

KEYCORP /NEW/
Form 10-Q
November 07, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549
Form 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2008
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) 689-6300

(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 ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

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

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

495,007,818 Shares

(Title of class)

(Outstanding at October 31, 2008)

KEYCORP
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<i>dollars in millions</i>	September 30, 2008 (Unaudited)	December 31, 2007	September 30, 2007 (Unaudited)
ASSETS			
Cash and due from banks	\$ 1,937	\$ 1,814	\$ 2,016
Short-term investments	653	516	528
Trading account assets	1,449	1,056	1,060
Securities available for sale	8,391	7,860	7,915
Held-to-maturity securities (fair value: \$28, \$28 and \$36)	28	28	36
Other investments	1,556	1,538	1,509
Loans, net of unearned income of \$2,497, \$2,202 and \$2,227	76,705	70,823	68,999
Less: Allowance for loan losses	1,554	1,200	955
Net loans	75,151	69,623	68,044
Loans held for sale	1,475	4,736	4,791
Premises and equipment	801	681	631
Operating lease assets	1,030	1,128	1,135
Goodwill	1,595	1,252	1,202
Other intangible assets	135	123	105
Corporate-owned life insurance	2,940	2,872	2,845
Derivative assets	951	879	539
Accrued income and other assets	3,198	4,122	3,781
Total assets	\$ 101,290	\$ 98,228	\$ 96,137
LIABILITIES			
Deposits in domestic offices:			
NOW and money market deposit accounts	\$ 25,789	\$ 27,635	\$ 24,198
Savings deposits	1,731	1,513	1,544
Certificates of deposit (\$100,000 or more)	10,316	6,982	6,672
Other time deposits	13,929	11,615	11,403
Total interest-bearing	51,765	47,745	43,817
Noninterest-bearing	11,122	11,028	14,003
Deposits in foreign office $\frac{3}{4}$ interest-bearing	1,791	4,326	5,894
Total deposits	64,678	63,099	63,714
Federal funds purchased and securities sold under repurchase agreements	1,799	3,927	5,398
Bank notes and other short-term borrowings	5,352	5,861	2,429
Derivative liabilities	589	252	218
Accrued expense and other liabilities	4,624	5,386	5,009

Long-term debt	15,597	11,957	11,549
Total liabilities	92,639	90,482	88,317

SHAREHOLDERS' EQUITY

Preferred stock, \$1 par value, authorized 25,000,000 shares:

7.750% Noncumulative Perpetual Convertible Preferred
Stock, Series A, \$100

liquidation preference; authorized 7,475,000 shares; issued

6,575,000 shares

658Common shares, \$1 par value; authorized 1,400,000,000
shares;

issued 584,061,120, 491,888,780 and 491,888,780 shares

584

492

492

Capital surplus

2,552

1,623

1,617

Retained earnings

7,320

8,522

8,788

Treasury stock, at cost (89,295,628, 103,095,907 and
103,180,446 shares)**(2,616)**

(3,021)

(3,023)

Accumulated other comprehensive income (loss)

153

130

(54)

Total shareholders' equity

8,651

7,746

7,820

Total liabilities and shareholders' equity

\$ 101,290

\$ 98,228

\$ 96,137

See Notes to Consolidated Financial Statements (Unaudited).

Table of Contents**Consolidated Statements of Income (Unaudited)**

	Three months ended		Nine months ended	
	September 30,		September 30,	
<i>dollars in millions, except per share amounts</i>	2008	2007	2008	2007
INTEREST INCOME				
Loans	\$ 1,066	\$ 1,209	\$ 2,906	\$ 3,546
Loans held for sale	21	91	128	248
Securities available for sale	110	106	330	312
Held-to-maturity securities	1		2	1
Trading account assets	16	11	39	26
Short-term investments	6	5	23	24
Other investments	12	12	38	40
Total interest income	1,232	1,434	3,466	4,197
INTEREST EXPENSE				
Deposits	347	482	1,122	1,362
Federal funds purchased and securities sold under repurchase agreements	10	55	53	163
Bank notes and other short-term borrowings	34	30	100	59
Long-term debt	142	173	421	554
Total interest expense	533	740	1,696	2,138
NET INTEREST INCOME	699	694	1,770	2,059
Provision for loan losses	407	69	1,241	166
Net interest income after provision for loan losses	292	625	529	1,893
NONINTEREST INCOME				
Trust and investment services income	133	119	400	359
Service charges on deposit accounts	94	88	275	247
Investment banking and capital markets (loss) income	(31)	9	57	105
Operating lease income	69	70	206	200
Letter of credit and loan fees	53	51	141	134
Corporate-owned life insurance income	28	27	84	84
Electronic banking fees	27	25	78	74
Net losses from loan securitizations and sales	(30)	(53)	(98)	(11)
Net securities gains (losses)	1	4	3	(41)
Net (losses) gains from principal investing	(24)	9	(29)	128
Gain from redemption of Visa Inc. shares			165	
Gain from sale of McDonald Investments branch network				171
Other income	68	89	189	291
Total noninterest income	388	438	1,471	1,741

NONINTEREST EXPENSE

Personnel	381	383	1,194	1,222
Net occupancy	65	60	193	182
Computer processing	46	49	136	149
Operating lease expense	56	58	169	165
Professional fees	35	27	91	79
Equipment	23	22	70	71
Marketing	27	21	62	60
Other expense	129	133	360	424
Total noninterest expense	762	753	2,275	2,352

(LOSS) INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES

Income taxes	(46)	86	669	363
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(LOSS) INCOME FROM CONTINUING OPERATIONS

Loss from discontinued operations, net of taxes of (\$8) and (\$15), respectively (see Note 3)	(36)	224	(944)	919
		(14)		(25)

NET (LOSS) INCOME	\$ (36)	\$ 210	\$ (944)	\$ 894
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Net (loss) income applicable to common shares	\$ (48)	\$ 210	\$ (956)	\$ 894
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Per common share:

(Loss) income from continuing operations	\$ (.10)	\$.58	\$ (2.19)	\$ 2.34
Net (loss) income	(.10)	.54	(2.19)	2.28

Per common share assuming dilution:

(Loss) income from continuing operations	\$ (.10)	\$.57	\$ (2.19)	\$ 2.31
Net (loss) income	(.10)	.54	(2.19)	2.25

Cash dividends declared per common share	\$.1875	\$.365	\$.9375	\$ 1.095
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Weighted-average common shares outstanding (000)	491,179	389,319	435,846	393,048
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Weighted-average common shares and potential common shares outstanding (000)	491,179	393,164	435,846	397,816
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See Notes to Consolidated Financial Statements (Unaudited).

Table of Contents**Consolidated Statements of Changes in Shareholders' Equity (Unaudited)**

	Preferred Stock Outstanding (000)	Common Shares Outstanding (000)	Preferred Common Stock (000)	Common Capital Surplus (000)	Retained Earnings (000)	Accumulated Treasury Stock at Cost (000)	Other Comprehensive Income (Loss) (000)	Comprehensive Income (Loss) (000)
<i>dollars in millions, except per share amounts</i>								
BALANCE AT DECEMBER 31, 2006		399,153		\$ 492	\$ 1,602	\$ 8,377	\$ (2,584)	\$ (184)
Cumulative effect of adopting FSP 13-2, net of income taxes of (\$2)						(52)		
Cumulative effect of adopting FIN 48, net of income taxes of (\$1)						(1)		
BALANCE AT JANUARY 1, 2007						8,324		
Net income						894		\$ 894
Other comprehensive income:								
Net unrealized gains on securities available for sale, net of income taxes of \$31 ^a							50	50
Net unrealized gains on derivative financial instruments, net of income taxes of \$25							42	42
Foreign currency translation adjustments							23	23
Net pension and postretirement benefit costs, net of income taxes							15	15
Total comprehensive income								\$ 1,024
Deferred compensation					12	(3)		
Cash dividends declared on common shares (\$1.095 per share)						(427)		
Common shares reissued for stock options and other employee benefit plans		5,555				3	156	
Common shares repurchased		(16,000)					(595)	
BALANCE AT SEPTEMBER 30, 2007		388,708		\$ 492	\$ 1,617	\$ 8,788	\$ (3,023)	\$ (54)
BALANCE AT DECEMBER 31, 2007		388,793		\$ 492	\$ 1,623	\$ 8,522	\$ (3,021)	\$ 130
Net loss						(944)		\$ (944)
Other comprehensive loss:								
Net unrealized gains on securities available for sale, net of income taxes of \$40 ^a							64	64
Net unrealized losses on derivative financial instruments, net of income taxes of \$(3)							(24)	(24)

Net unrealized losses on common investments held in employee welfare benefits trust, net of income taxes							(1)	(1)
Foreign currency translation adjustments							(22)	(22)
Net pension and postretirement benefit costs, net of income taxes							6	6
Total comprehensive loss								\$ (921)
Deferred compensation					6	(3)		
Cash dividends declared on common shares (\$.5625 per share)						(243)		
Cash dividends declared on preferred shares (\$1.873 per share)						(12)		
Preferred stock issued	6,575		\$ 658		(20)			
Common shares issued		92,172		92	967			
Common shares reissued:								
Acquisition of U.S.B. Holding Co., Inc.		9,895			58	290		
Stock options and other employee benefit plans		3,905			(82)	115		
BALANCE AT SEPTEMBER 30, 2008	6,575	494,765	\$ 658	\$ 584	\$ 2,552	\$ 7,320	\$ (2,616)	\$ 153

(a) Net of reclassification adjustments.

See Notes to Consolidated Financial Statements (Unaudited).

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

	Nine months ended September 30,	
<i>in millions</i>	2008	2007
OPERATING ACTIVITIES		
Net (loss) income	\$ (944)	\$ 894
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Provision for loan losses	1,241	166
Depreciation and amortization expense	327	316
Write-off of goodwill	4	
Honsador litigation reserve	(23)	42
Net securities (gains) losses	(3)	41
Liability to Visa	(64)	
Gain from redemption of Visa Inc. shares	(165)	
Gain from sale of McDonald Investments branch network		(171)
Gain related to MasterCard Incorporated shares		(67)
Gain from settlement of automobile residual value insurance litigation		(26)
Net losses (gains) from principal investing	29	(128)
Net losses from loan securitizations and sales	98	11
Loss from sale of discontinued operations		2
Proceeds from settlement of automobile residual value insurance litigation		279
Deferred income taxes	(245)	(53)
Net decrease (increase) in loans held for sale from continuing operations	378	(1,154)
Net increase in trading account assets	(393)	(148)
Other operating activities, net	504	(603)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	744	(599)
INVESTING ACTIVITIES		
Proceeds from redemption of Visa Inc. shares	165	
Proceeds from sale of McDonald Investments branch network, net of retention payments		199
Proceeds from sale of MasterCard Incorporated shares		67
Cash used in acquisitions, net of cash acquired	(184)	
Net increase in short-term investments	(70)	(168)
Purchases of securities available for sale	(1,191)	(4,333)
Proceeds from sales of securities available for sale	877	2,506
Proceeds from prepayments and maturities of securities available for sale	1,124	1,788
Purchases of held-to-maturity securities	(6)	
Proceeds from prepayments and maturities of held-to-maturity securities	6	5
Purchases of other investments	(391)	(500)
Proceeds from sales of other investments	148	275
Proceeds from prepayments and maturities of other investments	124	138
Net increase in loans, excluding acquisitions, sales and transfers	(2,798)	(3,723)
Purchases of loans	(18)	(61)
Proceeds from loan securitizations and sales	280	306
Purchases of premises and equipment	(114)	(123)
Proceeds from sales of premises and equipment	8	9

Proceeds from sales of other real estate owned	16	61
NET CASH USED IN INVESTING ACTIVITIES	(2,024)	(3,554)
FINANCING ACTIVITIES		
Net (decrease) increase in deposits	(227)	4,594
Net (decrease) increase in short-term borrowings	(3,427)	3,306
Net proceeds from issuance of long-term debt	4,957	393
Payments on long-term debt	(1,189)	(3,490)
Purchases of treasury shares		(595)
Net proceeds from issuance of common shares and preferred stock	1,688	
Net proceeds from reissuance of common shares	6	111
Tax benefits (under) over recognized compensation cost for stock-based awards	(2)	13
Cash dividends paid	(403)	(427)
NET CASH PROVIDED BY FINANCING ACTIVITIES	1,403	3,905
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	123	(248)
CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD	1,814	2,264
CASH AND DUE FROM BANKS AT END OF PERIOD	\$ 1,937	\$ 2,016
Additional disclosures relative to cash flows:		
Interest paid	\$ 1,683	\$ 2,211
Income taxes paid	329	276
Noncash items:		
Assets acquired	\$ 2,810	
Liabilities assumed	2,648	
Loans transferred to portfolio from held for sale	3,342	
Loans transferred to held for sale from portfolio	459	
Loans transferred to other real estate owned	67	\$ 31

See Notes to Consolidated Financial Statements (Unaudited).

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Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The unaudited condensed consolidated interim financial statements include the accounts of KeyCorp and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. As used in these notes:

- “ **KeyCorp** refers solely to the parent holding company.
- “ **KeyBank** refers to KeyCorp’s subsidiary bank, KeyBank National Association.
- “ **Key** refers to the consolidated entity consisting of KeyCorp and its subsidiaries.

The consolidated financial statements include any voting rights entity in which Key has a controlling financial interest. In accordance with Financial Accounting Standards Board (FASB) Revised Interpretation No. 46,

Consolidation of Variable Interest Entities, a variable interest entity (VIE) is consolidated if Key has a variable interest in the entity and is exposed to the majority of its expected losses and/or residual returns (i.e., Key is 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 8 (Variable Interest Entities) on page 23 for information on Key’s involvement with VIEs.

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

Qualifying special purpose entities, including securitization trusts, established by Key under the provisions of Statement of Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, are not consolidated. Information on SFAS No. 140 is included in Note 1 (Summary of Significant Accounting Policies) of Key’s 2007 Annual Report to Shareholders under the heading Loan Securitizations on page 67.

Management believes that the unaudited condensed 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. Some previously reported results have been reclassified to conform to current reporting practices.

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 Key’s 2007 Annual Report to Shareholders.

Goodwill and Other Intangible Assets

Under SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and certain intangible assets are subject to impairment testing, which must be conducted at least annually. Key typically performs this required testing in the fourth quarter of each year, or more frequently if events or circumstances indicate possible impairment. Key’s reporting units for purposes of this testing are its major business segments: Community Banking and National Banking.

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The first step in impairment testing is to determine the fair value of each reporting unit. If the carrying amount of a reporting unit exceeds its fair value, goodwill impairment may be indicated. In such a case, Key would estimate a purchase price for the reporting unit (representing the unit's fair value) and then compare that hypothetical purchase price to the fair value of the unit's net assets (excluding goodwill). Any excess of the estimated purchase price over the fair value of the reporting unit's net assets represents the implied fair value of goodwill. An impairment loss would be recognized as a charge to earnings to the extent the carrying amount of the reporting unit's goodwill exceeds the implied fair value of goodwill.

Key's results for the first nine months of 2008 were adversely affected by after-tax charges of \$1.011 billion recorded during the second quarter as a result of a previously announced adverse federal court decision on the tax treatment of a Service Contract Lease transaction, and a substantial increase to the provision for loan losses. Additionally, 2008 results have been adversely affected by severe market disruptions that continued through the third quarter. As a result of these factors, management tested Key's goodwill for impairment as of June 30, 2008, and determined that no impairment existed at that date. Based on a September 30, 2008, review of the fair value of Key's reporting units, management determined that no further impairment testing was required as of that date. As in prior years, management will perform Key's annual impairment testing of goodwill as of October 1, 2008.

Derivatives

Effective January 1, 2008, Key adopted the accounting guidance in FASB Staff Position FIN 39-1, Amendment of FASB Interpretation 39, and as a result, also adopted the provisions of Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts. As a result of adopting this guidance, Key changed its accounting policy pertaining to the recognition of derivative assets and liabilities to take into account the impact of master netting agreements that allow Key to settle all derivative contracts held with a single counterparty on a net basis and to offset the net derivative position with the related cash collateral. Additional information regarding Key's adoption of this accounting guidance is provided in Note 14 (Derivatives and Hedging Activities), which begins on page 32, and under the heading Accounting Pronouncements Adopted in 2008 on page 9 of this note.

Fair Value Measurements

Effective January 1, 2008, Key adopted SFAS No. 157, Fair Value Measurements, for all applicable financial and nonfinancial assets and liabilities. This accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances.

As defined in SFAS No. 157, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants. It represents an exit price at the measurement date. Market participants are buyers and sellers, who are independent, knowledgeable, and willing and able to transact in the principal (or most advantageous) market for the asset or liability being measured. Current market conditions, including imbalances between supply and demand, are considered in determining fair value.

Key values its assets and liabilities in the principal market where it sells the particular asset or transfers the liability with the greatest volume and level of activity. In the absence of a principal market, the valuation is based on the most advantageous market for the asset or liability

(i.e., the market where the asset could be sold or the liability transferred at a price that maximizes the amount to be received for the asset or minimizes the amount to be paid to transfer the liability).

In measuring the fair value of an asset, Key assumes the highest and best use of the asset by a market participant to maximize the value of the asset, and does not consider the intended use of the asset.

When measuring the fair value of a liability, Key assumes that the nonperformance risk associated with the liability is the same before and after the transfer. Nonperformance risk is the risk that an obligation will not be satisfied and encompasses not only Key's own credit risk (i.e., the risk that Key will fail to meet its obligation), but also other risks such as settlement risk. Key considers the effect of its own credit risk on the fair value for any period in which fair value is measured.

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There are three acceptable valuation techniques that can be used to measure fair value: the market approach, the income approach and the cost approach. Selection of the appropriate technique for valuing a particular asset or liability takes into consideration the exit market, the nature of the asset or liability being valued, and how a market participant would value the same asset or liability. Ultimately, determination of the appropriate valuation method requires significant judgment, and sufficient knowledge and expertise are required to apply the valuation techniques. Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability using one of the three valuation techniques. Inputs can be observable or unobservable. Observable inputs are those assumptions which market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from a source independent of Key.

Unobservable inputs are assumptions based on Key's own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy which gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs

(Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Key considers an input to be significant if it drives 10% or more of the total fair value of a particular asset or liability.

Assets and liabilities are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly or quarterly). Recurring valuation occurs at a minimum on the measurement date.

Assets and liabilities are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheet. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements which require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value.

The fair value of assets or liabilities transferred in or out of Level 3 is measured on the transfer date, with any additional changes in fair value subsequent to the transfer considered to be realized or unrealized gains or losses.

Additional information regarding fair value measurements and Key's adoption of SFAS No. 157 is provided in Note 15 (Fair Value Measurements), which begins on page 35, and under the heading Accounting Pronouncements Adopted in 2008 below.

Accounting Pronouncements Adopted in 2008

Fair value measurements. In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for Key). In February 2008, the FASB issued Staff Position FAS 157-2, which delayed the effective date of SFAS No. 157 for all nonfinancial assets and liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008. However, early adoption of SFAS No. 157 for nonfinancial assets and liabilities within the scope of the new guidance is permitted. Key's January 1, 2008, adoption of SFAS No. 157 for all financial and nonfinancial assets and

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liabilities did not have a material effect on Key's financial condition or results of operations. Additional information regarding fair value measurements and Key's adoption of this accounting guidance is provided in Note 15 and under the heading "Fair Value Measurements" on page 8 of this note.

Fair value option for financial assets and financial liabilities. In February 2007, the FASB issued SFAS No. 159,

The Fair Value Option for Financial Assets and Financial Liabilities. This guidance provides an option to selectively report financial assets and liabilities at fair value, and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for Key). Key has elected to not apply this fair value option to any of its existing assets or liabilities. However, Key may apply this guidance to assets or liabilities in the future as permitted under SFAS No. 159.

Offsetting of amounts related to certain contracts. In April 2007, the FASB issued Staff Position FIN 39-1, which supplements Interpretation No. 39 by allowing reporting entities to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash (a payable) arising from derivative instruments with the same counterparty. Interpretation No. 39 allowed reporting entities to offset fair value amounts recognized for derivative instruments executed with the same counterparty under a master netting agreement. Key did not previously adopt the provisions of Interpretation No. 39 that were permitted but not required. The accounting guidance in Staff Position FIN 39-1 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for Key). Key has elected to adopt the accounting guidance in Staff Position FIN 39-1, and as a result, also adopted the provisions of Interpretation No. 39. The adoption of this accounting guidance did not have a material effect on Key's financial condition or results of operations. Additional information regarding Key's adoption of this accounting guidance is provided in Note 14 and under the heading "Derivatives" on page 8 of this note.

Determining the fair value of a financial asset when the market for that asset is not active. In October 2008, the FASB issued Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active." This accounting guidance clarifies the application of SFAS No. 157 in determining the fair value of a financial asset when the market for that financial asset is not active. This Staff Position is effective upon issuance, and also applies to prior periods for which financial statements have not been issued. Therefore, it is effective for Key for the three months ended September 30, 2008. The adoption of this accounting guidance did not have a material effect on Key's financial condition or results of operations.

Accounting Pronouncements Pending Adoption at September 30, 2008

Employers' accounting for defined benefit pension and other postretirement plans. In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." Except for the measurement requirement, Key adopted this accounting guidance as of December 31, 2006. Additional information regarding the adoption of SFAS No. 158 is included in Note 1 ("Summary of Significant Accounting Policies") under the heading "Accounting Pronouncements Pending Adoption at December 31, 2007" on page 71 of Key's 2007 Annual Report to Shareholders. The requirement to measure plan assets and benefit obligations as of the end of an employer's fiscal year is effective for years ending after December 15, 2008 (December 31, 2008, for Key). Adoption of this guidance is not expected to have a material effect on Key's financial condition or results of operations.

Business combinations. In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." The new pronouncement requires the acquiring entity in a business combination to recognize only the assets acquired and liabilities assumed in a transaction (e.g., acquisition costs must be expensed when incurred), establishes the fair value at the date of acquisition as the initial measurement for all assets acquired and liabilities assumed, and requires expanded disclosures. SFAS No. 141(R) will be effective for fiscal years beginning after December 15, 2008 (January 1, 2009, for Key). Early adoption is prohibited.

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Noncontrolling interests. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51. The new pronouncement requires all entities to report noncontrolling (minority) interests in subsidiaries as a component of shareholders' equity. SFAS No. 160 will be effective for fiscal years beginning after December 15, 2008 (January 1, 2009, for Key). Early adoption is prohibited. Adoption of this accounting guidance is not expected to have a material effect on Key's financial condition or results of operations.

Accounting for transfers of financial assets and repurchase financing transactions. In February 2008, the FASB issued Staff Position FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This Staff Position provides guidance on accounting for a transfer of a financial asset and a repurchase financing, and presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing shall be evaluated separately under SFAS No. 140. Staff Position FAS 140-3 will be effective for fiscal years beginning after November 15, 2008 (January 1, 2009, for Key), and for interim periods within those fiscal years. Early adoption is prohibited. Adoption of this accounting guidance is not expected to have a material effect on Key's financial condition or results of operations.

