

KEYCORP /NEW/  
Form 10-Q  
November 07, 2007

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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, 2007  
or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the Transition Period From \_\_\_\_\_ To \_\_\_\_\_  
Commission File Number 1-11302

(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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

388,768,905

(Title of class)

(Outstanding at October 31, 2007)

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Consolidated Balance Sheets**

<i>dollars in millions</i>	<b>September 30, 2007 (Unaudited)</b>	<b>December 31, 2006</b>	<b>September 30, 2006 (Unaudited)</b>
<b>ASSETS</b>			
Cash and due from banks	\$ 2,016	\$ 2,264	\$ 2,957
Short-term investments	1,723	1,407	1,582
Securities available for sale	7,915	7,827	7,441
Investment securities (fair value: \$36, \$42 and \$42)	36	41	41
Other investments	1,509	1,352	1,367
Loans, net of unearned income of \$2,227, \$2,136 and \$2,075	68,999	65,826	65,551
Less: Allowance for loan losses	955	944	944
Net loans	68,044	64,882	64,607
Loans held for sale	4,791	3,637	7,150
Premises and equipment	631	595	567
Operating lease assets	1,135	1,124	1,076
Goodwill	1,202	1,202	1,372
Other intangible assets	105	120	127
Corporate-owned life insurance	2,845	2,782	2,754
Derivative assets	1,497	1,091	915
Accrued income and other assets	3,917	4,013	4,199
Total assets	\$ 97,366	\$ 92,337	\$ 96,155
<b>LIABILITIES</b>			
Deposits in domestic offices:			
NOW and money market deposit accounts	\$ 24,198	\$ 24,340	\$ 25,150
Savings deposits	1,544	1,642	1,672
Certificates of deposit (\$100,000 or more)	6,672	5,941	5,734
Other time deposits	11,403	11,956	11,848
Total interest-bearing deposits	43,817	43,879	44,404
Noninterest-bearing deposits	14,003	13,553	13,396
Deposits in foreign office interest-bearing	5,894	1,684	3,629
Total deposits	63,714	59,116	61,429
Federal funds purchased and securities sold under repurchase agreements	5,398	3,643	4,701
Bank notes and other short-term borrowings	2,743	1,192	2,594
Derivative liabilities	1,063	922	844
Accrued expense and other liabilities	5,079	5,228	4,986
Long-term debt	11,549	14,533	13,654

Total liabilities	<b>89,546</b>	84,634	88,208
<b>SHAREHOLDERS EQUITY</b>			
Preferred stock, \$1 par value; authorized 25,000,000 shares, none issued			
Common shares, \$1 par value; authorized 1,400,000,000 shares; issued 491,888,780 shares	<b>492</b>	492	492
Capital surplus	<b>1,617</b>	1,602	1,588
Retained earnings	<b>8,788</b>	8,377	8,371
Treasury stock, at cost (103,180,446, 92,735,595 and 89,140,338 shares)	<b>(3,023)</b>	(2,584)	(2,434)
Accumulated other comprehensive loss	<b>(54)</b>	(184)	(70)
Total shareholders equity	<b>7,820</b>	7,703	7,947
Total liabilities and shareholders equity	<b>\$ 97,366</b>	\$ 92,337	\$ 96,155

See Notes to Consolidated Financial Statements (Unaudited).

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

<i>dollars in millions, except per share amounts</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>INTEREST INCOME</b>				
Loans	\$ 1,209	\$ 1,178	\$ 3,546	\$ 3,374
Loans held for sale	91	94	248	235
Investment securities		1	1	2
Securities available for sale	106	84	312	251
Short-term investments	16	16	50	47
Other investments	12	16	40	58
Total interest income	1,434	1,389	4,197	3,967
<b>INTEREST EXPENSE</b>				
Deposits	482	428	1,362	1,136
Federal funds purchased and securities sold under repurchase agreements	55	30	163	70
Bank notes and other short-term borrowings	30	24	59	75
Long-term debt	173	202	554	583
Total interest expense	740	684	2,138	1,864
<b>NET INTEREST INCOME</b>	<b>694</b>	<b>705</b>	<b>2,059</b>	<b>2,103</b>
Provision for loan losses	69	35	166	97
Net interest income after provision for loan losses	625	670	1,893	2,006
<b>NONINTEREST INCOME</b>				
Trust and investment services income	119	137	359	411
Service charges on deposit accounts	88	78	247	227
Investment banking and capital markets income	9	44	105	161
Operating lease income	70	58	200	166
Letter of credit and loan fees	51	48	134	133
Corporate-owned life insurance income	27	23	84	74
Electronic banking fees	25	27	74	78
Net gains (losses) from loan securitizations and sales	(53)	14	(11)	34
Net securities gains (losses)	4	(7)	(41)	(2)
Gain on sale of McDonald Investments branch network			171	
Other income	98	121	419	287
Total noninterest income	438	543	1,741	1,569
<b>NONINTEREST EXPENSE</b>				
Personnel	383	418	1,222	1,245
Net occupancy	60	62	182	182

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Computer processing	<b>49</b>	52	<b>149</b>	157
Operating lease expense	<b>58</b>	48	<b>165</b>	134
Professional fees	<b>27</b>	28	<b>79</b>	101
Equipment	<b>22</b>	26	<b>71</b>	78
Marketing	<b>21</b>	32	<b>60</b>	70
Other expense	<b>133</b>	124	<b>424</b>	373
Total noninterest expense	<b>753</b>	790	<b>2,352</b>	2,340
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>	<b>310</b>	423	<b>1,282</b>	1,235
Income taxes	<b>86</b>	118	<b>363</b>	353
<b>INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>	<b>224</b>	305	<b>919</b>	882
(Loss) income from discontinued operations, net of taxes of (\$8), \$4, (\$15) and \$14, respectively (see Note 3)	<b>(14)</b>	7	<b>(25)</b>	22
<b>INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>	<b>210</b>	312	<b>894</b>	904
Cumulative effect of accounting change, net of taxes (see Note 1)				5
<b>NET INCOME</b>	<b>\$ 210</b>	<b>\$ 312</b>	<b>\$ 894</b>	<b>\$ 909</b>
Per common share:				
Income from continuing operations before cumulative effect of accounting change	<b>\$ .58</b>	<b>\$ .76</b>	<b>\$ 2.34</b>	<b>\$ 2.18</b>
Income before cumulative effect of accounting change	<b>.54</b>	<b>.77</b>	<b>2.28</b>	<b>2.23</b>
Net income	<b>.54</b>	<b>.77</b>	<b>2.28</b>	<b>2.24</b>
Per common share assuming dilution:				
Income from continuing operations before cumulative effect of accounting change	<b>\$ .57</b>	<b>\$ .74</b>	<b>\$ 2.31</b>	<b>\$ 2.15</b>
Income before cumulative effect of accounting change	<b>.54</b>	<b>.76</b>	<b>2.25</b>	<b>2.20</b>
Net income	<b>.54</b>	<b>.76</b>	<b>2.25</b>	<b>2.21</b>
Cash dividends declared per common share	<b>\$ .365</b>	<b>\$ .345</b>	<b>\$ 1.095</b>	<b>\$ 1.035</b>
Weighted-average common shares outstanding (000)	<b>389,319</b>	403,780	<b>393,048</b>	405,218
Weighted-average common shares and potential common shares outstanding (000)	<b>393,164</b>	409,428	<b>397,816</b>	411,029

See Notes to Consolidated Financial Statements (Unaudited).

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

	Common			Accumulated			
	Shares Outstanding	Common Shares	Capital Surplus	Retained Earnings	Treasury Stock at Cost	Other Comprehensive Loss	Comprehensive Income
<i>dollars in millions, except per share amounts</i>							
<b>BALANCE AT DECEMBER 31, 2005</b>	406,624	\$ 492	\$ 1,534	\$ 7,882	\$ (2,204)	\$ (106)	
Net income				909			\$ 909
Other comprehensive income (losses):							
Net unrealized gains on securities available for sale, net of income taxes of \$5 <sup>a</sup>						6	6
Net unrealized gains on derivative financial instruments, net of income taxes						1	1
Net unrealized losses on common investments held in employee welfare benefits trust, net of income taxes						(1)	(1)
Foreign currency translation adjustments						30	30
Total comprehensive income							\$ 945
Deferred compensation				21			
Cash dividends declared on common shares (\$1.035 per share)				(420)			
Issuance of common shares for stock options and other employee benefit plans	8,624		33		227		
Repurchase of common shares	(12,500)				(457)		
<b>BALANCE AT SEPTEMBER 30, 2006</b>	402,748	\$ 492	\$ 1,588	\$ 8,371	\$ (2,434)	\$ (70)	
<b>BALANCE AT DECEMBER 31, 2006</b>	399,153	\$ 492	\$ 1,602	\$ 8,377	\$ (2,584)	\$ (184)	
Cumulative effect of adopting FSP 13-2, net of income taxes of (\$2) (see Note 1)				(52)			
Cumulative effect of adopting FIN 48, net of income taxes of (\$1) (see Note 1)				(1)			
<b>BALANCE AT JANUARY 1, 2007</b>				<b>8,324</b>			
Net income				<b>894</b>			\$ <b>894</b>
Other comprehensive income:							
Net unrealized gains on securities available for sale, net of income taxes of \$31 <sup>a</sup>						<b>50</b>	<b>50</b>
Net unrealized gains on derivative financial instruments, net of income taxes of \$25						<b>42</b>	<b>42</b>
Foreign currency translation adjustments						<b>23</b>	<b>23</b>
						<b>15</b>	<b>15</b>



Net pension and postretirement benefit costs,  
net of income taxes

Total comprehensive income **\$ 1,024**

Deferred compensation **12 (3)**

Cash dividends declared on common shares  
(\$1.095 per share) **(427)**

Issuance of common shares for stock options  
and other employee benefit plans **5,555 3 156**

Repurchase of common shares **(16,000) (595)**

**BALANCE AT SEPTEMBER 30, 2007** **388,708 \$ 492 \$ 1,617 \$ 8,788 \$ (3,023) \$ (54)**

(a) Net of reclassification adjustments.

See Notes to Consolidated Financial Statements (Unaudited).

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

<i>in millions</i>	<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 894	\$ 909
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	166	94
Depreciation and amortization expense	316	292
Litigation reserve	42	
Net securities losses	41	2
Gain from sale of McDonald Investments branch network	(171)	
Gains related to MasterCard Incorporated shares	(67)	(9)
Proceeds from settlement of automobile residual value insurance litigation	279	
Gain from settlement of automobile residual value insurance litigation	(26)	
Net gains from principal investing	(128)	(48)
Net gains (losses) from loan securitizations and sales	11	(34)
Loss from sale of discontinued operations	2	
Deferred income taxes	(53)	(230)
Net increase in loans held for sale	(1,154)	(1,295)
Net (increase) decrease in trading account assets	(148)	33
Other operating activities, net	(603)	(232)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(599)</b>	<b>(518)</b>
<b>INVESTING ACTIVITIES</b>		
Cash used in acquisitions, net of cash acquired		(34)
Proceeds from sale of McDonald Investments branch network, net of retention payments	199	
Proceeds from sale of MasterCard Incorporated shares	67	9
Net increase in other short-term investments	(168)	(23)
Purchases of securities available for sale	(4,333)	(2,730)
Proceeds from sales of securities available for sale	2,506	154
Proceeds from prepayments and maturities of securities available for sale	1,788	2,421
Purchases of investment securities		(2)
Proceeds from prepayments and maturities of investment securities	5	53
Purchases of other investments	(500)	(401)
Proceeds from sales of other investments	275	189
Proceeds from prepayments and maturities of other investments	138	209
Net increase in loans, excluding acquisitions, sales and transfers	(3,723)	(1,990)
Purchases of loans	(61)	(64)
Proceeds from loan securitizations and sales	306	298
Purchases of premises and equipment	(123)	(68)
Proceeds from sales of premises and equipment	9	4
Proceeds from sales of other real estate owned	61	20
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(3,554)</b>	<b>(1,955)</b>
<b>FINANCING ACTIVITIES</b>		

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Net increase in deposits	<b>4,594</b>	2,674
Net increase in short-term borrowings	<b>3,306</b>	680
Net proceeds from issuance of long-term debt	<b>393</b>	1,609
Payments on long-term debt	<b>(3,490)</b>	(1,997)
Purchases of treasury shares	<b>(595)</b>	(457)
Net proceeds from issuance of common stock	<b>111</b>	207
Tax benefits in excess of recognized compensation cost for stock-based awards	<b>13</b>	26
Cash dividends paid	<b>(427)</b>	(420)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>3,905</b>	2,322
<b>NET DECREASE IN CASH AND DUE FROM BANKS</b>	<b>(248)</b>	(151)
<b>CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD</b>	<b>2,264</b>	3,108
<b>CASH AND DUE FROM BANKS AT END OF PERIOD</b>	<b>\$ 2,016</b>	\$ 2,957
Additional disclosures relative to cash flows:		
Interest paid	<b>\$ 2,211</b>	\$ 2,042
Income taxes paid	<b>276</b>	328
Noncash items:		
Loans transferred from portfolio to held for sale		\$ 2,474
Loans transferred to other real estate owned	<b>\$ 31</b>	52

See Notes to Consolidated Financial Statements (Unaudited).

**Table of Contents****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 company and *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 22 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 estimated fair value.

Qualifying special purpose entities ( SPEs ), 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 2006 Annual Report to Shareholders under the heading Loan Securitizations on page 69.

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 2006 Annual Report to Shareholders.

**Servicing Assets**

Key s servicing assets, which totaled \$352 million at September 30, 2007, \$282 million at December 31, 2006, and \$263 million at September 30, 2006, are included in accrued income and other assets on the balance sheet. Key services both mortgage and education loans. Servicing assets at September 30, 2007, include \$322 million related to mortgage loan servicing and \$30 million related to education loan servicing.

Effective January 1, 2007, Key adopted SFAS No. 156, Accounting for Servicing of Financial Assets an Amendment of FASB Statement No. 140, which requires that newly purchased or retained servicing assets and liabilities be initially measured at fair value, if practicable. SFAS No. 156 also requires the subsequent remeasurement of servicing assets and liabilities at each reporting date using one of two methods: amortization over the servicing period or measurement at fair value.

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When no ready market value such as quoted market prices or prices based on sales or purchases of similar assets is available to determine the fair value of servicing assets, the fair value is determined by estimating the present value of future cash flows associated with servicing the loans. The estimate is based on a number of assumptions, including the cost of servicing, discount rate, prepayment rate and default rate.

Key has elected to subsequently remeasure servicing assets using the amortization method. The amortization of servicing assets is determined in proportion to, and over the period of, the estimated net servicing income and is recorded in other income on the income statement.

In accordance with SFAS No. 140, the initial value of servicing assets purchased or retained prior to January 1, 2007, was determined by allocating the amount of the assets sold or securitized to the retained interests and the assets sold based on their relative fair values at the date of transfer. These servicing assets are reported at the lower of amortized cost or fair value.

Servicing assets are evaluated quarterly for possible impairment by classifying the assets based on the types of loans serviced and their associated interest rates, and estimating the fair value of each class. If the evaluation indicates that the carrying amount of the servicing assets exceeds their fair value, the carrying amount is reduced through a charge to income in the amount of such excess. For the nine-month periods ended September 30, 2007 and 2006, no servicing asset impairment occurred. Additional information pertaining to servicing assets is included in Note 7 ( Mortgage Servicing Assets ), which begins on page 21.

**Stock-Based Compensation**

Effective January 1, 2006, Key adopted SFAS No. 123R, Share-Based Payment, which replaced SFAS No. 123. SFAS 123R requires stock-based compensation to be measured using the fair value method of accounting, with the measured cost to be recognized over the period during which the recipient is required to provide service in exchange for the award. SFAS No. 123R also changes the manner of accounting for forfeited stock-based awards. Under the new standard, companies are no longer permitted to account for forfeitures as they occur. Instead, companies that had been using this alternative method of accounting for forfeitures must now estimate expected forfeitures at the date the awards are granted and record compensation expense only for those that are expected to vest. As of the effective date, companies had to estimate expected forfeitures and reduce their related compensation obligation for expense previously recognized in the financial statements. The after-tax amount of this reduction is presented on the income statement as a cumulative effect of a change in accounting principle. Key's cumulative after-tax adjustment increased first quarter 2006 earnings by \$5 million, or \$.01 per diluted common share.

**Accounting Pronouncements Adopted in 2007**

**Accounting for leveraged leases.** In July 2006, the FASB issued 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, which provides additional guidance on the application of SFAS No. 13, Accounting for Leases. This guidance affects when earnings from leveraged lease transactions will be recognized, and requires a lessor to recalculate its recognition of lease income when there are changes or projected changes in the timing of cash flows, including changes due to final or expected settlements of tax matters. Previously, leveraged lease transactions were required to be recalculated only when a change in the total projected net income from the lease occurred. This guidance became effective for fiscal years beginning after December 15, 2006 (effective January 1, 2007, for Key). Adoption of this guidance resulted in a cumulative after-tax charge of \$52 million to Key's retained earnings. Future earnings are expected to increase over the remaining term of the affected leases by a similar amount. Additional information related to Staff Position No. 13-2 is included in Note 12 ( Income Taxes ) under the heading Tax-Related Accounting Pronouncements Adopted in 2007 on page 26.

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**Accounting for uncertain tax positions.** In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the application of SFAS No. 109, Accounting for Income Taxes, by defining the minimum threshold that a tax position must meet for the associated tax benefit to be recognized in a company's financial statements. It also provides guidance on measurement and derecognition of tax benefits, and requires expanded disclosures. The interpretation became effective for fiscal years beginning after December 15, 2006 (effective January 1, 2007, for Key). Adoption of this guidance did not have a material impact on Key's financial condition or results of operations. Additional information related to this interpretation is included in Note 12 under the heading Tax-Related Accounting Pronouncements Adopted in 2007.

**Accounting for servicing of financial assets.** As discussed under the heading Servicing Assets on page 7, effective January 1, 2007, Key adopted SFAS No. 156, which requires that servicing assets and liabilities be initially measured at fair value, if practicable. SFAS No. 156 also requires the subsequent remeasurement of servicing assets and liabilities at each reporting date using one of two methods: amortization over the servicing period or measurement at fair value. Adoption of this guidance did not have a material effect on Key's financial condition or results of operations. Additional information related to SFAS No. 156 is included in Note 7.

**Accounting for certain hybrid financial instruments.** In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments. A hybrid financial instrument is one in which a derivative is embedded in another financial instrument. SFAS No. 155 permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require the financial instrument and derivative to be separated. This guidance eliminates the prohibition on a qualifying SPE from holding certain derivative financial instruments. SFAS No. 155 became effective for all financial instruments acquired or issued in fiscal years beginning after September 15, 2006 (effective January 1, 2007, for Key). Adoption of this guidance did not have a material effect on Key's financial condition or results of operations.

**Accounting Pronouncements Pending Adoption**

**Accounting for investment companies.** In June 2007, the Accounting Standards Executive Committee, under the auspices of the FASB, issued Statement of Position ( SOP ) No. 07-1, Clarification of the Scope of the Audit and Accounting Guide *Investment Companies* and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies. The new pronouncement provides guidance for determining whether an entity is within the scope of the Guide and whether the specialized industry accounting principles of the Guide should be applied by a parent company in accounting for an investment company subsidiary. SOP No. 07-1 will be effective for fiscal years beginning on or after December 15, 2007 (effective January 1, 2008, for Key). Management is evaluating the potential effect this guidance may have on Key's financial condition or results of operations.

**Investment companies under Revised Interpretation No. 46.** In May 2007, the FASB issued Staff Position FIN 46(R)-7, Application of FASB Interpretation No. 46(R) to Investment Companies. The new pronouncement provides an exception to the scope of Revised Interpretation No. 46 for investment companies within the scope of SOP No. 07-1. Staff Position FIN 46(R)-7 will be effective for fiscal years beginning on or after December 15, 2007 (effective January 1, 2008, for Key). Management is evaluating the potential effect this guidance may have on Key's financial condition or results of operations.

**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 will be effective for fiscal years beginning after November 15, 2007 (effective January 1, 2008, for Key). Management is evaluating whether this fair value option will be used for any of Key's financial assets or liabilities, and the resulting effect on Key's financial condition or results of operations.

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**Fair value measurements.** In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, 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 will be effective for fiscal years beginning after November 15, 2007 (effective January 1, 2008, for Key). Management is evaluating the potential effect this guidance may have on Key's financial condition or results of operations.

**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 Adopted in 2006 on page 72 of Key's 2006 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 with earlier application encouraged (no later than 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.

**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>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>EARNINGS</b>				
Income from continuing operations before cumulative effect of accounting change	\$ 224	\$ 305	\$ 919	\$ 882
(Loss) income from discontinued operations, net of taxes	(14)	7	(25)	22
Income before cumulative effect of accounting change	210	312	894	904
Net income	210	312	894	909
<b>WEIGHTED-AVERAGE COMMON SHARES</b>				
Weighted-average common shares outstanding (000)	389,319	403,780	393,048	405,218
Effect of dilutive common stock options and other stock awards (000)	3,845	5,648	4,768	5,811
Weighted-average common shares and potential common shares outstanding (000)	393,164	409,428	397,816	411,029
<b>EARNINGS PER COMMON SHARE</b>				
Income per common share from continuing operations before cumulative effect of accounting change	\$ .58	\$ .76	\$ 2.34	\$ 2.18
(Loss) income per common share from discontinued operations	(.03)	.02	(.06)	.05
Income per common share before cumulative effect of accounting change	.54	.77	2.28	2.23
Net income per common share	.54	.77	2.28	2.24

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Income per common share from continuing operations before cumulative effect of accounting change assuming dilution	\$	<b>.57</b>	\$	.74	\$	<b>2.31</b>	\$	2.15
(Loss) income per common share from discontinued operations assuming dilution		<b>(.03)</b>		.02		<b>(.06)</b>		.05
Income per common share before cumulative effect of accounting change assuming dilution		<b>.54</b>		.76		<b>2.25</b>		2.20
Net income per common share assuming dilution		<b>.54</b>		.76		<b>2.25</b>		2.21



**Table of Contents****3. Acquisitions and Divestitures**

Acquisitions and divestitures either completed by Key during 2006 and the first nine months of 2007, or pending completion, are summarized below.

**Acquisitions****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 acquisition were not material.

**Austin Capital Management, Ltd.**

On April 1, 2006, Key acquired Austin Capital Management, Ltd., an investment firm headquartered in Austin, Texas with approximately \$900 million in assets under management at the date of acquisition. Austin specializes in selecting and managing hedge fund investments for its principally institutional customer base. The terms of the acquisition 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 nonprime 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.

As a result of these actions, Key has applied discontinued operations accounting to this business for all periods presented in this report. The results of the discontinued Champion Mortgage finance business are presented on one line as (loss) income from discontinued operations, net of taxes in the Consolidated Statements of Income on page 4. The components of (loss) income from discontinued operations are as follows:

<i>in millions</i>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
(Loss) income, net of taxes of (\$2), \$4, (\$5) and \$14, respectively <sup>a</sup>	\$ (3)	\$ 7	\$ (9)	\$ 22
Loss on disposal, net of taxes of (\$1)			(1)	
Disposal transaction costs, net of taxes of (\$6) and (\$9), respectively <sup>b</sup>	(11)		(15)	
(Loss) income from discontinued operations	\$ (14)	\$ 7	\$ (25)	\$ 22

(a) Includes after-tax charges of \$.06 million and \$19 million for the three-month periods ended September 30, 2007 and 2006, respectively, and \$.7 million and \$54 million for the nine-month periods ended September 30, 2007 and 2006, respectively, determined by applying a matched funds transfer pricing methodology to the liabilities assumed necessary to support Champion's operations.

(b) Disposal transaction costs were attributable largely to a write-down on the building lease for the former Champion headquarters recorded during the third quarter of 2007.

