KEYCORP /NEW/
Form 10-Q
August 04, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2017

Commission File Number 001-11302

Exact name of registrant as specified in its charter:

Ohio	34-6542451
State or other jurisdiction of incorporation or organization	I.R.S. Employer Identification Number:

127 Public Square, Cleveland, Ohio	44114-1306
Address of principal executive offices:	Zip Code:

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Common Shares with a par value of $1 each	1,087,545,416 shares
Title of class	Outstanding at August 2, 2017

Table of Contents

KEYCORP
TABLE OF CONTENTS
PART I. FINANCIAL INFORMATION

Table of Contents

Table of Contents

PART I. FINANCIAL INFORMATION

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

Introduction

This section reviews the financial condition and results of operations of KeyCorp and its subsidiaries for the quarterly periods ended June 30, 2017, and June 30, 2016. Some tables may include additional periods to comply with disclosure requirements or to illustrate trends in greater depth. When you read this discussion, you should also refer to the consolidated financial statements and related notes in this report. The page locations of specific sections and notes that we refer to are presented in the Table of Contents.

References to our “2016 Form 10-K” refer to our Form 10-K for the year ended December 31, 2016, which has been filed with the SEC and is available on its website (www.sec.gov) and on our website (www.key.com/ir).

Terminology

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

Throughout the following discussion, industry-specific terms are used as defined below:

- We use the phrase continuing operations in this document to mean all of our businesses other than the education lending business and Austin. The education lending business and Austin have been accounted for as discontinued operations since 2009.
- Our exit loan portfolios are separate from our discontinued operations. These portfolios, which are in a run-off mode, stem from product lines we decided to cease because they no longer fit with our corporate strategy. These exit loan portfolios are included in Other Segments.
- We engage in capital markets activities primarily through business conducted by our Key Corporate Bank segment. These activities encompass a variety of products and services. Among other things, we trade securities as a dealer, enter into derivative contracts (both to accommodate clients’ financing needs and to mitigate certain risks), and conduct transactions in foreign currencies (both to accommodate clients’ needs and to benefit from fluctuations in exchange rates).
- For regulatory purposes, capital is divided into two classes. Federal regulations currently prescribe that at least one-half of a bank or BHC’s total risk-based capital must qualify as Tier 1 capital. Both total and Tier 1 capital serve as bases for several measures of capital adequacy, which is an important indicator of financial stability and condition. As described under the heading “Regulatory capital requirements – Capital planning and stress testing” in the section entitled “Supervision and Regulation” that begins on page 8 of our 2016 Form 10-K, the regulators are required to conduct a supervisory capital assessment of all BHCs with assets of at least $50 billion, including KeyCorp. As part of this capital adequacy review, banking regulators evaluate a component of Tier 1 capital, known as Common Equity Tier 1, under the Regulatory Capital Rules. The “Capital” section of this report under the heading “Capital adequacy” provides more information on total capital, Tier 1 capital, and the Regulatory Capital Rules, including Common Equity Tier 1, and describes how these measures are calculated.

Table of Contents

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

AICPA: American Institute of Certified Public Accountants.
ALCO: Asset/Liability Management Committee.
ALLL: Allowance for loan and lease losses.
A/LM: Asset/liability management.
AOCI: Accumulated other comprehensive income (loss).
APBO: Accumulated postretirement benefit obligation.
Austin: Austin Capital Management, Ltd.
BHCs: Bank holding companies.
Board: KeyCorp Board of Directors.
CCAR: Comprehensive Capital Analysis and Review.
CMBS: Commercial mortgage-backed securities.
CME: Chicago Mercantile Exchange.
CMO: Collateralized mortgage obligation.
Common Shares: KeyCorp common shares, $1 par value.
DIF: Deposit Insurance Fund of the FDIC.
Dodd-Frank Act: Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
EBITDA: Earnings before interest, taxes, depreciation, and amortization.
EPS: Earnings per share.
ERISA: Employee Retirement Income Security Act of 1974.
ERM: Enterprise risk management.
EVE: Economic value of equity.
FASB: Financial Accounting Standards Board.
FDIC: Federal Deposit Insurance Corporation.
Federal Reserve: Board of Governors of the Federal Reserve System.
FHLB: Federal Home Loan Bank of Cincinnati.
FHLMC: Federal Home Loan Mortgage Corporation.
FICO: Fair Isaac Corporation
First Niagara: First Niagara Financial Group, Inc. (NASDAQ: FNFG).
FNMA: Federal National Mortgage Association, or Fannie Mae.
FSOC: Financial Stability Oversight Council.
GAAP: U.S. generally accepted accounting principles.
GNMA: Government National Mortgage Association, or Ginnie Mae.
HelloWallet: HelloWallet Holdings, Inc.
ISDA: International Swaps and Derivatives Association.
KAHC: Key Affordable Housing Corporation.
KCC: Key Capital Corporation.
KCDC: Key Community Development Corporation.
KEF: Key Equipment Finance.
KPP: Key Principal Partners.
KREEC: Key Real Estate Equity Capital, Inc.
LCR: Liquidity coverage ratio.
LIBOR: London Interbank Offered Rate.
LIHTC: Low-income housing tax credit.
LTV: Loan-to-value.
Moody's: Moody's Investor Services, Inc.
MRM: Market Risk Management group.
N/A: Not applicable.
NASDAQ: The NASDAQ Stock Market LLC.
NAV: Net asset value.
N/M: Not meaningful.
NOW: Negotiable Order of Withdrawal.
NPR: Notice of proposed rulemaking.
NYSE: New York Stock Exchange.
OCC: Office of the Comptroller of the Currency.
OCI: Other comprehensive income (loss).
OREO: Other real estate owned.
OTTI: Other-than-temporary impairment.
PBO: Projected benefit obligation.
PCI: Purchased credit impaired.
S&P: Standard and Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc.
SEC: U.S. Securities and Exchange Commission.
Series A Preferred Stock: KeyCorp's 7.750% Noncumulative Perpetual Convertible Preferred Stock, Series A.
SIFIs: Systemically important financial institutions including BHCs with total consolidated assets of at least $50 billion and nonbank financial companies designated by FSOC for supervision by the Federal Reserve.
TDR: Troubled debt restructuring.
TE: Taxable-equivalent.
U.S. Treasury: United States Department of the Treasury.
VaR: Value at risk.
VEBA: Voluntary Employee Beneficiary Association.
VIE: Variable interest entity.

Table of Contents

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 stateme 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 and industrial loans;
- the extensive and increasing regulation of the U.S. financial services industry;
- operational or risk management failures by us or critical third parties;
- 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;
- negative outcomes from claims or litigation;
- the occurrence of natural or man-made disasters, conflicts, or terrorist attacks, or other adverse external events;
- evolving 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 and our ability to secure alternative funding sources;
- 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;
- tax reform and other changes in tax laws;
- 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;
- our ability to adapt our products and services to industry standards and consumer preferences;
- 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.

Table of Contents

Selected financial data

Our financial performance for each of the last five quarters is summarized in Figure 1.

Figure 1. Selected Financial Data

	2017		2016			Six months ended June 30,	
dollars in millions, except per share amounts	Second	First	Fourth	Third	Second	2017	2016
FOR THE PERIOD							
Interest income	$1,117	$1,050	$1,062	$890	$684	$2,167	$1,367
Interest expense	144	132	124	110	87	276	166
Net interest income	973	918	938	780	597	1,891	1,201
Provision for credit losses	66	63	66	59	52	129	141
Noninterest income	653	577	618	549	473	1,230	904
Noninterest expense	995	1,013	1,220	1,082	751	2,008	1,454
Income (loss) from continuing operations before income taxes	565	419	270	188	267	984	510
Income (loss) from continuing operations attributable to Key	407	324	233	171	199	731	386
Income (loss) from discontinued operations, net of taxes (a)	5	—	(4)	1	3	5	4
Net income (loss) attributable to Key	412	324	229	172	202	736	390
Income (loss) from continuing operations attributable to Key common shareholders	393	296	213	165	193	689	375
Income (loss) from discontinued operations, net of taxes (a)	5	—	(4)	1	3	5	4
Net income (loss) attributable to Key common shareholders	398	296	209	166	196	694	379
PER COMMON SHARE							
Income (loss) from continuing operations attributable to Key common shareholders	$.36	$.28	$.20	$.17	$.23	$.64	$.45
Income (loss) from discontinued operations, net of taxes (a)	—	—	—	—	—	—	—
Net income (loss) attributable to Key common shareholders (b)	.37	.28	.20	.17	.23	.64	.45
Income (loss) from continuing operations attributable to Key common shareholders — assuming dilution	.36	.27	.20	.16	.23	.63	.44
Income (loss) from discontinued operations, net of taxes — assuming dilution (a)	—	—	—	—	—	—	—
Net income (loss) attributable to Key common shareholders — assuming dilution (b)	.36	.27	.19	.17	.23	.63	.45
Cash dividends paid	.095	.085	.085	.085	.085	.180	.160
Book value at period end	13.02	12.71	12.58	12.78	13.08	13.02	13.08

Tangible book value at period end	10.40	10.21	9.99	10.14	11.81	10.40	11.81
Market price:							
High	19.10	19.53	18.62	12.64	13.08	19.53	13.37
Low	16.91	16.54	12.00	10.38	10.21	16.54	9.88
Close	18.74	17.78	18.27	12.17	11.05	18.74	11.05
Weighted-average common shares outstanding (000)	1,076,203	1,068,609	1,067,771	982,080	831,899	1,083,486	829,640
Weighted-average common shares and potential common shares outstanding (000) (c)	1,093,039	1,086,540	1,083,717	994,660	838,496	1,099,294	836,778
AT PERIOD END							
Loans	$86,503	$86,125	$86,038	$85,528	$62,098	$86,503	$62,098
Earning assets	121,243	120,261	121,966	121,089	90,065	121,243	90,065
Total assets	135,824	134,476	136,453	135,805	101,150	135,824	101,150
Deposits	102,821	103,982	104,087	104,185	75,325	102,821	75,325
Long-term debt	13,261	12,324	12,384	12,622	11,388	13,261	11,388
Key common shareholders' equity	14,228	13,951	13,575	13,831	11,023	14,228	11,023
Key shareholders' equity	15,253	14,976	15,240	14,996	11,313	15,253	11,313
PERFORMANCE RATIOS — FROM CONTINUING OPERATIONS							
Return on average total assets	1.23 %	.99 %	.69 %	.55 %	.82 %	1.11 %	.81 %
Return on average common equity	11.12	8.76	6.22	5.09	7.15	9.97	7.01
Return on average tangible common equity (d)	13.80	10.98	7.88	6.16	7.94	12.43	7.79
Net interest margin (TE)	3.30	3.13	3.12	2.85	2.76	3.21	2.83
Cash efficiency ratio (d)	59.3	65.8	76.2	80.0	69.0	62.4	67.8
PERFORMANCE RATIOS — FROM CONSOLIDATED OPERATIONS							
Return on average total assets	1.23 %	.98 %	.67 %	.55 %	.82 %	1.11 %	.80 %
Return on average common equity	11.26	8.76	6.10	5.12	7.26	10.04	7.08
Return on average tangible common equity (d)	13.98	10.98	7.73	6.20	8.06	12.52	7.87
Net interest margin (TE)	3.28	3.11	3.09	2.83	2.74	3.19	2.80
Loan-to-deposit (e)	87.2	85.6	85.2	84.7	85.3	87.2	85.3
CAPITAL RATIOS AT PERIOD END							
Key shareholders' equity to assets	11.23 %	11.14 %	11.17 %	11.04 %	11.18 %	11.23 %	11.18 %
Key common shareholders' equity to assets	10.48	10.37	9.95	10.18	10.90	10.48	10.90
Tangible common equity to tangible assets (d)	8.56	8.51	8.09	8.27	9.95	8.56	9.95
Common Equity Tier 1 (d)	9.91	9.91	9.54	9.56	11.10	9.91	11.10
Tier 1 risk-based capital	10.73	10.74	10.89	10.53	11.41	10.73	11.41
Total risk-based capital	12.64	12.69	12.85	12.63	13.63	12.64	13.63
Leverage	9.95	9.81	9.90	10.22	10.59	9.95	10.59
TRUST ASSETS							
Assets under management	$37,613	$37,417	$36,592	$36,752	$34,535	$37,613	$34,535
OTHER DATA							
Average full-time-equivalent employees	18,344	18,386	18,849	17,079	13,419	18,365	13,411
Branches	1,210	1,216	1,217	1,322	949	1,210	949

(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 12 ("Acquisition, Divestiture, 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.

Table of Contents

(d) See Figure 6 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).

Economic Overview

GDP data suggests that the U.S. economy got off to a slow start in 2017, with 1.2% GDP growth in the first quarter of 2017 and 2.6% GDP growth in the second quarter of 2017. The initial estimate suggests growth in consumer spending bounced back to 2.8% in the second quarter of 2017 after slowing down to 1.9% in the first quarter of 2017. Gross private domestic investment, up 2.0%, also added to second quarter of 2017 growth after weighing on growth during the first quarter of 2017, down 1.2%. The IMF estimates that global growth is expected to rise from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018, on expectations of more robust global demand, reduced deflationary pressures, and optimistic financial markets.

Oil prices have fallen since the beginning of the year to $45 per barrel, but are above the lows in early 2016 when prices dropped to $25 per barrel. Although inventories remain elevated from a historical standpoint, recent declines may help clear the way for stronger appreciation in 2017 and help support America’s energy industry. The stock market reached new records in the second quarter of 2017, with the S&P 500 equity index up 8.2% since the end of 2016. A general rally has occurred following the November elections, based on expectations for growth-friendly economic policies from the new U.S. presidential administration.

