EXTREME NETWORKS INC
Form 8-K
April 27, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 8-K

CURRENT REPORT

PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

Date of report (date of earliest event reported): April 27, 2016

EXTREME NETWORKS, INC.

(Exact name of registrant as specified in its charter)

| Delaware | 000-25711 | 77-0430270 |
|---|---|---|
| (State or other jurisdiction of incorporation) | (Commission File No.) | (I.R.S. Employer Identification No.) |

145 Rio Robles

San Jose, California 95134

(Address of principal executive offices)

Registrant's telephone number, including area code:

(408) 579-2800

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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Item 2.02 Results of Operations and Financial Condition

On April 27, 2016, Extreme Networks, Inc. (the “Company”) issued a press release announcing certain financial results for the quarter ended March 31, 2016. A copy of the press release is attached hereto as Exhibit 99.1 and incorporated herein by reference in its entirety.

The information in Item 2.02 of this Current Report on Form 8-K, including Exhibit 99.1 to this Current Report on Form 8-K, shall not be deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section or Sections 11 and 12(a)(2) of the Securities Act of 1933, as amended. The information contained in this Item 2.02 and in the accompanying Exhibit 99.1 shall not be incorporated by reference into any registration statement or other document filed by Extreme Networks with the Securities and Exchange Commission, whether made before or after the date of this Current Report, regardless of any general incorporation language in such filing, except as shall be expressly set forth by specific reference to this Item 2.02 and Exhibit 99.1 in such filing.

Item 9.01 Financial Statements and Exhibits

(d) Exhibits.

99.1 Press Release dated April 27, 2016.

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SIGNATURES

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 hereunto duly authorized.

Date: April 27, 2016

EXTREME NETWORKS, INC.

By: /s/ Kenneth AROLA
Kenneth Arola
Executive Vice President, Chief Financial Officer (Principal Accounting Officer)

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**PERFORMANCE RATIOS FROM CONTINUING OPERATIONS**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Return on average total assets | **.82%** | **.80%** | .97% | .95% | 1.03% | **.81%** | 1.03% |
| Return on average common equity | **7.15** | **6.86** | 8.51 | 8.30 | 8.96 | **7.01** | 8.86 |
| Return on average tangible common equity [(d)] | **7.94** | **7.64** | 9.50 | 9.27 | 10.01 | **7.79** | 9.91 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Net interest margin (TE) | **2.76** | **2.89** | 2.87 | 2.87 | 2.88 | **2.83** | 2.89 |
| Cash efficiency ratio [d] | **69.0** | **66.6** | 66.4 | 66.9 | 65.1 | **67.8** | 65.1 |

**PERFORMANCE RATIOS FROM CONSOLIDATED OPERATIONS**

Return on average total assets

**.82%** **.79%** .93% .92% 1.02% **.80%** 1.02%

Return on average common equity

**7.26** **6.90** 8.36 8.19 9.07 **7.08** 9.01

Return on average tangible common equity [d]

**8.06** **7.68** 9.33 9.14 10.14 **7.87** 10.08

Net interest margin (TE)

**2.74** **2.83** 2.84 2.84 2.85 **2.80** 2.86

Loan-to-deposit [e]

**85.3** **85.7** 87.8 89.3 87.3 **85.3** 87.3

**CAPITAL RATIOS AT PERIOD END**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Key shareholders equity to assets | **11.18%** | **11.25%** | 11.30% | 11.22% | 11.19% | **11.18%** | 11.19% |
| Key common shareholders equity to assets | **10.90** | **10.95** | 10.99 | 10.91 | 10.89 | **10.90** | 10.89 |
| Tangible common equity to tangible assets (d) | **9.95** | **9.97** | 9.98 | 9.90 | 9.86 | **9.95** | 9.86 |
| Common Equity Tier 1 (d) | **11.10** | **11.07** | 10.94 | 10.47 | 10.71 | **11.10** | 10.71 |
| Tier 1 risk-based capital | **11.41** | **11.38** | 11.35 | 10.87 | 11.11 | **11.41** | 11.11 |
| Total risk-based capital | **13.63** | **13.12** | 12.97 | 12.47 | 12.66 | **13.63** | 12.66 |
| Leverage | **10.59** | **10.73** | 10.72 | 10.68 | 10.74 | **10.59** | 10.74 |

**TRUST AND BROKERAGE ASSETS**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Assets under management | **$34,535** | **$34,107** | $33,983 | $35,158 | $38,399 | **$34,535** | $38,399 |
| Nonmanaged and brokerage assets | **52,102** | **49,474** | 47,681 | 46,796 | 48,789 | **52,102** | 48,789 |

**OTHER DATA**

Average full-time-equivalent employees

**13,419** **13,403** 13,359 13,555 13,455 **13,411** 13,512

Branches

**949** **961** 966 972 989 **949** 989

(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. As a result of this decision, we have accounted for this business as a discontinued operation. For further discussion regarding the income (loss) from discontinued operations, see Note 11 ( Acquisitions and Discontinued Operations ).

(b) EPS may not foot due to rounding.

(c) Assumes conversion of common share options and other stock awards and/or convertible preferred stock, as applicable.

(d) See Figure 7 entitled GAAP to Non-GAAP Reconciliations, which presents the computations of certain financial measures related to tangible common equity, Common Equity Tier 1 and cash efficiency. The table reconciles the GAAP performance measures to the corresponding non-GAAP measures, which provides a basis for period-to-period comparisons.

(e) Represents period-end consolidated total loans and loans held for sale divided by period-end consolidated total deposits (excluding deposits in foreign office).

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**Forward-looking statements**

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

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

deterioration of commercial real estate market fundamentals;

defaults by our loan counterparties or clients;

adverse changes in credit quality trends;

declining asset prices;

our concentrated credit exposure in commercial, financial and agricultural loans;

the extensive and increasing regulation of the U.S. financial services industry;

changes in accounting policies, standards, and interpretations;

breaches of security or failures of our technology systems due to technological or other factors and cybersecurity threats;

operational or risk management failures by us or critical third parties;

negative outcomes from claims or litigation;

the occurrence of natural or man-made disasters, conflicts, or terrorist attacks, or other adverse external events;

increasing capital and liquidity standards under applicable regulatory rules;

unanticipated changes in our liquidity position, including but not limited to, changes in our access to or the cost of funding, our ability to enter the financial markets and to secure alternative funding sources;

our ability to receive dividends from our subsidiary, KeyBank;

downgrades in our credit ratings or those of KeyBank;

a reversal of the U.S. economic recovery due to financial, political, or other shocks;

our ability to anticipate interest rate changes and manage interest rate risk;

deterioration of economic conditions in the geographic regions where we operate;

the soundness of other financial institutions;

our ability to attract and retain talented executives and employees and to manage our reputational risks;

our ability to timely and effectively implement our strategic initiatives;

increased competitive pressure due to industry consolidation;

unanticipated adverse effects of strategic partnerships or acquisitions and dispositions of assets or businesses;

our ability to realize the anticipated benefits of the First Niagara merger; and

our ability to develop and effectively use the quantitative models we rely upon in our business planning.

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

**Economic overview**

The economy rebounded in the second quarter of 2016, with the Federal Reserve Bank of Atlanta estimating real GDP of 2.4%, up from just 1.1% in the first quarter. Second quarter GDP growth was supported by a rebound in consumption even as nonresidential and residential investment dragged on growth. Meanwhile, average job gains fell for the third straight quarter as a result of a disappointing May employment report. Housing market data improved further, with slow advances in residential construction and modest improvement year-over-year in sales of existing homes. Geopolitical tensions, slowing global growth and uncertainty around prospective Federal Reserve actions prevented the economy from accelerating further during the first half of the year.

In the second quarter of 2016, real spending advanced in April and May, rebounding from weak spending dating back to the end of last year, with improvements in both durable and nondurable goods expenditures. Retail sales have shown steady improvement with sales excluding automobiles rising 3.2% year-over-year in June, up from 2.1% in March 2016. Consumer confidence rose modestly from the first quarter, with the Conference Board measure ending the second quarter of 2016 at 98.0, up 1.9 points from March. Inflation remains well below the Federal Reserve target, with the personal consumption expenditure index up just .9% year-over-year as of May 2016.

In the labor market, average monthly job gains declined to 147,000 during the second quarter of 2016, compared to the solid first quarter 2016 average of 196,000, marking the third straight quarter of decline in the monthly average. The second quarter average was adversely impacted by a weak May report, with gains of only 11,000 for the month. Gains continue to be driven by the services sectors, while the goods-producing sectors have reported weakness since the end of last year. The unemployment rate rose to 4.9% in June of 2016, up 20 basis points from May, but down 10 basis points from the end of the first quarter, driven in part by a declining labor force and a lower participation rate.

The housing market improved modestly in the second quarter, with most metrics above year-ago levels. Existing home sales ended the quarter at 5.6 million units, compared to 5.4 million in March and slightly above year-ago levels. New Home Sales rebounded, ending the second quarter of 2016 10% higher than March and up 26% year-over-year increase. Housing starts have fallen modestly since the same period last year, totaling a seasonally adjusted annual rate of 1.19 million in June 2016, down 2% year-over-year and up 7% since the end of the first quarter. Housing permits rebounded from the start of the year, increasing 7% from March of 2016, but remain 14% below year-ago levels in June 2016. Home price appreciation is moderating, with May 2016 home prices up 5.9% year-over-year, down slightly from 6.7% from March 2016.

The Federal Reserve remained accommodative in the second quarter of 2016, continuing to reinvest principal payments to ease financial conditions. Forward guidance is somewhat unclear as to when the Federal Open Market Committee (FOMC) will again raise the federal funds target rate, as global economic conditions and inflation measures remain concerns. This, along with market uncertainty related to the United Kingdom leaving the European Union, has pushed interest rates lower. The yield on the 10-year U.S. Treasury dropped 29 basis points in the second quarter of 2016 to 1.49%.

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**Long-term financial goals**

Our long-term financial goals are as follows:

Improve balance sheet efficiency by targeting a loan-to-deposit ratio range of 90% to 100%;

Maintain a moderate risk profile by targeting a net loan charge-offs to average loans ratio and provision for credit losses to average loans ratio in the range of .40% to .60%;

Grow high quality, diverse revenue streams by targeting a net interest margin in the range of 3.00% to 3.25% and a ratio of noninterest income to total revenue of greater than 40%;

Generate positive operating leverage and target a cash efficiency ratio excluding merger-related expense of less than 60%; and

Maintain disciplined capital management and target a return on average assets excluding merger-related expense in the range of 1.00% to 1.25%.

Figure 2 shows the evaluation of our long-term financial goals for the six months ended June 30, 2016.

**Figure 2. Evaluation of Our Long-Term Financial Goals**

| KEY Business Model | Key Metrics [a] | 2Q16 | YTD 2016 | Targets |
|---|---|---|---|---|
| **Balance sheet efficiency** | Loan-to-deposit ratio [b] | 85% | 85% | 90 - 100% |
| **Moderate risk profile** | Net loan charge-offs to average loans | .28% | .30% | .40 - .60% |
| | Provision for credit losses to average loans | .34% | .47% | |
| **High quality, diverse revenue streams** | Net interest margin | 2.76% | 2.83% | 3.00 - 3.25% |
| | Noninterest income to total revenue | 44% | 43% | > 40% |
| **Positive operating leverage** | Cash efficiency ratio [c] | 69.0% | 67.8% | < 60% |
| | Cash efficiency ratio excluding merger-related expense [c] | 64.8% | 64.6% | |
| **Financial Returns** | Return on average assets | .82% | .81% | 1.00 - 1.25% |
| | Return on average assets excluding merger-related expense [c] | .94% | .90% | |

(a) Calculated from continuing operations, unless otherwise noted.
(b) Represents period-end consolidated total loans and loans held for sale divided by period-end consolidated total deposits (excluding deposits in foreign office).
(c) Non-GAAP measure: see Figure 7 for reconciliation.

**Strategic developments**

Our actions and results during the first six months of 2016 supported our corporate strategy described in the Introduction section under the Corporate strategy heading on page 38 of our 2015 Form 10-K.

We continue to focus on growing our businesses and remain committed to improving productivity and efficiency. During the first six months of 2016, we generated positive operating leverage excluding merger-related expense from the prior year, with revenue up 1.3% from 2015. Net interest income benefited from higher earning asset balances and an increase in earning asset yields, largely the result of our loan portfolio repricing to the higher short-term interest rates. Although noninterest income declined slightly from the prior year, we saw a benefit from increases in several of our core fee-based businesses where we continue to make investments: service charges on deposit accounts, corporate services income, and cards and payments income. Excluding merger-related expense of $69 million, noninterest expense increased $5 million from the prior year primarily due to slight increases across various nonpersonnel areas.

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Although asset quality measures were impacted during the first six months of 2016 by credit migration, primarily in our oil and gas portfolio, our net loan charge-offs were .30% of average loans, below our targeted range, and the provision for credit losses was .47% of average loans, within our targeted range.

Capital management remains a priority for 2016. As previously reported, our existing share repurchase program under the 2015 capital plan (which was effective through the second quarter of 2015) was suspended in the fourth quarter of 2015 in connection with the announcement of our acquisition of First Niagara. On June 29, 2016, the Federal Reserve announced that it did not object to our 2016 capital plan. Share repurchases of up to $350 million were included in the 2016 capital plan, which is effective through the second quarter of 2017. We anticipate repurchasing common shares in the third quarter of 2016 following the completion of the acquisition of First Niagara.

As previously reported, our 2015 capital plan proposed an increase in our quarterly common share dividend from $.075 to $.085 per share, which was approved by our Board in May 2016. An additional potential increase in our quarterly common share dividend, up to $.095 per share, will be considered by the Board for the second quarter of 2017, consistent with the 2016 capital plan.

On August 1, 2016, First Niagara merged with and into KeyCorp, with KeyCorp as the surviving entity after receiving regulatory approval on July 12, 2016. The total consideration for the transaction was approximately $4.0 billion. Systems and client conversion is expected during the fourth quarter of 2016, subject to pending regulatory approval. On April 28, 2016, KeyCorp and First Niagara entered into an agreement with Northwest Bank, a wholly-owned subsidiary of Northwest Bancshares, Inc., to sell 18 branches in the Buffalo, New York market. The branches are being divested in connection with the merger between First Niagara and KeyCorp and pursuant to an agreement with the United States Department of Justice and commitments to the Board of Governors of the Federal Reserve System following a customary antitrust review in connection with the proposed merger.

**Demographics**

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

Key Community Bank serves individuals and small to mid-sized businesses by offering a variety of deposit, investment, lending, credit card, and personalized wealth management products and business advisory services. These products and services are provided through our relationship managers and specialists working in our 12-state branch network, which is organized into eight internally defined geographic regions: Pacific, Rocky Mountains, Indiana, Western Ohio and Michigan, Eastern Ohio, Western New York, Eastern New York, and New England. In addition, some of these product capabilities are delivered by Key Corporate Bank to clients of Key Community Bank.

Figure 3 shows the geographic diversity of Key Community Bank s average deposits, commercial loans, and home equity loans.

**Figure 3. Key Community Bank Geographic Diversity**

**Geographic Region**

**Three months ended**

**June 30, 2016**

| *dollars in millions* | **Pacific** | **Rocky Mountains** | **Indiana** | **West Ohio/ Michigan** | **East Ohio** | **Western New York** | **Eastern New York** | **New England** | **NonRegion [(a)]** | **Total** |
|---|---|---|---|---|---|---|---|---|---|---|
| Average deposits | $ 12,754 | $ 5,416 | $ 2,400 | $ 4,717 | $ 10,083 | $ 5,185 | $ 8,107 | $ 3,041 | $ 2,091 | $ 53,794 |
| Percent of total | 23.7% | 10.1% | 4.5% | 8.8% | 18.7% | 9.6% | 15.1% | 5.6% | 3.9% | 100.0% |
| Average commercial loans | $ 3,421 | $ 1,927 | $ 893 | $ 1,236 | $ 2,369 | $ 684 | $ 1,916 | $ 824 | $ 3,178 | $ 16,448 |
| Percent of total | 20.8% | 11.7% | 5.4% | 7.5% | 14.4% | 4.2% | 11.7% | 5.0% | 19.3% | 100.0% |
| Average home equity loans | $ 3,131 | $ 1,495 | $ 482 | $ 803 | $ 1,227 | $ 823 | $ 1,235 | $ 642 | $ 70 | $ 9,908 |
| Percent of total | 31.6% | 15.1% | 4.8% | 8.1% | 12.4% | 8.3% | 12.5% | 6.5% | .7% | 100.0% |

(a) Represents average deposits, commercial loan products, and home equity loan products centrally managed outside of our eight Key Community Bank regions.

Key Corporate Bank is a full-service corporate and investment bank focused principally on serving the needs of middle market clients in seven industry sectors: consumer, energy, healthcare, industrial, public sector, real estate, and technology.

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Key Corporate Bank delivers a broad suite of banking and capital markets products to its clients, including syndicated finance, debt and equity capital markets, commercial payments, equipment finance, commercial mortgage banking, derivatives, foreign exchange, financial advisory, and public finance. Key Corporate Bank is also a significant servicer of commercial mortgage loans and a significant special servicer of CMBS. Key Corporate Bank delivers many of its product capabilities to clients of Key Community Bank.

Further information regarding the products and services offered by our Key Community Bank and Key Corporate Bank segments is included in this report in Note 18 ( Line of Business Results ).

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**Supervision and regulation**

Regulatory reform developments

On July 21, 2010, the Dodd-Frank Act became law. It was intended to address perceived deficiencies and gaps in the regulatory framework for financial services in the U.S., reduce the risks of bank failures, better equip the nation s regulators to guard against or mitigate any future financial crises, and manage systemic risk through increased supervision of bank and nonbank SIFIs, such as KeyCorp and KeyBank. Further discussion concerning the Dodd-Frank Act, related regulatory developments, and the risks that they present to Key is available under the heading Supervision and Regulation in Item 1. Business and under the heading II. Compliance Risk in Item 1A. Risk Factors of our 2015 Form 10-K. Many proposed rules referenced in our prior reports remain pending. The following discussion provides a summary of recent regulatory developments relating to the Dodd-Frank Act or regulatory developments that relate to our results this quarter.

Regulatory capital rules

In October 2013, federal banking regulators published the final Basel III capital framework for U.S. banking organizations (the Regulatory Capital Rules ). The Regulatory Capital Rules generally implement in the U.S. the Basel III capital framework published by the Basel Committee in December 2010 and revised in June 2011 and January 2014 (the Basel III capital framework ). The Basel III capital framework and the U.S. implementation of the Basel III capital framework are discussed in more detail in Item 1. Business of our 2015 Form 10-K under the heading Supervision and Regulation Basel III capital and liquidity frameworks.

While the Regulatory Capital Rules became effective on January 1, 2014, the mandatory compliance date for Key as a standardized approach banking organization was January 1, 2015, subject to transitional provisions extending to January 1, 2019.

*New minimum capital and leverage ratio requirements*

Under the Regulatory Capital Rules, standardized approach banking organizations, like KeyCorp, are required to meet the minimum capital and leverage ratios set forth in Figure 4 below. At June 30, 2016, Key had an estimated Common Equity Tier 1 Capital Ratio of 11.05% under the fully phased-in Regulatory Capital Rules. Also at June 30, 2016, based on the fully phased-in Regulatory Capital Rules, Key estimates that its capital and leverage ratios, after adjustment for market risk, would be as set forth in Figure 4.

**Figure 4. Estimated Ratios vs. Minimum Capital Ratios Calculated Under the Fully Phased-In Regulatory Capital Rules**

| Ratios (including Capital conservation buffer) | Key June 30, 2016 Estimated | Minimum January 1, 2016 | Phase-in Period | Minimum January 1, 2019 |
|---|---|---|---|---|
| Common Equity Tier 1 [(a)] | 11.05% | 4.5% | None | 4.5% |
| Capital conservation buffer [(b)] | | | 1/1/16-1/1/19 | 2.5 |
| Common Equity Tier 1 + Capital conservation buffer | | 4.5 | 1/1/16-1/1/19 | 7.0 |
| Tier 1 Capital | 11.11 | 6.0 | None | 6.0 |
| Tier 1 Capital + Capital conservation buffer | | 6.0 | 1/1/16-1/1/19 | 8.5 |

| | | | | |
|---|---|---|---|---|
| Total Capital | 13.34 | 8.0 | None | 8.0 |
| Total Capital + Capital conservation buffer | | 8.0 | 1/1/16-1/1/19 | 10.5 |
| Leverage [c] | 10.36 | 4.0 | None | 4.0 |

(a) See Figure 7 entitled GAAP to Non-GAAP Reconciliations, which presents the computation for estimated Common Equity Tier 1. The table reconciles the GAAP performance measure to the corresponding non-GAAP measure, which provides a basis for period-to-period comparisons.

(b) Capital conservation buffer must consist of Common Equity Tier 1 capital. As a standardized approach banking organization, KeyCorp is not subject to the countercyclical capital buffer of up to 2.5% imposed upon an advanced approaches banking organization under the Regulatory Capital Rules.

(c) As a standardized approach banking organization, KeyCorp is not subject to the 3% supplemental leverage ratio requirement, which becomes effective January 1, 2018.

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*Revised prompt corrective action capital category ratios*

Under the Regulatory Capital Rules, the prompt corrective action capital category threshold ratios applicable to FDIC-insured depository institutions such as KeyBank were revised effective January 1, 2015. Figure 5 identifies the capital category threshold ratios for a well capitalized and an adequately capitalized institution under the Regulatory Capital Rules.

**Figure 5. Well Capitalized and Adequately Capitalized Capital Category Ratios under Revised Prompt Corrective Action Rules**

| Prompt Corrective Action | Capital Category | |
|---|---|---|
| Ratio | Well Capitalized [a] | Adequately Capitalized |
| Common Equity Tier 1 Risk-Based | 6.5% | 4.5% |
| Tier 1 Risk-Based | 8.0 | 6.0 |
| Total Risk-Based | 10.0 | 8.0 |
| Tier 1 Leverage | 5.0 | 4.0 |

(a) A well capitalized institution also must not be subject to any written agreement, order, or directive to meet and maintain a specific capital level for any capital measure.

(b) As a standardized approach banking organization, KeyBank is not subject to the 3% supplemental leverage ratio requirement, which becomes effective January 1, 2018.

As of June 30, 2016, KeyBank meets all well capitalized capital adequacy requirements under the Regulatory Capital Rules.

Liquidity coverage ratio

In October 2014, the federal banking agencies published the final Basel III liquidity framework for U.S. banking organizations (the Liquidity Coverage Rules ) that create a minimum LCR for certain internationally active bank and nonbank financial companies (excluding KeyCorp) and a modified version of the LCR ( Modified LCR ) for BHCs and other depository institution holding companies with over $50 billion in consolidated assets that are not internationally active (including KeyCorp).

Because KeyCorp is a Modified LCR BHC under the Liquidity Coverage Rules, Key is required to maintain its ratio of high-quality liquid assets to its total net cash outflow amount, determined by prescribed assumptions in a standardized hypothetical stress scenario over a 30-calendar day period. Implementation for Modified LCR banking organizations, like Key, began on January 1, 2016, with a minimum requirement of 90% coverage, reaching 100% coverage by January 1, 2017. For the second quarter of 2016, our Modified LCR was above 100%. In the future, we may change the composition of our investment portfolio, increase the size of the overall investment portfolio, and/or modify product offerings to enhance or optimize our liquidity position.

KeyBank will not be subject to the LCR or the Modified LCR under the Liquidity Coverage Rules unless the OCC affirmatively determines that application to KeyBank is appropriate in light of KeyBank s asset size, level of complexity, risk profile, scope of operations, affiliation with foreign or domestic covered entities, or risk to the financial system.

Net stable funding ratio

As previously disclosed in the Supervision and Regulation section of Item 1. Business of our 2015 Form 10-K under the heading Basel III capital and liquidity frameworks, the Basel Committee finalized the Basel III net stable funding ratio ( NSFR ) in October 2014. The Basel Committee published final Basel III NSFR disclosure standards in June 2015. In April and May 2016, the federal banking regulators issued an NPR proposing to implement the final Basel III NSFR and the final Basel III NSFR disclosure standards. The proposal would create a minimum NSFR for certain internationally active banking organizations (excluding KeyCorp) and a modified version of the NSFR for BHCs and other depository institution holding companies with over $50 billion in consolidated assets that are not internationally active (including KeyCorp). The proposal would also require quarterly quantitative and qualitative public disclosures regarding the NSFR. The proposed NSFR requirement would apply beginning on January 1, 2018. The comment period for the NPR expires on August 5, 2016.

Common equity surcharge

In July 2015, the Federal Reserve adopted a final rule to implement the common equity surcharge on U.S. global systemically important banks ( G-SIBs ). The final rule was effective December 1, 2015, although the surcharge, which will be added to the capital conservation buffer under the Regulatory Capital Rules, will be phased in during the January 1, 2016, through January 1, 2019, period. Notably, this final rule applies to advanced approaches banking organizations, not standardized approach banking organizations like Key.

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Deposit insurance and assessments

In March 2015, the FDIC approved a final rule to impose a surcharge, as required by the Dodd-Frank Act, on the quarterly deposit insurance assessments of insured depository institutions having total consolidated assets of at least $10 billion (like KeyBank). The surcharge is 4.5 cents per $100 of the institution s assessment base (after making certain adjustments). The final rule became effective on July 1, 2016. If the DIF reserve ratio reaches 1.15% before that date, surcharges will begin July 1, 2016. If the reserve ratio has not reached 1.15% by that date, surcharges will begin the first quarter after the reserve ratio reaches 1.15%. The DIF reserve ratio was 1.13% at the end of the first quarter of 2016. It is expected that the FDIC will announce the DIF reserve ratio for the end of the second quarter of 2016 in late August or early September of 2016. Surcharges will continue through the quarter that the DIF reserve ratio reaches or exceeds 1.35%, but not later than December 31, 2018. If the reserve ratio does not reach 1.35% by December 31, 2018 (provided it is at least 1.15%), the FDIC will impose a shortfall assessment on March 31, 2019, on insured depository institutions with total consolidated assets of $10 billion or more (like KeyBank).

In February 2016, the FDIC issued an NPR proposing to impose recordkeeping requirements on insured depository institutions with two million or more deposit accounts (including KeyBank) in order to facilitate rapid payment of insured deposits to customers if the institutions were to fail. The proposal would require such insured depository institutions (i) to maintain complete and accurate data on each depositor s ownership interest by right and capacity for all of the institution s deposit accounts and (ii) to develop the capability to calculate the insured and uninsured amounts for each deposit owner within 24 hours of failure. The FDIC would conduct periodic testing of covered institutions compliance with these requirements and such institutions would be required to file a deposit insurance coverage summary report with the FDIC annually. Compliance would be required two years after the effective date of a final rule. After being extended, the comment period for the NPR expired on June 25, 2016.

Single counterparty credit limits

In March 2016, the Federal Reserve issued an NPR proposing to establish single counterparty credit limits for BHCs with total consolidated assets of $50 billion or more. This proposal would implement a provision in the Dodd-Frank Act and replaces proposals on this subject issued by the Federal Reserve in 2011 and 2012. Under the proposal, a covered BHC (including KeyCorp) would not be allowed to have an aggregate net credit exposure to any unaffiliated counterparty that exceeds 25% of the consolidated capital stock and surplus of the covered BHC. G-SIBs and certain other large BHCs (excluding KeyCorp) would be subject to stricter limits under the proposal. A covered BHC such as KeyCorp would be required to comply with the proposed limits and quarterly reporting to show such compliance starting two years after the effective date of a final rule. The comment period for the NPR expired on June 3, 2016.

