KEYCORP /NEW/
Form 10-Q
November 03, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

Form 10-Q

[ü] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2011

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From __________ To __________

Commission File Number 1-11302

KeyCorp

(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No þ

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

Common Shares with a par value of $1 each	952,888,140 Shares
(Title of class)	(Outstanding at November 1, 2011)

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KEYCORP

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

in millions, except per share data		September 30, 2011 (Unaudited)		December 31, 2010		September 30, 2010 (Unaudited)
ASSETS						
Cash and due from banks	$	**828**	$	278	$	823
Short-term investments		**4,766**		1,344		1,871
Trading account assets		**729**		985		1,155
Securities available for sale		**17,612**		21,933		21,241
Held-to-maturity securities (fair value: $1,186, $17 and $18)		**1,176**		17		18
Other investments		**1,210**		1,358		1,405
Loans, net of unearned income of $1,413, $1,572 and $1,587		**48,195**		50,107		51,354
Less: Allowance for loan and lease losses		**1,131**		1,604		1,957
Net loans		**47,064**		48,503		49,397
Loans held for sale		**479**		467		637
Premises and equipment		**924**		908		888
Operating lease assets		**393**		509		563
Goodwill		**917**		917		917
Other intangible assets		**18**		21		39
Corporate-owned life insurance		**3,227**		3,167		3,145
Derivative assets		**940**		1,006		1,258
Accrued income and other assets (including $87 of consolidated LIHTC guaranteed funds VIEs, see Note 9)[(a)]		**2,946**		3,876		3,936
Discontinued assets (including $2,860 of consolidated education loan securitization trust VIEs (see Note 9) and $75 of loans in portfolio at fair value)[(a)]		**6,033**		6,554		6,750
Total assets	$	**89,262**	$	91,843	$	94,043
LIABILITIES						
Deposits in domestic offices:						
NOW and money market deposit accounts	$	**27,548**	$	27,066	$	26,350
Savings deposits		**1,968**		1,879		1,856
Certificates of deposit ($100,000 or more)		**4,457**		5,862		6,850
Other time deposits		**6,695**		8,245		9,014
Total interest-bearing		**40,668**		43,052		44,070
Noninterest-bearing		**19,803**		16,653		16,275
Deposits in foreign office interest-bearing		**561**		905		1,073
Total deposits		**61,032**		60,610		61,418
Federal funds purchased and securities sold under repurchase agreements		**1,728**		2,045		2,793
Bank notes and other short-term borrowings		**519**		1,151		685
Derivative liabilities		**1,141**		1,142		1,330
Accrued expense and other liabilities		**1,556**		1,931		1,862
Long-term debt		**10,717**		10,592		11,443
Discontinued liabilities (including $2,651 of consolidated education loan securitization trust VIEs at fair value, see Note 9)[(a)]		**2,651**		2,998		3,124
Total liabilities		**79,344**		80,469		82,655
EQUITY						
Preferred stock, $1 par value, authorized 25,000,000 shares:						

7.75% Noncumulative Perpetual Convertible Preferred Stock, Series A, $100 liquidation preference; authorized 7,475,000 shares; issued 2,904,839, 2,904,839 and 2,904,839 shares		**291**		291		291
Fixed-Rate Cumulative Perpetual Preferred Stock, Series B, $100,000 liquidation preference; authorized and issued 25,000 shares				2,446		2,442
Common shares, $1 par value; authorized 1,400,000,000 shares; issued 1,016,969,905, 946,348,435 and 946,348,435 shares		**1,017**		946		946
Common stock warrant				87		87
Capital surplus		**4,191**		3,711		3,710
Retained earnings		**6,079**		5,557		5,287
Treasury stock, at cost (64,161,618, 65,740,726 and 66,020,414)		**(1,820)**		(1,904)		(1,914)
Accumulated other comprehensive income (loss)		**143**		(17)		285
Key shareholders equity		**9,901**		11,117		11,134
Noncontrolling interests		**17**		257		254
Total equity		**9,918**		11,374		11,388
Total liabilities and equity	**$**	**89,262**	$	91,843	$	94,043

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

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Income (Unaudited)

dollars in millions, except per share amounts	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
INTEREST INCOME				
Loans	**$ 543**	$ 649	**$ 1,664**	$ 2,036
Loans held for sale	**3**	4	**10**	13
Securities available for sale	**140**	170	**455**	474
Held-to-maturity securities	**2**	1	**3**	2
Trading account assets	**5**	8	**21**	29
Short-term investments	**3**	1	**5**	5
Other investments	**9**	11	**33**	38
Total interest income	**705**	844	**2,191**	2,597
INTEREST EXPENSE				
Deposits	**95**	147	**305**	547
Federal funds purchased and securities sold under repurchase agreements	**1**	1	**4**	4
Bank notes and other short-term borrowings	**3**	4	**9**	11
Long-term debt	**57**	52	**163**	153
Total interest expense	**156**	204	**481**	715
NET INTEREST INCOME	**549**	640	**1,710**	1,882
Provision (credit) for loan and lease losses	**10**	94	**(38)**	735
Net interest income (expense) after provision for loan and lease losses	**539**	546	**1,748**	1,147
NONINTEREST INCOME				
Trust and investment services income	**107**	110	**330**	336
Service charges on deposit accounts	**74**	75	**211**	231
Operating lease income	**30**	41	**97**	131
Letter of credit and loan fees	**55**	61	**157**	143
Corporate-owned life insurance income	**31**	39	**86**	95
Net securities gains (losses) [(a)]		1	**1**	2
Electronic banking fees	**33**	30	**96**	86
Gains on leased equipment	**7**	4	**16**	14
Insurance income	**13**	15	**42**	52
Net gains (losses) from loan sales	**18**	18	**48**	47
Net gains (losses) from principal investing	**34**	18	**86**	72
Investment banking and capital markets income (loss)	**25**	42	**110**	82
Other income	**56**	32	**114**	137
Total noninterest income	**483**	486	**1,394**	1,428
NONINTEREST EXPENSE				
Personnel	**382**	359	**1,133**	1,106
Net occupancy	**65**	70	**192**	200
Operating lease expense	**23**	40	**76**	114
Computer processing	**40**	46	**124**	140
Business services and professional fees	**47**	41	**129**	120
FDIC assessment	**7**	27	**45**	97
OREO expense, net	**1**	4	**8**	58
Equipment	**26**	24	**78**	74
Marketing	**16**	21	**36**	50
Provision (credit) for losses on lending-related commitments	**(1)**	(10)	**(17)**	(22)
Other expense	**86**	114	**269**	353
Total noninterest expense	**692**	736	**2,073**	2,290

INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		**330**		296		**1,069**		285
Income taxes		**95**		85		**300**		14
INCOME (LOSS) FROM CONTINUING OPERATIONS		**235**		211		**769**		271
Income (loss) from discontinued operations, net of taxes of ($11), $10, ($23) and ($5) (see Note 11)		**(17)**		15		**(37)**		(10)
NET INCOME (LOSS)		**218**		226		**732**		261
Less: Net income (loss) attributable to noncontrolling interests		**1**		7		**12**		27
NET INCOME (LOSS) ATTRIBUTABLE TO KEY	**$**	**217**	$	219	**$**	**720**	$	234
Income (loss) from continuing operations attributable to Key common shareholders	**$**	**229**	$	163	**$**	**656**	$	121
Net income (loss) attributable to Key common shareholders		**212**		178		**619**		111
Per common share:								
Income (loss) from continuing operations attributable to Key common shareholders	**$**	**.24**	$	.19	**$**	**.71**	$	.14
Income (loss) from discontinued operations, net of taxes		**(.02)**		.02		**(.04)**		(.01)
Net income (loss) attributable to Key common shareholders		**.22**		.20		**.67**		.13
Per common share assuming dilution:								
Income (loss) from continuing operations attributable to Key common shareholders	**$**	**.24**	$	.19	**$**	**.71**	$	.14
Income (loss) from discontinued operations, net of taxes		**(.02)**		.02		**(.04)**		(.01)
Net income (loss) attributable to Key common shareholders		**.22**		.20		**.67**		.13
Cash dividends declared per common share	**$**	**.03**	$	.01	**$**	**.07**	$	.03
Weighted-average common shares outstanding (000) [(b)]		**948,702**		874,433		**926,298**		874,495
Weighted-average common shares and potential common shares outstanding (000)		**950,686**		874,433		**930,449**		874,495

(a) For the three months ended September 30, 2011 and September 30, 2010, we did not have impairment losses related to securities.

(b) Assumes conversion of stock options and/or Preferred Series A, as applicable.
See Notes to Consolidated Financial Statements (Unaudited).

Consolidated Statements of Changes in Equity (Unaudited)

	Key Shareholders Equity										
dollars in millions, except per share amounts	Preferred Shares Outstanding (000)	Common Shares Outstanding (000)	Preferred Stock	Common Shares	Common Stock Warrant	Capital Surplus	Retained Earnings	Treasury Stock, at Cost	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Comprehensive Income (Loss)
BALANCE AT DECEMBER 31, 2009	2,930	878,535	$ 2,721	$ 946	$ 87	$ 3,734	$ 5,158	$ (1,980)	$ (3)	$ 270	
Cumulative effect adjustment to beginning balance of Retained Earnings							45 [(a)]				
Net income (loss)							234			27	$ 261
Other comprehensive income (loss):											
Net unrealized gains (losses) on securities available for sale, net of income taxes of $214									361		361
Net unrealized gains (losses) on derivative financial instruments, net of income taxes of ($49)									(82)		(82)
Net distribution to noncontrolling interests										(43)	(43)
Foreign currency translation adjustments									(8)		(8)
Net pension and postretirement benefit costs, net of income taxes									17		17
Total comprehensive income (loss)											$ 506 [(a)]
Deferred compensation						11					
Cash dividends declared on common shares ($.03 per share)							(27)				
Cash dividends declared on Noncumulative Series A Preferred Stock ($5.8125 per share)							(17)				
Cash dividends accrued on Cumulative Series B Preferred Stock (5% per annum)							(94)				
Amortization of discount on Series B Preferred Stock			12				(12)				
Common shares reissued for stock options and other employee benefit plans		1,793				(35)		66			
BALANCE AT SEPTEMBER 30, 2010	2,930	880,328	$ 2,733	$ 946	$ 87	$ 3,710	$ 5,287	$ (1,914)	$ 285	$ 254	
BALANCE AT DECEMBER 31, 2010	2,930	880,608	$ 2,737	$ 946	$ 87	$ 3,711	$ 5,557	$ (1,904)	$ (17)	$ 257	
Correction of an error in cumulative effect adjustment							(30)[(b)]				
Net income (loss)							720			12	$ 732
Other comprehensive income (loss):											
Net unrealized gains (losses) on securities available for sale, net of income taxes of $93									157		157
Net unrealized gains (losses) on derivative financial instruments, net of income taxes of $(3)									(6)		(6)
Net distribution from noncontrolling interests										(252)	(252)
Foreign currency translation adjustments									5		5
Net pension and postretirement benefit costs, net of income taxes									4		4
Total comprehensive income (loss)											$ 640
Deferred compensation						(2)					
							(67)				

Cash dividends declared on common shares ($.07 per share)										
Cash dividends declared on Noncumulative Series A Preferred Stock ($5.8125 per share)							(17)			
Cash dividends accrued on Cumulative Series B Preferred Stock (5% per annum)							(31)			
Series B Preferred Stock - TARP redemption	(25)		(2,451)				(49)			
Repurchase of common stock warrant					(87)	17				
Amortization of discount on Series B Preferred Stock			4				(4)			
Common shares issuance		70,621		71		533				
Common shares reissued for stock options and other employee benefit plans		1,579				(68)		84		
Other			1							
BALANCE AT SEPTEMBER 30, 2011	2,905	952,808	$ 291	$ 1,017		$ 4,191	$ 6,079	$ (1,820)	$ 143	$ 17

(a) The $45 million cumulative effect adjustment on January 1, 2010 was erroneously shown as a component of Comprehensive Income (Loss) and has been removed for financial reporting presentation. Therefore, Total Comprehensive Income (Loss) was previously shown as $551 million and has now been reflected at $506 million for financial reporting presentation purposes.

