeasure servicing assets using the amortization method. The amortization of servicing assets is determined in proportion to, and over the period of, the estimated net servicing income. The amortization of servicing assets for each period, as shown in the preceding table, is recorded as a reduction to fee income. Both the contractual fee income and the amortization are recorded in other income on the income statement.

Subsequent to its January 19, 2011 publicly issued announcement, Moody s, a credit rating agency that rates KeyCorp and KeyBank debt securities, indicated to KeyBank that certain escrow deposits associated with our mortgage servicing operations had to be moved to another financial institution which meets Moody s minimum ratings threshold.

As a result of this decision by Moody s, during the first quarter of 2011, KeyBank transferred approximately $1.5 billion of these escrow deposit balances to an acceptably-rated institution resulting in an immaterial impairment of the related mortgage servicing assets. We funded this movement of the escrow deposits by selling a similar amount of securities available for sale at the time of the transfer. KeyBank had ample liquidity reserves to offset the loss of these deposits, and currently remains in a strong liquidity position.

Additional information pertaining to the accounting for mortgage and other servicing assets is included in Note 1 ( Summary of Significant Accounting Policies ) under the heading Servicing Assets on page 103 of our 2010 Annual Report on Form 10-K and Note 11 ( Divestiture and Discontinued Operations ) in this report under the heading Education lending.

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## 9. Variable Interest Entities

A VIE is a partnership, limited liability company, trust or other legal entity that meets any one of the following criteria:

- The entity does not have sufficient equity to conduct its activities without additional subordinated financial support from another party.
- The entity s investors lack the power to direct the activities that most significantly impact the entity s economic performance.
- The entity s equity at risk holders do not have the obligation to absorb losses or the right to receive residual returns.
- The voting rights of some investors are not proportional to their economic interests in the entity, and substantially all of the entity s activities involve, or are conducted on behalf of, investors with disproportionately few voting rights.

Our VIEs are summarized below. We define a significant interest in a VIE as a subordinated interest that exposes us to a significant portion, but not the majority, of the VIE s expected losses or residual returns, even though we do not have the power to direct the activities that most significantly impact the entity s economic performance.

| | **Consolidated VIEs** | | **Unconsolidated VIEs** | | |
|---|---|---|---|---|---|
| *in millions* | **Total Assets** | **Total Liabilities** | **Total Assets** | **Total Liabilities** | **Maximum Exposure to Loss** |
| June 30, 2011 | | | | | |
| LIHTC funds | $ 91 | N/A | $ 149 | | |
| Education loan securitization trusts | 3,134 | $ 2,949 | N/A | N/A | N/A |
| LIHTC investments | N/A | N/A | 1,064 | | $ 476 |

Our involvement with VIEs is described below.

Consolidated VIEs

***LIHTC guaranteed funds.*** KAHC formed limited partnerships, known as funds that invested in LIHTC operating partnerships. Interests in these funds were offered in syndication to qualified investors who paid a fee to KAHC for a guaranteed return. We also earned syndication fees from the funds and continue to earn asset management fees. The funds assets primarily are investments in LIHTC operating partnerships, which totaled $75 million at June 30, 2011. These investments are recorded in accrued income and other assets on the balance sheet and serve as collateral for the funds limited obligations.

We have not formed new funds or added LIHTC partnerships since October 2003. However, we continue to act as asset manager and provide occasional funding for existing funds under a guarantee obligation. As a result of this guarantee obligation, we have determined that we are the primary beneficiary of these funds. Additional information on return guarantee agreements with LIHTC investors is presented in Note 12 ( Contingent Liabilities and Guarantees ) under the heading Guarantees.

In accordance with the applicable accounting guidance for distinguishing liabilities from equity, third-party interests associated with our LIHTC guaranteed funds are considered mandatorily redeemable instruments and are recorded in accrued expense and other liabilities on the balance sheet. However, the FASB has indefinitely deferred the measurement and recognition provisions of this accounting guidance for mandatorily redeemable third-party interests associated with finite-lived subsidiaries, such as our LIHTC guaranteed funds. We adjust our financial statements each period for the third-party investors share of the funds profits and losses. At June 30, 2011, we estimated the settlement value of these third-party interests to be between $42 million and $47 million, while the recorded value, including

reserves, totaled $100 million. The partnership agreement for each of our guaranteed funds requires the fund to be dissolved by a certain date.

***Education loan securitization trusts.*** In September 2009, we decided to exit the government-guaranteed education lending business. Therefore, we have accounted for this business as a discontinued operation. In the past, as part of our education lending business model, we originated and securitized education loans. As the transferor, we retained a portion of the risk in the form of a residual interest and also retained the right to service the securitized loans and receive servicing fees. We have not securitized any education loans since 2006.

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We consolidated our ten outstanding education loan securitization trusts as of January 1, 2010. We were required to consolidate these trusts because we hold the residual interests and as the master servicer we have the power to direct the activities that most significantly impact the trusts economic performance. We elected to consolidate these trusts at fair value. The trust assets can be used only to settle the obligations or securities that the trusts issue; we cannot sell the assets or transfer the liabilities. The security holders or beneficial interest holders do not have recourse to us, and we do not have any liability recorded related to their securities. Additional information regarding the education loan securitization trusts is provided in Note 11 ( Divestiture and Discontinued Operations ) under the heading Education lending.

Unconsolidated VIEs

***LIHTC nonguaranteed funds.*** Although we hold significant interests in certain nonguaranteed funds that we formed and funded, we have determined that we are not the primary beneficiary because we do not absorb the majority of the funds expected losses and do not have the power to direct activities that most significantly impact the economic performance of these entities. At June 30, 2011, assets of these unconsolidated nonguaranteed funds totaled $149 million. Our maximum exposure to loss in connection with these funds is minimal, and we do not have any liability recorded related to the funds. We have not formed nonguaranteed funds since October 2003.

***LIHTC investments.*** Through Key Community Bank, we have made investments directly in LIHTC operating partnerships formed by third parties. As a limited partner in these operating partnerships, we are allocated tax credits and deductions associated with the underlying properties. We have determined that we are not the primary beneficiary of these investments because the general partners have the power to direct the activities that most significantly impact the economic performance of the partnership and have the obligation to absorb expected losses and the right to receive benefits.

At June 30, 2011, assets of these unconsolidated LIHTC operating partnerships totaled approximately $1.1 billion. At June 30, 2011, our maximum exposure to loss in connection with these partnerships is the unamortized investment balance of $392 million plus $84 million of tax credits claimed but subject to recapture. We do not have any liability recorded related to these investments because we believe the likelihood of any loss is remote. During the first six months of 2011, we did not obtain significant direct investments (either individually or in the aggregate) in LIHTC operating partnerships.

We have additional investments in unconsolidated LIHTC operating partnerships that are held by the consolidated LIHTC guaranteed funds. Total assets of these operating partnerships were approximately $1 billion at June 30, 2011. The tax credits and deductions associated with these properties are allocated to the funds investors based on their ownership percentages. We have determined that we are not the primary beneficiary of these partnerships because the general partners have the power to direct the activities that most significantly impact their economic performance and the obligation to absorb expected losses and right to receive residual returns. Information regarding our exposure to loss in connection with these guaranteed funds is included in Note 12 under the heading Return guarantee agreement with LIHTC investors.

***Commercial and residential real estate investments and principal investments.*** Our Principal Investing unit and the Real Estate Capital and Corporate Banking Services line of business make equity and mezzanine investments, some of which are in VIEs. These investments are held by nonregistered investment companies subject to the provisions of the AICPA Audit and Accounting Guide, Audits of Investment Companies. We are not currently applying the accounting or disclosure provisions in the applicable accounting guidance for consolidations to these investments, which remain unconsolidated. The FASB has indefinitely deferred the effective date of this guidance for such nonregistered investment companies.

## 10. Income Taxes

### Income Tax Provision

In accordance with the applicable accounting guidance, the principal method established for computing the provision for income taxes in interim periods requires us to make our best estimate of the effective tax rate expected to be applicable for the full year. This estimated effective tax rate is then applied to interim consolidated pre-tax operating income to determine the interim provision for income taxes. Additionally, the accounting guidance allows for an alternative method to computing the effective tax rate and, thus the interim provision for income taxes, when a

taxpayer is unable to calculate a reliable estimate of the effective tax rate for the entire year. Due to the current economic environment, we have concluded that the alternative method is more reliable in determining the provision for income taxes for 2011. The alternative method was also used for determining the provision for income taxes in 2010. The provision for the current quarter is calculated by applying the statutory federal income tax rate to the quarter s consolidated operating income before taxes after modifications. These items include modifications for non-taxable items recognized in the quarter, which include income from corporate-owned life insurance, tax credits related to investments in low income housing projects, and state taxes.

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The effective tax rate, which is the provision for income taxes as a percentage of income from continuing operations before income taxes, was 27.1% for the second quarter of 2011, 28.2% for the first quarter of 2011, and 9.7% for the second quarter of 2010. The effective tax rates are below our combined federal and state statutory tax rate of 37.2%, due primarily to income from investments in tax-advantaged assets such as corporate-owned life insurance, and credits associated with investments in low-income housing projects.

**Deferred Tax Asset**

As of June 30, 2011, we had a net deferred tax asset from continuing operations of $208 million compared to $348 million as of March 31, 2011 and $594 million as of June 30, 2010, included in accrued income and other assets on the balance sheet. To determine the amount of deferred tax assets that are more-likely-than-not to be realized, and therefore recorded, we conduct a quarterly assessment of all available evidence. This evidence includes, but is not limited to, taxable income in prior periods, projected future taxable income, and projected future reversals of deferred tax items. Based on these criteria, and in particular our projections for future taxable income, we currently believe that it is more-likely-than-not that we will realize the net deferred tax asset in future periods.

**Unrecognized Tax Benefits**

As permitted under the applicable accounting guidance for income taxes, it is our policy to recognize interest and penalties related to unrecognized tax benefits in income tax expense.