Disclosures about derivative instruments and hedging activities. In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, which amends and expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This accounting guidance requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and gains and losses on derivative instruments, and disclosures about credit risk-related contingent features in derivative agreements. SFAS No. 161 will be effective for fiscal years beginning after November 15, 2008 (January 1, 2009, for Key).

Determination of the useful life of intangible assets. In April 2008, the FASB issued Staff Position FAS 142-3, Determination of the Useful Life of Intangible Assets. This accounting guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. This Staff Position will be effective for fiscal years beginning after December 15, 2008 (January 1, 2009, for Key), and for interim periods within those fiscal years. Early adoption is prohibited. Adoption of this accounting guidance is not expected to have a material effect on Key's financial condition or results of operations.

Hierarchy of generally accepted accounting principles. In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles. This guidance identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. generally accepted accounting principles. SFAS No. 162 will be effective 60 days following the Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. Adoption of this accounting guidance is not expected to have a material effect on Key's financial condition or results of operations.

Accounting for convertible debt instruments. In May 2008, the FASB issued Staff Position APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). This guidance requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's nonconvertible debt borrowing rate. This Staff Position is effective for fiscal years beginning after December 15, 2008 (January 1, 2009, for Key), and for interim periods within those fiscal years. Early adoption is prohibited. Key has not issued and does not have any convertible debt instruments outstanding that are subject to the accounting guidance in this Staff Position. Therefore, adoption of this accounting guidance is not expected to have a material effect on Key's financial condition or results of operations.

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Disclosures about credit derivatives and certain guarantees. In September 2008, the FASB issued Staff Position No. 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161. This Staff Position amends SFAS No. 133 to require additional disclosure about the potential adverse effects of changes in credit risk on the financial position, financial performance, and cash flows of the sellers of credit derivatives, including freestanding derivatives and derivatives embedded in hybrid instruments. This accounting guidance also amends Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34, to require additional disclosure about the status of the payment/performance risk of guarantees. This Staff Position is effective for fiscal years ending after November 15, 2008 (December 31, 2008, for Key).

2. Earnings Per Common Share

Key's basic and diluted earnings per common share are calculated as follows:

<i>dollars in millions, except per share amounts</i>	Three months ended September 30, 2008		Nine months ended September 30, 2008	
	2007		2007	
EARNINGS				
(Loss) income from continuing operations	\$ (36)	\$ 224	\$ (944)	\$ 919
Loss from discontinued operations, net of taxes		(14)		(25)
Net (loss) income	\$ (36)	\$ 210	\$ (944)	\$ 894
Net (loss) income applicable to common shares	\$ (48)	\$ 210	\$ (956)	\$ 894
WEIGHTED-AVERAGE COMMON SHARES				
Weighted-average common shares outstanding (000)	491,179	389,319	435,846	393,048
Effect of dilutive convertible preferred stock, common stock options and other stock awards (000)		3,845		4,768
Weighted-average common shares and potential common shares outstanding (000)	491,179	393,164	435,846	397,816
EARNINGS PER COMMON SHARE				
(Loss) income from continuing operations	\$ (.10)	\$.58	\$ (2.19)	\$ 2.34
Loss from discontinued operations		(.03)		(.06)
Net (loss) income	(.10)	.54	(2.19)	2.28
(Loss) income from continuing operations assuming dilution	\$ (.10)	\$.57	\$ (2.19)	\$ 2.31
Loss from discontinued operations assuming dilution		(.03)		(.06)
Net (loss) income assuming dilution	(.10)	.54	(2.19)	2.25

3. Acquisitions and Divestitures

Acquisitions and divestitures completed by Key during 2007 and the first nine months of 2008 are summarized below.

Acquisitions

U.S.B. Holding Co., Inc.

On January 1, 2008, Key acquired U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York. U.S.B. Holding Co. had assets of \$2.8 billion and deposits of \$1.8 billion at the date of acquisition. Under the terms of the agreement, 9,895,000 KeyCorp common shares, with a value of \$348 million, and \$194 million in cash were exchanged for all of the outstanding shares of U.S.B. Holding Co. In connection with the acquisition, Key recorded goodwill of approximately \$350 million. The acquisition expanded Key's presence in markets both within and contiguous to its current operations in the Hudson Valley.

Table of Contents**Tuition Management Systems, Inc.**

On October 1, 2007, Key acquired Tuition Management Systems, Inc., one of the nation's largest providers of outsourced tuition planning, billing, counseling and payment services. Headquartered in Warwick, Rhode Island, Tuition Management Systems serves more than 700 colleges, universities, elementary and secondary educational institutions. The terms of the transaction were not material.

Divestitures**Champion Mortgage**

On February 28, 2007, Key sold the Champion Mortgage loan origination platform to an affiliate of Fortress Investment Group LLC, a global alternative investment and asset management firm, for cash proceeds of \$.5 million. On November 29, 2006, Key sold the subprime mortgage loan portfolio held by the Champion Mortgage finance business to a wholly owned subsidiary of HSBC Finance Corporation for cash proceeds of \$2.5 billion. The loan portfolio totaled \$2.5 billion at the date of sale.

Key has applied discontinued operations accounting to the Champion Mortgage finance business. The results of this discontinued business are presented on one line as loss from discontinued operations, net of taxes in the Consolidated Statements of Income on page 4. The components of loss from discontinued operations are as follows:

	Three months ended September 30, 2007		Nine months ended September 30, 2007	
<i>in millions</i>				
Loss, net of taxes of (\$2) and (\$5), respectively ^a	\$	(3)	\$	(9)
Loss on disposal, net of taxes of (\$1)				(1)
Disposal transaction costs, net of taxes of (\$6) and (\$9), respectively		(11)		(15)
Loss from discontinued operations	\$	(14)	\$	(25)

(a) Includes after-tax charges of \$.06 million for the three-month period ended September 30, 2007, and \$.7 million for the nine-month period ended September 30, 2007, determined by applying a matched funds transfer pricing methodology to the liabilities assumed necessary to support Champion's operations.

The discontinued assets and liabilities of Champion Mortgage included in the Consolidated Balance Sheets on page 3 are as follows:

	December 31, 2007		September 30, 2007	
<i>in millions</i>				
Loans	\$	8	\$	9
Accrued income and other assets				2
Total assets	\$	8	\$	11
Accrued expense and other liabilities	\$	10	\$	14
Total liabilities	\$	10	\$	14

McDonald Investments branch network

On February 9, 2007, McDonald Investments Inc., a wholly owned subsidiary of KeyCorp, sold its branch network, which included approximately 570 financial advisors and field support staff, and certain fixed assets to UBS Financial Services Inc., a subsidiary of UBS AG. Key received cash proceeds of \$219 million and recorded a gain of \$171 million (\$107 million after tax, \$.26 per diluted common share) in connection with the sale. Key retained McDonald Investments corporate and institutional businesses, including Institutional Equities and Equity Research, Debt Capital Markets and Investment Banking. In addition, KeyBank continues to operate the Wealth Management, Trust and Private Banking businesses. On April 16, 2007, Key renamed the registered broker-dealer through which its corporate and institutional investment banking and securities businesses operate to KeyBanc Capital Markets Inc.

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4. Line of Business Results

Community Banking

Regional Banking provides individuals with branch-based deposit and investment products, personal finance services and loans, including residential mortgages, home equity and various types of installment loans. This line of business also provides small businesses with deposit, investment and credit products, and business advisory services.

Regional Banking also offers financial, estate and retirement planning, and asset management services to assist high-net-worth clients with their 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.

National Banking

Real Estate Capital and Corporate Banking Services consists of two business units. 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 nonaffiliated third parties). Particular emphasis has been placed on providing clients with finance solutions through access to the capital markets.

Corporate Banking Services provides cash management, interest rate derivatives, and foreign exchange products and services to clients throughout the Community Banking and National Banking groups. Through its Public Sector and Financial Institutions businesses, Corporate Banking Services provides a full array of commercial banking products and services to government and not-for-profit entities, and to community banks.

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 relationship with the client.

Institutional and Capital Markets, through its KeyBanc Capital Markets unit, provides commercial lending, treasury management, investment banking, derivatives and 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.

Consumer Finance provides government guaranteed education loans to students and their parents, and processes tuition payments for private schools. Through its Commercial Floor Plan Lending unit, this line of business also finances inventory for automobile dealers. Beginning in October 2008, Consumer Finance will exit direct and indirect retail and floor-plan lending for marine and recreational vehicle products and will limit new education loans to those backed by government guarantee. It will continue to service existing loans in these portfolios and to honor existing education loan commitments. These actions are consistent with Key's strategy of de-emphasizing nonrelationship or out-of-footprint businesses.

Other Segments

Other Segments consist of Corporate Treasury and Key's Principal Investing unit.

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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 that spans pages 16 and 17 shows selected financial data for each major business group for the three- and nine-month periods ended September 30, 2008 and 2007. This table is accompanied by supplementary information for each of the lines of business that make up these groups. The information was derived from the internal financial reporting system that management uses to monitor and manage Key's financial performance. U.S. generally accepted accounting principles (GAAP) guide financial accounting, but there is no authoritative guidance for "management accounting" the way management uses its judgment and experience to make reporting decisions. Consequently, the line of business results Key reports may not be comparable with 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. According to Key's 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. The net effect of this funds transfer pricing is charged to the lines of business based on the total loan and deposit balances of each line.
- .. Indirect expenses, such as computer servicing costs and corporate overhead, are allocated based on assumptions regarding the extent to which each line actually uses the services.
- .. Key's consolidated provision for loan 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 management uses to estimate Key's consolidated allowance for loan losses. This methodology is described in Note 1 (Summary of Significant Accounting Policies) under the heading Allowance for Loan Losses on page 67 of Key's 2007 Annual Report to Shareholders.
- .. 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 2.5%.
- .. Capital is assigned based on management's assessment of economic risk factors (primarily credit, operating and market risk) directly attributable to each line.

Developing and applying the methodologies that management uses to allocate items among Key's 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 Key's organizational structure.

Effective January 1, 2008, Key moved the Public Sector, Bank Capital Markets and Global Treasury Management units from the Institutional and Capital Markets line of business to the Real Estate Capital and Corporate Banking Services (previously known as Real Estate Capital) line of business within the National Banking group.

Table of Contents**Three months ended September 30,**
*dollars in millions***Community Banking**
2008 2007**National Banking**
2008 2007**SUMMARY OF OPERATIONS**

Net interest income (loss) (TE)	\$ 445	\$ 412	\$ 322	\$ 355
Noninterest income	213	217	160 ^d	152
Total revenue (TE) ^a	658	629	482	507
Provision for loan losses	56	2	350	69
Depreciation and amortization expense	36	33	78	74
Other noninterest expense	409	380	264	253
Income (loss) from continuing operations before income taxes (TE)	157	214	(210)	111
Allocated income taxes and TE adjustments	59	80	(77)	41
Income (loss) from continuing operations	98	134	(133)	70
Loss from discontinued operations, net of taxes				(14)
Net income (loss)	\$ 98	\$ 134	\$ (133)	\$ 56
Percent of consolidated income from continuing operations	N/M	60%	N/M	31%
Percent of total segments income from continuing operations	N/M	61	N/M	32
AVERAGE BALANCES ^b				
Loans and leases	\$ 28,872	\$ 26,944	\$ 47,075	\$ 40,279
Total assets ^a	31,934	29,708	56,183	50,961
Deposits	50,384	46,729	12,439	12,631
OTHER FINANCIAL DATA				
Net loan charge-offs	\$ 70	\$ 19	\$ 203	\$ 40
Return on average allocated equity ^b	12.84%	21.20%	(10.28)%	6.62%
Return on average allocated equity	12.84	21.20	(10.28)	5.30
Average full-time equivalent employees	8,949	8,625	3,589	3,869

Nine months ended September 30,
*dollars in millions***Community Banking**
2008 2007**National Banking**
2008 2007**SUMMARY OF OPERATIONS**

Net interest income (loss) (TE)	\$ 1,307	\$ 1,248	\$ 184 ^d	\$ 1,035
Noninterest income	642	819 ^c	606 ^d	684 ^d
Total revenue (TE) ^a	1,949	2,067	790	1,719
Provision for loan losses	118	37	1,128	131

Depreciation and amortization expense	105	101	226	215
Other noninterest expense	1,218	1,222	760	759
Income (loss) from continuing operations before income taxes (TE)	508	707	(1,324)	614
Allocated income taxes and TE adjustments	190	265	(495)	230
Income (loss) from continuing operations	318	442	(829)	384
Loss from discontinued operations, net of taxes				(25)
Net income (loss)	\$ 318	\$ 442	\$ (829)	\$ 359

Percent of consolidated income from continuing operations	N/M	48%	N/M	42%
Percent of total segments income from continuing operations	N/M	50	N/M	43

AVERAGE BALANCES ^b

Loans and leases	\$ 28,483	\$ 26,659	\$ 46,374	\$ 39,487
Total assets ^a	31,418	29,445	56,254	49,666
Deposits	50,035	46,459	12,205	12,008

OTHER FINANCIAL DATA

Net loan charge-offs	\$ 138	\$ 64	\$ 780	\$ 92
Return on average allocated equity ^b	14.03%	23.82%	(21.68)%	12.40%
Return on average allocated equity	14.03	23.82	(21.68)	11.59
Average full-time equivalent employees	8,817	9,034	3,650	4,003

- (a) Substantially all revenue generated by Key's major business groups is derived from clients with residency in the United States. Substantially all long-lived assets, including premises and equipment, capitalized software and goodwill held by Key's major business groups are located in the United States.
- (b) From continuing operations.
- (c) Community Banking's results for the first quarter of 2007 include a \$171 million (\$107 million after tax) gain from the February 9, 2007, sale of the McDonald Investments branch network. See Note 3 (Acquisitions and Divestitures), which begins on page 12, for more information about this transaction.
- (d) National Banking's results for the third quarter of 2008 include \$54 million (\$33 million after tax) of derivative-related charges recorded as a result of market disruption caused by the failure of Lehman Brothers and \$31 million (\$19 million after tax) of realized and unrealized losses from the residential properties segment of the construction loan portfolio. During the second quarter of 2008, National Banking's taxable-equivalent net interest income and net income were reduced by \$838 million and \$536 million, respectively, as a result of an adverse federal court decision on the tax treatment of a Service Contract Lease transaction. During the first quarter of 2008, National Banking increased its tax reserves for certain lease in, lease out transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced National Banking's taxable-equivalent revenue by \$34 million and its net income by \$21 million in the first quarter. National Banking's results for the first quarter of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation.

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Other Segments		Total Segments		Reconciling Items		Key	
2008	2007	2008	2007	2008	2007	2008	2007
\$ (35)	\$ (24)	\$ 732	\$ 743	\$ (27)	\$ (31)	\$ 705	\$ 712
18 ^e	39	391	408	(3)	30 ^f	388	438
(17)	15	1,123	1,151	(30)	(1)	1,093	1,150
		406	71	1	(2)	407	69
		114	107			114	107
(14)	6	659	639	(11)	7	648	646
(3)	9	(56)	334	(20)	(6)	(76)	328
(12)	(7)	(30)	114	(10) ^f	(10)	(40)	104
9	16	(26)	220	(10)	4	(36)	224
			(14)				(14)
\$ 9	\$ 16	\$ (26)	\$ 206	\$ (10)	\$ 4	\$ (36)	\$ 210
N/M	7%	N/M	98%	N/M	2%	N/M	100%
N/M	7	N/M	100	N/A	N/A	N/A	N/A
\$ 165	\$ 245	\$ 76,112	\$ 67,468	\$ 59	\$ 212	\$ 76,171	\$ 67,680
13,803	12,523	101,920	93,192	1,236	1,970	103,156	95,162
1,965	3,203	64,788	62,563	(206)	(42)	64,582	62,521
		\$ 273	\$ 59			\$ 273	\$ 59
N/M	N/M	(1.19)%	12.10%	N/M	N/M	(1.64)%	11.50%
N/M	N/M	(1.19)	11.33	N/M	N/M	(1.64)	10.79
42	43	12,580	12,537	5,711	6,030	18,291	18,567
Other Segments		Total Segments		Reconciling Items		Key	
2008	2007	2008	2007	2008	2007	2008	2007
\$ (94)	\$ (70)	\$ 1,397	\$ 2,213	\$ (88)	\$ (95)	\$ 1,309	\$ 2,118
71 ^e	167 ^e	1,319	1,670	152 ^f	71 ^f	1,471	1,741
(23)	97	2,716	3,883	64	(24)	2,780	3,859
		1,246	168	(5)	(2)	1,241	166
		331	316			331	316
3	49 ^e	1,981	2,030	(37)	6 ^f	1,944	2,036
(26)	48	(842)	1,369	106	(28)	(736)	1,341

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(43)	(15)	(348)	480	556 ^f	(58)	208	422
17	63	(494)	889 (25)	(450)	30	(944)	919 (25)
\$ 17	\$ 63	\$ (494)	\$ 864	\$ (450)	\$ 30	\$ (944)	\$ 894
N/M	7%	N/M	97%	N/M	3%	N/M	100%
N/M	7	N/M	100	N/A	N/A	N/A	N/A
\$ 193	\$ 263	\$ 75,050	\$ 66,409	\$ 124	\$ 153	\$ 75,174	\$ 66,562
14,106	12,401	101,778	91,512	1,489	2,056	103,267	93,568
3,281	2,575	65,521	61,042	(190)	(139)	65,331	60,903
		\$ 918	\$ 156			\$ 918	\$ 156
N/M	N/M	(7.63)%	16.74%	N/M	N/M	(14.66)%	16.03%
N/M	N/M	(7.63)	16.27	N/M	N/M	(14.66)	15.59
43	43	12,510	13,080	5,784	6,001	18,294	19,081

- (e) Other Segments results for the third quarter of 2008 include a \$23 million (\$14 million after tax) credit, representing the reversal of the remaining reserve associated with the Honsador litigation, which was settled in September. Other Segments results for the second quarter of 2007 include a \$26 million (\$16 million after tax) charge for litigation. This charge and the litigation charge referred to in note (f) below comprise the initial \$42 million reserve established in connection with the Honsador litigation. Other Segments results for the first quarter of 2007 include a \$49 million (\$31 million after tax) loss from the repositioning of the securities portfolio.
- (f) Reconciling Items for the third and second quarters of 2008 include charges of \$30 million and \$475 million, respectively, to income taxes for the interest cost associated with the leveraged lease tax litigation. Reconciling Items for the first quarter of 2008 include a \$165 million (\$103 million after tax) gain from the partial redemption of Key's equity interest in Visa Inc. and a \$17 million charge to income taxes for the interest cost associated with the increase to Key's tax reserves for certain LILO transactions. Reconciling Items for the third and second quarters of 2007 include gains of \$27 million (\$17 million after tax) and \$40 million (\$25 million after tax), respectively, related to MasterCard Incorporated shares. During the second quarter of 2007, Reconciling Items include a \$16 million (\$10 million after tax) charge for litigation.

TE = Taxable Equivalent

N/A = Not Applicable

N/M = Not Meaningful

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Supplementary information (Community Banking lines of business)

Three months ended September 30, <i>dollars in millions</i>	Regional Banking		Commercial Banking	
	2008	2007	2008	2007
Total revenue (TE)	\$ 557	\$ 534	\$ 101	\$ 95
Provision for loan losses	39	12	17	(10)
Noninterest expense	399	367	46	46
Net income	74	97	24	37
Average loans and leases	19,794	18,667	9,078	8,277
Average deposits	46,655	43,237	3,729	3,492
Net loan charge-offs	41	17	29	2
Net loan charge-offs to average loans	.82%	.36%	1.27%	.10%
Nonperforming assets at period end	\$ 168	\$ 119	\$ 57	\$ 40
Return on average allocated equity	13.67%	22.03%	10.83%	19.29%
Average full-time equivalent employees	8,603	8,264	346	361

Nine months ended September 30, <i>dollars in millions</i>	Regional Banking		Commercial Banking	
	2008	2007	2008	2007
Total revenue (TE)	\$ 1,646	\$ 1,787	\$ 303	\$ 280
Provision for loan losses	77	50	41	(13)
Noninterest expense	1,187	1,179	136	144
Net income	239	349	79	93
Average loans and leases	19,659	18,546	8,824	8,113
Average deposits	46,361	43,006	3,674	3,453
Net loan charge-offs	103	55	35	9
Net loan charge-offs to average loans	.70%	.40%	.53%	.15%
Nonperforming assets at period end	\$ 168	\$ 119	\$ 57	\$ 40
Return on average allocated equity	14.67%	26.80%	12.39%	16.80%
Average full-time equivalent employees	8,470	8,666	347	368

Supplementary information (National Banking lines of business)

Three months ended September 30, <i>dollars in millions</i>	Real Estate Capital and Corporate Banking Services		Institutional and Consumer Finance					
	Equipment Finance		Capital Markets		Consumer Finance			
	2008	2007	2008	2007	2008	2007		
Total revenue (TE)	\$ 92	\$ 128	\$ 111	\$ 138	\$ 183	\$ 156	\$ 96	\$ 85
Provision for loan losses	99	43	64	16	16	(2)	171	12
Noninterest expense	89	88	90	93	107	105	56	41
(Loss) income from continuing operations	(60)	(2)	(27)	18	37	34	(83)	20
Net (loss) income	(60)	(2)	(27)	18	37	34	(83)	6

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Average loans and leases ^a	16,447	14,160	10,012	10,681	8,364	6,716	12,252	8,722
Average loans held for sale ^a	792	1,584	49	6	649	373	161	2,729
Average deposits ^a	10,446	10,243	20	16	1,479	1,844	494	528
Net loan charge-offs (recoveries)	100	7	32	16	(1)	6	72	11
Net loan charge-offs (recoveries) to average loans ^a	2.42%	.20%	1.27%	.59%	(.05)%	.35%	2.34%	.50%
Nonperforming assets at period end	\$ 714	\$ 281	\$ 115	\$ 65	\$ 58	\$ 17	\$ 127	\$ 47
Return on average allocated equity ^a	(11.76)%	(.56)%	(11.99)%	8.00%	11.47%	12.55%	(35.09)%	9.87%
Return on average allocated equity	(11.76)	(.56)	(11.99)	8.00	11.47	12.55	(35.09)	2.96
Average full-time equivalent employees	1,222	1,309	827	900	975	1,019	565	641

Nine months ended September 30, dollars in millions	Real Estate Capital and Corporate Banking		Institutional and					
	Services		Equipment Finance		Capital Markets		Consumer Finance	
	2008	2007	2008	2007	2008	2007	2008	2007
Total revenue (TE)	\$ 405	\$ 531	\$ (488)	\$ 425	\$ 570	\$ 474	\$ 303	\$ 289
Provision for loan losses	509	51	124	45	69		426	35
Noninterest expense	219	264	274	272	335	307	158	131
(Loss) income from continuing operations	(202)	135	(554)	67	104	105	(177)	77
Net (loss) income	(202)	135	(554)	67	104	105	(177)	52
Average loans and leases ^a	16,676	13,838	10,310	10,590	7,966	6,612	11,422	8,447
Average loans held for sale ^a	799	1,327	44	7	566	325	1,209	2,672
Average deposits ^a	10,231	9,416	18	15	1,441	2,028	515	549
Net loan charge-offs	513	11	84	45	7	6	176	30
Net loan charge-offs to average loans ^a	4.11%	.11%	1.09%	.57%	.12%	.12%	2.06%	.47%
Nonperforming assets at period end	\$ 714	\$ 281	\$ 115	\$ 65	\$ 58	\$ 17	\$ 127	\$ 47
Return on average allocated equity ^a	(13.37)%	13.07%	(81.32)%	10.19%	11.11%	12.94%	(25.42)%	12.95%
Return on average allocated equity	(13.37)	13.07	(81.32)	10.19	11.11	12.94	(25.42)	8.75
Average full-time equivalent employees	1,227	1,293	841	893	949	1,023	633	794

(a) From continuing operations.