(b) Corrects the cumulative effect adjustment made to beginning retained earnings on January 1, 2010 related to the consolidation of the student loan securitization trusts in discontinued operations. See Note 11 (Divestiture and Discontinued Operations) for more information.

See Notes to Consolidated Financial Statements (Unaudited).

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Consolidated Statements of Cash Flows (Unaudited)

in millions	Nine months ended September 30, 2011	2010
OPERATING ACTIVITIES		
Net income (loss)	**$ 732**	$ 261
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Provision (credit) for loan and lease losses	**(38)**	735
Depreciation and amortization expense	**208**	254
FDIC (payments) net of FDIC expense	**41**	79
Deferred income taxes (benefit)	**(261)**	16
Net losses (gains) and writedown on OREO	**6**	52
Provision (credit) for customer derivative losses	**(12)**	28
Net losses (gains) from loan sales	**(48)**	(47)
Net losses (gains) from principal investing	**(86)**	(72)
Provision (credit) for losses on lending-related commitments	**(17)**	(22)
(Gains) losses on leased equipment	**(16)**	(14)
Net securities losses (gains)	**(1)**	(2)
Net decrease (increase) in loans held for sale excluding loan transfers from continuing operations	**66**	176
Net decrease (increase) in trading account assets	**256**	54
Other operating activities, net	**1,045**	471
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	**1,875**	1,969
INVESTING ACTIVITIES		
Net decrease (increase) in short-term investments	**(3,422)**	(128)
Purchases of securities available for sale	**(624)**	(6,993)
Proceeds from sales of securities available for sale	**1,662**	61
Proceeds from prepayments and maturities of securities available for sale	**3,532**	2,918
Proceeds from prepayments and maturities of held-to-maturity securities	**11**	5
Purchases of held-to-maturity securities	**(1,170)**	(2)
Purchases of other investments	**(125)**	(106)
Proceeds from sales of other investments	**57**	131
Proceeds from prepayments and maturities of other investments	**63**	87
Net decrease (increase) in loans, excluding acquisitions, sales and transfers	**1,257**	5,107
Proceeds from loan sales	**111**	431
Purchases of premises and equipment	**(102)**	(102)
Proceeds from sales of premises and equipment	**1**	1
Proceeds from sales of other real estate owned	**112**	143
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	**1,363**	1,553
FINANCING ACTIVITIES		
Net increase (decrease) in deposits	**422**	(4,153)
Net increase (decrease) in short-term borrowings	**(949)**	1,396
Net proceeds from issuance of long-term debt	**1,021**	776
Payments on long-term debt	**(1,086)**	(1,051)
Net proceeds from issuance of common stock	**604**	
Series B Preferred Stock - TARP redemption	**(2,500)**	
Repurchase of common stock warrant	**(70)**	
Cash dividends paid	**(130)**	(138)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	**(2,688)**	(3,170)
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	**550**	352
CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD	**278**	471
CASH AND DUE FROM BANKS AT END OF PERIOD	**$ 828**	$ 823
Additional disclosures relative to cash flows:		

Interest paid	**$**	**445**	$	680
Income taxes paid (refunded)		**(314)**		(159)
Noncash items:				
Loans transferred to held for sale from portfolio	**$**	**78**	$	370
Loans transferred to other real estate owned		**34**		195

See Notes to Consolidated Financial Statements (Unaudited).

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Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

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

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

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

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

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

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

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

Effective January 1, 2010, we prospectively adopted new accounting guidance that changes the way we account for securitizations and SPEs by eliminating the concept of a QSPE and changing the requirements for derecognition of financial assets. In adopting this guidance, we had to analyze our existing QSPEs for possible consolidation. As a result, we consolidated our education loan securitization trusts. That consolidation added $2.8 billion in discontinued assets, and liabilities and equity to our balance sheet, of which $2.6 billion of the assets represented loans. During the third quarter of 2011, we determined that the $45 million cumulative effect adjustment made related to the consolidation of these trusts on January 1, 2010 was incorrect. Further information regarding this error and its correction is provided in Note 11 (Divestiture and Discontinued Operations). Prior to January 1, 2010, QSPEs, including securitization trusts, established under the applicable accounting guidance for transfers of financial assets were not consolidated. For additional information related to the consolidation of our education loan securitization trusts, see Note 9 (Variable Interest Entities) and Note 11.

We believe that the unaudited consolidated interim financial statements reflect all adjustments of a normal recurring nature and disclosures that are necessary for a fair presentation of the results for the interim periods presented. As noted above, see Note 11 for further information regarding the error correction that was made during the third quarter of 2011.

The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our 2010 Annual Report on Form 10-K. As noted above, see Note 11 for further information regarding the error correction that was made during the third quarter of 2011.