ERISA fiduciary standard

On April 8, 2016, the Department of Labor published final rules and amendments to certain prohibited transaction exemptions regarding which service providers would be regarded as fiduciaries under ERISA for making investment advice recommendations to: 1) certain retirement plan fiduciaries, participants or beneficiaries and 2) owners or beneficiaries of individual retirement accounts and health savings accounts, among other retirement plans. In sum, the rules intend to place fiduciary obligations, rather than the lesser legal obligations that currently apply, on these service providers. The rules require any financial institution making recommendations for either the purchase or sale of investments in or rollover of the respective retirement plan be subject to certain fiduciary obligations under ERISA such as an impartial conduct standard and not selling certain investment products whose compensation may raise a conflict of interest for the advisor without entering into a contract providing certain disclosures and legal remedies to the customer. The requirement of impartial conduct is effective April 10, 2017, and the contract provisions must be in place by January 1, 2018. At present, we expect that this rule will affect our brokerage, trust and consumer deposit

taking lines of business but are not able to determine how significant the new rules financial impact will be on our financial position.

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## Highlights of Our Performance

### Financial performance

For the second quarter of 2016, we announced net income from continuing operations attributable to Key common shareholders of $193 million, or $.23 per common share. Our second quarter of 2016 results compare to net income from continuing operations attributable to Key common shareholders of $230 million, or $.27 per common share, for the second quarter of 2015.

Our taxable-equivalent net interest income was $605 million for the second quarter of 2016, and the net interest margin was 2.76%. These results compare to taxable-equivalent net interest income of $591 million and a net interest margin of 2.88% for the second quarter of 2015. The $14 million increase in net interest income reflects higher earning asset balances and an increase in earning asset yields, largely the result of our loan portfolio re-pricing to higher short-term interest rates. The benefit to net interest income from these items was partly offset by lower reinvestment yields in our securities and derivatives portfolios. The 12 basis point decline in the net interest margin reflects higher levels of liquidity, lower reinvestment yields in the securities and derivatives portfolios, and lower loan fees. Our Federal Reserve account averaged $5.6 billion during the second quarter of 2016, which increased $2.3 billion compared to the second quarter of 2015 and reduced the net interest margin by 7 basis points. For the full year of 2016, we expect low to mid-single-digit growth in net interest income compared to the prior year without the benefit of higher rates or mid-single digit growth with the benefit of higher interest rates.

Our noninterest income was $473 million for the second quarter of 2016, compared to $488 million for the year-ago quarter. The decrease from the prior year was largely attributable to lower investment banking and debt placement fees of $43 million, reflecting challenging market conditions, as well as $6 million of lower operating lease income and other leasing gains. These declines were offset by an increase of $17 million in other income primarily related to gains from certain real estate investments, along with continued growth in some of our core fee-based businesses, including corporate services and cards and payments. For the full year of 2016, we expect stable to up low single-digit growth in our noninterest income compared to the prior year.

Our noninterest expense was $751 million for the second quarter of 2016. Noninterest expense included $45 million of merger-related expense, primarily made up of $35 million in personnel expense related to technology development for systems conversions and fully-dedicated personnel for merger and integration efforts. The remaining $10 million of merger-related expense was nonpersonnel expense, largely recognized in business services and professional fees and marketing. There was no merger-related expense incurred in the second quarter of 2015. Excluding merger-related expense, noninterest expense was $5 million lower than the second quarter of last year. The decrease is primarily attributable to $16 million in lower personnel expense related to lower performance-based compensation, along with lower net occupancy expenses and business services and professional fees. These decreases were partially offset by an increase in other expense, reflecting the impact of certain real estate investments and other miscellaneous items, along with increased non-merger related marketing expense. For the full year of 2016, we expect noninterest expense excluding merger-related expense to be relatively stable with 2015.

Average loans were $61.1 billion for the second quarter of 2016, an increase of $3.2 billion compared to the second quarter of 2015. The loan growth primarily occurred in the commercial, financial and agricultural portfolio, which increased $3.6 billion and was spread across our commercial lines of business. Consumer loans declined by $504 million mostly due to paydowns on our home equity loan portfolio and continued run-off in our consumer exit portfolios. For the full year of 2016, we anticipate average loan growth in the mid-single digit range.

Average deposits, excluding deposits in foreign office, totaled $73.9 billion for the second quarter of 2016, an increase of $3.6 billion compared to the year-ago quarter. Interest-bearing deposits increased $4.9 billion driven by a $3.6 billion increase in NOW and money market deposit accounts and a $1.3 billion increase in certificates of deposit and other time deposits. The increase in average deposits from the year-ago quarter reflects core deposit growth in our retail banking franchise, growth in escrow deposits from the commercial mortgage servicing business, and commercial deposit inflows. These increases were partially offset by a $1.2 billion decline in noninterest-bearing deposits.

Our provision for credit losses was $52 million for the second quarter of 2016, compared to $41 million for the year-ago quarter. Our ALLL was $854 million, or 1.38% of total period-end loans at June 30, 2016, compared to 1.37% at June 30, 2015. For the remainder of 2016, we expect our ALLL as a percentage of period-end loans to remain relatively stable with the second quarter of 2016.

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Net loan charge-offs for the second quarter of 2016 totaled $43 million, or .28% of average total loans, compared to .25% for the same period last year. We expect net loan charge-offs to average total loans to continue to be below our targeted range of .40% to .60% for the remainder of 2016.

At June 30, 2016, our nonperforming loans totaled $619 million and represented 1.00% of period-end portfolio loans, compared to $419 million, or .72% of period-end portfolio loans, at June 30, 2015. Nonperforming assets at June 30, 2016, totaled $637 million and represented 1.03% of period-end portfolio loans and OREO and other nonperforming assets, compared to $440 million, or .75% of period-end portfolio loans, at June 30, 2015. The increase in our nonperforming assets was primarily due to credit migration in the oil and gas portfolio.

Our capital ratios remain strong. Our tangible common equity and Tier 1 risk-based capital ratios at June 30, 2016, are 9.95% and 11.41%, respectively, compared to 9.86% and 11.11%, respectively, at June 30, 2015. In addition, our Common Equity Tier 1 ratio is 11.10% at June 30, 2016, compared to 10.71% at June 30, 2015. We continue to return capital to our shareholders through our quarterly common share dividend. In the second quarter of 2016, we paid a cash dividend of $.085 per common share, an increase from $.075 per common share, under our 2015 capital plan authorization.

Figure 6 shows our continuing and discontinued operating results for the current, past, and year-ago quarters. Our financial performance for each of the past five quarters is summarized in Figure 1.

**Figure 6. Results of Operations**

| | Three months ended | | | Six months ended | |
|---|---|---|---|---|---|
| *in millions, except per share amounts* | **6-30-16** | **3-31-16** | **6-30-15** | **6-30-16** | **6-30-15** |
| **Summary of operations** | | | | | |
| Income (loss) from continuing operations attributable to Key | **$ 199** | $ 187 | $ 235 | **$ 386** | $ 463 |
| Income (loss) from discontinued operations, net of taxes [(a)] | **3** | 1 | 3 | **4** | 8 |
| Net income (loss) attributable to Key | **$ 202** | $ 188 | $ 238 | **$ 390** | $ 471 |
| Income (loss) from continuing operations attributable to Key | **$ 199** | $ 187 | $ 235 | **$ 386** | $ 463 |
| Less: Dividends on Series A Preferred Stock | **6** | 5 | 5 | **11** | 11 |
| Income (loss) from continuing operations attributable to Key common shareholders | **193** | 182 | 230 | **375** | 452 |
| Income (loss) from discontinued operations, net of taxes [(a)] | **3** | 1 | 3 | **4** | 8 |
| Net income (loss) attributable to Key common shareholders | **$ 196** | $ 183 | $ 233 | **$ 379** | $ 460 |
| **Per common share assuming dilution** | | | | | |
| Income (loss) from continuing operations attributable to Key common shareholders | **$ .23** | $ .22 | $ .27 | **$ .44** | $ .52 |
| Income (loss) from discontinued operations, net of taxes [(a)] | | | | | .01 |
| Net income (loss) attributable to Key common shareholders [(b)] | **$ .23** | $ .22 | $ .27 | **$ .45** | $ .53 |

(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. As a result of this decision, we have accounted for this business as a discontinued operation. For further discussion regarding the income (loss) from discontinued operations, see Note 11 ( Acquisitions and Discontinued Operations ).

(b) EPS may not foot due to rounding.

Figure 7 presents certain non-GAAP financial measures related to tangible common equity, return on tangible common equity, Common Equity Tier 1, pre-provision net revenue, certain financial measures excluding merger-related expense, and cash efficiency ratio.

The tangible common equity ratio and the return on tangible common equity ratio have been a focus for some investors, and management believes these ratios may assist investors in analyzing Key s capital position without regard to the effects of intangible assets and preferred stock. Traditionally, the banking regulators have assessed bank and BHC capital adequacy based on both the amount and the composition of capital, the calculation of which is prescribed in federal banking regulations. The Federal Reserve focuses its assessment of capital adequacy on a component of Tier 1 capital known as Common Equity Tier 1. Because the Federal Reserve has long indicated that voting common shareholders equity (essentially Tier 1 risk-based capital less preferred stock and noncontrolling interests in subsidiaries) generally should be the dominant element in Tier 1 risk-based capital, this focus on Common Equity Tier 1 is consistent with existing capital adequacy categories. The Regulatory Capital Rules, described in more detail under the section Supervision and regulation in Item 2 of this report, also make Common Equity Tier 1 a priority. The Regulatory Capital Rules change the regulatory capital standards that apply to BHCs by, among other changes, phasing out the treatment of trust preferred securities and cumulative preferred securities as Tier 1 eligible capital. Starting in 2016, our trust preferred securities are only included in Tier 2 capital. Since analysts and banking regulators may assess our capital adequacy using tangible common equity and Common Equity Tier 1, we believe it is useful to enable investors to assess our capital adequacy on these same bases. Figure 7 also reconciles the GAAP performance measures to the corresponding non-GAAP measures.

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Figure 7 also shows the computation for and reconciliation of pre-provision net revenue, which is not formally defined by GAAP. We believe that eliminating the effects of the provision for credit losses makes it easier to analyze our results by presenting them on a more comparable basis.

As disclosed in Note 11 ( Acquisitions and Discontinued Operations ), KeyCorp completed its purchase of First Niagara on August 1, 2016. The definitive agreement and plan of merger to acquire First Niagara was originally announced on October 30, 2015. As a result of this transaction, we ve recognized merger-related expense. Figure 7 shows the computation of noninterest expense excluding merger-related expense and return on average assets from continuing operations excluding merger-related expense. We believe that eliminating the effects of the merger-related expense makes it easier to analyze our results by presenting them on a more comparable basis.

The cash efficiency ratio is a ratio of two non-GAAP performance measures. Accordingly, there is no directly comparable GAAP performance measure. The cash efficiency ratio excludes the impact of our intangible asset amortization from the calculation. We also disclosed the cash efficiency ratio excluding merger-related expense. We believe these ratios provide greater consistency and comparability between our results and those of our peer banks. Additionally, these ratios are used by analysts and investors as they develop earnings forecasts and peer bank analysis.

Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied, and are not audited. Although these non-GAAP financial measures are frequently used by investors to evaluate a company, they have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

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**Figure 7. GAAP to Non-GAAP Reconciliations**

| | Three months ended | | | | |
|---|---|---|---|---|---|
| *dollars in millions* | **6-30-16** | **3-31-16** | **12-31-15** | **9-30-15** | **6-30-15** |
| **Tangible common equity to tangible assets at period end** | | | | | |
| Key shareholders equity (GAAP) | **$ 11,313** | $ 11,066 | $ 10,746 | $ 10,705 | $ 10,590 |
| Less: Intangible assets [a] | **1,074** | 1,077 | 1,080 | 1,084 | 1,085 |
| Series A Preferred Stock [b] | **281** | 281 | 281 | 281 | 281 |
| Tangible common equity (non-GAAP) | **$ 9,958** | $ 9,708 | $ 9,385 | $ 9,340 | $ 9,224 |
| Total assets (GAAP) | **$ 101,150** | $ 98,402 | $ 95,131 | $ 95,420 | $ 94,604 |
| Less: Intangible assets [a] | **1,074** | 1,077 | 1,080 | 1,084 | 1,085 |
| Tangible assets (non-GAAP) | **$ 100,076** | $ 97,325 | $ 94,051 | $ 94,336 | $ 93,519 |
| Tangible common equity to tangible assets ratio (non-GAAP) | **9.95%** | 9.97% | 9.98% | 9.90% | 9.86% |
| **Common Equity Tier 1 at period end** | | | | | |
| Key shareholders equity (GAAP) | **$ 11,313** | $ 11,066 | $ 10,746 | $ 10,705 | 10,590 |
| Less: Series A Preferred Stock [b] | **281** | 281 | 281 | 281 | 281 |
| Common Equity Tier 1 capital before adjustments and deductions | **11,032** | 10,785 | 10,465 | 10,424 | 10,309 |
| Less: Goodwill, net of deferred taxes | **1,031** | 1,033 | 1,034 | 1,036 | 1,034 |
| Intangible assets, net of deferred taxes | **30** | 35 | 26 | 29 | 33 |
| Deferred tax assets | **1** | 1 | 1 | 1 | 1 |
| Net unrealized gains (losses) on available-for-sale securities, net of deferred taxes | **129** | 70 | (58) | 54 | |
| Accumulated gains (losses) on cash flow hedges, net of deferred taxes | **77** | 46 | (20) | 21 | (20) |
| Amounts in AOCI attributed to pension and postretirement benefit costs, net of deferred taxes | **(362)** | (365) | (365) | (385) | (361) |
| Total Common Equity Tier 1 capital | **$ 10,126** | $ 9,965 | $ 9,847 | $ 9,668 | 9,622 |
| Net risk-weighted assets (regulatory) | **$ 91,195** | $ 90,014 | $ 89,980 | $ 92,307 | 89,851 |
| Common Equity Tier 1 ratio (non-GAAP) | **11.10%** | 11.07% | 10.94% | 10.47% | 10.71% |
| **Average tangible common equity** | | | | | |
| Average Key shareholders equity (GAAP) | **$ 11,147** | $ 10,953 | $ 10,731 | $ 10,614 | $ 10,590 |
| Less: Intangible assets (average) [c] | **1,076** | 1,079 | 1,082 | 1,083 | 1,086 |
| Series A Preferred Stock (average) | **290** | 290 | 290 | 290 | 290 |

| | | | | | |
|---|---|---|---|---|---|
| Average tangible common equity (non-GAAP) | **$ 9,781** | $ 9,584 | $ 9,359 | $ 9,241 | $ 9,214 |
| **Return on average tangible common equity from continuing operations** | | | | | |
| Net income (loss) from continuing operations attributable to Key common shareholders (GAAP) | **$ 193** | $ 182 | $ 224 | $ 216 | $ 230 |
| Average tangible common equity (non-GAAP) | **9,781** | 9,584 | 9,359 | 9,241 | 9,214 |
| Return on average tangible common equity from continuing operations (non-GAAP) | **7.94%** | 7.64% | 9.50% | 9.27% | 10.01% |
| **Return on average tangible common equity consolidated** | | | | | |
| Net income (loss) attributable to Key common shareholders (GAAP) | **$ 196** | $ 183 | $ 220 | $ 213 | $ 233 |
| Average tangible common equity (non-GAAP) | **9,781** | 9,584 | 9,359 | 9,241 | 9,214 |
| Return on average tangible common equity consolidated (non-GAAP) | **8.06%** | 7.68% | 9.33% | 9.14% | 10.14% |
| **Pre-provision net revenue** | | | | | |
| Net interest income (GAAP) | **$ 597** | $ 604 | $ 602 | $ 591 | $ 584 |
| Plus: Taxable-equivalent adjustment | **8** | 8 | 8 | 7 | 7 |
| Noninterest income | **473** | 431 | 485 | 470 | 488 |
| Less: Noninterest expense | **751** | 703 | 736 | 724 | 711 |
| Pre-provision net revenue from continuing operations (non-GAAP) | **$ 327** | $ 340 | $ 359 | $ 344 | $ 368 |
| **Noninterest expense excluding merger-related expense** | | | | | |
| Noninterest expense (GAAP) | **$ 751** | $ 703 | $ 736 | $ 724 | $ 711 |
| Less: Merger-related expense | **45** | 24 | 6 | | |
| Noninterest expense excluding merger-related expense (non-GAAP) | **$ 706** | $ 679 | $ 730 | $ 724 | $ 711 |
| **Cash efficiency ratio** | | | | | |
| Noninterest expense (GAAP) | **$ 751** | $ 703 | $ 736 | $ 724 | $ 711 |
| Less: Intangible asset amortization | **7** | 8 | 9 | 9 | 9 |
| Adjusted noninterest expense (non-GAAP) | **$ 744** | $ 695 | $ 727 | $ 715 | $ 702 |
| Less: Merger-related expense | **45** | 24 | 6 | | |
| Adjusted noninterest expense excluding merger-related expense (non-GAAP) | **$ 699** | $ 671 | $ 721 | $ 715 | $ 702 |
| Net interest income (GAAP) | **$ 597** | $ 604 | $ 602 | $ 591 | $ 584 |
| Plus: Taxable-equivalent adjustment | **8** | 8 | 8 | 7 | 7 |
| Noninterest income (GAAP) | **473** | 431 | 485 | 470 | 488 |
| Total taxable-equivalent revenue (non-GAAP) | **$ 1,078** | $ 1,043 | $ 1,095 | $ 1,068 | $ 1,079 |
| Cash efficiency ratio (non-GAAP) | **69.0%** | 66.6% | 66.4% | 66.9% | 65.1% |

| | | | | | |
|---|---|---|---|---|---|
| Cash efficiency ratio excluding merger-related expense (non-GAAP) | **64.8%** | 64.3% | 65.8% | 66.9% | 65.1% |
| **Return on average total assets from continuing operations excluding merger-related expense** | | | | | |
| Income from continuing operations attributable to Key (GAAP) | **$ 199** | $ 187 | $ 230 | $ 222 | $ 235 |
| Add: Merger-related expense, after tax | **28** | 15 | 4 | | |
| Income from continuing operations attributable to Key excluding merger-related expense, after tax (non-GAAP) | **$ 227** | $ 202 | $ 234 | $ 222 | $ 235 |
| Average total assets from continuing operations (GAAP) | **$ 97,413** | $ 94,477 | $ 94,117 | $ 92,649 | $ 91,658 |
| Return on average total assets from continuing operations excluding merger-related expense (non-GAAP) | **.94%** | .86% | .99% | .95% | 1.03% |

(a) For the three months ended June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, and June 30, 2015, intangible assets exclude $36 million, $40 million, $45 million, $50 million, and $55 million, respectively, of period-end purchased credit card receivables.

(b) Net of capital surplus.

(c) For the three months ended June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, and June 30, 2015, average intangible assets exclude $38 million, $42 million, $47 million, $52 million, and $58 million, respectively, of average purchased credit card receivables.

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**Figure 7. GAAP to Non-GAAP Reconciliations, continued**

| *dollars in millions* | | Three months ended 6-30-16 |
|---|---|---|
| **Common Equity Tier 1 under the Regulatory Capital Rules (estimates)** | | |
| Common Equity Tier 1 under current Regulatory Capital Rules | **$** | **10,126** |
| Adjustments from current Regulatory Capital Rules to the fully phased-in Regulatory Capital Rules: | | |
| Deferred tax assets and other intangible assets [(d)] | | **(21)** |
| Common Equity Tier 1 anticipated under the fully phased-in Regulatory Capital Rules [(e)] | **$** | **10,105** |
| Net risk-weighted assets under current Regulatory Capital Rules | **$** | **91,195** |
| Adjustments from current Regulatory Capital Rules to the fully phased-in Regulatory Capital Rules: | | |
| Mortgage servicing assets [(f)] | | **485** |
| Volcker Funds | | **(224)** |
| All other assets | | **17** |
| Total risk-weighted assets anticipated under the fully phased-in Regulatory Capital Rules [(e)] | **$** | **91,473** |
| Common Equity Tier 1 ratio under the fully phased-in Regulatory Capital Rules [(e)] | | **11.05%** |

| *dollars in millions* | Six months ended 6-30-16 | 6-30-15 |
|---|---|---|
| **Pre-provision net revenue** | | |
| Net interest income (GAAP) | **$ 1,201** | $ 1,155 |
| Plus: Taxable-equivalent adjustment | **16** | 13 |
| Noninterest income (GAAP) | **904** | 925 |
| Less: Noninterest expense (GAAP) | **1,454** | 1,380 |
| Pre-provision net revenue from continuing operations (non-GAAP) | **$ 667** | $ 713 |
| **Average tangible common equity** | | |
| Average Key shareholders equity (GAAP) | **$ 11,050** | $ 10,580 |
| Less: Intangible assets (average) [(c)] | **1,077** | 1,088 |
| Preferred Stock, Series A (average) | **290** | 290 |
| Average tangible common equity (non-GAAP) | **$ 9,683** | $ 9,202 |
| **Return on average tangible common equity from continuing operations** | | |
| Net income (loss) from continuing operations attributable to Key common shareholders (GAAP) | **$ 375** | $ 452 |
| Average tangible common equity (non-GAAP) | **9,683** | 9,202 |
| Return on average tangible common equity from continuing operations (non-GAAP) | **7.79%** | 9.91% |

| | | |
|---|---|---|
| **Return on average tangible common equity consolidated** | | |
| Net income (loss) attributable to Key common shareholders (GAAP) | **$ 379** | $ 460 |
| Average tangible common equity (non-GAAP) | **9,683** | 9,202 |
| Return on average tangible common equity consolidated (non-GAAP) | **7.87%** | 10.08% |
| **Cash efficiency ratio** | | |
| Noninterest expense (GAAP) | **$ 1,454** | $ 1,380 |
| Less: Intangible asset amortization (GAAP) | **15** | 18 |
| Adjusted noninterest expense (non-GAAP) | **1,439** | 1,362 |
| Less: Merger-related expense | **69** | |
| | **$ 1,370** | $ 1,362 |
| Net interest income (GAAP) | **$ 1,201** | $ 1,155 |
| Plus: Taxable-equivalent adjustment | **16** | 13 |
| Noninterest income (GAAP) | **904** | 925 |
| Total taxable-equivalent revenue (non-GAAP) | **$ 2,121** | $ 2,093 |
| Cash efficiency ratio (non-GAAP) | **67.8%** | 65.1% |
| Cash efficiency ratio excluding merger-related expense (non-GAAP) | **64.6%** | 65.1% |
| **Return on average total assets from continuing operations excluding merger-related expense** | | |
| Income from continuing operations attributable to Key (GAAP) | **$ 386** | $ 463 |
| Add: Merger-related expense, after tax | **43** | |
| Income from continuing operations attributable to Key excluding merger-related expense, after tax (non-GAAP) | **$ 429** | $ 463 |
| Average total assets from continuing operations (GAAP) | **$ 95,945** | $ 90,648 |
| Return on average total assets from continuing operations excluding merger-related expense (non-GAAP) | **.90%** | 1.03% |

(d) Includes the deferred tax assets subject to future taxable income for realization, primarily tax credit carryforwards, as well as intangible assets (other than goodwill and mortgage servicing assets) subject to the transition provisions of the final rule.

(e) The anticipated amount of regulatory capital and risk-weighted assets is based upon the federal banking agencies Regulatory Capital Rules (as fully phased-in on January 1, 2019); we are subject to the Regulatory Capital Rules under the standardized approach.

(f) Item is included in the 10%/15% exceptions bucket calculation and is risk-weighted at 250%.

## Results of Operations

### Net interest income

One of our 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 8 shows the various components of our 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 to net interest income reported in accordance with GAAP for each of those quarters. The net interest margin, which is an indicator of the profitability of the earning assets portfolio less cost of funding, is calculated by dividing annualized taxable-equivalent net interest income by average earning assets.

Taxable-equivalent net interest income was $605 million for the second quarter of 2016, and the net interest margin was 2.76%. These results compare to taxable-equivalent net interest income of $591 million and a net interest margin of 2.88% for the second quarter of 2015. The $14 million increase in net interest income compared to the year-ago quarter reflects higher earning asset balances and an increase in earning asset yields, largely the result of our loan portfolio re-pricing to higher short-term interest rates. The benefit to net interest income from these items was partly offset by lower reinvestment yields in our securities and derivatives portfolios. The 12 basis point decline in the net interest margin reflects higher levels of liquidity, lower reinvestment yields in the securities and derivatives portfolios, and lower loan fees. Our Federal Reserve account averaged $5.6 billion during the second quarter of 2016, which increased $2.3 billion compared to the second quarter of 2015 and reduced the net interest margin by 7 basis points.

For the six months ended June 30, 2016, taxable-equivalent net interest income increased by $49 million, and the net interest margin decreased by 6 basis points. The increase in net interest income reflects higher earning asset balances and an increase in earning asset yields. Higher levels of liquidity and lower reinvestment yields in the securities and derivatives portfolios drove the decline in the net interest margin and more than offset the benefit from higher earning

asset yields.

Average loans were $61.1 billion for the second quarter of 2016, an increase of $3.2 billion compared to the second quarter of 2015. The loan growth occurred primarily in the commercial, financial and agricultural portfolio, which increased $3.6 billion and was spread across our commercial lines of business. Consumer loans declined $504 million mostly due to paydowns in our home equity loan portfolio and continued run-off in our consumer exit portfolios.

Average deposits, excluding deposits in foreign office, totaled $73.9 billion for the second quarter of 2016, an increase of $3.6 billion compared to the year-ago quarter. Interest-bearing deposits increased $4.9 billion driven by a $3.6 billion increase in NOW and money market deposit accounts and a $1.3 billion increase in certificates of deposit and other time deposits. The increase in average deposits from the year-ago quarter reflects core deposit growth in our retail banking franchise, growth in escrow deposits from the commercial mortgage servicing business, and commercial deposit inflows. These increases were partially offset by a $1.2 billion decline in noninterest-bearing deposits.