TE = Taxable Equivalent

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5. Securities

Securities available for sale. These are securities that Key intends to hold for an indefinite period of time but that may 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 shareholders' equity as a component of accumulated other comprehensive income (loss) on the balance sheet. Unrealized losses on specific securities deemed to be other-than-temporary are included in net securities gains (losses) on the income statement, as are actual gains and losses resulting from the sales of securities. When Key retains an interest in loans it securitizes, it bears risk that the loans will be prepaid (which would reduce expected interest income) or not paid at all. Key accounts for these retained interests as debt securities and classifies them as available for sale.

Other securities held in the available-for-sale portfolio are primarily marketable equity securities.

Held-to-maturity securities. These are debt securities that Key has the intent and ability to hold until maturity. Debt securities are carried at cost, 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 are foreign bonds and preferred equity securities.

The amortized cost, unrealized gains and losses, and approximate fair value of Key's securities available for sale and held-to-maturity securities are presented in the following tables. Gross unrealized gains and losses are represented by 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 improve or worsen.

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<i>in millions</i>	September 30, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	\$ 10			\$ 10
States and political subdivisions	92		\$ 2	90
Collateralized mortgage obligations	6,368	\$ 113	13	6,468
Other mortgage-backed securities	1,511	25	2	1,534
Retained interests in securitizations	158	37		195
Other securities	98	3	7	94
Total securities available for sale	\$ 8,237	\$ 178	\$ 24	\$ 8,391

HELD-TO-MATURITY SECURITIES

States and political subdivisions	\$ 7			\$ 7
Other securities	21			21
Total held-to-maturity securities	\$ 28			\$ 28

<i>in millions</i>	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	\$ 19			\$ 19
States and political subdivisions	10			10
Collateralized mortgage obligations	6,167	\$ 33	\$ 33	6,167
Other mortgage-backed securities	1,393	13	3	1,403
Retained interests in securitizations	149	36		185
Other securities	72	8	4	76
Total securities available for sale	\$ 7,810	\$ 90	\$ 40	\$ 7,860

HELD-TO-MATURITY SECURITIES

States and political subdivisions	\$ 9			\$ 9
Other securities	19			19
Total held-to-maturity securities	\$ 28			\$ 28

<i>in millions</i>	September 30, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	\$ 18			\$ 18
States and political subdivisions	12			12
Collateralized mortgage obligations	6,357	\$ 32	\$ 37	6,352
Other mortgage-backed securities	1,188	4	7	1,185
Retained interests in securitizations	149	43		192
Other securities	141	17	2	156
Total securities available for sale	\$ 7,865	\$ 96	\$ 46	\$ 7,915
HELD-TO-MATURITY SECURITIES				
States and political subdivisions	\$ 15			\$ 15
Other securities	21			21
Total held-to-maturity securities	\$ 36			\$ 36

Table of Contents**6. Loans and Loans Held for Sale**

Key's loans by category are summarized as follows:

<i>in millions</i>	September 30, 2008	December 31, 2007	September 30, 2007
Commercial, financial and agricultural	\$ 27,207	\$ 24,797	\$ 23,192
Commercial real estate:			
Commercial mortgage	10,569	9,630	9,272
Construction	7,708	8,102	8,214
Total commercial real estate loans	18,277 ^a	17,732	17,486
Commercial lease financing	9,437	10,176	10,309
Total commercial loans	54,921	52,705	50,987
Real estate residential mortgage	1,898	1,594	1,583
Home equity:			
Community Banking	9,970	9,655	9,674
National Banking	1,101	1,262	1,230
Total home equity loans	11,071	10,917	10,904
Consumer other Community Banking	1,274	1,298	1,308
Consumer other National Banking:			
Marine	3,529	3,637	3,549
Education	3,711 ^b	331	334
Other	301	341	334
Total consumer other National Banking	7,541	4,309	4,217
Total consumer loans	21,784	18,118	18,012
Total loans	\$ 76,705	\$ 70,823	\$ 68,999

(a) During the second quarter of 2008, Key transferred \$384 million of commercial real estate loans (\$719 million of primarily construction loans, net of \$335 million in net charge-offs) from the loan

portfolio to
held-for-sale
status.

- (b) On March 31,
2008, Key
transferred
\$3.3 billion of
education loans
from loans held
for sale to the
loan portfolio.

Key uses interest rate swaps to manage interest rate risk; these swaps modify the repricing characteristics of certain loans. For more information about such swaps, see Note 19 (Derivatives and Hedging Activities), which begins on page 100 of Key's 2007 Annual Report to Shareholders.

Key's loans held for sale by category are summarized as follows:

<i>in millions</i>	September 30, 2008	December 31, 2007	September 30, 2007
Commercial, financial and agricultural	\$ 159	\$ 250	\$ 67
Real estate commercial mortgage	718	1,219	1,560
Real estate construction	262 ^a	35	237
Commercial lease financing	52	1	5
Real estate residential mortgage	57	47	36
Home equity		1	1
Education	223 ^b	3,176	2,877
Automobile	4	7	8
Total loans held for sale	\$ 1,475	\$ 4,736	\$ 4,791

- (a) During the
second quarter
of 2008, Key
transferred
\$384 million of
commercial real
estate loans
(\$719 million of
primarily
construction
loans, net of
\$335 million in
net charge-offs)
from the loan
portfolio to
held-for-sale
status.

- (b) On March 31, 2008, Key transferred \$3.3 billion of education loans from loans held for sale to the loan portfolio.

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

<i>in millions</i>	Three months ended September 30, 2008		Nine months ended September 30, 2008	
	2008	2007	2008	2007
Balance at beginning of period	\$ 1,421	\$ 945	\$ 1,200	\$ 944
Charge-offs	(300)	(82)	(1,002)	(218)
Recoveries	27	23	84	62
Net loans charged off	(273)	(59)	(918)	(156)
Provision for loan losses from continuing operations	407	69	1,241	166
Allowance related to loans acquired, net			32	
Foreign currency translation adjustment	(1)		(1)	1
Balance at end of period	\$ 1,554	\$ 955	\$ 1,554	\$ 955

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

<i>in millions</i>	Three months ended September 30, 2008		Nine months ended September 30, 2008	
	2008	2007	2008	2007
Balance at beginning of period	\$ 51	\$ 50	\$ 80	\$ 53
Provision (credit) for losses on lending-related commitments	8	5	(21)	3
Charge-offs				(1)
Balance at end of period ^a	\$ 59	\$ 55	\$ 59	\$ 55

(a) Included in accrued expense and other liabilities on the consolidated balance sheet.

7. Mortgage Servicing Assets

Key originates and periodically sells commercial mortgage loans but continues to service those loans for the buyers. Key may also purchase the right to service commercial mortgage loans for other lenders. Changes in the carrying amount of mortgage servicing assets are summarized as follows:

<i>in millions</i>	Nine months ended September 30, 2008	
	2008	2007
Balance at beginning of period	\$ 313	\$ 247
Servicing retained from loan sales	13	16
Purchases	4	122
Amortization	(75)	(63)
Balance at end of period	\$ 255	\$ 322

Fair value at end of period	\$ 412	\$ 420
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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. Primary economic assumptions used to measure the fair value of Key's mortgage servicing assets at September 30, 2008, and 2007, are as follows:

- .. prepayment speed generally at an annual rate of 0.00% to 25.00%;
- .. expected credit losses at a static rate of 2.00%; and
- .. residual cash flows discount rate of 8.50% to 15.00%.

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Changes in these assumptions could cause the fair value of mortgage servicing assets to change in the future. The volume of loans serviced and expected credit losses are critical to the valuation of servicing assets. A 1.00% increase in the assumed default rate of commercial mortgage loans at September 30, 2008, would cause a \$9 million decrease in the fair value of Key's mortgage servicing assets.

Contractual fee income from servicing commercial mortgage loans totaled \$52 million and \$54 million for the nine-month periods ended September 30, 2008 and 2007, respectively. The amortization of servicing assets for each year, 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.

8. Variable Interest Entities

A VIE is a partnership, limited liability company, trust or other legal entity that meets any one of certain criteria specified in FASB Revised Interpretation No. 46. This interpretation requires a VIE to be consolidated by the party that is exposed to a majority of the VIE's expected losses and/or residual returns (i.e., the primary beneficiary). Key's VIEs, including those consolidated and those in which Key holds a significant interest, are summarized below. Key defines a significant interest in a VIE as a subordinated interest that exposes Key to a significant portion, but not the majority, of the VIE's expected losses or residual returns.

	Consolidated VIEs		Unconsolidated VIEs	
	Total Assets		Total Assets	Maximum Exposure to Loss
<i>in millions</i>				
September 30, 2008				
Low-income housing tax credit (LIHTC) funds	\$	251	\$	158
LIHTC investments		N/A	717	\$ 314

N/A = Not

Applicable

The third party interests associated with the consolidated LIHTC guaranteed funds are considered mandatorily redeemable instruments and are recorded in accrued expense and other liabilities on the balance sheet. The FASB has indefinitely deferred the measurement and recognition provisions of SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, for mandatorily redeemable noncontrolling interests associated with finite-lived subsidiaries, such as Key's LIHTC guaranteed funds. Key adjusts the financial statements each period for the third party investors' share of the funds' profits and losses. At September 30, 2008, the settlement value of these third party interests was estimated to be between \$213 million and \$247 million, while the recorded value, including reserves, totaled \$264 million.

Key's Principal Investing unit and the Real Estate Capital and Corporate Banking Services line of business make equity and mezzanine investments in entities, some of which are VIEs. These investments are held by nonregistered investment companies subject to the provisions of the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, Audits of Investment Companies. The FASB deferred the effective date of Revised Interpretation No. 46 for such nonregistered investment companies until the AICPA clarifies the scope of the Audit Guide. As a result, Key is not currently applying the accounting or disclosure provisions of Revised Interpretation No. 46 to its principal and real estate equity and mezzanine investments, which remain unconsolidated.

Additional information pertaining to Revised Interpretation No. 46 and the activities of the specific VIEs with which Key is involved is provided in Note 8 (Loan Securitizations, Servicing and Variable Interest Entities) of Key's 2007 Annual Report to Shareholders under the heading Variable Interest Entities on page 82.

Table of Contents**9. Nonperforming Assets and Past Due Loans**

Impaired loans totaled \$777 million at September 30, 2008, compared to \$519 million at December 31, 2007, and \$344 million at September 30, 2007. Impaired loans had an average balance of \$703 million for the third quarter of 2008 and \$240 million for the third quarter of 2007.

Key's nonperforming assets and past due loans were as follows:

<i>in millions</i>	September 30, 2008	December 31, 2007	September 30, 2007
Impaired loans	\$ 777	\$ 519	\$ 344
Other nonaccrual loans	190	168	154
Total nonperforming loans	967 ^a	687	498
Nonperforming loans held for sale	169 ^a	25	6
Other real estate owned (OREO)	64	21	21
Allowance for OREO losses	(4)	(2)	(1)
OREO, net of allowance	60	19	20
Other nonperforming assets ^b	43	33	46
Total nonperforming assets	\$ 1,239	\$ 764	\$ 570
Impaired loans with a specifically allocated allowance	\$ 678	\$ 426	\$ 35
Specifically allocated allowance for impaired loans	193	126	11
Accruing loans past due 90 days or more	\$ 328	\$ 231	\$ 190
Accruing loans past due 30 through 89 days	937	843	717

(a) During the second quarter of 2008, Key transferred \$384 million of commercial real estate loans (\$719 million of primarily construction loans, net of \$335 million in net charge-offs) from the loan portfolio to held-for-sale status.

- (b) Primarily
investments
held by the
Private Equity
unit within Key's
Real Estate
Capital and
Corporate
Banking
Services line of
business.

At September 30, 2008, Key did not have any significant commitments to lend additional funds to borrowers with loans on nonperforming status.

Management evaluates the collectibility of Key's loans as described in Note 1 (Summary of Significant Accounting Policies) under the heading Allowance for Loan Losses on page 67 of Key's 2007 Annual Report to Shareholders.

Table of Contents**10. Capital Securities Issued by Unconsolidated Subsidiaries**

KeyCorp owns the outstanding common stock of business trusts 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 capital securities.

The capital securities provide an attractive source of funds: they constitute Tier 1 capital for regulatory reporting purposes, but have the same tax advantages as debt for federal income tax purposes. During the first quarter of 2005, the Federal Reserve Board adopted a rule that allows bank holding companies to continue to treat capital securities as Tier 1 capital, but imposed stricter quantitative limits that take effect after a five-year transition period ending March 31, 2009. Management believes the new rule will not have any material effect on Key's financial condition. KeyCorp unconditionally guarantees 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.

During the first quarter of 2008, the KeyCorp Capital X trust issued \$740 million of securities. Also included in the table below are the capital securities held by the Union State Capital I, Union State Statutory II and Union State Statutory IV business trusts. The outstanding common stock of these trusts was owned by U.S.B. Holding Co., Inc., which Key acquired on January 1, 2008.

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

	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
<i>dollars in millions</i>					
September 30, 2008					
KeyCorp Capital I	\$ 197	\$ 8	\$ 201	3.531%	2028
KeyCorp Capital II	187	8	183	6.875	2029
KeyCorp Capital III	236	8	214	7.750	2029
KeyCorp Capital V	172	5	194	5.875	2033
KeyCorp Capital VI	75	2	80	6.125	2033
KeyCorp Capital VII	249	8	268	5.700	2035
KeyCorp Capital VIII	260		282	7.000	2066
KeyCorp Capital IX	506		505	6.750	2066
KeyCorp Capital X	735		731	8.000	2068
Union State Capital I	20	1	21	9.580	2027
Union State Statutory II	20		20	6.379	2031
Union State Statutory IV	10		10	5.591	2034
Total	\$ 2,667	\$ 40	\$ 2,709	6.820%	
December 31, 2007	\$ 1,848	\$ 39	\$ 1,896	6.599%	

September 30, 2007	\$	1,782	\$	39	\$	1,874	6.611%
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(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. Included in certain capital securities at September 30, 2008, December 31, 2007, and September 30, 2007, are basis adjustments of \$84 million, \$55 million and (\$11) million, respectively, related to fair value hedges. See Note 19 (Derivatives and Hedging Activities), which begins on page 100 of Key s 2007 Annual Report to Shareholders, for an explanation of fair value hedges.

(b)

KeyCorp has
the right to
redeem its
debentures:
(i) in whole or
in part, on or
after July 1,
2008 (for
debentures
owned by
Capital I);
March 18, 1999
(for debentures
owned by
Capital II);
July 16, 1999
(for debentures
owned by
Capital III);
July 31, 2006
(for debentures
owned by Union
State Statutory
II); February 1,
2007 (for
debentures
owned by Union
State Capital I);
July 21, 2008

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(for debentures owned by Capital V); December 15, 2008 (for debentures owned by Capital VI); April 7, 2009 (for debentures owned by Union State Statutory IV); June 15, 2010 (for debentures owned by Capital VII); June 15, 2011 (for debentures owned by Capital VIII); December 15, 2011 (for debentures owned by Capital IX); and March 15, 2013 (for debentures owned by Capital X); and (ii) in whole at any time within 90 days after and during the continuation of a tax event, an investment company event or a capital treatment event (as defined in the applicable indenture). If the debentures purchased by Union State Statutory IV, Capital I, Capital V, Capital VI, Capital VII, Capital VIII, Capital IX or Capital X are redeemed before they mature, the redemption price

will be the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Union State Capital I are redeemed before they mature, the redemption price will be 104.31% of the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Union State Statutory II are redeemed before they mature, the redemption price will be 104.5% of the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Capital II or 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 for Capital III), plus any accrued but unpaid interest. When debentures are redeemed in response to tax or capital treatment events, the redemption price generally is slightly more favorable to KeyCorp. Included in the principal amount of debentures at September 30, 2008, December 31, 2007, and September 30, 2007, are adjustments relating to hedging with financial instruments totaling \$86 million, \$64 million and \$42 million, respectively.

- (c) The interest rates for Capital II, Capital III, Capital V, Capital VI, Capital VII, Capital VIII, Capital IX, Capital X and Union State Capital I are fixed. 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 rates shown
 as the totals at
 September 30,
 2008,
 December 31,
 2007, and
 September 30,
 2007, are
 weighted-average
 rates.

11. Employee Benefits

Pension Plans

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

<i>in millions</i>	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Service cost of benefits earned	\$ 13	\$ 12	\$ 39	\$ 38
Interest cost on projected benefit obligation	15	15	47	44
Expected return on plan assets	(23)	(22)	(70)	(66)
Amortization of prior service cost			1	
Amortization of losses	4	7	10	21
Curtailment gain				(3)
Net pension cost	\$ 9	\$ 12	\$ 27	\$ 34

Other Postretirement Benefit Plans

Key sponsors 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. Key also sponsors life insurance plans covering certain grandfathered employees. These plans are principally noncontributory. Separate Voluntary Employee Beneficiary Association trusts are used to fund the healthcare plan and one of the life insurance plans.

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

<i>in millions</i>	Three months ended September 30, 2008		Nine months ended September 30, 2008		2007	
Service cost of benefits earned		\$ 2	\$ 1		\$ 6	
Interest cost on accumulated postretirement benefit obligation	\$ 1	2	3		5	
Expected return on plan assets	(2)	(1)	(4)		(3)	
Amortization of unrecognized: Transition obligation		1			3	
Prior service benefit			(1)			
Cumulative net gain			(1)			
Net postretirement benefit (income) cost	\$ (1)	\$ 4	\$ (2)		\$ 11	

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12. Income Taxes

Lease Financing Transactions

In the ordinary course of business, Key's equipment finance business unit (KEF) enters into various types of lease financing transactions. Between 1996 and 2004, KEF entered into three types of lease financing transactions with both foreign and domestic customers (primarily municipal authorities) for terms ranging from ten to fifty years. Lease in, lease out (LILO) transactions are leveraged leasing transactions in which KEF leases property from an unrelated third party and then leases the property back to that party. The transaction is similar to a sale-leaseback, except that KEF leases the property rather than purchasing it. Qualified Technological Equipment Leases (QTEs) and Service Contract Leases are even more like sale-leaseback transactions, as KEF is considered to be the purchaser of the equipment for tax purposes. LILO and Service Contract Lease transactions involve commuter rail equipment, public utility facilities and commercial aircraft. QTE transactions involve sophisticated high technology hardware and related software, such as telecommunications equipment.

Like other forms of leasing transactions, LILO transactions generate income tax deductions for Key from net rental expense associated with the leased property, interest expense on nonrecourse debt incurred to fund the transaction, and transaction costs. QTE and Service Contract Lease transactions generate rental income, as well as deductions from the depreciation of the property, interest expense on nonrecourse debt incurred to fund the transaction, and transaction costs.

Prior to 2004, LILO, QTE and Service Contract Leases were prevalent in the financial services industry and in certain other industries. The tax treatment that Key applied was based on applicable statutes, regulations and judicial authority. However, in subsequent years, the Internal Revenue Service (IRS) has challenged the tax treatment of these transactions by a number of bank holding companies and other corporations.

Currently, the IRS is auditing Key's income tax returns for the 2004 through 2006 tax years. The IRS has completed audits of Key's income tax returns for the 1995 through 2003 tax years and has disallowed all net deductions that relate to LILOs, QTEs and Service Contract Leases. Key appealed the examination results for the tax years 1995 through 1997, which pertained to LILOs only, to the Appeals Division of the IRS. During the fourth quarter of 2005, discussions with the Appeals Division were discontinued without a resolution. In April 2006, Key received a final assessment from the IRS, consisting of taxes, interest and penalties, disallowing all LILO deductions taken in the 1995-1997 tax years. Key paid the final assessment and filed a refund claim for the total amount. Key also has filed appeals with the Appeals Division of the IRS with regard to the proposed disallowance of the LILO, QTE and Service Contract Lease deductions taken in the 1998 through 2003 tax years.

In addition, in connection with one Service Contract Lease transaction entered into by AWG Leasing Trust (AWG Leasing), in which Key is a partner, the IRS completed its audit for the 1998 through 2003 tax years, disallowed all deductions related to the transaction for those years and assessed penalties. In March 2007, Key filed a lawsuit in the United States District Court for the Northern District of Ohio (captioned AWG Leasing Trust, KSP Investments, Inc., as Tax Matters Partner v. United States of America, and referred to herein as the AWG Leasing Litigation), claiming that the disallowance of the deductions and assessment of penalties were erroneous. The case proceeded to a bench trial, which commenced on January 21, 2008. On May 28, 2008, the Court rendered a decision that was adverse to Key. Management disagreed with the decision and, on July 23, 2008, Key filed a notice of appeal to the United States Court of Appeals for the Sixth Circuit.

On August 6, 2008, the IRS announced an initiative for the settlement of all transactions that the IRS has characterized as LILO/SILO transactions (the LILO/SILO Settlement Initiative). As preconditions to its participation, Key was required to provide written acceptance to the IRS of the terms of the LILO/SILO Settlement Initiative and to dismiss its appeal of the AWG Leasing Litigation. While management continues to believe that the tax treatment applied to Key's leveraged lease transactions complied with all

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tax laws, regulations and judicial authorities in effect at that time, it would take years of effort and expense to resolve this matter through litigation. Accordingly, Key has elected to participate in the LILO/SILO Settlement Initiative and has complied with the preconditions, including filing a dismissal of its appeal of the AWG Leasing Litigation. Key was accepted into the LILO/SILO Settlement Initiative by the IRS on October 6, 2008; however, Key's acceptance is not binding until a closing agreement is executed by both Key and the IRS. Management believes that, upon the execution of a closing agreement, which could occur by year end, Key should realize an after-tax recovery of between \$75 million and \$100 million for previously accrued interest on disputed tax balances.