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

Offsetting Derivative Positions

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

Accounting Guidance Adopted in 2011

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

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Credit quality disclosures. In July 2010, the FASB issued new accounting guidance that requires additional disclosures about the credit quality of financing receivables (i.e., loans) and the allowance for credit losses. Most of these additional disclosures were required for interim and annual reporting periods ending on or after December 15, 2010 (effective December 31, 2010, for us). Specific items regarding activity that occurred before the issuance of this accounting guidance, such as the allowance rollforward disclosures, are required for periods beginning after December 15, 2010 (January 1, 2011, for us). The required disclosures are provided in Note 4 (Asset Quality).

Troubled debt restructurings. In April 2011, the FASB issued accounting guidance to assist creditors in evaluating whether a modification or restructuring of a loan is a TDR. It clarifies existing guidance on whether the creditor has granted a concession and whether the debtor is experiencing financial difficulties, which are the two criteria used to determine whether a modification or restructuring is a TDR. This accounting guidance also requires additional disclosures regarding TDRs. It is effective for the first interim or annual period beginning after June 15, 2011 (effective July 1, 2011, for us) and is applied retrospectively for all modifications and restructurings that have occurred from the beginning of the annual period of adoption (2011 for us). The required disclosures are provided in Note 4 (Asset Quality). Adoption of this accounting guidance did not have a material effect on our financial condition or results of operations.

Accounting Guidance Pending Adoption at September 30, 2011

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

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

Testing goodwill for impairment. In September 2011, the FASB issued new accounting guidance that simplifies how an entity will test goodwill for impairment. It will permit an entity to first assess qualitative factors to determine whether additional goodwill impairment testing is required. This accounting guidance will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 (effective January 1, 2012, for us). Early adoption is permitted. We do not expect the adoption of this accounting guidance to have a material effect on our financial condition or results of operations.

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

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2. Earnings Per Common Share

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

dollars in millions, except per share amounts	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
EARNINGS				
Income (loss) from continuing operations	**$ 235**	$ 211	**$ 769**	$ 271
Less: Net income (loss) attributable to noncontrolling interests	**1**	7	**12**	27
Income (loss) from continuing operations attributable to Key	**234**	204	**757**	244
Less: Dividends on Series A Preferred Stock	**5**	6	**17**	17
Cash dividends on Series B Preferred Stock [b]		31	**31**	94
Amortization of discount on Series B Preferred Stock[b]		4	**53**	12
Income (loss) from continuing operations attributable to Key common shareholders	**229**	163	**656**	121
Income (loss) from discontinued operations, net of taxes[a]	**(17)**	15	**(37)**	(10)
Net income (loss) attributable to Key common shareholders	**$ 212**	$ 178	**$ 619**	$ 111
WEIGHTED-AVERAGE COMMON SHARES				
Weighted-average common shares outstanding (000)	**948,702**	874,433	**926,298**	874,495
Effect of dilutive convertible preferred stock, common stock options and other stock awards (000)	**1,984**		**4,151**	
Weighted-average common shares and potential common shares outstanding (000)	**950,686**	874,433	**930,449**	874,495
EARNINGS PER COMMON SHARE				
Income (loss) from continuing operations attributable to Key common shareholders	**$ .24**	$ .19	**$ .71**	$ .14
Income (loss) from discontinued operations, net of taxes [a]	**(.02)**	.02	**(.04)**	(.01)
Net income (loss) attributable to Key common shareholders[c]	**.22**	.20	**.67**	.13
Income (loss) from continuing operations attributable to Key common shareholders assuming dilution	**$ .24**	$ .19	**$ .71**	$ .14
Income (loss) from discontinued operations, net of taxes [a]	**(.02)**	.02	**(.04)**	(.01)
Net income (loss) attributable to Key common shareholders assuming dilution[c]	**.22**	.20	**.67**	.13

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

(b) Nine months ended September 30, 2011, includes a $49 million deemed dividend recorded in the first quarter of 2011 related to the repurchase of the $2.5 billion Fixed-Rate Perpetual Preferred Stock, Series B.

(c) EPS may not foot due to rounding.

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3. Loans and Loans Held for Sale

Our loans by category are summarized as follows:

in millions	September 30, 2011	December 31, 2010	September 30, 2010
Commercial, financial and agricultural	**$ 17,848**	$ 16,441	$ 16,451
Commercial real estate:			
Commercial mortgage	**7,958**	9,502	9,673
Construction	**1,456**	2,106	2,731
Total commercial real estate loans	**9,414**	11,608	12,404
Commercial lease financing	**5,957**	6,471	6,583
Total commercial loans	**33,219**	34,520	35,438
Residential prime loans:			
Real estate residential mortgage	**1,875**	1,844	1,853
Home equity:			
Key Community Bank	**9,347**	9,514	9,655
Other	**565**	666	707
Total home equity loans	**9,912**	10,180	10,362
Total residential prime loans	**11,787**	12,024	12,215
Consumer other Key Community Bank	**1,187**	1,167	1,174
Consumer other:			
Marine	**1,871**	2,234	2,355
Other	**131**	162	172
Total consumer other	**2,002**	2,396	2,527
Total consumer loans	**14,976**	15,587	15,916
Total loans [a]	**$ 48,195**	$ 50,107	$ 51,354

(a) Excludes loans in the amount of $6.0 billion, $6.5 billion and $6.6 billion at September 30, 2011, December 31, 2010 and September 30, 2010, respectively, related to the discontinued operations of the education lending business.