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

<i>in millions</i>	September 30, 2007	December 31, 2006	September 30, 2006
Loans	\$ 9	\$ 10	\$ 11
Loans held for sale		179	2,484
Accrued income and other assets	2	22	230
<b>Total assets</b>	<b>\$ 11</b>	<b>\$ 211</b>	<b>\$ 2,725</b>
Deposits		\$ 88	\$ 8
Accrued expense and other liabilities	\$ 14	17	5
<b>Total liabilities</b>	<b>\$ 14</b>	<b>\$ 105</b>	<b>\$ 13</b>

**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 the corporate and institutional businesses, including Institutional Equities and Equity Research, Debt Capital Markets and Investment Banking. In addition, KeyBank National Association ( KeyBank ), KeyCorp's subsidiary bank, continues to conduct its 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.

**Acquisition Pending****U.S.B. Holding Co., Inc.**

On July 26, 2007, Key entered into a definitive agreement to acquire U.S.B. Holding Co., Inc., the holding company for Union State Bank, a state-chartered commercial bank headquartered in Orangeburg, New York, with 31 branches. U.S.B. Holding Co. has assets of approximately \$3 billion and deposits of approximately \$2 billion. Under the terms of the agreement, each share of U.S.B. Holding Co. common stock will be exchanged at the closing for .455 KeyCorp common shares and \$8.925 in cash. Based on the closing price of KeyCorp common shares on July 26, 2007 (the last trading day preceding the announcement of the agreement), the transaction would be valued at approximately \$575 million. The transaction is expected to close early in 2008, subject to approval by U.S.B. Holding Co. shareholders and the banking regulators. After the close, Key plans to merge Union State Bank into KeyBank. The acquisition will expand Key's presence in markets both within and contiguous to its current operations in the Hudson Valley.

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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** provides construction and interim lending, permanent debt placements and servicing, and equity and investment banking services to developers, brokers and owner-investors. This line of business deals exclusively 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).

**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** provides products and services to large corporations, middle-market companies, financial institutions, government entities and not-for-profit organizations. These products and services include commercial lending, treasury management, investment banking, derivatives and foreign exchange, equity and debt underwriting and trading, and syndicated finance.

Through its Victory Capital Management unit, Institutional and Capital Markets also manages or gives 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** includes Indirect Lending, Commercial Floor Plan Lending, Home Equity Services and Business Services.

Indirect Lending offers loans to consumers through dealers. This business unit also provides federal and private education loans to students and their parents, and processes payments on loans that private schools make to parents. Commercial Floor Plan Lending finances inventory for automobile and marine dealers.

Home Equity Services works with home improvement contractors to provide home equity and home improvement financing solutions.

Business Services provides payroll processing solutions for businesses of all sizes.

**Other Segments**

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

**Table of Contents****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 15 and 16 shows selected financial data for each major business group for the three- and nine-month periods ended September 30, 2007 and 2006. 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 level 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 69 of Key's 2006 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, 2007, Key reorganized the following business units within its lines of business:

- .. The Mortgage Services unit, previously included under the Consumer Finance line of business within the National Banking group, has been moved to the Regional Banking line of business within the Community Banking group.
- .. In light of the Champion divestiture, the National Home Equity unit, previously included under the Consumer Finance line of business within the National Banking group, has been eliminated and replaced by the remaining Home Equity Services unit.
- .. Business Services has been added as a unit under the Consumer Finance line of business within the National Banking group.



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Net interest income (TE)	\$ 1,242	\$ 1,309	\$ 1,045	\$ 1,039	\$ (72)	\$ (91)
Noninterest income	818 <sup>c</sup>	714	682 <sup>d</sup>	709	167 <sup>e</sup>	129
Total revenue (TE) <sup>a</sup>	2,060	2,023	1,727	1,748	95	38
Provision for loan losses	36	71	130	26		
Depreciation and amortization expense	105	112	211	178		
Other noninterest expense	1,231	1,323	757	734	49 <sup>e</sup>	21
Income (loss) from continuing operations before income taxes and cumulative effect of accounting change (TE)	688	517	629	810	46	17
Allocated income taxes and TE adjustments	258	194	236	301	(16)	(22)
Income from continuing operations before cumulative effect of accounting change	430	323	393	509	62	39
(Loss) income from discontinued operations, net of taxes			(25)	22		
Income before cumulative effect of accounting change	430	323	368	531	62	39
Cumulative effect of accounting change, net of taxes						
Net income	\$ 430	\$ 323	\$ 368	\$ 531	\$ 62	\$ 39
Percent of consolidated income from continuing operations	47%	37%	43%	58%	6%	4%
Percent of total segments income from continuing operations	49	37	44	59	7	4
<b>AVERAGE BALANCES <sup>b</sup></b>						
Loans and leases	\$ 26,661	\$ 26,803	\$ 39,485	\$ 37,545	\$ 263	\$ 302
Total assets <sup>a</sup>	29,454	29,883	49,665	47,659	12,401	11,456
Deposits	46,458	46,459	12,009	10,597	2,575	2,042
<b>OTHER FINANCIAL DATA</b>						
Net loan charge-offs	\$ 65	\$ 74	\$ 91	\$ 42		
Return on average allocated equity <sup>b</sup>	23.23%	17.27%	12.83%	17.83%	N/M	N/M
Return on average allocated equity	23.23	17.27	12.02	17.47	N/M	N/M
Average full-time equivalent employees	9,043	9,697	3,955	4,235	43	40

(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 results for the first nine months 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 11, for more information pertaining to this transaction.
- (d) National Banking results for the first nine months of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation during the first quarter.
- (e) Other Segments results for the first nine months of 2007 include a \$26 million (\$16 million after tax) charge for litigation recorded during the second quarter. This charge and the litigation charge referred to in note (f) below comprise the \$42 million charge recorded in connection with the Honsador litigation disclosed in Note 13 ( Contingent Liabilities and Guarantees ), which begins on page 28. Results for the current year-to-date period also include a \$49 million (\$31 million after tax) loss recorded during the first quarter in connection with the repositioning of the securities portfolio.
- (f) Reconciling Items include gains of \$27 million (\$17 million after

tax) recorded during the third quarter of 2007, \$40 million (\$25 million after tax) recorded during the second quarter of 2007 and \$9 million (\$6 million after tax) recorded during the second quarter of 2006 related to MasterCard Incorporated shares. Results for the first nine months of 2007 also include a \$16 million (\$10 million after tax) charge for litigation recorded during the second quarter.

TE = Taxable Equivalent, N/A = Not Applicable, N/M = Not Meaningful



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Total Segments		Reconciling Items		Key	
2007	2006	2007	2006	2007	2006
\$ 744	\$ 760	\$ (32)	\$ (34)	\$ 712	\$ 726
407	538	31 <sub>f</sub>	5	438	543
1,151	1,298	(1)	(29)	1,150	1,269
69	35			69	35
107	99			107	99
644	698	2	(7)	646	691
331	466	(3)	(22)	328	444
112	165	(8)	(26)	104	139
219	301	5	4	224	305
(14)	7			(14)	7
\$ 205	\$ 308	\$ 5	\$ 4	\$ 210	\$ 312
98%	99%	2%	1%	100%	100%
100	100	N/A	N/A	N/A	N/A
\$ 67,469	\$ 64,947	\$ 211	\$ 233	\$ 67,680	\$ 65,180
93,193	89,904	1,969	2,359	95,162	92,263
62,563	60,269	(42)	(229)	62,521	60,040
\$ 59	\$ 43			\$ 59	\$ 43
12.14%	17.48%	N/M	N/M	11.50%	15.52%
11.37	17.27	N/M	N/M	10.79	15.88
12,516	14,182	6,051	6,082	18,567	20,264
Total Segments		Reconciling Items		Key	
2007	2006	2007	2006	2007	2006
\$ 2,215	\$ 2,257	\$ (97)	\$ (83)	\$ 2,118	\$ 2,174
1,667	1,552	74 <sub>f</sub>	17 <sub>f</sub>	1,741	1,569

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<b>3,882</b>	3,809	<b>(23)</b>	(66)	<b>3,859</b>	3,743
<b>166</b>	97			<b>166</b>	97
<b>316</b>	290			<b>316</b>	290
<b>2,037</b>	2,078	<b>(1)<sub>f</sub></b>	(28)	<b>2,036</b>	2,050
<b>1,363</b>	1,344	<b>(22)</b>	(38)	<b>1,341</b>	1,306
<b>478</b>	473	<b>(56)</b>	(49)	<b>422</b>	424
<b>885</b>	871	<b>34</b>	11	<b>919</b>	882
<b>(25)</b>	22			<b>(25)</b>	22
<b>860</b>	893	<b>34</b>	11	<b>894</b>	904
			5		5
<b>\$ 860</b>	<b>\$ 893</b>	<b>\$ 34</b>	<b>\$ 16</b>	<b>\$ 894</b>	<b>\$ 909</b>
<b>96%</b>	99%	<b>4%</b>	1%	<b>100%</b>	100%
<b>100</b>	100	<b>N/A</b>	N/A	<b>N/A</b>	N/A
<b>\$ 66,409</b>	<b>\$ 64,650</b>	<b>\$ 153</b>	<b>\$ 152</b>	<b>\$ 66,562</b>	<b>\$ 64,802</b>
<b>91,520</b>	88,998	<b>2,048</b>	2,249	<b>93,568</b>	91,247
<b>61,042</b>	59,098	<b>(139)</b>	(162)	<b>60,903</b>	58,936
<b>\$ 156</b>	<b>\$ 116</b>			<b>\$ 156</b>	<b>\$ 116</b>
<b>16.78%</b>	17.25%	<b>N/M</b>	N/M	<b>16.03%</b>	15.44%
<b>16.31</b>	17.06	<b>N/M</b>	N/M	<b>15.59</b>	15.82
<b>13,041</b>	13,972	<b>6,040</b>	6,002	<b>19,081</b>	19,974

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Supplementary Information (Community Banking lines of business)

<b>Three months ended September 30,</b> <i>dollars in millions</i>	<b>Regional Banking</b>		<b>Commercial Banking</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Total revenue (TE)	\$ 532	\$ 587	\$ 94	\$ 100
Provision (credit) for loan losses	12	19	(11)	3
Noninterest expense	371	436	46	50
Net income	94	83	37	29
Average loans and leases	18,661	18,822	8,286	7,972
Average deposits	43,229	43,495	3,498	3,444
Net loan charge-offs	18	19	2	2
Return on average allocated equity	21.38%	18.52%	19.37%	15.80%
Average full-time equivalent employees	8,322	9,516	310	320

<b>Nine months ended September 30,</b> <i>dollars in millions</i>	<b>Regional Banking</b>		<b>Commercial Banking</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Total revenue (TE)	\$ 1,781	\$ 1,730	\$ 279	\$ 293
Provision (credit) for loan losses	51	60	(15)	11
Noninterest expense	1,192	1,283	144	152
Net income	336	242	94	81
Average loans and leases	18,535	18,860	8,126	7,943
Average deposits	42,994	43,009	3,464	3,450
Net loan charge-offs	56	61	9	13
Return on average allocated equity	25.85%	18.28%	17.05%	14.84%
Average full-time equivalent employees	8,726	9,378	317	319

Supplementary Information (National Banking lines of business)

<b>Three months ended September 30,</b> <i>dollars in millions</i>	<b>Real Estate Capital</b>		<b>Equipment Finance</b>		<b>Institutional and Capital Markets</b>		<b>Consumer Finance</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Total revenue (TE)	\$ 104	\$ 170	\$ 139	\$ 137	\$ 183	\$ 190	\$ 85	\$ 89
Provision (credit) for loan losses	43	7	16	11	(3)	3	12	(8)
Noninterest expense	77	70	94	81	118	110	39	43
Income (loss) from continuing operations	(10)	58	18	28	42	48	22	35
Net income (loss)	(10)	58	18	28	42	48	8	42
Average loans and leases <sup>a</sup>	13,187	12,854	10,681	10,100	7,693	7,390	8,716	7,527
Average loans held for sale <sup>a</sup>	1,584	1,022	6	6	373	454	2,729	3,071
Average deposits <sup>a</sup>	5,559	3,593	16	19	6,633	7,042	425	452
Net loan charge-offs	7		16	11	5	5	11	6
Return on average allocated equity <sup>a</sup>	(2.96)%	19.06%	7.92%	13.02%	14.34%	16.46%	11.81%	20.85%
Return on average allocated equity	(2.96)	19.06	7.92	13.02	14.34	16.46	4.29	18.29
	1,007	970	985	927	1,320	1,385	529	1,023

Average full-time equivalent employees

Nine months ended September 30, <i>dollars in millions</i>	Real Estate Capital		Equipment Finance		Institutional and Capital Markets		Consumer Finance	
	2007	2006	2007	2006	2007	2006	2007	2006
Total revenue (TE)	\$ 458	\$ 502	\$ 427	\$ 397	\$ 557	\$ 589	\$ 285	\$ 260
Provision (credit) for loan losses	51	9	45	16	(1)	(4)	35	5
Noninterest expense	226	205	272	230	349	343	121	134
Income from continuing operations	113	180	69	95	130	157	81	77
Net income	113	180	69	95	130	157	56	99
Average loans and leases <sup>a</sup>	12,925	12,682	10,590	9,849	7,529	7,605	8,441	7,409
Average loans held for sale <sup>a</sup>	1,325	765	7	16	327	236	2,672	3,005
Average deposits <sup>a</sup>	4,910	3,422	15	16	6,683	6,729	401	430
Net loan charge-offs (recoveries)	11	4	45	18	5	(3)	30	23
Return on average allocated equity <sup>a</sup>	11.65%	20.21%	10.39%	15.30%	14.70%	18.63%	14.90%	15.41%
Return on average allocated equity	11.65	20.21	10.39	15.30	14.70	18.63	10.30	14.47
Average full-time equivalent employees	990	977	969	926	1,325	1,321	671	1,011

(a) From continuing operations.

TE = Taxable Equivalent

**Table of Contents****5. Securities**

Key classifies each security held into one of four categories: trading, available for sale, investment or other investments.

**Trading account securities.** These are debt and equity securities that Key purchases and holds with the intent of selling them in the near term. Trading account securities are reported at fair value (\$1.1 billion at September 30, 2007, \$912 million at December 31, 2006, and \$817 million at September 30, 2006) and are included in short-term investments on the balance sheet. Realized and unrealized gains and losses on trading account securities are reported in investment banking and capital markets income on the income statement.

**Securities available for sale.** These are securities that Key intends to hold for an indefinite period of time and that may be sold in response to changes in interest rates, prepayment risk, liquidity needs or other factors. Securities available for sale, which include debt and marketable equity securities with readily determinable fair values, 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 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.

**Investment 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 investment securities portfolio are primarily foreign bonds.

**Other investments.** Principal investments  $\frac{3}{4}$  investments in equity and mezzanine instruments made by Key's Principal Investing unit  $\frac{3}{4}$  represent 64% of other investments at September 30, 2007. These securities include direct investments (investments made in a particular company), as well as indirect investments (investments made through funds that include other investors). Principal investments are predominantly made in privately-held companies and are carried at fair value (\$970 million at September 30, 2007, \$830 million at December 31, 2006, and \$843 million at September 30, 2006). Changes in estimated fair values, and actual gains and losses on sales of principal investments, are included in other income on the income statement.

In addition to principal investments, other investments include other equity and mezzanine instruments that do not have readily determinable fair values. These securities include certain real estate-related investments that are carried at estimated fair value, as well as other types of securities that generally are carried at cost. The carrying amount of the securities carried at cost is adjusted for declines in value that are considered to be other-than-temporary. These adjustments are included in investment banking and capital markets income on the income statement. Neither these securities nor principal investments have stated maturities.

The amortized cost, unrealized gains and losses, and approximate fair value of Key's securities available for sale and investment 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>	<b>September 30, 2007</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	
<b>SECURITIES AVAILABLE FOR SALE</b>				
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

<b>INVESTMENT SECURITIES</b>				
States and political subdivisions	\$ 15			\$ 15
Other securities	21			21
Total investment securities	\$ 36			\$ 36

<i>in millions</i>	<b>December 31, 2006</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	
<b>SECURITIES AVAILABLE FOR SALE</b>				
U.S. Treasury, agencies and corporations	\$ 94			\$ 94
States and political subdivisions	14	\$ 1		15
Collateralized mortgage obligations	7,098	13	\$ 110	7,001
Other mortgage-backed securities	336	2	4	334
Retained interests in securitizations	151	57		208
Other securities	165	10		175
Total securities available for sale	\$ 7,858	\$ 83	\$ 114	\$ 7,827

<b>INVESTMENT SECURITIES</b>				
States and political subdivisions	\$ 20	\$ 1		\$ 21
Other securities	21			21
Total investment securities	\$ 41	\$ 1		\$ 42

<i>in millions</i>	<b>September 30, 2006</b>			<b>Fair Value</b>
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	
<b>SECURITIES AVAILABLE FOR SALE</b>				
U.S. Treasury, agencies and corporations	\$ 220			\$ 220
States and political subdivisions	16	\$ 1		17
Collateralized mortgage obligations	6,762	13	\$ 125	6,650
Other mortgage-backed securities	210	2	3	209
Retained interests in securitizations	122	35		157
Other securities	179	9		188
Total securities available for sale	\$ 7,509	\$ 60	\$ 128	\$ 7,441
<b>INVESTMENT SECURITIES</b>				
States and political subdivisions	\$ 26	\$ 1		\$ 27
Other securities	15			15
Total investment securities	\$ 41	\$ 1		\$ 42

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

Key's loans by category are summarized as follows:

<i>in millions</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
Commercial, financial and agricultural	\$ 23,192	\$ 21,412	\$ 21,556
Commercial real estate:			
Commercial mortgage	9,272	8,426	8,266
Construction	8,214	8,209	8,272
Total commercial real estate loans	17,486	16,635	16,538
Commercial lease financing	10,309	10,259	9,860
Total commercial loans	50,987	48,306	47,954
Real estate residential mortgage	1,583	1,442	1,407
Home equity	10,904	10,826	10,988
Consumer direct	1,308	1,536	1,576
Consumer indirect:			
Marine	3,549	3,077	2,982
Other	668	639	644
Total consumer indirect loans	4,217	3,716	3,626
Total consumer loans	18,012	17,520	17,597
Total loans	\$ 68,999	\$ 65,826	\$ 65,551

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 2006 Annual Report to Shareholders.

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

<i>in millions</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
Commercial, financial and agricultural	\$ 67	\$ 47	\$ 219
Real estate commercial mortgage	1,560	946	1,062
Real estate construction	237	36	198
Commercial lease financing	5	3	2
Real estate residential mortgage	36	21	21
Home equity <sup>a</sup>	1	180	2,485
Education	2,877	2,390	3,147
Automobile	8	14	16
Total loans held for sale	\$ 4,791	\$ 3,637	\$ 7,150



- (a) On August 1, 2006, Key transferred \$2.5 billion of home equity loans from the loan portfolio to loans held for sale in connection with the anticipated November 29, 2006, sale of the Champion Mortgage finance business.

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

<i>in millions</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 945	\$ 956	\$ 944	\$ 966
Charge-offs	(82)	(70)	(218)	(194)
Recoveries	23	27	62	78
Net loans charged off	(59)	(43)	(156)	(116)
Provision for loan losses from continuing operations	69	35	166	97
Provision for loan losses from discontinued operations		(4)		(3)
Foreign currency translation adjustment			1	
Balance at end of period	\$ 955	\$ 944	\$ 955	\$ 944

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

<i>in millions</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 50	\$ 59	\$ 53	\$ 59
Provision for losses on lending-related commitments	5		3	
Charge-offs			(1)	
Balance at end of period <sup>a</sup>	\$ 55	\$ 59	\$ 55	\$ 59

(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 which it continues to service 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>	<b>Nine months ended</b>	
	<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>
Balance at beginning of period	\$ 247	\$ 248
Servicing retained from loan sales	16	10
Purchases	122	29
Amortization	(63)	(48)
Balance at end of period	\$ 322	\$ 239
Fair value at beginning of period	\$ 332	\$ 301

Fair value at end of period 420 329

The fair value of mortgage servicing assets is estimated 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, 2007 and 2006, 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%.

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, 2007, would cause a \$7 million decrease in the fair value of Key's mortgage servicing assets.

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Contractual fee income from servicing commercial mortgage loans totaled \$54 million for each of the nine-month periods ended September 30, 2007 and 2006. The amortization of servicing assets for the respective nine-month periods, as shown in the table above, 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.

Additional information pertaining to the accounting for mortgage and other servicing assets is included in Note 1 (Basis of Presentation) under the heading Servicing Assets on page 7.

**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 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.

<i>in millions</i>	<b>Consolidated VIEs</b>		<b>Unconsolidated VIEs</b>	
	<b>Total Assets</b>	<b>Total Assets</b>	<b>Maximum Exposure to Loss</b>	
September 30, 2007				
Commercial paper conduit	\$ 151		N/A	N/A
Low-income housing tax credit ( LIHTC ) funds	281	\$ 186		
LIHTC investments	N/A	781	\$	273

N/A = Not Applicable

The noncontrolling 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 currently accounts for these interests as minority interests and adjusts the financial statements each period for the investors' share of the funds profits and losses. At September 30, 2007, the settlement value of these noncontrolling interests was estimated to be between \$295 million and \$347 million, while the recorded value, including reserves, totaled \$283 million.

Key's Principal Investing unit and the Real Estate Capital 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. As discussed in Note 1 (Basis of Presentation) under the heading Accounting Pronouncements Pending Adoption on page 9, in May 2007, the FASB issued Staff Position FIN 46(R)-7, which provides an exception to the scope of Revised Interpretation No. 46 for investment companies within the scope of SOP No. 07-1. Staff Position FIN 46(R)-7 will be effective for fiscal years beginning on or after December 15, 2007 (effective January 1, 2008, for Key). Management is evaluating the potential effect this guidance may have on Key's financial condition or results of operations.

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 2006 Annual Report to Shareholders under the heading Variable Interest Entities on page 84.



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

Impaired loans totaled \$344 million at September 30, 2007, compared to \$95 million at December 31, 2006, and \$122 million at September 30, 2006. Impaired loans averaged \$240 million for the third quarter of 2007 and \$121 million for the third quarter of 2006.

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

<i>in millions</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
Impaired loans	\$ 344	\$ 95	\$ 122
Other nonaccrual loans	154	120	101
Total nonperforming loans	498	215	223
Nonperforming loans held for sale <sup>a</sup>	6	3	56
Other real estate owned ( OREO )	21	57	52
Allowance for OREO losses	(1)	(3)	(3)
OREO, net of allowance	20	54	49
Other nonperforming assets	46 <sup>b</sup>	1	1
Total nonperforming assets	\$ 570	\$ 273	\$ 329
Impaired loans with a specifically allocated allowance	\$ 35	\$ 34	\$ 27
Specifically allocated allowance for impaired loans	11	14	12
Accruing loans past due 90 days or more	\$ 190	\$ 120	\$ 125
Accruing loans past due 30 through 89 days	717	644	715

(a) On August 1, 2006, Key transferred approximately \$55 million of home equity loans from nonperforming loans to nonperforming loans held for sale in connection with the anticipated November 29, 2006, sale of the Champion Mortgage finance business.

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

At September 30, 2007, 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 69 of Key's 2006 Annual Report to Shareholders.

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

KeyCorp owns the outstanding common securities 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 securities 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

• amounts due if a trust is liquidated or terminated.

During the first nine months of 2007, the business trusts did not repurchase any capital securities and KeyCorp did not repurchase any of the related debentures.