## 11. Divestiture and Discontinued Operations

**Divestiture**

***Tuition Management Systems.*** On November 21, 2010, we entered into a definitive agreement to sell substantially all of the net assets of the Tuition Management Systems business (TMS) to a wholly-owned subsidiary of Boston-based First Marblehead Corporation for approximately $47 million in cash. The transaction closed on December 31, 2010. We wrote off $15 million of customer relationship intangible assets in conjunction with this transaction against the purchase price, to determine the net gain on sale.

**Discontinued operations**

***Education lending.*** In September 2009, we decided to exit the government-guaranteed education lending business. As a result of this decision, we have accounted for this business as a discontinued operation.

The changes in fair value of the assets and liabilities of the education loan securitization trusts (discussed later in this note) and the interest income and expense from the loans and the securities of the trusts are all recorded as a component of income (loss) from discontinued operations, net of taxes on the income statement. These amounts are shown separately in the following table. Gains and losses attributable to changes in fair value are recorded as a component of noninterest income or expense. It is our policy to recognize interest income and expense related to the loans and securities separately from changes in fair value. These amounts are shown as a component of Net interest income.

The components of income (loss) from discontinued operations, net of taxes for the education lending business are as follows:

| *in millions* | **Three months ended June 30, 2011** | **Three months ended June 30, 2010** | **Six months ended June 30, 2011** | **Six months ended June 30, 2010** |
|---|---|---|---|---|
| Net interest income | **$ 35** | $ 39 | **$ 71** | $ 79 |
| Provision for loan and lease losses | **30** | 14 | **62** | 38 |
| Net interest income (expense) after provision for loan and lease losses | **5** | 25 | **9** | 41 |
| Noninterest income | **(11)** | (55) | **(21)** | (56) |
| Noninterest expense | **9** | 13 | **20** | 25 |
| Income (loss) before income taxes | **(15)** | (43) | **(32)** | (40) |

| | | | | |
|---|---|---|---|---|
| Income taxes | **(6)** | (16) | **(12)** | (15) |
| Income (loss) from discontinued operations, net of taxes [a] | **$ (9)** | $ (27) | **$ (20)** | $ (25) |

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(a) Includes after-tax charges of $12 million and $15 million for the three-month periods ended June 30, 2011 and 2010, respectively, and $25 million and $30 million for the six-month periods ended June 30, 2011 and 2010, respectively, determined by applying a matched funds transfer pricing methodology to the liabilities assumed necessary to support the discontinued operations.

The discontinued assets and liabilities of our education lending business included on the balance sheet are as follows:

| *in millions* | **June 30, 2011** | **December 31, 2010** | **June 30, 2010** |
|---|---|---|---|
| Loans at fair value | **$ 3,100** | $ 3,125 | $ 3,223 |
| Loans, net of unearned income of $1, $1 and $1 | **3,161** | 3,326 | 3,371 |
| Less: Allowance for loan and lease losses | **109** | 114 | 128 |
| Net loans | **6,152** | 6,337 | 6,466 |
| Loans held for sale | | 15 | 92 |
| Accrued income and other assets | **144** | 169 | 223 |
| Total assets | **$ 6,296** | $ 6,521 | $ 6,781 |
| Accrued expense and other liabilities | **$ 30** | $ 31 | $ 46 |
| Securities at fair value | **2,919** | 2,966 | 3,092 |
| Total liabilities | **$ 2,949** | $ 2,997 | $ 3,138 |

In the past, as part of our education lending business model, we originated and securitized education loans. The process of securitization involves taking a pool of loans from our balance sheet and selling them to a bankruptcy remote QSPE, or trust. This trust then issues securities to investors in the capital markets to raise funds to pay for the loans. The interest generated on the loans goes to pay holders of the securities issued. As the transferor, we retain a portion of the risk in the form of a residual interest and also retain the right to service the securitized loans and receive servicing fees.

In June 2009, the FASB issued new consolidation accounting guidance that required us to analyze our existing QSPEs for possible consolidation. We determined that we should consolidate our ten outstanding securitization trusts as of January 1, 2010, since we hold the residual interests and are the master servicer with the power to direct the activities that most significantly impact the economic performance of these trusts.

The trust assets can be used only to settle the obligations or securities the trusts issue; we cannot sell the assets or transfer the liabilities. The loans in the consolidated trusts are comprised of both private and government-guaranteed loans. The security holders or beneficial interest holders do not have recourse to Key. Our economic interest or risk of loss associated with these education loan securitization trusts is approximately $185 million as of June 30, 2011. We record all income and expense (including fair value adjustments) through the income (loss) from discontinued operations, net of tax line item in our income statement.

We elected to consolidate these trusts at fair value when we prospectively adopted this new consolidation guidance. Carrying the assets and liabilities of the trusts at fair value better depicts our economic interest. A cumulative effect adjustment of approximately $45 million, which increased our beginning balance of retained earnings at January 1, 2010, was recorded when the trusts were consolidated. The amount of this cumulative effect adjustment was driven primarily by derecognizing the residual interests and servicing assets related to these trusts and consolidating the

assets and liabilities at fair value.

At June 30, 2011, the primary economic assumptions used to measure the fair value of the assets and liabilities of the trusts are shown in the following table. The fair value is determined by calculating the present value of the future expected cash flows; those cash flows are affected by the following assumptions. We rely on unobservable inputs (Level 3) when determining the fair value of the assets and liabilities of the trusts because observable market data is not available.

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| June 30, 2011 | |
|---|---|
| Weighted-average life (years) | 1.4 - 6.0 |
| **PREPAYMENT SPEED ASSUMPTIONS (ANNUAL RATE)** | 4.00 % - 26.00 % |
| **EXPECTED CREDIT LOSSES** | 2.00 % - 80.00 % |
| **LOAN DISCOUNT RATES (ANNUAL RATE)** | 2.04 % - 6.79 % |
| **SECURITY DISCOUNT RATES (ANNUAL RATE)** | 1.68 % - 6.70 % |
| **EXPECTED DEFAULTS (STATIC RATE)** | 3.75 % - 40.00 % |

The following table shows the consolidated trusts assets and liabilities at fair value and their related contractual values as of June 30, 2011. At June 30, 2011, loans held by the trusts with unpaid principal balances of $43 million ($42 million on a fair value basis) were 90 days or more past due, and loans aggregating $18 million ($18 million on a fair value basis) were in nonaccrual status.

| **June 30, 2011**<br>*in millions* | **Contractual Amount** | **Fair Value** |
|---|---|---|
| **ASSETS** | | |
| Loans | $ 3,175 | $ 3,100 |
| Other assets | 34 | 34 |
| **LIABILITIES** | | |
| Securities | $ 3,282 | $ 2,919 |
| Other liabilities | 30 | 30 |

The following table presents the assets and liabilities of the trusts that were consolidated and are measured at fair value on a recurring basis.

| **June 30, 2011**<br>*in millions* | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| **ASSETS MEASURED ON A RECURRING BASIS** | | | | |
| Loans | | | $ 3,100 | $ 3,100 |
| Other assets | | | 34 | 34 |
| Total assets on a recurring basis at fair value | | | $ 3,134 | $ 3,134 |

| | | |
|---|---|---|
| **LIABILITIES MEASURED ON A RECURRING BASIS** | | |
| Securities | $ 2,919 | $ 2,919 |
| Other liabilities | 30 | 30 |
| Total liabilities on a recurring basis at fair value | $ 2,949 | $ 2,949 |

The following table shows the change in the fair values of the Level 3 consolidated education loan securitization trusts for the six-month period ended June 30, 2011.

| *in millions* | **Trust Student Loans** | **Other Assets** | **Trust Securities** | **Other Liabilities** |
|---|---|---|---|---|
| Balance at January 1, 2011 | $ 3,125 | $ 45 | $ 2,966 | $ 31 |
| Gains (losses) recognized in earnings [(a)] | 159 | | 181 | |
| Purchases | | | | |
| Sales | | | | |
| Issuances | | | | |
| Settlements | (184) | (11) | (228) | (1) |
| Balance at June 30, 2011 | $ 3,100 | $ 34 | $ 2,919 | $ 30 |

(a) Gains (losses) on the Trust Student Loans and Trust Securities were driven primarily by fair value adjustments.

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***Austin Capital Management, Ltd.*** In April 2009, we decided to wind down the operations of Austin, a subsidiary that specialized in managing hedge fund investments for institutional customers. As a result of this decision, we have accounted for this business as a discontinued operation.

The results of this discontinued business are included in income (loss) from discontinued operations, net of taxes on the income statement. The components of income (loss) from discontinued operations, net of taxes for Austin are as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| *in millions* | **2011** | **2010** | **2011** | **2010** |
| Noninterest income | | $ 1 | **$ 1** | $ 4 |
| Other noninterest expense | | 2 | **1** | 4 |
| Income (loss) before income taxes | | (1) | | |
| Income taxes | | (1) | | |
| Income (loss) from discontinued operations, net of taxes | | | | |

The discontinued assets and liabilities of Austin included on the balance sheet are as follows:

| *in millions* | **June 30, 2011** | **December 31, 2010** | **June 30, 2010** |
|---|---|---|---|
| Cash and due from banks | **$ 32** | $ 33 | $ 32 |
| Other intangible assets | | | 1 |
| Total assets | **$ 32** | $ 33 | $ 33 |
| Accrued expense and other liabilities | **$ 1** | $ 1 | $ 1 |
| Total liabilities | **$ 1** | $ 1 | $ 1 |

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***Combined discontinued operations.*** The combined results of the discontinued operations are as follows:

| in millions | Three months ended June 30, 2011 | Three months ended June 30, 2010 | Six months ended June 30, 2011 | Six months ended June 30, 2010 |
|---|---|---|---|---|
| Net interest income | **$ 35** | $ 39 | **$ 71** | $ 79 |
| Provision for loan and lease losses | **30** | 14 | **62** | 38 |
| Net interest income (expense) after provision for loan and lease losses | **5** | 25 | **9** | 41 |
| Noninterest income | **(11)** | (54) | **(20)** | (52) |
| Noninterest expense | **9** | 15 | **21** | 29 |
| Income (loss) before income taxes | **(15)** | (44) | **(32)** | (40) |
| Income taxes | **(6)** | (17) | **(12)** | (15) |
| Income (loss) from discontinued operations, net of taxes [(a)] | **$ (9)** | $ (27) | **$ (20)** | $ (25) |

(a) Includes after-tax charges of $12 million and $15 million for the three-month periods ended June 30, 2011 and 2010, respectively, and $25 million and $30 million for the six-month periods ended June 30, 2011 and 2010, respectively, determined by applying a matched funds transfer pricing methodology to the liabilities assumed necessary to support the discontinued operations.