581,000 new jobs were added in the U.S. during the second quarter of 2017. This was up from the first quarter of 2017, which saw gains of 498,000. However, bad weather accelerated hiring at the beginning of the year and a late Easter depressed payrolls in March of 2017, when employment increased by only 50,000 jobs. The unemployment rate edged higher to 4.4% as more workers entered the labor force. Despite steady gains and a tight labor market, wage growth has failed to accelerate, with earnings for all workers increasing by only 2.5% over the past year. This suggests that even though the labor market has tightened, it may not yet actually be at full employment as speculated, estimated at 4.6%. Headline inflation was up by 1.6% year over year in June 2017, below the Federal Reserve’s target of 2.0%, although the Federal Reserve has stated that it believes that this weakness is likely transitory. Core inflation was also subdued year over year, at 1.7%.

Thanks to the solid economy and still low interest rates, the housing market generally benefited in the second quarter of 2017. New home sales growth was up 6.4% compared to the second quarter of 2016, while existing home sales were up 1.6%. Prices are also up, with average new home prices up 4.2% from year ago levels, and existing home prices up 4.9%. Single family housing starts also posted respectable gains in the second quarter of 2017, up 9.0%, from the second quarter of 2016, although multi-family construction was down 14.6%.

The Federal Reserve raised the target range for the federal funds rate by 25 basis points in June 2017, to 1% to 1.25%. This was widely expected and consistent with the central bank’s plan to gradually normalize interest rates. The Federal Reserve said that economic activity has been rising moderately so far this year, an upgrade from the May statement that noted it had slowed. The statement acknowledged that job growth has moderated but remains strong. The Federal Reserve sounded more upbeat on consumer spending and business investment. Risks to the economic outlook were again described as roughly balanced. The Federal Open Market Committee meeting minutes also suggested that a reduction of the Federal Reserve’s balance sheet will begin later this year. The 10-year U.S. Treasury yield stood at 2.2% at the end of the second quarter of 2017, which was 29 basis points below the prior quarter.

Long-term financial targets

Our long-term financial targets are as follows:

- Generate positive operating leverage and a cash efficiency ratio of less than 60%;
- Maintain a moderate risk profile by targeting a net loan charge-offs to average loans ratio in the range of .40% to .60%; and
- Achieve a return on tangible common equity ratio in the range of 13% to 15%.

Table of Contents

Figure 2 shows the evaluation of our long-term financial targets for the three months and six months ended June 30, 2017.

Figure 2. Evaluation of Our Long-Term Targets

	Key Metrics [a]	2Q17	YTD 2017	Targets
Positive operating leverage	Cash efficiency ratio [b]	59.3 %	62.4 %	< 60%
	Cash efficiency ratio excluding notable items [b]	59.4 %	59.9 %	
Moderate Risk Profile	Net loan charge-offs to average loans	.31 %	.29 %	.40 - .60%
Financial Returns	Return on average tangible common equity [c]	13.80 %	12.43 %	13.00 - 15.00%
	Return on average tangible common equity excluding notable items [c]	12.86 %	12.86 %	

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

(b) Excludes intangible asset amortization; non-GAAP measure; see Figure 6 entitled “GAAP to Non-GAAP Reconciliations” for reconciliation.

(c) Non-GAAP measure: see Figure 6 entitled “GAAP to Non-GAAP Reconciliations” for reconciliation.

Strategic developments

Our actions and results during the first six months of 2017 supported our corporate strategy described in the “Introduction” section under the “Corporate strategy” heading on page 35 of our 2016 Form 10-K.

- We continued to generate positive operating leverage versus the prior year and our cash efficiency ratio improved to 59.3%, or 59.4%, excluding notable items. Revenue growth was driven by net interest income and fee-based businesses. We also achieved $400 million in annualized cost savings from First Niagara and remain on track to achieve $50 million in incremental savings by early 2018.

- We made investments for growth across our franchise, including the acquisition of Key Merchant Services, LLC and the announced acquisition of HelloWallet.

- Net loan charge-offs increased during the first six months of 2017 compared to the year-ago period due to loan growth over the past twelve months and credit quality migration in our commercial loan portfolio. Our net loan charge-offs were .29% of average loans for the first six months of 2017, below our targeted range.

- Capital management remains a priority for 2017. As previously reported, share repurchases of up to $350 million were included in the 2016 capital plan, which was effective through the second quarter of 2017. We completed $94 million of Common Share repurchases, including $88 million of Common Share repurchases in the open market and $6 million of Common Share repurchases related to employee equity compensation programs in the second quarter of 2017 under this authorization. In April 2017, we submitted to the Federal Reserve and provided to the OCC our 2017 capital plan under the annual CCAR process. On June 28, 2017, the Federal Reserve announced that it did not object to our 2017 capital plan. Share repurchases of up to $800 million are included in the 2017 capital plan, which is effective from the third quarter of 2017 through the second quarter of 2018.

- As previously reported, our 2016 capital plan proposed an increase in our quarterly common share dividend from $.085 to $.095 for the second quarter of 2017, which was approved by our Board in May 2017. In the fourth quarter of 2017, the Board plans to consider a potential increase in our quarterly common share dividend, up to $.105 per share, consistent with the 2017 capital plan. An additional potential increase in the quarterly common share dividend, up to $.12 per share, is expected to be considered by the Board for the second quarter of 2018.

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 and investment, lending, credit card, and personalized wealth management products and business advisory services. Key Community Bank offers personal property and casualty insurance, such as home, auto, renters, watercraft, and umbrella policies. Key Community Bank also purchases motor vehicle retail installment sales contracts relating to new or used automobiles and light and medium-duty trucks via a network of dealers who regularly originate these third party installment sales contracts. These products and services are provided primarily through our relationship managers and specialists working in our 15-state branch network, which is organized into ten internally defined geographic regions: Washington, Oregon/Alaska, Rocky Mountains, Indiana/Northwest Ohio/Michigan, Central/Southwest Ohio, East Ohio/Western Pennsylvania, Atlantic, 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.

Table of Contents

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. 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 19 (“Line of Business Results”).

Supervision and regulation

The following discussion provides a summary of recent regulatory developments and should be read in conjunction with the disclosure included in our 2016 Form 10-K under the heading “Supervision and Regulation” in Item 1. Business and under the heading “II. Compliance Risk” in Item 1A. Risk Factors.

Regulatory capital requirement

In July 2013, the U.S. banking agencies adopted a final rule to implement the Basel III international capital framework (“Basel III”) with an effective date of January 1, 2015, and a multi-year transition period ending on December 31, 2018 (“Regulatory Capital Rules”). Consistent with Basel III, the Regulatory Capital Rules further restrict the type of instruments that may be recognized in Tier 1 and Tier 2 capital (including the phase out of trust preferred securities from tier 1 capital for BHCs above a certain asset threshold, like KeyCorp), establish a minimum Tier 1 Common Equity Capital ratio requirement of 4.5% and capital buffers to address procyclicality concerns and absorb losses during periods of financial stress, and refine several of the methodologies used for determining risk-weighted assets. The Regulatory Capital Rules provide additional requirements for large banking organizations with over $250 billion in total consolidated assets or $10 billion in foreign exposure, but those additional requirements do not apply to KeyCorp nor to KeyBank. Accordingly, for purposes of the Regulatory Capital Rules, KeyCorp and KeyBank are treated as “standardized approach” banking organizations.

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 2016 Form 10-K under the heading “Supervision and Regulation - Regulatory capital 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 3 below. At June 30, 2017, Key had an estimated Common Equity Tier 1 Capital Ratio of 9.82% under the fully phased-in Regulatory Capital Rules. Also at June 30, 2017, 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 3.

Figure 3. Pro Forma Ratios vs. Minimum Capital Ratios Calculated Under the Fully Phased-In Regulatory Capital Rules

Ratios (including capital conservation buffer)	Key June 30, 2017 Pro	Minimum January 1, 2017	Phase-in Period	Minimum January 1, 2019

	forma						
Common Equity Tier 1 [(a)]	9.82	%	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	10.52	%	6.0	%	None	6.0	
Tier 1 Capital + Capital conservation buffer			6.0		1/1/16-1/1/19	8.5	
Total Capital	12.46	%	8.0	%	None	8.0	
Total Capital + Capital conservation buffer			8.0		1/1/16-1/1/19	10.5	
Leverage [(c)]	9.81	%	4.0	%	None	4.0	

(a) See Figure 6 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.

Table of Contents

Revised prompt corrective action framework

The federal prompt corrective action ("PCA") framework under the FDIA groups FDIC-insured depository institutions into one of five capital categories: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized," for purposes of determining whether a bank should be required to establish a capital restoration plan and become subject to limitations on the bank's activities, capital actions, and payment of management fees.

In addition to implementing Basel III in the United States, the Regulatory Capital Rules also revised the capital category thresholds under the PCA framework for FDIC-insured depository institutions such as KeyBank. The revised PCA framework table in Figure 4 identifies the capital category thresholds for a "well capitalized" and an "adequately capitalized" institution under the Regulatory Capital Rules.

Figure 4. "Well Capitalized" and "Adequately Capitalized" Capital Category Ratios under Revised PCA Framework

Prompt Corrective Action Ratio	Capital Category 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 [b]	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.

We believe that, as of June 30, 2017, KeyBank (consolidated) satisfied the risk-based and leverage capital requirements to be considered "well capitalized" for purposes of the revised PCA framework. However, investors should not regard this determination as a representation of the overall financial condition or prospects of KeyBank because the PCA framework is intended to serve a limited supervisory function. Moreover, it is important to note that the PCA framework does not apply to BHCs, like KeyCorp.

Capital planning and stress testing

On January 30, 2017, the Federal Reserve released a final rule to revise the capital plan and stress test rules as they apply to large, noncomplex BHCs and U.S. intermediaries of foreign banks. Under the final rule, a large noncomplex BHC is one with total consolidated assets of more than $50 billion but less than $250 billion, and nonbank assets of less than $75 billion ("covered BHCs"). This includes KeyCorp.

The final rule provides relief from the compliance requirements associated with the Federal Reserve's capital plan and stress test rules. Specifically, the final rule relieves covered BHCs from the qualitative assessment portion of the Federal Reserve's CCAR program and modifies the reporting requirements for these organizations by reducing the reporting requirements applicable to covered BHCs under the FR Y-14A and by raising the materiality thresholds for specific portfolio reporting requirements.

The final rule also limits the amount of capital a covered BHC is authorized to distribute in excess of the amount set forth in its capital plan without Federal Reserve approval (the "de minimis exception"), and establishes a one-quarter blackout period during which a BHC is not permitted to submit a notice to use the de minimis exception or seek prior approval to make a capital distribution in an amount that exceeds the de minimis exception level. If exigent circumstances arise during the blackout period that require a capital distribution, a covered BHC may resubmit its capital plan and request expedited review from the Federal Reserve; however, the Federal Reserve is not required to expedite the review process.

The final rule also requires covered BHCs to measure nonbank assets on a monthly basis and report the monthly average to the Federal Reserve on a quarterly basis beginning March 31, 2017.

The final rule became effective 30 days after publication in the Federal Register, and therefore, the relief provided under the final rule from the qualitative assessment portion of the CCAR program is effective for the 2017 CCAR cycle.

On June 9, 2017, the Federal Reserve released a proposal and request for comment on certain information collection activities conducted under the series FR Y-14 schedules and reports that are used in connection with the CCAR program. As they would pertain to Key, the proposed revisions to the FR Y-14A and FR Y-14Q generally consist of modifications to reported items and

Table of Contents

instructions that would clarify the intended reporting of those items, and seek to further align reported items with the methodology, standards, and treatment in other regulatory reports or with the FR Y-14 schedules. In addition, the Federal Reserve has proposed to eliminate two schedules from the FR Y-14A to reduce the burden, but also to add a new sub-schedule to supplement the existing information collection around business plan change information. Other aspects of the proposal that do not pertain to Key would require the U.S. intermediate holding companies of foreign banks to apply the global market shock adjustment to certain reporting schedules under the FR Y-14A and FR Y-14Q.

The comment period for the proposed rule ends on August 8, 2017. If the proposal is adopted in final form, it is expected to have a neutral-to-low impact on Key’s reporting and compliance obligations.

Liquidity requirements

In October 2014, the federal banking agencies published a final rule to implement the Basel III liquidity coverage ratio (“Basel III LCR”) for U.S. banking organizations (the “Liquidity Coverage Rules”) that establishes 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). 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.

Under the Liquidity Coverage Rules, KeyCorp must calculate a Modified LCR on a monthly basis, and was required to satisfy a minimum Modified LCR requirement of 100% by January 1, 2017. At June 30, 2017, Key’s estimated Modified LCR was above 100%. In the future, KeyCorp may change the composition of our investment portfolio, increase the size of the overall investment portfolio, and modify product offerings to enhance or optimize our liquidity position.

Net stable funding ratio

The federal banking agencies commenced the U.S. implementation of the Basel III net stable funding ratio (“NSFR”) in April and May 2016, with the release of a proposed rule to implement a NSFR requirement for certain internationally active banking organizations (excluding KeyCorp) and a modified version of the minimum NSFR requirement (“Modified NSFR”) for BHCs and other depository institution holding companies with over $50 billion in consolidated assets that are not internationally active (including KeyCorp), together with quarterly public disclosure requirements. The proposed rule would require banking organizations to satisfy a minimum NSFR requirement of 1.0 on an ongoing basis. However, banking organizations subject to the Modified NSFR (like KeyCorp) would be required to maintain a lower minimum amount of available stable funding, equal to 70% of the required stable funding under the NSFR. The proposed rule would be effective on January 1, 2018. The comment period for the NPR expired on August 5, 2016. If the proposed NSFR requirement is adopted as a final rule, then similar to actions taken in connection with the implementation of the Liquidity Coverage Rules, KeyCorp may adjust its balance sheet or modify product offerings to enhance its liquidity position.