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**Figure 8. Consolidated Average Balance Sheets, Net Interest Income and Yields/Rates From Continuing Operations**

| | Second Quarter 2016 | | | First Quarter 2016 | | |
|---|---|---|---|---|---|---|
| *dollars in millions* | Average Balance | Interest [a] | Yield/ Rate [a] | Average Balance | Interest [a] | Yield/ Rate [a] |
| **ASSETS** | | | | | | |
| Loans [b], [c] | | | | | | |
| Commercial, financial and agricultural [d] | $ 32,630 | $ 270 | 3.32% | $ 31,590 | $ 263 | 3.35% |
| Real estate commercial mortgage | 8,404 | 80 | 3.85 | 8,138 | 77 | 3.78 |
| Real estate construction | 869 | 8 | 3.78 | 1,016 | 10 | 4.11 |
| Commercial lease financing | 3,949 | 37 | 3.77 | 3,957 | 36 | 3.65 |
| Total commercial loans | 45,852 | 395 | 3.47 | 44,701 | 386 | 3.47 |
| Real estate residential mortgage | 2,253 | 22 | 4.11 | 2,236 | 24 | 4.18 |
| Home equity loans | 10,098 | 102 | 4.04 | 10,240 | 103 | 4.06 |
| Consumer direct loans | 1,599 | 26 | 6.53 | 1,593 | 26 | 6.53 |
| Credit cards | 792 | 21 | 10.58 | 784 | 21 | 10.72 |
| Consumer indirect loans | 554 | 9 | 6.56 | 602 | 10 | 6.44 |
| Total consumer loans | 15,296 | 180 | 4.74 | 15,455 | 184 | 4.76 |
| Total loans | 61,148 | 575 | 3.78 | 60,156 | 570 | 3.80 |
| Loans held for sale | 611 | 5 | 3.18 | 826 | 8 | 4.02 |
| Securities available for sale [b], [e] | 14,268 | 74 | 2.08 | 14,207 | 75 | 2.12 |
| Held-to-maturity securities [b] | 4,883 | 24 | 1.98 | 4,817 | 24 | 2.01 |
| Trading account assets | 967 | 6 | 2.28 | 817 | 7 | 3.50 |
| Short-term investments | 5,559 | 6 | .45 | 3,432 | 4 | .46 |
| Other investments [e] | 610 | 2 | 1.54 | 647 | 3 | 1.73 |
| Total earning assets | 88,046 | 692 | 3.16 | 84,902 | 691 | 3.27 |
| Allowance for loan and lease losses | (833) | | | (803) | | |
| Accrued income and other assets | 10,200 | | | 10,378 | | |
| Discontinued assets | 1,738 | | | 1,804 | | |
| **Total assets** | $ 99,151 | | | $ 96,281 | | |
| **LIABILITIES** | | | | | | |
| NOW and money market deposit accounts | $ 39,687 | 16 | .17 | $ 37,708 | 15 | .16 |
| Savings deposits | 2,375 | | .02 | 2,349 | | .02 |
| Certificates of deposit ($100,000 or more) [f] | 3,233 | 11 | 1.39 | 2,761 | 10 | 1.37 |
| Other time deposits | 3,252 | 7 | .85 | 3,200 | 6 | .79 |
| Total interest-bearing deposits | 48,547 | 34 | .29 | 46,018 | 31 | .27 |
| Federal funds purchased and securities sold under repurchase agreements | 337 | | .01 | 437 | | .07 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Bank notes and other short-term borrowings | **694** | **3** | **1.39** | **591** | **2** | **1.63** |
| Long-term debt [(f), (g)] | **9,294** | **50** | **2.25** | **8,566** | **46** | **2.19** |
| Total interest-bearing liabilities | **58,872** | **87** | **.60** | **55,612** | **79** | **.57** |
| Noninterest-bearing deposits | **25,357** | | | **25,580** | | |
| Accrued expense and other liabilities | **2,032** | | | **2,322** | | |
| Discontinued liabilities [(g)] | **1,738** | | | **1,804** | | |
| **Total liabilities** | **87,999** | | | **85,318** | | |
| **EQUITY** | | | | | | |
| Key shareholders equity | **11,147** | | | **10,953** | | |
| Noncontrolling interests | **5** | | | **10** | | |
| Total equity | **11,152** | | | **10,963** | | |
| **Total liabilities and equity** | **$ 99,151** | | | **$ 96,281** | | |
| Interest rate spread (TE) | | | **2.56%** | | | **2.70%** |
| Net interest income (TE) and net interest margin (TE) | | **605** | **2.76%** | | **612** | **2.89%** |
| TE adjustment [(b)] | | **8** | | | **8** | |
| Net interest income, GAAP basis | | **$ 597** | | | **$ 604** | |

(a) Results are from continuing operations. Interest excludes the interest associated with the liabilities referred to in (g) below, calculated using a matched funds transfer pricing methodology.

(b) 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%.

(c) For purposes of these computations, nonaccrual loans are included in average loan balances.

(d) Commercial, financial and agricultural average balances include $87 million, $85 million, $87 million, $88 million, and $88 million of assets from commercial credit cards for the three months ended June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, and June 30, 2015, respectively.

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**Figure 8. Consolidated Average Balance Sheets, Net Interest Income and Yields/Rates From Continuing Operations**

| Fourth Quarter 2015 | | | Third Quarter 2015 | | | Second Quarter 2015 | | |
|---|---|---|---|---|---|---|---|---|
| Average Balance | Interest [(a)] | Yield/ Rate [(a)] | Average Balance | Interest [(a)] | Yield/ Rate [(a)] | Average Balance | Interest [(a)] | Yield/ Rate [(a)] |
| $ 30,884 | $ 253 | 3.25% | $ 30,374 | $ 244 | 3.19% | $ 29,017 | $ 233 | 3.23% |
| 8,019 | 75 | 3.70 | 7,988 | 73 | 3.65 | 7,981 | 74 | 3.70 |
| 1,067 | 10 | 3.65 | 1,164 | 11 | 3.78 | 1,199 | 11 | 3.60 |
| 3,910 | 36 | 3.68 | 3,946 | 35 | 3.57 | 3,981 | 36 | 3.58 |
| 43,880 | 374 | 3.38 | 43,472 | 363 | 3.32 | 42,178 | 354 | 3.36 |
| 2,252 | 24 | 4.18 | 2,258 | 24 | 4.19 | 2,237 | 23 | 4.22 |
| 10,418 | 105 | 3.97 | 10,510 | 105 | 3.96 | 10,510 | 104 | 3.98 |
| 1,605 | 26 | 6.50 | 1,597 | 26 | 6.53 | 1,571 | 26 | 6.52 |
| 780 | 21 | 10.66 | 759 | 21 | 10.74 | 737 | 19 | 10.57 |
| 641 | 10 | 6.45 | 685 | 11 | 6.47 | 745 | 12 | 6.38 |
| 15,696 | 186 | 4.69 | 15,809 | 187 | 4.69 | 15,800 | 184 | 4.69 |
| 59,576 | 560 | 3.72 | 59,281 | 550 | 3.69 | 57,978 | 538 | 3.72 |
| 841 | 8 | 4.13 | 939 | 10 | 3.96 | 1,263 | 12 | 3.91 |
| 14,168 | 76 | 2.13 | 14,247 | 74 | 2.11 | 13,360 | 73 | 2.17 |
| 4,908 | 24 | 1.99 | 4,923 | 24 | 1.95 | 4,965 | 24 | 1.91 |
| 822 | 6 | 3.31 | 699 | 5 | 2.50 | 805 | 5 | 2.55 |
| 3,483 | 3 | .28 | 2,257 | 1 | .26 | 3,228 | 2 | .26 |
| 674 | 4 | 2.71 | 696 | 4 | 2.52 | 713 | 5 | 2.48 |
| 84,472 | 681 | 3.21 | 83,042 | 668 | 3.21 | 82,312 | 659 | 3.21 |
| (790) | | | (790) | | | (793) | | |
| 10,435 | | | 10,397 | | | 10,139 | | |
| 1,947 | | | 2,118 | | | 2,194 | | |
| $ 96,064 | | | $ 94,767 | | | $ 93,852 | | |
| $ 37,640 | 14 | .15 | $ 36,289 | 15 | .16 | $ 36,122 | 14 | .16 |
| 2,338 | | .02 | 2,371 | | .02 | 2,393 | | .02 |
| 2,150 | 7 | 1.31 | 1,985 | 6 | 1.27 | 2,010 | 6 | 1.25 |
| 3,047 | 5 | .72 | 3,064 | 6 | .70 | 3,136 | 5 | .70 |
| 354 | | .24 | 492 | | .23 | 583 | 1 | .23 |
| 45,529 | 26 | .24 | 44,201 | 27 | .24 | 44,244 | 26 | .24 |
| 392 | | .02 | 859 | | .08 | 557 | | .02 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 556 | 3 | 1.65 | 567 | 2 | 1.51 | 657 | 2 | 1.39 |
| 8,316 | 42 | 2.05 | 7,893 | 41 | 2.20 | 6,967 | 40 | 2.30 |
| 54,793 | 71 | .52 | 53,520 | 70 | .53 | 52,425 | 68 | .52 |
| 26,292 | | | 26,268 | | | 26,594 | | |
| 2,289 | | | 2,236 | | | 2,039 | | |
| 1,947 | | | 2,118 | | | 2,194 | | |
| 85,321 | | | 84,142 | | | 83,252 | | |
| 10,731 | | | 10,614 | | | 10,590 | | |
| 12 | | | 11 | | | 10 | | |
| 10,743 | | | 10,625 | | | 10,600 | | |
| $ 96,064 | | | $ 94,767 | | | $ 93,852 | | |
| | | 2.69% | | | 2.68% | | | 2.69% |
| | 610 | 2.87% | | 598 | 2.87% | | 591 | 2.88% |
| | 8 | | | 7 | | | 7 | |
| | $ 602 | | | $ 591 | | | $ 584 | |

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

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

(g) A portion of long-term debt and the related interest expense is allocated to discontinued liabilities as a result of applying our matched funds transfer pricing methodology to discontinued operations.

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Figure 9 shows how the changes in yields or rates and average balances from the prior year period affected net interest income. The section entitled Financial Condition contains additional discussion about changes in earning assets and funding sources.

**Figure 9. Components of Net Interest Income Changes from Continuing Operations**

| *in millions* | From three months ended June 30, 2015 to three months ended June 30, 2016 | | | From six months ended June 30, 2015 to six months ended June 30, 2016 | | |
|---|---|---|---|---|---|---|
| | **Average Volume** | **Yield/ Rate** | **Net Change [(a)]** | **Average Volume** | **Yield/ Rate** | **Net Change [(a)]** |
| **INTEREST INCOME** | | | | | | |
| Loans | $ 30 | $ 7 | $ 37 | $ 55 | $ 23 | $ 78 |
| Loans held for sale | (6) | (1) | (7) | (6) | | (6) |
| Securities available for sale | 5 | (4) | 1 | 11 | (5) | 6 |
| Held-to-maturity securities | | | | (1) | 1 | |
| Trading account assets | 1 | | 1 | 2 | 1 | 3 |
| Short-term investments | 2 | 2 | 4 | 3 | 3 | 6 |
| Other investments | (1) | (2) | (3) | (1) | (4) | (5) |
| Total interest income (TE) | 31 | 2 | 33 | 63 | 19 | 82 |
| **INTEREST EXPENSE** | | | | | | |
| NOW and money market deposit accounts | 1 | 1 | 2 | 2 | 2 | 4 |
| Certificates of deposit ($100,000 or more) | 4 | 1 | 5 | 7 | 1 | 8 |
| Other time deposits | | 2 | 2 | | 2 | 2 |
| Deposits in foreign office | (1) | | (1) | (1) | | (1) |
| Total interest-bearing deposits | 4 | 4 | 8 | 8 | 5 | 13 |
| Bank notes and other short-term borrowings | | 1 | 1 | | 1 | 1 |
| Long-term debt | 13 | (3) | 10 | 26 | (7) | 19 |
| Total interest expense | 17 | 2 | 19 | 34 | (1) | 33 |
| Net interest income (TE) | $ 14 | | $ 14 | $ 29 | $ 20 | $ 49 |

(a) 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.

**Noninterest income**

As shown in Figure 10, noninterest income was $473 million for the second quarter of 2016, compared to $488 million for the year-ago quarter, a decrease of $15 million, or 3.1%. The decrease from the prior year was largely attributable to lower investment banking and debt placement fees of $43 million, reflecting challenging market conditions, as well as $6 million of lower operating lease income and other leasing gains. These declines were offset

by an increase in other income of $17 million primarily related to gains from certain real estate investments, along with continued growth in some of our core fee-based business, including corporate services and cards and payments.

For the six months ended June 30, 2016, noninterest income decreased $21 million, or 2.3%, from the same period one year ago. Investment banking and debt placement fees declined $40 million and net gains from principal investing decreased $29 million reflecting market weakness. These decreases were partially offset by increases of $17 million in corporate services income due to higher loan commitment fees, other non-yield loans fees, and dealer trading and derivatives income, and $29 million in other income.

**Figure 10. Noninterest Income**

| | Three months ended June 30, | | Change | | Six months ended June 30, | | Change | |
|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **2016** | **2015** | **Amount** | **Percent** | **2016** | **2015** | **Amount** | **Percent** |
| Trust and investment services income | **$ 110** | $ 111 | $ (1) | (.9)% | **$ 219** | $ 220 | $ (1) | (.5)% |
| Investment banking and debt placement fees | **98** | 141 | (43) | (30.5) | **169** | 209 | (40) | (19.1) |
| Service charges on deposit accounts | **68** | 63 | 5 | 7.9 | **133** | 124 | 9 | 7.3 |
| Operating lease income and other leasing gains | **18** | 24 | (6) | (25.0) | **35** | 43 | (8) | (18.6) |
| Corporate services income | **53** | 43 | 10 | 23.3 | **103** | 86 | 17 | 19.8 |
| Cards and payments income | **52** | 47 | 5 | 10.6 | **98** | 89 | 9 | 10.1 |
| Corporate-owned life insurance income | **28** | 30 | (2) | (6.7) | **56** | 61 | (5) | (8.2) |
| Consumer mortgage income | **3** | 4 | (1) | (25.0) | **5** | 7 | (2) | (28.6) |
| Mortgage servicing fees | **10** | 9 | 1 | 11.1 | **22** | 22 | | |
| Net gains (losses) from principal investing | **11** | 11 | | | **11** | 40 | (29) | (72.5) |
| Other income [(a)] | **22** | 5 | 17 | 340.0 | **53** | 24 | 29 | 120.8 |
| Total noninterest income | **$ 473** | $ 488 | $ (15) | (3.1)% | **$ 904** | $ 925 | $ (21) | (2.3)% |

(a) Included in this line item is our "Dealer trading and derivatives income (loss)." Additional detail is provided in Figure 11.

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**Figure 11. Dealer Trading and Derivatives Income (Loss)**

| | Three months ended June 30, | | Change | | Six months ended June 30, | | Change | |
|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **2016** | **2015** | **Amount** | **Percent** | **2016** | **2015** | **Amount** | **Percent** |
| Dealer trading and derivatives income (loss), proprietary [(a), (b)] | **$ 1** | $ (4) | $ 5 | N/M | | $ (5) | $ 5 | N/M |
| Dealer trading and derivatives income (loss), nonproprietary [(b)] | **1** | 2 | (1) | (50.0)% | **$ 10** | 5 | 5 | 100.0% |
| Total dealer trading and derivatives income (loss) | **$ 2** | $ (2) | $ 4 | N/M | **$ 10** | | $ 10 | 100.0% |

(a) For the quarter ended June 30, 2016, income of $3 million related to fixed income, foreign exchange, interest rates, and commodity derivative trading was offset by losses related to equity securities trading and credit portfolio management activities. For the quarter ended June 30, 2015, income of $1 million related to foreign exchange, interest rate, fixed income, and commodity derivative trading was offset by losses related to equity securities trading and credit portfolio management activities.

(b) The allocation between proprietary and nonproprietary is made based upon whether the trade is conducted for the benefit of Key or Key s clients rather than based upon rulemaking under the Volcker Rule. For more information on prohibitions and restrictions imposed by the Volcker Rule, see the discussion under the heading Other Regulatory Developments under the Dodd-Frank Act Volcker Rule in the section entitled Supervision and Regulation in Item 1 of our 2015 Form 10-K.

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

Trust and investment services income

Trust and investment services income is one of our largest sources of noninterest income and consists of brokerage commissions, trust and asset management commissions, and insurance income. The assets under management that primarily generate these revenues are shown in Figure 12. For the three and six months ended June 30, 2016, trust and investment services income decreased $1 million, or ..9% and .5%, respectively. These declines were due to lower trust and asset management commissions, partially offset by an increase in insurance income.

A significant portion of our trust and investment services income depends on the value and mix of assets under management. At June 30, 2016, our bank, trust, and registered investment advisory subsidiaries had assets under management of $34.5 billion, compared to $38.4 billion at June 30, 2015. The decreases in the equity and securities lending, as shown in Figure 12, were primarily attributable to client attrition and market declines. These declines were partially offset by increases in the money market and fixed income portfolios.

**Figure 12. Assets Under Management**

| | 2016 | | 2015 | | |
|---|---|---|---|---|---|
| *in millions* | **Second** | **First** | **Fourth** | **Third** | **Second** |
| Assets under management by investment type: | | | | | |
| Equity | **$ 20,458** | **$ 20,210** | $ 20,199 | $ 19,728 | $ 21,226 |
| Securities lending | **968** | **1,147** | 1,215 | 2,872 | 4,438 |
| Fixed income | **10,053** | **9,789** | 9,705 | 9,823 | 9,899 |
| Money market | **3,056** | **2,961** | 2,864 | 2,735 | 2,836 |
| Total | **$ 34,535** | **$ 34,107** | $ 33,983 | $ 35,158 | $ 38,399 |

Investment banking and debt placement fees

Investment banking and debt placement fees consist of syndication fees, debt and equity financing fees, financial advisor fees, gains on sales of commercial mortgages, and agency origination fees. Investment banking and debt placement fees decreased $43 million, or 30.5%, for the second quarter of 2016, and $40 million, or 19.1%, for the six months ended June 30, 2016, compared to the same periods one year ago. These decreases were primarily attributable to a decline in merger and acquisition advisory fees and a decline in gains on sales of commercial mortgages reflecting challenging market conditions.

Service charges on deposit accounts

Service charges on deposit accounts increased $5 million, or 7.9%, and $9 million, or 7.3%, from the three and six months ended June 30, 2016, compared to the same periods one year ago. These increases were primarily due to higher overdraft and account analysis fees.

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Operating lease income and other leasing gains

Operating lease income and other leasing gains decreased $6 million, or 25%, for the second quarter of 2016, and $8 million, or 18.6%, for the six months ended June 30, 2016, compared to the same periods one year ago. These declines were primarily due to lower gains realized on the sale of returned leased equipment. The expense related to the rental of leased equipment is presented in Figure 13 as operating lease expense.

Corporate services income

Corporate services income increased $10 million, or 23.3%, from the year-ago quarter, and $17 million, or 19.8%, for the six months ended June 30, 2016, compared to the same period one year ago. These increases were driven by higher non-yield loan fees, dealer trading and derivatives income, and foreign exchange trading income.

Cards and payments income

Cards and payments income, which consists of debit card, consumer and commercial credit card, and merchant services income, increased $5 million, or 10.6%, from the year-ago quarter, and $9 million, or 10.1%, for the six months ended June 30, 2016, compared to the same period one year ago. This increase was due to higher purchase card, credit card, and ATM debit card fees driven by increased volume.

Consumer mortgage income

Consumer mortgage income decreased $1 million, or 25%, from the year-ago quarter, and $2 million, or 28.6%, for the six months ended June 30, 2016, compared to the same period one year ago. These decreases were primarily due to lower gains on consumer mortgage loans sold.

Mortgage servicing fees

Mortgage servicing fees increased $1 million, or 11.1%, from the year-ago quarter, and were flat for the six months ended June 30, 2016, compared to the same period one year ago. The increase from the year-ago quarter was driven by increased service fee income on mortgage loans sold.

Other income

Other income, which consists primarily of gains on sales of loans held for sale, other service charges, and certain dealer trading income, increased $17 million, or 340%, from the year-ago quarter, and $29 million, or 120.8%, for the six months ended June 30, 2016, compared to the same period one year ago. These increases were primarily due to gains from certain real estate investments.

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**Noninterest expense**

As shown in Figure 13, noninterest expense was $751 million for the second quarter of 2016, compared to $711 million for the year-ago quarter, representing an increase of $40 million, or 5.6%. Noninterest expense included $45 million of merger-related expense, primarily made up of $35 million in personnel expense related to technology development for systems conversions and fully dedicated personnel for acquisition and integration efforts. The remaining $10 million of merger-related expense was nonpersonnel expense, largely recognized in business services and professional fees and marketing. There was no merger-related expense incurred in the second quarter of 2015.

Excluding merger-related expense, noninterest expense was $5 million lower than the second quarter of 2015. The decrease is primarily attributable to $16 million in lower personnel expense related to lower performance based compensation, along with lower net occupancy expenses and business services and professional fees. These decreases were partially offset by an increase in other expense, reflecting the impact of certain real estate investments and other miscellaneous items, along with increased non-merger related marketing expense.

For the six months ended June 30, 2016, noninterest expense increased $74 million, or 5.4%, compared to the same period one year ago. Noninterest expense included $69 million of merger-related expense, primarily made up of $51 million in personnel expense and $18 million of nonpersonnel expense.

Excluding merger-related expense, noninterest expense for the six months ended June 30, 2016, was $5 million higher than the same period one year ago. Other expense increased $26 million, reflecting the impact of certain real estate investments, and computer processing expenses increased $8 million. These increases were partially offset by lower personnel expense related to lower performance based compensation, along with lower net occupancy expenses.

**Figure 13. Noninterest Expense**

| | **Three months ended June 30,** | | **Change** | | **Six months ended June 30,** | | **Change** | |
|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **2016** | **2015** | **Amount** | **Percent** | **2016** | **2015** | **Amount** | **Percent** |
| Personnel [(a)] | **$ 427** | $ 408 | $ 19 | 4.7% | **$ 831** | $ 797 | $ 34 | 4.3% |
| Net occupancy | **59** | 66 | (7) | (10.6) | **120** | 131 | (11) | (8.4) |
| Computer processing | **45** | 42 | 3 | 7.1 | **88** | 80 | 8 | 10.0 |
| Business services and professional fees | **40** | 42 | (2) | (4.8) | **81** | 75 | 6 | 8.0 |
| Equipment | **21** | 22 | (1) | (4.5) | **42** | 44 | (2) | (4.5) |
| Operating lease expense | **14** | 12 | 2 | 16.7 | **27** | 23 | 4 | 17.4 |
| Marketing | **22** | 15 | 7 | 46.7 | **34** | 23 | 11 | 47.8 |
| FDIC assessment | **8** | 8 | | | **17** | 16 | 1 | 6.3 |
| Intangible asset amortization | **7** | 9 | (2) | (22.2) | **15** | 18 | (3) | (16.7) |
| OREO expense, net | **2** | 1 | 1 | 100.0 | **3** | 3 | | |
| Other expense | **106** | 86 | 20 | 23.3 | **196** | 170 | 26 | 15.3 |
| Total noninterest expense | **$ 751** | $ 711 | $ 40 | 5.6% | **$ 1,454** | $ 1,380 | $ 74 | 5.4% |
| Merger-related expense [(b)] | **45** | | 45 | N/M | **69** | | 69 | N/M |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total noninterest expense excluding merger- related expense [c] | **$ 706** | $ 711 | $ (5) | (.7)% | **$ 1,385** | $ 1,380 | $ 5 | .4% |
| Average full-time equivalent employees [d] | **13,419** | 13,455 | (36) | (.3)% | **13,411** | 13,512 | (101) | (.7)% |

(a) Additional detail provided in Figure 15 entitled Personnel Expense.
(b) Additional detail provided in Figure 14 entitled Merger-Related Expense.
(c) Non-GAAP measure. See Figure 7 entitled GAAP to Non-GAAP Reconciliations.
(d) The number of average full-time equivalent employees has not been adjusted for discontinued operations.

**Figure 14. Merger-Related Expense**

| | **Three months ended June 30,** | | **Change** | | **Six months ended June 30,** | | **Change** | |
|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **2016** | **2015** | **Amount** | **Percent** | **2016** | **2015** | **Amount** | **Percent** |
| Personnel [a] | **$ 35** | | $ 35 | N/M | **$ 51** | | $ 51 | N/M |
| Business services and professional fees | **5** | | 5 | N/M | **12** | | 12 | N/M |
| Marketing | **3** | | 3 | N/M | **4** | | 4 | N/M |
| Other nonpersonnel expense | **2** | | 2 | N/M | **2** | | 2 | N/M |
| Total merger-related expense | **$ 45** | | $ 45 | N/M | **$ 69** | | $ 69 | N/M |

(a) Personnel expense includes technology development related to systems conversions, as well as fully-dedicated personnel for merger and integration efforts.

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Personnel

As shown in Figure 15, personnel expense, the largest category of our noninterest expense, increased by $19 million, or 4.7%, for the second quarter of 2016 compared to the year-ago quarter. For the six months ended June 30, 2016, personnel expense increased $34 million, or 4.3% from the same period one year ago. Personnel expense included $35 million for the second quarter of 2016, and $51 million for the six months ended June 30, 2016, of merger-related expense related to technology development for system conversions and fully dedicated personnel for acquisition and integration efforts. Personnel expense, adjusting for merger-related expense, declined $16 million from the year-ago quarter, and $17 million for the six months ended June 30, 2016, compared to the same period one year ago. These decreases were primarily due to lower performance based compensation and lower severance costs.

**Figure 15. Personnel Expense**

| | **Three months ended June 30,** | | **Change** | | **Six months ended June 30,** | | **Change** | |
|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **2016** | **2015** | **Amount** | **Percent** | **2016** | **2015** | **Amount** | **Percent** |
| Salaries and contract labor | **$ 266** | $ 239 | $ 27 | 11.3% | **$ 510** | $ 467 | $ 43 | 9.2% |
| Incentive and stock-based compensation | **101** | 109 | (8) | (7.3) | **190** | 192 | (2) | (1.0) |
| Employee benefits | **58** | 55 | 3 | 5.5 | **126** | 127 | (1) | (.8) |
| Severance | **2** | 5 | (3) | (60.0) | **5** | 11 | (6) | (54.5) |
| Total personnel expense | **$ 427** | $ 408 | $ 19 | 4.7% | **$ 831** | $ 797 | $ 34 | 4.3% |

Net occupancy

Net occupancy expense decreased $7 million, or 10.6 %, for the second quarter of 2016, and $11 million, or 8.4%, for the six months ended June 30, 2016, compared to the same periods one year ago. These declines were primarily due to lower rental expenses.

Operating lease expense

Operating lease expense increased $2 million, or 16.7%, from the year-ago quarter, and $4 million, or 17.4%, from the six-month period ended one year ago. These increases were due to increased depreciation expense on operating lease equipment. Income related to the rental of leased equipment is presented in Figure 10 as operating lease income and other leasing gains.

Other expense

Other expense comprises various miscellaneous expense items. The $20 million, or 23.3%, increase in the current quarter and the $26 million, or 15.3%, increase in the first six months of 2016 compared to the same periods one year ago reflect the impact of certain real estate investments and other miscellaneous expenses.

**Income taxes**

We recorded tax expense from continuing operations of $69 million for the second quarter of 2016 and $84 million for the second quarter of 2015. For the first six months of 2016, we recorded tax expense from continuing operations of $125 million, compared to $158 million for the same period one year ago.

Our federal tax expense (benefit) differs from the amount that would be calculated using the federal statutory tax rate, primarily because we generate income from investments in tax-advantaged assets, such as corporate-owned life insurance, and credits associated with renewable energy and low-income housing investments.

Additional information pertaining to how our tax expense (benefit) and the resulting effective tax rates were derived is included in Note 12 ( Income Taxes ) beginning on page 184 of our 2015 Form 10-K.

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## Line of Business Results

This section summarizes the financial performance and related strategic developments of our two major business segments (operating segments): Key Community Bank and Key Corporate Bank. Note 18 ( Line of Business Results ) describes the products and services offered by each of these business segments, provides more detailed financial information pertaining to the segments, and explains Other Segments and Reconciling Items.

Figure 16 summarizes the contribution made by each major business segment to our taxable-equivalent revenue from continuing operations and income (loss) from continuing operations attributable to Key for the three-month periods ended June 30, 2016, and June 30, 2015.