The combined assets and liabilities of the discontinued operations are as follows:

| in millions | June 30, 2011 | December 31, 2010 | June 30, 2010 |
|---|---|---|---|
| Cash and due from banks | **$ 32** | $ 33 | $ 32 |
| Loans at fair value | **3,100** | 3,125 | 3,223 |
| Loans, net of unearned income of $1, $1 and $1 | **3,161** | 3,326 | 3,371 |
| Less: Allowance for loan and lease losses | **109** | 114 | 128 |
| Net loans | **6,152** | 6,337 | 6,466 |
| Loans held for sale | | 15 | 92 |
| Other intangible assets | | | 1 |
| Accrued income and other assets | **144** | 169 | 223 |
| Total assets | **$ 6,328** | $ 6,554 | $ 6,814 |
| Accrued expense and other liabilities | **$ 31** | $ 32 | $ 47 |
| Securities at fair value | **2,919** | 2,966 | 3,092 |
| Total liabilities | **$ 2,950** | $ 2,998 | $ 3,139 |

## 12. Contingent Liabilities and Guarantees

### Legal Proceedings

The following provides information on material developments in our legal proceedings during the quarter. For additional information on our legal proceedings, we refer you to our 2010 Annual Report on Form 10-K, Note 16 ( Commitments, Contingent Liabilities and Guarantees ) under the heading Legal Proceedings on pages 147 to 148, and our Quarterly Report on Form 10-Q for the period ended March 31, 2011, Note 12 ( Contingent Liabilities and Guarantees ) under the heading Legal Proceedings on page 46 to 47.

***Austin Related Claims***

Madoff-related claims. As previously reported, Austin, a subsidiary that specialized in managing hedge fund investments for institutional customers, determined that its funds had suffered investment losses of up to approximately $186 million resulting from the crimes perpetrated by Bernard L. Madoff and entities that he controlled. The investment losses borne by Austin s funds stem from investments in certain Madoff-advised hedge funds. Several lawsuits, including putative class actions and direct actions, and an arbitration proceeding, are pending against Austin, KeyCorp, Victory Capital Management and certain employees and former employees of Key alleging various claims (collectively the KeyCorp defendants ), including negligence, fraud, breach of fiduciary duties, and violations of federal securities laws and ERISA. Additionally, an informal demand asserted against Austin seeks recovery related to certain redemptions of investments made by Austin funds in Madoff-advised hedge funds prior to the revelation of Madoff s crimes. Most of the lawsuits have been consolidated into one action styled *In re Austin Capital Management, Ltd., Securities & Employee Retirement Income Security Act (ERISA) Litigation* ( Austin MDL ) pending in federal court in New York, which has been previously reported. The KeyCorp defendants motion to dismiss the consolidated amended complaint is pending in the Austin MDL. The arbitration proceeding remains in abeyance.

Also pending is a qui tam action (brought by a plaintiff to recover on behalf of the state as well as for himself) against Austin, Victory Capital Management, and KeyCorp as well as certain employees and former employees of Key in state court in New Mexico seeking recovery under New Mexico law for alleged losses sustained by certain New Mexico public investment funds.

Acquisition-related claim. KeyCorp is named as a defendant in an action filed in June 2011 by the former owners of Austin in the United States District Court for the Northern District of Ohio. This lawsuit seeks recovery for breach of contract and related claims. The acquisition-related lawsuit concerns an alleged breach of contract by KeyCorp of the purchase and sale agreement between the plaintiffs and KeyCorp, which related to our original purchase of Austin. On July 22, 2011 KeyCorp filed a motion to dismiss.

The costs associated with the Austin-related proceedings are expected to be significant, and we have established reserves for our legal costs in the proceedings, consistent with applicable accounting guidance and the advice of our counsel. At this early stage of the proceedings, however, we are unable to determine if the Madoff-related claims and the acquisition-related lawsuit, individually or in the aggregate, would reasonably be expected to have a material adverse effect on our financial condition. We strongly disagree with the allegations asserted against us in these matters, and intend to vigorously defend them.

The Madoff-related litigation proceedings and arbitration proceedings as well as the Taylor litigation proceedings (discussed in our 2010 Annual Report on Form 10-K) are claims made under the same policy year for insurance purposes. Based upon the information currently available to us, including the advice of counsel, we believe that if we were to incur any liability for such litigation proceedings and arbitration proceeding, it should be covered under the terms and conditions of our insurance policy, subject to a $25 million self-insurance deductible and usual policy exceptions and limits. Information concerning the Taylor litigation proceedings is set forth in Note 13 ( Acquisition, Divestiture and Discontinued Operations ) of our Annual Report on Form 10-K beginning on page 140.

In April 2009, we decided to wind down Austin s operations and determined that the related exit costs would not be material. Information regarding the Austin discontinued operations is included in Note 11 ( Divestiture and Discontinued Operations ) in this report as well as in Note 13 ( Acquisition, Divestiture and Discontinued Operations ) of our Annual Report on Form 10-K beginning on page 140.

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***Monday litigation***

Warren Monday, et al., v. Henry L. Meyer, III, et al. The previously reported defendants motion to dismiss the consolidated amended complaint remains pending before the court.

**Guarantees**

We are a guarantor in various agreements with third parties. The following table shows the types of guarantees that we had outstanding at June 30, 2011. Information pertaining to the basis for determining the liabilities recorded in connection with these guarantees is included in Note 1 ( Summary of Significant Accounting Policies ) under the heading Guarantees on page 105 of our 2010 Annual Report on Form 10-K.

| **June 30, 2011** *in millions* | **Maximum Potential Undiscounted Future Payments** | **Liability Recorded** |
|---|---|---|
| Financial guarantees: | | |
| Standby letters of credit | $ 9,913 | $ 55 |
| Recourse agreement with FNMA | 841 | 16 |
| Return guarantee agreement with LIHTC investors | 65 | 65 |
| Written put options [(a)] | 1,594 | 41 |
| Default guarantees | 63 | 2 |
| Total | $ 12,476 | $ 179 |

(a) The maximum potential undiscounted future payments represent notional amounts of derivatives qualifying as guarantees.

We determine the payment/performance risk associated with each type of guarantee described below based on the probability that we could be required to make the maximum potential undiscounted future payments shown in the preceding table. We use a scale of low (0-30% probability of payment), moderate (31-70% probability of payment) or high (71-100% probability of payment) to assess the payment/performance risk, and have determined that the payment/performance risk associated with each type of guarantee outstanding at June 30, 2011 is low.

***Standby letters of credit.*** KeyBank issues standby letters of credit to address clients financing needs. These instruments obligate us to pay a specified third party when a client fails to repay an outstanding loan or debt instrument or fails to perform some contractual nonfinancial obligation. Any amounts drawn under standby letters of credit are treated as loans to the client; they bear interest (generally at variable rates) and pose the same credit risk to us as a loan. At June 30, 2011, our standby letters of credit had a remaining weighted-average life of 2.1 years, with remaining actual lives ranging from less than one year to as many as eight years.

***Recourse agreement with FNMA.*** We participate as a lender in the FNMA Delegated Underwriting and Servicing program. FNMA delegates responsibility for originating, underwriting and servicing mortgages, and we assume a limited portion of the risk of loss during the remaining term on each commercial mortgage loan that we sell to FNMA. We maintain a reserve for such potential losses in an amount that we believe approximates the fair value of our liability. At June 30, 2011, the outstanding commercial mortgage loans in this program had a weighted-average remaining term of 5.9 years, and the unpaid principal balance outstanding of loans sold by us as a participant was $2.6 billion. As shown in the preceding table, the maximum potential amount of undiscounted future payments that we could be required to make under this program is equal to approximately one-third of the principal balance of loans outstanding at June 30, 2011. If we are required to make a payment, we would have an interest in the collateral underlying the related commercial mortgage loan. Therefore, any loss incurred could be offset by the amount of any recovery from the collateral.

***Return guarantee agreement with LIHTC investors.*** KAHC, a subsidiary of KeyBank, offered limited partnership interests to qualified investors. Partnerships formed by KAHC invested in low-income residential rental properties that qualify for federal low income housing tax credits under Section 42 of the Internal Revenue Code. In certain partnerships, investors paid a fee to KAHC for a guaranteed return that is based on the financial performance of the property and the property s confirmed LIHTC status throughout a fifteen-year compliance period. Typically, KAHC provides these guaranteed returns by distributing tax credits and deductions associated with the specific properties. If KAHC defaults on its obligation to provide the guaranteed return, KeyBank is obligated to make any necessary payments to investors. No recourse or collateral is available to offset our guarantee obligation other than the underlying income stream from the properties and the residual value of the operating partnership interests.