Resolution and recovery planning

BHCs with at least $50 billion in total consolidated assets, like KeyCorp, are required to periodically submit to the Federal Reserve and FDIC a plan discussing how the company could be rapidly and efficiently resolved if the company failed or experienced material financial distress. Insured depository institutions with at least $50 billion in total consolidated assets, like KeyBank, are also required to submit a resolution plan to the FDIC. These plans are due annually. KeyCorp and KeyBank were not required to submit resolution plans for 2016 because the FDIC and Federal

Reserve deferred such requirement until December 2017. By letter dated March 24, 2017, KeyCorp received guidance from the Federal Reserve and the FDIC regarding the information requirements for certain aspects of KeyCorp's December 2017 resolution plan submission. That letter is publicly available on the Federal Reserve's website, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20170324a.htm.

The Federal Reserve and FDIC make available on their websites the public sections of resolution plans for the companies, including KeyCorp and KeyBank, that submitted plans. The public section of the resolution plans of KeyCorp and KeyBank is available at http://www.federalreserve.gov/bankinforeg/resolution-plans.htm and https://www.fdic.gov/regulations/reform/resplans/.

On September 28, 2016, the OCC released final guidelines that establish standards for recovery planning by certain large OCC-regulated institutions, including KeyBank. The guidelines require such institutions to establish a comprehensive framework for evaluating the financial effects of severe stress events, and recovery actions an institution may pursue to remain a viable, going concern during a period of severe financial stress. Under the final guidelines, an institution's recovery plan must include triggers to alert the institution of severe stress events, escalation procedures, recovery options, and a process for periodic review and approval by senior management and the board of directors. The recovery plan should be tailored to the complexity, scope of operations, and risk profile of the institution.

Because KeyBank had average total consolidated assets of greater than $100 billion but less than $750 billion as reported on KeyBank's Consolidated Reports of Condition and Income for the four most recent consecutive quarters prior to January 1, 2017, it must be in compliance with the guidelines not later than January 1, 2018.

Deposit insurance and assessments

As required under the Dodd-Frank Act, in March 2015, the FDIC approved a final rule to impose a surcharge 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. As of July 1, 2016, KeyBank must pay a surcharge to assist in bringing the reserve ratio to the statutory minimum of 1.35%. 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 December 2016, the FDIC issued a final rule that imposes 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 rule requires those insured depository institutions to: (i) 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) develop the capability to calculate the insured and uninsured amounts for each deposit owner within 24 hours of failure. The FDIC will conduct periodic testing of compliance with these requirements, and institutions subject to the rule must submit to the FDIC a certification of compliance, signed by the KeyBank CEO, and deposit insurance coverage summary report on or before the mandatory compliance date and annually thereafter. The final rule became effective on April 1, 2017, with a mandatory compliance date of April 1, 2020.

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. Globally, systemically important banks 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

In April 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: (i) certain retirement plan fiduciaries, participants, or beneficiaries; and (ii) owners or beneficiaries of individual retirement accounts and health savings accounts, among other retirement plans. The purpose of the rules is to place fiduciary obligations, rather than the lesser legal obligations that currently apply, on these service providers. Accordingly, the rules subject any financial institution making recommendations for either the purchase or sale of investments in or rollover of the respective retirement plan 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. Under the Department of Labor’s original rules, the impartial standard requirement for financial institutions and their advisors was to become effective April 10, 2017. However, in response to a Presidential Order, the Department of Labor extended the effective date to June 9, 2017. The contract provisions must be in place by January 1, 2018. The Department of Labor will continue to review whether to modify, further delay, or rescind these rules in whole or in part.

Table of Contents

Highlights of Our Performance

Financial performance

For the second quarter of 2017, we announced net income from continuing operations attributable to Key common shareholders of $393 million, or $.36 per common share. Our second quarter of 2017 results compare to net income from continuing operations attributable to Key common shareholders of $193 million, or $.23 per common share, for the second quarter of 2016. During the second quarter of 2017, our results included a number of notable items, including a gain related to our merchant services business, the finalization of purchase accounting, merger-related charges, and a charitable contribution. These notable items had a pre-tax net benefit of $43 million, or $.02 per common share, for the second quarter of 2017.

Second quarter 2017 net interest income included $100 million of purchase accounting accretion related to the acquisition of First Niagara, including $42 million related to the finalization of previous purchase accounting estimates.

Our taxable-equivalent net interest income was $987 million for the second quarter of 2017, and the net interest margin was 3.30%, compared to taxable-equivalent net interest income of $605 million and a net interest margin of 2.76% for the second quarter of 2016, reflecting the benefit from the First Niagara acquisition, including purchase accounting accretion, as well as higher earning asset yields and balances. For the full year of 2017, we expect net interest income to be in the range of $3.8 billion to $3.9 billion. Our outlook does not include any additional rate increases in 2017.

Our noninterest income was $653 million for the second quarter of 2017, compared to $473 million for the year-ago quarter. Growth was largely driven by the acquisition of First Niagara, as well as core business momentum and a $64 million one-time gain from acquiring the remaining ownership interest in a merchant services joint venture. Investment banking and debt placement fees grew $37 million, related to strong commercial mortgage banking, underwriting, and advisory fees. For the full year of 2017, we expect noninterest income to be in the range of $2.35 billion to $2.45 billion.

Our noninterest expense was $995 million for the second quarter of 2017, which included $44 million of merger-related charges. Merger-related charges for the quarter were made up of $31 million of personnel expense and $13 million of nonpersonnel expense, largely reflected in business services and professional fees and marketing expense. During the second quarter of 2016, we incurred $45 million of merger-related charges.

Excluding merger-related charges, noninterest expense was $245 million higher than the second quarter of last year. The increase from the prior year, reflected in both personnel and non-personnel expense, was primarily driven by the acquisition of First Niagara. Higher incentive compensation related to stronger capital markets performance also contributed to the year-over-year increase. For the full year of 2017, we expect noninterest expense excluding merger-related charges to be in the range of $3.7 billion to $3.8 billion.

Average loans were $86.5 billion for the second quarter of 2017, an increase of $25.4 billion compared to the second quarter of 2016, primarily reflecting the impact of the First Niagara acquisition as well as growth in commercial and industrial loans which was broad-based and spread across Key's commercial lines of business. During the second quarter of 2017, our Community Bank middle market segment lending grew 4% from the first quarter of 2016. We anticipate low-end of mid-single digit (4%-6%) loan growth from the fourth quarter of 2016, which translates to $87 billion to $88 billion for fiscal year 2017 average balances.

Average deposits totaled $102.8 billion for the second quarter of 2017, an increase of $28.9 billion compared to the year-ago quarter, primarily reflecting the acquisition of First Niagara and core retail and commercial deposit growth. Our consolidated loan-to-deposit ratio was 87.2% at June 30, 2017, compared to 85.3% at June 30, 2016. We anticipate average deposits to be in the range of $102.5 billion to $103 billion for the fiscal year 2017.

Our provision for credit losses was $66 million for the second quarter of 2017, compared to $52 million for the second quarter of 2016. Our allowance for loan and lease losses was $870 million, or 1.01% of total period-end loans, at June 30, 2017, compared to 1.38% at June 30, 2016. For the remainder of 2017, we expect the provision for credit losses to slightly exceed net loan charge-offs to provide for loan growth.

Net loan charge-offs for the second quarter of 2017 totaled $66 million, or .31% of average total loans, compared to $43 million, or .28%, for the second quarter of 2016. For the remainder of 2017, we expect net loan charge-offs to average loans to remain below our targeted range of 40 to 60 basis points.

Table of Contents

At June 30, 2017, our nonperforming loans totaled $507 million, which represented .59% of period-end portfolio loans, compared to $619 million, or 1.00% of period-end portfolio loans, at June 30, 2016. Nonperforming assets at June 30, 2017, totaled $556 million and represented .64% of period-end portfolio loans and OREO and other nonperforming assets, compared to $637 million, or 1.03% of period-end portfolio loans and OREO and other nonperforming assets, at June 30, 2016.

Our capital ratios remain strong. Our tangible common equity and Tier 1 risk-based capital ratios at June 30, 2017, are 8.56% and 10.73%, respectively, compared to 9.95% and 11.41%, respectively, at June 30, 2016. In addition, our Common Equity Tier 1 ratio is 9.91% at June 30, 2017, compared to 11.10% at June 30, 2016. The decrease in our capital ratios was driven by the acquisition of First Niagara.

We continue to return capital to our shareholders by repurchasing Common Shares and through our quarterly common share dividend. In the second quarter of 2017, we completed $94 million of Common Share repurchases, including $88 million of common share repurchases in the open market and $6 million of Common Share repurchases related to employee equity compensation programs and paid a cash dividend of $.095 per Common Share, under our 2016 capital plan authorization.

Figure 5 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 5. Results of Operations

	Three months ended			Six months ended	
in millions, except per share amounts	6/30/2017	3/31/2017	6/30/2016	6/30/2017	6/30/2016
Summary of operations					
Income (loss) from continuing operations attributable to Key	$407	$ 324	$ 199	$731	$ 386
Income (loss) from discontinued operations, net of taxes [a]	5	—	3	5	4
Net income (loss) attributable to Key	$412	$ 324	$ 202	$736	$ 390
Income (loss) from continuing operations attributable to Key	$407	$ 324	$ 199	$731	$ 386
Less: Dividends on Preferred Stock	14	28	6	42	11
Income (loss) from continuing operations attributable to Key common shareholders	393	296	193	689	375
Income (loss) from discontinued operations, net of taxes [a]	5	—	3	5	4
Net income (loss) attributable to Key common shareholders	$398	$ 296	$ 196	$694	$ 379
Per common share — assuming dilution					
Income (loss) from continuing operations attributable to Key common shareholders	$.36	$ .27	$ .23	$.63	$ .44
Income (loss) from discontinued operations, net of taxes [a]	—	—	—	—	—
Net income (loss) attributable to Key common shareholders [b]	$.36	$ .27	$ .23	$.63	$ .45

(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 these business as a discontinued operation. For further discussion regarding the income (loss) from discontinued operations, see Note 12 (“Acquisition, Divestiture, and Discontinued Operations”).

(b) EPS may not foot due to rounding.

Figure 6 presents certain non-GAAP financial measures related to “tangible common equity,” “return on tangible common equity,” “Common Equity Tier 1,” “cash efficiency ratio,” certain financial measures excluding notable items, and “Common Equity Tier 1 under the Regulatory Capital Rules (estimates).”

Notable items include certain revenue or expense items that may occur in a reporting period which management does not consider indicative of ongoing financial performance. Management believes it is useful to consider certain financial metrics with and without merger-related charges and/or other notable items in order to enable a better understanding of Company results, increase comparability of period-to-period results, and to evaluate and forecast those results.

The tangible common equity ratio and the return on tangible common equity ratio have been a focus for some investors, and management believes that 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

Table of Contents

investors to assess our capital adequacy on these same bases. Figure 6 reconciles the GAAP performance measures to the corresponding non-GAAP measures.

As disclosed in Note 2 (“Business Combination”) and Note 12 (“Acquisition, Divestiture, 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 charges. Figure 6 shows the computation of pre provision net revenue excluding notable items and return on average assets from continuing operations excluding notable items. For the second quarter of 2017, merger-related charges are included in the total for “notable items,” the detail of which is provided in Figure 6. We believe that eliminating the effects of the notable items makes it easier to analyze our results by presenting them on a more comparable basis with our prior results.

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 disclose the cash efficiency ratio excluding notable items. 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, nor as a substitute for analyses of results as reported under GAAP.