**Figure 16. Major Business Segments Taxable-Equivalent (TE) Revenue from Continuing Operations and Income (Loss) from Continuing Operations Attributable to Key**

| | Three months ended June 30, | | Change | | Six months ended June 30, | | Change | |
|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | 2016 | 2015 | Amount | Percent | 2016 | 2015 | Amount | Percent |
| **REVENUE FROM CONTINUING OPERATIONS (TE)** | | | | | | | | |
| Key Community Bank | **$ 598** | $ 560 | $ 38 | 6.8% | **$ 1,193** | $ 1,108 | $ 85 | 7.7% |
| Key Corporate Bank | **452** | 478 | (26) | (5.4) | **877** | 880 | (3) | (.3) |
| Other Segments | **31** | 43 | (12) | (27.9) | **52** | 109 | (57) | (52.3) |
| Total Segments | **1,081** | 1,081 | | | **2,122** | 2,097 | 25 | 1.2 |
| Reconciling Items | **(3)** | (2) | (1) | N/M | **(1)** | (4) | 3 | N/M |
| Total | **$ 1,078** | $ 1,079 | $ (1) | (0.1)% | **$ 2,121** | $ 2,093 | $ 28 | 1.3% |
| **INCOME (LOSS) FROM CONTINUING OPERATIONS ATTRIBUTABLE TO KEY** | | | | | | | | |
| Key Community Bank | **$ 81** | $ 69 | $ 12 | 17.4% | **$ 154** | $ 120 | $ 34 | 28.3% |
| Key Corporate Bank | **135** | 131 | 4 | 3.1 | **254** | 258 | (4) | (1.6) |
| Other Segments | **24** | 31 | (7) | (22.6) | **38** | 74 | (36) | (48.6) |
| Total Segments | **240** | 231 | 9 | 3.9 | **446** | 452 | (6) | (1.3) |
| Reconciling Items | **(41)** | 4 | (45) | N/M | **(60)** | 11 | (71) | N/M |
| Total | **$ 199** | $ 235 | $ (36) | (15.3)% | **$ 386** | $ 463 | $ (77) | (16.6)% |

**Key Community Bank summary of operations**

Positive operating leverage from prior year

Net income increased to $81 million, 17.4% growth from prior year

Commercial, financial and agricultural average loan growth of $675 million, or 5.4% from prior year

Average deposits up $3 billion, or 6.0% from the prior year

As shown in Figure 17, Key Community Bank recorded net income attributable to Key of $81 million for the second quarter of 2016, compared to net income attributable to Key of $69 million for the year-ago quarter.

Taxable-equivalent net interest income increased by $29 million, or 8.0%, from the second quarter of 2015 due to favorable deposit rates and balance growth. Average deposits increased $3 billion, or 6.0%, from one year ago, and average loans and leases grew $229 million, or .7%. Commercial, financial and agricultural loans grew by $675 million, or 5.4%, from the prior year.

Noninterest income increased $9 million, or 4.5%, from the year-ago quarter. Service charges on deposit accounts increased $4 million, and cards and payments income and investment banking and debt placement fees each increased $3 million. These increases were partially offset by market weakness affecting Key s Private Bank as well as lower consumer mortgage income.

The provision for credit losses increased by $22 million from the second quarter of 2015. Net loan charge-offs decreased $3 million from the same period one year ago.

Noninterest expense remained relatively stable, decreasing by $3 million, or .7%, from the year-ago quarter.

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**Figure 17. Key Community Bank**

| *dollars in millions* | Three months ended June 30, 2016 | 2015 | Change Amount | Percent | Six months ended June 30, 2016 | 2015 | Change Amount | Percent |
|---|---|---|---|---|---|---|---|---|
| **SUMMARY OF OPERATIONS** | | | | | | | | |
| Net interest income (TE) | **$ 391** | $ 362 | $ 29 | 8.0% | **$ 790** | $ 720 | $ 70 | 9.7% |
| Noninterest income | **207** | 198 | 9 | 4.5 | **403** | 388 | 15 | 3.9 |
| Total revenue (TE) | **598** | 560 | 38 | 6.8 | **1,193** | 1,108 | 85 | 7.7 |
| Provision for credit losses | **25** | 3 | 22 | 733.3 | **66** | 32 | 34 | 106.3 |
| Noninterest expense | **444** | 447 | (3) | (.7) | **881** | 884 | (3) | (.3) |
| Income (loss) before income taxes (TE) | **129** | 110 | 19 | 17.3 | **246** | 192 | 54 | 28.1 |
| Allocated income taxes (benefit) and TE adjustments | **48** | 41 | 7 | 17.1 | **92** | 72 | 20 | 27.8 |
| Net income (loss) attributable to Key | **$ 81** | $ 69 | $ 12 | 17.4% | **$ 154** | $ 120 | $ 34 | 28.3% |
| **AVERAGE BALANCES** | | | | | | | | |
| Loans and leases | **$ 30,936** | $ 30,707 | $ 229 | .7% | **$ 30,863** | $ 30,684 | $ 179 | .6% |
| Total assets | **32,963** | 32,809 | 154 | .5 | **32,910** | 32,789 | 121 | .4 |
| Deposits | **53,794** | 50,765 | 3,029 | 6.0 | **53,299** | 50,591 | 2,708 | 5.4 |
| Assets under management at period end | **$ 34,535** | $ 38,399 | $ (3,864) | (10.1)% | **$ 34,535** | $ 38,399 | $ (3,864) | (10.1)% |

**ADDITIONAL KEY COMMUNITY BANK DATA**

| *dollars in millions* | Three months ended June 30, 2016 | 2015 | Change Amount | Percent | Six months ended June 30, 2016 | 2015 | Change Amount | Percent |
|---|---|---|---|---|---|---|---|---|
| **NONINTEREST INCOME** | | | | | | | | |
| Trust and investment services income | **$ 73** | $ 76 | $ (3) | (3.9)% | **$ 146** | $ 150 | $ (4) | (2.7)% |
| Services charges on deposit accounts | **56** | 52 | 4 | 7.7 | **110** | 103 | 7 | 6.8 |
| | **46** | 43 | 3 | 7.0 | **89** | 80 | 9 | 11.3 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Cards and payments income | | | | | | | | |
| Other noninterest income | **32** | 27 | 5 | 18.5 | **58** | 55 | 3 | 5.5 |
| Total noninterest income | **$ 207** | $ 198 | $ 9 | 4.5% | **$ 403** | $ 388 | $ 15 | 3.9% |
| **AVERAGE DEPOSITS OUTSTANDING** | | | | | | | | |
| NOW and money market deposit accounts | **$ 30,144** | $ 28,284 | $ 1,860 | 6.6% | **$ 29,788** | $ 28,080 | $ 1,708 | 6.1% |
| Savings deposits | **2,365** | 2,385 | (20) | (.8) | **2,353** | 2,381 | (28) | (1.2) |
| Certificates of deposits ($100,000 or more) | **2,383** | 1,547 | 836 | 54.0 | **2,251** | 1,552 | 699 | 45.0 |
| Other time deposits | **3,245** | 3,132 | 113 | 3.6 | **3,221** | 3,171 | 50 | 1.6 |
| Deposits in foreign office | | 299 | (299) | N/M | | 316 | (316) | N/M |
| Noninterest-bearing deposits | **15,657** | 15,118 | 539 | 3.6 | **15,686** | 15,091 | 595 | 3.9 |
| Total deposits | **$ 53,794** | $ 50,765 | $ 3,029 | 6.0% | **$ 53,299** | $ 50,591 | $ 2,708 | 5.4% |
| **HOME EQUITY LOANS** | | | | | | | | |
| Average balance | **$ 9,908** | $ 10,266 | | | | | | |
| Combined weighted-average loan-to-value ratio (at date of origination) | **71%** | 71% | | | | | | |
| Percent first lien positions | **61** | 60 | | | | | | |
| **OTHER DATA** | | | | | | | | |
| Branches | **949** | 989 | | | | | | |
| Automated teller machines | **1,236** | 1,280 | | | | | | |

**Key Corporate Bank summary of operations**

Average loan and lease balances up $3.3 billion, or 13.1% from the prior year

Net income increased to $135 million, 3.1% growth from the prior year

As shown in Figure 18, Key Corporate Bank recorded net income attributable to Key of $135 million for the second quarter of 2016, compared to $131 million for the same period one year ago.

Taxable-equivalent net interest income decreased by $6 million, or 2.6%, compared to the second quarter of 2015. Average loan and lease balances increased $3.3 billion, or 13.1%, from the year-ago quarter, primarily driven by growth in commercial, financial and agricultural loans. This loan growth was offset by spread compression due to higher funding costs and a decline in loan fees due to lower refinance activity from the prior year. Average deposit balances decreased $580 million, or 2.9%, from the year-ago quarter, mostly driven by lower public deposits.

Noninterest income was down $20 million, or 8.0%, from the prior year. Investment banking and debt placement fees declined $45 million, or 32.4%, due to challenging market conditions. Other noninterest income increased $15 million

from the year-ago quarter mostly due to gains from certain real estate investments. Corporate services income was up $7 million, or 21.2%, due to growth in commitment fees and derivatives.

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The provision for credit losses decreased $11 million, or 26.8%, compared to the second quarter of 2015 as lower provisioning related to unfunded commitments offset higher net loan charge-offs.

Noninterest expense increased by $3 million, or 1.2%, from the second quarter of 2015. Increases in various other expense items, including operating lease expense, were partially offset by lower personnel costs.

**Figure 18. Key Corporate Bank**

| *dollars in millions* | Three months ended June 30, 2016 | 2015 | Change Amount | Change Percent | Six months ended June 30, 2016 | 2015 | Change Amount | Change Percent |
|---|---|---|---|---|---|---|---|---|
| **SUMMARY OF OPERATIONS** | | | | | | | | |
| Net interest income (TE) | **$ 222** | $ 228 | $ (6) | (2.6)% | **$ 440** | $ 442 | $ (2) | (.5)% |
| Noninterest income | **230** | 250 | (20) | (8.0) | **437** | 438 | (1) | (.2) |
| Total revenue (TE) | **452** | 478 | (26) | (5.4) | **877** | 880 | (3) | (.3) |
| Provision for credit losses | **30** | 41 | (11) | (26.8) | **73** | 47 | 26 | 55.3 |
| Noninterest expense | **259** | 256 | 3 | 1.2 | **495** | 475 | 20 | 4.2 |
| Income (loss) before income taxes (TE) | **163** | 181 | (18) | (9.9) | **309** | 358 | (49) | (13.7) |
| Allocated income taxes and TE adjustments | **29** | 50 | (21) | (42.0) | **57** | 99 | (42) | (42.4) |
| Net income (loss) | **134** | 131 | 3 | 2.3 | **252** | 259 | (7) | (2.7) |
| Less: Net income (loss) attributable to noncontrolling interests | **(1)** | | (1) | N/M | **(2)** | 1 | (3) | N/M |
| Net income (loss) attributable to Key | **$ 135** | $ 131 | $ 4 | 3.1% | **$ 254** | $ 258 | $ (4) | (1.6)% |
| **AVERAGE BALANCES** | | | | | | | | |
| Loans and leases | **$ 28,607** | $ 25,298 | $ 3,309 | 13.1% | **$ 28,164** | $ 25,012 | $ 3,152 | 12.6% |
| Loans held for sale | **591** | 1,234 | (643) | (52.1) | **701** | 1,006 | (305) | (30.3) |
| Total assets | **33,909** | 31,173 | 2,736 | 8.8 | **33,661** | 30,709 | 2,952 | 9.6 |
| Deposits | **19,129** | 19,709 | (580) | (2.9) | **18,602** | 19,142 | (540) | (2.8) |

**ADDITIONAL KEY CORPORATE BANK DATA**

| | Change | | Change |
|---|---|---|---|

| *dollars in millions* | Three months ended June 30, 2016 | 2015 | Amount | Percent | Six months ended June 30, 2016 | 2015 | Amount | Percent |
|---|---|---|---|---|---|---|---|---|
| **NONINTEREST INCOME** | | | | | | | | |
| Trust and investment services income | **$ 37** | $ 35 | $ 2 | 5.7% | **$ 73** | $ 70 | $ 3 | 4.3% |
| Investment banking and debt placement fees | **94** | 139 | (45) | (32.4) | **164** | 207 | (43) | (20.8) |
| Operating lease income and other leasing gains | **15** | 18 | (3) | (16.7) | **28** | 32 | (4) | (12.5) |
| Corporate services income | **40** | 33 | 7 | 21.2 | **78** | 65 | 13 | 20.0 |
| Service charges on deposit accounts | **12** | 11 | 1 | 9.1 | **23** | 21 | 2 | 9.5 |
| Cards and payments income | **6** | 4 | 2 | 50.0 | **9** | 8 | 1 | 12.5 |
| Payments and services income | **58** | 48 | 10 | 20.8 | **110** | 94 | 16 | 17.0 |
| Mortgage servicing fees | **10** | 9 | 1 | 11.1 | **22** | 22 | | |
| Other noninterest income | **16** | 1 | 15 | N/M | **40** | 13 | 27 | 207.7 |
| Total noninterest income | **$ 230** | $ 250 | $ (20) | (8.0)% | **$ 437** | $ 438 | $ (1) | (.2)% |

**Other Segments**

Other Segments consist of Corporate Treasury, Key s Principal Investing unit and various exit portfolios. Other Segments generated net income attributable to Key of $24 million for the second quarter of 2016, compared to $31 million for the same period last year. This decline was largely attributable to spread compression.

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## Financial Condition

### Loans and loans held for sale

At June 30, 2016, total loans outstanding from continuing operations were $62.1 billion, compared to $59.9 billion at December 31, 2015, and $58.3 billion at June 30, 2015. The increase in our outstanding loans from continuing operations over the past twelve months results primarily from increased lending activity in our commercial, financial and agricultural and commercial mortgage portfolios. Loans related to the discontinued operations of the education lending business, which are excluded from total loans at June 30, 2016, December 31, 2015, and June 30, 2015, totaled $1.7 billion, $1.8 billion, and $2 billion, respectively. For more information on balance sheet carrying value, see Note 1 ( Summary of Significant Accounting Policies ) under the headings Loans and Loans Held for Sale on page 121 of our 2015 Form 10-K.

Commercial loan portfolio

Commercial loans outstanding were $46.8 billion at June 30, 2016, an increase of $4.4 billion, or 10.4%, compared to June 30, 2015.

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Figure 19 provides our commercial loan portfolios by industry classification at June 30, 2016, December 31, 2015, and June 30, 2015.

**Figure 19. Commercial Loans by Industry**

| **June 30, 2016** *dollars in millions* | **Commercial, financial and agricultural** | **Commercial real estate** | **Commercial lease financing** | **Total commercial loans** | **Percent of total** |
|---|---|---|---|---|---|
| Industry classification: | | | | | |
| Agricultural | $ 697 | $ 155 | $ 147 | $ 999 | 2.1% |
| Automotive | 1,799 | 440 | 66 | 2,305 | 4.9 |
| Business products | 1,127 | 111 | 31 | 1,269 | 2.7 |
| Business services | 2,387 | 109 | 281 | 2,777 | 5.9 |
| Commercial real estate | 4,317 | 5,685 | 2 | 10,004 | 21.4 |
| Construction materials and contractors | 905 | 142 | 64 | 1,111 | 2.4 |
| Consumer discretionary | 2,754 | 337 | 247 | 3,338 | 7.1 |
| Consumer services | 1,696 | 403 | 68 | 2,167 | 4.6 |
| Equipment | 1,304 | 70 | 83 | 1,457 | 3.1 |
| Financial | 3,342 | 65 | 252 | 3,659 | 7.8 |
| Healthcare | 2,928 | 1,462 | 452 | 4,842 | 10.3 |
| Materials manufacturing and mining | 2,430 | 162 | 185 | 2,777 | 5.9 |
| Media | 321 | 32 | 68 | 421 | .9 |
| Oil and gas | 1,083 | 56 | 54 | 1,193 | 2.5 |
| Public exposure | 1,592 | 144 | 877 | 2,613 | 5.6 |
| Technology | 402 | 4 | 16 | 422 | .9 |
| Transportation | 781 | 82 | 840 | 1,703 | 3.6 |
| Utilities | 3,092 | 3 | 255 | 3,350 | 7.2 |
| Other | 419 | 1 | | 420 | .9 |
| Total | $ 33,376 | $ 9,463 | $ 3,988 | $ 46,827 | 100.0% |

| **December 31, 2015** *dollars in millions* | **Commercial, financial and agricultural** | **Commercial real estate** | **Commercial lease financing** | **Total commercial loans** | **Percent of total** |
|---|---|---|---|---|---|
| Industry classification: | | | | | |
| Agricultural | $ 745 | $ 147 | $ 143 | $ 1,035 | 2.3% |
| Automotive | 1,736 | 387 | 31 | 2,154 | 4.9 |
| Business products | 1,093 | 115 | 40 | 1,248 | 2.8 |
| Business services | 2,222 | 116 | 293 | 2,631 | 5.9 |
| Commercial real estate | 3,906 | 5,387 | 2 | 9,295 | 21.0 |
| Construction materials and contractors | 750 | 141 | 67 | 958 | 2.2 |
| Consumer discretionary | 2,521 | 347 | 270 | 3,138 | 7.1 |
| Consumer services | 1,683 | 452 | 73 | 2,208 | 5.0 |

| | | | | | |
|---|---|---|---|---|---|
| Equipment | 1,170 | 79 | 50 | 1,299 | 2.9 |
| Financial | 3,347 | 68 | 270 | 3,685 | 8.3 |
| Healthcare | 3,089 | 1,281 | 493 | 4,863 | 11.0 |
| Materials manufacturing and mining | 2,074 | 164 | 183 | 2,421 | 5.5 |
| Media | 349 | 22 | 88 | 459 | 1.0 |
| Oil and gas | 1,080 | 52 | 67 | 1,199 | 2.7 |
| Public exposure | 1,477 | 148 | 856 | 2,481 | 5.6 |
| Technology | 354 | 5 | 22 | 381 | .9 |
| Transportation | 806 | 90 | 836 | 1,732 | 3.9 |
| Utilities | 2,482 | 5 | 236 | 2,723 | 6.2 |
| Other | 356 | 6 | | 362 | .8 |
| Total | $ 31,240 | $ 9,012 | $ 4,020 | $ 44,272 | 100.0% |

| **June 30, 2015**<br>*dollars in millions* | **Commercial, financial and agricultural** | **Commercial real estate** | **Commercial lease financing** | **Total commercial loans** | **Percent of total** |
|---|---|---|---|---|---|
| Industry classification: | | | | | |
| Agricultural | $ 682 | $ 143 | $ 126 | $ 951 | 2.2% |
| Automotive | 1,680 | 410 | 43 | 2,133 | 5.0 |
| Business products | 1,142 | 124 | 39 | 1,305 | 3.1 |
| Business services | 2,102 | 122 | 298 | 2,522 | 5.9 |
| Commercial real estate | 3,341 | 5,392 | 3 | 8,736 | 20.6 |
| Construction materials and contractors | 779 | 151 | 66 | 996 | 2.3 |
| Consumer discretionary | 2,564 | 332 | 250 | 3,146 | 7.4 |
| Consumer services | 1,549 | 481 | 75 | 2,105 | 5.0 |
| Equipment | 1,204 | 77 | 67 | 1,348 | 3.2 |
| Financial | 2,940 | 64 | 258 | 3,262 | 7.7 |
| Healthcare | 2,652 | 1,306 | 509 | 4,467 | 10.5 |
| Materials manufacturing and mining | 2,244 | 169 | 177 | 2,590 | 6.1 |
| Media | 350 | 16 | 100 | 466 | 1.1 |
| Oil and gas | 987 | 44 | 63 | 1,094 | 2.6 |
| Public exposure | 1,389 | 184 | 838 | 2,411 | 5.7 |
| Technology | 326 | 5 | 11 | 342 | .8 |
| Transportation | 859 | 93 | 855 | 1,807 | 4.3 |
| Utilities | 2,133 | 4 | 232 | 2,369 | 5.6 |
| Other | 362 | 11 | | 373 | .9 |
| Total | $ 29,285 | $ 9,128 | $ 4,010 | $ 42,423 | 100.0% |

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***Commercial, financial and agricultural.*** Our commercial, financial and agricultural loans, also referred to as commercial and industrial, represented 54% of our total loan portfolio at June 30, 2016, 52% at December 31, 2015, and 50% at June 30, 2015, and is the largest component of our total loans. These loans are originated by both Key Corporate Bank and Key Community Bank and consist of fixed and variable rate loans to our large, middle market, and small business clients.

Commercial, financial and agricultural loans increased $4.1 billion, or 14%, from the same period last year, with Key Corporate Bank increasing $3.6 billion, Key Community Bank up $474 million, and Other Segments increasing $4 million. We have experienced growth in new high credit quality loan commitments and utilization with clients in our middle market segment and Institutional and Capital Markets business. Our two largest industry classifications commercial real estate and financial increased by 29.2% and 13.7%, respectively, when compared to one year ago. The commercial real estate and financial industries represented approximately 13% and 10%, respectively, of the total commercial, financial and agricultural loan portfolio at June 30, 2016, and approximately 11% and 10%, respectively, at June 30, 2015. In addition, utilities and healthcare, which each represented approximately 9% of the commercial, financial and agricultural loan portfolio at June 30, 2016, increased 45% and 10.4%, respectively, from one year ago. Utilities were higher due to alternative energy project financings, which predominantly rely directly or indirectly on the creditworthiness of public utilities. Healthcare grew due to a focus on more institutional-scale sponsor/owners of skilled nursing and assisted living facilities.

Our oil and gas loan portfolio focuses on lending to middle market companies and represents approximately 2% of total loans outstanding at June 30, 2016. Our oil and gas portfolio represented $1.1 billion of outstanding commercial, financial and agricultural loans at June 30, 2016. In addition, the commercial real estate and commercial lease financing loan portfolios also include $56 million and $54 million, respectively, of outstanding oil and gas loans at June 30, 2016. We have nearly 15 years of experience in energy lending with over 20 specialists dedicated to this sector, focusing on middle market companies, which is aligned with our relationship strategy.

The upstream segment, comprising oil and gas exploration and production, represents approximately 57% of our exposure, is primarily secured by oil and gas reserves, subject to a borrowing base, and regularly stress-tested. The midstream segment, comprising mostly distribution companies, has lower exposure to commodity risk. Oil field services exposure is minimal and concentrated in very few borrowers. This mix was essentially unchanged from the prior year. Our total commitments in the oil and gas sector were approximately $3.1 billion at June 30, 2016.

***Commercial real estate loans***. Our commercial real estate lending business is conducted through two primary sources: our 12-state banking franchise, and KeyBank Real Estate Capital, a national line of business that cultivates relationships with owners of commercial real estate located both within and beyond the branch system. This line of business deals primarily with nonowner-occupied properties (generally properties for which at least 50% of the debt service is provided by rental income from nonaffiliated third parties) and accounted for approximately 70% of our average year-to-date commercial real estate loans, compared to 67% one year ago. KeyBank Real Estate Capital generally focuses on larger owners and operators of commercial real estate.

Commercial real estate loans totaled $9.5 billion at June 30, 2016, and $9.1 billion at June 30, 2015, and represented 15% and 16% of our total loan portfolio at June 30, 2016, and June 30, 2015, respectively. These loans, which include both owner- and nonowner-occupied properties, represented 20% and 22% of our commercial loan portfolio at June 30, 2016, and June 30, 2015, respectively. We continue to de-risk the portfolio by changing our focus from developers to owners of completed and stabilized commercial real estate.

Figure 20 includes commercial mortgage and construction loans in both Key Community Bank and Key Corporate Bank. As shown in Figure 20, this loan portfolio is diversified by both property type and geographic location of the

underlying collateral.

As presented in Figure 20, at June 30, 2016, our commercial real estate portfolio included mortgage loans of $8.6 billion and construction loans of $881 million, representing 14% and 1%, respectively, of our total loans. At June 30, 2016, nonowner-occupied loans represented 11% of our total loans and owner-occupied loans represented 4% of our total loans. The average size of mortgage loans originated during the second quarter of 2016 was $8.8 million, and our largest mortgage loan at June 30, 2016, had a balance of $109.5 million. At June 30, 2016, our average construction loan commitment was $7.9 million, our largest construction loan commitment was $50.5 million, and our largest construction loan amount outstanding was $30.1 million.

Also shown in Figure 20, 74% of our commercial real estate loans at June 30, 2016, were for nonowner-occupied properties compared to 71% at June 30, 2015. Approximately 12% of these loans were construction loans at June 30, 2016, compared

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to 17% at June 30, 2015. Typically, these properties are not fully leased at the origination of the loan. The borrower relies upon additional leasing through the life of the loan to provide the cash flow necessary to support debt service payments. A significant decline in economic growth, and in turn rental rates and occupancy, would adversely affect our portfolio of construction loans.

**Figure 20. Commercial Real Estate Loans**

| | Geographic Region | | | | | | | | Percent of | | Commercial |
|---|---|---|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **West** | **Southwest** | **Central** | **Midwest** | **Southeast** | **Northeast** | **National** | **Total** | **Total** | **Construction** | **Mortgage** |
| **June 30, 2016** | | | | | | | | | | | |
| Nonowner-occupied: | | | | | | | | | | | |
| Retail properties | $ 231 | $ 66 | $ 79 | $ 149 | $ 192 | $ 89 | $ 168 | $ 974 | 10.3% | $ 77 | $ 897 |
| Multifamily properties | 370 | 185 | 528 | 579 | 1,086 | 156 | 169 | 3,073 | 32.5 | 500 | 2,573 |
| Health facilities | 248 | | 134 | 89 | 471 | 237 | 49 | 1,228 | 13.0 | 83 | 1,145 |
| Office buildings | 76 | 7 | 153 | 116 | 120 | 49 | 3 | 524 | 5.5 | 33 | 491 |
| Warehouses | 104 | 8 | 45 | 99 | 60 | 77 | 185 | 578 | 6.1 | 60 | 518 |
| Manufacturing facilities | 6 | | 2 | 10 | 16 | 3 | 58 | 95 | 1.0 | | 95 |
| Hotels/Motels | 70 | | 16 | 6 | | 6 | | 98 | 1.0 | | 98 |
| Residential properties | 1 | | 45 | 5 | | 7 | | 58 | .6 | 24 | 34 |
| Land and development | 9 | | 1 | 3 | 9 | 3 | | 25 | .3 | 18 | 7 |
| Other | 60 | 12 | 3 | 13 | 46 | 94 | 133 | 361 | 3.8 | 12 | 349 |
| Total nonowner-occupied | 1,175 | 278 | 1,006 | 1,069 | 2,000 | 721 | 765 | 7,014 | 74.1 | 807 | 6,207 |
| Owner-occupied | 904 | | 339 | 592 | 14 | 600 | | 2,449 | 25.9 | 74 | 2,375 |
| Total | $ 2,079 | $ 278 | $ 1,345 | $ 1,661 | $ 2,014 | $ 1,321 | $ 765 | $ 9,463 | 100.0% | $ 881 | $ 8,582 |
| **December 31, 2015** | | | | | | | | | | | |
| Total | $ 2,163 | $ 277 | $ 1,309 | $ 1,671 | $ 1,721 | $ 1,282 | $ 589 | $ 9,012 | | $ 1,053 | $ 7,959 |
| **June 30, 2015** | | | | | | | | | | | |
| Total | $ 2,424 | $ 240 | $ 1,390 | $ 1,660 | $ 1,473 | $ 1,349 | $ 592 | $ 9,128 | | $ 1,254 | $ 7,874 |
| **June 30, 2016** | | | | | | | | | | | |
| Nonowner-occupied: | | | | | | | | | | | |
| Nonperforming loans | | | $ 17 | $ 5 | | $ 4 | | $ 26 | N/M | $ 19 | $ 7 |
| Accruing loans past due 90 days or more | | | | 2 | | 2 | | 4 | N/M | | 4 |
| Accruing loans past due 30 through 89 | $ | | | | | | | | N/M | | |

days

| | |
|---|---|
| West | Alaska, California, Hawaii, Idaho, Montana, Oregon, Washington, and Wyoming |
| Southwest | Arizona, Nevada, and New Mexico |
| Central | Arkansas, Colorado, Oklahoma, Texas, and Utah |
| Midwest | Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin |
| Southeast | Alabama, Delaware, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, Washington D.C., and West Virginia |
| Northeast | Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, and Vermont |
| National | Accounts in three or more regions |

During the first six months of 2016, nonperforming loans related to nonowner-occupied properties increased by $10 million from December 31, 2015, to $26 million at June 30, 2016, and increased by $10 million when compared to June 30, 2015. Our nonowner-occupied commercial real estate portfolio has increased by 7.8%, or approximately $508 million, since June 30, 2015, as many of our clients have taken advantage of opportunities to permanently refinance their loans at historically low interest rates.