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

	Capital Securities, Net of Discount <sup>a</sup>		Common Securities	Principal Amount of Debentures, Net of Discount <sup>b</sup>	Interest Rate of Capital Securities and Debentures <sup>c</sup>	Maturity of Capital Securities and Debentures
<i>dollars in millions</i>						
September 30, 2007						
KeyCorp Capital I	\$	197	\$ 8	\$ 205	6.100%	2028
KeyCorp Capital II		171	8	165	6.875	2029
KeyCorp Capital III		218	8	197	7.750	2029
KeyCorp Capital V		161	5	180	5.875	2033
KeyCorp Capital VI		72	2	77	6.125	2033
KeyCorp Capital VII		224	8	258	5.700	2035
KeyCorp Capital VIII		251		250	7.000	2066
KeyCorp Capital IX		488		500	6.750	2066
Total	\$	1,782	\$ 39	\$ 1,832	6.611%	
December 31, 2006	\$	1,804	\$ 39	\$ 1,832	6.613%	
September 30, 2006	\$	1,830	\$ 54	\$ 1,847	6.977%	

(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, 2007, December 31, 2006, and September 30, 2006, are basis adjustments of (\$11) million, \$11 million and \$37 million, respectively, related to fair value hedges. See Note 19 ( Derivatives and Hedging Activities ), which begins on page 100 of Key s 2006 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 21, 2008  
(for debentures  
owned by Capital  
V), December 15,  
2008 (for  
debentures owned  
by Capital VI),  
June 15, 2010 (for  
debentures owned  
by Capital VII),  
June 15, 2011 (for  
debentures owned  
by Capital VIII)  
and December 15,  
2011 (for  
debentures owned  
by Capital IX);  
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  
Capital I, Capital  
V, Capital VI,  
Capital VII,  
Capital VIII or  
Capital IX are  
redeemed before  
they mature, the  
redemption price  
will be 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.

- (c) The interest rates for Capital II, Capital III, Capital V, Capital VI, Capital VII, Capital VIII and Capital IX are fixed. Capital I has a floating interest rate equal to three-month LIBOR plus 74 basis points; it reprices quarterly. The rates shown as the total at September 30,

2007,  
December 31,  
2006, and  
September 30,  
2006, are  
weighted-average  
rates.

**Table of Contents****11. Employee Benefits****Pension Plans**

Net pension cost for all funded and unfunded plans includes the following components:

<i>in millions</i>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service cost of benefits earned	\$ 12	\$ 12	\$ 38	\$ 36
Interest cost on projected benefit obligation	15	13	44	41
Expected return on plan assets	(22)	(22)	(66)	(66)
Amortization of losses	7	8	21	23
Net pension cost	12	11	37	34
Curtailment gain			(3)	
Total pension cost	\$ 12	\$ 11	\$ 34	\$ 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.

Net postretirement benefit cost for all funded and unfunded plans includes the following components:

<i>in millions</i>	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Service cost of benefits earned	\$ 2	\$ 1	\$ 6	\$ 4
Interest cost on accumulated postretirement benefit obligation	2	2	5	6
Expected return on plan assets	(1)	(1)	(3)	(3)
Amortization of unrecognized transition obligation	1	1	3	3
Amortization of losses		1		2
Net postretirement benefit cost	\$ 4	\$ 4	\$ 11	\$ 12

**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 the property is leased by KEF rather than purchased. 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.

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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. Subsequently, the Internal Revenue Service ( IRS ) has challenged the tax treatment of these transactions by a number of bank holding companies and other corporations.

The IRS has completed audits of Key's income tax returns for the 1995 through 2003 tax years and has disallowed all net deductions taken in those tax years 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 those tax years. Key paid the assessment and filed a refund claim for the total amount. Key has also 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. Management continues to believe that Key's treatment of these LILO, QTE and Service Contract Lease transactions is appropriate and in compliance with applicable tax law and regulations. Key intends to vigorously pursue the IRS appeals process and litigation alternatives. 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. A trial date has been set for January 21, 2008.

Management believes Key's tax position is correct and well-supported by applicable statutes, regulations and judicial authority, but tax litigation is inherently uncertain. Consequently, management cannot predict the outcome of the AWG Leasing Litigation or its other disputes with the IRS related to its LILO, QTE or Service Contract Lease transactions. If Key were not to prevail in these efforts, in addition to accrued deferred taxes of approximately \$1.7 billion reflected on Key's balance sheet as of September 30, 2007, Key would owe interest on any taxes and possibly penalties. In the event of an unfavorable resolution of this issue, management estimates that, as of September 30, 2007, the after-tax interest cost on any taxes due could be up to approximately \$385 million. This amount would vary based upon the then applicable interest rates, and grow over the period any tax assessments remain outstanding. No reserves have been established for any such interest or penalties. An adverse outcome in these disputes could have a material adverse effect on Key's results of operations and a potentially substantial impact on its capital as discussed in the following section.

**Tax-Related Accounting Pronouncements Adopted in 2007**

**Accounting for leveraged leases.** In July 2006, the FASB issued 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, which provides additional guidance on the application of SFAS No. 13, Accounting for Leases. This guidance affects when earnings from leveraged lease transactions (such as LILOs, QTEs and Service Contract Leases) will be recognized, and requires a lessor to recalculate its recognition of lease income when there are changes or projected changes in the timing of cash flows, including changes due to final or expected settlements of tax matters. Previously, leveraged lease transactions were required to be recalculated only when a change in the total projected net income from the lease occurred. Key adopted this guidance on January 1, 2007, and recorded a cumulative after-tax charge of \$52 million to retained earnings related to the LILO transactions. Future earnings are expected to increase over the remaining term of the affected leases by a similar amount.

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An adverse outcome in the AWG Leasing Litigation, certain settlement scenarios or other factors could change management's current assumptions pertaining to the expected timing of the cash flows related to income taxes for some or all of the leveraged lease transactions previously described. In the event of such a change in management's assumptions, in accordance with Staff Position No. 13-2, Key would be required to recalculate its lease income from the inception of the affected leases and recognize a reduction in its net investment with a corresponding charge to earnings in the period in which the recalculation occurs. Management is currently unable to make a determination regarding the ultimate financial impact, if any, of these events because of the uncertainty of the outcome of the AWG Leasing Litigation, the range of possible settlement opportunities that might be available to Key and other factors. Management believes that under certain outcomes, the recalculation would result in a charge that could have a material adverse effect on Key's results of operations and a potentially substantial impact on its capital. However, management would expect future earnings to increase over the remaining term of the affected leases by an amount equal to a substantial portion of the charge.

***Accounting for uncertain tax positions.*** In July 2006, the FASB also issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the application of SFAS No. 109, Accounting for Income Taxes, by defining the minimum threshold that a tax position must meet for the associated tax benefit to be recognized in a company's financial statements. In accordance with this guidance, a company may recognize a benefit if management concludes that the tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. If such a conclusion is reached, the tax benefit is measured as the largest amount of such benefit that is greater than 50% likely to be realized upon ultimate settlement. This interpretation also provides guidance on measurement and derecognition of tax benefits, and requires expanded disclosures.

Key adopted FASB Interpretation No. 48 on January 1, 2007, which resulted in an immaterial increase in Key's liability for unrecognized tax benefits and was accounted for as a reduction to retained earnings. The total amount of unrecognized tax benefits was \$27 million at January 1, 2007, and \$21 million at September 30, 2007. The decrease in unrecognized tax benefits was a result of \$6 million of tax payments made in connection with tax positions taken in prior years. The amount of unrecognized tax benefits, if recognized, would impact Key's effective tax rate.

Additionally, the amount of unrecognized tax benefits could materially increase or decrease over the next twelve months as a result of developments in the AWG Leasing Litigation or any possible settlement of tax matters related to the leveraged lease transactions. However, management cannot currently estimate the range of possible change.

As permitted under FASB Interpretation No. 48, Key continues to recognize interest and penalties related to unrecognized tax benefits in income tax expense. During the nine-month period ended September 30, 2007, Key recognized \$4 million of interest. At September 30, 2007, Key had a \$19 million liability for accrued interest payable on the balance sheet.

Key files income tax returns in the United States federal jurisdiction, as well as various state and foreign jurisdictions. With the exception of the California and New York jurisdictions, Key is not subject to U.S. federal, state and local, and foreign 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 could impact the recognition of benefits related to Key's tax positions.

**Table of Contents****13. Contingent Liabilities and Guarantees****Legal Proceedings**

**Residual value insurance litigation.** Key has previously reported on its on-going litigation with Swiss Reinsurance America Corporation ( Swiss Re ) in the United States Federal District Court in Ohio relating to insurance coverage of the residual value of certain automobile leases through Key Bank USA (the Residual Value Litigation ).

As previously reported, on February 13, 2007, Key and Swiss Re entered into an agreement to settle the Residual Value Litigation, subject to certain conditions. On February 16, 2007, the conditions to settlement were satisfied. Under the settlement agreement, Swiss Re agreed to pay Key \$279 million in two installments: \$50 million, which was paid on March 15, 2007, and \$229 million, which was paid on June 29, 2007. As a result of the settlement, during the first quarter of 2007, Key recorded a one-time gain of \$26 million (\$17 million after tax, or \$.04 per diluted common share), representing the difference between the proceeds received and the receivable recorded on Key s balance sheet.

**Tax disputes.** In the ordinary course of business, Key enters into certain 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 and on the potential implications to Key is included in Note 12 ( Income Taxes ) under the heading Lease Financing Transactions on page 25.

**Honsador litigation.** On May 23, 2007, in the case of Honsador Holdings LLC v. Key Principal Partners, LLC ( KPP ), pending in the Circuit Court of the First Circuit, a Hawaii state court, the jury returned a verdict in favor of the plaintiffs in a lawsuit relating to KPP s investment in a Hawaiian business, and on June 13, 2007, the state court entered a final judgment in favor of the plaintiffs in the amount of \$38.25 million ( Final Judgment ). During the three months ended June 30, 2007, Key established a \$42 million reserve for this case for the verdict, legal costs and other expenses associated with the lawsuit.

On September 27, 2007, KPP filed a notice of appeal with the Intermediate Court of Appeals for the State of Hawaii, contesting the Final Judgment. On October 4, 2007, the trial court issued an amended final judgment in which the court modified the Final Judgment (the Amended Final Judgment ). On October 22, 2007, KPP filed an amended notice of appeal, challenging both the Final Judgment and the Amended Final Judgment.

**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 believes there are no such legal actions to which KeyCorp or any of its subsidiaries is a party, or involving any of their properties, that, individually or in the aggregate, could reasonably be expected to have a material adverse effect on Key s financial condition.

**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, 2007. 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 71 of Key s 2006 Annual Report to Shareholders.



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<i>in millions</i>	<b>Maximum Potential Undiscounted Future Payments</b>	<b>Liability Recorded</b>
Financial guarantees:		
Standby letters of credit	\$ 12,974	\$ 35
Credit enhancement for asset-backed commercial paper conduit	28	
Recourse agreement with FNMA	579	6
Return guarantee agreement with LIHTC investors	347	41
Default guarantees	12	1
Written interest rate caps <sup>a</sup>	105	7
Total	\$ 14,045	\$ 90

(a) At September 30, 2007, the weighted-average interest rate on written interest rate caps was 5.3%, and the weighted-average strike rate was 5.7%. Maximum potential undiscounted future payments were calculated assuming a 10% interest rate.

**Standby letters of credit.** These instruments, issued on behalf of clients, 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. Many of Key's lines of business issue standby letters of credit to address clients' financing needs. 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, 2007, Key's standby letters of credit had a remaining weighted-average life of approximately 2.6 years, with remaining actual lives ranging from less than one year to as many as eleven years.

**Credit enhancement for asset-backed commercial paper conduit.** Key provides credit enhancement in the form of a committed facility to ensure the continuing operations of an asset-backed commercial paper conduit that is owned by a third party and administered by an unaffiliated financial institution. The commitment to provide credit enhancement extends until November 30, 2007, and specifies that in the event of default by certain borrowers whose loans are held by the conduit, Key will provide financial relief to the conduit in an amount that is based on defined criteria that consider the level of credit risk involved and other factors.

At September 30, 2007, Key's maximum potential funding requirement under the credit enhancement facility totaled \$28 million, but there were no drawdowns under the facility during the quarter. Key has no recourse or other collateral available to offset any amounts that may be funded under this credit enhancement facility. Management periodically

evaluates Key's commitment to provide credit enhancement to the conduit.

***Recourse agreement with Federal National Mortgage Association.*** KeyBank participates as a lender in the Federal National Mortgage Association ( FNMA ) Delegated Underwriting and Servicing ( DUS ) 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, 2007, the outstanding commercial mortgage loans in this program had a remaining weighted-average term of 7.8 years, and the unpaid principal balance outstanding of loans sold by KeyBank as a participant in this program was approximately \$1.8 billion. The maximum potential amount of undiscounted future payments that may be required under this program is generally equal to approximately one-third of the principal balance of loans outstanding at September 30, 2007. If payment is required under this program, Key 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

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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.

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 29, KAHC maintained a reserve in the amount of \$41 million at September 30, 2007, 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.

**Default guarantees.** Some lines of business provide or participate in various types of 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 fifteen years. Although no collateral is held, Key would have recourse against the debtor for any payments made under a default guarantee.

**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, 2007, these caps had a weighted-average life of approximately 2.1 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's potential amount of future payments under these obligations is mitigated by offsetting positions with third parties.

**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 FASB Interpretation No. 45 and from other relationships.

**Significant liquidity facilities that support asset-backed commercial paper conduits.** Key provides liquidity facilities to various asset-backed commercial paper conduits. These facilities obligate Key to provide funding in the event of a disruption in credit markets or other factors that preclude the issuance of commercial paper by the conduits. Key's commitments to provide liquidity are periodically evaluated by management. Three of these liquidity facilities, all of which expire by September 29, 2008, obligate Key to provide funding of up to \$166 million in total to a commercial paper conduit that is consolidated in accordance with Key's consolidation policy described in Note 1 (*Basis of Presentation*), which begins on page 7. The aggregate amount available to be drawn by the conduit, which is based on the amount of current commitments to borrowers, was \$128 million at September 30, 2007, but there were no drawdowns under these committed facilities at that date. Additional information pertaining to this conduit is included in this note under the heading *Guarantees* on page 28 and in Note 8 (*Loan Securitizations, Servicing and Variable Interest Entities*) of Key's 2006 Annual Report to Shareholders under the heading *Consolidated VIEs* on page 84. Key also provides liquidity facilities to several unconsolidated third-party commercial paper conduits. These liquidity facilities, all of which expire by November 10, 2010, obligate Key to provide funding of up to \$687 million in total, with individual facilities ranging from \$10 million to \$100 million. The amounts available to be drawn, which are based on the amount of current commitments to borrowers, totaled \$494 million at September 30, 2007, but there were no drawdowns under these committed facilities at that date.

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**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. Amounts paid, if any, with respect to these indemnifications did not have a significant effect on Key's financial condition or results of operations.

**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.

**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. The primary derivatives that Key uses are interest rate swaps, caps and futures, and foreign exchange forward contracts. Generally, these instruments help Key manage exposure to market risk, mitigate the credit risk inherent in the loan portfolio and meet client financing 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.

At September 30, 2007, Key had \$464 million of derivative assets and \$112 million of derivative liabilities on its balance sheet that arose from derivatives that were being used for hedging purposes. As of the same date, derivative assets and liabilities classified as trading derivatives totaled \$1.0 billion and \$951 million, respectively. Derivative assets and liabilities are recorded at fair value on the balance sheet.

**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, as described below, before taking into account the effects of master netting arrangements and other means used to mitigate risk.

<i>in millions</i>	September 30, 2007	December 31, 2006	September 30, 2006
Interest rate	\$ 713	\$ 697	\$ 635
Credit	44	43	45
Foreign exchange	643	321	172
Equity	36	45	46
Energy	61	29	17
Total	\$ 1,497	\$ 1,135	\$ 915

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 or a broker/dealer, fails to meet its contractual obligations. This risk is measured as the expected positive replacement value of contracts. To mitigate credit risk when managing asset, liability and trading positions, Key deals exclusively with counterparties that have high credit ratings.

Key uses two additional means to manage exposure to credit risk on derivative contracts. First, Key generally enters into bilateral collateral and master netting arrangements. These agreements provide for the net settlement of all contracts with a single counterparty in the event of default. Second, Key's Credit Administration department monitors credit risk exposure to the counterparty on each contract to determine appropriate limits on Key's total credit exposure and decide whether to demand collateral. If Key determines that collateral is required, it is generally collected immediately. Key generally holds collateral in the form of cash and highly rated Treasury and agency-issued securities.



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At September 30, 2007, Key was party to derivative contracts with 53 different counterparties. These derivatives include interest rate swaps and caps, credit derivatives, foreign exchange contracts, equity derivatives and energy derivatives. Among these were contracts entered into to offset the risk of client exposure. Key had aggregate exposure of \$448 million on these instruments to 26 of the 53 counterparties. However, at September 30, 2007, Key held approximately \$309 million in pooled collateral to mitigate that exposure, resulting in net exposure of \$139 million. The largest exposure to an individual counterparty was approximately \$229 million, which Key secured with approximately \$211 million in collateral.

**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 2006 Annual Report to Shareholders.

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

<i>in millions</i>	<b>December 31, 2006</b>	<b>Reclassification 2007 Hedging Activity</b>	<b>of Gains to Net Income</b>	<b>September 30, 2007</b>
Accumulated other comprehensive (loss) income resulting from cash flow hedges	\$ (19)	\$ 48	\$ (6)	\$ 23

Key reclassifies gains and losses from accumulated other comprehensive 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. Key expects to reclassify an estimated \$8 million of net losses on derivative instruments from accumulated other comprehensive loss to earnings during the next twelve months.

**Credit Risk Management**

Key uses credit derivatives <sup>3</sup>/<sub>4</sub> primarily credit default swaps <sup>3</sup>/<sub>4</sub> 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, 2007, the notional amount of credit default swaps purchased by Key was \$1.1 billion. Key also provides credit protection to other lenders through the sale of credit default swaps. These transactions may generate fee income and can diversify overall exposure to credit loss. At September 30, 2007, the notional amount of credit default swaps sold by Key was \$50 million.

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.

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**Trading Portfolio**

Key's trading portfolio includes:

- interest rate swap contracts entered into to accommodate the needs of clients;
- positions with third parties that are intended to offset or mitigate the interest rate risk of client positions;
- foreign exchange forward contracts entered into to accommodate the needs of clients; and
- proprietary trading positions in financial assets and liabilities.

The fair values of these trading portfolio items are included in derivative assets or derivative liabilities on the balance sheet. Adjustments to the fair values are included in investment banking and capital markets income on the income statement. Key has established a reserve in the amount of \$12 million at September 30, 2007, 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 2006 Annual Report to Shareholders.

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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, 2007 and 2006, and the related condensed consolidated statements of income for the three-month and nine-month periods then ended, and the condensed consolidated statements of changes in shareholders equity and cash flows for the nine-month periods ended September 30, 2007 and 2006. 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, 2006, 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 23, 2007, 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, 2006, 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 7, 2007



**Table of Contents****Item 2. Management's Discussion & Analysis of Financial Condition & Results of Operations****Introduction**

This section generally reviews the financial condition and results of operations of KeyCorp and its subsidiaries for the quarterly and year-to-date periods ended September 30, 2007 and 2006. Some tables may include additional periods to comply with disclosure requirements or to illustrate trends in greater depth. When reading this discussion, also refer to the consolidated financial statements and related notes that appear on pages 3 through 33. A description of Key's business is included under the heading "Description of Business" on page 18 of Key's 2006 Annual Report to Shareholders. This description does not reflect the reorganization within some of Key's lines of business that took effect January 1, 2007. For a current description of Key's lines of business, see Note 4 ("Line of Business Results"), which begins on page 13.

**Terminology**

This report contains some shortened names and industry-specific terms. We want to explain some of these terms at the outset to provide a better understanding of 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 nonprime mortgage loan portfolio held by the Champion Mortgage finance business and announced a separate agreement to sell Champion's loan 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**. 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).
- All earnings per share data included in this discussion are presented on a **diluted** basis, which takes into account all common shares outstanding as well as potential common shares that could result from the exercise of outstanding stock options and other stock awards. Some of the financial information tables also include **basic** earnings per share, which takes into account only common shares outstanding.
- 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. A more detailed explanation of total and Tier 1 capital and how they are calculated is presented in the section entitled "Capital," which begins on page 61.

**Long-term goals**

Key's long-term financial goals are to achieve an annual return on average equity at or above the median of its peer group and to grow earnings per common share at an annual rate of 8% to 10%. The strategy for achieving these goals is described under the heading "Corporate Strategy" on page 20 of Key's 2006 Annual Report to Shareholders.

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Key from time-to-time uses capital that exceeds internal guidelines and minimum regulatory requirements to repurchase common shares in the open market or through privately-negotiated transactions. As a result of such repurchases, Key's weighted-average fully-diluted common shares decreased to 397.8 million shares for the first nine months of 2007 from 411.0 million shares for the first nine months of 2006. Reducing the share count can foster both earnings per share growth and improved returns on average equity, but Key's share repurchase activity was not significant enough to cause a material effect on either of these profitability measures in either the current or prior year periods.

**Forward-looking statements**

This report may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements about our 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, projects, believes, estimates, or other similar words, expressions or con- 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.
- Recent problems in the mortgage markets and related conditions in the financial markets, or other issues could cause a 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.
- Increased competitive pressure among financial services companies may adversely affect Key's ability to market its products and services.
- 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.
- 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.
- Key may continue to become subject to heightened regulatory practices, requirements or expectations.
- 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.
- Changes 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.

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- .. 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.
- .. Key may become subject to new accounting, tax or regulatory practices or requirements, which impede its profitability.

**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 important; not only are they necessary to comply with U.S. generally accepted accounting principles ( GAAP ), they also reflect management's view of the most appropriate manner in which 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 67 of Key's 2006 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.

Key relies heavily on the use of judgment, assumptions and estimates in a number of important areas, including accounting for the allowance for loan losses; loan securitizations; contingent liabilities, guarantees and income taxes; derivatives and related hedging activities; principal investments; goodwill; and pension and other postretirement obligations. A brief discussion of each of these areas appears on pages 20 through 22 of Key's 2006 Annual Report to Shareholders.

During the first nine months of 2007, there were no significant changes in the manner in which Key's critical accounting policies were applied or in which related assumptions and estimates were developed. Additionally, no new critical accounting policies were adopted.

**Highlights of Key's Performance**

**Financial performance**

Key's third quarter income from continuing operations was \$224 million, or \$.57 per diluted common share, compared to \$305 million, or \$.74 per share, for the third quarter of 2006. Key's income from continuing operations for the first nine months of 2007 was \$919 million, or \$2.31 per diluted common share. This compares to income from continuing operations before the cumulative effect of an accounting change of \$882 million, or \$2.15 per share, for the first nine months of 2006.

Net income totaled \$210 million, or \$.54 per diluted common share, for the third quarter of 2007, compared to net income of \$312 million, or \$.76 per share, for the third quarter of 2006. Key's net income for the first nine months of 2007 was \$894 million, or \$2.25 per diluted common share, compared to \$909 million, or \$2.21 per share, for the same period last year.

Figure 1 shows Key's continuing and discontinued operating results and related performance ratios for the three- and nine-month periods ended September 30, 2007 and 2006. Key's financial performance for each of the past five quarters and the nine-month periods ended September 30, 2007 and 2006, is summarized in Figure 3 on page 41.

**Table of Contents****Figure 1. Results of Operations**

<i>in millions, except per share amounts</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>9-30-07</b>	<b>9-30-06</b>	<b>9-30-07</b>	<b>9-30-06</b>
<b>SUMMARY OF OPERATIONS</b>				
Income from continuing operations before cumulative effect of accounting change	\$ 224	\$ 305	\$ 919	\$ 882
(Loss) income from discontinued operations, net of taxes <sup>a</sup>	(14)	7	(25)	22
Cumulative effect of accounting change, net of taxes				5
Net income	\$ 210	\$ 312	\$ 894	\$ 909
<b>PER COMMON SHARE ASSUMING DILUTION</b>				
Income from continuing operations before cumulative effect of accounting change	\$ .57	\$ .74	\$ 2.31	\$ 2.15
(Loss) income from discontinued operations <sup>a</sup>	(.03)	.02	(.06)	.05
Cumulative effect of accounting change				.01
Net income	\$ .54	\$ .76	\$ 2.25	\$ 2.21
<b>PERFORMANCE RATIOS</b>				
<b>From continuing operations:</b>				
Return on average total assets	.93%	1.31%	1.31%	1.30%
Return on average equity	11.50	15.52	16.03	15.44
<b>From consolidated operations:</b>				
Return on average total assets	.88%	1.30%	1.28%	1.29%
Return on average equity	10.79	15.88	15.59	15.82

(a) Key sold the nonprime 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 loss from discontinued operations recorded in the third quarter of 2007 was attributable largely to a write-down on the building lease for the former Champion headquarters.