Our loans held for sale are summarized as follows:

in millions	September 30, 2011	December 31, 2010	September 30, 2010
Commercial, financial and agricultural	**$ 29**	$ 196	$ 128
Real estate commercial mortgage	**325**	118	327
Real estate construction	**20**	35	77
Commercial lease financing	**26**	8	13
Real estate residential mortgage	**79**	110	92
Total loans held for sale	**$ 479**	$ 467 [a]	$ 637

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

Our summary of changes in loans held for sale follows:

in millions	September 30, 2011	December 31, 2010	September 30, 2010
Balance at beginning of the three-month period	**$ 381**	$ 637	$ 699
New originations	**853**	1,053	684
Transfers from held to maturity, net	**23**		202
Loan sales	**(759)**	(1,174)	(835)
Loan draws (payments), net	**1**	(49)	(49)
Transfers to OREO / valuation adjustments	**(20)**		(64)
Balance at end of period	**$ 479**	$ 467	$ 637

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4. Asset Quality

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

Our nonperforming assets and past due loans were as follows:

in millions	September 30, 2011	December 31, 2010	September 30, 2010
Total nonperforming loans	**$ 788**	$ 1,068	$ 1,372
Nonperforming loans held for sale	**42**	106	230
OREO	**63**	129	163
Other nonperforming assets	**21**	35	36
Total nonperforming assets	**$ 914**	$ 1,338	$ 1,801
Impaired loans	**$ 653**	$ 881	$ 1,120
Impaired loans with a specifically allocated allowance	**441**	621	840
Specifically allocated allowance for impaired loans	**44**	58	135
Restructured loans included in nonperforming loans [(a)]	**$ 178**	$ 202	$ 228
Restructured loans with a specifically allocated allowance [(b)]	**27**	57	35
Specifically allocated allowance for restructured loans [(c)]	**5**	18	6
Accruing loans past due 90 days or more	**$ 118**	$ 239	$ 152
Accruing loans past due 30 through 89 days	**478**	476	662

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

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

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

Impaired loans totaled $653 million at September 30, 2011, compared to $881 million at December 31, 2010, and $1.1 billion at September 30, 2010. Impaired loans had an average balance of $697 million and $1.4 billion for the nine months ended September 30, 2011 and 2010.

Of total impaired loans, $441 million required a specifically allocated allowance at September 30, 2011, in accordance with our $2.5 million threshold for such loans. As a result, $153 million of these loans had $44 million of specifically allocated allowance and $288 million had a zero specific allocation. Also, $212 million of impaired loans under the $2.5 million threshold were allocated an allowance of $75 million at September 30, 2011, for a total of $365 million of loans with an allowance of $119 million at September 30, 2011, as shown in the table below.

At September 30, 2011, the approximate carrying amount of our commercial nonperforming loans outstanding represented 55% of their original contractual amount, total nonperforming loans outstanding represented 64% of their original contractual amount owed, and nonperforming assets in total were carried at 61% of their original contractual amount.

At September 30, 2011, our twenty largest nonperforming loans totaled $265 million, representing 34% of total loans on nonperforming status from continuing operations as compared to $306 million in nonperforming loans representing 29% of total loans on nonperforming status at December 31, 2010, and $364 million in nonperforming loans representing 27% of total loans on nonperforming status at September 30, 2010.

At September 30, 2011, we did not have any significant commitments to lend additional funds to borrowers with loans on nonperforming status. The amount by which loans and loans held for sale, which were classified as nonperforming, reduced expected interest income was $24 million for the nine months ended September 30, 2011, and $22 million for the year ended December 31, 2010.

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

September 30, 2011 *in millions*	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
With no related allowance recorded:				
Commercial, financial and agricultural	$ 202	$ 91		$ 217
Commercial real estate:				
Commercial mortgage	292	140		267
Construction	203	57		230
Total commercial real estate loans	495	197		497
Commercial lease financing				
Total commercial loans	697	288		714
Real estate residential mortgage				
Home equity:				
Key Community Bank	2			2
Other				
Total home equity loans	2			2
Consumer other Key Community Bank				0
Total loans with no related allowance recorded	699	288		716
With an allowance recorded:				
Commercial, financial and agricultural	144	87	$ 36	145
Commercial real estate:				
Commercial mortgage	171	134	42	193
Construction	86	38	19	101
Total commercial real estate loans	257	172	61	294
Commercial lease financing	34	20	10	36
Total commercial loans	435	279	107	475
Real estate residential mortgage	51	38	3	48
Home equity:				
Key Community Bank	21	21	7	22
Other				
Total Home Equity Loans	21	21	7	22
Consumer other Key Community Bank	28	27	2	26
Total loans with an allowance recorded	535	365	119	571
Total	$ 1,234	$ 653	$ 119	$ 1,287

At September 30, 2011, aggregate restructured loans (accrual, nonaccrual, and held-for-sale loans) totaled $277 million while at December 31, 2010, total restructured loans totaled $297 million. Although we added $140 million in restructured loans during the nine months ended September 30, 2011, the overall decrease in restructured loans was primarily attributable to $160 million in payments and charge-offs.

A further breakdown of restructured loans included in nonperforming loans (TDRs) by loan category as of September 30, 2011, follows:

September 30, 2011 *dollars in millions*	**Number of loans**	**Pre-modification Outstanding Recorded Investment**	**Post-modification Outstanding Recorded Investment**
LOAN TYPE			
Nonperforming:			
Commercial, financial and agricultural	11	$ 84	$ 46
Commercial real estate:			
Real estate commercial mortgage	12	74	69
Real estate construction	6	50	18
Total commercial real estate loans	18	124	87
Commercial lease financing	182	24	11
Total commercial loans	211	232	144
Real estate residential mortgage	73	7	7
Home equity:			
Key Community Bank	30	2	1
Other	29	1	1
Total home equity loans	59	3	2
Consumer other Key Community Bank	7		
Consumer other:			
Marine	43	26	25
Other	18		
Total consumer other	61	26	25
Total consumer loans	200	36	34
Total nonperforming TDRs	411	268	178
Prior-year accruing:[(a)]			
Commercial, financial and agricultural	1	8	5
Commercial real estate:			
Real estate commercial mortgage	4	57	32
Real estate construction	3	39	19
Total commercial real estate loans	7	96	51
Commercial lease financing	167	17	13
Total commercial loans	175	121	69
Real estate residential mortgage	56	9	9
Home equity:			
Key Community Bank	64	6	6
Other	71	3	2
Total home equity loans	135	9	8
Consumer other Key Community Bank	14		
Consumer other:			
Marine	109	13	11
Other	34	2	2
Total consumer other	143	15	13
Total consumer loans	348	33	30
Total prior-year accruing TDRs	523	154	99
Total TDRs	934	$ 422	$ 277

(a) All TDRs that have been restructured prior to January 1, 2011 and are fully accruing.