***Commercial lease financing.*** We conduct commercial lease financing arrangements through our KEF line of business and have both the scale and array of products to compete in the equipment lease financing business. Commercial lease financing receivables represented 9% of commercial loans at both June 30, 2016, and June 30, 2015.

Commercial loan modification and restructuring

We modify and extend certain commercial loans in the normal course of business for our clients. Loan modifications vary and are handled on a case-by-case basis with strategies responsive to the specific circumstances of each loan and borrower. In many cases, borrowers have other resources and can reinforce the credit with additional capital, collateral, guarantees, or other income sources.

Modifications are negotiated to achieve mutually agreeable terms that maximize loan credit quality while at the same time meeting our clients financing needs. Modifications made to loans of creditworthy borrowers not experiencing financial difficulties and under circumstances where ultimate collection of all principal and interest is not in doubt are not classified as TDRs. In accordance with applicable accounting guidance, a loan is classified as a TDR only when the borrower is experiencing financial difficulties and a creditor concession has been granted.

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Our concession types are primarily interest rate reductions, forgiveness of principal, and other modifications. Loan extensions are sometimes coupled with these primary concession types. Because economic conditions have improved modestly and we have restructured loans to provide the optimal opportunity for successful repayment by the borrower, certain of our restructured loans have returned to accrual status and consistently performed under the restructured loan terms over the past year.

If loan terms are extended at less than normal market rates for similar lending arrangements, our Asset Recovery Group is consulted to help determine if any concession granted would result in designation as a TDR. Transfer to our Asset Recovery Group is considered for any commercial loan determined to be a TDR. During the first six months of 2016, we had $7 million of new restructured commercial loans compared to $48 million new restructured commercial loans during the first six months of 2015.

For more information on concession types for our commercial accruing and nonaccruing TDRs, see Note 4 ( Asset Quality ).

**Figure 21. Commercial TDRs by Accrual Status**

| *in millions* | **June 30, 2016** | March 31, 2016 | December 31, 2015 | September 30, 2015 | June 30, 2015 |
|---|---|---|---|---|---|
| **Commercial TDRs by Accrual Status** | | | | | |
| Nonaccruing | **$ 33** | $ 50 | $ 52 | $ 57 | $ 66 |
| Accruing | **20** | 2 | 2 | 4 | 4 |
| Total Commercial TDRs | **$ 53** | $ 52 | $ 54 | $ 61 | $ 70 |

We often use an A-B note structure for our TDRs, breaking the existing loan into two tranches. First, we create an A note. Since the objective of this TDR note structure is to achieve a fully performing and well-rated A note, we focus on sizing that note to a level that is supported by cash flow available to service debt at current market terms and consistent with our customary underwriting standards. This note structure typically will include a debt coverage ratio of 1.2 or better of cash flow to monthly payments of market interest, and principal amortization of generally not more than 25 years. These metrics are adjusted from time to time based upon changes in long-term markets and take-out underwriting standards of our various lines of business. Appropriately sized A notes are more likely to return to accrual status, allowing us to resume recognizing interest income. As the borrower s payment performance improves, these restructured notes typically also allow for an upgraded internal quality risk rating classification.

The B note typically is a structurally subordinate note that may or may not require any debt service until the primary payment source stabilizes and generates excess cash flow. This excess cash flow customarily is captured for application to either the A note or B note dependent upon the terms of the restructure. We evaluate the B note when we consider returning the A note to accrual status. In many cases, the B note is charged off at the same time the A note is returned to accrual status in accordance with our interpretation of accounting and regulatory guidance applicable to TDRs. Alternatively, both A and B notes may be simultaneously returned to accrual if credit metrics are supportive.

Restructured nonaccrual loans may be returned to accrual status based on a current, well-documented evaluation of the credit, which would include analysis of the borrower s financial condition, prospects for repayment under the modified terms, and alternate sources of repayment such as the value of loan collateral. We consider the borrower s ability to

perform under the modified terms for a reasonable period (generally a minimum of six months) before returning the loan to accrual status. Sustained historical repayment performance prior to the restructuring also may be taken into account. The primary consideration for returning a restructured loan to accrual status is the reasonable assurance that the full contractual principal balance of the loan and the ongoing contractually required interest payments will be fully repaid. Although our policy is a guideline, considerable judgment is required to review each borrower s circumstances.

All loans processed as TDRs, including A notes and any non-charged-off B notes, are reported as TDRs during the calendar year in which the restructure took place. At June 30, 2016, we had $52 million and $2 million of A note and B note commercial TDRs, respectively.

Additional information regarding TDRs is provided in Note 4 ( Asset Quality ).

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***Extensions.*** Project loans typically are refinanced into the permanent commercial loan market at maturity, but they are often modified and extended. Extension terms take into account the specific circumstances of the client relationship, the status of the project, and near-term prospects for the client, the repayment source, and the collateral. In all cases, pricing and loan structure are reviewed and, where necessary, modified to ensure the loan has been priced to achieve a market rate of return and loan terms that are appropriate for the risk. Typical enhancements include one or more of the following: principal pay down, increased amortization, additional collateral, increased guarantees, and a cash flow sweep. Some maturing loans have automatic extension options built in; in those cases, pricing and loan terms cannot be altered.

Loan pricing is determined based on the strength of the borrowing entity, the strength of the guarantor, if any, and the structure and residual risk of the transaction. Therefore, pricing for an extended loan may remain the same because the loan is already priced at or above current market.

We do not consider loan extensions in the normal course of business (under existing loan terms or at market rates) as TDRs, particularly when ultimate collection of all principal and interest is not in doubt and no concession has been made. In the case of loan extensions where either collection of all principal and interest is uncertain or a concession has been made, we would analyze such credit under the applicable accounting guidance to determine whether it qualifies as a TDR. Extensions that qualify as TDRs are measured for impairment under the applicable accounting guidance.

***Guarantors.*** We conduct a detailed guarantor analysis (1) for all new extensions of credit, (2) at the time of any material modification/extension, and (3) typically annually, as part of our on-going portfolio and loan monitoring procedures. This analysis requires the guarantor entity to submit all appropriate financial statements, including balance sheets, income statements, tax returns, and real estate schedules.

While the specific steps of each guarantor analysis may vary, the high-level objectives include determining the overall financial conditions of the guarantor entities, including size, quality, and nature of asset base; net worth (adjusted to reflect our opinion of market value); leverage; standing liquidity; recurring cash flow; contingent and direct debt obligations; and near-term debt maturities.

Borrower and guarantor financial statements are required at least annually within 90-120 days of the calendar/fiscal year end. Income statements and rent rolls for project collateral are required quarterly. We may require certain information, such as liquidity, certifications, status of asset sales or debt resolutions, and real estate schedules, to be provided more frequently.

We routinely seek performance from guarantors of impaired debt if the guarantor is solvent. We may not seek to enforce the guaranty if we are precluded by bankruptcy or we determine the cost to pursue a guarantor exceeds the value to be returned given the guarantor s verified financial condition. We often are successful in obtaining either monetary payment or the cooperation of our solvent guarantors to help mitigate loss, cost, and the expense of collections.

Mortgage and construction loans with a loan-to-value ratio greater than 1.0 are accounted for as performing loans. These loans were not considered impaired due to one or more of the following factors: (i) underlying cash flow adequate to service the debt at a market rate of return with adequate amortization; (ii) a satisfactory borrower payment history; and (iii) acceptable guarantor support. As of June 30, 2016, we did not have any mortgage and construction loans that had a loan-to-value ratio greater than 1.0.

Consumer loan portfolio

Consumer loans outstanding decreased by $570 million, or 4%, from one year ago. The home equity portfolio is the largest segment of our consumer loan portfolio. Approximately 98% of this portfolio at June 30, 2016, was originated from our Key Community Bank within our 12-state footprint. The remainder of the portfolio, which has been in an exit mode since the fourth quarter of 2007, was originated from the Consumer Finance line of business and is now included in Other Segments. Home equity loans in Key Community Bank decreased by $417 million, or 4%, over the past twelve months.

As shown in Figure 17, we held the first lien position for approximately 61% of the Key Community Bank home equity portfolio at June 30, 2016, and 60% at June 30, 2015. For consumer loans with real estate collateral, we track borrower performance monthly. Regardless of the lien position, credit metrics are refreshed quarterly, including recent Fair Isaac Corporation scores as well as original and updated loan-to-value ratios. This information is used in establishing the ALLL. Our methodology is described in Note 1 ( Summary of Significant Accounting Policies ) under the heading Allowance for Loan and Lease Losses beginning on page 122 of our 2015 Form 10-K.

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At June 30, 2016, 39% of our home equity portfolio was secured by second lien mortgages. On at least a quarterly basis, we continue to monitor the risk characteristics of these loans when determining whether our loss estimation methods are appropriate.

Figure 22 summarizes our home equity loan portfolio 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 22. Home Equity Loans**

| | 2016 | | 2015 | | |
|---|---|---|---|---|---|
| *dollars in millions* | **Second** | **First** | **Fourth** | **Third** | **Second** |
| Home Equity Loans | **$ 10,062** | **$ 10,149** | $ 10,335 | $ 10,504 | $ 10,532 |
| Nonperforming loans at period end | **$ 189** | **$ 191** | $ 190 | $ 181 | $ 184 |
| Net loan charge-offs for the period | **3** | **7** | 5 | 3 | 8 |
| Yield for the period | **4.04%** | **4.06%** | 3.97% | 3.96% | 3.98% |

Loans held for sale

As shown in Note 3 ( Loans and Loans Held for Sale ), our loans held for sale decreased to $442 million at June 30, 2016, from $639 million at December 31, 2015, and from $835 million at June 30, 2015.

At June 30, 2016, loans held for sale included $150 million of commercial, financial and agricultural loans, which decreased $67 million from June 30, 2015, $270 million of commercial mortgage loans, which decreased $306 million from June 30, 2015, $19 million of residential mortgage loans, which decreased $16 million from June 30, 2015, and $3 million of commercial lease financing loans, which decreased $4 million from June 30, 2015.

Loan sales

As shown in Figure 23, during the first six months of 2016, we sold $2.4 billion of commercial real estate loans, $200 million of residential real estate loans, $209 million of commercial lease financing loans, and $129 million of commercial loans. Most of these sales came from the held-for-sale portfolio; however, $72 million of these loan sales related to the held-to-maturity portfolio.

Loan sales classified as held for sale generated net gains of $31 million in the first six months of 2016 and are included in investment banking and debt placement fees and other income on the income statement.

Among the factors that we consider in determining which loans to sell are:

- our business strategy for particular lending areas;
- whether particular lending businesses meet established performance standards or fit with our relationship banking strategy;

our A/LM needs;

the cost of alternative funding sources;

the level of credit risk;

capital requirements; and

market conditions and pricing.

Figure 23 summarizes our loan sales for the first six months of 2016 and all of 2015.

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**Figure 23. Loans Sold (Including Loans Held for Sale)**

| *in millions* | Commercial | Commercial Real Estate | Commercial Lease Financing | Residential Real Estate | Total |
|---|---|---|---|---|---|
| **2016** | | | | | |
| Second quarter | **$ 83** | **$ 1,518** | **$ 121** | **$ 111** | **$ 1,833** |
| First quarter | **46** | **925** | **88** | **89** | **1,148** |
| Total | **$ 129** | **$ 2,443** | **$ 209** | **$ 200** | **$ 2,981** |
| **2015** | | | | | |
| Fourth quarter | $ 86 | $ 1,570 | $ 204 | $ 104 | $ 1,964 |
| Third quarter | 150 | 1,246 | 100 | 142 | 1,638 |
| Second quarter | 41 | 2,210 | 48 | 188 | 2,487 |
| First quarter | 58 | 1,010 | 63 | 120 | 1,251 |
| Total | $ 335 | $ 6,036 | $ 415 | $ 554 | $ 7,340 |

Figure 24 shows loans that are either administered or serviced by us, but not recorded on the balance sheet, and includes loans that were sold.

**Figure 24. Loans Administered or Serviced**

| *in millions* | June 30, 2016 | March 31, 2016 | December 31, 2015 | September 30, 2015 | June 30, 2015 |
|---|---|---|---|---|---|
| Commercial real estate loans | **$ 213,879** | **$ 214,756** | $ 211,274 | $ 206,893 | $ 203,315 |
| Education loans | **1,226** | **1,280** | 1,339 | 1,398 | 1,459 |
| Commercial lease financing | **930** | **891** | 932 | 779 | 709 |
| Commercial loans | **355** | **347** | 335 | 340 | 337 |
| Total | **$ 216,390** | **$ 217,274** | $ 213,880 | $ 209,410 | $ 205,820 |

In the event of default by a borrower, we are subject to recourse with respect to approximately $2 billion of the $216 billion of loans administered or serviced at June 30, 2016. Additional information about this recourse arrangement is included in Note 15 ( Contingent Liabilities and Guarantees ) under the heading Recourse agreement with FNMA.

We derive income from several sources when retaining the right to administer or service loans that are sold. We earn noninterest income (recorded as mortgage servicing fees ) from fees for servicing or administering loans. This fee income is reduced by the amortization of related servicing assets. In addition, we earn interest income from investing funds generated by escrow deposits collected in connection with the servicing of commercial real estate loans.

**Securities**

Our securities portfolio totaled $19.4 billion at June 30, 2016, compared to $19.1 billion at December 31, 2015, and $19.3 billion at June 30, 2015. Available-for-sale securities were $14.6 billion at June 30, 2016, compared to $14.2 billion at December 31, 2015, and $14.3 billion at June 30, 2015. Held-to-maturity securities were $4.8 billion at June 30, 2016, compared to $4.9 billion at December 31, 2015, and $5 billion at June 30, 2015.

As shown in Figure 25, all of our mortgage-backed securities, which include both securities available for sale and held-to-maturity securities, are issued by government-sponsored enterprises or GNMA and traded in liquid secondary markets. These securities are recorded on the balance sheet at fair value for the available-for-sale portfolio and at cost for the held-to-maturity portfolio. For more information about these securities, see Note 5 ( Fair Value Measurements ) under the heading Qualitative Disclosures of Valuation Techniques, and Note 6 ( Securities ).

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**Figure 25. Mortgage-Backed Securities by Issuer**

| *in millions* | June 30, 2016 | December 31, 2015 | June 30, 2015 |
| --- | --- | --- | --- |
| FHLMC | **$ 4,001** | $ 4,349 | $ 5,037 |
| FNMA | **5,330** | 4,511 | 5,085 |
| GNMA | **9,999** | 10,152 | 9,083 |
| Total [a] | **$ 19,330** | $ 19,012 | $ 19,205 |

(a) Includes securities held in the available-for-sale and held-to-maturity portfolios.

Securities available for sale

The majority of our securities available-for-sale portfolio consists of Federal Agency CMOs and mortgage-backed securities. CMOs are debt securities secured by a pool of mortgages or mortgage-backed securities. These mortgage securities generate interest income, serve as collateral to support certain pledging agreements, and provide liquidity value under regulatory requirements. At June 30, 2016, we had $14.5 billion invested in CMOs and other mortgage-backed securities in the available-for-sale portfolio, compared to $14.2 billion at December 31, 2015, and $14.2 billion at June 30, 2015.

We periodically evaluate our securities available-for-sale portfolio in light of established A/LM objectives, changing market conditions that could affect the profitability of the portfolio, the regulatory environment, and the level of interest rate risk to which we are exposed. These evaluations may cause us to take steps to adjust our overall balance sheet positioning.

In addition, the size and composition of our securities available-for-sale portfolio could vary with our needs for liquidity and the extent to which we are required (or elect) to hold these assets as collateral to secure public funds and trust deposits. Although we generally use debt securities for this purpose, other assets, such as securities purchased under resale agreements or letters of credit, are used occasionally when they provide a lower cost of collateral or more favorable risk profiles.

Our investing activities continue to complement other balance sheet developments and provide for our ongoing liquidity management needs. Our actions to not reinvest the monthly security cash flows at various times provide the liquidity necessary to address our funding requirements. These funding requirements include ongoing loan growth and occasional debt maturities. At other times, we may make additional investments that go beyond the replacement of maturities or mortgage security cash flows as our liquidity position and/or interest rate risk management strategies may require. Lastly, our focus on investing in high quality liquid assets, including GNMA-related securities, is related to liquidity management strategies to satisfy regulatory requirements.

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Figure 26 shows the composition, yields, and remaining maturities of our securities available for sale. For more information about these securities, including gross unrealized gains and losses by type of security and securities pledged, see Note 6.

**Figure 26. Securities Available for Sale**

| *dollars in millions* | States and Political Subdivisions | Collateralized Mortgage Obligations (a) | Other Mortgage-Backed Securities (a) | Other Securities (b) | Total | Weighted-Average Yield (c) |
|---|---|---|---|---|---|---|
| **June 30, 2016** | | | | | | |
| Remaining maturity: | | | | | | |
| One year or less | **$ 1** | **$ 239** | **$ 12** | | **$ 252** | **3.13%** |
| After one through five years | **11** | **12,279** | **1,346** | **$ 13** | **13,649** | **2.09** |
| After five through ten years | | | **642** | **7** | **649** | **2.12** |
| After ten years | | | **2** | | **2** | **5.59** |
| Fair value | **$ 12** | **$ 12,518** | **$ 2,002** | **$ 20** | **$ 14,552** | |
| Amortized cost | **11** | **12,344** | **1,970** | **21** | **14,346** | **2.11%** |
| Weighted-average yield (c) | **6.22%** | **2.09%** | **2.22%** | | **2.11% (d)** | |
| Weighted-average maturity | **2.9 years** | **3.5 years** | **4.2 years** | **3.9 years** | **3.6 years** | |
| **December 31, 2015** | | | | | | |
| Fair value | $ 14 | $ 11,995 | $ 2,189 | $ 20 | $ 14,218 | |
| Amortized cost | 14 | 12,082 | 2,193 | 21 | 14,310 | 2.14% |
| **June 30, 2015** | | | | | | |
| Fair value | $ 19 | $ 11,751 | $ 2,452 | $ 22 | $ 14,244 | |
| Amortized cost | 19 | 11,765 | 2,439 | 20 | 14,243 | 2.13% |

(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 $20 million of securities at June 30, 2016, that have no stated yield.

Held-to-maturity securities

Federal Agency CMOs and mortgage-backed securities constitute essentially all of our held-to-maturity securities. The remaining balance comprises foreign bonds and capital securities. Figure 27 shows the composition, yields, and remaining maturities of these securities.

**Figure 27. Held-to-Maturity Securities**

| *dollars in millions* | Collateralized Mortgage Obligations | Other Mortgage-backed Securities | Other Securities | Total | Weighted-Average Yield (a) |
|---|---|---|---|---|---|
| **June 30, 2016** | | | | | |
| Remaining maturity: | | | | | |
| One year or less | **$ 77** | | **$ 9** | **$ 86** | **2.41%** |
| After one through five years | **4,022** | | **13** | **4,035** | **1.90** |
| After five through ten years | | **$ 711** | | **711** | **2.70** |
| After ten years | | | | | |
| Amortized cost | **$ 4,099** | **$ 711** | **$ 22** | **$ 4,832** | **2.03%** |
| Fair value | **4,138** | **729** | **22** | **4,889** | |
| Weighted-average yield | **1.91%** | **2.70%** | **2.61%** (b) | **2.03%** (b) | |
| Weighted-average maturity | **3.1 years** | **7.5 years** | **1.7 years** | **3.7 years** | |
| **December 31, 2015** | | | | | |
| Amortized cost | $ 4,174 | $ 703 | $ 20 | $ 4,897 | 2.01% |
| Fair value | 4,129 | 699 | 20 | 4,848 | |
| **June 30, 2015** | | | | | |
| Amortized cost | $ 4,463 | $ 539 | $ 20 | $ 5,022 | 1.97% |
| Fair value | 4,437 | 535 | 20 | 4,992 | |

(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 $5 million of securities at June 30, 2016, that have no stated yield.

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### Other investments

Principal investments investments in equity and debt instruments made by our Principal Investing unit represented 39%, 46%, and 50% of other investments at June 30, 2016, December 31, 2015, and June 30, 2015, respectively. They 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. The fair value of the direct investments was $40 million at June 30, 2016, $69 million at December 31, 2015, and $70 million at June 30, 2015, while the fair value of the indirect investments was $184 million at June 30, 2016, $235 million at December 31, 2015, and $282 million at June 30, 2015. Under the requirements of the Volcker Rule, we will be required to dispose of some or all of our indirect principal investments. The Federal Reserve extended the conformance period to July 21, 2017, for all banking entities with respect to covered funds. Key is permitted to file for an additional extension of up to five years for illiquid funds, to retain the indirect investments for a longer period of time. We plan to continue to evaluate our options, including applying for the extension and holding the investments. Additional information about this investment is provided in the Principal investments section of Note 5 ( Fair Value Measurements ). For more information about the Volcker Rule, see the discussion in Item 1 under the heading Other Regulatory Developments under the Dodd-Frank Act Volcker Rule in the section entitled Supervision and Regulation beginning on page 17 of our 2015 Form 10-K.

In addition to principal investments, other investments include other equity and mezzanine instruments, such as certain real-estate-related investments and an indirect ownership interest in a partnership, that are carried at fair value, as well as other types of investments that generally are carried at cost. The real-estate-related investments were valued at $8 million at June 30, 2016 and December 31, 2015, and $9 million at June 30, 2015. The indirect investment in a partnership was valued at $4 million at June 30, 2015. Under the requirements of the Volcker Rule, we were required to dispose of this investment, which was redeemed prior to December 31, 2015. Additional information pertaining to the equity investment is included in the Assets and Liabilities Measured at Fair Value on a Recurring Basis section of Note 5.

Most of our other investments are not traded on an active market. We determine the fair value at which these investments should be recorded based on the nature of the specific investment and all available relevant information. This review may encompass such factors as the issuer s past financial performance and future potential, the values of public 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, our knowledge of the industry, third-party data, and other relevant factors. During the first six months of 2016, net gains from our principal investing activities (including results attributable to noncontrolling interests) totaled $11 million, which includes $45 million of net unrealized losses. These net losses are recorded as net gains (losses) from principal investing on the income statement. Additional information regarding these investments is provided in Note 5.

### Deposits and other sources of funds

Domestic deposits are our primary source of funding. The composition of our average deposits is shown in Figure 8 in the section entitled Net interest income. During the second quarter of 2016, average domestic deposits were $73.9 billion and represented 84% of the funds we used to support loans and other earning assets, compared to $70.3 billion and 85% during the second quarter of 2015. Interest-bearing deposits increased $4.9 billion driven by a $3.6 billion increase in NOW and money market deposit accounts and a $1.3 billion increase in certificates of deposit and other time deposits. The increase in average deposits from the year-ago quarter reflects core deposit growth in our retail banking franchise, growth in escrow deposits from the commercial mortgage servicing business, and commercial deposit inflows. These increases were partially offset by a $1.2 billion decline in noninterest-bearing deposits.

Wholesale funds, consisting of deposits in our foreign office and short-term borrowings, averaged $1 billion during the second quarter of 2016, compared to $1.8 billion during the second quarter of 2015. The change from the second quarter of 2015 was caused by declines of $583 million in foreign office deposits and $220 million in federal funds purchased and securities sold under repurchase agreements, partially offset by an increase of $37 million in bank notes and other short-term borrowings.

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## Capital

At June 30, 2016, our shareholders equity was $11.3 billion, up $567 million from December 31, 2015. The following sections discuss certain factors that contributed to this change. For other factors that contributed to the change, see the Consolidated Statements of Changes in Equity (Unaudited).

CCAR and capital actions

As part of its ongoing supervisory process, the Federal Reserve requires BHCs like KeyCorp to submit an annual comprehensive capital plan and to update that plan to reflect material changes in the BHC s risk profile, business strategies, or corporate structure, including but not limited to changes in planned capital actions. The 2015 capital plan, which was effective through the second quarter of 2016, included a common share repurchase program of up to $725 million, which included repurchases to offset issuances of common shares under our employee compensation plans. Common share repurchases under the 2015 capital plan began in the second quarter of 2015 and were suspended in the fourth quarter of 2015 in connection with the announcement of our acquisition of First Niagara. In April 2016, we submitted to the Federal Reserve and provided to the OCC our 2016 capital plan under the annual CCAR process. On June 29, 2016, the Federal Reserve announced that it did not object to our 2016 capital plan. Share repurchases of up to $350 million were included in the 2016 capital plan, which is effective through the second quarter of 2017. We anticipate repurchasing common shares in the third quarter of 2016 following the completion of the acquisition of First Niagara.

Dividends

As previously reported, our 2015 capital plan proposed an increase in our quarterly common share dividend from $.075 to $.085 per share, which was approved by our Board in May 2016. An additional potential increase in our quarterly common share dividend, up to $.095 per share, will be considered by the Board for the second quarter of 2017, consistent with the 2016 capital plan. Further information regarding the capital planning process and CCAR is included under the heading Regulatory capital and liquidity in the Supervision and Regulation section beginning on page 10 of our 2015 Form 10-K.

Consistent with the 2015 capital plan, we made a dividend payment of $.085 per share, or $72 million, on our common shares during the second quarter of 2016.

We also made quarterly a dividend payment of $1.9375 per share, or $5.6 million, on our Series A Preferred Stock during the second quarter of 2016.

Common shares outstanding

Our common shares are traded on the NYSE under the symbol KEY with 26,501 holders of record at June 30, 2016. Our book value per common share was $13.08 based on 842.7 million shares outstanding at June 30, 2016, compared to $12.51 per common share based on 835.8 million shares outstanding at December 31, 2015, and $12.21 per common share based on 843.6 million shares outstanding at June 30, 2015. At June 30, 2016, our tangible book value per common share was $11.81, compared to $11.22 per common share at December 31, 2015, and $10.92 per common share at June 30, 2015.

Figure 28 shows activities that caused the change in outstanding common shares over the past five quarters.

**Figure 28. Changes in Common Shares Outstanding**

| | 2016 | | | 2015 | |
|---|---|---|---|---|---|
| *in thousands* | **Second** | **First** | **Fourth** | **Third** | **Second** |
| **Shares outstanding at beginning of period** | **842,290** | **835,751** | 835,285 | 843,608 | 850,920 |
| Common shares repurchased | | | | (8,386) | (8,794) |
| Shares reissued (returned) under employee benefit plans | **413** | **6,539** | 466 | 63 | 1,482 |
| **Shares outstanding at end of period** | **842,703** | **842,290** | 835,751 | 835,285 | 843,608 |

As shown above, common shares outstanding increased by .4 million shares during the second quarter of 2016 due to the net activity in our employee benefit plans.