During the second quarter of 2008, Key concluded that the Court decision in the AWG Leasing Litigation, under applicable accounting guidance, had implications for the timing of the recognition of tax benefits on Key's entire portfolio of LILO, QTE and Service Contract Leases. Therefore, management updated its assessment of Key's tax position in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* and, as a result, Key increased the amount of its unrecognized tax benefits associated with all of the leases under challenge by the IRS by \$2.15 billion. Key has deposited \$1.975 billion (including \$1.775 billion deposited with the IRS in October 2008) in response to the LILO/SILO Settlement Initiative to cover the anticipated amount of taxes due to the IRS for the tax years 1998 through 2006. Key also recorded a related \$475 million charge to the provision for income taxes for the interest cost associated with the contested leases. Key did not recognize any charge for penalties or interest on penalties that the IRS has asserted or may assert in the future and, as a result of its participation in the LILO/SILO Settlement Initiative, does not expect to have to record any such charges.

The second quarter 2008 increase in unrecognized tax benefits associated with the contested leases necessitated a recalculation of Key's lease income under FASB Staff Position No. 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction*. This resulted in a \$536 million reduction of Key's second quarter 2008 after-tax earnings, including a \$359 million reduction to lease income and a \$177 million increase to the provision for income taxes.

During the first quarter of 2008, Key increased the amount of its unrecognized tax benefits associated with its LILO transactions by \$46 million. This adjustment resulted from an updated assessment of Key's tax position performed by management in accordance with the provisions of FASB Interpretation No. 48. The increase in unrecognized tax benefits associated with Key's LILO transactions also necessitated a recalculation of Key's lease income under FASB Staff Position No. 13-2 and an increase to Key's tax reserves. These actions reduced Key's first quarter 2008 after-tax earnings by \$38 million, including a \$3 million reduction to lease income, an \$18 million increase to the provision for income taxes and a \$17 million charge to the tax provision for the associated interest charges.

During the third quarter of 2008, Key recorded a \$30 million charge to the provision for income taxes for the interest cost associated with its contested LILO, QTE and Service Contract Lease transactions. As permitted under FASB Interpretation No. 48, it is Key's policy to recognize interest and penalties related to unrecognized tax benefits in income tax expense. For the first nine months of 2008, Key recognized \$836 million of pre-tax interest, of which \$835 million (\$522 million after tax) was attributable to the total unrecognized tax benefits associated with its LILO, QTE and Service Contract Lease transactions. Key's liability for accrued interest payable was \$853 million at September 30, 2008.

Key files United States federal income tax returns, as well as returns in various state and foreign jurisdictions. With the exception of the California and New York jurisdictions, Key is not subject to income tax examinations by tax authorities for years prior to 2001. Income tax returns filed in California and New York are subject to examination beginning with the years 1995 and 2000, respectively. As previously discussed, the audits of the 1998 through 2003 federal income tax returns are currently on appeal to the Appeals Division of the IRS. The outcomes of these appeals or the execution of a closing agreement under the LILO/SILO Settlement Initiative will likely impact the recognition of benefits related to Key's state and federal tax positions.

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13. Contingent Liabilities and Guarantees

Legal Proceedings

Lehman Brothers bankruptcy. On September 15, 2008, Lehman Brothers Holdings Inc. (Holdings) filed a petition in the United States Bankruptcy Court for the Southern District of New York for protection under Chapter 11 of the U.S. Bankruptcy Code. As of that date, both KeyCorp and KeyBank had outstanding interest rate swaps and other derivative transactions (collectively, the Swap Transactions) with Lehman Brothers Special Financing Inc. (LBSF), an affiliate of Holdings. Holdings guaranteed all of LBSF's obligations under the Swap Transactions. Accordingly, the bankruptcy filing by Holdings constituted an Event of Default under the agreements governing the Swap Transactions, and both KeyCorp and KeyBank exercised their rights to terminate the Swap Transactions. In order to maintain its hedged position, Key entered into replacement contracts for the Swap Transactions with other parties. The aggregate net value of the Swap Transactions at the time of termination was in favor of Key. On October 3, 2008, LBSF filed its own petition in the United States Bankruptcy Court for the Southern District of New York for protection under Chapter 11 of the U.S. Bankruptcy Code. Key has filed claims against both LBSF and Holdings in the bankruptcy proceeding.

Taylor and Wildes litigation. On August 11, 2008, a purported class action case was filed against KeyCorp, its directors and certain employees (collectively, Key), captioned *Taylor v. KeyCorp et al.* in the United States District Court for the Northern District of Ohio. On September 16, 2008, a second and related case was filed in the same district court, captioned *Wildes v. KeyCorp et al.* The plaintiffs in these cases seek to represent a class of all participants in Key's 401(k) Savings Plan and allege that Key breached fiduciary duties owed to them under the Employment Retirement Income Security Act (ERISA). Plaintiffs have filed a motion to consolidate the cases, pursuant to which they would be required to file a consolidated complaint within thirty days from the date the motion is granted. Key strongly disagrees with the allegations contained in the complaints and intends to vigorously defend against them.

Tax disputes. In the ordinary course of business, Key enters into transactions that have tax consequences. On occasion, the IRS may challenge a particular tax position taken by Key. The IRS has completed audits of Key's income tax returns for the 1995 through 2003 tax years and has disallowed all deductions taken in those tax years that relate to certain lease financing transactions. Further information on these matters is included in Note 12 (Income Taxes), which begins on page 27.

Honsador litigation. Key has previously disclosed information pertaining to a litigation matter involving its Key Principal Partners, LLC affiliate (KPP), in which KPP was sued in Hawaii state court in connection with its investment in a Hawaiian business. On May 23, 2007, in the case of *Honsador Holdings LLC v. KPP*, the jury returned a verdict in favor of the plaintiffs, and the court entered a final judgment in favor of the plaintiffs in the amount of \$38.25 million. During the quarter ended June 30, 2007, Key established a reserve for the verdict, legal costs and other expenses associated with this lawsuit, and as of June 30, 2008, that reserve totaled approximately \$47 million. Key had filed a notice of appeal with the Intermediate Court of Appeals for the State of Hawaii, but in September 2008, Key entered into a settlement agreement with the plaintiffs and withdrew its appeal in exchange for a complete settlement and release of the case by the plaintiffs. A notice of dismissal was entered into the court record on October 2, 2008. As a result of the settlement, Key reversed the remaining reserve in September 2008 as a reduction to expense.

Other litigation. In the ordinary course of business, Key is subject to other legal actions that involve claims for substantial monetary relief. Based on information presently known to management, management does not believe there is any legal action to which KeyCorp or any of its subsidiaries is a party that, individually or in the aggregate, would reasonably be expected to have a material adverse effect on Key's financial condition.

Table of Contents**Guarantees**

Key is a guarantor in various agreements with third parties. The following table shows the types of guarantees that Key had outstanding at September 30, 2008. 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 69 of Key's 2007 Annual Report to Shareholders.

<i>in millions</i>	Maximum Potential Undiscounted Future Payments	Liability Recorded
Financial guarantees:		
Standby letters of credit	\$ 14,651	\$ 38
Recourse agreement with FNMA	692	6
Return guarantee agreement with LIHTC investors	247	57
Written interest rate caps ^a	177	25
Default guarantees	12	1
Total	\$ 15,779	\$ 127

(a) As of September 30, 2008, the weighted-average interest rate of written interest rate caps was 2.8%, and the weighted-average strike rate was 5.0%. Maximum potential undiscounted future payments were calculated assuming a 10% interest rate.

Standby letters of credit. Many of Key's lines of business issue standby letters of credit to address clients' financing needs. These instruments obligate Key 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; they bear interest (generally at variable rates) and pose the same credit risk to Key as a loan. At September 30, 2008, Key's standby letters of credit had a remaining weighted-average life of approximately 2.1 years, with remaining actual lives ranging from less than one year to as many as ten years.

Recourse agreement with Federal National Mortgage Association. KeyBank participates as a lender in the Federal National Mortgage Association (FNMA) Delegated Underwriting and Servicing program. As a condition to FNMA's delegation of responsibility for originating, underwriting and servicing mortgages, KeyBank has agreed to assume a limited portion of the risk of loss during the remaining term on each commercial mortgage loan KeyBank sells to FNMA. Accordingly, KeyBank maintains a reserve for such potential losses in an amount estimated by management

to approximate the fair value of KeyBank's liability. At September 30, 2008, the outstanding commercial mortgage loans in this program had a weighted-average remaining term of 7.2 years, and the unpaid principal balance outstanding of loans sold by KeyBank as a participant in this program was approximately \$2.2 billion. The maximum potential amount of undiscounted future payments that KeyBank may be required to make under this program is equal to approximately one-third of the principal balance of loans outstanding at September 30, 2008. If KeyBank is required to make a payment, it would have an interest in the collateral underlying the commercial mortgage loan on which the loss occurred.

Return guarantee agreement with LIHTC investors. Key Affordable Housing Corporation (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 LIHTCs under Section 42 of the Internal Revenue Code. In certain partnerships, investors pay 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. If KAHC defaults on its obligation to provide the guaranteed return, Key is obligated to make any necessary payments to investors. In October 2003, management elected to discontinue new partnerships under this program. Additional information regarding these partnerships is included in Note 8 (Variable Interest Entities) on page 23.

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No recourse or collateral is available to offset Key's guarantee obligation other than the underlying income stream from the properties. These guarantees have expiration dates that extend through 2018. Key meets its obligations pertaining to the guaranteed returns generally by distributing tax credits and deductions associated with the specific properties.

As shown in the table on page 30, KAHC maintained a reserve in the amount of \$57 million at September 30, 2008, which management believes 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. In accordance with FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, the amount of all fees received in consideration for any return guarantee agreements entered into or modified with LIHTC investors on or after January 1, 2003, has been recognized as a component of the recorded liability.

Written interest rate caps. In the ordinary course of business, Key writes interest rate caps for commercial loan clients that have variable rate loans with Key and wish to limit their exposure to interest rate increases. At September 30, 2008, these caps had a weighted-average life of approximately 1.8 years.

Key is obligated to pay the client if the applicable benchmark interest rate exceeds a specified level (known as the strike rate). These instruments are accounted for as derivatives. Key mitigates its potential future payments by entering into offsetting positions with third parties.

Default guarantees. Some lines of business provide or participate in guarantees that obligate Key to perform if the debtor fails to satisfy all of its payment obligations to third parties. Key generally undertakes these guarantees to support or protect its underlying investment or where the risk profile of the debtor should provide an investment return. The terms of these default guarantees range from less than one year to as many as fourteen years. Although no collateral is held, Key would have recourse against the debtor for any payments made under a default guarantee.

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 Interpretation No. 45 and from other relationships.

Liquidity facilities that support asset-backed commercial paper conduits. Key provides liquidity facilities to several unconsolidated third-party commercial paper conduits. These facilities obligate Key to provide funding if there is a disruption in credit markets or other factors exist that preclude the issuance of commercial paper by the conduits. The liquidity facilities, all of which expire by November 10, 2010, obligate Key to provide aggregate funding of up to \$995 million, with individual facilities ranging from \$10 million to \$125 million. The aggregate amount available to be drawn is based on the amount of current commitments to borrowers and totaled \$799 million at September 30, 2008. At that date, \$23 million had been drawn under these committed facilities. Key's commitments to provide liquidity are periodically evaluated by management.

Indemnifications provided in the ordinary course of business. Key provides certain indemnifications primarily through representations and warranties in contracts that are entered into 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. Key maintains reserves, when appropriate, with respect to liability it reasonably expects to incur in connection with these indemnities.

Intercompany guarantees. KeyCorp and certain other Key affiliates are parties to various guarantees that facilitate the ongoing business activities of other Key affiliates. These business activities encompass debt issuance, certain lease and insurance obligations, investments and securities, and certain leasing transactions involving clients.

Table of Contents**14. Derivatives and Hedging Activities**

Key, mainly through its subsidiary bank, KeyBank, is party to various derivative instruments that are used for asset and liability management, credit risk management and trading purposes. Derivative instruments are contracts between two or more parties. They have a notional amount and underlying variable, require no net investment and allow for the net settlement of positions. The notional amount serves as the basis for the payment provision of the contract and takes the form of units, such as shares or dollars. The underlying variable represents a specified interest rate, index or other component. The interaction between the notional amount and the underlying variable determines the number of units to be exchanged between the parties and drives the market value of the derivative contract.

The primary derivatives that Key uses are interest rate swaps and caps, foreign exchange contracts, energy derivatives, credit derivatives and equity derivatives. Generally, these instruments help Key manage exposure to market risk, mitigate the credit risk inherent in the loan portfolio and meet client financing and hedging needs. Market risk represents the possibility that economic value or net interest income will be adversely affected by changes in interest rates or other economic factors.

Derivative assets and liabilities are recorded at fair value on the balance sheet, after taking into account the effects of master netting agreements. These agreements allow Key to settle all derivative contracts held with a single counterparty on a net basis, and to offset net derivative positions with the related cash collateral. As a result, Key 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 September 30, 2008, Key had \$292 million of derivative assets and \$130 million of derivative liabilities that relate to contracts entered into for hedging purposes. As of the same date, Key had trading derivative assets of \$659 million and trading derivative liabilities of \$459 million.

Counterparty Credit Risk

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

<i>in millions</i>	September 30, 2008	December 31, 2007	September 30, 2007
Interest rate	\$ 794	\$ 850	\$ 395
Foreign exchange	260	492	400
Energy	139	52	18
Credit	36	13	3
Equity	3	34	16
Derivative assets before cash collateral	1,232	1,441	832
Less: Related cash collateral	281	562	293
Total derivative assets	\$ 951	\$ 879	\$ 539

Like other financial instruments, derivatives contain an element of credit risk—the possibility that Key will incur a loss because a counterparty, which may be a bank, a broker-dealer or a client, fails to meet its contractual obligations. This risk is measured as the expected positive replacement value of contracts on the date of the default. During the third quarter of 2008, Key recorded a \$54 million pre-tax loss as a result of the failure of Lehman Brothers and the inability of one of its subsidiaries to meet its contractual obligations.

Key uses several means to mitigate credit risk and manage exposure to credit risk on derivative contracts. Key generally enters into bilateral collateral and master netting agreements using standard forms published by the

International Swaps and Derivatives Association (ISDA). These agreements provide for the net settlement of all contracts with a single counterparty in the event of default. Additionally, Key monitors credit risk

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exposure to the counterparty on each contract to determine appropriate limits on Key's total credit exposure. Key reviews its collateral positions on a daily basis and exchanges collateral with its counterparties in accordance with ISDA and other related agreements. Key generally holds collateral in the form of cash and highly rated securities issued by the U.S. Treasury, government sponsored enterprises or the Government National Mortgage Association. The cash collateral netted against derivative assets on the balance sheet was \$281 million at September 30, 2008, \$562 million at December 31, 2007, and \$293 million at September 30, 2007. The cash collateral netted against derivative liabilities was \$348 million at September 30, 2008, \$254 million at December 31, 2007, and \$114 million at September 30, 2007.

At September 30, 2008, Key's derivative contracts included interest rate swaps and caps, foreign exchange contracts, energy derivatives, credit derivatives and equity derivatives. Key's aggregate gross exposure on these instruments totaled \$2.6 billion. However, after taking into account the effects of master netting agreements and cash collateral held, Key had net exposure of \$951 million as shown in the table on page 32. Key's net exposure at September 30, 2008, was further reduced to \$876 million by \$75 million of additional collateral held in the form of securities. The largest gross exposure to an individual counterparty was \$239 million, which was secured with \$164 million in collateral. Additionally, Key had a derivative liability of \$55 million with this counterparty that, when netted against the gross exposure under a master netting agreement, resulted in net exposure of \$20 million.

Asset and Liability Management

Key uses fair value and cash flow hedging strategies to manage its exposure to interest rate risk. These strategies reduce the potential adverse impact of interest rate movements on future net interest income. For more information about these asset and liability management strategies, see Note 19 (Derivatives and Hedging Activities), which begins on page 100 of Key's 2007 Annual Report to Shareholders.

The change in accumulated other comprehensive income (loss) resulting from cash flow hedges is as follows:

	Reclassification			
	December 31, 2007	2008 Hedging Activity	of Gains to Net Income	September 30, 2008
<i>in millions</i>				
Accumulated other comprehensive income (loss) resulting from cash flow hedges	\$ 103	\$ 69	\$ (93)	\$ 79

Key reclassifies gains and losses from accumulated other comprehensive income (loss) to earnings when a hedged item causes Key to pay variable-rate interest on debt, receive variable-rate interest on commercial loans, or sell or securitize commercial real estate loans. If interest rates, yield curves and notional amounts remain at September 30, 2008, levels, management would expect to reclassify an estimated \$64 million of net gains on derivative instruments from accumulated other comprehensive income (loss) to earnings during the next twelve months. The maximum length of time over which forecasted transactions are hedged is twenty years.

Credit Risk Management

Key uses credit derivatives ³/₄ primarily credit default swaps ³/₄ to mitigate credit risk by transferring a portion of the risk associated with the underlying extension of credit to a third party. These instruments are also used to manage portfolio concentration and correlation risks. At September 30, 2008, the notional amount of credit default swaps purchased by Key was \$1.3 billion. Key also provides credit protection to other lenders through the sale of credit default swaps. In most instances, this is accomplished through the use of an investment-grade diversified dealer-traded basket of credit default swaps. These transactions may generate fee income and can diversify and reduce overall portfolio credit risk volatility. At September 30, 2008, the notional amount of credit default swaps sold by Key was \$343 million.

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These derivatives are recorded on the balance sheet at fair value, which is based on the creditworthiness of the borrowers. Related gains or losses, as well as the premium paid or received for credit protection, are included in investment banking and capital markets income on the income statement. Key does not apply hedge accounting to credit derivatives.

Trading Portfolio

Key's trading portfolio is composed of the following instruments:

- “ interest rate swap, cap, floor and futures contracts entered into to accommodate the needs of clients;
- “ commodity swap and options contracts entered into to accommodate the needs of clients;
- “ positions with third parties that are intended to offset or mitigate the market risk related to client positions discussed above;
- “ foreign exchange forward contracts entered into to accommodate the needs of clients; and
- “ interest rate, foreign currency and credit default swaps for proprietary purposes.

The fair values of these trading portfolio items are included in derivative assets or derivative liabilities on the balance sheet. Key does not apply hedge accounting to any of these contracts. Adjustments to the fair values are included in investment banking and capital markets (loss) income on the income statement. In addition to the collateral exchange agreements previously discussed, Key has established a reserve in the amount of \$19 million at September 30, 2008, which management believes will be sufficient to cover estimated future losses on the trading portfolio in the event of client default. Additional information pertaining to Key's trading portfolio is summarized in Note 19 of Key's 2007 Annual Report to Shareholders.

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15. Fair Value Measurements

Effective January 1, 2008, Key adopted SFAS No. 157, Fair Value Measurements, for all applicable financial and nonfinancial assets and liabilities. This accounting guidance defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances. Additional information pertaining to Key's accounting policy for fair value measurements is summarized in Note 1 (Basis of Presentation) under the heading Fair Value Measurements on page 8.

Fair Value Determination

As defined in SFAS No. 157, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in Key's principal market. Key has established and documented its process for determining the fair values of its 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, management determines the fair value of Key's assets and liabilities using valuation models or third-party pricing services, both of which 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 management's judgment, assumptions and estimates related to credit quality, liquidity, interest rates and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and Key's 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. Most classes of derivative contracts are valued using internally-developed models based on market-standard derivative pricing conventions, which rely primarily on observable market inputs, such as interest rate yield curves and volatilities. Market convention implies a credit rating of double-A equivalent in the pricing of derivative contracts, which assumes all counterparties have the same creditworthiness. In determining the fair value of derivatives, management applies cash collateral and/or a default reserve to reflect the credit quality of the counterparty.

Liquidity valuation adjustments are made when management is unable to observe recent market transactions for identical or similar instruments. Management adjusts the fair value to reflect the uncertainty in the pricing and trading of the instrument. 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.

Key has various controls in place to ensure that fair value measurements are accurate and appropriate. These controls include:

- “ an independent review and approval of valuation models;
 - “ a detailed review of profit and loss conducted on a regular basis; and
 - “ validation of valuation model components against benchmark data and similar products, where possible.
- Any changes to valuation methodologies are reviewed by management to ensure they are relevant and justified. Valuation methodologies are refined as more market-based data becomes available.

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Fair Value Hierarchy

SFAS No. 157 establishes a three-level valuation hierarchy for determining fair value that is based on the transparency of the inputs used in the valuation process. The inputs used in determining fair value in each of the three levels of the hierarchy are as follows:

- “ **Level 1.** Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- “ **Level 2.** Either: (i) quoted market prices for similar assets or liabilities; (ii) observable inputs, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data.
- “ **Level 3.** Unobservable inputs.

The hierarchy gives the highest ranking to Level 1 inputs and the lowest ranking to Level 3 inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the overall fair value measurement.

Qualitative Disclosures of Valuation Techniques

Loans. Loans recorded as trading account assets are valued based on market spreads for identical or similar assets. Generally, these loans are classified as Level 2 since the fair value recorded is based on observable market data. Key corroborates these inputs periodically through a pricing service, which obtains data about actual transactions in the marketplace for identical or similar assets.

Securities (trading and available for sale). Where quoted prices are available in an active market, securities are classified as Level 1. Level 1 instruments include highly liquid government bonds, securities issued by the U.S. Treasury and exchange-traded equity securities. If quoted prices are not available, management determines fair value using pricing models, quoted prices of similar securities or discounted cash flows. These instruments include assets such as municipal bonds and certain agency collateralized mortgage obligations and are classified as Level 2. In certain cases where there is limited activity in the market for a particular instrument, assumptions must be made to determine their fair value. Such instruments include certain mortgage-backed securities, certain commercial paper and restricted stock, and are classified as Level 3.

Private equity and mezzanine investments. Valuations of private equity and mezzanine investments, held primarily within Key’s Real Estate Capital and Corporate Banking Services line of business, are based primarily on management’s judgment due to the lack of readily determinable fair values, inherent illiquidity and the long-term nature of these assets. These investments are initially valued based upon the transaction price. The carrying amount is then adjusted upward or downward based upon the estimated future cash flows associated with the investments. Factors used in determining future cash flows include, but are not limited to, the cost of build-out, future selling prices, current market outlook and operating performance of the particular investment. Private equity and mezzanine investments are classified as Level 3.

Principal investments. Valuations of principal investments, made by KPP, are based on the underlying investments of the fund. In the case of equity securities where readily available market quotes exist, those market quotes are utilized, and the related investments are classified as Level 1. Most of KPP’s investments are in private companies without readily available market data. For these investments, the inputs are classified as Level 3 and are used in valuation methodologies such as discounted cash flows, price/earnings ratios, and multiples of earnings before interest, tax, depreciation and amortization.

Derivatives. Exchange-traded derivatives are valued using quoted prices and, therefore, are classified as Level 1. Only a few types of derivatives are exchange-traded; thus, the majority of Key’s derivative positions are valued using internally-developed models that use observable market inputs. These derivative contracts are classified as Level 2 and include interest rate swaps, options and credit default

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swaps. Market convention implies a credit rating of double-A equivalent in the pricing of derivative contracts, which assumes all counterparties have the same creditworthiness. In order to reflect the actual exposure on Key's derivative contracts related to both counterparty and Key's own creditworthiness, management records a fair value adjustment in the form of a reserve. The credit component is valued on a counterparty-by-counterparty basis and considers master netting agreements and collateral.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly or quarterly). The following table shows Key's assets and liabilities measured at fair value on a recurring basis.