We classify loan modifications as TDRs when a borrower is experiencing financial difficulties and we have granted a concession to the borrower. All commercial loan TDRs, regardless of size, are evaluated for impairment individually to determine the probable loss content and are assigned a specific loan allowance, if deemed appropriate in the determination of the ALLL. Consumer loan TDRs are assigned a loss rate that reflects the current assessment of that category of consumer loans to determine the appropriate allowance level. The financial effects of TDRs are reflected in the components that comprise the allowance for loan and lease losses in either the amount of charge-offs or loan loss provision and ultimate allowance level. There have been no significant payment defaults in this interim period relating to TDRs that were categorized as such within the previous 12 months.

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Key s loan modifications are handled on a case by case basis and are negotiated to achieve mutually agreeable terms that maximize loan collectability and meet our client s financial needs. A majority of our concessions granted to borrowers are in the form of interest rate reductions with other concession types that include forgiveness of principal and other modifications of loan terms. Consumer loan concessions are primarily comprised of interest rate reductions.

The following table shows the concession types for our commercial accruing and nonaccruing TDRs.

dollars in millions	**September 30, 2011**	**June 30, 2011**	**March 31, 2011**	**December 31, 2010**	**September 30, 2010**
Interest rate reduction	**$ 195**	**$ 175**	**$ 165**	$ 188	$ 238
Forgiveness of principal	**12**	**10**	**10**	38	67
Other modification of loan terms	**6**	**6**	**7**	14	2
Total	**$ 213**	**$ 191**	**$ 182**	$ 240	$ 307
Total commercial and consumer TDRs	**$ 277**	**252**	**$ 242**	$ 297	$ 360
Total commercial TDRs to total commercial loans	**.64 %**	**.58 %**	**.55 %**	.70 %	.87 %
Total commercial TDRs to total loans	**.44**	**.40**	**.37**	.48	.60
Total commercial loans	**$ 33,219**	**$ 32,688**	**$ 33,298**	$ 34,520	$ 35,438
Total loans	**48,195**	**47,840**	**48,552**	50,107	51,354

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

At September 30, 2011, approximately $47 billion, or 97%, of our total loans are current. Total past due loans of $1.4 billion represent approximately 3% of total loans.

The following aging analysis as of September 30, 2011, of past due and current loans provides further information regarding Key s credit exposure.

September 30, 2011 *in millions*	**Current**	**30-59 Days Past Due**	**60-89 Days Past Due**	**Greater Than 90 Days**	**Nonperforming Loans**	**Total Past Due**	**Total Loans**
LOAN TYPE							
Commercial, financial and agricultural	$ 17,576	$ 40	$ 20	$ 24	$ 188	$ 272	$ 17,848
Commercial real estate:							
Commercial mortgage	7,612	101	3	5	237	346	7,958
Construction	1,345	5	5	8	93	111	1,456
Total commercial real estate loans	8,957	106	8	13	330	457	9,414
Commercial lease financing	5,812	57	23	34	31	145	5,957
Total commercial loans	$ 32,345	$ 203	$ 51	$ 71	$ 549	$ 874	$ 33,219
Real estate residential mortgage	$ 1,747	$ 20	$ 11	$ 9	$ 88	$ 128	$ 1,875
Home equity:							
Key Community Bank	9,125	63	35	22	102	222	9,347
Other	529	13	7	4	12	36	565
Total home equity loans	9,654	76	42	26	114	258	9,912
Consumer other Key Community Bank	1,159	11	5	8	4	28	1,187
Consumer other:							
Marine	1,781	36	19	3	32	90	1,871
Other	125	3	1	1	1	6	131
Total consumer other	1,906	39	20	4	33	96	2,002
Total consumer loans	$ 14,466	$ 146	$ 78	$ 47	$ 239	$ 510	$ 14,976
Total loans	$ 46,811	$ 349	$ 129	$ 118	$ 788	$ 1,384	$ 48,195

The risk characteristic prevalent to both commercial and consumer loans is the risk of loss arising from an obligor s inability or failure to meet contractual payment or performance terms. Evaluation of this risk is stratified and monitored by the assigned loan risk rating grades for the commercial loan portfolios and the regulatory risk ratings assigned for the consumer

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loan portfolios. This risk rating stratification assists in the determination of the allowance for loan and lease losses. Loan grades are assigned at the time of origination, verified by credit risk management and periodically reevaluated thereafter.

Most extensions of credit are subject to loan grading or scoring. This risk rating methodology blends our judgment with quantitative modeling. Commercial loans generally are assigned two internal risk ratings. The first rating reflects the probability that the borrower will default on an obligation; the second reflects expected recovery rates on the credit facility. Default probability is determined based on, among other factors, the financial strength of the borrower, an assessment of the borrower s management, the borrower s competitive position within its industry sector and our view of industry risk within the context of the general economic outlook. Types of exposure, transaction structure and collateral, including credit risk mitigants, affect the expected recovery assessment.

Credit quality indicators for loans are updated on an ongoing basis. Bond rating classifications are indicative of the credit quality of our commercial loan portfolios and are determined by converting our internally assigned risk rating grades to bond rating categories. Payment activity and the regulatory classifications of pass, special mention and substandard are indicators of the credit quality of our consumer loan portfolios.