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At June 30, 2016, we had 174.3 million treasury shares, compared to 181.2 million treasury shares at December 31, 2015, and 173.4 million treasury shares at June 30, 2015. Going forward we expect to reissue treasury shares as needed in connection with stock-based compensation awards and for other corporate purposes.

Information on repurchases of common shares by KeyCorp is included in Part II, Item 2. Unregistered Sales of Equity Securities and Use of Proceeds of this report.

Capital adequacy

Capital adequacy is an important indicator of financial stability and performance. All of our capital ratios remained in excess of regulatory requirements at June 30, 2016. Our capital and liquidity levels are intended to position us to weather an adverse credit cycle while continuing to serve our clients needs, as well as to meet the Regulatory Capital Rules described in the Supervision and regulation section of Item 2 of this report. Our shareholders equity to assets ratio was 11.18% at June 30, 2016, compared to 11.30% at December 31, 2015, and 11.19% at June 30, 2015. Our tangible common equity to tangible assets ratio was 9.95% at June 30, 2016, compared to 9.98% at December 31, 2015, and 9.86% at June 30, 2015.

Federal banking regulators have promulgated minimum risk-based capital and leverage ratio requirements for BHCs like KeyCorp and their banking subsidiaries like KeyBank. As of January 1, 2016, Key and KeyBank (consolidated) were each required to maintain a minimum Tier 1 risk-based capital ratio of 6.0%, a total risk-based capital ratio of 8.0%, and a Tier 1 leverage ratio of 4.0%. At June 30, 2016, our Tier 1 risk-based capital ratio, total risk-based capital ratio, and Tier 1 leverage ratio were 11.41%, 13.63%, and 10.59%, respectively, compared to 11.35%, 12.97%, and 10.72%, respectively, at December 31, 2015, and 11.11%, 12.66%, and 10.74%, respectively, at June 30, 2015. In addition, as of January 1, 2016, Key and KeyBank (consolidated) were each required to maintain a minimum Common Equity Tier 1 capital ratio of 4.5%. At June 30, 2016, our Common Equity Tier 1 capital ratio was 11.10%.

The adoption of the Regulatory Capital Rules changes the regulatory capital standards that apply to BHCs by phasing out the treatment of capital securities and cumulative preferred securities as eligible Tier 1 capital. The phase-out period, which began January 1, 2015, for standardized approach banking organizations such as KeyCorp, resulted in our trust preferred securities issued by the KeyCorp capital trusts being treated only as Tier 2 capital starting in 2016. The new minimum capital and leverage ratios under the Regulatory Capital Rules together with the estimated ratios of Key at June 30, 2016, calculated on a fully phased-in basis, are set forth under the heading New minimum capital and leverage ratio requirements in the Supervision and regulation section in Item 2 of this report.

As previously indicated in the Supervision and Regulation section of Item 1 of our 2015 Form 10-K under the heading Revised prompt corrective action capital category ratios, the prompt corrective action capital category regulations do not apply to BHCs. If, however, these regulations did apply to BHCs, we believe KeyCorp would qualify for the well capitalized capital category at June 30, 2016. The threshold ratios for a well capitalized and an adequately capitalized institution under the Regulatory Capital Rules are described in the Supervision and Regulation section of Item 1 of this report under the heading Revised prompt corrective action capital category ratios. Since the regulatory capital categories under these regulations serve a limited supervisory function, investors should not use them as a representation of the overall financial condition or prospects of KeyCorp. A discussion of the regulatory capital standards and other related capital adequacy regulatory standards is included in the section Regulatory capital and liquidity in Supervision and Regulation under Item 1 of our 2015 Form 10-K.

Traditionally, the banking regulators have assessed bank and BHC capital adequacy based on both the amount and composition of capital, the calculation of which is prescribed in federal banking regulations. The capital modifications mandated by the Regulatory Capital Rules, which became effective on January 1, 2015, for Key, require higher and

better-quality capital and introduced a new capital measure, Common Equity Tier 1. Common Equity Tier 1 is not formally defined by GAAP and is considered to be a non-GAAP financial measure. Figure 7 in the Highlights of Our Performance section reconciles Key shareholders equity, the GAAP performance measure, to Common Equity Tier 1, the corresponding non-GAAP measure. Our Common Equity Tier 1 ratio was 11.10% at June 30, 2016.

At June 30, 2016, for Key s consolidated operations, we had a federal net deferred tax asset of $91 million and a state deferred tax asset of $13 million, compared to a federal net deferred tax asset of $210 million and a state deferred tax asset of $25 million at June 30, 2015. We had a valuation allowance against the gross deferred tax assets associated with certain state net operating loss carryforwards and state credit carryforwards of less than $1 million at June 30, 2016, and June 30, 2015. Starting with the implementation of the Regulatory Capital Rules on January 1, 2015, deferred tax assets that arise from net

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operating loss and tax credit carryforwards are deductible from Common Equity Tier 1 on a phase-in basis. As of June 30, 2016, this balance was $1 million.

Figure 29 represents the details of our regulatory capital position at June 30, 2016, December 31, 2015, and June 30, 2015, under the Regulatory Capital Rules.

**Figure 29. Capital Components and Risk-Weighted Assets (Regulatory Capital Rules)**

| *dollars in millions* | **June 30, 2016** | **December 31, 2015** | **June 30, 2015** |
|---|---|---|---|
| **COMMON EQUITY TIER 1** | | | |
| Key shareholders equity (GAAP) | **$ 11,313** | $ 10,746 | $ 10,590 |
| Less: Series A Preferred Stock [a] | **281** | 281 | 281 |
| Common Equity Tier 1 capital before adjustments and deductions | **11,032** | 10,465 | 10,309 |
| Less: Goodwill, net of deferred taxes | **1,031** | 1,034 | 1,034 |
| Intangible assets, net of deferred taxes | **30** | 26 | 33 |
| Deferred tax assets | **1** | 1 | 1 |
| Net unrealized gains (losses) on available-for-sale securities, net of deferred taxes | **129** | (58) | |
| Accumulated gains (losses) on cash flow hedges, net of deferred taxes | **77** | (20) | (20) |
| Amounts in AOCI attributed to pension and postretirement benefit costs, net of deferred taxes | **(362)** | (365) | (361) |
| Total Common Equity Tier 1 capital | **$ 10,126** | $ 9,847 | $ 9,622 |
| **TIER 1 CAPITAL** | | | |
| Common Equity Tier 1 | **$ 10,126** | $ 9,847 | $ 9,622 |
| Additional Tier 1 capital instruments and related surplus | **281** | 281 | 281 |
| Non-qualifying capital instruments subject to phase out | | 85 | 85 |
| Less: Deductions | **1** | 1 | 1 |
| Total Tier 1 capital | **10,406** | 10,212 | 9,987 |
| **TIER 2 CAPITAL** | | | |
| Tier 2 capital instruments and related surplus | **1,101** | 578 | 521 |
| Allowance for losses on loans and liability for losses on lending-related commitments [b] | **925** | 881 | 863 |
| Net unrealized gains on available-for-sale preferred stock classified as an equity security | | | 1 |
| Less: Deductions | | | |
| Total Tier 2 capital | **2,026** | 1,459 | 1,385 |

| | | | |
|---|---|---|---|
| Total risk-based capital | **$ 12,432** | $ 11,671 | $ 11,372 |
| **RISK-WEIGHTED ASSETS** | | | |
| Risk-weighted assets on balance sheet | **$ 68,981** | $ 67,390 | $ 67,460 |
| Risk-weighted off-balance sheet exposure | **21,499** | 21,983 | 21,808 |
| Market risk-equivalent assets | **715** | 607 | 583 |
| Gross risk-weighted assets | **91,195** | 89,980 | 89,851 |
| Less: Excess allowance for loan and lease losses | | | |
| Net risk-weighted assets | **$ 91,195** | $ 89,980 | $ 89,851 |
| **AVERAGE QUARTERLY TOTAL ASSETS** | **$ 98,290** | $ 95,272 | $ 93,024 |
| **CAPITAL RATIOS** | | | |
| Tier 1 risk-based capital | **11.41%** | 11.35% | 11.11% |
| Total risk-based capital | **13.63** | 12.97 | 12.66 |
| Leverage [(c)] | **10.59** | 10.72 | 10.74 |
| Common Equity Tier 1 | **11.10** | 10.94 | 10.71 |

(a) Net of capital surplus.

(b) The ALLL included in Tier 2 capital is limited by regulation to 1.25% of the institution s standardized total risk-weighted assets (excluding its standardized market risk-weighted assets). The ALLL includes $20 million, $28 million, and $22 million of allowance classified as discontinued assets on the balance sheet at June 30, 2016, December 31, 2015, and June 30, 2015, respectively.

(c) This ratio is Tier 1 capital divided by average quarterly total assets as defined by the Federal Reserve less: (i) goodwill, (ii) the disallowed intangible and deferred tax assets, and (iii) other deductions from assets for leverage capital purposes.

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## Risk Management

### Overview

Like all financial services companies, we engage in business activities and assume the related risks. The most significant risks we face are credit, compliance, operational, liquidity, market, reputation, strategic, and model risks. Our risk management activities are focused on ensuring we properly identify, measure, and manage such risks across the entire enterprise to maintain safety and soundness and maximize profitability. Certain of these risks are defined and discussed in greater detail in the remainder of this section.

The Board serves in an oversight capacity ensuring that Key s risks are managed in a manner that is effective and balanced and adds value for the shareholders. The Board understands Key s risk philosophy, approves the risk appetite, inquires about risk practices, reviews the portfolio of risks, compares the actual risks to the risk appetite, and is apprised of significant risks, both actual and emerging, and determines whether management is responding appropriately. The Board challenges management and ensures accountability.

The Board s Audit Committee assists the Board in oversight of financial statement integrity, regulatory and legal requirements, independent auditors qualifications and independence, and the performance of the internal audit function and independent auditors. The Audit Committee meets with management and approves significant policies relating to the risk areas overseen by the Audit Committee. The Audit Committee has responsibility over all risk review functions, including internal audit, as well as financial reporting, legal matters, and fraud risk. The Audit Committee also receives reports on enterprise risk. In addition to regularly scheduled bi-monthly meetings, the Audit Committee convenes to discuss the content of our financial disclosures and quarterly earnings releases.

The Board s Risk Committee assists the Board in oversight of strategies, policies, procedures, and practices relating to the assessment and management of enterprise-wide risk, including credit, market, liquidity, model, operational, compliance, reputation, and strategic risks. The Risk Committee also assists the Board in overseeing risks related to capital adequacy, capital planning, and capital actions. The Risk Committee reviews and provides oversight of management s activities related to the enterprise-wide risk management framework, which includes review of the ERM Policy, including the Risk Appetite Statement, and management and ERM reports. The Risk Committee also approves any material changes to the charter of the ERM Committee and significant policies relating to risk management.

The Audit and Risk Committees meet jointly, as appropriate, to discuss matters that relate to each committee s responsibilities. Committee chairpersons routinely meet with management during interim months to plan agendas for upcoming meetings and to discuss emerging trends and events that have transpired since the preceding meeting. All members of the Board receive formal reports designed to keep them abreast of significant developments during the interim months.

Our ERM Committee, chaired by the Chief Executive Officer and comprising other senior level executives, is responsible for managing risk and ensuring that the corporate risk profile is managed in a manner consistent with our risk appetite. The ERM Program encompasses our risk philosophy, policy, framework, and governance structure for the management of risks across the entire company. The ERM Committee reports to the Board s Risk Committee. Annually, the Board reviews and approves the ERM Policy, as well as the risk appetite, including corporate risk tolerances for major risk categories. We use a risk-adjusted capital framework to manage risks. This framework is approved and managed by the ERM Committee.

Tier 2 Risk Governance Committees support the ERM Committee by identifying early warning events and trends, escalating emerging risks, and discussing forward-looking assessments. Risk Governance Committees include

attendees from each of the Three Lines of Defense. The First Line of Defense is the Line of Business primarily responsible to accept, own, proactively identify, monitor, and manage risk. The Second Line of Defense comprises Risk Management representatives who provide independent, centralized oversight over all risk categories by aggregating, analyzing, and reporting risk information. Risk Review, our internal audit function, provides the Third Line of Defense in their role to provide independent assessment and testing of the effectiveness, appropriateness, and adherence to KeyCorp s risk management policies, practices, and controls.

The Chief Risk Officer ensures that relevant risk information is properly integrated into strategic and business decisions, ensures appropriate ownership of risks, provides input into performance and compensation decisions, assesses aggregate enterprise risk, monitors capabilities to manage critical risks, and executes appropriate Board and stakeholder reporting.

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Federal banking regulators continue to emphasize with financial institutions the importance of relating capital management strategy to the level of risk at each institution. We believe our internal risk management processes help us achieve and maintain capital levels that are commensurate with our business activities and risks and conform to regulatory expectations.

**Market risk management**

Market risk is the risk that movements in market risk factors, including interest rates, foreign exchange rates, equity prices, commodity prices, credit spreads, and volatilities will reduce Key s income and the value of its portfolios. These factors influence prospective yields, values, or prices associated with the instrument. For example, the value of a fixed-rate bond will decline when market interest rates increase, while the cash flows associated with a variable rate loan will increase when interest rates increase. The holder of a financial instrument is exposed to market risk when either the cash flows or the value of the instrument is tied to such external factors.

We are exposed to market risk both in our trading and nontrading activities, which include asset and liability management activities. Our trading positions are carried at fair value with changes recorded in the income statement. These positions are subject to various market-based risk factors that impact the fair value of the financial instruments in the trading category. Our traditional banking loan and deposit products as well as long-term debt and certain short-term borrowings are nontrading positions. These positions are generally carried at the principal amount outstanding for assets and the amount owed for liabilities. The nontrading positions are subject to changes in economic value due to varying market conditions, primarily changes in interest rates.

Trading market risk

Key incurs market risk as a result of trading, investing, and client facilitation activities, principally within our investment banking and capital markets businesses. Key has exposures to a wide range of interest rates, equity prices, foreign exchange rates, credit spreads, and commodity prices, as well as the associated implied volatilities and spreads. Our primary market risk exposures are a result of trading activities in the derivative and fixed income markets and maintaining positions in these instruments. We maintain modest trading inventories to facilitate customer flow, make markets in securities, and hedge certain risks. The majority of our positions are traded in active markets.

***Management of trading market risks***. Market risk management is an integral part of Key s risk culture. The Risk Committee of our Board provides oversight of trading market risks. The ERM Committee and the Market Risk Committee regularly review and discuss market risk reports prepared by our MRM that contain our market risk exposures and results of monitoring activities. Market risk policies and procedures have been defined and approved by the Market Risk Committee, a Tier 2 Risk Governance Committee, and take into account our tolerance for risk and consideration for the business environment.

The MRM is an independent risk management function that partners with the lines of business to identify, measure, and monitor market risks throughout our company. The MRM is responsible for ensuring transparency of significant market risks, monitoring compliance with established limits, and escalating limit exceptions to appropriate senior management. The various business units and trading desks are responsible for ensuring that market risk exposures are well-managed and prudent. Market risk is monitored through various measures, such as VaR, and through routine stress testing, sensitivity, and scenario analyses. The MRM conducts stress tests for each covered position using historical worst case and standard shock scenarios. VaR, stressed VaR, and other analyses are prepared daily and distributed to appropriate management.

***Covered positions.*** We monitor the market risk of our covered positions, which includes all of our trading positions as well as all foreign exchange and commodity positions, regardless of whether the position is in a trading account. All positions in the trading account are recorded at fair value, and changes in fair value are reflected in our consolidated statements of income. Information regarding our fair value policies, procedures, and methodologies is provided in Note 1 ( Summary of Significant Accounting Policies ) under the heading Fair Value Measurements on page 124 of our 2015 Form 10-K and Note 5 ( Fair Value Measurements ) in this report. Instruments that are used to hedge nontrading activities, such as bank-issued debt and loan portfolios, equity positions that are not actively traded, and securities financing activities, do not meet the definition of a covered position. The MRM is responsible for identifying our portfolios as either covered or non-covered. The Covered Position Working Group develops the final list of covered positions, and a summary is provided to the Market Risk Committee.

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Our significant portfolios of covered positions are detailed below. We analyze market risk by portfolios of covered positions, and do not separately measure and monitor our portfolios by risk type. The descriptions below incorporate the respective risk types associated with each of these portfolios.

Fixed income includes those instruments associated with our capital markets business and the trading of securities as a dealer. These instruments may include positions in municipal bonds, bonds backed by the U.S. government, agency and corporate bonds, certain mortgage-backed securities, securities issued by the U.S. Treasury, money markets, and certain CMOs. The activities and instruments within the fixed income portfolio create exposures to interest rate and credit spread risks.

Interest rate derivatives include interest rate swaps, caps, and floors, which are transacted primarily to accommodate the needs of commercial loan clients. In addition, we enter into interest rate derivatives to offset or mitigate the interest rate risk related to the client positions. The activities within this portfolio create exposures to interest rate risk.

Credit derivatives generally include credit default swap indexes, which are used to manage the credit risk exposure associated with anticipated sales of certain commercial real estate loans. The transactions within the credit derivatives portfolio result in exposure to counterparty credit risk and market risk.

***VaR and stressed VaR.*** VaR is the estimate of the maximum amount of loss on an instrument or portfolio due to adverse market conditions during a given time interval within a stated confidence level. Stressed VaR is used to assess extreme conditions on market risk within our trading portfolios. MRM calculates VaR and stressed VaR on a daily basis, and the results are distributed to appropriate management. VaR and stressed VaR results are also provided to our regulators and utilized in regulatory capital calculations.

We use a historical VaR 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 our covered positions. Historical scenarios are customized for specific covered positions, and numerous risk factors are incorporated in the calculation. Additional consideration is given to the risk factors to estimate the exposures that contain optionality features, such as options and cancelable provisions. VaR is calculated using daily observations over a one-year time horizon, and approximates a 95% confidence level. Statistically, this means that we would expect to incur losses greater than VaR, on average, five out of 100 trading days, or three to four times each quarter. We also calculate VaR and stressed VaR at a 99% confidence level.

The VaR model is an effective tool in estimating ranges of possible gains and losses on our covered positions. However, there are limitations inherent in the VaR model since it uses historical results over a given time interval to estimate future performance. Historical results may not be indicative of future results, and changes in the market or composition of our portfolios could have a significant impact on the accuracy of the VaR model. We regularly review and enhance the modeling techniques, inputs and assumptions used. Our market risk policy includes the independent validation of our VaR model by Key s Risk Management Group on an annual basis. The Model Risk Management Committee oversees the Model Validation Program, and results of validations are discussed with the ERM Committee.

Actual losses for the total covered positions did not exceed aggregate daily VaR on any day during the quarters ended June 30, 2016, and June 30, 2015. The MRM backtests our VaR model on a daily basis to evaluate its predictive

power. The test compares VaR model results at the 99% confidence level to daily held profit and loss. Results of backtesting are provided to the Market Risk Committee. Backtesting exceptions occur when trading losses exceed VaR.

We do not engage in correlation trading, or utilize the internal model approach for measuring default and credit migration risk. Our net VaR approach incorporates diversification, but our VaR calculation does not include the impact of counterparty risk and our own credit spreads on derivatives.

The aggregate VaR at the 99% confidence level for all covered positions was $.8 million at June 30, 2016, and $1 million at June 30, 2015. The decrease in aggregate VaR was primarily due to the decreased exposure in our fixed income and equity portfolios. Figure 31 summarizes our VaR at the 99% confidence level for significant portfolios of covered positions for the three months ended June 30, 2016, and June 30, 2015. During these periods, none of our significant portfolios daily trading VaR numbers exceeded their VaR limits or stress VaR limits.

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**Figure 31. VaR for Significant Portfolios of Covered Positions**

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Three months ended June 30, | | | | Three months ended June 30, | | | |
| *in millions* | **High** | **Low** | **Mean** | **June 30,** | **High** | **Low** | **Mean** | **June 30,** |
| Trading account assets: | | | | | | | | |
| Fixed income | **$ 1.2** | **$ .4** | **$ .6** | **$ .4** | $ .9 | $ .3 | $ .6 | $ .6 |
| Derivatives: | | | | | | | | |
| Interest rate | **$ .2** | | **$ .1** | **$ .1** | $ .1 | .1 | $ .1 | $ .1 |
| Credit | **.2** | | **.1** | **.2** | .3 | $ .1 | .2 | .1 |

Stressed VaR is calculated using our general VaR results at the 99% confidence level and applying certain assumptions. The aggregate stressed VaR for all covered positions was $2.7 million at June 30, 2016, and $2.9 million at June 30, 2015. Figure 32 summarizes our stressed VaR for significant portfolios of covered positions for the three months ended June 30, 2016, and June 30, 2015, as used for market risk capital charge calculation purposes.

**Figure 32. Stressed VaR for Significant Portfolios of Covered Positions**

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | Three months ended June 30, | | | | Three months ended June 30, | | | |
| *in millions* | **High** | **Low** | **Mean** | **June 30,** | **High** | **Low** | **Mean** | **June 30,** |
| Trading account assets: | | | | | | | | |
| Fixed income | **$ 2.9** | **$ 1.1** | **$ 1.8** | **$ 1.2** | $ 2.6 | $ .9 | $ 1.7 | $ 1.8 |
| Derivatives: | | | | | | | | |
| Interest rate | **$ .3** | **$ .1** | **$ .1** | **$ .2** | $ .3 | $ .2 | $ .2 | $ .2 |
| Credit | **.8** | **.1** | **.2** | **.8** | .9 | .2 | .7 | .4 |

***Internal capital adequacy assessment.*** Market risk is a component of our internal capital adequacy assessment. Our risk-weighted assets include a market risk-equivalent asset position, which consists of a VaR component, stressed VaR component, a de minimis exposure amount, and a specific risk add-on, which are added together to arrive at total market risk equivalent assets. Specific risk is the price risk of individual financial instruments, which is not accounted for by changes in broad market risk factors and is measured through a standardized approach. Specific risk calculations are run quarterly by the MRM, and approved by the Chief Market Risk Officer.

Nontrading market risk

Most of our nontrading market risk is derived from interest rate fluctuations and its impacts on our traditional loan and deposit products, as well as investments, hedging relationships, long-term debt, and certain short-term borrowings. Interest rate risk, which is inherent in the banking industry, is measured by the potential for fluctuations in net interest income and the EVE. 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. We manage the exposure to changes in net interest income and the EVE in accordance with our risk appetite and within Board-approved policy limits.

Interest rate risk positions are influenced by a number of factors including the balance sheet positioning that arises out of consumer preferences for loan and deposit products, economic conditions, the competitive environment within our

markets, changes in market interest rates that affect client activity, and our hedging, investing, funding, and capital positions. The primary components of interest rate risk exposure consist of reprice risk, basis risk, yield curve risk, and option risk.

The management of nontrading market risk is centralized within Corporate Treasury. The Risk Committee of our Board provides oversight of nontrading market risk. The ERM Committee and the ALCO review reports on the components of interest rate risk described above as well as sensitivity analyses of these exposures. These committees have various responsibilities related to managing nontrading market risk, including recommending, approving, and monitoring strategies that maintain risk positions within approved tolerance ranges. The A/LM policy provides the framework for the oversight and management of interest rate risk and is administered by the ALCO. Internal and external emerging issues are monitored on a daily basis. The MRM, as the second line of defense, provides additional oversight.

***Reprice risk*** is the exposure to changes in interest rates and occurs when the volume of interest-bearing liabilities and the volume of interest-earning assets they fund (e.g., deposits used to fund loans) do not mature or reprice at the same time.

***Basis risk*** is the exposure to asymmetrical changes in interest rate indexes and occurs when floating-rate assets and floating-rate liabilities reprice at the same time, but in response to different market factors or indexes.

***Yield curve risk*** is the exposure to non-parallel changes in the slope of the yield curve (where the yield curve depicts the relationship between the yield on a particular type of security and its term to maturity) and occurs when interest-bearing liabilities and the interest-earning assets that they fund do not price or reprice to the same term point on the yield curve.

***Option risk*** is the exposure to a customer or counterparty s ability to take advantage of the interest rate environment and terminate or reprice one of our assets, liabilities, or off-balance sheet instruments prior to contractual maturity without a penalty. Option risk occurs when exposures to customer and counterparty early withdrawals or prepayments are not mitigated with an offsetting position or appropriate compensation.

***Net interest income simulation analysis.*** The primary tool we use to measure our interest rate risk is simulation analysis. For purposes of this analysis, we estimate our net interest income based on the current and projected composition of our on- and off-balance sheet positions, accounting for recent and anticipated trends in customer activity. The analysis also incorporates assumptions for the current and projected interest rate environments, including a most likely macro-economic scenario. Simulation modeling assumes that residual risk exposures will be managed to within the risk appetite and Board-approved policy limits.

We measure the amount of net interest income at risk by simulating the change in net interest income that would occur if the federal funds target rate were to gradually increase or decrease over the next 12 months, and term rates were to move in a similar direction, although at a slower pace. Our standard rate scenarios encompass a gradual increase or decrease of 200 basis points, but due to the low interest rate environment, we have modified the standard to a gradual decrease of 50 basis points over three months with no change over the following nine months. After calculating the amount of net interest income at risk to interest rate changes, we compare that amount with the base case of an unchanged interest rate environment. We also perform regular stress tests and sensitivities on the model inputs that could materially change the resulting risk assessments. One set of stress tests and sensitivities assesses the effect of interest rate inputs on simulated exposures. Assessments are performed using different shapes of the yield curve, including steepening or flattening of the yield curve, changes in credit spreads, an immediate parallel change in market interest rates, and changes in the relationship of money market interest rates. Another set of stress tests and sensitivities assesses the effect of loan and deposit assumptions and assumed discretionary strategies on simulated exposures. Assessments are performed on changes to the following assumptions: the pricing of deposits without contractual maturities; changes in lending spreads; prepayments on loans and securities; other loan and deposit balance shifts; investment, funding and hedging activities; and liquidity and capital management strategies.

Simulation analysis produces only a sophisticated estimate of interest rate exposure based on judgments related to assumption inputs into the simulation model. We tailor assumptions to the specific interest rate environment and yield curve shape being modeled, and validate those assumptions on a regular basis. Our 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 residual risk profile. However, actual results may differ from those derived in simulation analysis due to unanticipated changes to the balance sheet composition, customer behavior,

product pricing, market interest rates, investment, funding and hedging activities, and repercussions from unanticipated or unknown events.

Figure 33 presents the results of the simulation analysis at June 30, 2016, and June 30, 2015. At June 30, 2016, our simulated exposure to changes in interest rates was moderately asset sensitive, and net interest income would benefit over time from either an increase in short-term or intermediate-term interest rates. Tolerance levels for risk management require the development of remediation plans to maintain residual risk within tolerance if simulation modeling demonstrates that a gradual increase or decrease in short-term interest rates over the next 12 months would adversely affect net interest income over the same period by more than 4%. In December 2015, the Federal Reserve increased the range for the federal funds target rate, which led to an increased modeled exposure to declining interest rates. Subsequent to the Federal Reserve s action in December, we increased the magnitude of the declining rate scenario to 50 basis points, increasing our overall modeled exposure. The modeled exposure depends on the relationships of interest rates on our interest earning assets and interest bearing liabilities, notably on instruments that are expected to react to the short end of the yield curve. As shown in Figure 33, we are operating within these levels as of June 30, 2016.