Table of Contents

Figure 6. GAAP to Non-GAAP Reconciliations

	Three months ended					Six months ended	
dollars in millions	6/30/2017	3/31/2017	12/31/2016	9/30/2016	6/30/2016	6/30/2017	6/30/2016
Tangible common equity to tangible assets at period-end							
Key shareholders' equity (GAAP)	$15,253	$14,976	$15,240	$14,996	$11,313		
Less: Intangible assets [(a)]	2,866	2,751	2,788	2,855	1,074		
Preferred Stock [(b)]	1,009	1,009	1,640	1,150	281		
Tangible common equity (non-GAAP)	$11,378	$11,216	$10,812	$10,991	$9,958		
Total assets (GAAP)	$135,824	$134,476	$136,453	$135,805	$101,150		
Less: Intangible assets [(a)]	2,866	2,751	2,788	2,855	1,074		
Tangible assets (non-GAAP)	$132,958	$131,725	$133,665	$132,950	$100,076		
Tangible common equity to tangible assets ratio (non-GAAP)	8.56 %	8.51 %	8.09 %	8.27 %	9.95 %		
Common Equity Tier 1 at period-end							
Key shareholders' equity (GAAP)	$15,253	$14,976	$15,240	$14,996	$11,313		
Less: Preferred Stock [(b)]	1,009	1,009	1,640	1,150	281		
Common Equity Tier 1 capital before adjustments and deductions	14,244	13,967	13,600	13,846	11,032		
Less: Goodwill, net of deferred taxes	2,411	2,379	2,405	2,450	1,031		
Intangible assets, net of deferred taxes	257	194	155	216	30		
Deferred tax assets	5	11	4	6	1		
Net unrealized gains (losses) on available-for-sale securities, net of deferred taxes	(145)	(179)	(185)	101	129		
Accumulated gains (losses) on cash flow hedges, net of deferred taxes	(64)	(76)	(52)	39	77		
Amounts in AOCI attributed to pension and postretirement benefit costs, net of deferred taxes	(334)	(335)	(339)	(359)	(362)		
Total Common Equity Tier 1 capital	$12,114	$11,973	$11,612	$11,393	$10,126		
Net risk-weighted assets (regulatory)	$122,263	$120,852	$121,671	$119,120	$91,195		
Common Equity Tier 1 ratio (non-GAAP)	9.91 %	9.91 %	9.54 %	9.56 %	11.10 %		
Notable items							
Merger-related charges	$(44)	$(81)	$(198)	$(207)	(45)	$(125)	$(69)
Merchant services gain	64	—	—	—	—	64	—

Purchase accounting finalization, net	43	—	—	—	—	43	—
Charitable contribution	(20)	—	—	—	—	(20)	—
Total notable items	$43	$(81)	$(198)	$(207)	(45)	$(38)	$(69)
Income taxes	16	(30)	(74)	(75)	(17)	(14)	(26)
Total notable items after tax	$27	$(51)	$(124)	$(132)	(28)	$(24)	$(43)
Average tangible common equity							
Average Key shareholders' equity (GAAP)	$15,200	$15,184	$14,901	$13,552	$11,147	$15,192	$11,050
Less: Intangible assets (average) [c]	2,756	2,772	2,874	2,255	1,076	2,764	1,077
Preferred Stock (average)	1,025	1,480	1,274	648	290	1,251	290
Average tangible common equity (non-GAAP)	$11,419	$10,932	$10,753	$10,649	$9,781	$11,177	$9,683
Return on average tangible common equity from continuing operations							
Net income (loss) from continuing operations attributable to Key common shareholders (GAAP)	$393	$296	$213	$165	$193	$689	$375
Plus: Notable items, after tax	(27)	51	124	132	28	24	43
Net income (loss) from continuing operations attributable to Key common shareholders after notable items (non-GAAP)	$366	$347	$337	$297	$221	$713	$418
Average tangible common equity (non-GAAP)	11,419	10,932	10,753	10,649	9,781	11,177	9,683
Return on average tangible common equity from continuing operations (non-GAAP)	13.80%	10.98%	7.88%	6.16%	7.94%	12.43%	7.79%
Return on average tangible common equity from continuing operations excluding notable items (non-GAAP)	12.86	12.87	12.47	11.10	9.09	12.86	8.68
Return on average tangible common equity consolidated							
Net income (loss) attributable to Key common shareholders (GAAP)	$398	$296	$209	$166	$196	$694	$379
Average tangible common equity (non-GAAP)	11,419	10,932	10,753	10,649	9,781	11,177	9,683
Return on average tangible common equity consolidated (non-GAAP)	13.98%	10.98%	7.73%	6.20%	8.06%	12.52%	7.87%
Cash efficiency ratio							
Noninterest expense (GAAP)	$995	$1,013	$1,220	$1,082	$751	$2,008	$1,454
Less: Intangible asset amortization	22	22	27	13	7	44	15
	$973	$991	$1,193	$1,069	$744	$1,964	$1,439

Adjusted noninterest expense (non-GAAP)							
Less: Notable items [d]	60	81	207	189	45	141	69
Adjusted noninterest expense excluding notable items (non-GAAP)	$913	$910	$986	$880	$699	$1,823	$1,370
Net interest income (GAAP)	$973	$918	$938	$780	$597	$1,891	$1,201
Plus: Taxable-equivalent adjustment	14	11	10	8	8	25	16
Noninterest income (GAAP)	653	577	618	549	473	1,230	904
Total taxable-equivalent revenue (non-GAAP)	$1,640	$1,506	$1,566	$1,337	$1,078	$3,146	$2,121
Plus: Notable items [e]	(103)	—	(9)	18	—	(103)	—
Adjusted noninterest income excluding notable items (non-GAAP)	$1,537	$1,506	$1,557	$1,355	$1,078	$3,043	$2,121
Cash efficiency ratio (non-GAAP)	59.3 %	65.8 %	76.2 %	80.0 %	69.0 %	62.4 %	67.8 %
Cash efficiency ratio excluding notable items (non-GAAP)	59.4	60.4	63.3	64.9	64.8	59.9	64.6
Return on average total assets from continuing operations excluding notable items							
Income from continuing operations attributable to Key (GAAP)	$407	$324	$233	$171	$199	$731	$386
Plus: Notable items, after tax	(27)	51	124	132	28	24	43
Income from continuing operations attributable to Key excluding notable items, after tax (non-GAAP)	$380	$375	$357	$303	$227	$755	$429
Average total assets from continuing operations (GAAP)	$132,491	$132,741	$134,428	$123,469	$97,413	$132,615	$95,945
Return on average total assets from continuing operations excluding notable items (non-GAAP)	1.15 %	1.15 %	1.06 %	.98 %	.94 %	1.15 %	.90 %

17

Table of Contents

Figure 6. GAAP to Non-GAAP Reconciliations, continued

dollars in millions	Three months ended June 30, 2017
Common Equity Tier 1 under the Regulatory Capital Rules (estimates)	
Common Equity Tier 1 under current Regulatory Capital Rules	$12,114
Adjustments from current Regulatory Capital Rules to the fully phased-in Regulatory Capital Rules:	
Deferred tax assets and other intangible assets [(f)]	(66)
Common Equity Tier 1 anticipated under the fully phased-in Regulatory Capital Rules [(g)]	$12,048
Net risk-weighted assets under current Regulatory Capital Rules	$122,263
Adjustments from current Regulatory Capital Rules to the fully phased-in Regulatory Capital Rules:	
Mortgage servicing assets [(h)]	603
Volcker Funds	(149)
All other assets	(17)
Total risk-weighted assets anticipated under the fully phased-in Regulatory Capital Rules [(g)]	$122,700
Common Equity Tier 1 ratio under the fully phased-in Regulatory Capital Rules [(g)]	9.82 %

(a) For the three months ended June 30, 2017, March 31, 2017, December 31, 2016, September 30, 2016, and June 30, 2016, intangible assets exclude $33 million, $38 million, $42 million, $51 million, and $36 million, respectively, of period-end purchased credit card relationships.

(b) Net of capital surplus.

(c) For the three months ended June 30, 2017, March 31, 2017, December 31, 2016, September 30, 2016, and June 30, 2016, average intangible assets exclude $36 million, $40 million, $46 million, $47 million, and $38 million, respectively, of average purchased credit card relationships. For the six months ended June 30, 2017, and June 30, 2016, average intangible assets exclude $38 million and $40 million, respectively, of average purchased credit card receivables.

(d) Notable items for the three months ended June 30, 2017, include $44 million of merger-related expense, a $20 million charitable contribution, and a credit of $4 million related to purchase accounting finalization.

(e) Notable items for the three months ended June 30, 2017, include $64 million related to the merchant services gain and $39 million related to purchase accounting finalization.

(f) 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.

(g) 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."

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

Table of Contents

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 both the results across 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 all income were taxable and at the same rate). For example, \$100 of tax-exempt income would be presented as \$154, an amount that, if taxed at the statutory federal income tax rate of 35%, would yield \$100.

Figure 7 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 TE 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 TE net interest income by average earning assets.

Second quarter 2017 net interest income included \$100 million of purchase accounting accretion related to the acquisition of First Niagara, including \$42 million related to the finalization of previous purchase accounting estimates. First quarter 2017 results included \$53 million of purchase accounting accretion.

TE net interest income was \$987 million for the second quarter of 2017, and the net interest margin was 3.30%, compared to TE net interest income of \$605 million and a net interest margin of 2.76% for the second quarter of 2016, reflecting benefit from the First Niagara acquisition, including purchase accounting accretion, as well as higher earning asset yields and balances.

Compared to the first quarter of 2017, TE net interest income increased by \$58 million, and the net interest margin increased by 17 basis points. The increase in net interest income and the net interest margin reflects an increase in purchase accounting accretion and higher earning asset yields, partly offset by a decline in loan fees and higher interest-bearing deposit costs, largely the result of an increase in commercial deposit rates and growth in higher-yielding deposit products. Net interest income also benefited from one additional day in the second quarter of 2017.

For the six months ended June 30, 2017, TE net interest income was \$1.9 billion and the net interest margin was 3.21%, compared to TE net interest income of \$1.2 billion and a net interest margin of 2.83% for the prior year, reflecting the benefit from the First Niagara acquisition, growth in our core earning asset balances, and higher interest rates.

Average loans were \$86.5 billion for the second quarter of 2017, an increase of \$25.4 billion compared to the second quarter of 2016, primarily reflecting the impact of the First Niagara acquisition, as well as growth in commercial and industrial loans, which was broad-based and spread across our commercial lines of business. During the second quarter of 2017, Key finalized the fair value of the First Niagara acquired loan portfolio, adjusting the discount from $548 million to $603 million. At June 30, 2017, $345 million of the fair value discount remained.

Compared to the first quarter of 2017, average loans increased by $369 million. Commercial and industrial loans increased $664 million, with strength in middle market lending. Consumer loans decreased $110 million, mostly from continued declines in the home equity loan portfolio, largely the result of paydowns on home equity lines of credit.

Average deposits totaled $102.8 billion for the second quarter of 2017, an increase of $28.9 billion compared to the year-ago quarter, primarily reflecting the acquisition of First Niagara and core retail and commercial deposit growth.

Compared to the first quarter of 2017, average deposits increased by $701 million, driven by growth in certificates of deposits and NOW and money market deposit accounts, partly offset by a decline in escrow deposits. During the quarter, Key also experienced a shift in deposit mix from noninterest-bearing and low-cost interest-bearing deposits to higher-yielding deposit

Table of Contents

products. On a period end basis, total deposits decreased $1.1 billion compared to the linked-quarter, largely the result of seasonal deposit growth that occurred in the first quarter of 2017.

Table of Contents

Figure 7. Consolidated Average Balance Sheets, Net Interest Income, and Yields/Rates from Continuing Operations

dollars in millions	Second Quarter 2017 Average Balance	Second Quarter 2017 Interest [a]	Second Quarter 2017 Yield/ Rate [a]	First Quarter 2017 Average Balance	First Quarter 2017 Interest [a]	First Quarter 2017 Yield/ Rate [a]
ASSETS						
Loans [b], [c]						
Commercial and industrial [d]	$40,666	$ 409	4.04 %	$40,002	$ 373	3.77 %
Real estate — commercial mortgage	15,096	187	4.97	15,187	164	4.39
Real estate — construction	2,204	31	5.51	2,353	26	4.54
Commercial lease financing	4,690	50	4.33	4,635	44	3.76
Total commercial loans	62,656	677	4.34	62,177	607	3.95
Real estate — residential mortgage	5,509	52	3.77	5,520	54	3.94
Home equity loans	12,473	135	4.31	12,611	131	4.22
Consumer direct loans	1,743	31	7.07	1,762	30	6.97
Credit cards	1,044	29	11.04	1,067	29	11.06
Consumer indirect loans	3,077	38	5.02	2,996	37	4.91
Total consumer loans	23,846	285	4.77	23,956	281	4.75
Total loans	86,502	962	4.46	86,133	888	4.17
Loans held for sale	1,082	9	3.58	1,188	13	4.28
Securities available for sale [b], [e]	17,997	90	1.97	19,181	95	1.95
Held-to-maturity securities [b]	10,469	55	2.09	9,988	51	2.04
Trading account assets	1,042	7	3.00	968	7	2.75
Short-term investments	1,970	5	.96	1,610	3	.79
Other investments [e]	687	3	1.87	709	4	2.26
Total earning assets	119,749	1,131	3.78	119,777	1,061	3.57
Allowance for loan and lease losses	(864)			(855)		
Accrued income and other assets	13,606			13,819		
Discontinued assets	1,477			1,540		
Total assets	$133,968			$134,281		
LIABILITIES						
NOW and money market deposit accounts	$54,416	34	.25	$54,295	32	.24
Savings deposits	6,854	4	.21	6,351	1	.10
Certificates of deposit ($100,000 or more)	6,111	19	1.23	5,627	16	1.16
Other time deposits	4,650	9	.77	4,706	9	.76
Total interest-bearing deposits	72,031	66	.36	70,979	58	.33
Federal funds purchased and securities sold under repurchase agreements	466	—	.23	795	1	.32
Bank notes and other short-term borrowings	1,216	4	1.43	1,802	5	1.06
Long-term debt [f], [g]	11,046	74	2.68	10,833	68	2.54
Total interest-bearing liabilities	84,759	144	.68	84,409	132	.63
Noninterest-bearing deposits	30,748			31,099		
Accrued expense and other liabilities	1,782			2,048		
Discontinued liabilities [g]	1,477			1,540		
Total liabilities	118,766			119,096		
EQUITY						
Key shareholders' equity	15,200			15,184		
Noncontrolling interests	2			1		

Total equity	15,202		15,185	
Total liabilities and equity	$133,968		$134,281	
Interest rate spread (TE)		3.10 %		2.94 %
Net interest income (TE) and net interest margin (TE)	987	3.30 %	929	3.13 %
TE adjustment [(b)]	14		11	
Net interest income, GAAP basis	$ 973		$ 918	

(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 TE 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 and industrial average balances include $117 million, $114 million, $119 million, $107 million, and $87 million of assets from commercial credit cards for the three months ended June 30, 2017, March 31, 2017, December 31, 2016, September 30, 2016, and June 30, 2016, respectively.