Credit quality indicators for our commercial and consumer loan portfolios based on bond rating, regulatory classification and payment activity as of September 30, 2011, are as follows:

Commercial Credit Exposure

Credit Risk Profile by Creditworthiness Category [(a)]

September 30,

in millions

RATING [(b)]	Commercial, financial and agricultural 2011	2010	RE Commercial 2011	2010	RE Construction 2011	2010	Commercial Lease 2011	2010	Total 2011	2010
AAA AA	**$ 109**	$ 97	**$ 2**	$ 2	**$ 3**		**$ 639**	$ 653	**$ 753**	$ 752
A	**655**	771	**62**	25	**1**	$ 5	**1,272**	1,333	**1,990**	2,134
BBB BB	**14,928**	11,717	**5,747**	6,205	**762**	1,033	**3,509**	3,705	**24,946**	22,660
B	**807**	1,395	**726**	1,202	**132**	448	**306**	552	**1,971**	3,597
CCC C	**1,349**	2,471	**1,421**	2,239	**558**	1,245	**231**	340	**3,559**	6,295
Total	**$ 17,848**	$ 16,451	**$ 7,958**	$ 9,673	**$ 1,456**	$ 2,731	**$ 5,957**	$ 6,583	**$ 33,219**	$ 35,438

(a) Credit quality indicators are updated on an ongoing basis and reflect credit quality information as of the interim period ending September 30, 2011.
(b) Our bond rating to loan grade conversion system is as follows: AAA - AA = 1, A = 2, BBB - BB = 3 - 13, B = 14 - 16, and CCC - C = 17 - 20.

Consumer Credit Exposure

Credit Risk Profile by Regulatory Classifications [(a)]

September 30,

in millions

GRADE	Residential Prime 2011	2010
Pass	**$ 11,550**	$ 11,966
Special Mention		
Substandard	**237**	249
Total	**$ 11,787**	$ 12,215

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

September 30,	Consumer Community	Key Bank	Consumer	Marine	Consumer	Other	Total	
in millions	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**	**2011**	**2010**
Performing	**$ 1,183**	$ 1,171	**$ 1,839**	$ 2,314	**$ 130**	$ 170	**$ 3,152**	$ 3,655
Nonperforming	**4**	3	**32**	41	**1**	2	**37**	46
Total	**$ 1,187**	$ 1,174	**$ 1,871**	$ 2,355	**$ 131**	$ 172	**$ 3,189**	$ 3,701

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

We use the following three-step process to estimate the appropriate level of the allowance for loan and lease losses on at least a quarterly basis: (1) we apply historical loss rates to existing loans with similar risk characteristics as noted in the credit quality indicator table above; (2) we exercise judgment to assess the impact of factors such as changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets; and, (3) for all TDRs, regardless of size, as well as impaired loans with an outstanding balance greater than $2.5 million, we conduct further analysis to determine the probable loss content and assign a specific allowance to the loan if deemed appropriate. We estimate the extent of impairment by comparing the carrying amount of the loan with the estimated present value of its future cash flows, the fair value of its underlying collateral or the loan s

observable market price. A specific allowance also may be assigned even when sources of repayment appear sufficient if we remain uncertain about whether the loan will be repaid in full. Additional information is provided in Note 1 (Summary of Significant Accounting Policies) under the heading Allowance for Loan and Lease Losses on page 102 of our 2010 Annual Report on Form 10-K. The allowance for loan and lease losses at September 30, 2011, represents our best estimate of the losses inherent in the loan portfolio at that date.

While quantitative modeling factors such as default probability and expected recovery rates are constantly changing as the financial strength of the borrower and overall economic conditions change, there have been no changes to the accounting policies or methodology we used to estimate the allowance for loan and lease losses.

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

At September 30, 2011, the allowance for loan and lease losses was $1.1 billion, or 2.35% of loans compared to $1.6 billion, or 3.20% of loans, at December 31, 2010, and $2 billion or 3.81% of loans at September 30, 2010. At September 30, 2011, the allowance for loan and lease losses was 143.53% of nonperforming loans compared to 142.64% at September 30, 2010.

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

	Three months ended September 30,		**Nine months ended September 30,**	
in millions	**2011**	**2010**	**2011**	**2010**
Balance at beginning of period continuing operations	**$ 1,230**	$ 2,219	**$ 1,604**	$ 2,534
Charge-offs	**(157)**	(430)	**(566)**	(1,479)
Recoveries	**48**	73	**130**	165
Net loans charged off	**(109)**	(357)	**(436)**	(1,314)
Provision for loan and lease losses from continuing operations	**10**	94	**(38)**	735
Foreign currency translation adjustment		1	**1**	2
Balance at end of period continuing operations	**$ 1,131**	$ 1,957	**$ 1,131**	$ 1,957

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

in millions	**December 31, 2010**	**Provision**	**Charge-offs**	**Recoveries**	**September 30, 2011**
Commercial, financial and agricultural	$ 485	**$ (24)**	**$ 124**	**$ 33**	**$ 370**
Real estate commercial mortgage	416	**(31)**	**89**	**9**	**305**
Real estate construction	145	**4**	**81**	**19**	**87**
Commercial lease financing	175	**(62)**	**36**	**19**	**96**
Total commercial loans	1,221	**(113)**	**330**	**80**	**858**
Real estate residential mortgage	49	**4**	**22**	**3**	**34**
Home equity:					
Key Community Bank	120	**59**	**78**	**9**	**110**
Other	57	**10**	**35**	**3**	**35**
Total home equity loans	177	**69**	**113**	**12**	**145**
Consumer other Key Community Bank	57	**12**	**34**	**6**	**41**
Consumer other:					
Marine	89	**(4)**	**60**	**26**	**51**
Other	11	**(5)**	**7**	**3**	**2**
Total consumer other:	100	**(9)**	**67**	**29**	**53**
Total consumer loans	383	**76**	**236**	**50**	**273**
Total ALLL continuing operations	1,604	**(37)** (a)	**566**	**130**	**1,131**
Discontinued operations	114	**99**	**107**	**9**	**115**
Total ALLL including discontinued operations	$ 1,718	**$ 62**	**$ 673**	**$ 139**	**$ 1,246**