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**Figure 33. Simulated Change in Net Interest Income**

| | | |
|---|---|---|
| **June 30, 2016** | | |
| Basis point change assumption (short-term rates) | **-50** | **+200** |
| Tolerance level | **-4.00%** | **-4.00%** |
| Interest rate risk assessment | **-3.37%** | **2.22%** |
| **June 30, 2015** | | |
| Basis point change assumption (short-term rates) | -25 | +200 |
| Tolerance level | -4.00% | -4.00% |
| Interest rate risk assessment | -.99% | 2.79% |

The results of additional sensitivity analysis of alternate interest rate paths and loan and deposit behavior assumptions indicates that net interest income could increase or decrease from the base simulation results presented in Figure 33. Net interest income is highly dependent on the timing, magnitude, frequency, and path of interest rate increases and the associated assumptions for deposit repricing relationships, lending spreads, and the balance behavior of transaction accounts. The unprecedented low level of interest rates increases the uncertainty of assumptions for deposit balance behavior and deposit repricing relationships to market interest rates. Recent balance growth in deposits has caused the uncertainty in assumptions to increase further. Our historical deposit repricing betas in the last rising rate cycle ranged between 50% and 60% for interest-bearing deposits, and we continue to make similar assumptions in our modeling. The sensitivity testing of these assumptions supports our confidence that actual results are likely to be within a 100 basis point range of modeled results.

Key will continue to monitor balance sheet flows and expects the benefit from rising rates to increase modestly prior to any increase in the federal funds rate. Our current interest rate risk position could fluctuate to higher or lower levels of risk depending on the competitive environment and client behavior that may affect the actual volume, mix, maturity, and repricing characteristics of loan and deposit flows. As changes occur to both the configuration of the balance sheet and the outlook for the economy, management proactively evaluates hedging opportunities that may change our interest rate risk profile.

We also conduct simulations that measure the effect of changes in market interest rates in the second and third years of a three-year horizon. These simulations are conducted in a manner similar to those based on a 12-month horizon. To capture longer-term exposures, we calculate exposures to changes of the EVE as discussed in the following section.

***Economic value of equity modeling.*** EVE complements net interest income simulation analysis as it estimates risk exposure beyond 12-, 24-, and 36-month horizons. EVE modeling measures the extent to which the economic values of assets, liabilities and off-balance sheet instruments may change in response to fluctuations in interest rates. EVE is calculated by subjecting the balance sheet to an immediate 200 basis point increase or decrease in interest rates, measuring the resulting change in the values of assets, liabilities and off-balance sheet instruments, and comparing those amounts with the base case of the current interest rate environment. Because the calculation of EVE under an immediate 200 basis point decrease in interest rates in the current low rate environment results in certain interest rates declining to zero and a less than 200 basis point decrease in certain yield curve term points, we have modified the standard declining rate scenario to an immediate 100 basis point decrease. This analysis is highly dependent upon assumptions applied to assets and liabilities with non-contractual maturities. Those assumptions are based on historical behaviors, as well as our expectations. We develop remediation plans that would maintain residual risk

within tolerance if this analysis indicates that our EVE will decrease by more than 15% in response to an immediate increase or decrease in interest rates. We are operating within these guidelines as of June 30, 2016.

***Management of interest rate exposure.*** We use the results of our various interest rate risk analyses to formulate A/LM strategies to achieve the desired risk profile while managing to our objectives for capital adequacy and liquidity risk exposures. Specifically, we manage interest rate risk positions by purchasing securities, issuing term debt with floating or fixed interest rates, and using derivatives predominantly in the form of interest rate swaps, which modify the interest rate characteristics of certain assets and liabilities.

Figure 34 shows all swap positions that we hold for 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. The volume, maturity and mix of portfolio swaps change frequently as we adjust our broader A/LM objectives and the balance sheet positions to be hedged. For more information about how we use interest rate swaps to manage our risk profile, see Note 7 ( Derivatives and Hedging Activities ).

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**Figure 34. Portfolio Swaps by Interest Rate Risk Management Strategy**

| | June 30, 2016 | | | | | June 30, 2015 | |
|---|---|---|---|---|---|---|---|
| | | | Weighted-Average | | | | |
| *dollars in millions* | Notional Amount | Fair Value | Maturity (Years) | Receive Rate | Pay Rate | Notional Amount | Fair Value |
| Receive fixed/pay variable conventional A/LM [a] | **$ 14,630** | **$ 165** | **2.1** | **1.0%** | **.5%** | $ 10,455 | $ 1 |
| Receive fixed/pay variable conventional debt | **8,005** | **353** | **3.6** | **1.7** | **.5** | 6,760 | 191 |
| Pay fixed/receive variable conventional debt | **50** | **(12)** | **12.0** | **.6** | **3.6** | 50 | (5) |
| Total portfolio swaps | **$ 22,685** | **$ 506 [b]** | **2.7** | **1.2%** | **.5%** | $ 17,265 | $ 187 [b] |

(a) Portfolio swaps designated as A/LM are used to manage interest rate risk tied to both assets and liabilities.
(b) Excludes accrued interest of $54 million and $58 million at June 30, 2016, and June 30, 2015, respectively.

**Liquidity risk management**

Liquidity risk, which is inherent in the banking industry, is measured by our ability to accommodate liability maturities and deposit withdrawals, meet contractual obligations, and fund new business opportunities 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.

Governance structure

We manage liquidity for all of our affiliates on an integrated basis. This approach considers the unique funding sources available to each entity, as well as each entity s capacity to manage through adverse conditions. The approach also recognizes that adverse market conditions or other events that could negatively affect the availability or cost of liquidity will affect the access of all affiliates to sufficient wholesale funding.

The management of consolidated liquidity risk is centralized within Corporate Treasury. Oversight and governance is provided by the Board, the ERM Committee, the ALCO, and the Chief Risk Officer. The Asset Liability Management Policy provides the framework for the oversight and management of liquidity risk and is administered by the ALCO. The MRM, as the second line of defense, provides additional oversight. Our current liquidity risk management practices are in compliance with the Federal Reserve Board s Enhanced Prudential Standards and the OCC s Heightened Standards for Large Insured National Banks.

These committees regularly review liquidity and funding summaries, liquidity trends, peer comparisons, variance analyses, liquidity projections, hypothetical funding erosion stress tests, and goal tracking reports. The reviews generate a discussion of positions, trends, and directives on liquidity risk and shape a number of our decisions. When liquidity pressure is elevated, positions are monitored more closely and reporting is more intensive. To ensure that emerging issues are identified, we also communicate with individuals inside and outside of the company on a daily

basis.

Factors affecting liquidity

Our liquidity could be adversely affected by both direct and indirect events. An example of a direct event would be a downgrade in our public credit ratings by a rating agency. Examples of indirect events (events unrelated to us) that could impair our access to liquidity would be an act of 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 us or the banking industry in general, may adversely affect the cost and availability of normal funding sources.

Following our announced acquisition of First Niagara in October 2015, S&P and Fitch affirmed Key s ratings but changed the outlook to negative. Moody s placed Key s ratings under review for downgrade. On July 13, 2016, Moody s subsequently confirmed Key s ratings and changed the outlook from negative to stable, concluding their review.

Our credit ratings at June 30, 2016, are shown in Figure 35. We believe these credit ratings, under normal conditions in the capital markets, will enable KeyCorp or KeyBank to issue fixed income securities to investors.

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**Figure 35. Credit Ratings**

| June 30, 2016 | Short-Term Borrowings | Long-Term Deposits | Senior Long-Term Debt | Subordinated Long-Term Debt | Capital Securities | Series A Preferred Stock |
|---|---|---|---|---|---|---|
| KEYCORP (THE PARENT COMPANY) | | | | | | |
| Standard & Poor s | A-2 | N/A | BBB+ | BBB | BB+ | BB+ |
| Moody s | P-2 | N/A | Baa1 | Baa1 | Baa2 | Baa3 |
| Fitch | F1 | N/A | A- | BBB+ | BB+ | BB |
| DBRS | R-2(high) | N/A | BBB(high) | BBB | BBB | N/A |
| KEYBANK | | | | | | |
| Standard & Poor s | A-2 | N/A | A- | BBB+ | N/A | N/A |
| Moody s | P-1 | Aa3 | A3 | Baa1 | N/A | N/A |
| Fitch | F1 | A | A- | BBB+ | N/A | N/A |
| DBRS | R-1(low) | A(low) | A(low) | BBB(high) | N/A | N/A |

Managing liquidity risk

Most of our liquidity risk is derived from our lending activities, which inherently places funds into illiquid assets. Liquidity risk is also derived from our deposit gathering activities and the ability of our customers to withdraw funds that do not have a stated maturity or to withdraw funds before their contractual maturity. The assessments of liquidity risk are measured under the assumption of normal operating conditions as well as under a stressed environment. We manage these exposures in accordance with our risk appetite, and within Board-approved policy limits.

We regularly monitor our liquidity position and funding sources and measure our capacity to obtain funds in a variety of hypothetical scenarios in an effort to maintain an appropriate mix of available and affordable funding. In the normal course of business, we perform a monthly hypothetical funding erosion stress test for both KeyCorp and KeyBank. In a heightened monitoring mode, we may conduct the hypothetical funding erosion stress tests more frequently, and use assumptions to reflect the changed market environment. Our testing incorporates estimates for loan and deposit lives based on our historical studies. Hypothetical erosion stress tests analyze potential liquidity scenarios under various funding constraints and time periods. Ultimately, they determine the periodic effects that major direct and indirect events would have on our access to funding markets and our ability to fund our normal operations. To compensate for the effect of these assumed liquidity pressures, we consider alternative sources of liquidity and maturities over different time periods to project how funding needs would be managed.

We maintain a Contingency Funding 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 managing liquidity through a problem period. As part of the plan, we maintain on-balance sheet liquid reserves referred to as our liquid asset portfolio, which consists of high quality liquid assets. During a problem period, that reserve could be used as a source of funding to provide time to develop and execute a longer-term strategy. The liquid asset portfolio at June 30, 2016, totaled $20.0 billion, consisting of $13.7 billion of unpledged securities, $514 million of securities available for secured funding at the FHLB, and $5.8 billion of net balances of federal funds sold and balances in our Federal Reserve account. The liquid asset portfolio can fluctuate due to excess liquidity, heightened

risk, or prefunding of expected outflows, such as debt maturities. Additionally, as of June 30, 2016, our unused borrowing capacity secured by loan collateral was $15.7 billion at the Federal Reserve Bank of Cleveland and $3 billion at the FHLB. During the second quarter of 2016, Key s outstanding FHLB advances were reduced by $9.5 million due to repayments.

Final U.S. liquidity coverage ratio

Under the Liquidity Coverage Rules, we are required to calculate the Modified LCR for Key. Implementation for Modified LCR banking organizations, like Key, began on January 1, 2016, with a minimum requirement of 90% coverage, reaching 100% coverage by January 1, 2017. For the second quarter of 2016, our Modified LCR was above 100%. In the future, we may change the composition of our investment portfolio, increase the size of the overall investment portfolio, and/or modify product offerings to enhance or optimize our liquidity position.

Additional information about the Liquidity Coverage Ratio is included in the Supervision and regulation section under the heading Liquidity coverage ratio in Item 2 of this report.

Long-term liquidity strategy

Our long-term liquidity strategy is to be predominantly funded by core deposits. However, we may use wholesale funds to sustain an adequate liquid asset portfolio, meet daily cash demands, and allow management flexibility to execute business initiatives. Key s client-based relationship strategy provides for a strong core deposit base that, in conjunction with intermediate and long-term wholesale funds managed to a diversified maturity structure and investor base, supports our liquidity risk management strategy. We use the loan-to-deposit ratio as a metric to monitor these strategies. Our target loan-to-deposit ratio is 90-100% (at June 30, 2016, our loan-to-deposit ratio was 85%), which we calculate as total loans, loans held for sale, and nonsecuritized discontinued loans divided by total deposits.

Sources of liquidity

Our primary sources of liquidity include customer deposits, wholesale funding, and liquid assets. If the cash flows needed to support operating and investing activities are not satisfied by deposit balances, we rely on wholesale funding or on-balance sheet liquid reserves. Conversely, excess cash generated by operating, investing, and deposit-gathering activities may be used to repay outstanding debt or invest in liquid assets.

Liquidity programs

We have several liquidity programs, which are described in Note 18 ( Long-Term Debt ) beginning on page 208 of our 2015 Form 10-K, that are designed to enable KeyCorp and KeyBank to raise funds in the public and private debt markets. The proceeds from most of these programs can be used for general corporate purposes, including acquisitions. These liquidity programs are reviewed from time to time by the Board and are renewed and replaced as necessary. There are no restrictive financial covenants in any of these programs.

On May 20, 2016, KeyBank issued $600 million of 3.40% Subordinated Bank Notes due May 20, 2026, under its Global Bank Note Program.

Liquidity for KeyCorp

The primary source of liquidity for KeyCorp is from subsidiary dividends, primarily from KeyBank. KeyCorp has sufficient liquidity when it can service its debt; support customary corporate operations and activities (including acquisitions); support occasional guarantees of subsidiaries obligations in transactions with third parties at a reasonable cost, in a timely manner, and without adverse consequences; and pay dividends to shareholders.

We use a parent cash coverage months metric as the primary measure to assess parent company liquidity. The parent cash coverage months metric measures the months into the future where projected obligations can be met with the current amount of liquidity. We generally issue term debt to supplement dividends from KeyBank to manage our liquidity position at or above our targeted levels. The parent company generally maintains cash and short-term investments in an amount sufficient to meet projected debt maturities over at least the next 24 months. At June 30, 2016, KeyCorp held $2.9 billion in short-term investments, which we projected to be sufficient to meet our projected obligations, including the repayment of our maturing debt obligations for the periods prescribed by our risk tolerance.

Typically, KeyCorp meets its liquidity requirements through regular dividends from KeyBank, supplemented with term debt. 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 second quarter of 2016, KeyBank paid $125 million in dividends to KeyCorp. As of

June 30, 2016, KeyBank had regulatory capacity to pay $619 million in dividends to KeyCorp without prior regulatory approval.

Our liquidity position and recent activity

Over the past quarter, our liquid asset portfolio, which includes overnight and short-term investments, as well as unencumbered, high quality liquid securities held as protection against a range of potential liquidity stress scenarios, has increased as a result of an increase in unpledged securities and net customer loan and deposit flows. The liquid asset portfolio continues to exceed the amount that we estimate would be necessary to manage through an adverse liquidity event by providing sufficient time to develop and execute a longer-term solution.

From time to time, KeyCorp or KeyBank may seek to retire, repurchase, or exchange outstanding debt, capital securities, preferred shares, or common shares through cash purchase, privately negotiated transactions or other means. Additional

information on repurchases of common shares by KeyCorp is included in Part II Item 2. Unregistered Sales of Equity Securities and Use of Proceeds of this report and in Part II, Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities on page 32 of our 2015 Form 10-K. Such transactions depend on prevailing market conditions, our liquidity and capital requirements, contractual restrictions, regulatory requirements, and other factors. The amounts involved may be material, individually or collectively.

We generate cash flows from operations and from investing and financing activities. We have approximately $204 million of cash and cash equivalents and short-term investments in international tax jurisdictions as of June 30, 2016. As we consider alternative long-term strategic and liquidity plans, opportunities to repatriate these amounts would result in approximately $3 million in taxes to be paid. We have included the appropriate amount as a deferred tax liability at June 30, 2016.

The Consolidated Statements of Cash Flows (Unaudited) summarize our sources and uses of cash by type of activity for the three-month periods ended June 30, 2016, and June 30, 2015.

**Credit risk management**

Credit risk is the risk of loss to us arising from an obligor s inability or failure to meet contractual payment or performance terms. Like other financial services institutions, we make loans, extend credit, purchase securities, and enter into financial derivative contracts, all of which have related credit risk.

Credit policy, approval, and evaluation

We manage credit risk exposure through a multifaceted program. The Credit Risk Committee and the Commercial Credit Policy Committee approve retail and commercial credit policies. These policies are communicated throughout the organization to foster a consistent approach to granting credit.

Our credit risk management team and individuals within our lines of business to whom credit risk management has delegated authority are responsible for credit approval. Individuals with assigned credit authority are authorized to grant exceptions to credit policies. It is not unusual to make exceptions to established policies when mitigating circumstances dictate, however, a corporate level tolerance has been established to keep exceptions at an acceptable level based upon portfolio and economic considerations.

Most extensions of credit are subject to loan grading or scoring. Loan grades are assigned to commercial loans at the time of origination, verified by the credit risk management team and periodically reevaluated thereafter. 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 rating reflects expected loss 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 loss assessment.

Our credit risk management team uses risk models to evaluate consumer loans. These models, known as scorecards, forecast the probability of serious delinquency and default for an applicant. The scorecards are embedded in the application processing system, which allows for real-time scoring and automated decisions for many of our products. We periodically validate the loan grading and scoring processes.

We maintain an active concentration management program to mitigate concentration risk in our credit portfolios. For aggregate credit relationships, we employ a sliding scale of exposure, known as hold limits, which is dictated by the type of loan and strength of the borrower. Our legal lending limit is approximately $1.6 billion for any aggregate credit relationship. However, internal hold limits generally restrict the largest exposures to less than 20% of that amount. As of June 30, 2016, we had five client relationships with loan commitments net of credit default swaps of more than $200 million. The average amount outstanding on these five individual net obligor commitments was $58 million at June 30, 2016. In general, our philosophy is to maintain a diverse portfolio with regard to credit exposures.

We actively manage the overall loan portfolio in a manner consistent with asset quality objectives and concentration risk tolerances to mitigate portfolio credit risk. We utilize credit default swaps on a limited basis to transfer a portion of the credit risk associated with a particular extension of credit to a third party. At June 30, 2016, we used credit default swaps with a notional amount of $270 million to manage the credit risk associated with specific commercial lending obligations. We may also sell credit derivatives primarily single name credit default swaps to offset our purchased credit default swap position prior to maturity. At June 30, 2016, we did not have any sold credit default swaps outstanding.

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 corporate services income and other income components of noninterest income.

Allowance for loan and lease losses

At June 30, 2016, the ALLL was $854 million, or 1.38% of period-end loans, compared to $796 million, or 1.33%, at December 31, 2015, or $796 million, or 1.37%, at June 30, 2015. The allowance includes $41 million that was specifically allocated for impaired loans of $571 million at June 30, 2016, compared to $35 million that was specifically allocated for impaired loans of $308 million at December 31, 2015, and $52 million that was specifically allocated for impaired loans of $334 million at June 30, 2015. For more information about impaired loans, see Note 4 ( Asset Quality ). At June 30, 2016, the ALLL was 138% of nonperforming loans, compared to 205.7% at December 31, 2015, and 190% at June 30, 2015.

Selected asset quality statistics for each of the past five quarters are presented in Figure 36. The factors that drive these statistics are discussed in the remainder of this section.

**Figure 36. Selected Asset Quality Statistics from Continuing Operations**

| | 2016 | | 2015 | | |
|---|---|---|---|---|---|
| *dollars in millions* | **Second** | **First** | **Fourth** | **Third** | **Second** |
| Net loan charge-offs | **$ 43** | **$ 46** | $ 37 | $ 41 | $ 36 |
| Net loan charge-offs to average total loans | **.28%** | **.31%** | .25% | .27% | .25% |
| Allowance for loan and lease losses | **$ 854** | **$ 826** | $ 796 | $ 790 | $ 796 |
| Allowance for credit losses [(a)] | **904** | **895** | 852 | 844 | 841 |
| Allowance for loan and lease losses to period-end loans | **1.38%** | **1.37%** | 1.33% | 1.31% | 1.37% |
| Allowance for credit losses to period-end loans | **1.46** | **1.48** | 1.42 | 1.40 | 1.44 |
| Allowance for loan and lease losses to nonperforming loans [(b)] | **138.0** | **122.2** | 205.7 | 197.5 | 190.0 |
| Allowance for credit losses to nonperforming loans [(b)] | **146.0** | **132.4** | 220.2 | 211.0 | 200.7 |
| Nonperforming loans at period end [(b)] | **$ 619** | **$ 676** | $ 387 | $ 400 | $ 419 |
| Nonperforming assets at period end [(b)] | **637** | **692** | 403 | 417 | 440 |
| Nonperforming loans to period-end portfolio loans [(b)] | **1.00%** | **1.12%** | .65% | .67% | .72% |
| Nonperforming assets to period-end portfolio loans plus OREO and other nonperforming assets [(b)] | **1.03** | **1.14** | .67 | .69 | .75 |

(a) Includes the ALLL plus the liability for credit losses on lending-related unfunded commitments.
(b) Nonperforming loan balances exclude $11 million, $11 million, $11 million, $12 million, and $12 million of PCI loans at June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, and June 30, 2015, respectively.

We estimate the appropriate level of the ALLL on at least a quarterly basis. The methodology used is described in Note 1 ( Summary of Significant Accounting Policies ) under the heading Allowance for Loan and Lease Losses beginning on page 122 of our 2015 Form 10-K. Briefly, our allowance applies expected loss rates to existing loans with similar risk characteristics. We exercise judgment to assess any adjustment to the expected loss rates for the impact of factors such as changes in economic conditions, lending policies including underwriting standards, and the level of credit risk associated with specific industries and markets.

For all commercial and consumer loan TDRs, regardless of size, as well as impaired commercial loans with an outstanding balance of $2.5 million or greater, 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 the individual impairment for commercial loans and TDRs by comparing the recorded investment 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. Secured consumer loan TDRs that are discharged through Chapter 7 bankruptcy and not formally re-affirmed are adjusted to reflect the fair value of the underlying collateral, less costs to sell. Other consumer loan TDRs are combined in homogenous pools and assigned a specific allocation based on the estimated present value of future cash flows using the effective interest rate. 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. On at least a quarterly basis, we evaluate the appropriateness of our loss estimation methods to reduce differences between estimated incurred losses and actual losses. The ALLL at June 30, 2016, represents our best estimate of the probable credit losses inherent in the loan portfolio at that date.

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As shown in Figure 37, our ALLL from continuing operations increased by $58 million, or 7.3%, during the past 12 months. Our allowance applies expected loss rates to our existing loans with similar risk characteristics as well as any adjustments to reflect our current assessment of qualitative factors, such as changes in economic conditions, underwriting standards, and concentrations of credit. Our commercial ALLL increased by $64 million, or 9.9%, during the past 12 months, primarily because of loan growth and increased incurred loss estimates. The increase in these incurred loss estimates during 2015 and into 2016 was primarily due to the continued decline in oil and gas prices since 2014. Partially offsetting this increase was a decrease in our consumer ALLL of $6 million, or 4%, since June 30, 2015. Our consumer ALLL decrease was primarily due to continued improvement in credit metrics, such as delinquency, average credit bureau score, and loan to value, which have decreased expected loss rates since 2014. The continued improvement in the consumer portfolio credit quality metrics since 2014 was primarily due to continued improved credit quality and benefits of relatively stable economic conditions. Our liability for credit losses on lending-related commitments increased by $5 million to $50 million at June 30, 2016. When combined with our ALLL, our total allowance for credit losses represented 1.46% of period-end loans at June 30, 2016, compared to 1.42% at December 31, 2015, and 1.44% at June 30, 2015.

**Figure 37. Allocation of the Allowance for Loan and Lease Losses**

| | **June 30, 2016** | | | **December 31, 2015** | | | **June 30, 2015** | | |
|---|---|---|---|---|---|---|---|---|---|
| *dollars in millions* | **Amount** | **Percent of Allowance to Total Allowance** | **Percent of Loan Type to Total Loans** | **Amount** | **Percent of Allowance to Total Allowance** | **Percent of Loan Type to Total Loans** | **Amount** | **Percent of Allowance to Total Allowance** | **Percent of Loan Type to Total Loans** |
| Commercial, financial and agricultural | **$ 513** | **60.1%** | **53.8%** | $ 450 | 56.5% | 52.2% | $ 418 | 52.5% | 50.3% |
| Commercial real estate: | | | | | | | | | |
| Commercial mortgage | **135** | **15.8** | **13.8** | 134 | 16.8 | 13.3 | 144 | 18.1 | 13.5 |
| Construction | **17** | **2.0** | **1.4** | 25 | 3.2 | 1.7 | 31 | 3.9 | 2.2 |
| Total commercial real estate loans | **152** | **17.8** | **15.2** | 159 | 20.0 | 15.0 | 175 | 22.0 | 15.7 |
| Commercial lease financing | **45** | **5.2** | **6.4** | 47 | 5.9 | 6.7 | 53 | 6.7 | 6.8 |
| Total commercial loans | **710** | **83.1** | **75.4** | 656 | 82.4 | 73.9 | 646 | 81.2 | 72.8 |
| Real estate residential mortgage | **18** | **2.1** | **3.7** | 18 | 2.3 | 3.7 | 20 | 2.5 | 3.9 |
| Home equity loans | **65** | **7.6** | **16.2** | 57 | 7.2 | 17.3 | 61 | 7.7 | 18.1 |
| Consumer direct loans | **19** | **2.3** | **2.6** | 20 | 2.5 | 2.7 | 21 | 2.6 | 2.7 |
| Credit cards | **30** | **3.5** | **1.3** | 32 | 4.0 | 1.3 | 31 | 3.9 | 1.3 |
| Consumer indirect loans | **12** | **1.4** | **.8** | 13 | 1.6 | 1.1 | 17 | 2.1 | 1.2 |
| Total consumer loans | **144** | **16.9** | **24.6** | 140 | 17.6 | 26.1 | 150 | 18.8 | 27.2 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Total loans [(a)] | **$ 854** | **100.0%** | **100.0%** | $ 796 | 100.0% | 100.0% | $ 796 | 100.0% | 100.0% |

(a) Excludes allocations of the ALLL related to the discontinued operations of the education lending business in the amount of $20 million, $28 million, and $22 million at June 30, 2016, December 31, 2015, and June 30, 2015, respectively.

Our provision for credit losses was $52 million for the second quarter of 2016, compared to $41 million for the second quarter of 2015. The increase in our provision is primarily due to the growth in our loan portfolio over the past twelve months and increased charge-offs, primarily in the oil and gas portfolio, compared to the first six months of 2015. We continue to reduce our exposure in our higher-risk businesses, including the residential properties portion of our construction loan portfolio, marine/RV financing, and other selected leasing portfolios through the sale of certain loans, payments from borrowers, or net loan charge-offs.

Asset quality on our oil and gas loan portfolio, which represents approximately 2% of total loans at June 30, 2016, is performing in-line with expectations. Our reserve for credit losses allocated to our oil and gas loan exposure was 8% of the total oil and gas loan portfolio at June 30, 2016, up from 6% at December 31, 2015, and reflected the estimated impact of current oil prices at that date.

Net loan charge-offs

Net loan charge-offs for the second quarter of 2016 totaled $43 million, or .28% of average loans, compared to net loan charge-offs of $36 million, or .25%, for the same period last year. Figure 38 shows the trend in our net loan charge-offs by loan type, while the composition of loan charge-offs and recoveries by type of loan is presented in Figure 39.

Over the past 12 months, net loan charge-offs increased $7 million. This increase is primarily attributable to growth and higher charge-offs in our commercial loan portfolio, partially offset by a decline in the consumer loan portfolio over the same period. As shown in Figure 41, our exit loan portfolio contributed a total of $5 million in net loan charge-offs for the second quarter of 2016, compared to $4 million in net loan charge-offs for the second quarter of 2015. The increase in net loan charge-offs in our exit loan portfolio was primarily driven by higher levels of net loan charge-offs in our commercial exit loan portfolio.