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As shown in the previous table, KAHC maintained a reserve in the amount of $65 million at June 30, 2011, which we believe will be sufficient to cover estimated future obligations under the guarantees. The maximum exposure to loss reflected in the table represents undiscounted future payments due to investors for the return on and of their investments. A significant portion of these amounts are due and payable within the next twelve months.
These guarantees have expiration dates that extend through 2019, but KAHC has not formed any new partnerships under this program since October 2003. Additional information regarding these partnerships is included in Note 9 ( Variable Interest Entities ).
***Written put options.*** In the ordinary course of business, we write interest rate caps and floors for commercial loan clients that have variable and fixed rate loans, respectively, with us and wish to mitigate their exposure to changes in interest rates. At June 30, 2011, our written put options had an average life of 1.5 years. These instruments are considered to be guarantees as we are required to make payments to the counterparty (the commercial loan client) based on changes in an underlying variable that is related to an asset, a liability or an equity security held by the guaranteed party (i.e., the commercial loan client). We are obligated to pay the client if the applicable benchmark interest rate is above or below a specified level (known as the strike rate ). These written put options are accounted for as derivatives at fair value, as further discussed in Note 7 ( Derivatives and Hedging Activities ). We typically mitigate our potential future payments by entering into offsetting positions with third parties.
Written put options where the counterparty is a broker-dealer or bank are accounted for as derivatives at fair value but are not considered guarantees since these counterparties typically do not hold the underlying instruments. In addition, we are a purchaser and seller of credit derivatives, which are further discussed in Note 7.
***Default guarantees.*** Some lines of business participate in guarantees that obligate us to perform if the debtor (typically a client) fails to satisfy all of its payment obligations to third parties. We generally undertake these guarantees for one of two possible reasons: either the risk profile of the debtor should provide an investment return, or we are supporting our underlying investment. The terms of these default guarantees range from less than one year to as many as eight years; some default guarantees do not have a contractual end date. Although no collateral is held, we would receive a pro rata share should the third party collect some or all of the amounts due from the debtor.

**Other Off-Balance Sheet Risk**

Other off-balance sheet risk stems from financial instruments that do not meet the definition of a guarantee as specified in the applicable accounting guidance, and from other relationships.
***Liquidity facilities that support asset-backed commercial paper conduits.*** At June 30, 2011, we had one liquidity facility remaining outstanding with an unconsolidated third-party commercial paper conduit. This liquidity facility, which will expire by May 15, 2013, obligates us to provide aggregate funding of up to $51 million in the event that a credit market disruption or other factors prevent the conduit from issuing commercial paper. The aggregate amount available to be drawn which is based on the amount of the conduit s current commitments to borrowers totaled $23 million at June 30, 2011. We periodically evaluate our commitment to provide liquidity.
***Indemnifications provided in the ordinary course of business.*** We provide certain indemnifications, primarily through representations and warranties in contracts that we execute in the ordinary course of business in connection with loan sales and other ongoing activities, as well as in connection with purchases and sales of businesses. We maintain reserves, when appropriate, with respect to liability that reasonably could arise as a result of these indemnities.
***Intercompany guarantees.*** KeyCorp and certain of our affiliates are parties to various guarantees that facilitate the ongoing business activities of other affiliates. These business activities encompass issuing debt, assuming certain lease and insurance obligations, purchasing or issuing investments and securities, and engaging in certain leasing transactions involving clients.

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## 13. Capital Securities Issued by Unconsolidated Subsidiaries

We own the outstanding common stock of business trusts formed by us that issued corporation-obligated mandatorily redeemable preferred capital securities. The trusts used the proceeds from the issuance of their capital securities and common stock to buy debentures issued by KeyCorp. These debentures are the trusts only assets; the interest payments from the debentures finance the distributions paid on the mandatorily redeemable preferred capital securities.

We unconditionally guarantee the following payments or distributions on behalf of the trusts:

- required distributions on the capital securities;
- the redemption price when a capital security is redeemed; and
- the amounts due if a trust is liquidated or terminated.

Our mandatorily redeemable preferred capital securities provide an attractive source of funds; they currently constitute Tier 1 capital for regulatory reporting purposes, but have the same federal tax advantages as debt.

In 2005, the Federal Reserve adopted a rule that allows BHCs to continue to treat capital securities as Tier 1 capital but imposed stricter quantitative limits that were to take effect March 31, 2009. However, in light of continued stress in the financial markets, the Federal Reserve later delayed the effective date of these new limits until March 31, 2011. This rule did not have a material effect on our financial condition.

The Dodd-Frank Act changes the regulatory capital standards that apply to BHCs by requiring the phase-out of the treatment of capital securities and cumulative preferred securities as Tier 1 eligible capital. This three-year phase-out period, which commences January 1, 2013, ultimately will result in our mandatorily redeemable preferred capital securities being treated only as Tier 2 capital. Generally speaking, these changes take the leverage and risk-based capital requirements that apply to depository institutions and apply them to BHCs, savings and loan companies, and nonbank financial companies identified as systemically important. The Federal Reserve has 18 months from the enactment of the Dodd-Frank Act to issue the relevant regulations. We anticipate that the rulemaking will provide additional clarity to the regulatory capital guidelines applicable to BHCs such as Key.

As of June 30, 2011, the capital securities issued by the KeyCorp and Union State Bank capital trusts represent $1.8 billion or 17% of our total qualifying Tier 1 capital, net of goodwill.

The capital securities, common stock and related debentures are summarized as follows:

| *dollars in millions* | Capital Securities, Net of Discount [a] | Common Stock | Principal Amount of Debentures, Net of Discount [b] | Interest Rate of Capital Securities and Debentures [c] | Maturity of Capital Securities and Debentures |
|---|---|---|---|---|---|
| June 30, 2011 | | | | | |
| KeyCorp Capital I | $ 156 | $ 6 | $ 159 | 1.045 % | 2028 |
| KeyCorp Capital II | 98 | 4 | 102 | 6.875 | 2029 |
| KeyCorp Capital III | 125 | 4 | 129 | 7.750 | 2029 |
| KeyCorp Capital V | 124 | 4 | 128 | 5.875 | 2033 |
| KeyCorp Capital VI | 58 | 2 | 60 | 6.125 | 2033 |
| KeyCorp Capital VII | 191 | 5 | 196 | 5.700 | 2035 |
| KeyCorp Capital VIII [d] | 173 | | 173 | 7.000 | 2066 |
| KeyCorp Capital IX [d] | 338 | | 338 | 6.750 | 2066 |
| KeyCorp Capital X [d] | 599 | | 599 | 8.000 | 2068 |
| Union State Capital I | 20 | 1 | 21 | 9.580 | 2027 |
| Union State Statutory II | 20 | | 20 | 3.853 | 2031 |
| Union State Statutory IV | 10 | | 10 | 3.078 | 2034 |
| Total | $ 1,912 | $ 26 | $ 1,935 | 6.570 % | |
| December 31, 2010 | $ 1,797 | $ 26 | $ 1,948 | 6.546 % | |
| June 30, 2010 | $ 1,795 | $ 26 | $ 2,001 | 6.546 % | |

(a) The capital securities must be redeemed when the related debentures mature, or earlier if provided in the governing indenture. Each issue of capital securities carries an interest rate identical to that of the related debenture. Certain capital securities include basis adjustments related to fair value hedges totaling $121 million at June 30, 2011, $6 million at December 31, 2010 and $4 million at June 30, 2010. See Note 7 ( Derivatives and Hedging Activities ) for an explanation of fair value hedges.

(b) We have the right to redeem our debentures: (i) in whole or in part, on or after July 1, 2008 (for debentures owned by KeyCorp Capital I); March 18, 1999 (for debentures owned by KeyCorp Capital II); July 16, 1999 (for debentures owned by KeyCorp Capital III); July 21, 2008 (for debentures owned by KeyCorp Capital V); December 15, 2008 (for debentures owned by KeyCorp Capital VI); June 15, 2011 (for debentures owned by KeyCorp Capital VIII); December 15, 2011 (for debentures owned by KeyCorp Capital IX); March 15, 2013 (for debentures owned by KeyCorp Capital X); February 1, 2007 (for debentures owned by Union State Capital I); July 31, 2006 (for debentures owned by Union State Statutory II); and April 7, 2009 (for debentures owned by

Union State Statutory IV); and (ii) in whole at any time within 90 days after and during the continuation of: a tax event, a capital treatment event , with respect to KeyCorp Capital V, VI, VII, VIII, IX and X only an investment company event, and with respect to KeyCorp Capital X only a rating agency event (as each is defined in the applicable indenture). If the debentures purchased by KeyCorp Capital I, KeyCorp Capital V, KeyCorp Capital VI, KeyCorp Capital VII, KeyCorp Capital VIII, KeyCorp Capital IX, Union State Capital I or Union State Statutory IV are redeemed before they mature, the redemption price will be the principal amount, plus any accrued but unpaid interest. If the debentures purchased by KeyCorp Capital II or KeyCorp Capital III are redeemed before they mature, the redemption price will be the greater of: (a) the principal amount, plus any accrued but unpaid interest or (b) the sum of the present values of principal and interest payments discounted at the Treasury Rate (as defined in the applicable indenture), plus 20 basis points (25 basis points or 50 basis points in the case of redemption upon either a tax event or a capital treatment event for KeyCorp Capital III), plus any accrued but unpaid interest. If the debentures purchased by Union State Capital I are optionally redeemed during 2011 the redemption price will be 102.874% of the principal amount. When debentures are redeemed in response to tax or capital treatment events, the redemption price for KeyCorp Capital II and KeyCorp Capital III generally is slightly more favorable to us. The principal amount of debentures includes adjustments related to hedging with financial instruments totaling $118 million at June 30, 2011, $131 million at December 31, 2010 and $184 million at June 30, 2010.

(c) The interest rates for KeyCorp Capital II, KeyCorp Capital III, KeyCorp Capital V, KeyCorp Capital VI, KeyCorp Capital VII, KeyCorp Capital VIII, KeyCorp Capital IX, KeyCorp Capital X and Union State Capital I are fixed. KeyCorp Capital I has a floating interest rate equal to three-month LIBOR plus 74 basis points that reprices quarterly. Union State Statutory II has a floating interest rate equal to three-month LIBOR plus 358 basis points that reprices quarterly. Union State Statutory IV has a floating interest rate equal to three-month LIBOR plus 280 basis points that reprices quarterly. The total interest rates are weighted-average rates.

(d) In connection with each of these issuances of capital securities, KeyCorp entered into a replacement capital covenant ( RCC ). Should KeyCorp redeem or purchase these securities or related subordinated debentures, absent receipt of consent from the holders of the Covered Debt or certain limited exceptions, KeyCorp would need to comply with the applicable RCC.

As previously reported, on August 2, 2011, KeyCorp submitted redemption notices to the property trustee for the redemption in full of each of the following capital securities: KeyCorp Capital V, KeyCorp Capital VI, KeyCorp Capital VIII, and Union State Capital I.