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

Our allowance for loan and lease losses decreased by $826 million, or 42%, since the third quarter of 2010. This contraction was associated with the improvement in credit quality of our loan portfolios, which has trended more favorably the past four quarters. Our asset quality metrics showed continued improvement, and therefore, have resulted in favorable risk rating migration and a reduction in our general allowance. Our general allowance encompasses the application of historical loss rates to our existing loans with similar risk characteristics and an assessment of factors such as changes in economic conditions and changes in credit policies or underwriting standards. Our delinquency trends improved throughout most of 2010 and into 2011. We attribute this improvement to a more moderate level of economic activity, more favorable conditions in the capital markets, improvement in client income statements and continued run off in our exit loan portfolio.

For continuing operations, the loans outstanding individually evaluated for impairment totaled $441 million, which had a corresponding allowance of $44 million at September 30, 2011. Loans outstanding collectively evaluated for impairment totaled $48 billion, with a corresponding allowance of $1.1 billion at September 30, 2011.

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

September 30, 2011	**Allowance[(a)]**		**Outstanding[(a)]**		
in millions	**Individually Evaluated for Impairment**	**Collectively Evaluated for Impairment**	**Loans**	**Individually Evaluated for Impairment**	**Collectively Evaluated for Impairment**
Commercial, financial and agricultural	$ 20	$ 349	$ 17,848	$ 144	$ 17,704
Commercial real estate:					
Commercial mortgage	14	291	7,958	217	7,741
Construction	10	78	1,456	78	1,378
Total commercial real estate loans	24	369	9,414	295	9,119
Commercial lease financing		96	5,957		5,957
Total commercial loans	44	814	33,219	439	32,780
Real estate residential mortgage		34	1,875		1,875
Home equity:					
Key Community Bank		110	9,347	2	9,345
Other		35	565		565
Total home equity loans		145	9,912	2	9,910
Consumer other Key Community Bank		41	1,187		1,187
Consumer other:					
Marine		51	1,871		1,871
Other		2	131		131
Total consumer other		53	2,002		2,002
Total consumer loans		273	14,976	2	14,974
Total ALLL continuing operations	44	1,087	48,195	441	47,754
Discontinued operations		115	5,984		5,984
Total ALLL including discontinued operations	$ 44	$ 1,202	$ 54,179	$ 441	$ 53,738

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

The liability for credit losses inherent in lending-related commitments, such as letters of credit and unfunded loan commitments, is included in accrued expense and other liabilities on the balance sheet. We establish the amount of this reserve by considering both historical trends and current market conditions quarterly, or more often if deemed necessary. Our liability for credit losses on lending-related commitments has decreased since the third quarter of 2010 by $43 million to $56 million at September 30, 2011. When combined with our allowance for loan and lease losses, our total allowance for credit losses represented 2.46% of loans at September 30, 2011, compared to 4.00% at September 30, 2010.

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

	Three months ended September 30,		**Nine months ended September 30,**	
in millions	**2011**	**2010**	**2011**	**2010**
Balance at beginning of period	**$ 57**	$ 109	**$ 73**	$ 121
Provision (credit) for losses on lending-related commitments	**(1)**	(10)	**(17)**	(22)

Balance at end of period	**$ 56**	$ 99	**$ 56**	$ 99

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5. Fair Value Measurements

Fair Value Determination

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

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

¿ the amount of time since the last relevant valuation;

¿ whether there is an actual trade or relevant external quote available at the measurement date; and

¿ volatility associated with the primary pricing components.

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

¿ an independent review and approval of valuation models;

¿ a detailed review of profit and loss conducted on a regular basis; and

¿ a validation of valuation model components against benchmark data and similar products, where possible.

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

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

Qualitative Disclosures of Valuation Techniques

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

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

¿ Securities are classified as Level 1 when quoted market prices are available in an active market for the identical securities. Level 1 instruments include exchange-traded equity securities.

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

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

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

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

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

September 30, 2011 *in millions*	**Fair Value**	**Unfunded Commitments**
INVESTMENT TYPE		
Passive funds [(a)]	$ 17	$ 3
Co-managed funds [(b)]	19	8
Total	$ 36	$ 11

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

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

Principal investments. Principal investments consist of investments in equity and debt instruments made by our principal investing entities. They include direct investments (investments made in a particular company), as well as indirect investments (investments made through funds that include other investors). During the first half of 2011, employees who managed our various principal investments formed two independent entities that will serve as investment managers of these investments going forward. Under this new arrangement, which was mutually agreeable to both parties, these individuals will no longer be employees of Key. As a result of these changes, during the second quarter of 2011, we deconsolidated certain of these direct and indirect investments, totaling $234 million.

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

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

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

September 30, 2011 *in millions*	**Fair Value**	**Unfunded Commitments**
INVESTMENT TYPE		
Private equity funds [(a)]	$ 487	$ 132
Hedge funds [(b)]	7	
Total	$ 494	$ 132

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

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

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

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

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

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September 30, 2011 *in millions*	**Level 1**	**Level 2**	**Level 3**	**Total**
ASSETS MEASURED ON A RECURRING BASIS				
Short-term investments:				
Securities purchased under resale agreements		$ 464		$ 464
Trading account assets:				
U.S. Treasury, agencies and corporations		439		