Table of Contents

Figure 7. Consolidated Average Balance Sheets, Net Interest Income, and Yields/Rates from Continuing Operations

Fourth Quarter 2016			Third Quarter 2016			Second Quarter 2016		
Average Balance	Interest [a]	Yield/ Rate [a]	Average Balance	Interest [a]	Yield/ Rate [a]	Average Balance	Interest [a]	Yield/ Rate [a]
$39,495	$ 365	3.68 %	$37,318	$ 317	3.38 %	$32,630	$ 270	3.32 %
14,771	168	4.50	12,879	126	3.91	8,404	80	3.85
2,222	37	6.72	1,723	21	4.67	869	8	3.78
4,624	50	4.34	4,508	38	3.33	3,949	37	3.77
61,112	620	4.04	56,428	502	3.54	45,852	395	3.47
5,554	57	4.17	4,453	45	3.96	2,253	22	4.11
12,812	129	3.99	11,968	122	4.07	10,098	102	4.04
1,785	31	6.84	1,666	30	7.20	1,599	26	6.53
1,088	29	10.78	996	27	10.80	792	21	10.58
3,009	42	5.50	2,186	28	5.23	554	9	6.56
24,248	288	4.73	21,269	252	4.73	15,296	180	4.74
85,360	908	4.24	77,697	754	3.86	61,148	575	3.78
1,323	11	3.39	1,152	10	3.48	611	5	3.18
20,145	92	1.82	17,972	88	1.99	14,268	74	2.08
9,121	44	1.95	6,250	30	1.86	4,883	24	1.98
892	6	2.54	860	4	2.12	967	6	2.28
3,717	5	.49	5,911	7	.48	5,559	6	.45
741	6	3.23	717	5	2.74	610	2	1.54
121,299	1,072	3.52	110,559	898	3.24	88,046	692	3.16
(855)			(847)			(833)		
13,984			13,757			10,200		
1,610			1,676			1,738		
$136,038			$125,145			$99,151		
$55,444	31	.22	$51,318	25	.20	$39,687	16	.17
6,546	2	.10	4,521	1	.07	2,375	—	.02
5,428	15	1.11	4,204	12	1.15	3,233	11	1.39
4,849	9	.77	5,031	11	.85	3,252	7	.85
72,267	57	.32	65,074	49	.30	48,547	34	.29
592	1	.11	578	—	.16	337	—	.01
934	3	1.11	1,186	2	.91	694	3	1.39
10,914	63	2.38	10,415	59	2.31	9,294	50	2.25
84,707	124	.58	77,253	110	.57	58,872	87	.60
32,424			29,844			25,357		
2,394			2,818			2,032		
1,610			1,676			1,738		
121,135			111,591			87,999		
14,901			13,552			11,147		
2			2			5		
14,903			13,554			11,152		

$136,038			$125,145			$99,151		
		2.94 %			2.67 %			2.56 %
	948	3.12 %		788	2.85 %		605	2.76 %
	10			8			8	
	$ 938			$ 780			$ 597	

(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.

22

Table of Contents

Figure 8 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 8. Components of Net Interest Income Changes from Continuing Operations

in millions	From three months ended June 30, 2016 to three months ended June 30, 2017			From six months ended June 30, 2016 to six months ended June 30, 2017		
	Average Volume	Yield/ Rate	Net Change [(a)]	Average Volume	Yield/ Rate	Net Change [(a)]
INTEREST INCOME						
Loans	$269	$118	$ 387	$534	$171	$ 705
Loans held for sale	4	—	4	8	1	9
Securities available for sale	19	(3)	16	44	(8)	36
Held-to-maturity securities	29	2	31	56	2	58
Trading account assets	—	1	1	2	(1)	1
Short-term investments	(6)	5	(1)	(8)	6	(2)
Other investments	—	1	1	1	1	2
Total interest income (TE)	315	124	439	637	172	809
INTEREST EXPENSE						
NOW and money market deposit accounts	7	11	18	15	20	35
Savings deposits	—	4	4	—	5	5
Certificates of deposit ($100,000 or more)	9	(1)	8	18	(4)	14
Other time deposits	3	(1)	2	6	(1)	5
Total interest-bearing deposits	19	13	32	39	20	59
Federal funds purchased and securities sold under repurchase agreements	—	—	—	—	1	1
Bank notes and other short-term borrowings	2	(1)	1	5	(1)	4
Long-term debt	10	14	24	24	22	46
Total interest expense	31	26	57	68	42	110
Net interest income (TE)	$284	$98	$ 382	$569	$130	$ 699

(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 9, noninterest income was $653 million for the second quarter of 2017, compared to $473 million for the year-ago quarter. For the six months ended June 30, 2017, noninterest income was $1.2 billion compared to $904 million for the same period one year ago. Noninterest income represented 40% and 39% of total revenue for the three and six months ended June 30, 2017, respectively, compared to 44% and 43% for the three and six months ended June 30, 2016, respectively.

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

Figure 9. Noninterest Income

	Three months ended June 30,		Change		Six months ended June 30,		Change	
dollars in millions	2017	2016	Amount	Percent	2017	2016	Amount	Percent
Trust and investment services income	$134	$110	$24	21.8 %	$269	$219	$50	22.8 %
Investment banking and debt placement fees	135	98	37	37.8	262	169	93	55.0
Service charges on deposit accounts	90	68	22	32.4	177	133	44	33.1
Operating lease income and other leasing gains	30	18	12	66.7	53	35	18	51.4
Corporate services income	55	53	2	3.8	109	103	6	5.8
Cards and payments income	70	52	18	34.6	135	98	37	37.8
Corporate-owned life insurance income	33	28	5	17.9	63	56	7	12.5
Consumer mortgage income	6	3	3	100.0	12	5	7	140.0
Mortgage servicing fees	15	10	5	50.0	33	22	11	50.0
Net gains (losses) from principal investing	—	11	(11)	N/M	1	11	(10)	(90.9)
Other income	85	22	63	286.4	116	53	63	118.9
Total noninterest income	$653	$473	$180	38.1 %	$1,230	$904	$326	36.1 %

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

23

Table of Contents

generate these revenues are shown in Figure 10. For the three months ended June 30, 2017, trust and investment services income increased $24 million, or 21.8%, compared to the same period one year ago, primarily due to the acquisition of First Niagara and assets under management market growth. Compared to the first quarter of 2017, trust and investment services income decreased $1 million, or .7%, due to lower insurance and brokerage commissions.

For the six months ended June 30, 2017, trust and investment services income was up $50 million, or 22.8%, from the six months ended June 30, 2016, primarily due to the acquisition of First Niagara.

A significant portion of our trust and investment services income depends on the value and mix of assets under management. At June 30, 2017, our bank, trust, and registered investment advisory subsidiaries had assets under management of $37.6 billion, compared to $34.5 billion at June 30, 2016. The increase in assets under management, as shown in Figure 10, was primarily attributable to the acquisition of First Niagara and growth in equity investments.

Figure 10. Assets Under Management

in millions	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Assets under management by investment type:					
Equity	$22,824	$22,522	$ 21,722	$ 21,568	$20,458
Securities lending	807	1,095	1,148	991	968
Fixed income	10,819	10,497	10,386	11,016	10,053
Money market	3,163	3,303	3,336	3,177	3,056
Total assets under management	$37,613	$37,417	$ 36,592	$ 36,752	$34,535

Investment banking and debt placement fees

Investment banking and debt placement fees consist of syndication fees, debt and equity financing fees, financial adviser fees, gains on sales of commercial mortgages, and agency origination fees. Investment banking and debt placement fees increased $37 million, or 37.8%, for the second quarter of 2017, related to strong commercial mortgage banking, underwriting, and advisory fees. Compared to the first quarter of 2017, investment banking and debt placement fees increased $8 million, or 6.3%, related to strong advisory fees.

For the six months ended June 30, 2017, investment banking and debt placement fees increased $93 million, or 55.0%, from the same period one year ago. This increase is primarily due to improved capital market conditions and activity compared to the first six months of 2016.

Service charges on deposit accounts

Service charges on deposit accounts increased $22 million, or 32.4%, for the three months ended June 30, 2017, compared to the same period one year ago. The increase from the three months ended June 30, 2016, was primarily due to the acquisition of First Niagara. Compared to the first quarter of 2017, service charges on deposit accounts increased $3 million, or 3.4%, primarily due to an increase in account analysis and other fees.

For the six months ended June 30, 2017, service charges on deposits accounts increased $44 million, or 33.1%, from the first half of 2016. In all fee categories, this increase was primarily due to the acquisition of First Niagara.

Cards and payments income

Cards and payments income, which consists of debit card, consumer and commercial credit card, and merchant services income, increased $18 million, or 34.6%, from the year-ago quarter. This increase was primarily due to the acquisition of First Niagara and to higher purchase and prepaid card fees in Key Corporate Bank. Compared to the first quarter of 2017, cards and payments income increased $5 million, or 7.7%, due to increased volume driving higher interchange income.

For the six months ended June 30, 2017, cards and payments income was $135 million, an increase of $37 million, or 37.8%, from the same period one year ago. This increase was primarily due to the acquisition of First Niagara and higher purchase and prepaid card fees in Key Corporate Bank.

Table of Contents

Other income

Other income, which consists primarily of gains on sales of loans held for sale, other service charges, and certain dealer trading income, was up $63 million, or 286.4%, from the year-ago quarter. Compared to the first quarter of 2017, other income increased $54 million, or 174.2%. This increase was primarily attributable to a $64 million one-time gain from acquiring the remaining ownership in a merchant services joint venture.

For the six months ended June 30, 2017, other income was up $63 million, or 118.9%, from the same period one year ago. This increase was driven by a $64 million one-time gain related to our merchant services business.

Noninterest expense

As shown in Figure 11, noninterest expense was $995 million for the second quarter of 2017 compared to $751 million for the second quarter of 2016. The second quarter of 2017 included $44 million of merger-related charges compared to $45 million for the second quarter of 2016.

For the six months ended June 30, 2017, noninterest expense was $2.0 billion compared to $1.5 billion for the same period one year ago. Merger-related charges for the six months ended June 30, 2017, were $125 million compared to $69 million for the same period one year ago.

Figure 11. Noninterest Expense

	Three months ended June 30,		Change		Six months ended June 30,		Change	
dollars in millions	2017	2016	Amount	Percent	2017	2016	Amount	Percent
Personnel [(a)]	$551	$ 427	$124	29.0 %	$1,107	$831	$276	33.2 %
Net occupancy	78	59	19	32.2	165	120	45	37.5
Computer processing	55	45	10	22.2	115	88	27	30.7
Business services and professional fees	45	40	5	12.5	91	81	10	12.3
Equipment	27	21	6	28.6	54	42	12	28.6
Operating lease expense	21	14	7	50.0	40	27	13	48.1
Marketing	30	22	8	36.4	51	34	17	50.0
FDIC assessment	21	8	13	162.5	41	17	24	141.2
Intangible asset amortization	22	7	15	214.3	44	15	29	193.3
OREO expense, net	3	2	1	50.0	5	3	2	66.7
Other expense	142	106	36	34.0	295	196	99	50.5
Total noninterest expense	$995	$ 751	$244	32.5 %	$2,008	$1,454	$554	38.1 %
Merger-related charges [(b)]	44	45	(1)	(2.2)	125	69	56	81.2
Total noninterest expense excluding merger-related charges [(c)]	$951	$ 706	$245	34.7 %	$1,883	$1,385	$498	36.0 %
Average full-time equivalent employees [(d)]	18,344	13,419	4,925	36.7 %	18,365	13,411	4,954	36.9 %

(a) Additional detail provided in Figure 13 entitled “Personnel Expense.”
(b) Additional detail provided in Figure 12 entitled “Merger-Related Charges.”
(c) Non-GAAP measure.
(d) The number of average full-time equivalent employees has not been adjusted for discontinued operations.

Figure 12. Merger-Related Charges

dollars in millions	Three months ended June 30, 2017	2016	Change Amount	Change Percent	Six months ended June 30, 2017	2016	Change Amount	Change Percent
Personnel	$31	$ 35	$(4)	(11.4)%	$61	$ 51	$10	19.6 %
Net occupancy	(1)	—	(1)	N/M	4	—	4	N/M
Business services and professional fees	6	5	1	20.0	11	12	(1)	(8.3)
Computer processing	2	—	2	N/M	7	—	7	N/M
Marketing	6	3	3	100.0	12	4	8	200.0
Other nonpersonnel expense	—	2	(2)	N/M	30	2	28	N/M
Noninterest expense	44	45	(1)	(2.2)	125	69	56	81.2
Total merger-related charges	$44	$ 45	$(1)	(2.2)%	$125	$ 69	$56	81.2 %

25

Table of Contents

Personnel

As shown in Figure 13, personnel expense, the largest category of our noninterest expense, increased by $124 million, or 29.0%, for the second quarter of 2017 compared to the year-ago quarter. This increase was primarily driven by the acquisition of First Niagara. Higher incentive compensation related to stronger capital markets performance also contributed to the year-over-year increase. Compared to the first quarter of 2017, personnel expense decreased $5 million, or .9%. Incentive and stock-based compensation and salaries expense increased but were more than offset by lower employee benefits expense.

For the six months ended June 30, 2017, personnel expense was up $276 million, or 33.2%, from the first half of 2016. This increase was primarily driven by the acquisition of First Niagara and higher incentive and stock-based compensation related to stronger capital markets performance.