As shown in Figure 2, the comparability of Key's income from continuing operations for the three- and nine-month periods ended September 30, 2007 and 2006, is affected by several significant items, certain of which were the result of strategic actions described on page 39 that were taken to improve Key's business mix and to reposition the balance sheet.

**Figure 2. Significant Items Affecting the Comparability of Earnings**

	Three months ended September 30, 2007		Three months ended September 30, 2006		Nine months ended September 30, 2007		Nine months ended September 30, 2006	
	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount	Pre-tax Amount	After-tax Amount
<i>in millions, except per share amounts</i>								
<b>INCOME FROM CONTINUING OPERATIONS</b>								
<b>GAAP BASIS</b>	\$ 310	\$ 224	\$ 423	\$ 305	\$ 1,282	\$ 919	\$ 1,235	\$ 882
Significant items:								
McDonald Investments branch network <sup>a</sup>	5	3	6	4	(146)	(92)	23	14
Gains related to MasterCard Incorporated shares	(27)	(17)			(67)	(42)	(9)	(6)
Litigation reserve					42	26		
Gain from settlement of automobile residual value insurance litigation					(26)	(17)		
Loss from repositioning of securities portfolio					49	31		
<b>INCOME FROM CONTINUING OPERATIONS ADJUSTED BASIS</b>	\$ 288	\$ 210	\$ 429	\$ 309	\$ 1,134	\$ 825	\$ 1,249	\$ 890
<b>PER COMMON SHARE ASSUMING DILUTION</b>								
	N/M	\$ .57	N/M	\$ .74	N/M	\$ 2.31	N/M	\$ 2.15

Income from continuing operations

GAAP basis

Income from continuing operations

adjusted basis

<b>N/M</b>	<b>.53</b>	<b>N/M</b>	<b>.75</b>	<b>N/M</b>	<b>2.07</b>	<b>N/M</b>	<b>2.17</b>
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(a) 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.

N/M = Not Meaningful

GAAP = U.S. generally accepted accounting principles

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During the first quarter of 2007, Key completed the previously announced sales of the McDonald Investments branch network and the Champion Mortgage loan origination platform. Both transactions are consistent with Key's strategy of focusing on core relationship businesses and exiting those areas in which it does not have either the scale or opportunity to build profitable client relationships.

During the same period, Key repositioned the securities portfolio in response to changing market conditions.

Management initiated this change to enhance Key's future financial performance, particularly in the event of a decline in interest rates. For more detailed information regarding the repositioning and composition of the securities portfolio, see the section entitled "Securities," which begins on page 58.

Key's top four priorities for 2007 are to profitably grow revenue, institutionalize a culture of compliance and accountability, maintain a strong credit culture and improve operating leverage so that revenue growth outpaces expense growth. During the third quarter of 2007:

- Key's noninterest income decreased by \$105 million from the third quarter of 2006. The adverse impact of fixed income market volatility on several of Key's capital markets-driven businesses, the sale of the McDonald Investments branch network completed in the first quarter of this year and lower net gains from principal investing activities caused the decrease. The reduction in noninterest income was moderated by a \$27 million gain from the sale of MasterCard Incorporated shares in the current quarter, growth in deposit service charge income and higher income from Key's asset management business. Net interest income decreased by \$11 million from the year-ago quarter as interest rate spreads on both loans and deposits remained under pressure due to the continuation of competitive pricing. The tightening of interest rate spreads more than offset the positive effect of a 4% increase in average earning assets.
- Key's nonperforming assets rose by \$192 million and were up \$241 million from the level reported one year ago. The increase was due primarily to the impact of deteriorating market conditions on the residential property segment of the commercial real estate construction portfolio with the majority of the growth coming from nonperforming loans outstanding in Florida and southern California. Outside of this portfolio, Key experienced only modest increases in nonperforming loans during the third quarter. For the third quarter of 2007, net loan charge-offs totaled \$59 million, or .35% of average total loans.
- Key continued to manage expenses effectively. Key's total noninterest expense decreased by 5% from the third quarter of 2006, largely as a result of the sale of the McDonald Investments branch network and lower incentive compensation accruals.
- Key continued to effectively manage its equity capital through dividends paid to shareholders, share repurchases and investing in its businesses. During the third quarter, Key repurchased 2.0 million of its common shares. At September 30, 2007, Key's tangible equity to tangible assets ratio was 6.78%.

The primary reasons that Key's revenue and expense components changed from those reported for the three- and nine-month periods ended September 30, 2006, are reviewed in greater detail throughout the remainder of the Management's Discussion & Analysis section.

**Financial outlook**

During the third quarter of 2007, the fixed income markets experienced extraordinary volatility, rapidly widening credit spreads and significantly reduced liquidity. Key participates in these markets primarily through business conducted by its National Banking group and through its principal investing activities. The widening of credit spreads had an adverse impact on the market values of Key's loans held-for-sale, trading account securities and certain real estate-related investments included in other investments on the balance sheet. During the third quarter of 2007, Key recorded net losses of \$77 million on these assets, compared to net gains of \$26 million in the third quarter of 2006. Net gains from principal investing activities were \$9 million for the current quarter, down from \$28 million for the same period last year.



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Although the fixed income markets continue to remain under pressure heading into the fourth quarter, management believes most of the financial impact on Key's market-sensitive portfolios has already been experienced and expects the performance of these portfolios to improve over the remainder of the year. Based on current market conditions, management expects earnings per common share for the fourth quarter of 2007 to be in the range of \$.68 to \$.74. Management's expectations for the fourth quarter of 2007 with regard to certain other financial performance measures include:

- a net interest margin in the low- to mid-3.30% range;
- an upper-single digit percentage increase in commercial loans, and a low-single digit percentage increase in consumer loans;
- a low- to mid-single digit percentage increase in core deposits;
- net loan charge-offs in the range of .35% to .45% of average loans; and
- an effective tax rate of approximately 32% on a taxable-equivalent basis.

**Strategic developments**

Key has taken a number of specific actions during 2007 and 2006 to support its corporate strategy.

- 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 payment plan systems and technology in place at Tuition Management Systems and the array of payment plan products offered by Key will create one of the largest payment plan providers in the nation.
- On July 27, 2007, Key entered into an agreement to acquire U.S.B. Holding Co., Inc., the holding company for Union State Bank, a state-chartered commercial bank headquartered in Orangeburg, New York, with 31 branches. U.S.B. Holding Co. has assets of approximately \$3 billion and deposits of approximately \$2 billion. This acquisition will expand Key's presence in markets both within and contiguous to its current operations in the Hudson Valley. See Note 3 ( Acquisitions and Divestitures ), which begins on page 11, for more information pertaining to this pending acquisition.
- 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 has 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.
- On November 29, 2006, Key sold the nonprime mortgage loan portfolio held by the Champion Mortgage finance business. Key completed the sale of the Champion loan origination platform on February 28, 2007.
- On April 1, 2006, Key broadened its asset management product line by acquiring Austin Capital Management, Ltd., an investment firm headquartered in Austin, Texas with approximately \$900 million in assets under management at the date of acquisition. Austin specializes in selecting and managing hedge fund investments for its principally institutional customer base.

**Table of Contents****Figure 3. Selected Financial Data**

<i>Dollars in millions, except per share amounts</i>					<b>Nine months ended</b>		
	<b>Third</b>	<b>2007 Second</b>	<b>First</b>	<b>2006 Fourth</b>	<b>Third</b>	<b>September 30, 2007</b>	<b>2006</b>
<b>FOR THE PERIOD</b>							
Interest income	\$ 1,434	\$ 1,395	\$ 1,368	\$ 1,413	\$ 1,389	\$ 4,197	\$ 3,967
Interest expense	740	709	689	701	684	2,138	1,864
Net interest income	694	686	679	712	705	2,059	2,103
Provision for loan losses	69	53	44	53	35	166	97
Noninterest income	438	649	654	558	543	1,741	1,569
Noninterest expense	753	815	784	809	790	2,352	2,340
Income from continuing operations before income taxes and cumulative effect of accounting change	310	467	505	408	423	1,282	1,235
Income from continuing operations before cumulative effect of accounting change	224	337	358	311	305	919	882
(Loss) income from discontinued operations, net of taxes	(14)	(3)	(8)	(165)	7	(25)	22
Income before cumulative effect of accounting change	210	334	350	146	312	894	904
Net income	210	334	350	146	312	894	909
<b>PER COMMON SHARE</b>							
Income from continuing operations before cumulative effect of accounting change	\$ .58	\$ .86	\$ .90	\$ .77	\$ .76	\$ 2.34	\$ 2.18
(Loss) income from discontinued operations	(.03)	(.01)	(.02)	(.41)	.02	(.06)	.05
Income before cumulative effect of accounting change	.54	.85	.88	.36	.77	2.28	2.23
Net income	.54	.85	.88	.36	.77	2.28	2.24
Income from continuing operations before cumulative effect of accounting change assuming dilution	.57	.85	.89	.76	.74	2.31	2.15
(Loss) income from discontinued operations assuming dilution	(.03)	(.01)	(.02)	(.40)	.02	(.06)	.05
Income before cumulative effect of accounting change assuming dilution	.54	.84	.87	.36	.76	2.25	2.20
Net income assuming dilution	.54	.84	.87	.36	.76	2.25	2.21
Cash dividends declared	.365	.365	.365	.345	.345	1.095	1.035
Book value at period end	20.12	19.78	19.57	19.30	19.73	20.12	19.73
Market price:							
High	37.09	38.96	39.90	38.63	38.15	39.90	38.31
Low	31.38	34.15	35.94	35.73	34.48	31.38	32.68
Close	32.33	34.33	37.47	38.03	37.44	32.33	37.44
Weighted-average common shares outstanding (000)	389,319	392,045	397,875	402,329	403,780	393,048	405,218

Weighted-average common shares and potential common shares outstanding (000)	<b>393,164</b>	<b>396,918</b>	<b>403,478</b>	407,828	409,428	<b>397,816</b>	411,029
<b>AT PERIOD END</b>							
Loans	<b>\$ 68,999</b>	<b>\$ 66,692</b>	<b>\$ 65,711</b>	\$ 65,826	\$ 65,551	<b>\$ 68,999</b>	\$ 65,551
Earning assets	<b>84,973</b>	<b>82,328</b>	<b>81,263</b>	80,090	83,132	<b>84,973</b>	83,132
Total assets	<b>97,366</b>	<b>94,076</b>	<b>93,219</b>	92,337	96,155	<b>97,366</b>	96,155
Deposits	<b>63,714</b>	<b>60,599</b>	<b>59,773</b>	59,116	61,429	<b>63,714</b>	61,429
Long-term debt	<b>11,549</b>	<b>12,581</b>	<b>13,061</b>	14,533	13,654	<b>11,549</b>	13,654
Shareholders' equity	<b>7,820</b>	<b>7,701</b>	<b>7,719</b>	7,703	7,947	<b>7,820</b>	7,947
<b>PERFORMANCE RATIOS</b>							
<b>From continuing operations:</b>							
Return on average total assets	<b>.93%</b>	<b>1.45%</b>	<b>1.58%</b>	1.33%	1.31%	<b>1.31%</b>	1.30%
Return on average equity	<b>11.50</b>	<b>17.66</b>	<b>19.06</b>	15.63	15.52	<b>16.03</b>	15.44
Net interest margin (taxable equivalent)	<b>3.40</b>	<b>3.46</b>	<b>3.50</b>	3.66	3.61	<b>3.46</b>	3.67
<b>From consolidated operations:</b>							
Return of average total assets	<b>.88%</b>	<b>1.43%</b>	<b>1.54%</b>	.61%	1.30%	<b>1.28%</b>	1.29%
Return of average equity	<b>10.79</b>	<b>17.50</b>	<b>18.63</b>	7.34	15.88	<b>15.59</b>	15.82
Net interest margin (taxable equivalent)	<b>3.40</b>	<b>3.46</b>	<b>3.51</b>	3.69	3.63	<b>3.46</b>	3.69
<b>CAPITAL RATIOS AT PERIOD END</b>							
Equity to assets	<b>8.03%</b>	<b>8.19%</b>	<b>8.28%</b>	8.34%	8.26%	<b>8.03%</b>	8.26%
Tangible equity to tangible assets	<b>6.78</b>	<b>6.89</b>	<b>6.97</b>	7.01	6.81	<b>6.78</b>	6.81
Per 1 risk-based capital	<b>7.94</b>	<b>8.14</b>	<b>8.15</b>	8.24	8.02	<b>7.94</b>	8.02
Total risk-based capital	<b>11.76</b>	<b>12.15</b>	<b>12.20</b>	12.43	12.13	<b>11.76</b>	12.13
Leverage	<b>8.96</b>	<b>9.11</b>	<b>9.17</b>	8.98	8.89	<b>8.96</b>	8.89
<b>TRUST AND BROKERAGE ASSETS</b>							
Assets under management	<b>\$ 88,100</b>	<b>\$ 85,592</b>	<b>\$ 82,388</b>	\$ 84,699	\$ 84,060	<b>\$ 88,100</b>	\$ 84,060
Nonmanaged and brokerage assets	<b>33,273</b>	<b>33,485</b>	<b>32,838</b>	56,292	55,221	<b>33,273</b>	55,221
<b>OTHER DATA</b>							
Average full-time equivalent employees	<b>18,567</b>	<b>18,888</b>	<b>19,801</b>	20,100	20,264	<b>19,081</b>	19,974
Branches	<b>954</b>	<b>954</b>	<b>950</b>	950	949	<b>954</b>	949

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 11, contains specific information about the acquisition and divestitures that Key completed during 2006 and the first nine months of 2007 to help in understanding how those transactions may have impacted Key's financial condition and results of operations.

**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 13. 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 4 summarizes the contribution made by each major business group to Key's taxable-equivalent revenue and income from continuing operations for the three- and nine-month periods ended September 30, 2007 and 2006. Key's line of business results for each of these periods reflect a new organizational structure that took effect January 1, 2007.

**Figure 4. Major Business Groups Taxable-Equivalent Revenue and Income from Continuing Operations**

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2007	2006	Amount	Change Percent	September 30, 2007	2006	Amount	Change Percent
<b>REVENUE FROM CONTINUING OPERATIONS (TE) <sup>a</sup></b>								
Community Banking	\$ 626	\$ 687	\$ (61)	(8.9)%	\$ 2,060	\$ 2,023	\$ 37	1.8%
National Banking	511	586	(75)	(12.8)	1,727	1,748	(21)	(1.2)
Other Segments	14	25	(11)	(44.0)	95	38	57	150.0
Total Segments	1,151	1,298	(147)	(11.3)	3,882	3,809	73	1.9
Reconciling Items	(1)	(29)	28	96.6	(23)	(66)	43	65.2
Total	\$ 1,150	\$ 1,269	\$ (119)	(9.4)%	\$ 3,859	\$ 3,743	\$ 116	3.1%
<b>INCOME FROM CONTINUING OPERATIONS <sup>a</sup></b>								
Community Banking	\$ 131	\$ 112	\$ 19	17.0%	\$ 430	\$ 323	\$ 107	33.1%
National Banking	72	169	(97)	(57.4)	393	509	(116)	(22.8)
Other Segments	16	20	(4)	(20.0)	62	39	23	59.0
Total Segments	219	301	(82)	(27.2)	885	871	14	1.6
Reconciling Items	5	4	1	25.0	34	11	23	209.1
Total	\$ 224	\$ 305	\$ (81)	(26.6)%	\$ 919	\$ 882	\$ 37	4.2%

(a) Community Banking results for the first nine months 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 11, for more information pertaining to this transaction.

National Banking results for the first nine months of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation during the first quarter.

Other Segments results for the first nine months of 2007 include a \$26 million (\$16 million after tax) charge for litigation recorded during the second quarter. This charge and the litigation charge referred to in the comment related to Reconciling Items below

comprise the \$42 million charge recorded in connection with the Honsador litigation disclosed in Note 13 ( Contingent Liabilities and Guarantees ), which begins on page 28. Results for the current year-to-date period also include a \$49 million (\$31 million after tax) loss recorded during the first quarter in connection with the repositioning of the securities portfolio.

Reconciling Items include gains of \$27 million (\$17 million after tax) recorded during the third quarter of 2007, \$40 million (\$25 million after tax) recorded during the second quarter of 2007 and \$9 million (\$6 million after tax) recorded during the second quarter of 2006 related

to MasterCard  
Incorporated  
shares. Results  
for the first nine  
months of 2007  
also include a  
\$16 million  
(\$10 million  
after tax) charge  
for litigation  
recorded during  
the second  
quarter.

TE = Taxable Equivalent

**Community Banking summary of operations**

As shown in Figure 5, net income for Community Banking was \$131 million for the third quarter of 2007, up from \$112 million for the year-ago quarter. Declines in both net interest income and noninterest income were more than offset by decreases in the provision for loan losses and noninterest expense.

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Taxable-equivalent net interest income decreased by \$34 million, or 8%, from the third quarter of 2006, as interest rate spreads on both average earning assets and deposits have remained under pressure due to the continuation of competitive pricing. The decrease also reflected the effect of the February 2007 sale of the McDonald Investments branch network in which Key transferred approximately \$1.3 billion of Negotiable Order of Withdrawal ( NOW ) and money market deposit accounts to the buyer. McDonald Investments NOW and money market deposit accounts averaged \$1.7 billion for the third quarter of 2006.

Noninterest income decreased by \$27 million, or 11%. The decrease was attributable to the McDonald Investments sale. Excluding the impact of this sale, noninterest income rose by \$13 million, or 6%, from the same period one year ago, due largely to growth in deposit service charge income.

The provision for loan losses decreased by \$21 million, compared to the third quarter of 2006.

Noninterest expense declined by \$69 million, or 14%, from the year-ago quarter. Reductions in costs resulting from the sale of the McDonald Investments branch network accounted for \$46 million of the decline, including a \$27 million decrease in personnel expense. The remainder of the decline in total noninterest expense reflected decreases in various direct and indirect charges, due in part to a reduction in the number of average full-time equivalent employees.

On July 27, 2007, Key entered into an agreement to acquire U.S.B. Holding Co., Inc., the holding company for Union State Bank, a state-chartered commercial bank headquartered in Orangeburg, New York, with 31 branches. U.S.B. Holding Company has assets of approximately \$3 billion and deposits of approximately \$2 billion. Key expects to complete this acquisition early in 2008, subject to approval by U.S.B. Holding Company shareholders and the banking regulators. The acquisition will expand Key's presence in markets both within and contiguous to its current operations in the Hudson Valley. See Note 3 ( Acquisitions and Divestitures ), which begins on page 11, for more information pertaining to this transaction.

**Figure 5. Community Banking**

<i>dollars in millions</i>	Three months ended				Nine months ended				
	September 30, 2007	September 30, 2006	Change Amount	Change Percent	September 30, 2007	September 30, 2006	Change Amount	Change Percent	
<b>SUMMARY OF OPERATIONS</b>									
Net interest income (TE)	\$ 409	\$ 443	\$ (34)	(7.7)%	\$ 1,242	\$ 1,309	\$ (67)	(5.1)%	
Noninterest income	217	244	(27)	(11.1)	818 <sup>a</sup>	714	104	14.6	
Total revenue (TE)	626	687	(61)	(8.9)	2,060	2,023	37	1.8	
Provision for loan losses	1	22	(21)	(95.5)	36	71	(35)	(49.3)	
Noninterest expense	417	486	(69)	(14.2)	1,336	1,435	(99)	(6.9)	
Income before income taxes (TE)	208	179	29	16.2	688	517	171	33.1	
Allocated income taxes and TE adjustments	77	67	10	14.9	258	194	64	33.0	
Net income	\$ 131	\$ 112	\$ 19	17.0%	\$ 430	\$ 323	\$ 107	33.1%	
Percent of consolidated income from continuing operations	59%	37%	N/A	N/A	47%	37%	N/A	N/A	



**AVERAGE BALANCES**

Loans and leases	<b>\$ 26,947</b>	\$ 26,794	\$ 153	.6%	<b>\$ 26,661</b>	\$ 26,803	\$ (142)	(.5)%
Total assets	<b>29,716</b>	29,871	(155)	(.5)	<b>29,454</b>	29,883	(429)	(1.4)
Deposits	<b>46,727</b>	46,939	(212)	(.5)	<b>46,458</b>	46,459	(1)	

(a) Community Banking results for the first nine months 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 11, for more information pertaining to this transaction.

TE = Taxable Equivalent

N/A = Not Applicable

**Table of Contents****ADDITIONAL COMMUNITY BANKING DATA**

<i>dollars in millions</i>	<b>Three months ended</b>				<b>Nine months ended</b>			
	<b>September 30,</b>		<b>Change</b>		<b>September 30,</b>		<b>Change</b>	
	<b>2007</b>	<b>2006</b>	<b>Amount</b>	<b>Percent</b>	<b>2007</b>	<b>2006</b>	<b>Amount</b>	<b>Percent</b>
<b>AVERAGE DEPOSITS OUTSTANDING</b>								
NOW and money market deposit accounts	\$ <b>20,305</b>	\$ 20,688	\$ (383)	(1.9)%	\$ <b>19,632</b>	\$ 20,564	\$ (932)	(4.5)%
Savings deposits	<b>1,569</b>	1,688	(119)	(7.0)	<b>1,602</b>	1,721	(119)	(6.9)
Certificates of deposits (\$100,000 or more)	<b>4,566</b>	4,101	465	11.3	<b>4,609</b>	4,023	586	14.6
Other time deposits	<b>11,485</b>	11,696	(211)	(1.8)	<b>11,856</b>	11,472	384	3.3
Deposits in foreign office	<b>1,128</b>	694	434	62.5	<b>1,044</b>	617	427	69.2
Noninterest-bearing deposits	<b>7,674</b>	8,072	(398)	(4.9)	<b>7,715</b>	8,062	(347)	(4.3)
Total deposits	\$ <b>46,727</b>	\$ 46,939	\$ (212)	(.5)%	\$ <b>46,458</b>	\$ 46,459	\$ (1)	

**HOME EQUITY LOANS**

Average balance	\$ <b>9,690</b>	\$ 10,048
Weighted-average loan-to-value ratio	<b>70%</b>	70%
Percent first lien positions	<b>58</b>	60

**OTHER DATA**

On-line households/household penetration	<b>743,909 / 45%</b>	646,993 / 52%
Branches	<b>954</b>	949
Automated teller machines	<b>1,439</b>	2,099

**National Banking summary of continuing operations**

As shown in Figure 6, income from continuing operations for National Banking was \$72 million for the third quarter of 2007, compared to \$169 million for the same period last year. Lower noninterest income along with increases in the provision for loan losses and noninterest expense accounted for the reduction, and more than offset an increase in net interest income.

Taxable-equivalent net interest income rose by \$11 million, or 3%, from the third quarter of 2006. Increases in average earning assets and deposits, and a more favorable interest rate spread on deposits more than offset the adverse effect of a tighter interest rate spread on average earning assets.

Noninterest income declined by \$86 million, or 36%, as several capital markets-driven businesses were adversely affected by volatility in the financial markets. Results for the current quarter included net losses of \$57 million from the sales and write-downs of primarily commercial real estate loans held for sale, compared to net gains of \$10 million for the year-ago quarter. Income from investment banking and capital markets activities decreased by \$39 million, due primarily to a \$25 million decline in the fair values of two real estate-related investments held by the Private Equity unit within the Real Estate Capital line of business, and less favorable results related to trading activities conducted in the Debt Capital markets area.

The provision for loan losses rose by \$55 million, reflecting increases in nonperforming loans in the Real Estate Capital and Consumer Finance lines of business.

Noninterest expense grew by \$24 million, or 8%, from the year-ago quarter, reflecting a \$12 million rise in costs associated with operating leases, and smaller increases in a variety of other expense components.

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 payment plan systems and technology in place at Tuition Management Systems and the array of payment plan products offered by Key will create one of the largest payment plan providers in the nation.