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## 14. Employee Benefits

**Pension Plans**

Effective December 31, 2009, we amended our pension plans to freeze all benefit accruals and close the plans to new employees. We will continue to credit participants existing account balances for interest until they receive their plan benefits. We changed certain pension plan assumptions as a result of freezing the pension plans.

The components of net pension cost for all funded and unfunded plans are as follows:

| *in millions* | Three months ended June 30, 2011 | 2010 | Six months ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| Interest cost on PBO | **$ 14** | $ 15 | **$ 28** | $ 30 |
| Expected return on plan assets | **(20)** | (18) | **(40)** | (36) |
| Amortization of losses | **3** | 9 | **6** | 18 |
| Net pension cost | **$ (3)** | $ 6 | **$ (6)** | $ 12 |

We made a discretionary contribution of $100 million to our primary qualified cash balance pension plan in the first quarter of 2011.

**Other Postretirement Benefit Plans**

We sponsor a contributory postretirement healthcare plan that covers substantially all active and retired employees hired before 2001 who meet certain eligibility criteria. Retirees contributions are adjusted annually to reflect certain cost-sharing provisions and benefit limitations. We also sponsor a death benefit plan covering certain grandfathered employees; the plan is noncontributory. We use separate VEBA trusts to fund the healthcare plan and the death benefit plan.

The components of net postretirement benefit cost for all funded and unfunded plans are as follows:

| *in millions* | Three months ended June 30, 2011 | 2010 | Six months ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| Interest cost on APBO | **$ 1** | $ 1 | **$ 2** | $ 2 |
| Expected return on plan assets | **(1)** | (1) | **(2)** | (2) |
| Amortization of unrecognized prior service benefit | | (1) | | (1) |
| Net postretirement benefit cost | | $ (1) | | $ (1) |

The Patient Protection and Affordable Care Act and Education Reconciliation Act of 2010, which were signed into law on March 23, 2010 and March 30, 2010, respectively, changed the tax treatment of federal subsidies paid to sponsors of retiree health benefit plans that provide a benefit that is at least actuarially equivalent to the benefits under Medicare Part D. As a result of these laws, these subsidy payments become taxable in tax years beginning after December 31, 2012. The accounting guidance applicable to income taxes requires the impact of a change in tax law to be immediately recognized in the period that includes the enactment date. The changes to the tax law as a result of the Patient Protection and Affordable Care Act and Education Reconciliation Act of 2010 did not impact us as we did not have a deferred tax asset recorded as a result of Medicare Part D subsidies received.

## 15. Shareholders Equity

**Comprehensive Capital Plan**

In November 2010, the Federal Reserve issued Revised Temporary Addendum to Supervisory Letter SR 09-4. This letter outlines specific criteria the Federal Reserve will consider when evaluating proposed capital actions by the 19 largest U.S. banking institutions that participated in the SCAP, including KeyCorp. These include actions such as increasing dividends, implementing common stock repurchase programs, or redeeming or repurchasing capital instruments more broadly. The Federal Reserve is required to assess the capital adequacy of the nineteen largest BHCs based upon a review of each BHC s comprehensive capital plan. On January 7, 2011, we submitted our comprehensive capital plan to the Federal Reserve. On March 18, 2011, the Federal Reserve informed us that it had no objections to the capital actions set forth in our Comprehensive Capital Plan following its Comprehensive Capital Analysis and Review ( CCAR ). On June 10, 2011, we submitted to the Federal Reserve and provided to the OCC an updated Comprehensive Capital Plan, which set forth additional capital actions related to redemptions of certain outstanding capital securities. On August 1, 2011**,** the Federal Reserve informed us that it had no objections to the capital actions set forth in our updated capital plan.

**Repurchase of TARP CPP Preferred Stock, Warrant and Completion of Equity and Debt Offerings**

As previously reported, Key completed the repurchase of the $2.5 billion of Series B Preferred Stock and corresponding warrant issued to the U.S. Treasury Department. As a result of the repurchase, we recorded a $49 million one-time deemed dividend in the first quarter of 2011 related to the remaining difference between the repurchase price and the carrying value of the preferred shares at the time of repurchase. Beginning with the second quarter of 2011, the repurchase resulted in the elimination of quarterly dividends of $31 million and discount amortization of $4 million, or $140 million on an annual basis, related to these preferred shares. In total, Key paid $2.867 billion to the U.S. Treasury during the investment period in the form of dividends, principal and repurchase of the warrant, resulting in a return to the U.S. Treasury of $367 million above the initial investment of $2.5 billion on November 14, 2008.

**Cumulative Effect Adjustment (after-tax)**

Effective January 1, 2010, we adopted new consolidation accounting guidance. As a result of adopting this new guidance, we consolidated our education loan securitization trusts (classified as discontinued assets and liabilities). That consolidation added $2.8 billion in assets, and liabilities and equity to our balance sheet and resulted in a cumulative effect adjustment (after-tax) of $45 million to beginning retained earnings on January 1, 2010. Additional information regarding the consolidation of these education loan securitization trusts is provided in Note 9 ( Variable Interest Entities ) and Note 11 ( Divestiture and Discontinued Operations ).

## 16. Line of Business Results

The specific lines of business that comprise each of the major business segments (operating segments) are described below.

**Key Community Bank**

***Regional Banking*** serves a range of clients.

- For individuals, Regional Banking offers branch-based deposit and investment products, personal finance services and loans, including residential mortgages, home equity and various types of installment loans.
- For small businesses, Regional Banking provides deposit, investment and credit products, and business advisory services.
- For high-net-worth clients, Regional Banking offers financial, estate and retirement planning, and asset management services to assist with banking, trust, portfolio management, insurance, charitable giving and related needs.

***Commercial Banking*** provides midsize businesses with products and services that include commercial lending, cash management, equipment leasing, investment and employee benefit programs, succession planning, access to capital markets, derivatives and foreign exchange.

**Key Corporate Bank**

***Real Estate Capital and Corporate Banking Services*** consists of two business units, Real Estate Capital and Corporate Banking Services.

Real Estate Capital is a national business that provides construction and interim lending, permanent debt placements and servicing, equity and investment banking, and other commercial banking products and services to developers, brokers and owner-investors. This unit deals primarily with nonowner-occupied properties (i.e., generally properties in which at least 50% of the debt service is provided by rental income from non-affiliated third parties).

Corporate Banking Services provides cash management, interest rate derivatives, and foreign exchange products and services to clients served by Key Community Bank and Key Corporate Bank. Through its Public Sector and Financial Institutions businesses, Corporate Banking Services also provides a full array of commercial banking products and services to government and not-for-profit entities and to community banks. A variety of cash management services are provided through the Global Treasury Management unit.

***Equipment Finance*** meets the equipment leasing needs of companies worldwide and provides equipment manufacturers, distributors and resellers with financing options for their clients. Lease financing receivables and related revenues are assigned to other lines of business (primarily Institutional and Capital Markets, and Commercial Banking) if those businesses are principally responsible for maintaining the applicable client relationships.

***Institutional and Capital Markets*** through its KeyBanc Capital Markets unit, provides commercial lending, treasury management, investment banking, derivatives, foreign exchange, equity and debt underwriting and trading, and syndicated finance products and services to large corporations and middle-market companies.

Through its Victory Capital Management unit, Institutional and Capital Markets also manages or offers advice regarding investment portfolios for a national client base, including corporations, labor unions, not-for-profit organizations, governments and individuals. These portfolios may be managed in separate accounts, common funds or the Victory family of mutual funds.

**Other Segments**

Other Segments consist of Corporate Treasury, our Principal Investing unit and various exit portfolios.

**Reconciling Items**

Total assets included under Reconciling Items primarily represent the unallocated portion of nonearning assets of corporate support functions. Charges related to the funding of these assets are part of net interest income and are allocated to the

business segments through noninterest expense. Reconciling Items also includes intercompany eliminations and certain items that are not allocated to the business segments because they do not reflect their normal operations.

The table on the following pages shows selected financial data for our two major business segments for the three- and six-month periods ended June 30, 2011 and 2010. This table is accompanied by supplementary information for each of the lines of business that make up these segments. The information was derived from the internal financial reporting system we use to monitor and manage our financial performance. GAAP guides financial accounting, but there is no authoritative guidance for management accounting the way we use our judgment and experience to make reporting decisions. Consequently, the line of business results we report may not be comparable to line of business results presented by other companies.

The selected financial data are based on internal accounting policies designed to compile results on a consistent basis and in a manner that reflects the underlying economics of the businesses. In accordance with our policies:

- Net interest income is determined by assigning a standard cost for funds used or a standard credit for funds provided based on their assumed maturity, prepayment and/or repricing characteristics.
- Indirect expenses, such as computer servicing costs and corporate overhead, are allocated based on assumptions regarding the extent to which each line of business actually uses the services.
- The consolidated provision for loan and lease losses is allocated among the lines of business primarily based on their actual net charge-offs, adjusted periodically for loan growth and changes in risk profile. The amount of the consolidated provision is based on the methodology that we use to estimate our consolidated allowance for loan and lease losses. This methodology is described in Note 1 ( Summary of Significant Accounting Policies ) under the heading Allowance for Loan and Lease Losses on page 102 in our 2010 Annual Report on Form 10-K.
- Income taxes are allocated based on the statutory federal income tax rate of 35% (adjusted for tax-exempt interest income, income from corporate-owned life insurance and tax credits associated with investments in low-income housing projects) and a blended state income tax rate (net of the federal income tax benefit) of 2.2%.
- Capital is assigned based on our assessment of economic risk factors (primarily credit, operating and market risk) directly attributable to each line of business.

Developing and applying the methodologies that we use to allocate items among our lines of business is a dynamic process. Accordingly, financial results may be revised periodically to reflect accounting enhancements, changes in the risk profile of a particular business or changes in our organizational structure.