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**Figure 38. Net Loan Charge-offs from Continuing Operations [(a)]**

| *dollars in millions* | **2016** Second | First | Fourth | 2015 Third | Second |
|---|---|---|---|---|---|
| Commercial, financial and agricultural | **$ 32** | **$ 23** | $ 15 | $ 24 | $ 15 |
| Real estate Commercial mortgage | **(4)** | **(1)** | (2) | | |
| Real estate Construction | | **(1)** | | | (1) |
| Commercial lease financing | **1** | **3** | 6 | | |
| Total commercial loans | **29** | **24** | 19 | 24 | 14 |
| Real estate Residential mortgage | **1** | | | 1 | |
| Home equity loans | **3** | **7** | 5 | 3 | 8 |
| Consumer direct loans | **4** | **5** | 5 | 5 | 4 |
| Credit cards | **7** | **7** | 7 | 6 | 7 |
| Consumer indirect loans | **(1)** | **3** | 1 | 2 | 3 |
| Total consumer loans | **14** | **22** | 18 | 17 | 22 |
| Total net loan charge-offs | **$ 43** | **$ 46** | $ 37 | $ 41 | $ 36 |
| Net loan charge-offs to average loans | **.28%** | **.31%** | .25% | .27% | .25% |
| Net loan charge-offs from discontinued operations education lending business | **$ 4** | **$ 6** | $ 7 | $ 7 | $ 2 |

(a) Credit amounts indicate that recoveries exceeded charge-offs.

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**Figure 39. Summary of Loan and Lease Loss Experience from Continuing Operations**

| *dollars in millions* | Three months ended June 30, 2016 | 2015 | Six months ended June 30, 2016 | 2015 |
|---|---|---|---|---|
| Average loans outstanding | **$ 61,148** | $ 57,978 | **$ 60,652** | $ 57,746 |
| Allowance for loan and lease losses at beginning of period | **$ 826** | $ 794 | **$ 796** | $ 794 |
| Loans charged off: | | | | |
| Commercial, financial and agricultural | **35** | 21 | **61** | 33 |
| Real estate commercial mortgage | **2** | | **3** | 2 |
| Real estate construction | | | | 1 |
| Total commercial real estate loans [a] | **2** | | **3** | 3 |
| Commercial lease financing | **3** | 1 | **6** | 3 |
| Total commercial loans [b] | **40** | 22 | **70** | 39 |
| Real estate residential mortgage | **1** | 1 | **3** | 3 |
| Home equity loans | **7** | 10 | **17** | 18 |
| Consumer direct loans | **6** | 6 | **12** | 12 |
| Credit cards | **8** | 8 | **16** | 16 |
| Consumer indirect loans | **2** | 5 | **6** | 11 |
| Total consumer loans | **24** | 30 | **54** | 60 |
| Total loans charged off | **64** | 52 | **124** | 99 |
| Recoveries: | | | | |
| Commercial, financial and agricultural | **3** | 6 | **6** | 11 |
| Real estate commercial mortgage | **6** | | **8** | 2 |
| Real estate construction | | 1 | **1** | 1 |
| Total commercial real estate loans [a] | **6** | 1 | **9** | 3 |
| Commercial lease financing | **2** | 1 | **2** | 5 |
| Total commercial loans [b] | **11** | 8 | **17** | 19 |
| Real estate residential mortgage | | 1 | **2** | 1 |
| Home equity loans | **4** | 2 | **7** | 5 |
| Consumer direct loans | **2** | 2 | **3** | 4 |
| Credit cards | **1** | 1 | **2** | 1 |
| Consumer indirect loans | **3** | 2 | **4** | 5 |
| Total consumer loans | 10 | 8 | 18 | 16 |
| Total recoveries | **21** | 16 | **35** | 35 |
| Net loan charge-offs | **(43)** | (36) | **(89)** | (64) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Provision (credit) for loan and lease losses | | **71** | | 37 | | **147** | | 66 |
| Foreign currency translation adjustment | | | | 1 | | | | |
| Allowance for loan and lease losses at end of period | **$** | **854** | $ | 796 | **$** | **854** | $ | 796 |
| Liability for credit losses on lending-related commitments at beginning of period | **$** | **69** | $ | 41 | **$** | **56** | $ | 35 |
| Provision (credit) for losses on lending-related commitments | | **(19)** | | 4 | | **(6)** | | 10 |
| Liability for credit losses on lending-related commitments at end of period (c) | **$** | **50** | $ | 45 | **$** | **50** | $ | 45 |
| Total allowance for credit losses at end of period | **$** | **904** | $ | 841 | **$** | **904** | $ | 841 |
| Net loan charge-offs to average total loans | | **.28%** | | .25% | | **.30%** | | .22% |
| Allowance for loan and lease losses to period-end loans | | **1.38** | | 1.37 | | **1.38** | | 1.37 |
| Allowance for credit losses to period-end loans | | **1.46** | | 1.44 | | **1.46** | | 1.44 |
| Allowance for loan and lease losses to nonperforming loans | | **138.0** | | 190.0 | | **138.0** | | 190.0 |
| Allowance for credit losses to nonperforming loans | | **146.0** | | 200.7 | | **146.0** | | 200.7 |
| Discontinued operations education lending business: | | | | | | | | |
| Loans charged off | **$** | **6** | $ | 6 | **$** | **15** | $ | 16 |
| Recoveries | | **2** | | 4 | | **5** | | 8 |
| Net loan charge-offs | **$** | **(4)** | $ | (2) | **$** | **(10)** | $ | (8) |

(a) See Figure 20 and the accompanying discussion in the Loans and loans held for sale section for more information related to our commercial real estate loan portfolio.

(b) See Figure 19 and the accompanying discussion in the Loans and loans held for sale section for more information related to our commercial loan portfolio.

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

Nonperforming assets

Figure 40 shows the composition of our nonperforming assets. These assets totaled $637 million at June 30, 2016, and represented 1.03% of period-end portfolio loans, OREO and other nonperforming assets, compared to $403 million, or .67%, at December 31, 2015, and $440 million, or .75%, at June 30, 2015. See Note 1 ( Summary of Significant Accounting Policies ) under the headings Nonperforming Loans, Impaired Loans, and Allowance for Loan and Lease Losses beginning on page 121 of our 2015 Form 10-K for a summary of our nonaccrual and charge-off policies.

**Figure 40. Summary of Nonperforming Assets and Past Due Loans from Continuing Operations**

| *dollars in millions* | **June 30, 2016** | **March 31, 2016** | **December 31, 2015** | **September 30, 2015** | **June 30, 2015** |
|---|---|---|---|---|---|
| Commercial, financial and agricultural | **$ 321** | $ 380 | $ 82 | $ 89 | $ 100 |
| Real estate commercial mortgage | **14** | 16 | 19 | 23 | 26 |
| Real estate construction | **25** | 12 | 9 | 9 | 12 |
| Total commercial real estate loans [a] | **39** | 28 | 28 | 32 | 38 |
| Commercial lease financing | **10** | 11 | 13 | 21 | 18 |
| Total commercial loans [b] | **370** | 419 | 123 | 142 | 156 |
| Real estate residential mortgage | **54** | 59 | 64 | 67 | 67 |
| Home equity loans | **189** | 191 | 190 | 181 | 184 |
| Consumer direct loans | **1** | 1 | 2 | 1 | 1 |
| Credit cards | **2** | 2 | 2 | 2 | 2 |
| Consumer indirect loans | **3** | 4 | 6 | 7 | 9 |
| Total consumer loans | **249** | 257 | 264 | 258 | 263 |
| Total nonperforming loans [c] | **619** | 676 | 387 | 400 | 419 |
| OREO | **15** | 14 | 14 | 17 | 20 |
| Other nonperforming assets | **3** | 2 | 2 | | 1 |
| Total nonperforming assets [c] | **$ 637** | $ 692 | $ 403 | $ 417 | $ 440 |
| Accruing loans past due 90 days or more | **$ 70** | $ 70 | $ 72 | $ 54 | $ 66 |
| Accruing loans past due 30 through 89 days | **203** | 237 | 208 | 271 | 181 |
| Restructured loans accruing and nonaccruing [d] | **277** | 283 | 280 | 287 | 300 |
| Restructured loans included in nonperforming loans [d] | **133** | 151 | 159 | 160 | 170 |
| Nonperforming assets from discontinued operations education lending business | **5** | 6 | 7 | 8 | 6 |
| Nonperforming loans to period-end portfolio loans [c] | **1.00%** | 1.12% | .65% | .67% | .72% |
| Nonperforming assets to period-end portfolio loans plus OREO and other | **1.03** | 1.14 | .67 | .69 | .75 |

nonperforming assets [c]

(a) See Figure 20 and the accompanying discussion in the Loans and loans held for sale section for more information related to our commercial real estate loan portfolio.
(b) See Figure 19 and the accompanying discussion in the Loans and loans held for sale section for more information related to our commercial loan portfolio.
(c) Nonperforming loan balances exclude $11 million, $11 million, $11 million, $12 million, and $12 million of PCI loans at June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, and June 30, 2015, respectively.
(d) Restructured loans (i.e., TDRs) are those for which Key, for reasons related to a borrower s financial difficulties, grants a concession to the borrower that it would not otherwise consider. These concessions are made to improve the collectability of the loan and generally take the form of a reduction of the interest rate, extension of the maturity date or reduction in the principal balance.

As shown in Figure 40, nonperforming assets at June 30, 2016, increased $197 million from one year ago. Increases in nonperforming assets in the commercial, financial and agricultural portfolio, which were primarily due to the credit migration in the oil and gas portfolio, were partially offset by declines in nonperforming assets in the commercial lease financing and consumer loan portfolios. As shown in Figure 41, our exit loan portfolio accounted for $14 million, or 2%, of our total nonperforming assets at June 30, 2016, compared to $26 million, or 6%, at June 30, 2015.

At June 30, 2016, the approximate carrying amount of our commercial nonperforming loans outstanding represented 83% of their contractual amount owed, total nonperforming loans outstanding represented 83% of their contractual amount owed, and nonperforming assets in total were carried at 83% of their original contractual amount owed. At the same date, OREO and other nonperforming assets represented 75% of its original contractual amount owed.

At June 30, 2016, our 20 largest nonperforming loans totaled $331 million, representing 54% of total nonperforming loans. At June 30, 2015, our 20 largest nonperforming loans totaled $120 million, representing 29% of total nonperforming loans.

Figure 41 shows the composition of our exit loan portfolio at June 30, 2016, and June 30, 2015, the net loan charge-offs recorded on this portfolio for the second quarter of 2016 and the second quarter of 2015, and the nonperforming status of these loans at June 30, 2016, and June 30, 2015. The exit loan portfolio represented 2% of total loans and loans held for sale at June 30, 2016, and 3% of total loans and loans held for sale at June 30, 2015.

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**Figure 41. Exit Loan Portfolio from Continuing Operations**

| *in millions* | Balance Outstanding 6-30-16 | Balance Outstanding 6-30-15 | Change 6-30-16 vs. 6-30-15 | Net Loan Charge-offs 6-30-16 | Net Loan Charge-offs 6-30-15 | Balance on Nonperforming Status 6-30-16 | Balance on Nonperforming Status 6-30-15 |
|---|---|---|---|---|---|---|---|
| Residential properties homebuilder | | $ 6 | $ (6) | | | **$ 4** | $ 8 |
| Marine and RV floor plan | | 2 | (2) | | | | 1 |
| Commercial lease financing [(a)] | **$ 731** | 831 | (100) | **$ 1** | | | |
| Total commercial loans | **731** | 839 | (108) | **1** | | **4** | 9 |
| Home equity Other | **183** | 236 | (53) | **1** | $ 1 | **7** | 8 |
| Marine | **496** | 673 | (177) | **3** | 3 | **3** | 8 |
| RV and other consumer | **35** | 47 | (12) | | | | 1 |
| Total consumer loans | **714** | 956 | (242) | **4** | 4 | **10** | 17 |
| Total exit loans in loan portfolio | **$ 1,445** | $ 1,795 | $ (350) | **$ 5** | $ 4 | **$ 14** | $ 26 |
| Discontinued operations education lending business (not included in exit loans above) | $ 1,692 | $ 1,962 | $ (270) | $ 4 | $ 2 | $ 5 | $ 6 |

(a) Includes (1) the business aviation, commercial vehicle, office products, construction, and industrial leases; (2) Canadian lease financing portfolios; (3) European lease financing portfolios; and (4) all remaining balances related to lease in, lease out; sale in, lease out; service contract leases; and qualified technological equipment leases.

Figure 42 shows the types of activity that caused the change in our nonperforming loans during each of the last five quarters.

**Figure 42. Summary of Changes in Nonperforming Loans from Continuing Operations**

| *in millions* | 2016 Second | 2016 First | 2015 Fourth | 2015 Third | 2015 Second |
|---|---|---|---|---|---|
| **Balance at beginning of period** | **$ 676** | **$ 387** | $ 400 | $ 419 | $ 437 |
| Loans placed on nonaccrual status | **124** | **406** | 81 | 81 | 92 |
| Charge-offs | **(64)** | **(60)** | (51) | (53) | (52) |
| Loans sold | | **(11)** | | (2) | |
| Payments | **(75)** | **(8)** | (21) | (16) | (25) |
| Transfers to OREO | **(6)** | **(4)** | (4) | (4) | (5) |
| Transfers to other nonperforming assets | | | (1) | | |
| Loans returned to accrual status | **(36)** | **(34)** | (17) | (25) | (28) |
| **Balance at end of period [(a)]** | **$ 619** | **$ 676** | $ 387 | $ 400 | $ 419 |

(a) Nonperforming loan balances exclude $11 million, $11 million, $11 million, $12 million, and $12 million of PCI loans at June 30, 2016, March 31, 2016, December 31, 2015, September 30, 2015, and June 30, 2015, respectively.

Figure 43 shows the factors that contributed to the change in our OREO during each of the last five quarters.

**Figure 43. Summary of Changes in Other Real Estate Owned, Net of Allowance, from Continuing Operations**

| | **2016** | | | **2015** | |
|---|---|---|---|---|---|
| *in millions* | **Second** | **First** | **Fourth** | **Third** | **Second** |
| **Balance at beginning of period** | **$ 14** | **$ 14** | $ 17 | $ 20 | $ 20 |
| Properties acquired nonperforming loans | **6** | **4** | 4 | 4 | 5 |
| Valuation adjustments | **(2)** | **(1)** | (2) | (2) | (1) |
| Properties sold | **(3)** | **(3)** | (5) | (5) | (4) |
| **Balance at end of period** | **$ 15** | **$ 14** | $ 14 | $ 17 | $ 20 |

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**Operational and compliance risk management**

Like all businesses, we are subject to operational risk, which is the risk of loss resulting from human error or malfeasance, inadequate or failed internal processes and systems, and external events. These events include, among other things, threats to our cybersecurity, as we are reliant upon information systems and the Internet to conduct our business activities.

Operational risk also encompasses compliance risk, which is the risk of loss from violations of, or noncompliance with, laws, rules and regulations, prescribed practices, and ethical standards. Under the Dodd-Frank Act, large financial companies like Key are subject to heightened prudential standards and regulation. This heightened level of regulation has increased our operational risk. We have created work teams to respond to and analyze the regulatory requirements that have been or will be promulgated as a result of the enactment of the Dodd-Frank Act. Resulting operational risk losses and/or additional regulatory compliance costs could take the form of explicit charges, increased operational costs, harm to our reputation, or foregone opportunities.

We seek to mitigate operational risk through identification and measurement of risk, alignment of business strategies with risk appetite and tolerance, and a system of internal controls and reporting. We continuously strive to strengthen our system of internal controls to improve the oversight of our operational risk and to ensure compliance with laws, rules, and regulations. For example, an operational event database tracks the amounts and sources of operational risk and losses. This tracking mechanism helps to identify weaknesses and to highlight the need to take corrective action. We also rely upon software programs designed to assist in assessing operational risk and monitoring our control processes. This technology has enhanced the reporting of the effectiveness of our controls to senior management and the Board.

The Operational Risk Management Program provides the framework for the structure, governance, roles, and responsibilities, as well as the content, to manage operational risk for Key. The Compliance Risk Committee serves the same function in managing compliance risk for Key. Primary responsibility for managing and monitoring internal control mechanisms lies with the managers of our various lines of business. The Operational Risk Committee and Compliance Risk Committee are senior management committees that oversee our level of operational and compliance risk and direct and support our operational and compliance infrastructure and related activities. These committees and the Operational Risk Management and Compliance functions are an integral part of our ERM Program. Our Risk Review function regularly assesses the overall effectiveness of our Operational Risk Management and Compliance Programs and our system of internal controls. Risk Review reports the results of reviews on internal controls and systems to senior management and the Risk and Audit Committees and independently supports the Risk Committee s oversight of these controls.

Cybersecurity

We maintain comprehensive Cyber Incident Response Plans, and we devote significant time and resources to maintaining and regularly updating our technology systems and processes to protect the security of our computer systems, software, networks, and other technology assets against attempts by third parties to obtain unauthorized access to confidential information, destroy data, disrupt or degrade service, sabotage systems, or cause other damage. We and many other U.S. financial institutions have experienced distributed denial-of-service attacks from technologically sophisticated third parties. These attacks are intended to disrupt or disable consumer online banking services and prevent banking transactions. We also periodically experience other attempts to breach the security of our systems and data. These cyberattacks have not, to date, resulted in any material disruption of our operations or material harm to our customers, and have not had a material adverse effect on our results of operations.

Cyberattack risks may also occur with our third-party technology service providers, and may interfere with their ability to fulfill their contractual obligations to us, with attendant potential for financial loss or liability that could adversely affect our financial condition or results of operations. Recent high-profile cyberattacks have targeted retailers and other businesses for the purpose of acquiring the confidential information (including personal, financial, and credit card information) of customers, some of whom are customers of ours. We may incur expenses related to the investigation of such attacks or related to the protection of our customers from identity theft as a result of such attacks. Risks and exposures related to cyberattacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking, and other technology-based products and services by us and our clients.

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## Critical Accounting Policies and Estimates

Our business is dynamic and complex. Consequently, we must exercise judgment in choosing and applying accounting policies and methodologies. These choices are critical not only are they necessary to comply with GAAP, they also reflect our view of the appropriate way to record and report our overall financial performance. All accounting policies are important, and all policies described in Note 1 ( Summary of Significant Accounting Policies ) beginning on page 119 of our 2015 Form 10-K should be reviewed for a greater understanding of how we record and report our financial performance.

In our opinion, some accounting policies are more likely than others to have a critical effect on our financial results and to expose those results to potentially greater volatility. These policies apply to areas of relatively greater business importance, or require us 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 prove to be inaccurate, or we may find it necessary to change them.

We rely heavily on the use of judgment, assumptions, and estimates to make a number of core decisions, including accounting for the ALLL; contingent liabilities, guarantees and income taxes; derivatives and related hedging activities; and assets and liabilities that involve valuation methodologies. In addition, we may employ outside valuation experts to assist us in determining fair values of certain assets and liabilities. A brief discussion of each of these areas appears on pages 103 through 107 of our 2015 Form 10-K.

At June 30, 2016, $17 billion, or 17%, of our total assets were measured at fair value on a recurring basis. Approximately 99% of these assets, before netting adjustments, were classified as Level 1 or Level 2 within the fair value hierarchy. At June 30, 2016, $1 billion, or 2%, of our total liabilities were measured at fair value on a recurring basis. All of these liabilities were classified as Level 1 or Level 2.

During the second quarter of 2016, $12 million of our total assets were measured at fair value on a nonrecurring basis. All of these assets were classified as Level 3. At June 30, 2016, there were no liabilities measured at fair value on a nonrecurring basis.

During the first six months of 2016, we did not significantly alter the manner in which we applied our critical accounting policies or developed related assumptions and estimates.

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**European Sovereign and Non-Sovereign Debt Exposures**

Our total European sovereign and non-sovereign debt exposure is presented in Figure 44.

**Figure 44. European Sovereign and Non-Sovereign Debt Exposures**

| **June 30, 2016** *in millions* | **Short-and Long-Term Commercial Total** [a] | **Foreign Exchange and Derivatives with Collateral** [b] | **Net Exposure** |
|---|---|---|---|
| France: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | $ 3 | $ 3 |
| Non-sovereign non-financial institutions | $ 13 | | 13 |
| Total | 13 | 3 | 16 |
| Germany: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | 186 | | 186 |
| Total | 186 | | 186 |
| Greece: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | | | |
| Total | | | |
| Iceland: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | | | |
| Total | | | |
| Ireland: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | | | |

| | | | |
|---|---|---|---|
| Total | | | |
| Italy: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | 27 | | 27 |
| Total | 27 | | 27 |
| Netherlands: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | 10 | | 10 |
| Total | 10 | | 10 |
| Portugal: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | | | |
| Total | | | |
| Spain: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | 16 | | 16 |
| Total | 16 | | 16 |
| Switzerland: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | (2) | (2) |
| Non-sovereign non-financial institutions | 60 | | 60 |
| Total | 60 | (2) | 58 |
| United Kingdom: | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | 149 | 149 |
| Non-sovereign non-financial institutions | 71 | | 71 |
| Total | 71 | 149 | 220 |
| Other Europe: (c) | | | |
| Sovereigns | | | |
| Non-sovereign financial institutions | | | |
| Non-sovereign non-financial institutions | 67 | | 67 |
| Total | 67 | | 67 |
| Total Europe: | | | |

| | | | |
|---|---|---|---|
| Sovereigns | | | |
| Non-sovereign financial institutions | | 150 | 150 |
| Non-sovereign non-financial institutions | 450 | | 450 |
| Total | $ 450 | $ 150 | $ 600 |

(a) Represents our outstanding leases.

(b) Represents contracts to hedge our balance sheet asset and liability needs, and to accommodate our clients trading and/or hedging needs. Our derivative mark-to-market exposures are calculated and reported on a daily basis. These exposures are largely covered by cash or highly marketable securities collateral with daily collateral calls.

(c) Other Europe consists of the following countries: Austria, Belarus, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Finland, Hungary, Lithuania, Luxembourg, Malta, Norway, Poland, Romania, Russia, Slovakia, Slovenia, Sweden, and Ukraine. 100% of our exposure in Other Europe is in Belgium, Finland, and Sweden.

Our credit risk exposure is largely concentrated in developed countries with emerging market exposure essentially limited to commercial facilities; these exposures are actively monitored by management. We do not have at-risk exposures in the rest of the world.

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**Item 3. Quantitative and Qualitative Disclosure about Market Risk**
The information presented in the Market risk management section of the Management s Discussion & Analysis of Financial Condition & 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 (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act )), to ensure that information required to be disclosed by KeyCorp in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to KeyCorp s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. 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 Exchange Act) 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 15 ( Contingent Liabilities and Guarantees ) of the Notes to Consolidated Financial Statements (Unaudited) is incorporated herein by reference.

On at least a quarterly basis, we assess our liabilities and contingencies in connection with outstanding legal proceedings utilizing the latest information available. Where it is probable that we will incur a loss and the amount of the loss can be reasonably estimated, we record a liability in our consolidated financial statements. These legal reserves may be increased or decreased to reflect any relevant developments on a quarterly basis. Where a loss is not probable or the amount of the loss is not estimable, we have not accrued legal reserves, consistent with applicable accounting guidance. Based on information currently available to us, advice of counsel, and available insurance coverage, we believe that our established reserves are adequate and the liabilities arising from the legal proceedings will not have a material adverse effect on our consolidated financial condition. We note, however, that in light of the inherent uncertainty in legal proceedings there can be no assurance that the ultimate resolution will not exceed established reserves. As a result, the outcome of a particular matter or a combination of matters may be material to our results of operations for a particular period, depending upon the size of the loss or our income for that particular period.

**Item 1A. Risk Factors**
For a discussion of certain risk factors affecting us, see the section titled Supervision and Regulation in Part I, Item 1. Business, on pages 9-18 of our 2015 Form 10-K; Part I, Item 1A. Risk Factors, on pages 18-30 of our 2015 Form 10-K; the section titled Supervision and regulation in this Form 10-Q; and our disclosure regarding forward-looking

statements in this Form 10-Q.

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

From time to time, KeyCorp or its principal subsidiary, KeyBank, may seek to retire, repurchase, or exchange outstanding debt of KeyCorp or KeyBank, and capital securities or preferred stock of KeyCorp, through cash purchase, privately negotiated transactions, or otherwise. Such transactions, if any, depend on prevailing market conditions, our liquidity and capital requirements, contractual restrictions, and other factors. The amounts involved may be material.

Common share repurchases under the 2015 capital plan began in the second quarter of 2015 and were suspended in the fourth quarter of 2015 in connection with the announcement of our acquisition of First Niagara. In April 2016, we submitted to the Federal Reserve and provided to the OCC our 2016 capital plan under the annual CCAR process. On June 29, 2016, the Federal Reserve announced that it did not object to our 2016 capital plan. Share repurchases of up to $350 million were included in the 2016 capital plan, which is effective through the second quarter of 2017. We anticipate repurchasing common shares in the third quarter of 2016 following the completion of the acquisition of First Niagara.

The following table summarizes our repurchases of our common shares for the three months ended June 30, 2016.

| Calendar month | Total number of shares repurchased [a] | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased as part of publicly announced plans or programs [b] |
|---|---|---|---|---|
| April 1 30 | 1,406 | $ 11.08 | | 37,658,833 |
| May 1 31 | 2,087 | 11.54 | | 36,100,077 |
| June 1 30 | 1,066 | 12.85 | | 41,881,384 |
| Total | 4,559 | $ 11.70 | | |

(a) Includes common shares deemed surrendered by employees in connection with our stock compensation and benefit plans to satisfy tax obligations. There were no common shares repurchased in the open market during the second quarter of 2016.

(b) Calculated using the remaining general repurchase amount divided by the closing price of KeyCorp common shares as follows: on April 30, 2016, at $12.29; on May 31, 2016, at $12.82; and on June 30, 2016, at $11.05.

**Item 6. Exhibits**

3 Second Amended and Restated Articles of Incorporation of KeyCorp, effective August 1, 2016, filed as Exhibit 3.1 to Form 8-K on August 1, 2016.*

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. |
| 101 | The following materials from KeyCorp s Form 10-Q Report for the quarterly period ended June 30, 2016, formatted in XBRL: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Consolidated Statements of Comprehensive Income, (iii) the Consolidated Statements of Changes in Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements. |

* Incorporated by reference. Copies of these Exhibits have been filed with the SEC. Exhibits that are not incorporated by reference are filed with this report. Shareholders may obtain a copy of any exhibit, upon payment of reproductions costs, by writing KeyCorp Investor Relations, 127 Public Square, Mail Code OH-01-27-0737, Cleveland, OH 44114-1306.

**Information Available on Website**

KeyCorp makes available free of charge on its website, www.key.com, its 2015 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 SEC. We also make available a summary of filings made with the SEC of statements of beneficial ownership of our equity securities filed by our directors and officers under Section 16 of the Exchange Act. The Regulatory Disclosures and Filings tab of the investor relations section of our website includes public disclosures concerning our annual and mid-year stress-testing activities under the Dodd-Frank Act. Information contained on or accessible through our website or any other website referenced in this report is not part of this report.

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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, on the date indicated.

KEYCORP
(Registrant)

Date: August 5, 2016

/s/ Douglas M. Schosser
By: Douglas M. Schosser
Chief Accounting Officer

(Principal Accounting Officer)

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