**Table of Contents****Figure 6. National Banking**

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2007	2006	Change Amount	Change Percent	September 30, 2007	2006	Change Amount	Change Percent
<b>SUMMARY OF OPERATIONS</b>								
Net interest income (TE)	\$ 359	\$ 348	\$ 11	3.2%	\$ 1,045	\$ 1,039	\$ 6	.6%
Noninterest income	152	238	(86)	(36.1)	682 <sup>a</sup>	709	(27)	(3.8)
Total revenue (TE)	511	586	(75)	(12.8)	1,727	1,748	(21)	(1.2)
Provision for loan losses	68	13	55	423.1	130	26	104	400.0
Noninterest expense	328	304	24	7.9	968	912	56	6.1
Income from continuing operations before income taxes (TE)	115	269	(154)	(57.2)	629	810	(181)	(22.3)
Allocated income taxes and TE adjustments	43	100	(57)	(57.0)	236	301	(65)	(21.6)
Income from continuing operations	72	169	(97)	(57.4)	393	509	(116)	(22.8)
(Loss) income from discontinued operations, net of taxes	(14)	7	(21)	N/M	(25)	22	(47)	N/M
Net income	\$ 58	\$ 176	\$ (118)	(67.0)%	\$ 368	\$ 531	\$ (163)	(30.7)%
Percent of consolidated income from continuing operations	32%	55%	N/A	N/A	43%	58%	N/A	N/A
<b>AVERAGE BALANCES FROM CONTINUING OPERATIONS</b>								
Loans and leases	\$ 40,277	\$ 37,871	\$ 2,406	6.4%	\$ 39,485	\$ 37,545	\$ 1,940	5.2%
Loans held for sale	4,692	4,553	139	3.1	4,331	4,022	309	7.7
Total assets	50,954	48,530	2,424	5.0	49,665	47,659	2,006	4.2
Deposits	12,633	11,106	1,527	13.7	12,009	10,597	1,412	13.3

(a) National Banking results for the first nine months of 2007 include a \$26 million

(\$17 million  
after tax) gain  
from the  
settlement of the  
residual value  
insurance  
litigation during  
the first quarter.

TE = Taxable Equivalent

N/A = Not Applicable

N/M = Not Meaningful

**Other Segments**

Other segments consist of Corporate Treasury and Key s Principal Investing unit. These segments generated net income of \$16 million for the third quarter of 2007, compared to \$20 million for the same period last year. A reduction in net gains from principal investing caused the decrease.

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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 7, which spans pages 48 and 49, 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. This figure also presents a reconciliation of taxable-equivalent net interest income for each of those quarters to net interest income reported in accordance with GAAP.

Taxable-equivalent net interest income was \$712 million for the third quarter of 2007, compared to \$726 million for the year-ago quarter. 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. Key's net interest margin declined by 21 basis points from the third quarter of 2006 to 3.40% for the third quarter of 2007. A basis point is equal to one one-hundredth of a percentage point, meaning 21 basis points equal .21%.

The reductions in net interest income and the net interest margin were due primarily to tighter interest rate spreads on both loans and deposits, reflecting the continuation of competitive pricing, and client preferences for deposit products with more attractive interest rates. Additionally, as part of the February 2007 sale of the McDonald Investments branch network, Key transferred approximately \$1.3 billion of NOW and money market deposit accounts to the buyer. McDonald Investments' NOW and money market deposit accounts averaged \$1.7 billion for the third quarter of 2006. The decrease in the net interest margin was moderated by the impact of a 14% rise in the volume of noninterest-bearing funds. The growth in these funds added approximately 12 basis points to the net interest margin. Average earning assets for the third quarter of 2007 totaled \$83.5 billion, which was \$3.6 billion, or 4%, higher than the third quarter 2006 level. Increases in commercial loans and securities available for sale drove the growth.

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Since December 31, 2005, the growth and composition of Key's earning assets have been affected by the following loan sales, most of which came from the held-for-sale portfolio:

- .. Key sold commercial mortgage loans of \$2.8 billion (\$238 million through a securitization) during the first nine months of 2007 and \$2.6 billion during all of 2006. 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 29.
  
- .. Key sold education loans of \$223 million during the first nine months of 2007 and \$1.4 billion (\$1.1 billion through a securitization) during all of 2006. Key uses the securitization market for education loans to diversify funding sources.
  
- .. Key sold other loans totaling \$874 million during the first nine months of 2007 and \$3.2 billion during all of 2006. This included the fourth quarter 2006 sale of the \$2.5 billion nonprime mortgage loan portfolio held by the Champion Mortgage finance business. The Champion business no longer fit strategically with Key's longer-term business goals and continued focus on Community Banking and relationship-oriented businesses.

**Table of Contents****Figure 7. Average Balance Sheets, Net Interest Income and Yields/Rates  
From Continuing Operations**

<i>dollars in millions</i>	Third Quarter 2007			Second Quarter 2007		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
<b>ASSETS</b>						
Loans <sup>a,b</sup>						
Commercial, financial and agricultural	\$ 22,393	\$ 410	7.25%	\$ 21,856	\$ 401	7.36%
Real estate commercial mortgage	8,855	172	7.69	8,565	165	7.75
Real estate construction	8,285	167	8.01	8,243	167	8.09
Commercial lease financing	10,172	147	5.80	10,096	142	5.62
Total commercial loans	49,705	896	7.16	48,760	875	7.19
Real estate residential	1,586	26	6.68	1,472	24	6.57
Home equity	10,883	199	7.22	10,752	193	7.22
Consumer direct	1,342	36	10.66	1,370	37	10.64
Consumer indirect	4,164	70	6.79	3,961	67	6.76
Total consumer loans	17,975	331	7.33	17,555	321	7.33
Total loans	67,680	1,227	7.20	66,315	1,196	7.23
Loans held for sale	4,731	91	7.59	4,415	82	7.50
Investment securities <sup>a</sup>	36		6.43	39		6.72
Securities available for sale <sup>c</sup>	7,825	106	5.45	7,793	106	5.45
Short-term investments	1,688	16	3.99	1,484	16	4.19
Other investments <sup>c</sup>	1,563	12	2.99	1,541	15	3.68
Total earning assets	83,523	1,452	6.92	81,587	1,415	6.95
Allowance for loan losses	(942)			(942)		
Accrued income and other assets	12,581			12,767		
<b>Total assets</b>	<b>\$ 95,162</b>			<b>\$ 93,412</b>		
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>						
NOW and money market deposit accounts	\$ 24,190	209	3.41	\$ 22,953	179	3.14
Savings deposits	1,581		.19	1,633	1	.19
Certificates of deposit (\$100,000 or more) <sup>d</sup>	6,274	80	5.06	6,237	79	5.03
Other time deposits	11,512	136	4.68	12,047	141	4.70
Deposits in foreign office <sup>e</sup>	4,540	57	5.00	3,600	47	5.20
Total interest-bearing deposits	48,097	482	3.98	46,470	447	3.85
Federal funds purchased and securities sold under repurchase agreements <sup>e</sup>	4,470	55	4.85	4,748	59	5.04
Bank notes and other short-term borrowings	2,539	30	4.70	1,771	18	4.14



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Long-term debt <sup>d, e</sup>	<b>11,801</b>	<b>173</b>	<b>5.89</b>	<b>12,909</b>	<b>185</b>	<b>5.83</b>
Total interest-bearing liabilities	<b>66,907</b>	<b>740</b>	<b>4.40</b>	<b>65,898</b>	<b>709</b>	<b>4.33</b>
Noninterest-bearing deposits	<b>14,424</b>			<b>13,927</b>		
Accrued expense and other liabilities	<b>6,106</b>			<b>5,933</b>		
Shareholders' equity	<b>7,725</b>			<b>7,654</b>		
<b>Total liabilities and shareholders' equity</b>	<b>\$ 95,162</b>			<b>\$ 93,412</b>		
Interest rate spread (TE)			<b>2.52%</b>			<b>2.62%</b>
Net interest income (TE) and net interest margin (TE)		<b>712</b>	<b>3.40%</b>		<b>706</b>	<b>3.46%</b>
TE adjustment <sup>a</sup>		<b>18</b>			<b>20</b>	
Net interest income, GAAP basis		<b>\$ 694</b>			<b>\$ 686</b>	

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

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

(e) 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

Table of Contents**Figure 7. Average Balance Sheets, Net Interest Income and Yields/Rates  
From Continuing Operations (Continued)**

First Quarter 2007			Fourth Quarter 2006			Third Quarter 2006		
Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
\$ 21,562	\$ 392	7.38%	\$ 21,384	\$ 400	7.42%	\$ 21,648	\$ 400	7.34%
8,426	163	7.83	8,399	167	7.86	8,106	164	8.04
8,227	166	8.20	8,347	174	8.25	7,965	171	8.51
10,094	146	5.78	9,891	160	6.47	9,850	144	5.83
48,309	867	7.26	48,021	901	7.44	47,569	879	7.34
1,444	24	6.60	1,428	24	6.59	1,415	23	6.49
10,706	191	7.22	10,896	197	7.22	11,017	200	7.19
1,450	36	10.15	1,557	34	8.63	1,585	36	9.07
3,760	64	6.79	3,671	62	6.85	3,594	61	6.83
17,360	315	7.32	17,552	317	7.21	17,611	320	7.23
65,669	1,182	7.28	65,573	1,218	7.38	65,180	1,199	7.31
3,940	75	7.70	4,547	90	7.86	4,578	94	8.17
39	1	7.21	38	1	7.68	42	1	8.12
7,548	100	5.27	7,765	96	4.88	7,216	84	4.61
1,607	18	4.55	1,584	16	4.04	1,588	16	3.78
1,400	13	3.65	1,351	24	6.76	1,363	16	4.67
80,203	1,389	6.99	80,858	1,445	7.09	79,967	1,410	7.00
(942)			(941)			(951)		
12,835			13,129			13,247		
\$ 92,096			\$ 93,046			\$ 92,263		
\$ 23,424	177	3.06	\$ 25,136	198	3.13	\$ 25,230	194	3.05
1,629	1	.19	1,651	1	.19	1,700	1	.19
6,151	76	5.03	6,013	75	4.93	5,517	67	4.82
12,063	138	4.64	11,921	136	4.50	11,700	127	4.29
3,258	41	5.12	2,245	30	5.55	2,820	39	5.55
46,525	433	3.77	46,966	440	3.72	46,967	428	3.61
3,903	49	5.04	2,816	37	5.21	2,315	30	5.05
1,113	11	3.98	1,814	19	4.17	2,285	24	4.29
13,617	196	5.90	14,092	205	5.80	13,763	202	5.83

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<b>65,158</b>	<b>689</b>	<b>4.29</b>	65,688	701	4.24	65,330	684	4.15
<b>13,237</b>			13,424			13,073		
<b>6,083</b>			6,041			6,063		
<b>7,618</b>			7,893			7,797		
<b>\$ 92,096</b>			\$ 93,046			\$ 92,263		
		<b>2.70%</b>			2.85%			2.85%
	<b>700</b>	<b>3.50%</b>		744	3.66%		726	3.61%
	<b>21</b>			32			21	
	<b>\$ 679</b>			<b>\$ 712</b>			<b>\$ 705</b>	

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Figure 8 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 55, contains more discussion about changes in earning assets and funding sources.

**Figure 8. Components of Net Interest Income Changes**

<i>in millions</i>	<b>From three months ended September 30, 2006 to three months ended September 30, 2007</b>			<b>From nine months ended September 30, 2006 to nine months ended September 30, 2007</b>		
	<b>Average Volume</b>	<b>Yield/ Rate</b>	<b>Net Change</b>	<b>Average Volume</b>	<b>Yield/ Rate</b>	<b>Net Change</b>
<b>INTEREST INCOME</b>						
Loans	\$ 46	\$ (18)	\$ 28	\$ 95	\$ 65	\$ 160
Loans held for sale	3	(6)	(3)	19	(6)	13
Investment securities		(1)	(1)	(1)		(1)
Securities available for sale	7	15	22	21	40	61
Short-term investments	1	(1)		(2)	5	3
Other investments	2	(6)	(4)	5	(23)	(18)
Total interest income (TE)	59	(17)	42	137	81	218
<b>INTEREST EXPENSE</b>						
NOW and money market deposit accounts	(8)	23	15	(32)	85	53
Savings deposits		(1)	(1)		(1)	(1)
Certificates of deposit (\$100,000 or more)	10	3	13	28	21	49
Other time deposits	(2)	11	9	12	58	70
Deposits in foreign office	22	(4)	18	56	(1)	55
Total interest-bearing deposits	22	32	54	64	162	226
Federal funds purchased and securities sold under repurchase agreements	27	(2)	25	88	5	93
Bank notes and other short-term borrowings	3	3	6	(20)	4	(16)
Long-term debt	(29)		(29)	(50)	21	(29)
Total interest expense	23	33	56	82	192	274
Net interest income (TE)	\$ 36	\$ (50)	\$ (14)	\$ 55	\$ (111)	\$ (56)

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**

Noninterest income for the third quarter of 2007 was \$438 million, compared to \$543 million for the same period last year. For the first nine months of the year, noninterest income was \$1.7 billion, representing an increase of \$172 million, or 11%, from the first nine months of 2006.

The decrease from the year-ago quarter was attributable to the impact of market volatility on several of Key's capital markets-driven businesses, as well as the sale of the McDonald Investments branch network completed in the first quarter of this year. As shown in Figure 9, results for the current quarter included \$53 million in net losses from the sales and write-downs of primarily commercial real estate loans held for sale, compared to net gains of \$14 million for the same period last year. Income from investment banking and capital markets activities decreased by \$35 million, due primarily to a \$25 million decline in the fair values of two real estate-related investments held by the Private Equity unit within the Real Estate Capital line of business. Net gains from principal investing declined by \$19 million from the third quarter of 2006, and trust and investment services income was down \$18 million, due to lower brokerage income resulting from the sale of the McDonald Investments branch network. The reduction in noninterest income was moderated by a \$27 million gain from the sale of MasterCard Incorporated shares in the current quarter and growth in deposit service charge income.

For the year-to-date period, the growth in noninterest income from the same period last year reflected several significant items. During the first quarter of 2007, Key recorded a \$171 million gain associated with the February 9, 2007, sale of the McDonald Investments branch network, a \$49 million loss recorded in connection with the repositioning of the securities portfolio and a \$26 million gain from the settlement of the automobile residual value insurance litigation. Excluding these items, Key's noninterest income was \$1.6 billion for the first nine months of 2007, representing a \$24 million increase from the first nine months

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of 2006. As shown in Figure 9, an \$80 million increase in net gains from principal investing, a \$58 million increase in gains associated with the sale of MasterCard Incorporated shares, higher income from operating leases, and an increase in deposit service charge income drove the growth. These positive results were substantially offset by decreases in income from trust and investment services, and investment banking and capital markets activities. In addition, Key recorded net losses from loan securitizations and sales in the current year, compared to net gains for the first nine months of 2006.

**Figure 9. Noninterest Income**

	Three months ended				Nine months ended			
	September 30, 2007		Change		September 30, 2007		Change	
<i>dollars in millions</i>	2007	2006	Amount	Percent	2007	2006	Amount	Percent
Trust and investment services income	\$ 119	\$ 137	\$ (18)	(13.1)%	\$ 359	\$ 411	\$ (52)	(12.7)%
Service charges on deposit accounts	88	78	10	12.8	247	227	20	8.8
Investment banking and capital markets income	9	44	(35)	(79.5)	105	161	(56)	(34.8)
Operating lease income	70	58	12	20.7	200	166	34	20.5
Letter of credit and loan fees	51	48	3	6.3	134	133	1	.8
Corporate-owned life insurance income	27	23	4	17.4	84	74	10	13.5
Electronic banking fees	25	27	(2)	(7.4)	74	78	(4)	(5.1)
Net gains (losses) from loan securitizations and sales	(53)	14	(67)	N/M	(11)	34	(45)	N/M
Net securities gains (losses)	4	(7)	11	N/M	(41)	(2)	(39)	N/M
Gain on sale of McDonald Investments branch network					171		171	N/M
Other income:								
Insurance income	16	18	(2)	(11.1)	45	49	(4)	(8.2)
Loan securitization servicing fees	5	5			16	15	1	6.7
Credit card fees	4	8	(4)	(50.0)	10	14	(4)	(28.6)
Net gains from principal investing	9	28	(19)	(67.9)	128	48	80	166.7
Gains related to MasterCard Incorporated shares	27		27	N/M	67	9	58	644.4
Litigation settlement - automobile residual value insurance					26		26	N/M
Miscellaneous income	37	62	(25)	(40.3)	127	152	(25)	(16.4)
Total other income	98	121	(23)	(19.0)	419	287	132	46.0
Total noninterest income	\$ 438	\$ 543	\$ (105)	(19.3)%	\$ 1,741	\$ 1,569	\$ 172	11.0%

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 is Key's largest source of noninterest income. The primary components of revenue generated by these services are shown in Figure 10. The decreases compared to 2006 results were attributable to lower brokerage income resulting from the sale of the McDonald Investments branch network. Excluding the impact of the sale, brokerage commissions and fee income was up \$3 million from the third quarter of last year and \$5 million from the first nine months of 2006. As shown in Figure 10, growth was also experienced in both personal and institutional asset management and custody fees.

**Figure 10. Trust and Investment Services Income**

<i>dollars in millions</i>	Three months ended				Nine months ended			
	September 30, 2007		2006		September 30, 2007		2006	
	Amount	Percent	Change	Amount	Percent	Change	Amount	Percent
Brokerage commissions and fee income	\$ 26	\$ 56	\$ (30)	(53.6)%	\$ 94	\$ 177	\$ (83)	(46.9)%
Personal asset management and custody fees	41	39	2	5.1	122	116	6	5.2
Institutional asset management and custody fees	52	42	10	23.8	143	118	25	21.2
Total trust and investment services income	\$ 119	\$ 137	\$ (18)	(13.1)%	\$ 359	\$ 411	\$ (52)	(12.7)%

A significant portion of Key's trust and investment services income depends on the value and mix of assets under management. At September 30, 2007, Key's bank, trust and registered investment advisory subsidiaries had assets under management of \$88.1 billion, compared to \$84.1 billion at September 30, 2006. As shown in Figure 11, the increase was due primarily to Key's equity portfolio, reflecting improvement in the equity markets in general. Key's fixed income portfolio and the higher-yielding hedge



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funds also contributed to the increase. The decrease in assets under management during the first quarter of 2007 was attributable to assets transferred in connection with the sale of the McDonald Investments branch network. The growth in total assets under management was moderated by declines in the money market portfolio and Key's securities lending business. 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.

**Figure 11. Assets Under Management**

<i>in millions</i>		2007		2006	
	Third	Second	First	Fourth	Third
Assets under management by investment type:					
Equity	\$ 44,465	\$ 42,462	\$ 40,065	\$ 41,877	\$ 39,831
Securities lending	22,056	22,595	21,608	21,146	22,699
Fixed income	11,372	11,187	11,420	11,242	11,311
Money market	8,861	8,069	8,260	9,402	9,298
Hedge funds	1,346	1,279	1,035	1,032	921
Total	\$ 88,100	\$ 85,592	\$ 82,388	\$ 84,699	\$ 84,060
Proprietary mutual funds included in assets under management:					
Money market	\$ 6,888	\$ 6,280	\$ 6,459	\$ 7,579	\$ 7,520
Equity	6,748	6,392	5,788	5,713	5,250
Fixed income	629	615	621	629	639
Total	\$ 14,265	\$ 13,287	\$ 12,868	\$ 13,921	\$ 13,409

**Service charges on deposit accounts.** Service charges on deposit accounts were up from the prior year, due primarily to an increase in overdraft fees resulting from higher transaction volume, a rate increase instituted during the second quarter of 2007 and growth in the number of transaction accounts within Key's Community Banking group.

**Investment banking and capital markets income.** As shown in Figure 12, the decreases in investment banking and capital markets income compared to the prior year were due primarily to less favorable results from other investments and from dealer trading and derivatives activities, reflecting extraordinary volatility in the fixed income markets during the third quarter of 2007. The loss recorded from other investments in the third quarter of 2007 was due largely to a \$25 million decline in the fair values of two real estate-related investments held by the Private Equity unit within the Real Estate Capital line of business. The year-to-date reduction in this revenue component was attributable to this decline and a \$25 million gain from the initial public offering completed by the New York Stock Exchange during the first quarter of last year.

**Figure 12. Investment Banking and Capital Markets Income**

Three months ended	Change	Nine months ended	Change
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<i>dollars in millions</i>	<b>September</b>				<b>September</b>			
	<b>30,</b>	<b>30,</b>	<b>Amoun</b>	<b>Percent</b>	<b>30,</b>	<b>30,</b>	<b>Amoun</b>	<b>Percent</b>
	<b>2007</b>	<b>2006</b>			<b>2007</b>	<b>2006</b>		
Investment banking income	<b>\$ 22</b>	\$ 21	\$ 1	4.8%	<b>\$ 65</b>	\$ 69	\$ (4)	(5.8)%
Income (loss) from other investments	<b>(22)</b>	5	(27)	N/M	<b>(11)</b>	37	(48)	N/M
Dealer trading and derivatives income (loss)	<b>(2)</b>	7	(9)	N/M	<b>18</b>	23	(5)	(21.7)
Foreign exchange income	<b>11</b>	11			<b>33</b>	32	1	3.1
Total investment banking and capital markets income	<b>\$ 9</b>	\$ 44	\$ (35)	(79.5)%	<b>\$ 105</b>	\$ 161	\$ (56)	(34.8)%

N/M = Not Meaningful

**Operating lease income.** The increase in operating lease income compared to the third quarter and first nine months of 2006 reflected a higher volume of activity in the Equipment Finance line of business. Depreciation expense related to the leased equipment is presented in Figure 13 as operating lease expense.

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**Net gains 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 third quarter of 2007, Key recorded \$53 million of net losses from loan sales as well as changes in the estimated fair values of primarily commercial real estate loans held for sale. Recent volatility in the fixed income markets and the related housing correction caused a significant decrease in the value of these loans. The types of loans sold during 2007 and 2006 are presented in Figure 17 on page 57.

**Net 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 (\$970 million at September 30, 2007, \$830 million at December 31, 2006, and \$843 million at September 30, 2006). The net gains presented in Figure 9 stem from changes in estimated fair values as well as gains resulting from the sales of principal investments.

**Noninterest expense**

Noninterest expense for the third quarter of 2007 was \$753 million, down from \$790 million for the third quarter of 2006. For the first nine months of the year, noninterest expense was \$2.4 billion, essentially unchanged from the level reported one year ago.

As shown in Figure 13, personnel expense decreased by \$35 million from the year-ago quarter, due to lower incentive compensation accruals. Nonpersonnel expense was down \$2 million. Reductions in costs resulting from the sale of the McDonald Investments branch network accounted for a \$46 million decline in total noninterest expense, including \$27 million of the decrease in personnel expense.

For the year-to-date period, personnel expense decreased by \$23 million from the same period last year, due to lower incentive compensation accruals stemming from the sale of the McDonald Investments branch network. Excluding a \$42 million charge to litigation (included in miscellaneous expense) recorded in the second quarter of 2007, nonpersonnel expense was down \$7 million. Reductions in professional fees, marketing expense and certain costs associated with the McDonald Investments branch network more than offset a substantial increase in operating lease expense. See Note 13 (Contingent Liabilities and Guarantees), which begins on page 28, for more information pertaining to the litigation charge.