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| Three months ended June 30, | Key Community Bank | | Key Corporate Bank | |
|---|---|---|---|---|
| *dollars in millions* | **2011** | 2010 | **2011** | 2010 |
| **SUMMARY OF OPERATIONS** | | | | |
| Net interest income (TE) | **$ 374** | $ 408 | **$ 174** | $ 198 |
| Noninterest income | **185** | 194 | **215** | 208 |
| Total revenue (TE) [a] | **559** | 602 | **389** | 406 |
| Provision (credit) for loan and lease losses | **79** | 121 | **(76)** | 99 |
| Depreciation and amortization expense | **10** | 9 | **19** | 24 |
| Other noninterest expense | **438** | 443 | **187** | 225 |
| Income (loss) from continuing operations before income taxes (TE) | **32** | 29 | **259** | 58 |
| Allocated income taxes and TE adjustments | **(2)** | (2) | **95** | 20 |
| Income (loss) from continuing operations | **34** | 31 | **164** | 38 |
| Income (loss) from discontinued operations, net of taxes | | | | |
| Net income (loss) | **34** | 31 | **164** | 38 |
| Less: Net income (loss) attributable to noncontrolling interests | | | **1** | |
| Net income (loss) attributable to Key | **$ 34** | $ 31 | **$ 163** | $ 38 |
| **AVERAGE BALANCES** [b] | | | | |
| Loans and leases | **$ 26,242** | $ 27,217 | **$ 17,168** | $ 20,949 |
| Total assets [a] | **29,688** | 30,303 | **21,468** | 24,789 |
| Deposits | **47,719** | 50,406 | **10,195** | 12,391 |
| **OTHER FINANCIAL DATA** | | | | |
| Net loan charge-offs [b] | **$ 79** | $ 148 | **$ 29** | $ 173 |
| Return on average allocated equity [b] | **4.26 %** | 3.49 % | **28.11 %** | 4.58 % |
| Return on average allocated equity | **4.26** | 3.49 | **28.11** | 4.58 |
| Average full-time equivalent employees [c] | **8,504** | 8,241 | **2,191** | 2,175 |

| Six months ended June 30, | Key Community Bank | | Key Corporate Bank | |
|---|---|---|---|---|
| *dollars in millions* | **2011** | 2010 | **2011** | 2010 |
| **SUMMARY OF OPERATIONS** | | | | |
| Net interest income (TE) | **$ 752** | $ 820 | **$ 358** | $ 394 |
| Noninterest income | **371** | 376 | **434** | 385 |

| | | | | |
|---|---|---|---|---|
| Total revenue (TE) [a] | **1,123** | 1,196 | **792** | 779 |
| Provision (credit) for loan and lease losses | **90** | 263 | **(97)** | 260 |
| Depreciation and amortization expense | **19** | 18 | **39** | 49 |
| Other noninterest expense | **873** | 886 | **395** | 472 |
| Income (loss) from continuing operations before income taxes (TE) | **141** | 29 | **455** | (2) |
| Allocated income taxes and TE adjustments | **26** | (14) | **167** | (4) |
| Income (loss) from continuing operations | **115** | 43 | **288** | 2 |
| Income (loss) from discontinued operations, net of taxes | | | | |
| Net income (loss) | **115** | 43 | **288** | 2 |
| Less: Net income (loss) attributable to noncontrolling interests | | | | |
| Net income (loss) attributable to Key | **$ 115** | $ 43 | **$ 288** | $ 2 |
| **AVERAGE BALANCES** [b] | | | | |
| Loans and leases | **$ 26,277** | $ 27,491 | **$ 17,421** | $ 21,691 |
| Total assets [a] | **29,713** | 30,593 | **21,607** | 25,525 |
| Deposits | **47,912** | 50,922 | **10,736** | 12,306 |
| **OTHER FINANCIAL DATA** | | | | |
| Net loan charge-offs [b] | **$ 155** | $ 264 | **$ 104** | $ 424 |
| Return on average allocated equity [b] | **7.16 %** | 2.43 % | **23.69 %** | .12 % |
| Return on average allocated equity | **7.16** | 2.43 | **23.69** | .12 |
| Average full-time equivalent employees [c] | **8,441** | 8,212 | **2,173** | 2,194 |

(a) Substantially all revenue generated by our major business segments is derived from clients that reside in the United States. Substantially all long-lived assets, including premises and equipment, capitalized software and goodwill held by our major business segments, are located in the United States.

(b) From continuing operations.

(c) The number of average full-time equivalent employees has not been adjusted for discontinued operations.

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| **Other Segments** | | **Total Segments** | | **Reconciling Items** | | **Key** | |
|---|---|---|---|---|---|---|---|
| **2011** | **2010** | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** |
| **$ 16** | $ 9 | **$ 564** | $ 615 | **$ 6** | $ 8 | **$ 570** | $ 623 |
| **54** | 85 | **454** | 487 | | 5 | **454** | 492 |
| **70** | 94 | **1,018** | 1,102 | **6** | 13 | **1,024** | 1,115 |
| **(10)** | 7 | **(7)** | 227 | **(1)** | 1 | **(8)** | 228 |
| **5** | 12 | **34** | 45 | **35** | 40 | **69** | 85 |
| **20** | 41 | **645** | 709 | **(34)** | (25) | **611** | 684 |
| **55** | 34 | **346** | 121 | **6** | (3) | **352** | 118 |
| **10** | 2 | **103** | 20 | **(3)** | (3) | **100** | 17 |
| **45** | 32 | **243** | 101 | **9** | | **252** | 101 |
| | | | | **(9)** | (27) | **(9)** | (27) |
| **45** | 32 | **243** | 101 | | (27) | **243** | 74 |
| **2** | 4 | **3** | 4 | | | **3** | 4 |
| **$ 43** | $ 28 | **$ 240** | $ 97 | | $ (27) | **$ 240** | $ 70 |
| **$ 4,980** | $ 6,738 | **$ 48,390** | $ 54,904 | **$ 64** | $ 49 | **$ 48,454** | $ 54,953 |
| **28,959** | 30,597 | **80,115** | 85,689 | **1,271** | 2,187 | **81,386** | 87,876 |
| **777** | 1,672 | **58,691** | 64,469 | **(150)** | (60) | **58,541** | 64,409 |
| **$ 26** | $ 115 | **$ 134** | $ 436 | | $ (1) | **$ 134** | $ 435 |
| **22.46 %** | 10.22 % | **15.28 %** | 4.87 % | **1.11 %** | | **10.45 %** | 3.65 % |
| **22.46** | 10.22 | **15.28** | 4.87 | | (4.07) % | **10.07** | 2.64 |
| **23** | 191 | **10,718** | 10,607 | **4,631** | 5,058 | **15,349** | 15,665 |

| **Other Segments** | | **Total Segments** | | **Reconciling Items** | | **Key** | |
|---|---|---|---|---|---|---|---|
| **2011** | **2010** | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** |
| **$ 50** | $ 27 | **$ 1,160** | $ 1,241 | **$ 14** | $ 14 | **$ 1,174** | $ 1,255 |
| **115** | 171 | **920** | 932 | **(9)** | 10 | **911** | 942 |
| **165** | 198 | **2,080** | 2,173 | **5** | 24 | **2,085** | 2,197 |
| **(35)** | 128 | **(42)** | 651 | **(6)** | (10) | **(48)** | 641 |
| **10** | 23 | **68** | 90 | **75** | 83 | **143** | 173 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **43** | 82 | **1,311** | 1,440 | **(73)** | (59) | **1,238** | 1,381 |
| **147** | (35) | **743** | (8) | **9** | 10 | **752** | 2 |
| **34** | (34) | **227** | (52) | **(9)** | (6) | **218** | (58) |
| **113** | (1) | **516** | 44 | **18** | 16 | **534** | 60 |
| | | | | **(20)** | (25) | **(20)** | (25) |
| **113** | (1) | **516** | 44 | **(2)** | (9) | **514** | 35 |
| **11** | 20 | **11** | 20 | | | **11** | 20 |
| **$ 102** | $ (21) | **$ 505** | $ 24 | **$ (2)** | $ (9) | **$ 503** | $ 15 |
| **$ 5,133** | $ 7,047 | **$ 48,831** | $ 56,229 | **$ 50** | $ 53 | **$ 48,881** | $ 56,282 |
| **30,151** | 29,978 | **81,471** | 86,096 | **1,361** | 2,187 | **82,832** | 88,283 |
| **783** | 1,763 | **59,431** | 64,991 | **(145)** | (109) | **59,286** | 64,882 |
| **$ 69** | $ 269 | **$ 328** | $ 957 | **$ (1)** | | **$ 327** | $ 957 |
| **26.30 %** | (3.74) % | **15.73 %** | .60 % | **.93 %** | 1.22 % | **10.16 %** | .75 % |
| **26.30** | (3.74) | **15.73** | .60 | **(.10)** | (.69) | **9.77** | .28 |
| **43** | 195 | **10,657** | 10,601 | **4,669** | 5,117 | **15,326** | 15,718 |

**Supplementary information (Key Community Bank lines of business)**

| **Three months ended June 30,** | **Regional Banking** | | **Commercial Banking** | |
|---|---|---|---|---|
| *dollars in millions* | **2011** | **2010** | **2011** | **2010** |
| Total revenue (TE) | $ **450** | $ 489 | $ **109** | $ 113 |
| Provision for loan and lease losses | **63** | 57 | **16** | 64 |
| Noninterest expense | **400** | 409 | **48** | 43 |
| Net income (loss) attributable to Key | **6** | 27 | **28** | 4 |
| Average loans and leases | **17,495** | 18,404 | **8,747** | 8,813 |
| Average loans held for sale | **42** | 69 | **21** | 1 |
| Average deposits | **41,710** | 45,219 | **6,009** | 5,187 |
| Net loan charge-offs | **65** | 82 | **14** | 66 |
| Net loan charge-offs to average loans | **1.49 %** | 1.79 % | **.64 %** | 3.00 % |
| Nonperforming assets at period end | $ **302** | $ 339 | $ **153** | $ 222 |
| Return on average allocated equity | **1.08 %** | 4.65 % | **11.59 %** | 1.30 % |
| Average full-time equivalent employees | **8,138** | 7,886 | **366** | 355 |

| **Six months ended June 30,** | **Regional Banking** | | **Commercial Banking** | |
|---|---|---|---|---|
| *dollars in millions* | **2011** | **2010** | **2011** | **2010** |
| Total revenue (TE) | $ **897** | $ 974 | $ **226** | $ 222 |
| Provision for loan and lease losses | **80** | 172 | **10** | 91 |
| Noninterest expense | **799** | 816 | **93** | 88 |
| Net income (loss) attributable to Key | **38** | 16 | **77** | 27 |
| Average loans and leases | **17,546** | 18,577 | **8,731** | 8,914 |
| Average loans held for sale | **56** | 75 | **26** | 1 |
| Average deposits | **41,948** | 45,698 | **5,964** | 5,224 |
| Net loan charge-offs | **127** | 179 | **28** | 85 |
| Net loan charge-offs to average loans | **1.46 %** | 1.94 % | **.65 %** | 1.92 % |
| Nonperforming assets at period end | $ **302** | $ 339 | $ **153** | $ 222 |
| Return on average allocated equity | **3.41 %** | 1.39 % | **15.59 %** | 4.38 % |
| Average full-time equivalent employees | **8,074** | 7,859 | **367** | 353 |