Figure 13. Personnel Expense

	Three months ended June 30,		Change		Six months ended June 30,		Change	
dollars in millions	2017	2016	Amount	Percent	2017	2016	Amount	Percent
Salaries and contract labor	$332	$266	$66	24.8 %	$656	$510	$146	28.6 %
Incentive and stock-based compensation	137	101	36	35.6	264	190	74	38.9
Employee benefits	76	58	18	31.0	172	126	46	36.5
Severance	6	2	4	200.0	15	5	10	200.0
Total personnel expense	$551	$427	$124	29.0 %	$1,107	$831	$276	33.2 %
Merger-related charges	31	35	(4)	(11.4)	61	51	10	N/M
Total personnel expense excluding merger-related charges	$520	$392	$128	32.7 %	$1,046	$780	$266	34.1 %

Net occupancy

Net occupancy expense increased $19 million, or 32.2%, for the second quarter of 2017, compared to the same period one year ago. This increase was primarily due to the acquisition of First Niagara. Compared to the first quarter of 2017, net occupancy expense decreased $9 million, or 10.3%, primarily attributable to lower property reserve expenses and seasonal trends.

For the six months ended June 30, 2017, net occupancy expense increased $45 million, or 37.5%, from the six months ended June 30, 2016, primarily due to the acquisition of First Niagara.

Other expense

Other expense comprises various miscellaneous expense items. The $36 million, or 34.0%, increase in the current quarter compared to the same period one year ago reflects the impact of the First Niagara acquisition and other miscellaneous expenses. Other notable items which impacted the second quarter included a $20 million charitable contribution and $4 million benefit from purchase accounting finalization, both of which are reflected in other expense. Compared to the first quarter of 2017, other expense decreased $11 million, or 7.2%, primarily due to decreases in other miscellaneous expenses.

For the six months ended June 30, 2017, other expense increased $99 million, or 50.5%, from the six months ended June 30, 2016, primarily due to the impact of First Niagara, an increase in other miscellaneous expenses, and the $20 million charitable contribution made in the six months ended June 30, 2017.

Income taxes

We recorded tax expense from continuing operations of $158 million for the second quarter of 2017 and $69 million for the second quarter of 2016. For the six months ended June 30, 2017, we recorded tax expense from continuing operations of $252 million, compared to $125 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, and make periodic adjustments to our tax reserves. Tax expense for the three months ended June 30, 2017, and June 30, 2016, was affected by net discrete income tax benefits of $3 million and detriments of $6 million, respectively. The tax expense for the second quarter of 2017 was also impacted due to notable items of $1 million. Excluding those expenses, the tax expense for the second quarter of 2017 was $157 million.

Table of Contents

Additional information pertaining to how our tax expense (benefit) and the resulting effective tax rates were derived is included in Note 13 ("Income Taxes") beginning on page 170 of our 2016 Form 10-K.

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 19 ("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 14 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- and six-month periods ended June 30, 2017, and June 30, 2016.

Figure 14. Major Business Segments — Taxable-Equivalent 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	2017	2016	Amount	Percent	2017	2016	Amount	Percent
REVENUE FROM CONTINUING OPERATIONS (TE)								
Key Community Bank	$1,012	$598	$414	69.2 %	$1,919	$1,194	$725	60.7 %
Key Corporate Bank	596	451	145	32.2	1,174	876	298	34.0
Other Segments	35	31	4	12.9	64	52	12	23.1
Total Segments	1,643	1,080	563	52.1	3,157	2,122	1,035	48.8
Reconciling Items [(a)]	(3)	(2)	(1)	N/M	(11)	(1)	(10)	N/M
Total	$1,640	$1,078	$562	52.1 %	$3,146	$2,121	$1,025	48.3 %
INCOME (LOSS) FROM CONTINUING OPERATIONS ATTRIBUTABLE TO KEY								
Key Community Bank	$197	$80	$117	146.3 %	$343	$154	$189	122.7 %
Key Corporate Bank	222	135	87	64.4	404	253	151	59.7
Other Segments	28	25	3	12.0	49	39	10	25.6
Total Segments	447	240	207	86.3	796	446	350	78.5
Reconciling Items [(a)]	(40)	(41)	1	N/M	(65)	(60)	(5)	N/M
Total	$407	$199	$208	104.5 %	$731	$386	$345	89.4 %

(a) Reconciling items consist primarily of the unallocated portion of merger-related charges and items not allocated to the business segments because
they do not reflect their normal operations.

Key Community Bank summary of operations

- Positive operating leverage from prior year
- Net income increased $117 million, or 146.3%, from prior year
- Average commercial and industrial loans increased $5.4 billion, or 41.2%, from the prior year
- Average deposits increased $25.9 billion, or 48.2%, from the prior year

As shown in Figure 15, Key Community Bank recorded net income attributable to Key of $197 million for the second quarter of 2017, compared to $80 million for the year-ago quarter, benefiting from momentum in Key's core businesses, as well as the impact of the First Niagara acquisition.

TE net interest income increased by $284 million, or 72.4%, from the second quarter of 2016. The increase was primarily attributable to the acquisition of First Niagara, as well as benefit from the Federal Reserve rate increase. Average loans and leases increased $16.5 billion, or 53.3%, largely driven by a $5.4 billion, or 41.2%, increase in commercial and industrial loans. Additionally, average deposits increased $25.9 billion, or 48.2%, from one year ago.

Noninterest income increased $130 million, or 63.1%, from the year-ago quarter, driven by the acquisition of First Niagara, including the addition of Key Insurance and Benefits Services. Strength in cards and payments and higher assets under management balances from market growth also contributed to the increase. The increase in other noninterest income was largely driven by the one-time gain related to Key’s merchant services business.

Table of Contents

The provision for credit losses increased by $22 million, or 88.0%, and net loan charge-offs increased $30 million, from the second quarter of 2016, primarily related to the acquisition of First Niagara.

Noninterest expense increased by $207 million, or 46.5%, from the year-ago quarter, largely driven by the acquisition of First Niagara, as well as an increase in core business activity and investments. Personnel expense increased $76 million, while non-personnel expense increased by $131 million, including higher intangible amortization expense and higher FDIC assessment expense.

Figure 15. Key Community Bank

	Three months ended June 30,		Change		Six months ended June 30,		Change	
dollars in millions	2017	2016	Amount	Percent	2017	2016	Amount	Percent
SUMMARY OF OPERATIONS								
Net interest income (TE)	$676	$392	$284	72.4 %	$1,306	$791	$515	65.1 %
Noninterest income	336	206	130	63.1	613	403	210	52.1
Total revenue (TE)	1,012	598	414	69.2	1,919	1,194	725	60.7
Provision for credit losses	47	25	22	88.0	94	66	28	42.4
Noninterest expense	652	445	207	46.5	1,279	883	396	44.8
Income (loss) before income taxes (TE)	313	128	185	144.5	546	245	301	122.9
Allocated income taxes (benefit) and TE adjustments	116	48	68	141.7	203	91	112	123.1
Net income (loss) attributable to Key	$197	$80	$117	146.3%	$343	$154	$189	122.7%
AVERAGE BALANCES								
Loans and leases	$47,431	$30,936	$16,495	53.3 %	$47,235	$30,863	$16,372	53.0 %
Total assets	51,419	32,963	18,456	56.0	51,192	32,910	18,282	55.6
Deposits	79,716	53,794	25,922	48.2	79,556	53,299	26,257	49.3
Assets under management at period end	$37,613	$34,535	$3,078	8.9 %	$37,613	$34,535	$3,078	8.9 %

ADDITIONAL KEY COMMUNITY BANK DATA

	Three months ended June 30,		Change		Six months ended June 30,		Change	
dollars in millions	2017	2016	Amount	Percent	2017	2016	Amount	Percent
NONINTEREST INCOME								
Trust and investment services income	$99	$73	$26	35.6 %	$197	$146	$51	34.9 %
Services charges on deposit accounts	77	56	21	37.5	152	110	42	38.2
Cards and payments income	60	46	14	30.4	116	89	27	30.3
Other noninterest income	100	31	69	222.6	148	58	90	155.2
Total noninterest income	$336	$206	$130	63.1 %	$613	$403	$210	52.1 %
AVERAGE DEPOSITS OUTSTANDING								
NOW and money market deposit accounts	$45,243	$30,144	$15,099	50.1 %	$45,135	$29,788	$15,347	51.5 %
Savings deposits	5,293	2,365	2,928	123.8	5,281	2,353	2,928	124.4
Certificates of deposits ($100,000 or more)	4,016	2,383	1,633	68.5	3,948	2,251	1,697	75.4
Other time deposits	4,640	3,245	1,395	43.0	4,666	3,221	1,445	44.9
Noninterest-bearing deposits	20,524	15,657	4,867	31.1	20,526	15,686	4,840	30.9
Total deposits	$79,716	$53,794	$25,922	48.2 %	$79,556	$53,299	$26,257	49.3 %
HOME EQUITY LOANS								
Average balance	$12,330	$9,908						

Combined weighted-average loan-to-value ratio (at date of origination)	71 %	71 %
Percent first lien positions	60	61
OTHER DATA		
Branches	1,210	949
Automated teller machines	1,589	1,236

Key Corporate Bank summary of operations

- Positive operating leverage compared to prior year
- Average loan and lease balances up $9.1 billion, or 32.0%, from the prior year
- Revenue up $145 million, or 32.2%, from the prior year
- Investment banking and debt placement fees up $40 million, or 42.6%, from prior year

Table of Contents

As shown in Figure 16, Key Corporate Bank recorded net income attributable to Key of $222 million for the second quarter of 2017, compared to $135 million for the same period one year ago.

Taxable-equivalent net interest income increased by $91 million, or 41.2%, compared to the second quarter of 2016 driven by higher earning asset yields and balances. Average loan and lease balances increased $9.1 billion, or 32.0%, from the year-ago quarter, primarily driven by the First Niagara acquisition as well as growth in commercial and industrial loans. Average deposit balances increased $2.0 billion, or 10.5%, from the year-ago quarter, mostly driven by the First Niagara acquisition.

Noninterest income was up $54 million, or 23.5%, from the prior year. This growth was mostly due to $40 million of higher investment banking and debt placement fees related to stronger commercial mortgage banking, underwriting, and advisory fees, as well as an increase of $7 million in operating lease income and other leasing gains related to higher originations. Additional increases of $4 million in both cards and payments income and other noninterest income were partially offset by a $2 million decrease in trust and investment services income.

The provision for credit losses decreased $11 million, or 36.7%, compared to the second quarter of 2016 due to $8 million of lower net loan charge-offs and improvement in the oil and gas portfolio.

Noninterest expense increased by $40 million, or 15.4%, from the second quarter of 2016. The increase from the prior year, reflected in both personnel and nonpersonnel expense, was largely driven by the acquisition of First Niagara, higher performance-based compensation and various other items, including operating lease, FDIC, and cards and payments expenses.

Figure 16. Key Corporate Bank

	Three months ended June 30,		Change		Six months ended June 30,		Change	
dollars in millions	2017	2016	Amount	Percent	2017	2016	Amount	Percent
SUMMARY OF OPERATIONS								
Net interest income (TE)	$312	$221	$91	41.2 %	$616	$439	$177	40.3 %
Noninterest income	284	230	54	23.5	558	437	121	27.7
Total revenue (TE)	596	451	145	32.2	1,174	876	298	34.0
Provision for credit losses	19	30	(11)	(36.7)	36	73	(37)	(50.7)
Noninterest expense	299	259	40	15.4	601	496	105	21.2
Income (loss) before income taxes (TE)	278	162	116	71.6	537	307	230	74.9
Allocated income taxes and TE adjustments	56	29	27	93.1	134	56	78	139.3
Net income (loss)	$222	$133	$89	66.9	$403	$251	$152	60.6
Less: Net income (loss) attributable to noncontrolling interests	—	(2)	2	N/M	(1)	(2)	1	N/M
Net income (loss) attributable to Key	$222	$135	$87	64.4 %	$404	$253	$151	59.7 %
AVERAGE BALANCES								
Loans and leases	$37,750	$28,607	$9,143	32.0 %	$37,744	$28,164	$9,580	34.0 %
Loans held for sale	1,000	591	409	69.2	1,048	701	347	49.5
Total assets	44,177	33,908	10,269	30.3	44,175	33,658	10,517	31.2
Deposits	21,146	19,129	2,017	10.5 %	21,075	18,602	2,473	13.3 %

ADDITIONAL KEY CORPORATE BANK DATA

	Change	Change

dollars in millions	Three months ended June 30, 2017	2016	Amount	Percent	Six months ended June 30, 2017	2016	Amount	Percent
NONINTEREST INCOME								
Trust and investment services income	$35	$37	$(2)	(5.4)%	$72	$73	$(1)	(1.4)%
Investment banking and debt placement fees	134	94	40	42.6	258	164	94	57.3
Operating lease income and other leasing gains	22	15	7	46.7	43	28	15	53.6
Corporate services income	38	40	(2)	(5.0)	75	78	(3)	(3.8)
Service charges on deposit accounts	13	12	1	8.3	25	23	2	8.7
Cards and payments income	10	6	4	66.7	19	9	10	111.1
Payments and services income	61	58	3	5.2	119	110	9	8.2
Mortgage servicing fees	12	10	2	20.0	28	22	6	27.3
Other noninterest income	20	16	4	25.0	38	40	(2)	(5.0)
Total noninterest income	$284	$230	$54	23.5 %	$558	$437	$121	27.7 %

Table of Contents

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 $28 million for the second quarter of 2017, compared to $25 million for the same period last year, driven by increases in operating lease income and other leasing gains and corporate-owned life insurance income.

Table of Contents

Financial Condition

Loans and loans held for sale

At June 30, 2017, total loans outstanding from continuing operations were $86.5 billion, compared to $86.0 billion at December 31, 2016. Loans related to the discontinued operations of the education lending business and excluded from total loans were $1.4 billion at June 30, 2017, and $1.6 billion at December 31, 2016. 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 107 of our 2016 Form 10-K.