**Figure 13. Noninterest Expense**

	Three months ended		Change		Nine months ended		Change	
	September 30, 2007	2006	Amount	Percent	September 30, 2007	2006	Amount	Percent
Personnel	\$ 383	\$ 418	\$ (35)	(8.4)%	\$ 1,222	\$ 1,245	\$ (23)	(1.8)%
Net occupancy	60	62	(2)	(3.2)	182	182		
Computer processing	49	52	(3)	(5.8)	149	157	(8)	(5.1)
Operating lease expense	58	48	10	20.8	165	134	31	23.1
Professional fees	27	28	(1)	(3.6)	79	101	(22)	(21.8)
Equipment	22	26	(4)	(15.4)	71	78	(7)	(9.0)
Marketing	21	32	(11)	(34.4)	60	70	(10)	(14.3)
Other expense:								
Postage and delivery	11	13	(2)	(15.4)	34	38	(4)	(10.5)
Franchise and business taxes	8	9	(1)	(11.1)	25	29	(4)	(13.8)
Telecommunications	7	7			21	21		
Provision for losses on lending-related commitments	5		5	N/M	3		3	N/M
Miscellaneous expense	102	95	7	7.4	341	285	56	19.6
Total other expense	133	124	9	7.3	424	373	51	13.7

Total noninterest expense	\$	<b>753</b>	\$	790	\$	(37)	(4.7)%	\$	<b>2,352</b>	\$	2,340	\$	12	.5%
Average full-time equivalent employees <sup>a</sup>		<b>18,567</b>		20,264		(1,697)	(8.4)%		<b>19,081</b>		19,974		(893)	(4.5)%

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

N/M = Not Meaningful

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

**Personnel.** As shown in Figure 14, personnel expense, the largest category of Key's noninterest expense, decreased by \$23 million, or 2%, from the first nine months of 2006. The decrease, which was attributable to the sale of the McDonald Investments branch network, was moderated by normal salary adjustments and higher stock-based compensation. The McDonald Investments branch network accounted for \$20 million of Key's personnel expense in the current year, compared to \$88 million for the first nine months of 2006. For the third quarter of 2007, the average number of full-time equivalent employees was 18,567, compared to 18,888 for the second quarter of 2007 and 20,264 for the third quarter of 2006.

**Figure 14. Personnel Expense**

<i>dollars in millions</i>	<b>Three months ended</b>		<b>Change</b>		<b>Nine months ended</b>		<b>Change</b>	
	<b>September 30, 2007</b>	<b>2006</b>	<b>Amount</b>	<b>Percent</b>	<b>September 30, 2007</b>	<b>2006</b>	<b>Amount</b>	<b>Percent</b>
Salaries	\$ 240	\$ 240			\$ 721	\$ 703	\$ 18	2.6%
Incentive compensation	55	93	\$ (38)	(40.9)%	212	268	(56)	(20.9)
Employee benefits	67	67			222	222		
Stock-based compensation <sup>a</sup>	17	15	2	13.3	57	47	10	21.3
Severance	4	3	1	33.3	10	5	5	100.0
Total personnel expense	\$ 383	\$ 418	\$ (35)	(8.4)%	\$ 1,222	\$ 1,245	\$ (23)	(1.8)%

(a) Excludes directors stock-based compensation of \$.4 million and \$.3 million for the three-month periods ended September 30, 2007 and 2006, respectively, and \$1.7 million and \$.9 million for the nine-month periods ended September 30, 2007 and 2006, respectively. Directors

stock-based  
 compensation is  
 included in the  
 miscellaneous  
 expense  
 component  
 shown in Figure  
 13.

**Operating lease expense.** The increase in operating lease expense compared to the third quarter and first nine months of 2006 reflected a higher volume of activity in the Equipment Finance line of business. Income related to the rental of leased equipment is presented in Figure 9 as operating lease income.

**Professional fees.** The decrease in professional fees for the year-to-date period was due in part to a reduction in costs associated with Key's efforts to strengthen compliance controls, for which substantial investment has already been made.

**Marketing expense.** The decreases in marketing expense for both the quarterly and year-to-date periods were attributable to additional costs incurred during 2006 to promote Key's free checking products.

**Income taxes**

The provision for income taxes from continuing operations was \$86 million for the third quarter of 2007, compared to \$118 million for the comparable period in 2006. The effective tax rate, which is the provision for income taxes from continuing operations as a percentage of income from continuing operations before income taxes, was 27.7% for the third quarter of 2007, compared to 27.9% for the year-ago quarter. For the first nine months of 2007, the provision for income taxes was \$363 million, compared to \$353 million for the first nine months of 2006. The effective tax rates for these periods were 28.3% and 28.6%, respectively.

The effective tax rates for both the current and prior year are substantially below Key's combined federal and state tax rate of 37.5%, primarily because Key generates income from investments in tax-advantaged assets such as corporate-owned life insurance, earns credits associated with investments in low-income housing projects and records tax deductions associated with dividends paid on Key common shares held in Key's 401(k) savings plan. In addition, a lower tax rate is applied to portions of the equipment lease portfolio that are managed by a foreign subsidiary in a lower tax jurisdiction. Since Key intends to permanently reinvest the earnings of this foreign subsidiary overseas, no deferred income taxes are recorded on those earnings in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes.

**Table of Contents****Financial Condition****Loans and loans held for sale**

At September 30, 2007, total loans outstanding were \$69.0 billion, compared to \$65.8 billion at December 31, 2006, and \$65.6 billion at September 30, 2006. The composition of Key's loan portfolio at each of these dates is presented in Note 6 (Loans and Loans Held for Sale), which begins on page 20. The increase in Key's loan portfolio over the past twelve months was primarily attributable to strong growth in the commercial mortgage, and commercial, financial and agricultural portfolios.

**Commercial loan portfolio.** Commercial loans outstanding grew by \$3.0 billion, or 6%, from one year ago, largely due to a higher volume of originations in the commercial mortgage, and commercial, financial and agricultural portfolios. Greater reliance by borrowers on commercial lines of credit in a volatile capital markets environment also contributed to the increase. The overall growth in the commercial loan portfolio was geographically broad-based and spread among a number of industry sectors.

Commercial real estate loans for both owner- and nonowner-occupied properties constitute one of the largest segments of Key's commercial loan portfolio. At September 30, 2007, Key's commercial real estate portfolio included mortgage loans of \$9.3 billion and construction loans of \$8.2 billion. The average mortgage loan originated during the first nine months of 2007 was \$2 million, and the largest mortgage loan at September 30, 2007, had a balance of \$83 million. At September 30, 2007, the average construction loan commitment was \$6 million. The largest construction loan commitment was \$95 million, of which the entire amount was outstanding and on nonperforming status.

Key's commercial real estate lending business is conducted through two primary sources: a thirteen-state banking franchise and Real Estate Capital, a national line of business that cultivates relationships both within and beyond the branch system. Real Estate Capital deals exclusively with nonowner-occupied properties (generally properties in which at least 50% of the debt service is provided by rental income from nonaffiliated third parties) and accounted for approximately 63% of Key's total average commercial real estate loans during the third quarter of 2007. Key's commercial real estate business generally focuses on larger real estate developers and, as shown in Figure 15, is diversified by both industry type and geographic location of the underlying collateral.

**Figure 15. Commercial Real Estate Loans**

September 30, 2007 <i>dollars in millions</i>	Geographic Region						Total	Percent of Total
	Northeast	Southeast	Southwest	Midwest	Central	West		
Nonowner-occupied:								
Residential properties	\$ 234	\$ 1,093	\$ 309	\$ 185	\$ 477	\$ 1,445	\$ 3,743	21.4%
Multi-family properties	330	293	243	263	471	449	2,049	11.7
Retail properties	167	652	175	389	338	255	1,976	11.3
Land and development	60	247	207	113	227	202	1,056	6.1
Office buildings	165	244	91	194	138	309	1,141	6.5
Warehouses	79	161	12	81	80	176	589	3.4
Health facilities	142	146	14	125	56	123	606	3.5
Manufacturing facilities	4	57	22	23		18	124	.7
Hotels/Motels	1	39		15	50	52	157	.9
Other	179	22	2	211	92	199	705	4.0
	1,361	2,954	1,075	1,599	1,929	3,228	12,146	69.5
Owner-occupied	1,044	204	109	2,006	483	1,494	5,340	30.5
Total	\$ 2,405	\$ 3,158	\$ 1,184	\$ 3,605	\$ 2,412	\$ 4,722	\$ 17,486	100.0%

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Nonowner-occupied:														
Nonperforming loans	\$	9	\$	106	\$	25	\$	7	\$	81	\$	228	N/M	
Accruing loans past due 90 days or more						4				32		36	N/M	
Accruing loans past due 30 through 89 days		29		20	\$	16		14		1		33	113	N/M

Northeast Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont

Southeast Alabama, Delaware, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, Washington D.C. and West Virginia

Southwest Arizona, Nevada and New Mexico

Midwest Idaho, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin

Central Arkansas, Colorado, Oklahoma, Texas and Utah

West Alaska, California, Hawaii, Montana, Oregon, Washington and Wyoming

N/M = Not Meaningful



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During the third quarter of 2007, nonperforming loans related to Key's nonowner-occupied properties rose by \$200 million, due primarily to deteriorating market conditions in the residential properties segment of Key's commercial real estate construction portfolio. The majority of the increase in this segment relates to loans outstanding in Florida and southern California.

Management believes Key has both the scale and array of products to compete on a world-wide basis in the specialty of equipment lease financing. These financing arrangements are conducted through the Equipment Finance line of business. Commercial lease financing receivables increased by \$449 million, or 5%, over the past twelve months.

**Consumer loan portfolio.** Consumer loans outstanding increased by \$415 million, or 2%, from one year ago. The growth was largely attributable to new originations in Key's indirect marine loan portfolio, offset in part by a decline in Key's consumer direct loan portfolio. The growth of the consumer loan portfolio also was moderated by a general slowdown in the level of home equity loan originations over the past year. Excluding loan sales and acquisitions, consumer loans would have increased by \$486 million, or 3%, during the past twelve months.

The home equity portfolio is by far the largest segment of Key's consumer loan portfolio. This portfolio is derived primarily from the Regional Banking line of business (responsible for 89% of home equity loans at September 30, 2007); the remainder originated from the Home Equity Services unit within Key's Consumer Finance line of business, which works with home improvement contractors to provide home equity and home improvement financing solutions. Figure 16 summarizes Key's home equity loan portfolio by source at the end of each of the last five quarters, as well as certain asset quality statistics and yields on the portfolio as a whole.

**Figure 16. Home Equity Loans**

<i>dollars in millions</i>	<b>Third</b>	<b>2007 Second</b>	<b>First</b>	<b>2006 Fourth</b>	<b>Third</b>
<b>SOURCES OF LOANS OUTSTANDING</b>					
Regional Banking	\$ 9,674	\$ 9,736	\$ 9,623	\$ 9,805	\$ 9,990
Home Equity Services unit	1,230	1,143	1,046	1,021	998
<b>Total</b>	<b>\$ 10,904</b>	<b>\$ 10,879</b>	<b>\$ 10,669</b>	<b>\$ 10,826</b>	<b>\$ 10,988</b>
Nonperforming loans at period end	\$ 61	\$ 55	\$ 52	\$ 50	\$ 46
Net loan charge-offs for the period	8	6	7	6	4
Yield for the period <sup>a</sup>	7.22%	7.22%	7.22%	7.22%	7.19%

(a) From continuing operations.

**Loans held for sale.** As shown in Note 6, Key's loans held for sale were \$4.8 billion at September 30, 2007, compared to \$3.6 billion at December 31, 2006, and \$7.2 billion at September 30, 2006. The decline over the past twelve months was due primarily to the November 2006 sale of the \$2.5 billion nonprime mortgage loan portfolio held by the Champion Mortgage finance business, which was transferred to the held-for-sale portfolio during the third quarter of 2006 in anticipation of the sale.

At September 30, 2007, Key's loans held for sale included \$2.9 billion of education loans and \$1.6 billion of commercial mortgage loans. In the absence of quoted market prices, management uses valuation models to measure the fair value of these loans and adjusts the amount recorded on the balance sheet if fair value falls below recorded cost. The models are based on assumptions related to prepayment speeds, default rates, funding cost and discount rates. In light of recent volatility in the financial markets, management has reviewed Key's assumptions and determined they are representative of current market conditions. As a result, no significant adjustments to the assumptions were required during the third quarter of 2007. During the third quarter, net losses pertaining to Key's

loans held for sale totaled \$74 million, of which \$37 million were unrealized. These losses are recorded in net gains (losses) from loan securitizations and sales on the income statement. Key has not been significantly impacted by market volatility in the nonprime mortgage lending industry due to the sale of the Champion Mortgage finance business discussed above.

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**Sales and securitizations.** Key continues to use alternative funding sources like loan sales and securitizations to support its loan origination capabilities. In addition, several acquisitions completed over the past several years have improved Key's ability to originate and sell new loans, and to securitize and service loans generated by others, especially in the area of commercial real estate.

During the past twelve months, Key sold \$3.9 billion of commercial mortgage loans (\$238 million through a securitization), \$2.7 billion of home equity loans, \$1.2 billion of education loans (\$963 million through a securitization), \$445 million of residential real estate loans, \$299 million of commercial loans and leases, and \$90 million of consumer direct loans. Most of these sales came from the held-for-sale portfolio.

Among the factors Key considers in determining whether to sell or securitize certain loans or portfolios are:

- whether particular lending businesses meet established performance standards or fit with Key's relationship banking strategy;
- Key's asset/liability management needs;
- whether the characteristics of a specific loan portfolio make it conducive to securitization;
- the cost of alternative funding sources;
- the level of credit risk;
- capital requirements; and
- market conditions and pricing.

Key typically completes an annual securitization and sale of education loans during the second half of the year. In light of recent volatility in the financial markets, this securitization has not yet occurred in 2007 and may be delayed until the first half of 2008.

Figure 17 summarizes Key's loan sales (including securitizations) for the first nine months of 2007 and all of 2006.

**Figure 17. Loans Sold (Including Loans Held for Sale)**

<i>in millions</i>	<b>Commercial</b>	<b>Commercial Real Estate</b>	<b>Commercial Lease Financing</b>	<b>Residential Real Estate</b>	<b>Home Equity</b>	<b>Consumer Direct</b>	<b>Education</b>	<b>Total</b>
<b>2007</b>								
Third quarter	\$ 17	\$ 1,059	\$ 35	\$ 127			\$ 44	\$ 1,282
Second quarter	36	1,079	98	118			118	1,449
First quarter	15	688	5	100	\$ 233	\$ 90	61	1,192
Total	\$ 68	\$ 2,826	\$ 138	\$ 345	\$ 233	\$ 90	\$ 223	\$ 3,923
<b>2006</b>								
Fourth quarter	\$ 80	\$ 1,070	\$ 13	\$ 100	\$ 2,474		\$ 983	\$ 4,720
Third quarter	37	679	16	109	2		143	986
Second quarter	64	483		97			110	754
First quarter	40	406	105	54			172	777
Total	\$ 221	\$ 2,638	\$ 134	\$ 360	\$ 2,476		\$ 1,408	\$ 7,237

Figure 18 shows loans that are either administered or serviced by Key, but not recorded on the balance sheet. Included are loans that have been both securitized and sold, or simply sold outright.

**Figure 18. Loans Administered or Serviced**

<i>in millions</i>	<b>September 30, 2007</b>	<b>June 30, 2007</b>	<b>March 31, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
Commercial real estate loans <sup>a</sup>	\$ 134,510	\$ 121,384	\$ 108,303	\$ 93,611	\$ 81,873
Education loans	4,984	5,118	5,251	5,475	4,640
Home equity loans <sup>b</sup>				2,360	4
Commercial lease financing	657	529	458	479	479
Commercial loans	228	242	243	268	252
<b>Total</b>	<b>\$ 140,379</b>	<b>\$ 127,273</b>	<b>\$ 114,255</b>	<b>\$ 102,193</b>	<b>\$ 87,248</b>

(a) Key acquired the servicing for commercial mortgage loan portfolios with an aggregate principal balance of \$21.1 billion for the third quarter 2007, \$6.4 billion for the second quarter 2007, \$12.7 billion for the first quarter 2007 and \$9.0 billion for the fourth quarter 2006.

(b) In November 2006, Key sold the \$2.5 billion nonprime mortgage loan portfolio held by the Champion Mortgage finance business but continued to provide servicing

through various  
dates in  
March 2007.

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In the event of default by a borrower, Key is subject to recourse with respect to \$579 million of the \$140.4 billion of loans administered or serviced at September 30, 2007. Additional information about this recourse arrangement is included in Note 13 ( Contingent Liabilities and Guarantees ) under the heading Recourse agreement with Federal National Mortgage Association on page 29.

Key derives income from several sources when loans are securitized or sold, but Key retains the right to administer or service them. Key earns noninterest income (recorded as other income ) from fees for servicing or administering loans. In addition, Key earns interest income from securitized assets retained and from lending funds generated by escrow deposits collected in connection with the servicing of commercial real estate loans. These deposits have contributed to the growth in Key s average noninterest-bearing deposits over the past twelve months, thereby moderating Key s overall cost of funds.

**Securities**

At September 30, 2007, the securities portfolio totaled \$10.5 billion, including \$7.9 billion of securities available for sale, \$36 million of investment securities, \$1.1 billion of trading account securities included in short-term investments on the balance sheet and \$1.5 billion of other investments (primarily principal investments). In comparison, the total portfolio at December 31, 2006, was \$10.1 billion and included \$7.8 billion of securities available for sale, \$41 million of investment securities, \$912 million of trading account securities and \$1.4 billion of other investments. At September 30, 2006, the securities portfolio totaled \$9.7 billion and included \$7.4 billion of securities available for sale, \$41 million of investment securities, \$817 million of trading account securities and \$1.4 billion of other investments.

**Securities available for sale.** The majority of Key s securities available-for-sale portfolio consists of collateralized mortgage obligations ( CMO ). A CMO is a debt security that is secured by a pool of mortgages or mortgage-backed securities. Key s CMOs generate interest income and serve as collateral to support certain pledging agreements. At September 30, 2007, Key had \$7.5 billion invested in CMOs and other mortgage-backed securities, compared to \$7.3 billion at December 31, 2006, and \$6.9 billion at September 30, 2006. Substantially all of Key s mortgage-backed securities are issued or backed by federal agencies.

Management periodically evaluates Key s securities available-for-sale portfolio in light of established asset/liability management objectives, and changing market conditions which could affect the profitability of the portfolio, as well as the level of interest rate risk to which Key is exposed. As a result of these evaluations, management may take steps to improve Key s overall balance sheet positioning.

In March 2007, management completed a comprehensive evaluation of the securities available-for-sale portfolio and determined that a repositioning of the portfolio was appropriate to enhance future financial performance, particularly in the event of a decline in interest rates. As a result, Key sold \$2.4 billion of shorter-maturity, agency-issued CMOs and reinvested the proceeds in agency-issued securities with higher yields and longer expected average maturities. The weighted-average yield of Key s available-for-sale portfolio increased from 4.78% at December 31, 2006, to 5.25% at September 30, 2007, and the weighted-average maturity of the portfolio increased from 2.6 years at December 31, 2006, to 3.5 years at September 30, 2007. The repositioning also served to reduce Key s exposure to prepayment risk in a declining interest rate scenario. This was accomplished by replacing the CMOs sold with those that have underlying mortgage loans with shorter maturities and lower coupon rates. Key maintains a modest liability-sensitive exposure to near-term changes in interest rates. Neither funding nor capital levels were affected materially by this portfolio repositioning.

As a result of the sale, Key recorded a loss of \$49 million (\$31 million after tax, \$.08 per diluted common share) during the first quarter of 2007. This loss was previously recorded in net unrealized losses on securities available for sale in the accumulated other comprehensive loss component of shareholders equity.

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In addition to changing market conditions, the size and composition of Key's securities available-for-sale portfolio could vary with Key's needs for liquidity and the extent to which Key is required (or elects) to hold these assets as collateral to secure public funds and trust deposits. Although debt securities are generally used for this purpose, other assets, such as securities purchased under resale agreements, may be used temporarily when they provide more favorable yields or risk profiles.

For most of Key's mortgage-backed securities, management employs an outside bond pricing service to assist in measuring the fair value at which they should be recorded on the balance sheet. In performing the valuations, the pricing service relies on models which are based on a number of economic observations, including quoted market prices and interest rate spreads on relevant benchmark securities, along with certain economic assumptions. For certain mortgage-backed securities, the pricing service is unable to provide pricing. In those instances, management uses a purchased pricing model and inputs data similar to that described above. All of the mortgage-backed security valuations are reviewed by Key's management for reasonableness to ensure they are representative of current market conditions. During the third quarter of 2007, net gains from Key's mortgage-backed securities totaled \$120 million, reflecting the decline in benchmark Treasury yields, offset in part by the widening of interest rate spreads on these securities. Substantially all of the net gains were unrealized and, therefore, recorded in the accumulated other comprehensive loss component of shareholders' equity. Realized gains and losses, which are recorded in net securities gains (losses) on the income statement, were not significant.

Figure 19 shows the composition, yields and remaining maturities of Key's securities available for sale. For more information about Key's securities, including gross unrealized gains and losses by type of security, see Note 5 (Securities), which begins on page 18.

**Figure 19. Securities Available for Sale**

	U.S. States		Other		Retained Interests in Securizations <sup>a</sup>	Other Securities <sup>b</sup>	Weighted-Average Yield <sup>c</sup>	
	Treasury, Agencies and Corporations	Political and Subdivisions	Collateralized Mortgage Obligations <sup>a</sup>	Mortgage Backed Securities <sup>a</sup>				Total
<i>dollars in millions</i>								
<b>SEPTEMBER 30, 2007</b>								
Remaining maturity:								
One year or less	\$ 4		\$ 5	\$ 8	\$ 3	\$ 66	\$ 86	5.28%
After one through five years	8	\$ 3	6,343	1,112	96	78	7,640	5.15
After five through ten years	4	4	3	62	93	3	169	9.70
After ten years	2	5	1	3		9	20	6.43
Fair value	\$ 18	\$ 12	\$ 6,352	\$ 1,185	\$ 192	\$ 156	\$ 7,915	
Amortized cost	18	12	6,357	1,188	149	141	7,865	5.25%
Weighted-average yield <sup>c</sup>	5.44%	8.35%	4.88%	5.18%	21.49%	5.42% <sup>d</sup>	5.25% <sup>d</sup>	
Weighted-average maturity	5.0 years	9.3 years	3.3 years	4.4 years	5.4 years	3.3 years	3.5 years	
<b>DECEMBER 31, 2006</b>								
Fair value	\$ 94	\$ 15	\$ 7,001	\$ 334	\$ 208	\$ 175	\$ 7,827	
Amortized cost	94	14	7,098	336	151	165	7,858	4.78%
<b>SEPTEMBER 30, 2006</b>								
Fair value	\$ 220	\$ 17	\$ 6,650	\$ 209	\$ 157	\$ 188	\$ 7,441	
Amortized cost	220	16	6,762	210	122	179	7,509	4.62%

- (a) Maturity is based upon expected average lives rather than contractual terms.
- (b) Includes primarily marketable equity securities.
- (c) Weighted-average yields are calculated based on amortized cost. Such yields have been adjusted to a taxable-equivalent basis using the statutory federal income tax rate of 35%.
- (d) Excludes securities of \$136 million at September 30, 2007, that have no stated yield.



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**Investment securities.** Foreign bonds and securities issued by states and political subdivisions constitute most of Key's investment securities. Figure 20 shows the composition, yields and remaining maturities of these securities.

**Figure 20. Investment Securities**

<i>dollars in millions</i>	States and Political Subdivisions	Other Securities	Total	Weighted- Average Yield <sup>a</sup>
<b>SEPTEMBER 30, 2007</b>				
Remaining maturity:				
One year or less	\$ 8	\$ 6	\$ 14	6.90%
After one through five years	7	15	22	7.19
Amortized cost	\$ 15	\$ 21	\$ 36	7.05%
Fair value	15	21	36	
Weighted-average yield	8.38%	5.49% <sup>b</sup>	7.05% <sup>b</sup>	
Weighted-average maturity	1.3 years	1.8 years	1.6 years	
<b>DECEMBER 31, 2006</b>				
Amortized cost	\$ 20	\$ 21	\$ 41	7.05%
Fair value	21	21	42	
<b>SEPTEMBER 30, 2006</b>				
Amortized cost	\$ 26	\$ 15	\$ 41	7.07%
Fair value	27	15	42	

(a) Weighted-average yields are calculated based on amortized cost. Such yields have been adjusted to a taxable-equivalent basis using the statutory federal income tax rate of 35%.

(b) Excludes securities of \$8 million at September 30, 2007, that have no stated yield.