September 30, 2008

<i>in millions</i>	Level 1	Level 2	Level 3	Netting Adjustments ^a	Total
ASSETS MEASURED ON A RECURRING BASIS					
Trading account assets	\$ 16	\$ 653	\$ 780		\$ 1,449
Securities available for sale	77	8,118			8,195
Other investments	26	8	1,172		1,206
Derivative assets	434	2,112	9	\$ (1,604)	951
Accrued income and other assets	3	5			8
Total assets on a recurring basis at fair value	\$ 556	\$ 10,896	\$ 1,961	\$ (1,604)	\$ 11,809
LIABILITIES MEASURED ON A RECURRING BASIS					
Bank notes and other short-term borrowings	\$ 30	\$ 158			\$ 188
Derivative liabilities	418	1,842	\$ 1	\$ (1,672)	589
Total liabilities on a recurring basis at fair value	\$ 448	\$ 2,000	\$ 1	\$ (1,672)	\$ 777

(a) Netting adjustments represent the amounts recorded to convert Key's derivative assets and liabilities from a gross basis to a net basis in conjunction

with Key s
 January 1, 2008,
 adoption of
 FASB
 Interpretation
 No. 39,
 Offsetting of
 Amounts
 Related to
 Certain
 Contracts, and
 FASB Staff
 Position FIN
 39-1,
 Amendment of
 FASB
 Interpretation
 39. The net
 basis takes into
 account the
 impact of
 master netting
 agreements
 which allow
 Key to settle all
 derivative
 contracts with a
 single
 counterparty on
 a net basis and
 to offset the net
 derivative
 position with
 the related cash
 collateral.

Changes in Level 3 Fair Value Measurements

The following table shows the change in the fair values of Key s Level 3 financial instruments for the nine months ended September 30, 2008. Classification in Level 3 is based on the significance of unobservable inputs relative to the overall fair value measurement of the instrument. In addition to unobservable inputs, Level 3 instruments also may have inputs that are observable within the market. Management mitigates the credit risk, interest rate risk and risk of loss related to many of these Level 3 instruments through the use of securities and derivative positions classified as Level 1 or Level 2. Level 1 or Level 2 instruments are not included in the following table; therefore, the gains or losses shown do not include the impact of Key s risk management activities related to these Level 3 instruments.

	Nine months ended September 30, 2008			
	Trading Account Assets	Securities Available for Sale	Other Investments	Derivative Instruments ^a
<i>in millions</i>				
Balance at beginning of period	\$ 338	\$ 4	\$ 1,161	\$ 6
(Losses) gains:				

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Included in earnings	(48) ^b	3 ^c	(8) ^d	3 ^b
Included in other comprehensive income		(2)		
Purchases, sales, issuances and settlements	490	(5)	32	(1)
Net transfers out of Level 3			(13)	
Balance at end of period	\$ 780		\$ 1,172	\$ 8

Unrealized (losses) gains included in earnings	\$ (38) ^b		\$ (22) ^d	\$ 3 ^b
--	----------------------	--	----------------------	-------------------

(a) Amount represents 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 on the income statement.

(c) Unrealized gains and losses on securities available for sale are reported in net securities (losses) gains on the income statement.

(d) Other investments consist of principal investments, and private equity and mezzanine

investments.
Realized and
unrealized gains
and losses on
principal
investments are
reported in net
(losses) gains
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
(loss) income on
the income
statement.

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Assets and liabilities are considered to be fair valued on a nonrecurring basis if the fair value measurement of the instrument does not necessarily result in a change in the amount recorded on the balance sheet. Generally, nonrecurring valuation is the result of the application of other accounting pronouncements which require assets or liabilities to be assessed for impairment or recorded at the lower of cost or fair value. The following table presents Key's assets measured at fair value on a nonrecurring basis.

September 30, 2008*in millions*

	Level 1	Level 2	Level 3	Total
--	----------------	----------------	----------------	--------------

ASSETS MEASURED ON A NONRECURRING BASIS

Securities available for sale			\$ 4	\$ 4
Other investments			1	1
Loans			54	54
Loans held for sale			459	459
Goodwill			47	47
Accrued income and other assets		\$ 5	52	57
Total assets on a nonrecurring basis at fair value		\$ 5	\$ 617	\$ 622

Through Key's quarterly analysis of its commercial and construction loan portfolios held for sale, management determined that certain adjustments were necessary to record the portfolios at the lower of cost or fair value in accordance with GAAP. After adjustments, these loans totaled \$459 million at September 30, 2008. Valuation of these loans is performed using an internal model which relies on market data from sales of similar assets, including credit spreads, interest rate curves and risk profiles, as well as Key's own assumptions about the exit market for the loans. The valuation methodology employed is based on Level 3 inputs. Key's loans held for sale, which are measured at fair value on a nonrecurring basis, include the remaining \$133 million of commercial real estate loans transferred from the loan portfolio to held-for-sale status in June 2008. The fair value of these loans was measured using nonbinding broker quotes obtained through a third party. Additionally, during the third quarter of 2008, Key transferred \$54 million of commercial loans from held for sale to the loan portfolio at their current fair value.

Other real estate owned and other repossessed properties are valued based on appraisals and third-party price opinions, less estimated selling costs. Assets that are acquired through, or in lieu of, loan foreclosures are recorded as held for sale initially at the lower of the loan balance or fair value upon the date of foreclosure. Subsequent to foreclosure, valuations are updated periodically, and the assets may be marked down further, reflecting a new cost basis. These assets, which totaled \$50 million at September 30, 2008, are considered to be nonrecurring items in the fair value hierarchy.

Current market conditions, including lower prepayments, interest rates and expected recovery rates have impacted Key's modeling assumptions pertaining to education lending-related servicing rights and residual interests, and consequently resulted in write-downs of these instruments. These instruments are included in accrued income and other assets and securities available for sale, respectively, in the preceding table.

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Report of Independent Registered Public Accounting Firm

Shareholders and Board of Directors

KeyCorp

We have reviewed the condensed consolidated balance sheets of KeyCorp and subsidiaries (Key) as of September 30, 2008 and 2007, and the related condensed consolidated statements of income, for the three- and nine-month periods then ended, and the condensed consolidated statement of changes in shareholders equity and cash flows for the nine-month periods ended September 30, 2008 and 2007. 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 condensed 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 sheet of Key as of December 31, 2007, and the related consolidated statements of income, changes in shareholders equity, and cash flows for the year then ended not presented herein, and in our report dated February 22, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio

November 4, 2008

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Item 2. Management's Discussion and Analysis of Financial Condition and 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 September 30, 2008 and 2007. 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 that appear on pages 3 through 38. A description of Key's business is included under the heading "Description of Business" on page 14 of Key's 2007 Annual Report to Shareholders. This description does not reflect the reorganization within some of Key's lines of business that took effect on January 1, 2008. For a current description of Key's lines of business, see Note 4 ("Line of Business Results"), which begins on page 14.

Terminology

This report contains some shortened names and industry-specific terms. We want to explain some of these terms at the outset so you can better understand the discussion that follows.

- .. **KeyCorp** refers solely to the parent holding company.
- .. **KeyBank** refers to KeyCorp's subsidiary bank, KeyBank National Association.
- .. **Key** refers to the consolidated entity consisting of KeyCorp and its subsidiaries.
- .. In November 2006, Key sold the subprime mortgage loan portfolio held by the Champion Mortgage finance business and announced a separate agreement to sell Champion's origination platform. As a result of these actions, Key has accounted for this business as a **discontinued operation**. We use the phrase **continuing operations** in this document to mean all of Key's business other than Champion. Key completed the sale of Champion's origination platform in February 2007.
- .. Key engages in **capital markets activities** primarily through business conducted by the National Banking group. These activities encompass a variety of products and services. Among other things, Key trades securities as a dealer, enters into derivative contracts (both to accommodate clients' financing needs and for proprietary trading purposes), and conducts 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 prescribe that at least one-half of a bank or bank holding company's **total risk-based capital** must qualify as **Tier 1**. 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. You will find a more detailed explanation of total and Tier 1 capital and how they are calculated in the section entitled "Capital," which begins on page 74.

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Forward-looking statements

This report and other reports filed by Key under the Securities Exchange Act of 1934 or registration statements filed by Key under the Securities Act of 1933 contain statements that are considered forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements about Key's long-term goals, financial condition, results of operations, earnings, levels of net loan charge-offs and nonperforming assets, interest rate exposure and profitability. These statements usually can be identified by the use of forward-looking language such as our goal, our objective, our plan, will likely result, expects, plans, anticipates, intends, project, estimates or other similar words, expressions or conditional verbs such as will, would, could and should. Forward-looking statements express management's current expectations, forecasts of future events or long-term goals and, by their nature, are subject to assumptions, risks and uncertainties. Although management believes that the expectations, forecasts and goals reflected in these forward-looking statements are reasonable, actual results could differ materially for a variety of reasons, including the following factors:

- .. Interest rates could change more quickly or more significantly than management expects, which may have an adverse effect on Key's financial results.
- .. Trade, monetary and fiscal policies of various governmental bodies may affect the economic environment in which Key operates, as well as its financial condition and results of operations.
- .. Unprecedented volatility in the stock markets, public debt markets and other capital markets, including continued disruption in the fixed income markets, could adversely affect Key's ability to raise capital or other funding for liquidity and business purposes, as well as its revenues from client-based underwriting, investment banking and other capital markets-driven businesses.
- .. There can be no assurance as to the actual impact that the Emergency Economic Stabilization Act of 2008 (EESA) or other initiatives undertaken by the U.S. government through the federal regulatory agencies will have on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of the EESA to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect Key's business, financial condition, results of operations, access to credit or the trading price of Key's common stock.
- .. Key's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions.
- .. Recent problems in the housing markets, including issues related to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and related conditions in the financial markets, or other issues, such as the price of oil or other commodities, could cause further deterioration in general economic conditions, or in the condition of the local economies or industries in which Key has significant operations or assets, and, among other things, materially impact credit quality in existing portfolios and/or Key's ability to generate loans in the future.
- .. Increasing interest rates or further weakening economic conditions could constrain borrowers' ability to repay outstanding loans or diminish the value of the collateral securing those loans. Additionally, the allowance for loan losses may be insufficient if the estimates and judgments management used to establish that allowance prove to be inaccurate.
- .. Increased competitive pressure among financial services companies due to the recent consolidation of certain competing financial institutions and the conversion of certain investment banks to bank holding companies may adversely affect Key's ability to market its products and services.

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- “ Key may become subject to new or heightened legal standards and regulatory requirements, practices or expectations which may impede its profitability or affect its financial condition, including new regulations imposed in connection with the Troubled Asset Relief Program (TARP) provisions of the EESA being implemented and administered by the U.S. Treasury Department (U.S. Treasury) in coordination with other federal regulatory agencies, further laws enacted by the U.S. Congress in an effort to strengthen the fundamentals of the U.S. economy, or other regulations promulgated by federal regulators to mitigate the systemic risk presented by the current financial crisis.
- “ It could take Key longer than anticipated to implement strategic initiatives, including those designed to grow revenue or manage expenses; Key may be unable to implement certain initiatives; or the initiatives may be unsuccessful.
- “ Increases in deposit insurance premiums imposed by the Federal Deposit Insurance Corporation (FDIC) on KeyBank due to the FDIC ’ s restoration plan for the Deposit Insurance Fund announced on October 7, 2008, and continued difficulties experienced by other financial institutions may have an adverse effect on Key ’ s results of operations.
- “ Acquisitions and dispositions of assets, business units or affiliates could adversely affect Key in ways that management has not anticipated.
- “ Key may experience operational or risk management failures due to technological or other factors.
- “ Changes in accounting principles or in tax laws, rules and regulations could have an adverse effect on Key ’ s financial results or its capital.
- “ Key may become subject to new legal obligations or liabilities, or the unfavorable resolution of pending litigation may have an adverse effect on its financial results or its capital.
- “ Terrorist activities or military actions could disrupt the economy and the general business climate, which may have an adverse effect on Key ’ s financial results or condition and that of its borrowers.

Forward-looking statements are not historical facts but instead represent only management ’ s current expectations and forecasts regarding future events, many of which, by their nature, are inherently uncertain and outside of Key ’ s control. The factors discussed above and in the section entitled Item 1A. Risk Factors, which begins on page 95, are not intended to be a complete summary of all risks and uncertainties that may affect Key ’ s business, the financial services industry and financial markets. Though management strives to monitor and mitigate risk, management cannot anticipate all potential economic, operational and financial developments that may have an adverse impact on Key ’ s operations and financial results. Forward-looking statements speak only as to the date the statement is made, and Key does not undertake any obligation to revise any forward-looking statement to reflect subsequent events. Before making an investment decision, you should carefully consider all risks and uncertainties disclosed in Key ’ s SEC filings, including this and Key ’ s other reports on Forms 8-K, 10-K and 10-Q and our registration statements under the Securities Act of 1933, all of which are accessible on the SEC ’ s website at www.sec.gov.

Long-term goals

Key ’ s long-term financial goals are to grow its earnings per common share and achieve a return on average equity, each at or above the respective median of its peer group. The strategy for achieving these goals is described under the heading Corporate Strategy on page 16 of Key ’ s 2007 Annual Report to Shareholders.

Economic overview

During the third quarter of 2008, financial markets were severely strained as the fallout from the housing market and the recognition of losses by financial institutions continued. Home sales remained weak even in the face of improved housing affordability and falling home values. The median price of existing homes fell by more than 9.0% from the respective price levels reported for the same month last year. Lower prices

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were partly a consequence of the elevated levels of foreclosures, which rose by 21% from the number of foreclosures experienced in September 2007. September new home sales were down 33% from one year ago and existing home sales were relatively flat for the same period. In response, homebuilder activity declined as housing starts hit a 17-year low, falling more than 30% from September 2007.

Further write-downs caused by distressed real estate values and increasing loan losses continued to pressure capital levels at financial institutions, forcing many to raise additional capital, often at substantially higher costs than in recent years. Some financial institutions were forced into liquidation or mergers as losses mounted, and the availability of funding and capital remained restricted. As concern over the strength of their peers' balance sheets increased, banks curbed lending to each other, and short-term unsecured lending rates rose. Short-term interbank lending rates increased by 127 basis points during the quarter, while the yield on short-term Treasury bills declined by 83 basis points. For regional banking institutions such as Key, there were no cost-effective means of accessing capital markets for unsecured term debt.

Early in the third quarter, inflationary pressures intensified before showing signs of subsiding. Most of the reduction came from lower oil prices, which declined to \$101 per barrel at September 30, 2008, after reaching an all time high of \$145 per barrel in early July 2008. Consumer prices in September 2008 rose 4.9% from September 2007, down slightly from a 5.0% annual increase in June 2008. Employment continued to weaken in the third quarter as the economy lost 299,000 jobs, which brought the number of jobs lost since December 2007 to 760,000. The average unemployment rate for the quarter rose to 6.0%, compared to the second quarter average of 5.3% and the 2007 average of 4.6%. The positive impact from the second quarter 2008 tax rebate checks dissipated in the third quarter. Consumer spending during the third quarter declined at an average monthly rate of .1%, compared to an average monthly rate increase of .5% in the second quarter of 2008.

While the downside risks to the economy increased during the third quarter of 2008, the Federal Reserve held the federal funds target rate at 2.00%, mainly due to elevated inflationary pressures. Meanwhile, as investors looked for safe-haven as the financial crisis continued, the benchmark two-year Treasury yield decreased to 1.96% at September 30, 2008, from 2.62% at June 30, 2008, and the ten-year Treasury yield, which began the third quarter at 3.97%, closed the quarter at 3.83%. In an effort to alleviate strains in the financial markets and increase liquidity available to U.S. financial institutions, the Federal Reserve expanded many of its liquidity programs, and together with the U.S. Treasury and the FDIC, took a variety of unprecedented actions. In September, the Federal Housing Finance Agency, with the support of the U.S. Treasury, placed Fannie Mae and Freddie Mac, two government-sponsored enterprises that play a critical role in the U.S. home mortgage market, in conservatorship, taking full management control. The Federal Reserve seized control of insurance giant American International Group Inc. in September, and provided traditional investment banks the authority to become bank holding companies and to access the discount window of the Federal Reserve. On October 3, 2008, President Bush signed into law the EESA, which is intended to restore liquidity and stability to the U.S. financial system through the purchase of up to \$700 billion of certain mortgages, mortgage-backed securities and other financial instruments (including preferred equity). On October 8, 2008, as falling oil prices tempered inflationary concerns and liquidity concerns remained, the Federal Reserve, as part of a coordinated effort with six other central banks to stabilize world markets, lowered the federal funds target rate to 1.50%. On October 14, 2008, the FDIC announced its Temporary Liquidity Guarantee Program, including its debt guarantee program for qualifying newly issued senior unsecured debt of insured depository institutions, their holding companies and certain other affiliates of insured depository institutions designated by the FDIC (the Debt Guarantee), and a transaction account guarantee for funds held at FDIC-insured depository institutions in noninterest-bearing transaction accounts in excess of the current standard maximum deposit insurance amount of \$250,000 (the Transaction Account Guarantee). Finally, on October 29, 2008, the Federal Reserve further lowered the federal funds target rate to 1.00%.

Demographics. The extent to which Key's business has been affected by continued volatility and weakness in the housing market is directly related to the state of the economy in the regions in which its two major business groups, Community Banking and National Banking, operate.

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Key's Community Banking group serves consumers and small to mid-sized businesses by offering a variety of deposit, investment, lending and wealth management products and services. These products and services are provided through a 14-state branch network organized into four geographic regions as defined by management: Northwest, Rocky Mountains, Great Lakes and Northeast. Figure 1 shows the geographic diversity of the Community Banking group's average core deposits, commercial loans and home equity loans. As of September 30, 2008, approximately two-thirds of the loans and deposits held by Community Banking were outside of the Great Lakes region, which has been particularly hard hit by the weakening economy. The Community Banking group continues to benefit from its geographic diversity. Compared to the third quarter of 2007, this business experienced growth in both revenue and deposits, with revenue increases coming from each of the group's 23 districts.

Figure 1. Community Banking Geographic Diversity

Three months ended September 30, 2008	Geographic Region					Total
	Rocky		Great Lakes	Northeast Nonregion a		
dollars in millions	Northwest Mountains					
Average core deposits	\$ 9,824	\$ 3,506	\$ 14,219	\$ 13,243	\$ 1,524	\$ 42,316
Percent of total	23.2%	8.3%	33.6%	31.3%	3.6%	100.0%
Average commercial loans	\$ 4,420	\$ 2,032	\$ 4,920	\$ 3,281	\$ 1,358	\$ 16,011
Percent of total	27.6%	12.7%	30.7%	20.5%	8.5%	100.0%
Average home equity loans	\$ 2,855	\$ 1,379	\$ 2,905	\$ 2,621	\$ 127	\$ 9,887
Percent of total	28.9%	13.9%	29.4%	26.5%	1.3%	100.0%

(a) Represents core deposit, commercial loan and home equity loan products centrally managed outside of the four Community Banking regions.

Key's National Banking group includes those corporate and consumer business units that operate nationally, within and beyond the 14-state branch network, as well as internationally. The specific products and services offered by the National Banking group are described in Note 4 (Line of Business Results), which begins on page 14.

The diversity of Key's commercial real estate lending business based on industry type and location is shown in Figure 18 on page 67. The homebuilder loan portfolio within the National Banking group has been adversely affected by the downturn in the U.S. housing market. As a result of deteriorating market conditions in the residential properties segment of Key's commercial real estate construction portfolio, principally in Florida and southern California, Key has experienced a significant increase in the level of its nonperforming assets since mid-2007 and has taken aggressive steps to reduce its exposure in this segment of its loan portfolio. As previously reported, during the fourth quarter of 2007, Key announced its decision to cease conducting business with nonrelationship homebuilders outside of its 14-state Community Banking footprint and, during the second quarter of 2008, initiated a process to further reduce its exposure through the planned sale of certain loans. As a result of these actions, Key has reduced the outstanding balances in the residential properties segment of its commercial real estate loan portfolio by \$1.3 billion, or 34%, over

the past twelve months, with the majority of the reduction coming from the weakest part of the portfolio. Additional information about the planned loan sales is included in the Credit risk management section, which begins on page 86. In recent quarters, results for the National Banking group have also been affected adversely by volatility in the capital markets, leading to declines in the market values at which certain assets (primarily commercial real estate loans and securities held for sale or trading) are recorded. Results for the third quarter of 2008 include \$33 million of after-tax derivative-related charges recorded as a result of market disruption caused by the failure of Lehman Brothers, and \$19 million of realized and unrealized after-tax losses from the residential properties segment of the construction loan portfolio.

During the third quarter of 2008, the banking industry, including Key, continued to experience commercial and industrial loan growth, due in part to increased reliance by borrowers on commercial lines of credit in response to the challenging economic environment.

Table of Contents**Critical accounting policies and estimates**

Key's business is dynamic and complex. Consequently, management must exercise judgment in choosing and applying accounting policies and methodologies in many areas. These choices are critical; not only are they necessary to comply with U.S. generally accepted accounting principles (GAAP), they also reflect management's view of the appropriate way to record and report Key's overall financial performance. All accounting policies are important, and all policies described in Note 1 (Summary of Significant Accounting Policies), which begins on page 65 of Key's 2007 Annual Report to Shareholders, should be reviewed for a greater understanding of how Key's financial performance is recorded and reported.

In management's opinion, some accounting policies are more likely than others to have a significant effect on Key's financial results and to expose those results to potentially greater volatility. These policies apply to areas of relatively greater business importance, or require management to exercise judgment and to make assumptions and estimates that affect amounts reported in the financial statements. Because these assumptions and estimates are based on current circumstances, they may change over time or prove to be inaccurate.

Management relies heavily on the use of judgment, assumptions and estimates to make a number of core decisions, including accounting for the allowance for loan losses; loan securitizations; contingent liabilities, guarantees and income taxes; derivatives and related hedging activities; and assets and liabilities that involve valuation methodologies. A brief discussion of each of these areas appears on pages 17 through 19 of Key's 2007 Annual Report to Shareholders. Information about Key's goodwill impairment testing conducted as of June 30, 2008, and the review performed as of September 30, 2008, is included in Note 1 (Basis of Presentation) under the heading Goodwill and Other Intangible Assets on page 7.

Effective January 1, 2008, Key adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. In the absence of quoted market prices, management determines the fair value of Key's assets and liabilities using internally-developed models which are based on management's judgment, assumptions and estimates regarding credit quality, liquidity, interest rates and other relevant inputs. Key's adoption of this accounting guidance and the process used in determining fair values are more fully described in Note 1 (Basis of Presentation) under the heading Fair Value Measurements on page 8 and Note 15 (Fair Value Measurements), which begins on page 35.