**Supplementary information (Key Corporate Bank lines of business)**

| **Three months ended June 30,** | **Real Estate Capital and Corporate Banking Services** | | **Equipment Finance** | | **Institutional and Capital Markets** | |
|---|---|---|---|---|---|---|
| *dollars in millions* | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** |
| Total revenue (TE) | $ **154** | $ 173 | $ **63** | $ 61 | $ **172** | $ 172 |
| Provision for loan and lease losses | **(49)** | 77 | **(30)** | 10 | **3** | 12 |
| Noninterest expense | **50** | 97 | **45** | 49 | **111** | 103 |
| | **95** | | **30** | 1 | **38** | 37 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net income (loss) attributable to Key | | | | | | |
| Average loans and leases | **7,713** | 11,466 | **4,545** | 4,478 | **4,910** | 5,005 |
| Average loans held for sale | **229** | 194 | | 16 | **73** | 171 |
| Average deposits | **7,371** | 9,728 | **12** | 5 | **2,812** | 2,658 |
| Net loan charge-offs | **26** | 142 | **2** | 18 | **1** | 13 |
| Net loan charge-offs to average loans | **1.35** % | 4.97 % | **.18** % | 1.61 % | **.08** % | 1.04 % |
| Nonperforming assets at period end | $ **245** | $ 867 | $ **39** | $ 106 | $ **55** | $ 116 |
| Return on average allocated equity | **30.66** % | | **37.02** % | 1.15 % | **20.11** % | 15.46 % |
| Average full-time equivalent employees | **902** | 901 | **511** | 549 | **778** | 725 |

| **Six months ended June 30,** | **Real Estate Capital and Corporate Banking Services** | | **Equipment Finance** | | **Institutional and Capital Markets** | |
|---|---|---|---|---|---|---|
| *dollars in millions* | **2011** | **2010** | **2011** | **2010** | **2011** | **2010** |
| Total revenue (TE) | $ **319** | $ 314 | $ **127** | $ 122 | $ **346** | $ 343 |
| Provision for loan and lease losses | **(39)** | 222 | **(56)** | 14 | **(2)** | 24 |
| Noninterest expense | **117** | 217 | **97** | 94 | **220** | 210 |
| Net income (loss) attributable to Key | **152** | (78) | **54** | 9 | **82** | 71 |
| Average loans and leases | **8,146** | 11,901 | **4,583** | 4,525 | **4,692** | 5,265 |
| Average loans held for sale | **185** | 154 | **2** | 9 | **102** | 148 |
| Average deposits | **7,987** | 9,683 | **9** | 5 | **2,740** | 2,618 |
| Net loan charge-offs | **91** | 349 | **12** | 36 | **1** | 39 |
| Net loan charge-offs to average loans | **2.25** % | 5.91 % | **.53** % | 1.60 % | **.04** % | 1.49 % |
| Nonperforming assets at period end | $ **245** | $ 867 | $ **39** | $ 106 | $ **55** | $ 116 |
| Return on average allocated equity | **22.42** % | (7.77)% | **34.24** % | 5.08 % | **21.56** % | 14.70 % |
| Average full-time equivalent employees | **892** | 911 | **516** | 556 | **765** | 727 |

## Report of Independent Registered Public Accounting Firm

Shareholders and Board of Directors
KeyCorp

We have reviewed the consolidated balance sheets of KeyCorp and subsidiaries ( Key ) as of June 30, 2011 and 2010, the related consolidated statements of income for the three- and six-month periods ended June 30, 2011 and 2010,and the consolidated statements of changes in shareholders equity and cash flows for the six-month periods ended June 30, 2011 and 2010. These financial statements are the responsibility of Key s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Key as of December 31, 2010, and the related consolidated statements of income, changes in equity, and cash flows for the year then ended not presented herein, and in our report dated February 24, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2010, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Cleveland, Ohio
August 4, 2011

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## Item 2. Management s Discussion & Analysis of Financial Condition & Results of Operations

### Introduction

This section generally reviews the financial condition and results of operations of KeyCorp and its subsidiaries for the quarterly and year to date periods ended June 30, 2011 and 2010. Some tables may include additional periods to comply with disclosure requirements or to illustrate trends in greater depth. When you read this discussion, you should also refer to the consolidated financial statements and related notes in this report. The page locations of specific sections and notes that we refer to are presented in the table of contents.

References to our 2010 Annual Report on Form 10-K refer to our Annual Report on Form 10-K for the year ended December 31, 2010, which has been filed with the U.S. Securities and Exchange Commission and is available on its website (www.sec.gov) or on our website (www.key.com/ir), and list specific sections and page locations in our 2010 Annual Report on Form 10-K as filed with the U.S. Securities and Exchange Commission.

### Terminology

Throughout this discussion, references to Key, we, our, us and similar terms refer to the consolidated entity consist of KeyCorp and its subsidiaries. KeyCorp refers solely to the parent holding company, and KeyBank refers to KeyCorp s subsidiary bank, KeyBank National Association.

We want to explain some industry-specific terms at the outset so you can better understand the discussion that follows.

- We use the phrase ***continuing operations*** in this document to mean all of our businesses other than the education lending business and Austin. The education lending business and Austin have been accounted for as ***discontinued operations*** since 2009.

- Our ***exit loan portfolios*** are separate from our ***discontinued operations*.** These portfolios, which are in a run-off mode, stem from product lines we decided to cease because they no longer fit with our corporate strategy. These exit loan portfolios are included in ***Other Segments.***

- We engage in ***capital markets activities*** primarily through business conducted by our Key Corporate Bank segment. These activities encompass a variety of products and services. Among other things, we trade securities as a dealer, enter into derivative contracts (both to accommodate clients financing needs and for proprietary trading purposes), and conduct transactions in foreign currencies (both to accommodate clients needs and to benefit from fluctuations in exchange rates).

- For regulatory purposes, capital is divided into two classes. Federal regulations currently prescribe that at least one-half of a bank or bank holding company s ***total risk-based capital*** must qualify as ***Tier 1 capital***. Both total and Tier 1 capital serve as bases for several measures of capital adequacy, which is an important indicator of financial stability and condition. As described in the section entitled Economic Overview that begins on page 31 of our 2010 Annual Report on Form 10-K, the regulators conduct a review of capital adequacy for each of the country s nineteen largest banking institutions, including KeyCorp. This regulatory assessment, which began in 2009, continued during 2010 and 2011. As part of this capital adequacy review, banking regulators evaluated a component of Tier 1 capital, known as ***Tier 1 common equity***. For a detailed explanation of total capital, Tier 1 capital and Tier 1 common equity, and how they are calculated see the section entitled Capital.

- During the first quarter of 2010, we re-aligned our reporting structure for our business segments. Previously, the Consumer Finance business group consisted mainly of portfolios that were identified as exit or run-off portfolios and were included in our Key Corporate Bank segment. We are now reflecting these exit portfolios in Other Segments. The automobile dealer floor plan business, previously included in Consumer Finance, has been re-aligned with the Commercial Banking line of business within the Key Community Bank segment. In addition, other previously identified exit portfolios included in the Key Corporate Bank segment, including our homebuilder loans from the Real Estate Capital line of business and commercial leases from the Equipment Finance line of business, have been moved to Other Segments. For more detailed financial information pertaining to each segment and its respective lines of business, see Note 16 ( Line of Business Results ).

Additionally, a comprehensive list of the acronyms and abbreviations used throughout this discussion is included in Note 1 ( Basis of Presentation ).

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**Forward-looking Statements**

From time to time, we have made or will make forward-looking statements. These statements can be identified by the fact that they do not relate strictly to historical or current facts. Forward-looking statements usually can be identified by the use of words such as goal, objective, plan, expect, anticipate, intend, project, believe, estimate, of similar meaning. Forward-looking statements provide our current expectations or forecasts of future events, circumstances, results or aspirations. Our disclosures in this report contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make forward-looking statements in our other documents filed or furnished with the SEC. In addition, we may make forward-looking statements orally to analysts, investors, representatives of the media and others.