**Other investments.** Most of Key's other investments (primarily principal investments) are not traded on a ready market. As such, management determines the fair value at which these investments should be recorded based on the nature of the specific investment and by considering all available information and relevant facts about the issuer's performance. Management's review may encompass such factors as the issuer's past financial performance and future potential, the values of companies in comparable businesses, the risks associated with the particular business or

investment type, current market conditions, the nature and duration of resale restrictions, the issuer's payment history, management's knowledge of the industry and other relevant factors. During the third quarter of 2007, net gains from Key's principal investing activities totaled \$9 million, which included \$6 million of net unrealized losses. These net gains are recorded in other income on the income statement. Net losses from other primarily real-estate related investments totaled \$22 million, including \$28 million of unrealized losses. Net losses related to these investments are recorded in investment banking and capital markets income.

For additional information pertaining to Key's trading account securities and other investments, see Note 5.

**Deposits and other sources of funds**

Core deposits—domestic deposits other than certificates of deposit of \$100,000 or more—are Key's primary source of funding. These deposits generally are stable, have a relatively low cost and typically react more slowly to changes in interest rates than market-based deposits. During the third quarter of 2007, core deposits averaged \$51.7 billion, and represented 62% of the funds Key used to support loans and other earning assets, compared to \$50.6 billion and 62% during the second quarter of 2007, and \$51.7 billion and 65% during the third quarter of 2006. The composition of Key's deposits is shown in Figure 7, which spans pages 48 and 49.

The increase in average core deposits compared to the second quarter of 2007 was attributable in part to the introduction during the third quarter of new relationship-based NOW and money market deposit products that are more attractively priced in the markets in which Key competes. The introduction and popularity of these new products also contributed to some migration of Key's time certificates of deposit.

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The level of average core deposits was essentially unchanged from that reported one year ago, as a \$1.4 billion increase in noninterest-bearing deposits was substantially offset by a \$1.0 billion reduction in NOW and money market deposit accounts. Average noninterest-bearing deposits increased from the year-ago quarter as a result of continued emphasis on cross-selling products, focused sales and marketing efforts related to Key's free checking products, and additional escrow deposits obtained in connection with the servicing of commercial real estate loans. As part of the February 2007 sale of the McDonald Investments branch network, Key transferred approximately \$1.3 billion of NOW and money market deposit accounts to the buyer. McDonald Investments' NOW and money market deposit accounts averaged \$1.7 billion for the third quarter of last year. Adjusting for the McDonald Investments sale, average core deposits were up approximately \$1.7 billion from the third quarter of 2006. Purchased funds, comprising large certificates of deposit, deposits in the foreign branch and short-term borrowings, averaged \$17.8 billion in the third quarter of 2007, compared to \$12.9 billion during the year-ago quarter. The increase was attributable to growth in all purchased funds components with the largest increases coming from federal funds purchased and securities sold under repurchase agreements, and foreign branch deposits. During the first nine months of 2007, Key used purchased funds more heavily in light of greater reliance by borrowers on commercial lines of credit in a volatile capital markets environment, the core deposits transferred in connection with the McDonald Investments sale, and a temporary need for additional short-term funding to facilitate the repositioning of the securities portfolio. In addition, these funds were used to pay down long-term debt. Management continues to consider loan sales and securitizations as a funding alternative when market conditions are favorable.

**Capital**

**Shareholders' equity.** Total shareholders' equity at September 30, 2007, was \$7.8 billion, up \$117 million from December 31, 2006.

Effective January 1, 2007, Key adopted 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*, which provides additional guidance on the application of SFAS No. 13, *Accounting for Leases*. This guidance affects when earnings from leveraged lease transactions will be recognized, and requires a lessor to recalculate its recognition of lease income when there are changes or projected changes in the timing of cash flows. As a result of adopting this guidance, Key recorded a cumulative after-tax charge of \$52 million to retained earnings during the first quarter. Future earnings are expected to increase over the remaining term of the affected leases by a similar amount. Additional information related to this new accounting guidance is included in Note 1 ( *Basis of Presentation* ) under the heading *Accounting Pronouncements Adopted in 2007* on page 8. See Note 12 ( *Income Taxes* ) under the heading *Tax-Related Accounting Pronouncements Adopted in 2007* on page 26 for a discussion of the potential impact of Staff Position No. 13-2 on Key in the event of an adverse outcome in Key's pending tax litigation, certain settlement scenarios and other factors. Other factors contributing to the change in shareholders' equity during the first nine months of 2007 are shown in the Consolidated Statements of Changes in Shareholders' Equity presented on page 5.

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**Changes in common shares outstanding.** Figure 21 shows activities that caused the change in Key's outstanding common shares over the past five quarters.

**Figure 21. Changes in Common Shares Outstanding**

<i>in thousands</i>	<b>Third</b>	<b>2007 Second</b>	<b>First</b>	<b>2006 Fourth</b>	<b>Third</b>
<b>Shares outstanding at beginning of period</b>	<b>389,362</b>	<b>394,483</b>	<b>399,153</b>	402,748	402,672
Issuance of shares under employee benefit plans	<b>1,346</b>	<b>879</b>	<b>3,330</b>	1,405	2,576
Repurchase of common shares	<b>(2,000)</b>	<b>(6,000)</b>	<b>(8,000)</b>	(5,000)	(2,500)
<b>Shares outstanding at end of period</b>	<b>388,708</b>	<b>389,362</b>	<b>394,483</b>	399,153	402,748

Key repurchases its common shares periodically under a repurchase program authorized by the Board of Directors. Key's repurchase activity for each of the three months ended September 30, 2007, is summarized in Figure 22.

**Figure 22. Share Repurchases**

<i>in thousands, except per share data</i>	<b>Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Number of Shares Purchased Under a Publicly Announced Program <sup>a</sup></b>	<b>Remaining Number of Shares That May be Purchased Under the Program as of Each Month-End <sup>a</sup></b>
July 1-31, 2007				16,000
August 1-31, 2007	2,000	\$ 34.17	2,000	14,000
September 1-30, 2007				14,000
<b>Total</b>	<b>2,000</b>	<b>\$ 34.17</b>	<b>2,000</b>	

(a) In January 2007, the Board of Directors authorized the repurchase of 25.0 million common shares, in addition to the shares remaining from a repurchase program authorized in July 2004. This action brought the total repurchase authorization to 30.0 million shares. These shares may be repurchased in the open market or through privately-negotiated transactions. The program does not have an expiration date.

At September 30, 2007, Key had 103.2 million treasury shares. Management expects to reissue those shares as needed in connection with stock-based compensation awards and other corporate purposes. During the first nine months of 2007, Key reissued 5.6 million treasury shares.

**Capital adequacy.** Capital adequacy is an important indicator of financial stability and performance. Overall, Key's capital position remains strong: the ratio of total shareholders' equity to total assets was 8.03% at September 30, 2007, compared to 8.34% at December 31, 2006, and 8.26% at September 30, 2006. Key's ratio of tangible equity to tangible assets was 6.78% at September 30, 2007, above Key's targeted range of 6.25% to 6.75%. Management believes Key's

capital position provides the flexibility to take advantage of investment opportunities, to repurchase shares when appropriate and to pay dividends.

Banking industry regulators prescribe minimum capital ratios for bank holding companies and their banking subsidiaries. Note 14 ( Shareholders Equity ), which begins on page 88 of Key s 2006 Annual Report to Shareholders, explains the implications of failing to meet these specific capital requirements.

Risk-based capital guidelines require a minimum level of capital as a percent of risk-weighted assets. Risk-weighted assets are comprised of total assets plus certain off-balance sheet items, subject to adjustment for predefined credit risk factors. Currently, banks and bank holding companies must maintain, at a minimum, Tier 1 capital as a percent of risk-weighted assets of 4.00%, and total capital as a percent of risk-weighted assets of 8.00%. As of September 30, 2007, Key s Tier 1 capital ratio was 7.94%, and its total capital ratio was 11.76%.

Another indicator of capital adequacy, the leverage ratio, is defined as Tier 1 capital as a percentage of average quarterly tangible assets. Leverage ratio requirements vary with the condition of the financial institution. Bank holding companies that either have the highest supervisory rating or have implemented the

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Federal Reserve's risk-adjusted measure for market risk-as KeyCorp has-must maintain a minimum leverage ratio of 3.00%. All other bank holding companies must maintain a minimum ratio of 4.00%. As of September 30, 2007, Key had a leverage ratio of 8.96%.

Federal bank regulators group FDIC-insured depository institutions into five categories, ranging from critically undercapitalized to well capitalized. Key's affiliate bank, KeyBank, qualified as well capitalized at September 30, 2007, since it exceeded the prescribed thresholds of 10.00% for total capital, 6.00% for Tier 1 capital and 5.00% for the leverage ratio. If these provisions applied to bank holding companies, Key also would qualify as well capitalized at September 30, 2007. The FDIC-defined capital categories serve a limited supervisory function. Investors should not treat them as a representation of the overall financial condition or prospects of KeyCorp or KeyBank.

Figure 23 presents the details of Key's regulatory capital position at September 30, 2007, December 31, 2006, and September 30, 2006.

**Figure 23. Capital Components and Risk-Weighted Assets**

<i>dollars in millions</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
<b>TIER 1 CAPITAL</b>			
Common shareholders' equity	\$ 7,935	\$ 7,924	\$ 8,019
Qualifying capital securities	1,792	1,792	1,792
Less: Goodwill	1,202	1,202	1,372
Other assets <sup>b</sup>	177	176	179
Total Tier 1 capital	<b>8,348</b>	8,338	8,260
<b>TIER 2 CAPITAL</b>			
Allowance for losses on loans and liability for losses on lending-related commitments	1,010	997	1,003
Net unrealized gains on equity securities available for sale	7	5	4
Qualifying long-term debt	3,000	3,227	3,229
Total Tier 2 capital	<b>4,017</b>	4,229	4,236
Total risk-based capital	<b>\$ 12,365</b>	\$ 12,567	\$ 12,496
<b>RISK-WEIGHTED ASSETS</b>			
Risk-weighted assets on balance sheet	\$ 81,566	\$ 77,490	\$ 79,764
Risk-weighted off-balance sheet exposure	24,554	24,968	24,463
Less: Goodwill	1,202	1,202	1,372
Other assets <sup>b</sup>	813	819	778
Plus: Market risk-equivalent assets	1,023	698	941
Total risk-weighted assets	<b>\$ 105,128</b>	\$ 101,135	\$ 103,018
<b>AVERAGE QUARTERLY TOTAL ASSETS</b>	<b>\$ 95,188</b>	\$ 94,896	\$ 94,918

**CAPITAL RATIOS**

Tier 1 risk-based capital ratio	<b>7.94%</b>	8.24%	8.02%
Total risk-based capital ratio	<b>11.76</b>	12.43	12.13
Leverage ratio <sup>c</sup>	<b>8.96</b>	8.98	8.89

- (a) Common shareholders' equity does not include net unrealized gains or losses on securities available for sale (except for net unrealized losses on marketable equity securities), net gains or losses on cash flow hedges, or the amount resulting from the adoption and application of SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans.
- (b) Other assets deducted from Tier 1 capital and risk-weighted assets consist of intangible assets (excluding goodwill) recorded after February 19, 1992, deductible portions of purchased mortgage servicing rights and deductible portions of nonfinancial equity investments.
- (c) This ratio is Tier 1 capital divided by average quarterly total assets less: (i) goodwill, (ii) the nonqualifying intangible assets described in footnote (b), (iii) deductible portions of nonfinancial equity investments, and (iv) net unrealized gains or losses on securities available for sale; plus assets derecognized as an offset to accumulated other comprehensive income resulting from the adoption and application of SFAS No. 158.

**Table of Contents****Risk Management****Overview**

Like other financial services companies, Key engages in business activities with inherent risks. The ability to properly and effectively identify, measure, monitor and report such risks is essential to maintaining safety and soundness and to maximizing profitability. Management believes that the most significant risks facing Key are market risk, credit risk, liquidity risk and operational risk. Each type of risk is defined and discussed in greater detail in the remainder of this section.

Key's Board of Directors has established and follows a corporate governance program that serves as the foundation for managing and mitigating risk. In accordance with this program, the Board focuses on the interests of shareholders, encourages strong internal controls, demands management accountability, mandates adherence to Key's code of ethics and administers an annual self-assessment process. The Board has established Audit and Risk Management committees whose appointed members help the Board meet its risk oversight responsibilities. The responsibilities of these two committees are summarized on page 47 of Key's 2006 Annual Report to Shareholders.

**Market risk management**

The values of some financial instruments vary not only with changes in market interest rates but also with changes in foreign exchange rates. Financial instruments also are susceptible to factors influencing valuations in the equity securities markets and other market-driven rates or prices. For example, the value of a fixed-rate bond will decline if market interest rates increase. Similarly, the value of the U.S. dollar regularly fluctuates in relation to other currencies. When the value of an instrument is tied to such external factors, the holder faces market risk. Most of Key's market risk is derived from interest rate fluctuations.

**Interest rate risk management**

Interest rate risk, which is inherent in the banking industry, is measured by the potential for fluctuations in net interest income and the economic value of equity. Such fluctuations may result from changes in interest rates and differences in the repricing and maturity characteristics of interest-earning assets and interest-bearing liabilities. To minimize the volatility of net interest income and the economic value of equity, Key manages exposure to interest rate risk in accordance with guidelines established by the Asset/Liability Management Committee (ALCO). This committee, which consists of senior finance and business executives, meets monthly and periodically reports Key's interest rate risk positions to the Risk Management Committee of the Board of Directors.

Interest rate risk positions can be influenced by a number of factors other than changes in market interest rates, including economic conditions, the competitive environment within Key's markets, consumer preferences for specific loan and deposit products, and the level of interest rate exposure arising from basis risk, gap risk, yield curve risk and option risk. Each of these types of risk is defined in the discussion of market risk management, which begins on page 47 of Key's 2006 Annual Report to Shareholders.

***Net interest income simulation analysis.*** The primary tool used by management to measure Key's interest rate risk is a simulation analysis. For purposes of this analysis, management estimates Key's net interest income based on the composition of its balance sheet and the current interest rate environment. The simulation assumes that growth in the balance sheet will reflect recent product trends, as well as consensus economic forecasts.

The amount of net interest income at risk is measured by simulating the change in the level of net interest income that would occur if the Federal Funds Target rate were to gradually increase or decrease by 200 basis points over the next twelve months, and term rates were to move in a similar fashion, but not as dramatically. The amount of net interest income at risk is compared to the base case of an unchanged interest rate environment. The analysis also considers sensitivity to changes in a number of other variables, including product pricing assumptions and deposit mix. In addition, management assesses the potential



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effect of different shapes of the yield curve, including a sustained flat yield curve, an inverted slope yield curve and other yield curve shifts. (The yield curve depicts the relationship between the yield on a particular type of security and its term to maturity.) Management also performs stress tests to measure the effect on net interest income of an immediate change in market interest rates.

Simulation analysis produces only a sophisticated estimate of interest rate exposure based on assumptions and judgments related to balance sheet growth, customer behavior, new products, new business volume, pricing and anticipated hedging activities. Management tailors the assumptions used in simulation analysis to the specific interest rate environment and yield curve shape being modeled, and validates those assumptions on a periodic basis.

Consistent with current practice, simulations are performed with the assumption that interest rate risk positions will be actively managed through the use of on- and off-balance sheet financial instruments to achieve the desired risk profile. Actual results may differ from those derived in simulation analysis due to the timing, magnitude and frequency of interest rate changes, actual hedging strategies employed and changes in balance sheet composition. Figure 28 ( Net Interest Income Volatility ) on page 48 of Key's 2006 Annual Report to Shareholders illustrates the variability of simulation results that can arise from changing certain major assumptions.

Figure 24 presents the results of the simulation analysis at September 30, 2007 and 2006. At September 30, 2007, Key's simulated exposure to a rising interest rate environment was modestly liability-sensitive and exposure to a falling interest rate environment decreased from September 30, 2006. ALCO policy guidelines for risk management call for preventive measures if simulation modeling demonstrates that a gradual 200 basis point increase or decrease in short-term rates over the next twelve months would adversely affect net interest income over the same period by more than 2%. As shown in Figure 24, Key is operating within these guidelines.

**Figure 24. Simulated Change in Net Interest Income**

Basis point change assumption (short-term rates)	-200	+200
ALCO policy guidelines	-2.00%	-2.00%

**INTEREST RATE RISK ASSESSMENT**

September 30, 2007	+1.65%	-.52%
September 30, 2006	+.90	-.12

During the first half of 2006, Key's simulated exposure to a rising interest rate environment changed from modestly asset-sensitive to relatively neutral. From July 2006 through August 2007, the Federal Reserve held short-term interest rates constant. In September 2007, the Federal Reserve reduced the Federal Funds Target rate by 50 basis points. This action was taken to help forestall adverse effects on the economy, including a more intensified housing correction, which might otherwise arise from recent disruptions in the financial markets. Although there is uncertainty with regard to the timing and magnitude of further interest rate reductions, Key's current positioning is consistent with its long-term bias to be modestly liability-sensitive, which will help protect net interest income in a declining interest rate environment.

Management also conducts simulations that measure the effect of changes in market interest rates in the second year of a two-year horizon. These simulations are conducted in a manner similar to those based on a twelve-month horizon. To capture longer-term exposures, management simulates changes to the economic value of equity as discussed below.

**Economic value of equity modeling.** Economic value of equity ( EVE ) measures the extent to which the economic values of assets, liabilities and off-balance sheet instruments may change in response to changes in interest rates. EVE is calculated by subjecting the balance sheet to an immediate 200 basis point increase or decrease in interest rates, and measuring the resulting change in the values of assets and liabilities. This analysis is highly dependent upon assumptions applied to assets and liabilities with noncontractual maturities. Those assumptions are based on historical behaviors, as well as management's expectations. EVE complements net interest income simulation analysis since it provides estimates of risk exposure beyond twelve and twenty-four month horizons. Management takes preventative

measures to ensure that Key's EVE will not decrease by more than 15% in response to an immediate 200 basis point increase or decrease in interest rates. Key is operating within these guidelines.

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**Management of interest rate exposure.** Management uses the results of its various simulation analyses to formulate strategies to achieve the desired risk profile within the parameters of Key's capital and liquidity guidelines. Interest rate risk positions are actively managed through the purchase of investment securities, the issuance of term debt with floating or fixed interest rates, and the use of derivatives—predominantly in the form of interest rate swaps. These swaps modify the interest rate characteristics of certain assets and liabilities by converting them from a fixed rate to a floating rate, from a floating rate to a fixed rate, or from one floating index to another. Figure 25 shows the maturity structure for all swap positions held for asset/liability management (A/LM) purposes. These positions are used to convert the contractual interest rate index of agreed-upon amounts of assets and liabilities (i.e., notional amounts) to another interest rate index. For example, fixed-rate debt is converted to a floating rate through a receive fixed/pay variable interest rate swap. For more information about how Key uses interest rate swaps to manage its balance sheet, see Note 14 (Derivatives and Hedging Activities), which begins on page 31.

**Figure 25. Portfolio Swaps by Interest Rate Risk Management Strategy**

<i>dollars in millions</i>	September 30, 2007					September 30, 2006	
	Notional Amount	Fair Value	Maturity (Years)	Weighted-Average Rate		Notional Amount	Fair Value
				Receive	Pay		
Receive fixed/pay variable conventional A/LM <sup>a</sup>	\$ 7,138	\$ 35	1.3	5.2%	5.5%	\$ 5,558	
Receive fixed/pay variable conventional debt	4,814	(9)	16.9	5.5	5.7	5,524	\$ 17
Receive fixed/pay variable forward starting	4,100	32	2.5	5.0	5.2		
Pay fixed/receive variable conventional debt	974	(7)	4.2	5.2	4.5	998	(12)
Foreign currency conventional debt	2,707	313	3.2	4.9	5.6	2,695	27
Basis swaps <sup>b</sup>						300	
Total portfolio swaps	\$ 19,733	\$ 364	5.8	5.2%	5.5%	\$ 15,075	\$ 32

(a) Portfolio swaps designated as A/LM are used to manage interest rate risk tied to both assets and liabilities.

(b) These portfolio swaps are not designated as hedging instruments under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities.

**Trading portfolio risk management**

Key's trading portfolio is described in Note 14. Management uses a value at risk (VAR) simulation model to measure the potential adverse effect of changes in interest rates, foreign exchange rates, equity prices and credit spreads on the fair value of Key's trading portfolio. Using two years of historical information, the model estimates the maximum potential one-day loss with a 95% confidence level. Statistically, this means that losses will exceed VAR, on average, five out of 100 trading days, or three to four times each quarter. Key manages exposure to market risk in accordance with VAR limits for trading activity which are established by the Financial Markets Committee. This committee, which consists of senior risk management and line of business executives, meets periodically. At September 30, 2007,

the aggregate one-day trading limit set by the committee was \$4.4 million. In addition to comparing VAR exposure against limits on a daily basis, management monitors loss limits, uses sensitivity measures and conducts stress tests. Risk Management reports Key's market risk exposure to Key's Risk Capital Committee and the Risk Management Committee of the Board of Directors.

Key is operating within the above constraints. During the first nine months of 2007 and 2006, Key's aggregate daily average, minimum and maximum VAR amounts were \$1.1 million, \$.7 million and \$2.1 million, respectively.

**Table of Contents****Credit risk management**

Credit risk is the risk of loss arising from an obligor's inability or failure to meet contractual payment or performance terms. Like other financial services institutions, Key makes loans, extends credit, purchases securities and enters into financial derivative contracts, all of which expose Key to credit risk.

***Credit policy, approval and evaluation.*** Key manages credit risk exposure through a multi-faceted program.

Independent committees approve both retail and commercial credit policies. These policies are communicated throughout Key to foster a consistent approach to granting credit. For more information about Key's credit policies, as well as related approval and evaluation processes, see the section entitled "Credit policy, approval and evaluation," on page 50 of Key's 2006 Annual Report to Shareholders.

Key actively manages the overall loan portfolio in a manner consistent with asset quality objectives. This process entails the use of credit derivatives <sup>3</sup>/<sub>4</sub> primarily credit default swaps <sup>3</sup>/<sub>4</sub> to mitigate Key's credit risk. Credit default swaps enable Key to transfer a portion of the credit risk associated with the underlying extension of credit to a third party, and to manage portfolio concentration and correlation risks. At September 30, 2007, credit default swaps with a notional amount of \$1.1 billion were used to manage the credit risk associated with specific commercial lending obligations. From time to time, Key also provides credit protection to other lenders through the sale of credit default swaps. These transactions may generate fee income and can diversify overall exposure to credit loss. At September 30, 2007, the notional amount of credit default swaps sold by Key was \$50 million.

Credit default swaps are recorded on the balance sheet at fair value. Related gains or losses, as well as the premium paid or received for credit protection, are included in the trading income component of noninterest income. These swaps did not have a significant effect on Key's operating results for the nine-month period ended September 30, 2007. Other actions used to manage the loan portfolio include loan securitizations, portfolio swaps, or bulk purchases and sales. The overarching goal is to continually manage the loan portfolio within a desirable range of asset quality.

***Watch and criticized assets.*** ***Watch assets*** are troubled commercial loans with the potential for further deterioration in quality due to the client's current financial condition and possible inability to perform in accordance with the terms of the underlying contract. ***Criticized assets*** are troubled loans and other assets that show additional signs of weakness that may lead, or have led, to an interruption in scheduled repayments from primary sources, potentially requiring Key to rely on repayment from secondary sources, such as collateral liquidation.

At September 30, 2007, the level of both watch assets and criticized commitments was higher than that experienced a year earlier. Most notably, both watch and criticized levels increased in the Real Estate Capital line of business, due principally to deteriorating market conditions in the residential properties segment of Key's commercial real estate construction portfolio. The increase in criticized commitments was offset in part by the favorable settlement of Key's automobile residual value insurance litigation, in which the related receivable was eliminated during the first quarter of 2007. Management continues to closely monitor fluctuations in Key's watch assets and criticized commitments.

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**Allowance for loan losses.** The allowance for loan losses at September 30, 2007, was \$955 million, or 1.38% of loans, compared to \$944 million, or 1.43%, at December 31, 2006, and \$944 million, or 1.44%, at September 30, 2006. The allowance includes \$11 million that was specifically allocated for impaired loans of \$35 million at September 30, 2007, compared to \$14 million that was allocated for impaired loans of \$34 million at December 31, 2006, and \$12 million that was allocated for impaired loans of \$27 million one year ago. For more information about impaired loans, see Note 9 ( Nonperforming Assets and Past Due Loans ) on page 23. At September 30, 2007, the allowance for loan losses was 191.77% of nonperforming loans, compared to 423.32% at September 30, 2006.