During the second quarter of 2017, Key finalized the fair value of the First Niagara acquired loan portfolio, adjusting the discount from $548 million to $603 million. At June 30, 2017, $345 million of the fair value discount remained. For more information on the financial sattement impact of the finalization of the First Niagara acquired loan portforlio, see Note 2 (“Business Combination”).

Commercial loan portfolio

Commercial loans outstanding were $62.6 billion at June 30, 2017, an increase of $723 million, or 1.2%, compared to December 31, 2016, primarily driven by an increase in commercial and industrial loans. Figure 17 provides our commercial loan portfolios by industry classification at June 30, 2017, and December 31, 2016.

Table of Contents

Figure 17. Commercial Loans by Industry

June 30, 2017 dollars in millions	Commercial and industrial	Commercial real estate	Commercial lease financing	Total commercial loans	Percent of total
Industry classification:					
Agricultural	$ 671	$ 163	$ 70	$ 904	1.4 %
Automotive	2,269	474	86	2,829	4.6
Business products	1,837	151	58	2,046	3.3
Business services	2,605	163	270	3,038	4.9
Commercial real estate	5,237	10,969	25	16,231	25.9
Construction materials and contractors	1,745	337	124	2,206	3.5
Consumer discretionary	3,784	547	403	4,734	7.6
Consumer services	2,854	950	231	4,035	6.4
Equipment	1,633	141	137	1,911	3.1
Financial	3,888	84	319	4,291	6.9
Healthcare	3,104	2,479	446	6,029	9.6
Materials manufacturing and mining	1,953	125	139	2,217	3.5
Media	509	23	52	584	.9
Oil and gas	914	19	50	983	1.6
Public exposure	2,350	62	1,062	3,474	5.5
Technology	499	6	10	515	.8
Transportation	1,439	261	886	2,586	4.1
Utilities	3,147	6	369	3,522	5.6
Other	476	21	—	497	.8
Total	$ 40,914	$ 16,981	$ 4,737	$ 62,632	100.0 %

December 31, 2016 dollars in millions	Commercial and industrial	Commercial real estate	Commercial lease financing	Total commercial loans	Percent of total
Industry classification:					
Agricultural	$ 844	$ 194	$ 151	$ 1,189	1.9 %
Automotive	2,139	491	74	2,704	4.4
Business products	1,243	152	31	1,426	2.3
Business services	2,648	179	303	3,130	5.1
Commercial real estate	4,759	11,235	2	15,996	25.8
Construction materials and contractors	1,282	307	79	1,668	2.7
Consumer discretionary	3,367	539	314	4,220	6.8
Consumer services	2,281	749	66	3,096	5.0
Equipment	1,582	107	87	1,776	2.9
Financial	3,864	95	296	4,255	6.9
Healthcare	3,487	2,577	526	6,590	10.6
Materials manufacturing and mining	2,743	276	212	3,231	5.2
Media	478	18	70	566	.9
Oil and gas	1,094	27	62	1,183	1.9
Public exposure	2,621	311	1,204	4,136	6.7
Technology	485	6	34	525	.8
Transportation	940	148	923	2,011	3.3
Utilities	3,441	26	251	3,718	6.0
Other	470	19	—	489	.8

Total	$ 39,768	$ 17,456	$ 4,685	$ 61,909	100.0 %

Commercial and industrial. Our commercial and industrial loans represented 47% of our total loan portfolio at June 30, 2017, and 46% at December 31, 2016, and are 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 and industrial loans increased $1.1 billion, or 2.9%, from December 31, 2016, with Key Corporate Bank increasing $459 million, Key Community Bank up $731 million, and Other Segments decreasing $44 million. This growth was partially attributable to growth within our middle market segment driven by increased production and productivity.

Our largest commercial and industrial loan industry classification, commercial real estate, increased by 10.0%, when compared to December 31, 2016. We experienced growth in our transportation, business products, and construction materials and contractors commercial and industrial loan classifications, increasing 53.1%, 47.8%, and 36.1%, respectively, from December 31, 2016. Partially offsetting these increases, the materials manufacturing and mining and healthcare commercial and industrial loan classifications, which represented approximately 5% and 8%, respectively, of the commercial and industrial loan portfolio at June 30, 2017, decreased 28.8% and 11.0%, respectively, from December 31, 2016.

Commercial real estate loans. Our commercial real estate lending business is conducted through two primary sources: our 15-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

Table of Contents

from nonaffiliated third parties) and accounted for approximately 70% of our average year-to-date commercial real estate loans for the three months ended June 30, 2017, and June 30, 2016. KeyBank Real Estate Capital generally focuses on larger owners and operators of commercial real estate.

Commercial real estate loans totaled $17.0 billion at June 30, 2017, and December 31, 2016, and represented 20% of our total loan portfolio at June 30, 2017, and December 31, 2016, respectively. The $475 million decrease from December 31, 2016, was due to an increase in paydowns and payoffs in our real estate—commercial mortgage loan portfolio. These loans, which include both owner- and nonowner-occupied properties, represented 27% or our commercial loan portfolio at June 30, 2017, and 28% at December 31, 2016.

Figure 18 includes commercial mortgage and construction loans in both Key Community Bank and Key Corporate Bank. As shown in Figure 18, this loan portfolio is diversified by both property type and geographic location of the underlying collateral.

As presented in Figure 18, at June 30, 2017, our commercial real estate portfolio included commercial mortgage loans of $14.8 billion and construction loans of $2.2 billion, representing 17% and 3%, respectively, of our total loans. At June 30, 2017, nonowner-occupied loans represented 16% of our total loans and owner-occupied loans represented 4% of our total loans. The average size of commercial mortgage loans originated during the second quarter of 2017 was $4.8 million, and our largest commercial mortgage loan at June 30, 2017, had a balance of $98 million. At June 30, 2017, our average construction loan commitment was $9.3 million, our largest construction loan commitment was $65 million, and our largest construction loan amount outstanding was $60.6 million.

Also shown in Figure 18, 79% of our commercial real estate loans at June 30, 2017, were for nonowner-occupied properties compared to 78% at December 31, 2016. Approximately 15% of these loans were construction loans at June 30, 2017, and 17% were construction loans at December 31, 2016. 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 in rental rates and occupancy, would adversely affect our portfolio of construction loans.

Figure 18. Commercial Real Estate Loans

	Geographic Region [a]										
dollars in millions	West	Southwest	Central	Midwest	Southeast	Northeast	National	Total	Percent of Total	Construction	Commercial Mortgage
June 30, 2017											
Nonowner-occupied:											
Retail properties	$ 209	$ 123	$ 123	$ 328	$ 257	$ 796	$ 238	$ 2,074	12.2 %	$ 245	$ 1,829
Multifamily properties	298	156	723	589	979	2,248	113	5,106	30.1	1,234	3,872
Health facilities	259	—	143	217	321	1,138	144	2,222	13.1	99	2,123
Office buildings	186	7	96	157	252	1,065	37	1,800	10.6	165	1,635
Warehouses	87	21	115	93	107	369	36	828	4.9	76	752
Manufacturing facilities	5	—	2	35	14	73	37	166	1.0	25	141
Hotels/Motels	14	—	16	5	25	201	18	279	1.6	32	247
Residential properties	1	—	—	2	2	193	—	198	1.1	78	120
Land and development	12	—	1	3	11	102	—	129	.8	56	73
Other	54	11	26	38	44	344	98	615	3.6	67	548
Total nonowner-occupied	1,125	318	1,245	1,467	2,012	6,529	721	13,417	79.0	2,077	11,340
Owner-occupied	954	7	259	599	183	1,562	—	3,564	21.0	91	3,473
Total	$ 2,079	$ 325	$ 1,504	$ 2,066	$ 2,195	$ 8,091	$ 721	16,981	100.0 %	$ 2,168	$ 14,813

December 31, 2016											
Total	$2,032	$ 291	$1,508	$2,281	$2,304	$8,340	$700	$17,456		$ 2,345	$ 15,111
June 30, 2017											
Nonowner-occupied:											
Nonperforming loans	1	—	—	6	12	13	—	32	N/M	7	25
Accruing loans past due 90 days or more	—	—	—	3	2	5	—	10	N/M	—	10
Accruing loans past due 30 through 89 days	3	—	—	4	—	17	—	24	N/M	2	22

Table of Contents

(a)Regions are defined as follows

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

Nonperforming loans related to nonowner-occupied properties increased by $10 million from December 31, 2016, to $32 million at June 30, 2017. Our nonowner-occupied commercial real estate portfolio has decreased by 1.8%, or approximately $244 million, since December 31, 2016. The decline reflects overall business activity and payoffs in our KeyBank Real Estate Capital line of business.

Commercial lease financing. We conduct commercial lease financing arrangements through our KEF line of business. Commercial lease financing receivables represented 8% of commercial loans at June 30, 2017, and December 31, 2016.

Commercial TDRs

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. For more information on concession types for our commercial accruing and nonaccruing TDRs, see Note 5 (“Asset Quality”), and the section titled “Loans and loans held for sale” in Part II, Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” on page 57 of our 2016 Form 10-K.

Figure 19. Commercial TDRs by Accrual Status

in millions	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Commercial TDRs by Accrual Status					
Nonaccruing	$ 106	$ 70	$ 51	$ 67	$ 33
Accruing	18	16	16	18	20
Total Commercial TDRs	$ 124	$ 86	$ 67	$ 85	$ 53

Consumer loan portfolio

Consumer loans outstanding decreased by $258 million, or 1.1%, from December 31, 2016, mostly related to continued decline in the home equity loan portfolio, largely the result of paydowns on home equity lines of credit.

The home equity portfolio is the largest segment of our consumer loan portfolio. Approximately 99% of this portfolio at June 30, 2017, was originated from our Key Community Bank within our 15-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.

As shown in Figure 15, we held the first lien position for approximately 60% of the Key Community Bank home equity portfolio at June 30, 2017, and 61% at June 30, 2016. At June 30, 2017, 40% of the Key Community Bank home equity portfolio was secured by second lien mortgages. For consumer loans with real estate collateral, we track borrower performance monthly. Regardless of the lien position, credit metrics are refreshed quarterly, including recent FICO 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 109 of our 2016 Form 10-K.

Table of Contents

Loans held for sale

As shown in Note 4 (“Loans and Loans Held for Sale”), our loans held for sale increased to $1.7 billion at June 30, 2017, from $1.1 billion at December 31, 2016. At June 30, 2017, loans held for sale included $338 million of commercial and industrial loans, which increased $319 million from December 31, 2016; $1.3 billion of commercial mortgage loans, which increased $310 million from December 31, 2016; $63 million of residential mortgage loans, which increased $1 million from December 31, 2016; and $10 million of commercial lease financing, which increased $10 million from December 31, 2016.

Loan sales

As shown in Figure 20, during the first six months of 2017, we sold $4.1 billion of commercial real estate loans, $424 million of residential real estate loans, $97 million of commercial lease financing loans, and $254 million of commercial loans. Most of these sales came from the held-for-sale portfolio; however, $77 million of these loan sales related to the held-to-maturity portfolio.

Loan sales classified as held for sale generated net gains of $74 million in the first six months of 2017 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 20 summarizes our loan sales for the first six months of 2017 and all of 2016.

Figure 20. Loans Sold (Including Loans Held for Sale)

in millions	Commercial	Commercial Real Estate	Commercial Lease Financing	Residential Real Estate	Total
2017					
Second quarter	205	2,097	14	230	2,546
First quarter	$ 49	$ 2,011	$ 83	$ 194	$2,337
Total	$ 254	$ 4,108	$ 97	$ 424	$4,883
2016					
Fourth quarter	$ 83	$ 2,521	$ 93	$ 232	$2,929
Third quarter	105	1,791	52	260	$2,208

Second quarter	83	1,518	121	111	$1,833
First quarter	46	925	88	89	$1,148
Total	$ 317	$ 6,755	$ 354	$ 692	$8,118

Table of Contents

Figure 21 shows loans that are either administered or serviced by us, but not recorded on the balance sheet; this includes loans that were sold.

Figure 21. Loans Administered or Serviced

in millions	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016
Commercial real estate loans	$218,667	$218,387	$218,135	$213,998	$213,879
Residential mortgage	4,345	4,272	4,198	—	—
Education loans	1,019	1,067	1,122	1,172	1,226
Commercial lease financing	833	916	899	930	930
Commercial loans	446	427	418	1,461	355
Total	$225,310	$225,069	$224,772	$217,561	$216,390

In the event of default by a borrower, we are subject to recourse with respect to approximately $2.8 billion of the $225.3 billion of loans administered or serviced at June 30, 2017. Additional information about this recourse arrangement is included in Note 16 (“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 $28.7 billion at June 30, 2017, compared to $30.4 billion at December 31, 2016. Available-for-sale securities were $18.0 billion at June 30, 2017, compared to $20.2 billion at December 31, 2016. Held-to-maturity securities were $10.6 billion at June 30, 2017, and $10.2 billion at December 31, 2016.

As shown in Figure 22, 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 6 (“Fair Value Measurements”) under the heading “Qualitative Disclosures of Valuation Techniques,” and Note 7 (“Securities”).

Figure 22. Mortgage-Backed Securities by Issuer

in millions	June 30, 2017	December 31, 2016
FHLMC	$5,876	$ 6,415
FNMA	8,764	9,879
GNMA	13,809	13,920
Total [(a)]	$28,449	$ 30,214

(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, 2017, we had $17.8 billion invested in CMOs and other mortgage-backed securities in the available-for-sale portfolio, compared to $20.0 billion at December 31, 2016.

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.

Table of Contents

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 securities, is related to liquidity management strategies to satisfy regulatory requirements.

Figure 23 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 7 ("Securities").