Forward-looking statements are not historical facts and, by their nature, are subject to assumptions, risks and uncertainties, many of which are outside of our control. Our actual results may differ materially from those set forth in our forward-looking statements. There is no assurance that any list of risks and uncertainties or risk factors is complete. Factors that could cause actual results to differ from those described in forward-looking statements include, but are not limited to:

- the economic recovery may face challenges causing its momentum to falter;
- the Dodd-Frank Act will subject us to a variety of new and more stringent legal and regulatory requirements;
- changes in local, regional and international business, economic or political conditions may occur in the regions where we operate or have significant assets;
- changes in trade, monetary and fiscal policies of governmental bodies and central banks could affect the economic environment in which we operate;
- our ability to effectively deal with an economic slowdown or other economic or market difficulty;
- adverse changes in credit quality trends;
- our ability to determine accurate values of certain assets and liabilities;
- reduction of the credit ratings assigned to KeyCorp and KeyBank;
- adverse behaviors in securities, public debt, and capital markets, including changes in market liquidity and volatility;
- changes in investor sentiment, consumer spending or saving behavior;
- our ability to manage liquidity;
- our ability to anticipate interest rate changes correctly and manage interest rate risk presented through unanticipated changes in our interest rate risk position and/or short- and long-term interest rates;
- unanticipated changes in our liquidity position, including but not limited to our ability to enter the financial markets to manage and respond to any changes to our liquidity position;
- changes in foreign exchange rates;
- adequacy of our risk management program;

- increased competitive pressure due to industry consolidation;
- other new or heightened legal standards and regulatory requirements, practices or expectations;
- our ability to timely and effectively implement our strategic initiatives;
- increases in FDIC premiums and fees;
- unanticipated adverse affects of acquisitions and dispositions of assets, business units or affiliates;
- our ability to attract and/or retain talented executives and employees;

- operational or risk management failures due to technological or other factors;
- changes in accounting principles or in tax laws, rules and regulations;
- adverse judicial proceedings;
- occurrence of natural or man-made disasters or conflicts or terrorist attacks disrupting the economy or our ability to operate; and
- other risks and uncertainties summarized in Part 1, Item 1A: Risk Factors in our 2010 Annual Report on Form 10-K.

Any forward-looking statements made by us or on our behalf speak only as of the date they are made, and we do not undertake any obligation to update any forward-looking statement to reflect the impact of subsequent events or circumstances. Before making an investment decision, you should carefully consider all risks and uncertainties disclosed in our SEC filings, including our reports on Forms 8-K, 10-K and 10-Q and our registration statements under the Securities Act of 1933, as amended, all of which are accessible on the SEC s website at www.sec.gov and at www.Key.com/IR.

**Economic overview**

During the second quarter of 2011, the economic recovery in the United States lost momentum. Job creation in the U.S. slowed as employers added 260,000 jobs in the second quarter of 2011, compared to the 497,000 jobs created in the first quarter of 2011. The average unemployment rate for the quarter rose to 9.1%, compared to the first quarter average of 8.9%. Despite the modest increase in the unemployment rate during the second quarter, the 9.1% rate is an improvement from the average rate of 9.6% seen for all of 2010. The 10 year average unemployment rate as of June 2011 was 6.3%.

Economic growth also faced headwinds from the earthquake in Japan in March 2011 and elevated food and energy prices. Production was delayed in many industries due to supply chain disruptions ongoing in Japan. The auto industry was especially impacted, and total U.S. auto sales for the second quarter declined by nearly 7% compared to the first quarter of the year. The average monthly rate of total consumer spending was unchanged in the second quarter of 2011, compared to an average monthly increase of .6% in the first quarter of 2011 and .4% for all of 2010. In the aggregate, consumer prices increased 3.6% for the twelve months ending in June 2011, up from the 2.7% and 1.5% annual increases at March 2011 and December 2010 respectively. Energy costs continued to contribute to the recent increase, as the national average price for a regular gallon of gasoline in the U.S. was nearly 30% higher at the end of June 2011 than a year earlier.

The persistence of a weak housing market continued to weigh on consumer wealth and confidence in the second quarter of 2011. June existing home sales were down 8.8% from the same month last year, while the median price of existing homes rose by only .8% over the same period. A continued high level of new foreclosures pressured existing home prices. Although foreclosures fell by 29% in June from a year earlier, they still remain at historically high levels. New home building activity showed some signs of improvement, although off of extremely low levels. June new home sales were up 1.6% from the same month a year ago, while the median price of new homes rose by 7.2% over the same period. Building activity also picked up as housing starts at the end of the quarter rose 16.7% from a year earlier.

Benchmark term interest rates ended the second quarter much lower, as renewed fears of a stalling economic recovery and the sovereign debt crisis in Europe emerged. These uncertainties sparked a flight to quality that sent the benchmark two-year Treasury yield down .37% from .83% at March 31, 2011 to .46% at June 30, 2011. The ten-year Treasury yield, which began the quarter at 3.47%, declined .31% to close the quarter at 3.16%. The Federal Reserve acknowledged the weakness in the economy and kept the federal funds target rate near zero in the second quarter of 2011 while maintaining its stance that the current economic conditions warrant keeping the rate at an exceptionally low level for an extended period. During the quarter, the Federal Reserve also continued to expand its holdings of Treasury securities as part of a round of quantitative easing originally announced in November 2010 and completed at

the end of the second quarter of 2011. The Federal Reserve also maintained its existing policy of reinvesting principal payments from its securities holdings, but offered no new accommodative policy, as it saw the economic soft patch largely as temporary and expected an economic rebound in the second half of 2011.

**Long-term financial goals**

Our long-term financial goals are as follows:

- Target a loan to core deposit ratio range of 90% to 100%.

- Return to a moderate risk profile by targeting a net charge-off ratio range of .40% to .50%.

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- Grow high quality and diverse revenue streams by targeting a net interest margin in excess of 3.50% and ratio of noninterest income to total revenue of greater than 40%.
- Create positive operating leverage and target an efficiency ratio in the range of 60 to 65%.
- Achieve a return on average assets in the range of 1.00% to 1.25%.

Figure 1 shows the evaluation of our long-term financial goals for the second quarter of 2011.

**Figure 1. Quarterly evaluation of our long-term financial goals**

| KEY Business Model | Key Metrics[a] | 2Q11 | Targets | Action Plans |
|---|---|---|---|---|
| **Core funded** | Loan to deposit ratio [b] | 86% | 90-100% | Improve risk profile of loan portfolio and grow relationships<br>Improve mix and grow deposit base |
| **Returning to a moderate risk profile** | NCOs to average loans | 1.11% | .40 - .50% | Focus on relationship clients<br>Exit noncore portfolios<br>Limit concentrations<br>Focus on risk-adjusted returns |
| **Growing high quality, diverse revenue streams** | Net Interest Margin | 3.19% | > 3.50% | Improve funding mix<br>Focus on risk-adjusted returns |
| | Noninterest income to total revenue | .44% | > 40% | Grow client relationships<br>Leverage Key s total client solutions and cross-selling capabilities |
| **Creating positive operating leverage** | Keyvolution cost savings | $320 million implemented | $300 $375 million | Improve efficiency and effectiveness |
| | Efficiency ratio | 66% | 60 65% | Leverage technology<br>Change cost base to more variable from fixed |
| **Executing our strategies** | Return on average assets | 1.23% | 1.00 1.25% | Execute our client insight-driven relationship model<br>Lower credit costs |

Improved funding mix with lower cost core deposits

Keyvolution savings

(a) Calculated from continuing operations, unless otherwise noted.

(b) Represents period end consolidated total loans and loans held for sale (excluding education loans in the securitization trusts) divided by period-end consolidated total deposits (excluding deposits in foreign office).

**Strategic developments**

We initiated the following actions during the first six months of 2011 to support our corporate strategy described in the Introduction section under the Corporate Strategy heading on page 30 of our 2010 Annual Report on Form 10-K.

- During the second quarter of 2011, our Board of Directors approved an increase in our quarterly cash dividend to $.03 per Common Share or $.12 on an annualized basis. This is a result of our return to sustained profitability, disciplined capital and expense management, and continued improvement in credit quality.

- As previously reported, Key completed the repurchase of the $2.5 billion of Series B Preferred Stock and corresponding warrant issued to the U.S. Treasury Department. As a result of the repurchase, we recorded a $49 million one-time deemed dividend in the first quarter of 2011 related to the remaining difference between the repurchase price and the carrying value of the preferred shares at the time of repurchase. Beginning with the second quarter of 2011, the repurchase resulted in the elimination of quarterly dividends of $31 million and discount amortization of $4 million, or $140 million on an annual basis, related to these preferred shares. In total, Key paid $2.867 billion to the U.S. Treasury during the investment period in the form of dividends, principal and repurchase of the warrant, resulting in a return to the U.S. Treasury of $367 million above the initial investment of $2.5 billion on November 14, 2008.

- During the second quarter of 2011, we continued to benefit from improved asset quality. Nonperforming assets declined $1.1 billion, and nonperforming loans decreased by $861 million from the year-ago quarter to $950 million and $842 million, respectively. Net charge-offs declined $301 million from the second quarter of 2010 to $134 million, or 1.11%, of average loan balances for the second quarter of 2011.

- Our capital accounts remain strong with a Tier 1 common equity ratio of 11.14%, our loan loss reserves were adequate at 2.57% to period-end loans and we were core funded with a loan to deposit ratio of 86% at June 30, 2011.

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¨ As of June 30, 2011, we had achieved $320 million of annual run-rate savings, placing us within our targeted savings goal of $300 million to $375 million. These savings were part of a formal corporate-wide initiative named Keyvolution, which is focused on business simplification, process improvement and demand management. Although the formal reporting of this initiative has concluded, we will continue to seek additional cost savings in this challenging revenue environment. However, we will not be reporting specifically on Keyvolution going forward as we consider the philosophy of Keyvolution to be a part of our normal operating rhythm. Instead, we will continue to manage our expenses and focus on delivering solutions that our clients value. In this regard we have established a target efficiency ratio of 60 65%. For the second quarter of 2011, our efficiency ratio was 66%.

**Demographics**

We have two major business segments: Key Community Bank and Key Corporate Bank.

Key Community Bank serves individuals and small to mid-sized businesses by offering a variety of deposit, investment, lending, and personalized wealth management products and services. These products and services are provided through our relationship managers and specialists residing in our 14-state branch network, which is organized into three internally defined geographic regions: Rocky Mountains and Northwest, Great Lakes, and Northeast.

Figure 2 shows the geographic diversity of Key Community Bank s average deposits, commercial loans and home equity loans.

**Figure 2. Key Community Bank Geographic Diversity**

| **Three months ended June 30, 2011** | **Geographic Region** | | | | |
|---|---|---|---|---|---|
| *dollars in millions* | **Rocky Mountains and Northwest** | **Great Lakes** | **Northeast** | **Nonregion[a]** | **Total** |
| Average deposits | $ 15,573 | $ 15,509 | $ 14,015 | $ 2,622 | $ 47,719 |
| Percent of total | 32.6 % | 32.5 % | 29.4 % | 5.5 % | 100.0 % |