Management estimates the appropriate level of the allowance for loan losses on a quarterly (and at times more frequent) basis. The methodology used is described in Note 1 ( Summary of Significant Accounting Policies ) under the heading Allowance for Loan Losses on page 69 of Key's 2006 Annual Report to Shareholders. Briefly, management estimates the appropriate level of Key's allowance for loan losses by applying historical loss rates to existing loans with similar risk characteristics and by exercising judgment to assess the impact of factors such as changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. For an impaired loan, special treatment exists if the outstanding balance is greater than \$2.5 million and the resulting allocation is deemed insufficient to cover the extent of the impairment. In such cases, a specific allowance is assigned to the loan. A specific allowance may be assigned even when sources of repayment appear sufficient if management remains uncertain about whether the loan will be repaid in full. The aggregate balance of the allowance for loan losses at September 30, 2007, represents management's best estimate of the losses inherent in the loan portfolio at that date.

As shown in Figure 26, Key's allowance for loan losses increased by \$11 million, or 1%, during the past twelve months. This increase was attributable to a higher level of allowance allocated to the real estate construction component of the commercial loan portfolio. During the same period, Key decreased the allowance allocated to the commercial lease financing and consumer loan portfolios.

**Figure 26. Allocation of the Allowance for Loan Losses**

	September 30, 2007			December 31, 2006			September 30, 2006		
	Percent of Allowance to Total	Percent of Loan Type to Total	Percent of Allowance to Total	Percent of Loan Type to Total	Percent of Allowance to Total	Percent of Loan Type to Total	Percent of Allowance to Total	Percent of Loan Type to Total	Percent of Allowance to Total
<i>dollars in millions</i>	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans	Loans
Commercial, financial and agricultural	\$ 345	36.1%	33.6%	\$ 341	36.1%	32.5%	\$ 360	38.1%	32.9%
Real estate commercial mortgage	156	16.4	13.4	170	18.0	12.8	161	17.0	12.6
Real estate construction	174	18.2	11.9	132	14.0	12.5	113	12.0	12.6
Commercial lease financing	123	12.9	15.0	139	14.7	15.6	145	15.4	15.1
Total commercial loans	798	83.6	73.9	782	82.8	73.4	779	82.5	73.2
Real estate residential mortgage	11	1.1	2.3	12	1.3	2.2	13	1.4	2.1

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Home equity	<b>75</b>	<b>7.9</b>	<b>15.8</b>	74	7.8	16.4	76	8.0	16.8
Consumer direct	<b>30</b>	<b>3.1</b>	<b>1.9</b>	29	3.1	2.3	28	3.0	2.4
Consumer indirect	<b>41</b>	<b>4.3</b>	<b>6.1</b>	47	5.0	5.7	48	5.1	5.5
Total consumer loans	<b>157</b>	<b>16.4</b>	<b>26.1</b>	162	17.2	26.6	165	17.5	26.8
Total	<b>\$ 955</b>	<b>100.0%</b>	<b>100.0%</b>	\$ 944	100.0%	100.0%	\$ 944	100.0%	100.0%

**Net loan charge-offs.** Net loan charge-offs for the third quarter of 2007 were \$59 million, or .35% of average loans from continuing operations. These results compare to net charge-offs of \$43 million, or .26%, for the same period last year. The composition of Key's loan charge-offs and recoveries by loan type is shown in Figure 27. The largest increases in net charge-offs relative to the third quarter of 2006 occurred in the construction, commercial lease financing and home equity portfolios.

**Table of Contents****Figure 27. Summary of Loan Loss Experience**

<i>dollars in millions</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2007</b>	<b>2006</b>	<b>September 30, 2007</b>	<b>2006</b>
Average loans outstanding from continuing operations	<b>\$ 67,680</b>	\$ 65,180	<b>\$ 66,562</b>	\$ 64,802
Allowance for loan losses at beginning of period	<b>\$ 945</b>	\$ 956	<b>\$ 944</b>	\$ 966
Loans charged off:				
Commercial, financial and agricultural	<b>33</b>	30	<b>80</b>	74
Real estate commercial mortgage	<b>2</b>	3	<b>13</b>	9
Real estate construction	<b>7</b>	1	<b>10</b>	3
Total commercial real estate loans <sup>a</sup>	<b>9</b>	4	<b>23</b>	12
Commercial lease financing	<b>11</b>	13	<b>33</b>	27
Total commercial loans	<b>53</b>	47	<b>136</b>	113
Real estate residential mortgage	<b>1</b>	2	<b>3</b>	5
Home equity	<b>9</b>	6	<b>25</b>	22
Consumer direct	<b>8</b>	7	<b>23</b>	26
Consumer indirect	<b>11</b>	8	<b>31</b>	28
Total consumer loans	<b>29</b>	23	<b>82</b>	81
	<b>82</b>	70	<b>218</b>	194
Recoveries:				
Commercial, financial and agricultural	<b>11</b>	8	<b>24</b>	27
Real estate commercial mortgage		2	<b>4</b>	3
Real estate construction	<b>1</b>	1	<b>1</b>	1
Total commercial real estate loans <sup>a</sup>	<b>1</b>	3	<b>5</b>	4
Commercial lease financing	<b>3</b>	9	<b>10</b>	23
Total commercial loans	<b>15</b>	20	<b>39</b>	54
Real estate residential mortgage			<b>1</b>	1
Home equity	<b>1</b>	2	<b>4</b>	5
Consumer direct	<b>3</b>	1	<b>6</b>	5
Consumer indirect	<b>4</b>	4	<b>12</b>	13
Total consumer loans	<b>8</b>	7	<b>23</b>	24
	<b>23</b>	27	<b>62</b>	78
Net loan charge-offs	<b>(59)</b>	(43)	<b>(156)</b>	(116)



Provision for loan losses from continuing operations	<b>69</b>	35	<b>166</b>	97
Provision for loan losses from discontinued operations		(4)		(3)
Foreign currency translation adjustment			<b>1</b>	
Allowance for loan losses at end of period	<b>\$ 955</b>	\$ 944	<b>\$ 955</b>	\$ 944
Net loan charge-offs to average loans from continuing operations	<b>.35%</b>	.26%	<b>.31%</b>	.24%
Allowance for loan losses to period-end loans	<b>1.38</b>	1.44	<b>1.38</b>	1.44
Allowance for loan losses to nonperforming loans	<b>191.77</b>	423.32	<b>191.77</b>	423.32

(a) See Figure 15 and the accompanying discussion on page 55 for more information related to Key's commercial real estate portfolio.

**Nonperforming assets.** Figure 28 shows the composition of Key's nonperforming assets. These assets totaled \$570 million at September 30, 2007, and represented .83% of loans, other real estate owned (known as OREO) and other nonperforming assets, compared to \$273 million, or .41%, at December 31, 2006, and \$329 million, or .50%, at September 30, 2006.

As shown in Figure 28, the growth in nonperforming assets over the past twelve months reflected increases in both nonperforming loans and other nonperforming assets. Most of the increase in nonperforming loans occurred during the third quarter of 2007 and was attributable primarily to deteriorating market conditions in the residential properties segment of Key's commercial real estate construction portfolio. The majority of the increase in this segment relates to loans outstanding in Florida and southern California. The growth in other nonperforming assets was attributable to investments held by the Private Equity unit within Key's Real Estate Capital line of business. The increase in total nonperforming assets was moderated by a reduction in OREO.

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At September 30, 2007, Key's 20 largest nonperforming loans totaled \$289 million, representing 58% of total loans on nonperforming status. Ten of the 20 largest credits reside in the construction loan portfolio.

**Figure 28. Summary of Nonperforming Assets and Past Due Loans**

<i>dollars in millions</i>	<b>September 30, 2007</b>	<b>June 30, 2007</b>	<b>March 31, 2007</b>	<b>December 31, 2006</b>	<b>September 30, 2006</b>
Commercial, financial and agricultural	\$ 94	\$ 83	\$ 70	\$ 38	\$ 42
Real estate commercial mortgage	41	41	44	48	36
Real estate construction	228	23	10	10	37
Total commercial real estate loans <sup>a</sup>	269	64	54	58	73
Commercial lease financing	30	34	31	22	20
Total commercial loans	393	181	155	118	135
Real estate residential mortgage	29	27	32	34	34
Home equity	61	55	52	50	46
Consumer direct	2	2	2	2	2
Consumer indirect	13	11	13	11	6
Total consumer loans	105	95	99	97	88
Total nonperforming loans	498	276	254	215	223
Nonperforming loans held for sale <sup>b</sup>	6	4	3	3	56
OREO	21	27	42	57	52
Allowance for OREO losses	(1)	(2)	(2)	(3)	(3)
OREO, net of allowance	20	25	40	54	49
Other nonperforming assets	46 <sup>c</sup>	73 <sup>c</sup>	56 <sup>c</sup>	1	1
Total nonperforming assets	\$ 570	\$ 378	\$ 353	\$ 273	\$ 329
Accruing loans past due 90 days or more	\$ 190	\$ 181	\$ 146	\$ 120	\$ 125
Accruing loans past due 30 through 89 days	717	623	626	644	715
Nonperforming loans to period-end portfolio loans	.72%	.41%	.39%	.33%	.34%
Nonperforming assets to period-end portfolio loans plus OREO and other nonperforming	.83	.57	.54	.41	.50

assets

- (a) See Figure 15 and the accompanying discussion on page 55 for more information related to Key's commercial real estate portfolio.
- (b) On August 1, 2006, Key transferred approximately \$55 million of home equity loans from nonperforming loans to nonperforming loans held for sale in connection with the anticipated November 29, 2006, sale of the Champion Mortgage finance business.
- (c) Primarily investments held by the Private Equity unit within Key's Real Estate Capital line of business.

Credit exposure by industry classification in the largest sector of Key's loan portfolio, commercial, financial and agricultural loans, is presented in Figure 29. The types of activity that caused the change in Key's nonperforming loans during each of the last five quarters are summarized in Figure 30.

**Table of Contents****Figure 29. Commercial, Financial and Agricultural Loans**

<b>September 30, 2007</b>	<b>Total Commitments<sup>a</sup></b>	<b>Loans Outstanding</b>	<b>Nonperforming Loans % of Loans</b>	
<i>dollars in millions</i>			<b>Amount</b>	<b>Outstanding</b>
Industry classification:				
Manufacturing	\$ 10,302	\$ 3,842	\$ 31	.8%
Services	10,077	3,432	8	.2
Retail trade	6,419	3,490	4	.1
Public utilities	3,920	761		
Financial services	3,734	1,276	8	.6
Wholesale trade	3,538	1,679	3	.2
Property management	3,041	1,338	1	.1
Insurance	2,687	197		
Building contractors	2,378	1,038	5	.5
Transportation	2,241	1,584	26	1.6
Mining	1,012	510		
Agriculture/forestry/fishing	945	562	2	.4
Public administration	893	337		
Communications	792	233		
Individuals	23	15		
Other	3,421	2,898	6	.2
<b>Total</b>	<b>\$ 55,423</b>	<b>\$ 23,192</b>	<b>\$ 94</b>	<b>.4%</b>

(a) Total commitments include unfunded loan commitments, unfunded letters of credit (net of amounts conveyed to others) and loans outstanding.

**Figure 30. Summary of Changes in Nonperforming Loans**

<i>in millions</i>	<b>2007 Third</b>	<b>2007 Second</b>	<b>2007 First</b>	<b>2006 Fourth</b>	<b>2006 Third</b>
Balance at beginning of period	\$ 276	\$ 254	\$ 215	\$ 223	\$ 279
Loans placed on nonaccrual status	337	130	129	115	134
Charge-offs	(81)	(72)	(61)	(74)	(70)

Loans sold	(6)	(7)		(5)	(22)
Payments	(13)	(21)	(7)	(23)	(43)
Transfer to held-for-sale portfolio <sup>a</sup>					(55)
Transfers to OREO	(12)		(9)	(12)	
Loans returned to accrual status	(3)	(8)	(13)	(9)	
Balance at end of period	\$ 498	\$ 276	\$ 254	\$ 215	\$ 223

(a) On August 1, 2006, Key transferred approximately \$55 million of home equity loans from nonperforming loans to nonperforming loans held for sale in connection with its intention to pursue the sale of the Champion Mortgage finance business.

#### Liquidity risk management

Key defines liquidity as the ongoing ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations, and fund asset growth and new business transactions at a reasonable cost, in a timely manner and without adverse consequences. Liquidity management involves maintaining sufficient and diverse sources of funding to accommodate planned as well as unanticipated changes in assets and liabilities under both normal and adverse conditions.

Key manages liquidity for all of its affiliates on an integrated basis. This approach considers the unique funding sources available to each entity and the differences in their capabilities to manage through adverse conditions. It also recognizes that the access of all affiliates to money market funding would be similarly affected by adverse market conditions or other events that could negatively affect the level or cost of liquidity. As part of the management process, Key's management has established guidelines or target ranges that relate to the maturities of various types of wholesale borrowings, such as money market funding and term debt. In addition, management assesses Key's needs for future reliance on wholesale borrowings and then develops strategies to address those needs. Moreover, Key will, on occasion, guarantee a subsidiary's obligations in transactions with third parties. Management closely monitors the extension of such guarantees to ensure that Key retains ample liquidity in the event it must step in to provide financial support.

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Key's liquidity could be adversely affected by both direct and indirect circumstances. An example of a direct (but hypothetical) event would be a downgrade in Key's public credit rating by a rating agency due to deterioration in asset quality, a large charge to earnings, a decline in profitability or other financial measures, or a significant merger or acquisition. Examples of indirect (but hypothetical) events unrelated to Key that could have an effect on Key's access to liquidity would be terrorism or war, natural disasters, political events, or the default or bankruptcy of a major corporation, mutual fund or hedge fund. Similarly, market speculation or rumors about Key or the banking industry in general may adversely affect the cost and availability of normal funding sources.

Key performs stress tests to consider the effect that a potential downgrade in its debt ratings could have on liquidity over various time periods. These debt ratings, which are presented in Figure 31 on page 74, have a direct impact on Key's cost of funds and ability to raise funds under normal as well as adverse conditions. The results of the stress tests indicate that, following the occurrence of an adverse event, Key can continue to meet its financial obligations and to fund its operations for at least one year. The stress test scenarios include major disruptions to Key's access to funding markets and consider the potential adverse effect of core client activity on cash flows. To compensate for the effect of these activities, alternative sources of liquidity are incorporated into the analysis over different time periods to project how fluctuations on the balance sheet would be managed. Key actively manages several alternatives for enhancing liquidity, including generating client deposits, securitizing or selling loans, extending the maturity of wholesale borrowings, purchasing deposits from other banks, and developing relationships with fixed income investors.

Management also measures Key's capacity to borrow using various debt instruments and funding markets.

Key maintains a liquidity contingency plan that outlines the process for addressing a liquidity crisis. The plan provides for an evaluation of funding sources under various market conditions. It also assigns specific roles and responsibilities for effectively managing liquidity through a problem period. Key has access to various sources of money market funding (such as federal funds purchased, securities sold under repurchase agreements, eurodollars and commercial paper) and also can borrow from the Federal Reserve Bank's discount window to meet short-term liquidity requirements. Key did not have any borrowings from the Federal Reserve Bank outstanding at September 30, 2007. Key monitors its funding sources and measures its capacity to obtain funds in a variety of wholesale funding markets in an effort to maintain an appropriate mix of funds, considering both cost and availability. Key uses several tools as described on page 55 of the 2006 Annual Report to Shareholders to actively manage and maintain sufficient liquidity on an ongoing basis.

In addition to cash flows from operations, Key's cash flows come from both investing and financing activities. Since December 31, 2005, prepayments and maturities of securities available for sale have been the primary sources of cash from investing activities. Securities sold in connection with the repositioning of the securities portfolio also provided significant cash inflow during the first quarter of 2007.

Investing activities that have required the greatest use of cash include lending and purchases of new securities.

Key utilizes financing activities to meet the cash flow needs generated by operating and investing activities that cannot be met by deposit growth. These cash needs may be addressed by increasing short- and/or long-term borrowings. Conversely, excess cash generated by operating, investing and deposit-gathering activities may be used to repay outstanding debt.

In 2006, cash generated by the sale of discontinued operations was used to pay down short-term borrowings. During the first nine months of 2007, short-term borrowings were used to pay down long-term debt, while the net increase in deposits was used to fund the growth in portfolio loans and loans held for sale.

The Consolidated Statements of Cash Flows on page 6 summarize Key's sources and uses of cash by type of activity for the nine-month periods ended September 30, 2007 and 2006.

**Table of Contents****Liquidity for KeyCorp (the parent company )**

The parent company has sufficient liquidity when it can service its debt, support customary corporate operations and activities (including acquisitions), at a reasonable cost, in a timely manner and without adverse consequences, and pay dividends to shareholders.

Management's primary tool for assessing parent company liquidity is the net short-term cash position, which measures the ability to fund debt maturing in twelve months or less with existing liquid assets. Another key measure of parent company liquidity is the liquidity gap, which represents the difference between projected liquid assets and anticipated financial obligations over specified time horizons. Key generally relies upon the issuance of term debt to manage the liquidity gap within targeted ranges assigned to various time periods.

The parent has met its liquidity requirements principally through regular dividends from KeyBank. Federal banking law limits the amount of capital distributions that a bank can make to its holding company without prior regulatory approval. A national bank's dividend-paying capacity is affected by several factors, including net profits (as defined by statute) for the two previous calendar years and for the current year up to the date of dividend declaration. During the first nine months of 2007, KeyBank paid the parent a total of \$500 million in dividends, and nonbank subsidiaries paid the parent a total of \$438 million in dividends. As of the close of business on September 30, 2007, KeyBank had an additional \$364 million available to pay dividends to the parent without prior regulatory approval and without affecting its status as well-capitalized under FDIC-defined capital categories.

The parent company generally maintains excess funds in short-term investments in an amount sufficient to meet projected debt maturities over the next twelve months. At September 30, 2007, the parent company held \$1.1 billion in short-term investments, which management projected to be sufficient to meet debt repayment obligations over a period of approximately 19 months.

**Additional sources of liquidity**

Management has implemented several programs that enable the parent company and KeyBank to raise funding in the public and private markets when necessary. The proceeds from most of these programs can be used for general corporate purposes, including acquisitions. Each of the programs is replaced or renewed as needed. There are no restrictive financial covenants in any of these programs.

**Bank note program.** KeyBank's bank note program provides for the issuance of both long- and short-term debt of up to \$20.0 billion. During the first nine months of 2007, there were \$350 million of notes issued under this program. At September 30, 2007, \$18.4 billion was available for future issuance.

**Euro medium-term note program.** Under Key's euro medium-term note program, the parent company and KeyBank may issue both long- and short-term debt of up to \$10.0 billion in the aggregate (\$9.0 billion by KeyBank and \$1.0 billion by the parent company). The notes are offered exclusively to non-U.S. investors and can be denominated in U.S. dollars or foreign currencies. During the first nine months of 2007, there were no notes issued under this program. At September 30, 2007, \$7.2 billion was available for future issuance.

**KeyCorp medium-term note program.** In January 2005, the parent company registered \$2.9 billion of securities under a shelf registration statement filed with the SEC. Of this amount, \$1.9 billion has been allocated for the issuance of both long- and short-term debt in the form of medium-term notes. During the first nine months of 2007, there were no notes issued under this program. At September 30, 2007, unused capacity under this shelf registration statement totaled \$1.9 billion.

**Commercial paper.** The parent company has a commercial paper program that provides funding availability of up to \$500 million. As of September 30, 2007, there were no borrowings outstanding under this program.

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KeyBank has a separate commercial paper program at a Canadian subsidiary that provides funding availability of up to C\$1.0 billion in Canadian currency. The borrowings under this program can be denominated in Canadian or U.S. dollars. As of September 30, 2007, borrowings outstanding under this commercial paper program totaled C\$395 million in Canadian currency and \$131 million in U.S. currency (equivalent to C\$130 million in Canadian currency).

Key's debt ratings are shown in Figure 31 below. Management believes that these debt ratings, under normal conditions in the capital markets, allow for future offerings of securities by the parent company or KeyBank that would be marketable to investors at a competitive cost.

**Figure 31. Debt Ratings**

September 30, 2007	Short-Term Borrowings	Senior Long-Term Debt	Subordinated Long-Term Debt	Capital Securities	Enhanced Trust Preferred Securities
<b>KeyCorp (the parent company)</b>					
Standard & Poor's	A-2	A-	BBB+	BBB	BBB
Moody's	P-1	A2	A3	A3	A3
Fitch	F1	A	A-	A-	A-
<b>KeyBank</b>					
Standard & Poor's	A-1	A	A-	N/A	N/A
Moody's	P-1	A1	A2	N/A	N/A
Fitch	F1	A	A-	N/A	N/A
<b>Key Nova Scotia Funding Company (KNSF)</b>					
Dominion Bond Rating Service <sup>a</sup>	R-1 (middle)	A (high)	N/A	N/A	N/A

(a) Reflects the guarantee by KeyBank of KNSF's issuance of Canadian commercial paper.

N/A = Not Applicable

**Operational risk management**

Key, like all businesses, is subject to operational risk, which is the risk of loss resulting from human error, inadequate or failed internal processes and systems, and external events. Operational risk also encompasses compliance (legal) risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices or ethical standards. Resulting losses could take the form of explicit charges, increased operational costs, harm to Key's reputation or forgone opportunities. Key seeks to mitigate operational risk through a system of internal controls. For more information on Key's efforts to monitor and manage its operational risk, see page 57 of Key's 2006 Annual Report to Shareholders.

**Regulatory agreements.** On October 17, 2005, KeyCorp entered into a memorandum of understanding with the Federal Reserve Bank of Cleveland (FRBC), and KeyBank entered into a consent order with the Comptroller of the Currency (OCC), concerning compliance-related matters, particularly arising under the Bank Secrecy Act. These



actions did not have a material effect on Key's operating results; neither the OCC nor the FRBC imposed a fine or civil money penalty in the matter. As part of the consent order and memorandum of understanding, Key agreed to continue to strengthen its anti-money laundering and other compliance controls. As such, management has taken actions to provide enhanced training for employees, upgrade client due diligence procedures and employ advanced technologies. As a result of progress made in this regard, during the second quarter of 2007, both the FRBC and the OCC terminated the regulatory agreements with Key.

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**Item 3. Quantitative and Qualitative Disclosure about Market Risk**

The information presented in the Market Risk Management section, which begins on page 64 of the Management's Discussion and Analysis of Financial Condition and Results of Operations, is incorporated herein by reference.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, KeyCorp carried out an evaluation, under the supervision and with the participation of KeyCorp's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of KeyCorp's disclosure controls and procedures. Based upon that evaluation, KeyCorp's Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective, in all material respects, as of the end of the period covered by this report. No changes were made to KeyCorp's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, KeyCorp's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

The information presented in the Legal Proceedings section of Note 13 ( Contingent Liabilities and Guarantees ), which begins on page 28 of the Notes to Consolidated Financial Statements, and in the Lease Financing Transactions section of Note 12 ( Income Taxes ), which begins on page 25 of the Notes to Consolidated Financial Statements, is incorporated herein by reference.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The information presented in Figure 22 on page 62 of the Management's Discussion and Analysis of Financial Condition and Results of Operations is incorporated herein by reference.

**Item 6. Exhibits**

- 15 Acknowledgment of Independent Registered Public Accounting Firm.
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Information Available on Website**

KeyCorp makes available free of charge on its website, [www.key.com](http://www.key.com), its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports as soon as reasonably practicable after KeyCorp electronically files such material with, or furnishes it to, the Securities and Exchange Commission.

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**SIGNATURE**

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

KEYCORP

(Registrant)

Date: November 7, 2007

/s/ Robert L. Morris

By: Robert L. Morris  
Executive Vice President  
and Chief Accounting Officer

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