At September 30, 2008, \$11.8 billion, or 12%, of Key's total assets were measured at fair value on a recurring basis. Approximately 97% of these assets were classified as Level 1 or Level 2 within the fair value hierarchy. At September 30, 2008, \$777 million, or 1%, of Key's total liabilities were measured at fair value on a recurring basis. Substantially all of these liabilities were classified as Level 1 or Level 2.

At September 30, 2008, \$622 million, or 1%, of Key's total assets were measured at fair value on a nonrecurring basis. Approximately 1% of these assets were classified as Level 1 or Level 2. At September 30, 2008, there were no liabilities measured at fair value on a nonrecurring basis.

Highlights of Key's Performance**Financial performance**

For the third quarter of 2008, Key recorded a loss from continuing operations of \$36 million, or \$.10 per common share. This compares to income from continuing operations of \$224 million, or \$.57 per diluted common share, for the third quarter of 2007, and a loss from continuing operations of \$1.126 billion, or \$2.70 per common share, for the second quarter of 2008.

Key's results for 2008 include additional charges associated with certain leveraged lease financing transactions being challenged by the Internal Revenue Service (IRS). Third and second quarter results include after-tax charges of \$30 million, or \$.06 per common share, and \$1.011 billion, or \$2.43 per common share, respectively, resulting from a previously announced adverse federal court decision on the tax treatment of a Service Contract Lease transaction.

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During the first quarter of 2008, Key increased its tax reserves for certain lease in, lease out (LILO) transactions and recalculated its lease income in accordance with prescribed accounting standards, resulting in after-tax charges of \$38 million, or \$.10 per common share.

For the first nine months of 2008, Key reported a loss from continuing operations of \$944 million, or \$2.19 per common share. Adjusting for the lease financing charges, Key had income from continuing operations of \$135 million, or \$.30 per diluted common share, compared to \$919 million, or \$2.31 per diluted common share, for the same period last year.

Key reported a net loss of \$36 million, or \$.10 per common share, for the third quarter of 2008, compared to net income of \$210 million, or \$.54 per diluted common share, for the third quarter of 2007, and a net loss of \$1.126 billion, or \$2.70 per common share, for the second quarter of 2008. For the first nine months of 2008, Key reported a net loss of \$944 million, or \$2.19 per common share, compared to net income of \$894 million, or \$2.25 per diluted common share, for the same period last year.

Figure 2 shows Key's continuing and discontinued operating results and related performance ratios for comparative quarters and the nine-month periods ended September 30, 2008 and 2007.

Figure 2. Results of Operations

<i>dollars in millions, except per share amounts</i>	Three months ended			Nine months ended	
	9-30-08	6-30-08	9-30-07	9-30-08	9-30-07
SUMMARY OF OPERATIONS					
(Loss) income from continuing operations	\$ (36)	\$ (1,126)	\$ 224	\$ (944)	\$ 919
Loss from discontinued operations, net of taxes ^a			(14)		(25)
Net (loss) income	\$ (36)	\$ (1,126)	\$ 210	\$ (944)	\$ 894
Net (loss) income applicable to common shares	\$ (48)	\$ (1,126)	\$ 210	\$ (956)	\$ 894
PER COMMON SHARE ASSUMING DILUTION					
(Loss) income from continuing operations	\$ (.10)	\$ (2.70)	\$.57	\$ (2.19)	\$ 2.31
Loss from discontinued operations ^a			(.03)		(.06)
Net (loss) income	\$ (.10)	\$ (2.70)	\$.54	\$ (2.19)	\$ 2.25
PERFORMANCE RATIOS					
From continuing operations:					
Return on average total assets	(.14)%	(4.38)%	.93%	(1.22)%	1.31%
Return on average common equity	(2.36)	(53.35)	11.50	(15.32)	16.03
Return on average total equity	(1.64)	(52.56)	11.50	(14.66)	16.03
From consolidated operations:					
Return on average total assets	(.14)%	(4.38)%	.88%	(1.22)%	1.28%
Return on average common equity	(2.36)	(53.35)	10.79	(15.32)	15.59
Return on average total equity	(1.64)	(52.56)	10.79	(14.66)	15.59

(a)

Key sold the subprime mortgage loan portfolio held by the Champion Mortgage finance business in November 2006, and completed the sale of Champion's origination platform in February 2007. As a result of these actions, Key has accounted for this business as a discontinued operation.

The continuation of a difficult economic environment and the resulting increase in Key's allowance for loan losses contributed to the loss recorded for the third quarter of 2008. The current quarter provision for loan losses exceeded net loan charge-offs by \$134 million and increased Key's allowance for loan losses to \$1.554 billion, or 2.03% of period-end loans. Additionally, third quarter results were adversely impacted by \$33 million of after-tax losses on derivative contracts that resulted from market disruption caused by the failure of Lehman Brothers, and \$19 million of realized and unrealized after-tax losses from the residential properties segment of the construction loan portfolio. As previously reported, Key has taken action to reduce its exposure to the residential properties segment of its commercial real estate construction loan portfolio through the planned sale of certain loans. As a result of these efforts and the December 2007 decision to cease conducting business with nonrelationship homebuilders outside of its 14-state Community Banking footprint, Key's total residential property exposure in commercial real estate, including loans held for sale, has been reduced by \$1.3 billion, or 34%, over the past twelve months, with the majority of the reduction coming from the weakest part of the portfolio. Additional information pertaining to the status of these loan sales is presented in the section entitled "Credit risk management," which begins on page 86.

Shown in Figure 3 below are significant items that affect the comparability of Key's financial performance for the periods presented.

Figure 3. Significant Items Affecting the Comparability of Earnings

	Three months ended				Nine months ended					
	September 30, 2008		June 30, 2008		September 30, 2007		September 30, 2008		September 30, 2007	
<i>in millions</i>	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount
Charges related to leveraged lease tax litigation		\$ (30)	\$ (359)	\$ (1,011)			\$ (362)	\$ (1,079)		
Provision for loan losses in excess of net charge-offs	\$ (134)	(83)	(123)	(77)	\$ (10)	\$ (6)	(323)	(202)	\$ (10)	\$ (6)
Realized and unrealized (losses) gains on loan and	(94) ^a	(59) ^a	62	39	(77)	(49)	(160) ^a	(100) ^a	(4)	(3)

securities portfolios held for sale or trading										
Severance and other exit costs	(19)	(14)	(8)	(5)	(4)	(3)	(33)	(22)	(10)	(6)
Net (losses) gains from principal investing	(24)	(15)	(14)	(8)	9	6	(29)	(18)	128	80
Honsador litigation reserve	23	14					23	14	(42)	(26)
Gain from redemption of Visa Inc. shares							165	103		
McDonald Investments branch network										
b					(5)	(3)			146	92
Gain related to MasterCard Incorporated shares					27	17			67	42
Gain from settlement of automobile residual value insurance litigation									26	17

(a) Includes
\$54 million
(\$33 million after
tax) of
derivative-related
charges recorded
as a result of
market disruption
caused by the
failure of Lehman
Brothers and
\$31 million (\$19
million after tax)
of realized and
unrealized losses
from the
residential
properties
segment of the
construction loan

portfolio.

- (b) Represents the financial effect of the McDonald Investments branch network, including a gain of \$171 million (\$107 million after tax) from the February 9, 2007, sale of that network.

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Events leading to the recognition of the items presented in Figure 3, as well as other factors that contributed to the changes in Key's revenue and expense components from those reported for the third quarter of 2007, are reviewed in detail throughout the remainder of the Management's Discussion and Analysis section.

Key's financial performance for each of the past five quarters and for the nine-month periods ended September 30, 2008 and 2007, is summarized in Figure 4.

Figure 4. Selected Financial Data

<i>in millions, except per share amounts</i>	Third	2008 Second	First	2007 Fourth	Third	Nine months ended September 30, 2008	
THE PERIOD							
Income	\$ 1,232	\$ 880	\$ 1,354	\$ 1,447	\$ 1,434	\$ 3,466	\$ 4,000
Expense	533	522	641	737	740	1,696	2,000
Interest income	699 ^a	358 ^a	713 ^a	710	694	1,770 ^a	2,000
Provision for loan losses	407	647	187	363	69	1,241	1,000
Interest income	388	555	528	488	438	1,471	1,000
Interest expense	762	781	732	896	753	2,275	2,000
Income from continuing operations							
Income taxes	(82)	(515)	322	(61)	310	(275)	1,000
Income from continuing operations	(36)	(1,126)	218	22	224	(944)	1,000
Income (loss) from discontinued operations, net of income taxes				3	(14)		
Income	(36) ^a	(1,126) ^a	218 ^a	25	210	(944) ^a	1,000
Income applicable to common shareholders	(48)	(1,126)	218	25	210	(956)	1,000
COMMON SHARE							
Income from continuing operations	\$ (.10)	\$ (2.70)	\$.55	\$.06	\$.58	\$ (2.19)	\$ 2.00
Income (loss) from discontinued operations				.01	(.03)		
Income	(.10)	(2.70)	.55	.06	.54	(2.19)	2.00
Income from continuing operations assuming dilution	(.10)	(2.70)	.54	.06	.57	(2.19)	2.00
Income (loss) from discontinued operations assuming dilution				.01	(.03)		
Income assuming dilution	(.10) ^a	(2.70) ^a	.54 ^a	.06	.54	(2.19) ^a	2.00
Dividends paid	.1875	.375	.375	.365	.365	.9375	1.000
Value at period end	16.16	16.59	21.48	19.92	20.12	16.16	20.00
Book value at period end	12.66	13.00	17.07	16.39	16.76	12.66	15.00
Price:							
	15.25	26.12	27.23	34.05	37.09	27.23	30.00
	7.93	10.00	19.00	21.04	31.38	7.93	30.00
	11.94	10.98	21.95	23.45	32.33	11.94	30.00
Weighted-average common shares outstanding (000)	491,179	416,629	399,121	388,940	389,319	435,846	399,000
Weighted-average common shares outstanding assuming dilution	491,179	416,629	399,769	389,911	393,164	435,846	399,000
Potential common shares							

ding (000)

PERIOD END

	\$ 76,705	\$ 75,855	\$ 76,444	\$ 70,823	\$ 68,999	\$ 76,705	\$ 68,999
g assets	90,257	89,893	89,719	86,557	84,838	90,257	84,838
assets	101,290	101,544	101,492	98,228	96,137	101,290	97,973
ts	64,678	64,396	64,702	63,099	63,714	64,678	63,099
term debt	15,597	15,106	14,337	11,957	11,549	15,597	11,549
on shareholders' equity	7,993	8,056	8,592	7,746	7,820	7,993	7,820
shareholders' equity	8,651	8,706	8,592	7,746	7,820	8,651	7,820

PERFORMANCE RATIOS**Continuing operations:**

on average total assets	(.14)%	(4.38)%	.85%	.09%	.93%	(1.22)%	
on average common equity	(2.36)	(53.35)	10.38	1.11	11.50	(15.32)	
on average total equity	(1.64)	(52.56)	10.38	1.11	11.50	(14.66)	
erest margin (taxable equivalent)	3.13	(.44)	3.14	3.48	3.40	1.95	

Consolidated operations:

on average total assets	(.14)% ^a	(4.38)% ^a	.85% ^a	.10%	.88%	(1.22)% ^a	
on average common equity	(2.36) ^a	(53.35) ^a	10.38 ^a	1.26	10.79	(15.32) ^a	
on average total equity	(1.64) ^a	(52.56) ^a	10.38 ^a	1.26	10.79	(14.66) ^a	
erest margin (taxable equivalent)	3.13 ^a	(.44) ^a	3.14 ^a	3.48	3.40	1.95 ^a	

FINANCIAL RATIOS AT PERIOD END

to assets	8.54%	8.57%	8.47%	7.89%	8.13%	8.54%	
le equity to tangible assets	6.95	6.98	6.85	6.58	6.87	6.95	
risk-based capital	8.55	8.53	8.33	7.44	7.94	8.48	
risk-based capital	12.40	12.41	12.34	11.38	11.76	12.31	
ge	9.28	9.34	9.15	8.39	8.96	9.46	

NET AND BROKERAGE ASSETS

under management	\$ 76,676	\$ 80,998	\$ 80,453	\$ 85,442	\$ 88,100	\$ 76,676	\$ 88,100
managed and brokerage assets	27,187	29,905	30,532	33,918	33,273	27,187	33,273

EMPLOYEE DATA

the full-time equivalent employees	18,291	18,164	18,426	18,500	18,567	18,294	19,000
es	986	985	985	955	954	986	

Acquisitions and divestitures completed by Key during the periods shown in this table may have had a significant effect on Key's results, making it difficult to compare results from one period to the next. Note 3 ("Acquisitions and Divestitures"), which begins on page 12, contains specific information about the acquisitions and divestitures that Key completed during 2007 and the first nine months of 2008 to help in understanding how those transactions may have impacted Key's financial condition and results of operations.

- (a) See Figure 5, which shows certain earnings data and performance ratios, excluding charges related

to the tax
treatment of
certain leveraged
lease financing
transactions
disallowed by
the IRS. Figure 5
reconciles
certain GAAP
performance
measures to the
corresponding
non-GAAP
measures and
provides a basis
for
period-to-period
comparisons.

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As a result of an adverse federal court decision on Key's tax treatment of a Service Contract Lease transaction entered into by AWG Leasing Trust, in which Key is a partner, Key recorded after-tax charges of \$30 million, or \$.06 per common share, during the third quarter of 2008, and \$1.011 billion, or \$2.43 per common share, during the second quarter of 2008. Additionally, during the first quarter of 2008, Key increased its tax reserves for certain LILO transactions and recalculated its lease income in accordance with prescribed accounting standards, resulting in after-tax charges of \$38 million, or \$.10 per common share. The table below presents certain earnings data and performance ratios, excluding these charges (non-GAAP), reconciles the GAAP performance measures to the corresponding non-GAAP measures and provides a basis for period-to-period comparisons. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. Non-GAAP financial measures should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

Figure 5. GAAP to Non-GAAP Reconciliations

<i>dollars in millions, except per share amounts</i>	Three months ended			Nine months ended
	9-30-08	6-30-08	3-31-08	9-30-08
NET INCOME				
Net (loss) income (GAAP)	\$ (36)	\$ (1,126)	\$ 218	\$ (944)
Charges related to leveraged lease tax litigation, after tax	30	1,011	38	1,079
Net (loss) income, excluding charges related to leveraged lease tax litigation (non-GAAP)	\$ (6)	\$ (115)	\$ 256	\$ 135
Net (loss) income applicable to common shares (GAAP)	\$ (48)	\$ (1,126)	\$ 218	\$ (956)
PER COMMON SHARE				
Net (loss) income assuming dilution (GAAP)	\$ (.10)	\$ (2.70)	\$.54	\$ (2.19)
Net (loss) income, excluding charges related to leveraged lease tax litigation assuming dilution (non-GAAP)	(.04)	(.28)	.64	.30
PERFORMANCE RATIOS				
Return on average total assets: ^a				
Average total assets	\$ 103,156	\$ 103,290	\$ 103,356	\$ 103,267
Return on average total assets (GAAP)	(.14)%	(4.38)%	.85%	(1.22)%
Return on average total assets, excluding charges related to leveraged lease tax litigation (non-GAAP)	(.02)	(.45)	1.00	.17
Return on average common equity: ^a				
Average common equity	\$ 8,077	\$ 8,489	\$ 8,445	\$ 8,336
Return on average common equity (GAAP)	(2.36)%	(53.35)%	10.38%	(15.32)%
Return on average common equity, excluding charges related to leveraged lease tax litigation (non-GAAP)	(.89)	(5.45)	12.19	1.97

Return on average total equity: ^a

Average total equity	\$ 8,734	\$ 8,617	\$ 8,445	\$ 8,599
Return on average total equity (GAAP)	(1.64)%	(52.56)%	10.38%	(14.66)%
Return on average total equity, excluding charges related to leveraged lease tax litigation (non-GAAP)	(.27)	(5.37)	12.19	2.10

NET INTEREST INCOME AND MARGIN**Net interest income:**

Net interest income (GAAP)	\$ 699	\$ 358	\$ 713	\$ 1,770
Charges related to leveraged lease tax litigation, pre-tax		359	3	362

Net interest income, excluding charges related to leveraged lease tax litigation (non-GAAP)	\$ 699	\$ 717	\$ 716	\$ 2,132
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Net interest income/margin (TE):

Net interest income (loss) (TE) (as reported)	\$ 705	\$ (100)	\$ 704	\$ 1,309
Charges related to leveraged lease tax litigation, pre-tax (TE)		838	34	872

Net interest income, excluding charges related to leveraged lease tax litigation (TE) (adjusted basis)	\$ 705	\$ 738	\$ 738	\$ 2,181
--	--------	--------	--------	----------

Net interest margin (TE) (as reported) ^a	3.13%	(.44)%	3.14%	1.95%
Impact of charges related to leveraged lease tax litigation, pre-tax (TE) ^a		3.76	.15	1.30

Net interest margin, excluding charges related to leveraged lease tax litigation (TE) (adjusted basis) ^a	3.13%	3.32%	3.29%	3.25%
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(a) Income statement amount has been annualized in calculation of percentage.

TE = Taxable Equivalent

GAAP = U.S. generally accepted accounting principles

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Financial outlook

Although difficult to project in this turbulent economy, considering current and anticipated conditions in the financial markets, and the continuation of competitive pricing for deposits, management expects that, in the fourth quarter of 2008, Key will experience:

- “ a taxable-equivalent net interest margin in the range of 3.00% to 3.10%;
- “ a low- to mid-single digit percentage increase in loans;
- “ a low- to mid-single digit percentage increase in deposits;
- “ net loan charge-offs in the range of 1.40% to 1.70% of average loans; and
- “ an infusion of \$2.5 billion of Tier 1 capital from Key's participation in the U.S. Treasury's TARP Capital Purchase Program.

On October 24, 2008, the U.S. Treasury informed KeyCorp that it had received preliminary approval to participate in the U.S. Treasury's TARP Capital Purchase Program. Under the TARP Capital Purchase Program, the U.S. Treasury would purchase \$2.5 billion of TARP preferred stock and warrants to purchase common shares of KeyCorp. KeyCorp anticipates receipt of the additional capital by December 31, 2008. The TARP Capital Purchase Program was initiated by the U.S. Treasury under authority provided in the EESA in order to restore liquidity and stability to the U.S. financial system. Additional information pertaining to the EESA and the TARP Capital Purchase Program is presented in the Capital discussion under the heading Emergency Economic Stabilization Act of 2008 on page 77.

Strategic developments

Management initiated a number of specific actions during 2008 and 2007 to support Key's corporate strategy, which is described under the heading Corporate Strategy on page 16 of Key's 2007 Annual Report to Shareholders.

- “ During the third quarter of 2008, Key decided to exit direct and indirect retail and floor-plan lending for marine and recreational vehicle products and to limit new student loans to those backed by government guarantee. Key also determined that it will cease conducting business with homebuilders within its 14-state Community Banking footprint.
- “ On January 1, 2008, Key acquired U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York. The acquisition doubles Key's branch presence in the attractive Lower Hudson Valley area. Assets and deposits acquired in this transaction were assigned to both the Community Banking and National Banking groups.
- “ On December 20, 2007, Key announced its decision to exit dealer-originated home improvement lending activities, which involve prime loans but are largely out-of-footprint. Key also announced that it will cease offering Payroll Online services, which are not of sufficient size to provide economies of scale to compete profitably. Additionally, Key has moved to cease conducting business with nonrelationship homebuilders outside of its 14-state Community Banking footprint.
- “ On October 1, 2007, Key acquired Tuition Management Systems, Inc., one of the nation's largest providers of outsourced tuition planning, billing, counseling and payment services. Headquartered in Warwick, Rhode Island, Tuition Management Systems serves more than 700 colleges, universities, elementary and secondary educational institutions. The combination of the payment plan systems and technology in place at Tuition Management Systems and the array of payment plan products offered by Key's Consumer Finance line of business created one of the largest education payment plan providers in the nation.

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- “ On February 9, 2007, McDonald Investments Inc., a wholly owned subsidiary of KeyCorp, sold its branch network, which included approximately 570 financial advisors and field support staff, and certain fixed assets. Key retained the corporate and institutional businesses, including Institutional Equities and Equity Research, Debt Capital Markets and Investment Banking. In addition, KeyBank continues to operate the Wealth Management, Trust and Private Banking businesses. On April 16, 2007, Key renamed the registered broker-dealer through which its corporate and institutional investment banking and securities businesses operate to KeyBanc Capital Markets Inc.

Table of Contents**Line of Business Results**

This section summarizes the financial performance and related strategic developments of Key's two major business groups: Community Banking and National Banking. To better understand this discussion, see Note 4 (Line of Business Results), which begins on page 14. Note 4 describes the products and services offered by each of these business groups, provides more detailed financial information pertaining to the groups and their respective lines of business, and explains Other Segments and Reconciling Items.

Figure 6 summarizes the contribution made by each major business group to Key's taxable-equivalent revenue and (loss) income from continuing operations for the three- and nine-month periods ended September 30, 2008 and 2007. Key's line of business results for each of these periods reflect a new organizational structure that took effect January 1, 2008.

Figure 6. Major Business Groups Taxable-Equivalent Revenue and (Loss) Income from Continuing Operations

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2008	September 30, 2007	Change Amount	Change Percent	September 30, 2008	September 30, 2007	Change Amount	Change Percent
REVENUE FROM CONTINUING OPERATIONS (TE)								
Community Banking ^a	\$ 658	\$ 629	\$ 29	4.6%	\$ 1,949	\$ 2,067	\$ (118)	(5.7)%
National Banking ^b	482	507	(25)	(4.9)	790	1,719	(929)	(54.0)
Other Segments ^c	(17)	15	(32)	N/M	(23)	97	(120)	N/M
Total Segments	1,123	1,151	(28)	(2.4)	2,716	3,883	(1,167)	(30.1)
Reconciling Items ^d	(30)	(1)	(29)	N/M	64	(24)	88	N/M
Total	\$ 1,093	\$ 1,150	\$ (57)	(5.0)%	\$ 2,780	\$ 3,859	\$ (1,079)	(28.0)%
(LOSS) INCOME FROM CONTINUING OPERATIONS								
Community Banking ^a	\$ 98	\$ 134	\$ (36)	(26.9)%	\$ 318	\$ 442	\$ (124)	(28.1)%
National Banking ^b	(133)	70	(203)	N/M	(829)	384	(1,213)	N/M
Other Segments ^c	9	16	(7)	(43.8)	17	63	(46)	(73.0)
Total Segments	(26)	220	(246)	N/M	(494)	889	(1,383)	N/M
Reconciling Items ^d	(10)	4	(14)	N/M	(450)	30	(480)	N/M
Total	\$ (36)	\$ 224	\$ (260)	N/M	\$ (944)	\$ 919	\$ (1,863)	N/M

(a) Community Banking's results

for the first quarter of 2007 include a \$171 million (\$107 million after tax) gain from the February 9, 2007, sale of the McDonald Investments branch network. See Note 3 (Acquisitions and Divestitures), which begins on page 12, for more information pertaining to this transaction.

- (b) National Banking s results for the third quarter of 2008 include \$54 million (\$33 million after tax) of derivative-related charges recorded as a result of market disruption caused by the failure of Lehman Brothers and \$31 million (\$19 million after tax) of realized and unrealized losses from the residential properties segment of the construction loan portfolio. During the second quarter of 2008, National Banking s taxable-equivalent net interest income and net income were reduced by \$838 million and \$536 million,

respectively, as a result of an adverse federal court decision on the tax treatment of a Service Contract Lease transaction. During the first quarter of 2008, National Banking increased its tax reserves for certain LILO transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced National Banking's taxable-equivalent revenue by \$34 million and its net income by \$21 million in the first quarter. National Banking's results for the first quarter of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation.

- (c) Other Segments results for the third quarter of 2008 include a \$23 million (\$14 million after tax) credit, representing the reversal of the remaining reserve associated with the

Honsador litigation, which was settled in September. Other Segments results for the second quarter of 2007 include a \$26 million (\$16 million after tax) charge for litigation. This charge and the litigation charge referred to in note (d) below comprise the initial \$42 million reserve established in connection with the Honsador litigation. Other Segments results for the first quarter of 2007 include a \$49 million (\$31 million after tax) loss from the repositioning of the securities portfolio.

- (d) Reconciling Items for the third and second quarters of 2008 include charges of \$30 million and \$475 million, respectively, to income taxes for the interest cost associated with the leveraged lease tax litigation. Reconciling Items for the first quarter of 2008 include a \$165 million (\$103 million after tax) gain from the

partial redemption of Key's equity interest in Visa Inc. and a \$17 million charge to income taxes for the interest cost associated with the increase to Key's tax reserves for certain LILO transactions.

Reconciling Items for the third and second quarters of 2007 include gains of \$27 million (\$17 million after tax) and \$40 million (\$25 million after tax), respectively, related to MasterCard Incorporated shares. During the second quarter of 2007, Reconciling Items include a \$16 million (\$10 million after tax) charge for litigation.

TE = Taxable
Equivalent

N/M = Not Meaningful

Table of Contents**Community Banking summary of operations**

As shown in Figure 7, Community Banking recorded net income of \$98 million for the third quarter of 2008, compared to \$134 million for the year-ago quarter. Increases in the provision for loan losses and noninterest expense were the primary causes of the decline, and more than offset an increase in net interest income.

Figure 7. Community Banking

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2008	September 30, 2007	Change Amount	Change Percent	September 30, 2008	September 30, 2007	Change Amount	Change Percent
SUMMARY OF OPERATIONS								
Net interest income (TE)	\$ 445	\$ 412	\$ 33	8.0%	\$ 1,307	\$ 1,248	\$ 59	4.7%
Noninterest income	213	217	(4)	(1.8)	642	819 ^a	(177)	(21.6)
Total revenue (TE)	658	629	29	4.6	1,949	2,067	(118)	(5.7)
Provision for loan losses	56	2	54	N/M	118	37	81	218.9
Noninterest expense	445	413	32	7.7	1,323	1,323		
Income before income taxes (TE)	157	214	(57)	(26.6)	508	707	(199)	(28.1)
Allocated income taxes and TE adjustments	59	80	(21)	(26.3)	190	265	(75)	(28.3)
Net income	\$ 98	\$ 134	\$ (36)	(26.9)%	\$ 318	\$ 442	\$ (124)	(28.1)%
Percent of consolidated income from continuing operations	N/M	60%	N/A	N/A	N/M	48%	N/A	N/A
AVERAGE BALANCES								
Loans and leases	\$ 28,872	\$ 26,944	\$ 1,928	7.2%	\$ 28,483	\$ 26,659	\$ 1,824	6.8%
Total assets	31,934	29,708	2,226	7.5	31,418	29,445	1,973	6.7
Deposits	50,384	46,729	3,655	7.8	50,035	46,459	3,576	7.7
Assets under management at period end	\$ 18,278	\$ 21,903	\$ (3,625)	(16.6)%	\$ 18,278	\$ 21,903	\$ (3,625)	(16.6)%

(a) Community Banking's results for the first quarter of 2007 include a \$171 million (\$107 million after tax) gain from the February 9, 2007, sale of the McDonald

Investments
branch network.
See Note 3
(Acquisitions
and
Divestitures),
which begins on
page 12, for
more
information
pertaining to
this transaction.

TE = Taxable
Equivalent

N/M = Not
Meaningful

N/A = Not
Applicable

Additional Community Banking Data

<i>dollars in millions</i>	Three months ended September 30,		Change		Nine months ended September 30,		Change	
	2008	2007	Amount	Percent	2008	2007	Amount	Percent
AVERAGE DEPOSITS OUTSTANDING								
NOW and money market deposit accounts	\$ 19,507	\$ 20,307	\$ (800)	(3.9)%	\$ 19,674	\$ 19,633	\$ 41	.2%
Savings deposits	1,752	1,569	183	11.7	1,770	1,602	168	10.5
Certificates of deposits (\$100,000 or more)	6,875	4,566	2,309	50.6	6,663	4,609	2,054	44.6
Other time deposits	13,103	11,485	1,618	14.1	12,869	11,856	1,013	8.5
Deposits in foreign office	1,193	1,128	65	5.8	1,252	1,044	208	19.9
Noninterest-bearing deposits	7,954	7,674	280	3.6	7,807	7,715	92	1.2
Total deposits	\$ 50,384	\$ 46,729	\$ 3,655	7.8%	\$ 50,035	\$ 46,459	\$ 3,576	7.7%

HOME EQUITY LOANS

Average balance	\$ 9,887	\$ 9,690
Weighted-average loan-to-value ratio	70%	70%
Percent first lien positions	54	58

OTHER DATA

Branches	986	954
Automated teller machines	1,479	1,439

Taxable-equivalent net interest income rose by \$33 million, or 8%, from the third quarter of 2007. The increase was attributable to a \$1.9 billion, or 7%, rise in average earning assets, due largely to growth in the commercial loan portfolio, and a \$3.7 billion, or 8%, increase in average deposits. Both loans and deposits experienced organic growth and benefited from the January 1, 2008, acquisition of U.S.B. Holding Co., Inc. described on page 54.

The provision for loan losses rose by \$54 million compared to the third quarter of 2007, reflecting a \$51 million increase in net loan charge-offs, almost half of which was attributable to two specific commercial loans.

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Noninterest expense rose by \$32 million, or 8%, from the year-ago quarter as a result of increases in personnel expense, marketing expense, professional fees, costs associated with other real estate owned, and smaller increases in a variety of other expense components. Overall, the increase in noninterest expense was largely attributable to initiatives undertaken with regard to branch modernization, deposit growth and the acquisition of U.S.B. Holding Co., Inc.

On January 1, 2008, Key acquired U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York. The acquisition doubles Key's branch presence in the attractive Lower Hudson Valley area. Assets and deposits acquired in this transaction were assigned to both the Community Banking and National Banking groups.

On February 9, 2007, McDonald Investments Inc., a wholly owned subsidiary of KeyCorp, sold its branch network, which included approximately 570 financial advisors and field support staff, and certain fixed assets. Key retained the corporate and institutional businesses, including Institutional Equities and Equity Research, Debt Capital Markets and Investment Banking. In addition, KeyBank continues to operate the Wealth Management, Trust and Private Banking businesses. On April 16, 2007, Key renamed its registered broker-dealer through which its corporate and institutional investment banking and securities businesses operate. The new name is KeyBanc Capital Markets Inc.

National Banking summary of continuing operations

As shown in Figure 8, National Banking recorded a loss of \$133 million from continuing operations for the third quarter of 2008, compared to income of \$70 million from continuing operations for the same period last year. A substantially higher provision for loan losses, lower net interest income and an increase in noninterest expense were offset in part by growth in noninterest income.

Figure 8. National Banking

	Three months ended				Nine months ended			
	September 30,		Change		September 30,		Change	
<i>dollars in millions</i>	2008	2007	Amount	Percent	2008	2007	Amount	Percent
SUMMARY OF OPERATIONS								
Net interest (loss) income (TE)	\$ 322 ^a	\$ 355	\$ (33)	(9.3)	\$ 184 ^a	\$ 1,035	\$ (851)	(82.2)%
Noninterest income	160	152	8	5.3%	606	684 ^a	(78)	(11.4)
Total revenue (TE)	482	507	(25)	(4.9)	790	1,719	(929)	(54.0)
Provision for loan losses	350	69	281	407.2	1,128	131	997	761.1
Noninterest expense	342	327	15	4.6	986	974	12	1.2
(Loss) income from continuing operations before income taxes (TE)	(210)	111	(321)	N/M	(1,324)	614	(1,938)	N/M
Allocated income taxes and TE adjustments	(77)	41	(118)	N/M	(495)	230	(725)	N/M
(Loss) income from continuing operations	(133)	70	(203)	N/M	(829)	384	(1,213)	N/M
Loss from discontinued operations, net of taxes		(14)	14	100.0		(25)	25	100.0
Net (loss) income	\$ (133)	\$ 56	\$ (189)	N/M	\$ (829)	\$ 359	\$ (1,188)	N/M

Percent of consolidated income from continuing operations	N/M	31%	N/A	N/A	N/M	42%	N/A	N/A
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AVERAGE BALANCES FROM CONTINUING OPERATIONS

Loans and leases	\$ 47,075	\$ 40,279	\$ 6,796	16.9%	\$ 46,374	\$ 39,487	\$ 6,887	17.4%
Loans held for sale	1,651	4,692	(3,041)	(64.8)	2,618	4,331	(1,713)	(39.6)
Total assets	56,183	50,961	5,222	10.2	56,254	49,666	6,588	13.3
Deposits	12,439	12,631	(192)	(1.5)	12,205	12,008	197	1.6
Assets under management at period end	\$ 58,398	\$ 66,197	\$ (7,799)	(11.8)%	\$ 58,398	\$ 66,197	\$ (7,799)	(11.8)%

(a) National Banking's results for the third quarter of 2008 include \$54 million (\$33 million after tax) of derivative-related charges recorded as a result of market disruption caused by the failure of Lehman Brothers and \$31 million (\$19 million after tax) of realized and unrealized losses from the residential properties segment of the construction loan portfolio. During the second quarter of 2008, National Banking's taxable-equivalent net interest income and net income were reduced by \$838 million and \$536 million, respectively, as a result of an adverse federal court decision on the tax treatment of a Service

Contract Lease transaction. During the first quarter of 2008, National Banking increased its tax reserves for certain LILO transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced National Banking's taxable-equivalent revenue by \$34 million and its net income by \$21 million in the first quarter. National Banking's results for the first quarter of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation.

TE = Taxable
Equivalent

N/M = Not Meaningful

N/A = Not Applicable

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Taxable-equivalent net interest income decreased by \$33 million, or 9%, from the third quarter of 2007 as a result of tighter loan and deposit spreads caused by competitive pricing, and a higher level of nonperforming assets. Also contributing to the decrease was the prospective reduction in net interest income caused by the second quarter 2008 recalculation of income previously recognized on all leveraged leases being contested by the IRS. Average loans and leases grew by \$6.8 billion, or 17%, while the level of average deposits was down slightly from the year-ago quarter. Contributing to the loan growth was the March 31, 2008, transfer of \$3.3 billion of education loans from loans held for sale to the loan portfolio.

Excluding \$54 million of derivative-related charges recorded in the current quarter as a result of market disruption caused by the failure of Lehman Brothers, noninterest income rose by \$62 million, or 41%, from the third quarter of 2007. The improvement reflected a \$15 million increase in income from trust and investment services, a \$23 million reduction in net losses from loan sales and write-downs, and a \$15 million decrease in losses attributable to changes in the fair values of certain real estate related investments held by the Private Equity unit within the Real Estate Capital and Corporate Banking Services line of business. Noninterest income also benefited from an increase in fee income generated from tuition payment plan processing.

The provision for loan losses rose by \$281 million, due primarily to higher levels of net loan charge-offs from the commercial, commercial real estate and education loan portfolios. National Banking's provision for loan losses for the third quarter of 2008 exceeded its net loan charge-offs by \$147 million, as the company continued to build reserves. Noninterest expense increased by \$15 million, or 5%, from the third quarter of 2007, reflecting \$10 million of additional expense attributable to severance and other costs recorded during the current quarter in connection with Key's decision to exit direct and indirect retail and floor-plan lending for marine and recreational vehicle products. During the third quarter of 2008, Key decided to exit direct and indirect retail and floor-plan lending for marine and recreational vehicle products and to limit new student loans to those backed by government guarantee. Additionally, Key has determined that it will cease conducting business with homebuilders within its 14-state Community Banking footprint. In December 2007, Key had previously announced its decision to cease lending to out-of-footprint homebuilders. These strategic actions are consistent with those taken over the past several years to exit low-return nonrelationship business.

Other Segments

Other segments consist of Corporate Treasury and Key's Principal Investing unit. These segments generated net income of \$9 million for the third quarter of 2008, compared to \$16 million for the same period last year. These results reflect less favorable results from principal investing in the current year.

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Results of Operations

Net interest income

One of Key's principal sources of revenue is net interest income. Net interest income is the difference between interest income received on earning assets (such as loans and securities) and loan-related fee income, and interest expense paid on deposits and borrowings. There are several factors that affect net interest income, including:

- the volume, pricing, mix and maturity of earning assets and interest-bearing liabilities;
- the volume and value of net free funds, such as noninterest-bearing deposits and equity capital;
- the use of derivative instruments to manage interest rate risk;
- interest rate fluctuations and competitive conditions within the marketplace; and
- asset quality.

To make it easier to compare results among several periods and the yields on various types of earning assets (some taxable, some not), we present net interest income in this discussion on a taxable-equivalent basis (i.e., as if it were all taxable and at the same rate). For example, \$100 of tax-exempt income would be presented as \$154, an amount that if taxed at the statutory federal income tax rate of 35% would yield \$100.

Figure 9, which spans pages 58 and 59, shows the various components of Key's balance sheet that affect interest income and expense, and their respective yields or rates over the past five quarters. The net interest margin, which is an indicator of the profitability of the earning assets portfolio, is calculated by dividing net interest income by average earning assets. This figure also presents a reconciliation of taxable-equivalent net interest income for each of the past five quarters to net interest income reported in accordance with GAAP.

Key's taxable-equivalent net interest income was \$705 million for the third quarter of 2008, compared to \$712 million for the year-ago quarter. Average earning assets rose by \$6.6 billion, or 8%, due primarily to growth in commercial loans and the January 1 acquisition of U.S.B. Holding Co., Inc., which added approximately \$1.5 billion to Key's loan portfolio. The net interest margin for the current quarter declined to 3.13% from 3.40% for the third quarter of 2007. Approximately 13 basis points of the reduction was attributable to the prospective reduction in net interest income caused by the second quarter 2008 recalculation of income previously recognized on all leveraged leases being contested by the IRS. Also contributing to the lower net interest margin were tighter loan and deposit spreads caused by competitive pricing, and a higher level of nonperforming assets.

As previously reported, Key's taxable-equivalent net interest income for the second quarter of 2008 was reduced significantly as a result of an adverse federal court decision on the company's tax treatment of a Service Contract Lease transaction entered into by AWG Leasing Trust, in which Key is a partner. In accordance with the accounting guidance provided under Financial Accounting Standards Board (FASB) Staff Position No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction, Key recalculated the lease income recognized from inception for all of the leveraged leases being contested by the IRS, not just the single leveraged lease subject to the Court decision. Key's second quarter results also reflect a \$475 million charge to income taxes for the interest cost associated with the contested tax liabilities. These actions reduced Key's taxable-equivalent net interest income and net interest margin for the second quarter of 2008 by \$838 million and 376 basis points, respectively, and reduced Key's earnings by \$1.011 billion, or \$2.43 per common share.

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During the first quarter of 2008, Key increased its tax reserves for certain LILO transactions, the deductions for which have been disallowed by the IRS. The change in the level of LILO reserves also necessitated a recalculation of lease income under FASB Staff Position No. 13-2. These actions reduced Key's taxable-equivalent net interest income and net interest margin for the first quarter of 2008 by \$34 million and 15 basis points, respectively, and reduced Key's earnings by \$38 million, or \$.10 per diluted common share.

As previously reported, Service Contract Leases, LILO transactions and Qualified Technological Equipment Leases represent a portion of Key's overall leveraged lease financing portfolio, and the tax deductions for some of these transactions are being challenged by the IRS. On August 6, 2008, the IRS announced a global initiative for the settlement of all transactions, including the contested leveraged leases entered into by Key, which the IRS has characterized as LILO/SILO transactions (the LILO/SILO Settlement Initiative). As preconditions to its participation, Key was required to provide written acceptance to the IRS of the terms of the LILO/SILO Settlement Initiative and to dismiss its appeal of the AWG Leasing Trust litigation. Key has complied with these preconditions and was accepted into the LILO/SILO Settlement Initiative by the IRS on October 6, 2008. However, Key's acceptance into this initiative is not binding until a closing agreement is executed by both Key and the IRS. Management believes that, upon the execution of a closing agreement, Key should realize an after-tax recovery of between \$75 million and \$100 million for previously accrued interest on disputed tax balances. Additional information related to these lease financing transactions, and the related LILO/SILO Settlement Initiative is included in Note 12 (Income Taxes), which begins on page 27.

For the fourth quarter of 2008, management expects Key's net interest margin to be in the range of 3.00% to 3.10%. Management believes the continuation of competitive pressure on deposit pricing and the effect of customer draws under existing lines of credit at relatively narrow spreads will offset the impact of more favorable spreads on new assets.

Since January 1, 2007, the growth and composition of Key's earning assets have been affected by the following actions:

- During the first quarter of 2008, Key increased its loan portfolio (primarily commercial real estate and consumer loans) through the acquisition of U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York.
- Key sold \$1.7 billion of commercial real estate loans during the first nine months of 2008 and \$3.8 billion (\$238 million through a securitization) during all of 2007. Since some of these loans have been sold with limited recourse (i.e., there is a risk that Key will be held accountable for certain events or representations made in the sales agreements), Key established and has maintained a loss reserve in an amount estimated by management to be appropriate. More information about the related recourse agreement is provided in Note 13 (Contingent Liabilities and Guarantees) under the heading Recourse agreement with Federal National Mortgage Association on page 30. In June 2008, Key transferred \$384 million of commercial real estate loans (\$719 million, net of \$335 million in net charge-offs) from the held-to-maturity loan portfolio to held-for-sale status as part of a process undertaken to aggressively reduce its exposure in the residential properties segment of its construction loan portfolio through the planned sale of certain loans. Additional information about the status of this process is included in the section entitled Commercial real estate loans on page 67.
- Key sold \$120 million of education loans during the first nine months of 2008 and \$247 million during all of 2007. In March 2008, Key transferred \$3.3 billion of education loans from held-for-sale status to the held-to-maturity loan portfolio. The secondary markets for these loans have been adversely affected by market liquidity issues, prompting the company's decision to move them to a held-to-maturity classification.
- Key sold \$700 million of other loans (including \$580 million of residential mortgage loans) during the first nine months of 2008 and \$1.2 billion during all of 2007.

Table of Contents**Figure 9. Average Balance Sheets, Net Interest Income and Yields/Rates
From Continuing Operations**

<i>dollars in millions</i>	Third Quarter 2008			Second Quarter 2008		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
ASSETS						
Loans: ^{a,b}						
Commercial, financial and agricultural	\$ 26,345	\$ 356	5.38%	\$ 26,057	\$ 352	5.42%
Real estate commercial mortgage	10,718	158	5.87	10,593	156	5.91
Real estate construction	7,806	109	5.53	8,484	118	5.61
Commercial lease financing	9,585	108	4.52	9,798	(709)	(28.94) ^c
Total commercial loans	54,454	731	5.35	54,932	(83)	(.58)
Real estate residential	1,899	28	6.04	1,918	30	6.12
Home equity:						
Community Banking	9,887	141	5.64	9,765	140	5.78
National Banking	1,138	22	7.65	1,200	23	7.68
Total home equity loans	11,025	163	5.85	10,965	163	5.99
Consumer other Community Banking	1,264	33	10.37	1,271	33	10.34
Consumer other National Banking:						
Marine	3,586	57	6.33	3,646	56	6.26
Education	3,635	54	5.90	3,595	53	5.88
Other	308	6	8.22	325	7	8.21
Total consumer other National Banking	7,529	117	6.20	7,566	116	6.16
Total consumer loans	21,717	341	6.25	21,720	342	6.32
Total loans	76,171	1,072	5.60	76,652	259	1.37
Loans held for sale	1,723	21	4.76	1,356	20	5.94
Securities available for sale ^{a,d}	8,266	110	5.38	8,315	111	5.40
Held-to-maturity securities ^a	27	1	13.81	25		11.47
Trading account assets	1,579	16	4.02	1,041	10	3.88
Short-term investments	794	6	3.44	773	8	3.83
Other investments ^d	1,563	12	2.87	1,580	14	3.09
Total earning assets	90,123	1,238	5.47	89,742	422	1.89
Allowance for loan losses	(1,498)			(1,338)		
Accrued income and other assets	14,531			14,886		
Total assets	\$ 103,156			\$ 103,290		
LIABILITIES AND SHAREHOLDERS' EQUITY						
NOW and money market deposit accounts	\$ 26,657	108	1.61	\$ 27,158	102	1.51

Savings deposits	1,783	1	.21	1,815	1	.27
Certificates of deposit (\$100,000 or more) ^e	9,506	97	4.05	8,670	88	4.09
Other time deposits	13,118	129	3.92	12,751	135	4.27
Deposits in foreign office	2,762	12	1.77	4,121	21	1.95
Total interest-bearing deposits	53,826	347	2.57	54,515	347	2.56
Federal funds purchased and securities sold under repurchase agreements	2,546	10	1.58	3,267	15	1.86
Bank notes and other short-term borrowings	4,843	34	2.72	4,770	27	2.26
Long-term debt ^{e f}	15,123	142	3.91	14,620	133	3.87
Total interest-bearing liabilities	76,338	533	2.80	77,172	522	2.75
Noninterest-bearing deposits	10,756			10,617		
Accrued expense and other liabilities	7,328			6,884		
Preferred stock	657			128		
Common shareholders' equity	8,077			8,489		
Total shareholders' equity	8,734			8,617		
Total liabilities and shareholders' equity	\$ 103,156			\$ 103,290		

Interest rate spread (TE)		2.67%		(.86)%
Net interest (loss) income (TE) and net interest margin (TE)	705	3.13%	(100) ^c	(.44)% ^c
TE adjustment ^a	6		(458)	
Net interest income, GAAP basis	\$ 699		\$ 358	

Average balances have not been restated to reflect Key's January 1, 2008, adoption of FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts, and FASB Staff Position FIN 39-1, Amendment of FASB Interpretation 39. Key's adoption of this accounting guidance is described in Note 1 (Basis of Presentation) under the heading Accounting Pronouncements Adopted in 2008 on page 9.

(a) Interest income on tax-exempt securities and loans has been adjusted to a taxable-equivalent basis using the statutory federal income tax rate of 35%.

(b) For purposes of these computations,

nonaccrual loans
are included in
average loan
balances.

- (c) During the second quarter of 2008, Key's taxable-equivalent net interest income was reduced by \$838 million as a result of an adverse federal court decision on Key's tax treatment of a Service Contract Lease transaction. Excluding this reduction, the taxable-equivalent yield on Key's commercial lease financing portfolio would have been 5.25% for the second quarter of 2008, and Key's taxable-equivalent net interest margin would have been 3.32%. During the prior quarter, Key increased its tax reserves for certain LILO transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced Key's first quarter 2008 taxable-equivalent net interest income by \$34 million. Excluding this reduction, the

taxable-equivalent
yield on Key s
commercial lease
financing portfolio
would have been
5.27% for the first
quarter of 2008,
and Key s
taxable-equivalent
net interest margin
would have been
3.29%.

Table of Contents**Figure 9. Average Balance Sheets, Net Interest Income and Yields/Rates
From Continuing Operations (Continued)**

First Quarter 2008			Fourth Quarter 2007			Third Quarter 2007		
Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
\$ 25,411	\$ 392	6.21%	\$ 23,825	\$ 419	6.98%	\$ 22,393	\$ 410	7.25%
10,283	175	6.84	9,351	175	7.42	8,855	172	7.69
8,468	134	6.36	8,192	153	7.42	8,285	167	8.01
10,004	98	3.91 ^c	10,252	171	6.65	10,172	147	5.80
54,166	799	5.93	51,620	918	7.06	49,705	896	7.16
1,916	30	6.29	1,596	27	6.72	1,586	26	6.68
9,693	154	6.38	9,658	168	6.92	9,690	175	7.14
1,260	24	7.74	1,259	24	7.77	1,193	24	7.85
10,953	178	6.54	10,917	192	7.02	10,883	199	7.22
1,305	34	10.59	1,308	35	10.73	1,342	36	10.66
3,646	58	6.31	3,608	58	6.34	3,506	55	6.32
363	7	8.04	329	8	9.47	332	8	9.65
339	7	8.32	339	7	8.66	326	7	8.92
4,348	72	6.61	4,276	73	6.76	4,164	70	6.79
18,522	314	6.81	18,097	327	7.20	17,975	331	7.33
72,688	1,113	6.15	69,717	1,245	7.10	67,680	1,227	7.20
4,984	87	7.01	4,748	89	7.53	4,731	91	7.59
8,419	110	5.28	7,858	115	5.89	7,825	106	5.45
29	1	11.02	30	1	6.24	36		6.43
1,075	13	4.84	1,042	12	4.40	1,055	11	4.39
1,165	9	3.18	1,226	13	3.94	633	5	3.32
1,552	12	3.05	1,589	12	3.02	1,563	12	2.99
89,912	1,345	6.01	86,210	1,487	6.86	83,523	1,452	6.92
(1,236)			(966)			(942)		
14,680			13,547			12,581		
\$ 103,356			\$ 98,791			\$ 95,162		
\$ 26,996	139	2.07	\$ 25,687	197	3.05	\$ 24,190	209	3.41

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1,865	3	.62	1,523	1	.19	1,581		.19
8,072	95	4.72	6,887	86	4.98	6,274	80	5.06
12,759	146	4.59	11,455	135	4.68	11,512	136	4.68
5,853	45	3.13	5,720	64	4.42	4,540	57	5.00
55,545	428	3.10	51,272	483	3.74	48,097	482	3.98
3,863	28	2.91	4,194	45	4.23	4,470	55	4.85
4,934	39	3.22	4,233	45	4.15	2,539	30	4.70
13,238	146	4.71	11,851	164	5.72	11,801	173	5.89
77,580	641	3.36	71,550	737	4.11	66,907	740	4.40
10,741			12,948			14,424		
6,590			6,405			6,106		
8,445			7,888			7,725		
8,445			7,888			7,725		
\$ 103,356			\$ 98,791			\$ 95,162		
		2.65%			2.75%			2.52%
	704 ^c	3.14% ^c		750	3.48%		712	3.40%
	(9)			40			18	
\$ 713			\$ 710			\$ 694		

(d) Yield is calculated on the basis of amortized cost.

(e) Rate calculation excludes basis adjustments related to fair value hedges.

(f) Results from continuing operations exclude the dollar amount of liabilities

assumed
necessary to
support
interest-earning
assets held by
the discontinued
Champion
Mortgage
finance
business. The
interest expense
related to these
liabilities, which
also is excluded
from continuing
operations, was
calculated using
a matched funds
transfer pricing
methodology.

TE = Taxable
Equivalent

GAAP = U.S.
generally accepted
accounting principles

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Figure 10 shows how the changes in yields or rates, and average balances from the prior year affected net interest income. The section entitled Financial Condition, which begins on page 67, contains more discussion about changes in earning assets and funding sources.

Figure 10. Components of Net Interest Income Changes

	From three months ended September 30, 2007 to three months ended September 30, 2008			From nine months ended September 30, 2007 to nine months ended September 30, 2008		
	Average Volume	Yield/ Rate	Net Change	Average Volume	Yield/ Rate	Net Change
<i>in millions</i>						
INTEREST INCOME						
Loans	\$ 142	\$ (297)	\$ (155)	\$ 421	\$ (1,582)	\$ (1,161)
Loans held for sale	(44)	(26)	(70)	(85)	(35)	(120)
Securities available for sale	6	(2)	4	24	(5)	19
Held-to-maturity securities		1	1		1	1
Trading account assets	5		5	11	2	13
Short-term investments	1		1	6	(7)	(1)
Other investments				2	(4)	(2)
Total interest income (TE)	110	(324)	(214)	379	(1,630)	(1,251)
INTEREST EXPENSE						
NOW and money market deposit accounts	19	(120)	(101)	73	(289)	(216)
Savings deposits		1	1		3	3
Certificates of deposit (\$100,000 or more)	35	(18)	17	85	(40)	45
Other time deposits	18	(25)	(7)	34	(39)	(5)
Deposits in foreign office	(17)	(28)	(45)	15	(82)	(67)
Total interest-bearing deposits	55	(190)	(135)	207	(447)	(240)
Federal funds purchased and securities sold under repurchase agreements	(17)	(28)	(45)	(35)	(75)	(110)
Bank notes and other short-term borrowings	20	(16)	4	69	(28)	41
Long-term debt	41	(72)	(31)	62	(195)	(133)
Total interest expense	99	(306)	(207)	303	(745)	(442)
Net interest income (TE)	\$ 11	\$ (18)	\$ (7)	\$ 76	\$ (885)	\$ (809)

The change in interest not due solely to volume or rate has been allocated in proportion to the absolute dollar amounts of the change in each.

TE = Taxable Equivalent

Noninterest income

Key's noninterest income was \$388 million for the third quarter of 2008, compared to \$438 million for the year-ago quarter. For the first nine months of the year, noninterest income was \$1.5 billion, representing a decrease of \$270 million, or 16%, from the first nine months of 2007.

In both the current and year-ago quarters, noninterest income was affected by significant items. Noninterest income for the third quarter of 2008 includes \$54 million of derivative-related charges recorded as a result of market disruption caused by the failure of Lehman Brothers, and \$31 million of net losses from the sales or write-downs of loans within the residential properties segment of the construction loan portfolio. Results for the third quarter of 2007 benefited from a \$27 million gain from the sale of MasterCard Incorporated shares. For more information about the failure of Lehman Brothers and the implications for Key, see Note 13 (Contingent Liabilities and Guarantees), which begins on page 29.

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Excluding significant items, Key's noninterest income was \$473 million for the third quarter of 2008, representing a \$62 million, or 15%, increase from the same period last year. As shown in Figure 12, the improvement reflects a \$14 million increase in income from trust and investment services, a \$6 million increase in deposit service charges and, as shown in Figure 15 on page 63, a \$15 million decrease in losses attributable to changes in the fair values of certain real estate related investments held by the Private Equity unit within the Real Estate Capital and Corporate Banking Services line of business. Excluding the \$31 million of loan-related losses discussed in the preceding paragraph, Key had net gains of \$1 million from loan sales in the current quarter, compared to net losses of \$53 million for the same period last year. These favorable results were offset in part by net losses of \$24 million from principal investing in the third quarter of 2008, compared to net gains of \$9 million for the year-ago quarter. The trend in the major components of Key's fee-based income over the past five quarters is shown in Figure 11.

Figure 11. Fee-Based Income Major Components

<i>in millions</i>		2008		2007	
	Third	Second	First	Fourth	Third
Trust and investment services income	\$ 133	\$ 138	\$ 129	\$ 131	\$ 119
Service charges on deposit accounts	94	93	88	90	88
Investment banking and capital markets (loss) income	(31)	80	8	12	9
Operating lease income	69	68	69	72	70
Letter of credit and loan fees	53	51	37	58	51
Corporate-owned life insurance income	28	28	28	37	27
Electronic banking fees	27	27	24	25	25

Significant items also impacted the comparability of Key's year-to-date results with those reported for the first nine months of 2007. In addition to the two third quarter 2008 items discussed on page 60, Key's noninterest income for the first nine months of 2008 includes a \$165 million gain from the partial redemption of Visa Inc. shares. Results for the first nine months of 2007 include a \$171 million gain associated with the sale of the McDonald Investments branch network, \$67 million in gains related to the sale of MasterCard Incorporated shares, and a \$26 million gain from the settlement of the automobile residual value insurance litigation.

Excluding significant items, Key's noninterest income was \$1.4 billion for the first nine months of 2008, representing an \$86 million, or 6%, decrease from the same period last year. As shown in Figure 12, Key recorded net losses of \$29 million from principal investing in the first nine months of 2008, compared to net gains of \$128 million for the first nine months of 2007. Excluding the \$31 million of net losses from the third quarter 2008 sales or write-downs of loans within the residential properties segment of the construction loan portfolio, net losses from loan sales rose by \$56 million. The reduction in noninterest income attributable to these factors was substantially offset by a \$49 million loss recorded during the first quarter of 2007 in connection with the repositioning of the securities portfolio, a \$28 million increase in income from deposit service charges and a \$41 million increase in income from trust and investment services. Last year's results include \$16 million of trust and investment services income generated by the McDonald Investments branch network. Adjusting for this revenue, trust and investment services income rose by \$57 million, or 17%, driven by growth in institutional asset management income and income from brokerage commissions and fees.

Table of Contents**Figure 12. Noninterest Income**

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2008	September 30, 2007	Amount	Change Percent	September 30, 2008	September 30, 2007	Amount	Change Percent
Trust and investment services income	\$ 133	\$ 119	\$ 14	11.8%	\$ 400	\$ 359	\$ 41	11.4%
Service charges on deposit accounts	94	88	6	6.8	275	247	28	11.3
Investment banking and capital markets (loss) income	(31)	9	(40)	N/M	57	105	(48)	(45.7)
Operating lease income	69	70	(1)	(1.4)	206	200	6	3.0
Letter of credit and loan fees	53	51	2	3.9	141	134	7	5.2
Corporate-owned life insurance income	28	27	1	3.7	84	84		
Electronic banking fees	27	25	2	8.0	78	74	4	5.4
Net losses from loan securitizations and sales	(30)	(53)	23	43.4	(98)	(11)	(87)	790.9
Net securities gains (losses)	1	4	(3)	(75.0)	3	(41)	44	N/M
Net (losses) gains from principal investing	(24)	9	(33)	N/M	(29)	128	(157)	N/M
Gain from redemption of Visa Inc. shares					165		165	N/M
Gain from sale of McDonald								
Investments branch network						171	(171)	(100.0)
Other income:								
Insurance income	15	16	(1)	(6.3)	50	45	5	11.1
Loan securitization servicing fees	4	5	(1)	(20.0)	13	16	(3)	(18.8)
Credit card fees	6	4	2	50.0	13	10	3	30.0
Gains related to MasterCard								
Incorporated shares		27	(27)	(100.0)		67	(67)	(100.0)
Litigation settlement automobile residual value insurance						26	(26)	(100.0)
Miscellaneous income	43	37	6	16.2	113	127	(14)	(11.0)

Total other income	68	89	(21)	(23.6)	189	291	(102)	(35.1)
Total noninterest income	\$ 388	\$ 438	\$ (50)	(11.4)%	\$ 1,471	\$ 1,741	\$ (270)	(15.5)%

N/M = Not
Meaningful

The following discussion explains the composition of certain elements of Key's noninterest income and the factors that caused those elements to change.

Trust and investment services income. Trust and investment services generally are Key's largest source of noninterest income. The primary components of revenue generated by these services are shown in Figure 13. The increases from 2007 results were attributable to strong growth in institutional asset management income and higher income from brokerage commissions and fees. Excluding the results of the McDonald Investments branch network, income from brokerage commissions and fees was up \$33 million from the first nine months of 2007.

Figure 13. Trust and Investment Services Income

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2008	2007	Amount	Change Percent	September 30, 2008	2007	Amount	Change Percent
Brokerage commissions and fee income	\$ 37	\$ 26	\$ 11	42.3%	\$ 111	\$ 94	\$ 17	18.1%
Personal asset management and custody fees	38	41	(3)	(7.3)	119	122	(3)	(2.5)
Institutional asset management and custody fees	58	52	6	11.5	170	143	27	18.9
Total trust and investment services income	\$ 133	\$ 119	\$ 14	11.8%	\$ 400	\$ 359	\$ 41	11.4%

A significant portion of Key's trust and investment services income depends on the value and mix of assets under management. At September 30, 2008, Key's bank, trust and registered investment advisory subsidiaries had assets under management of \$76.7 billion, compared to \$88.1 billion at September 30, 2007. As shown in Figure 14, most of the decrease was attributable to the equity and the securities lending portfolios. The reduction in the equity portfolio is attributable to weakness in the equity markets in general, while the decline in the securities lending portfolio was due in part to increased volatility in the fixed income markets and actions taken by management to maintain sufficient liquidity within the portfolio. When clients' securities are lent to a borrower, the borrower must provide Key with cash collateral, which is invested during the term of the loan. The difference between the revenue generated from the investment and the cost of the collateral is shared with the lending client. This business, although profitable, generates a significantly lower rate of return (commensurate with the lower level of risk) than other types of assets under management. Key's portfolio of hedge funds, which more than doubled over the past twelve months, generates a significantly higher rate of return and accounted for much of the improvement in Key's trust and investment services income.

Table of Contents**Figure 14. Assets Under Management**

<i>in millions</i>		2008			2007
	Third	Second	First	Fourth	Third
Assets under management by investment type:					
Equity	\$ 37,131	\$ 40,446	\$ 39,800	\$ 42,868	\$ 44,465
Securities lending	16,538	17,756	18,476	20,228	22,056
Fixed income	10,461	10,823	10,598	11,357	11,372
Money market	9,679	9,604	9,746	9,440	8,861
Hedge funds	2,867	2,369	1,833	1,549	1,346
Total	\$ 76,676	\$ 80,998	\$ 80,453	\$ 85,442	\$ 88,100
Proprietary mutual funds included in assets under management:					
Money market	\$ 6,871	\$ 7,178	\$ 7,131	\$ 7,298	\$ 6,888
Equity	6,771	7,202	6,556	6,957	6,748
Fixed income	633	617	631	631	629
Total	\$ 14,275	\$ 14,997	\$ 14,318	\$ 14,886	\$ 14,265

Service charges on deposit accounts. Service charges on deposit accounts were up from the prior year, due primarily to an increase in fee income from cash management services. The year-to-date increase from the prior year, to a lesser extent, also reflected higher overdraft fee income resulting from pricing and process changes.

Investment banking and capital markets (loss) income. As shown in Figure 15, the decreases in investment banking and capital markets (loss) income compared to the prior year were due to higher losses from dealer trading and derivatives, due primarily to the \$54 million of losses on derivative contracts recorded during the current quarter as a result of market disruption caused by the failure of Lehman Brothers.

Figure 15. Investment Banking and Capital Markets (Loss) Income

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2008	September 30, 2007	Change Amount	Change Percent	September 30, 2008	September 30, 2007	Change Amount	Change Percent
Investment banking income	\$ 20	\$ 22	\$ (2)	(9.1)%	\$ 78	\$ 65	\$ 13	20.0%
Losses from other investments	(7)	(22)	15	68.2	(12)	(11)	(1)	(9.1)
Dealer trading and derivatives (loss) income	(57)	(2)	(55)	N/M	(50)	18	(68)	N/M
Foreign exchange income	13	11	2	18.2	41	33	8	24.2
Total investment banking and capital markets (loss) income	\$ (31)	\$ 9	\$ (40)	N/M%	\$ 57	\$ 105	\$ (48)	(45.7)%

N/M = Not
Meaningful

Net losses from loan securitizations and sales. Key sells or securitizes loans to achieve desired interest rate and credit risk profiles, to improve the profitability of the overall loan portfolio or to diversify funding sources. During the first nine months of 2008, Key recorded \$98 million of net losses from loan sales and write-downs, compared to net losses of \$11 million for the first nine months of 2007. Results for the current year include \$31 million of net losses from the third quarter 2008 sales or write-downs of loans within residential properties segment of the construction loan portfolio and \$101 million of net losses from loan sales and write-downs recorded during the first quarter, due primarily to volatility in the fixed income markets and the related housing correction. Approximately \$84 million of these losses pertained to commercial real estate loans held for sale. The types of loans sold during 2008 and 2007 are presented in Figure 20 on page 70. In March 2008, Key transferred \$3.3 billion of education loans from held-for-sale status to the loan portfolio. The secondary markets for these loans have been adversely affected by market liquidity issues, precluding any recent securitizations and prompting the company's decision to move them to a held-to-maturity classification.

Net (losses) gains from principal investing. Principal investments consist of direct and indirect investments in predominantly privately held companies. Key's principal investing income is susceptible to volatility since most of it is derived from mezzanine debt and equity investments in small to medium-sized businesses. These investments are carried on the balance sheet at fair value (\$1.0 billion at September 30, 2008, \$993 million at December 31, 2007, and \$970 million at September 30, 2007). The net (losses) gains presented in Figure 12 derive from changes in fair values as well as the sales of principal investments.

Table of Contents**Noninterest expense**

Noninterest expense for the third quarter of 2008 was \$762 million, compared to \$753 million for the third quarter of 2007. For the first nine months of the year, noninterest expense was \$2.3 billion, representing a decrease of \$77 million, or 3%, from the first nine months of 2007.

As shown in Figure 16, personnel expense decreased by \$2 million from the third quarter of 2007, as increases in both salaries and severance expense were more than offset by reductions in costs associated with employee benefits and stock-based compensation. Nonpersonnel expense rose by \$11 million, reflecting increases of \$8 million in professional fees, \$6 million in marketing expense, \$5 million in net occupancy expense and \$7 million resulting from the write-down or amortization of intangible assets. Included in noninterest expense for the third quarter of 2008 is \$19 million of severance and other exit costs, including \$10 million of expense recorded in connection with Key's third quarter 2008 decision to exit direct and indirect retail and floor-plan lending for marine and recreational vehicle products. Key expects to record additional exit-related costs in the fourth quarter. The increase in noninterest expense relative to the year-ago quarter was moderated by a \$23 million credit (included in miscellaneous expense), representing the reversal of the remaining litigation reserve associated with the previously reported Honsador litigation, which was settled in September 2008. See Note 13 (Contingent Liabilities and Guarantees), which begins on page 29, for more information pertaining to the Honsador litigation.

For the year-to-date period, personnel expense decreased by \$28 million. Approximately \$17 million of the reduction was attributable to the sale of the McDonald Investments branch network. Nonpersonnel expense was down \$49 million, due to the initial \$42 million reserve established during the second quarter of 2007 in connection with the Honsador litigation and the related third quarter 2008 reversal of the remaining reserve discussed above. Additionally, nonpersonnel expense included a \$21 million credit for losses on lending-related commitments in the current year, compared to a \$3 million provision in the prior year. The sale of the McDonald Investments branch network reduced Key's total nonpersonnel expense by approximately \$19 million.

The decline in total noninterest expense was moderated by an increase in professional fees, higher net occupancy expense and additional expenses recorded during the first nine months of 2008 as a result of the January 1, 2008, acquisition of U.S.B. Holding Co., Inc. and the October 1, 2007, acquisition of Tuition Management Systems, Inc.

Figure 16. Noninterest Expense

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30,		Change		September 30,		Change	
	2008	2007	Amount	Percent	2008	2007	Amount	Percent
Personnel	\$ 381	\$ 383	\$ (2)	(.5)%	\$ 1,194	\$ 1,222	\$ (28)	(2.3)%
Net occupancy	65	60	5	8.3	193	182	11	6.0
Computer processing	46	49	(3)	(6.1)	136	149	(13)	(8.7)
Operating lease expense	56	58	(2)	(3.4)	169	165	4	2.4
Professional fees	35	27	8	29.6	91	79	12	15.2
Equipment	23	22	1	4.5	70	71	(1)	(1.4)
Marketing	27	21	6	28.6	62	60	2	3.3
Other expense:								
Postage and delivery	11	11			34	34		
Franchise and business taxes	7	8	(1)	(12.5)	23	25	(2)	(8.0)
Telecommunications	7	7			22	21	1	4.8
Provision (credit) for losses on lending-related commitments	8	5	3	60.0	(21)	3	(24)	N/M
Miscellaneous expense	96	102	(6)	(5.9)	302	341	(39)	(11.4)

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Total other expense	129	133	(4)	(3.0)	360	424	(64)	(15.1)
Total noninterest expense	\$ 762	\$ 753	\$ 9	1.2%	\$ 2,275	\$ 2,352	\$ (77)	(3.3)%
Average full-time equivalent employees	18,291	18,567 ^a	(276)	(1.5)%	18,294	19,081 ^a	(787)	(4.1)%

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

N/M = Not Meaningful

The following discussion explains the composition of certain elements of Key's noninterest expense and the factors that caused those elements to change.

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Personnel. As shown in Figure 17, personnel expense, the largest category of Key's noninterest expense, decreased by \$28 million, or 2%, from the first nine months of 2007. This improvement was largely attributable to lower costs associated with salaries and employee benefits stemming from a 4% reduction in the number of average full-time equivalent employees, and a decrease in stock-based compensation. The McDonald Investments branch network accounted for \$3 million of Key's personnel expense for the first nine months of 2008, compared to \$20 million for the same period last year. The reductions discussed above were offset in part by an increase in severance expense, including \$5 million of additional expense recorded in connection with Key's third quarter 2008 decision to exit certain businesses.

Figure 17. Personnel Expense

<i>dollars in millions</i>	Three months ended		Change		Nine months ended		Change	
	September 30, 2008	2007	Amount	Percent	September 30, 2008	2007	Amount	Percent
Salaries	\$ 245	\$ 240	\$ 5	2.1%	\$ 719	\$ 721	\$ (2)	(.3)%
Incentive compensation	55	55			208	212	(4)	(1.9)
Employee benefits	59	67	(8)	(11.9)	200	222	(22)	(9.9)
Stock-based compensation	8	17	(9)	(52.9)	39	57	(18)	(31.6)
Severance	14	4	10	250.0	28	10	18	180.0

Tota