Figure 23. Securities Available for Sale

dollars in millions	U.S. Treasury, Agencies, and Corporations	States and Political Subdivisions	Agency Residential Collateralized Mortgage Obligations (a)	Agency Residential Mortgage-backed Securities (a)	Agency Commercial Mortgage-backed Securities	Other Securities (b)	Total	Weighted-Average Yield (c)
June 30, 2017								
Remaining maturity:								
One year or less	$ 9	$ 3	$ 127	$ 20	—	—	$ 159	2.98 %
After one through five years	45	8	13,126	1,204	$ 1,807	$ 10	16,200	2.05
After five through ten years	113	—	1,038	394	90	9	1,644	2.08
After ten years	1	—	—	20	—	—	21	2.92
Fair value	$ 168	$ 11	$ 14,291	$ 1,638	$ 1,897	$ 19	$ 18,024	—
Amortized cost	170	10	14,469	1,646	1,941	17	18,253	2.06 %
Weighted-average yield (c)	1.79 %	6.19 %	2.04 %	2.11 %	2.23 %	— (d)	2.06 % (d)	—
Weighted-average maturity	4.7 years	2.1 years	3.8 years	3.9 years	4.1 years	3.4 years	3.9 years	—
December 31, 2016								
Fair value	$ 184	$ 11	$ 16,408	$ 1,846	$ 1,743	$ 20	$ 20,212	—
Amortized cost	188	11	16,652	1,857	1,778	21	20,507	2.00 %

(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 TE basis using the statutory federal income tax rate of 35%.

(d) Excludes $19 million of securities at June 30, 2017, 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 primarily foreign bonds. Figure 24 shows the composition, yields, and remaining maturities of these securities.

Figure 24. Held-to-Maturity Securities

dollars in millions	Agency Residential Collateralized Mortgage Obligations	Agency Residential Mortgage-backed Securities	Agency Commercial Mortgage-backed Securities	Other Securities	Total	Weighted-Average Yield [(a)]
June 30, 2017						
Remaining maturity:						
One year or less	$ 64	—	—	—	$64	2.32 %
After one through five years	7,029	—	$ 593	$ 15	7,637	1.99
After five through ten years	1,123	$ 630	576	—	2,329	2.43
After ten years	—	—	608	—	608	2.66
Amortized cost	$ 8,216	$ 630	$ 1,777	$ 15	$10,638	2.13 %
Fair value	8,071	627	1,750	15	10,463	—
Weighted-average yield	1.96 %	2.69 %	2.69 %	2.85 %	2.13 %	—
Weighted-average maturity	3.9 years	6.9 years	7.8 years	2.1 years	4.7 years	—
December 31, 2016						
Amortized cost	$ 8,404	$ 629	$ 1,184	$ 15	$10,232	2.05 %
Fair value	8,232	624	1,136	15	10,007	—

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

Table of Contents

Other investments

Principal investments — investments in equity and debt instruments made by our principal investing unit — represented 21% of other investments at June 30, 2017, and 25% at December 31, 2016. 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 $15 million at June 30, 2017, and $27 million at December 31, 2016, while the fair value of the indirect investments was $148 million at June 30, 2017, and $158 million at December 31, 2016. 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. On January 13, 2017, Key filed for an additional extension for illiquid funds, to retain certain indirect investments until the earlier of the date on which the investment is conformed or is expected to mature, or July 21, 2022. The application for an extension was approved on February 14, 2017. As of June 30, 2017, we have not committed to a plan to sell these investments. Therefore, these investments continue to be valued using the net asset value per share methodology. 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 16 of our 2016 Form 10-K.

Prior to June 30, 2017, "other investments" included real estate-related investments that were carried at fair value, as well as other types of investments that generally were carried at cost, in addition to principal investments. These real estate-related investments were valued $6 million at December 31, 2016. 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 6 ("Fair Value Measurements").

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 2017, net gains from our principal investing activities (including results attributable to noncontrolling interests) totaled $1 million, which includes $13 million of net unrealized losses. These net gains are recorded as "net gains (losses) from principal investing" on the income statement. Additional information regarding these investments is provided in Note 6 ("Fair Value Measurements").

Deposits and other sources of funds

Domestic deposits are our primary source of funding. The composition of our average deposits is shown in Figure 7 in the section entitled "Net interest income." During the second quarter of 2017, average deposits totaled $102.8 billion, an increase of $28.9 billion compared to the year-ago quarter, primarily reflecting the acquisition of First Niagara and core retail and commercial deposit growth. Compared to the first quarter of 2017, average deposits increased by $701 million, driven by growth in certificates of deposits and NOW and money market deposit accounts, partly offset by a decline in escrow deposits. During the quarter, Key also experienced a shift in deposit mix from noninterest-bearing and low-cost interest-bearing deposits to higher-yielding deposit products. On a period end basis, total deposits decreased $1.1 billion compared to the linked-quarter, largely the result of seasonal deposit growth that occurred in the first quarter of 2017. As of June 30, 2017, period-end deposits represented 87.2% of the funds we used to support loans and other earning assets, compared to 85.2% at December 31, 2016.

Wholesale funds, consisting of short-term borrowings, averaged $1.7 billion during the second quarter of 2017, compared to $1.0 billion during the second quarter of 2016. The change from the second quarter of 2016 was caused by increases of $129 million in federal funds purchased and securities sold under repurchase agreements, and $522 million in bank notes and other short-term borrowings.

Capital

At June 30, 2017, our shareholders’ equity was $15.3 billion, up $13 million from December 31, 2016. 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 and Note 18 (“Shareholders' Equity”).

Table of Contents

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 2016 capital plan, which was effective through the second quarter of 2017, included a Common Share repurchase program of up to $350 million, which included repurchases to offset issuances of common shares under our employee compensation plans. We completed $94 million of Common Share repurchases, including $88 million of Common Share repurchases in the open market and $6 million of Common Share repurchases related to employee equity compensation programs in the second quarter of 2017 under this authorization.

In April 2017, we submitted to the Federal Reserve and provided to the OCC our 2017 capital plan under the annual CCAR process. On June 28, 2017, the Federal Reserve announced that it did not object to our 2017 capital plan. For more information on our 2017 capital plan actions, see Note 18 ("Shareholders' Equity ").

Dividends

As previously reported, our 2016 capital plan proposed an increase in our quarterly common share dividend from $.085 to $.095 per Common Share for the second quarter of 2017 which was approved by our Board in May 2017. Other changes to future dividends may be evaluated by the Board based upon our earnings, financial condition, and other factors, including regulatory review. Further information regarding the capital planning process and CCAR is included under the heading "Capital planning and stress testing" in the "Supervision and Regulation" section beginning on page 12 of our 2016 Form 10-K.

Consistent with the 2016 capital plan, we made a dividend payment of $.095 per share, or $104 million, on our Common Shares during the second quarter of 2017.

During the second quarter of 2017, we made the following dividend payments on our preferred stock:

- $12.50 per depositary share, or $6 million, on the depositary shares related to our Series D Preferred Stock; and
- $.382813 per depositary share, or $8 million, on the depositary shares related to our Series E Preferred Stock.

Common shares outstanding

Our Common Shares are traded on the NYSE under the symbol KEY with 33,735 holders of record at June 30, 2017. Our book value per Common Share was $13.02 based on 1.093 billion shares outstanding at June 30, 2017, compared to $12.58 per Common Share based on 1.079 billion shares outstanding at December 31, 2016. At June 30, 2017, our tangible book value per Common Share was $10.40, compared to $9.99 per Common Share at December 31, 2016.

Figure 25 shows activities that caused the change in outstanding common shares over the past five quarters.

Figure 25. Changes in Common Shares Outstanding

	2017		2016		
in thousands	Second	First	Fourth	Third	Second
Shares outstanding at beginning of period	1,097,479	1,079,314	1,082,055	842,703	842,290
Open market repurchases and return of shares under employee compensation plans	(5,072)	(8,673)	(4,380)	(5,240)	—
	332	6,270	1,642	4,857	413

Shares issued under employee compensation plans (net of cancellations)					
Series A Preferred Stock exchanged for common shares	—	20,568	—	—	—
Common shares issued to acquire First Niagara	—	—	(3)	239,735	—
Shares outstanding at end of period	1,092,739	1,097,479	1,079,314	1,082,055	842,703

As shown above, Common Shares outstanding decreased by 4.7 million shares during the second quarter of 2017. This decrease was primarily due to common share repurchases under our 2016 capital plan.

At June 30, 2017, we had 164.0 million treasury shares, compared to 177.4 million treasury shares at December 31, 2016. 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.

Table of Contents

Capital adequacy

Capital adequacy is an important indicator of financial stability and performance. All of KeyCorp's capital ratios remained in excess of regulatory requirements at June 30, 2017. 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 11.23% at June 30, 2017, compared to 11.17% at December 31, 2016. Our tangible common equity to tangible assets ratio was 8.56% at June 30, 2017, compared to 8.09% at December 31, 2016.

The capital modifications mandated by the Regulatory Capital Rules, which became effective on January 1, 2015, for KeyCorp, require higher and better-quality capital and introduced a new capital measure, "Common Equity Tier 1." The Rules phased out
the treatment of certain 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 and acquired from First Niagara, 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 KeyCorp at June 30, 2017, 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. Beginning with the implementation of the Regulatory Capital Rules, deferred tax assets that arise from net operating loss and tax credit carryforwards are deductible from Common Equity Tier 1 on a phase-in basis.

As of January 1, 2016, KeyCorp (and its banking subsidiaries) were each required to maintain, on a consolidated basis, a minimum Common Equity Tier 1 capital ratio of 4.5%, 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, 2017, our Common Equity Tier 1 capital ratio, Tier 1 risk-based capital ratio, total risk-based capital ratio, and Tier 1 leverage ratio were 9.91%, 10.73%, 12.64%, and 9.95%, respectively, compared to 9.54%, 10.89%, 12.85%, and 9.90%, respectively, at December 31, 2016. Information regarding the regulatory capital ratios of KeyCorp's banking subsidiaries is presented annually, in Note 23 ("Shareholders' Equity") beginning on page 198 of our 2016 Form 10-K. Figure 26 presents more detail on the risk based capital ratios.

Figure 26. Capital Components and Risk-Weighted Assets

dollars in millions	June 30, 2017	December 31, 2016
COMMON EQUITY TIER 1		
Key shareholders' equity (GAAP)	$15,253	$15,240
Less: Preferred Stock [(a)]	1,009	1,640
Common Equity Tier 1 capital before adjustments and deductions	14,244	13,600
Less: Goodwill, net of deferred taxes	2,411	2,405
Intangible assets, net of deferred taxes	257	155
Deferred tax assets	5	4
Net unrealized gains (losses) on available-for-sale securities, net of deferred taxes	(145)	(185)
Accumulated gains (losses) on cash flow hedges, net of deferred taxes	(64)	(52)
Amounts in AOCI attributed to pension and postretirement benefit costs, net of deferred taxes	(334)	(339)
Total Common Equity Tier 1 capital	$12,114	$11,612
TIER 1 CAPITAL		
Common Equity Tier 1	$12,114	$11,612
Additional Tier 1 capital instruments and related surplus	1,009	1,640
Non-qualifying capital instruments subject to phase-out	—	—
Less: Deductions	2	3
Total Tier 1 capital	13,121	13,249
TIER 2 CAPITAL		
Tier 2 capital instruments and related surplus	1,389	1,450
Allowance for losses on loans and liability for losses on lending-related commitments [(b)]	941	939
Net unrealized gains on available-for-sale preferred stock classified as an equity security	—	—
Less: Deductions	—	—
Total Tier 2 capital	2,330	2,389
Total risk-based capital	$15,451	$15,638
RISK-WEIGHTED ASSETS		
Risk-weighted assets on balance sheet	$95,627	$94,959
Risk-weighted off-balance sheet exposure	25,296	25,848
Market risk-equivalent assets	1,340	864
Gross risk-weighted assets	122,263	121,671
Less: Excess allowance for loan and lease losses	—	—
Net risk-weighted assets	$122,263	$121,671
AVERAGE QUARTERLY TOTAL ASSETS	$131,832	$133,795
CAPITAL RATIOS		
Tier 1 risk-based capital	10.73 %	10.89 %
Total risk-based capital	12.64	12.85
Leverage [(c)]	9.95	9.90
Common Equity Tier 1 [(d)]	9.91	9.54

(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 $21 million and $24 million of allowance classified as "discontinued assets" on the balance sheet at June 30, 2017, and December 31, 2016, 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.

(d) Non-GAAP measure: see Figure 6 for reconciliation.

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 that we properly identify, measure, and manage such risks across the entire enterprise to maintain safety and soundness, and to maximize profitability.

The Board serves in an oversight capacity, ensuring that Key's risks are managed in a manner that is not only effective and balanced, but also 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

Table of Contents

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 its role to provide independent assessment and testing of the effectiveness of, appropriateness of, 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.

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 affect 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.

Table of Contents

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 of 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, as the second line of defense, 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 as defined in Market Risk Rule, 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 110 of our 2016 Form 10-K and Note 6 ("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 noncovered. The Covered Position Working Group develops the final list of covered positions, and a summary is provided to the Market Risk Committee.

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 indices, 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 simulation 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 and other non-covered positions. Historical

Table of Contents

scenarios are customized for specific 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 internal model validation 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, 2017, and June 30, 2016. 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 $1.2 million at June 30, 2017, and $.8 million at June 30, 2016. The increase in aggregate VaR was primarily due to the increased exposure in our fixed income and CMBS portfolios. Figure 27 summarizes our VaR at the 99% confidence level for significant portfolios of covered positions for the three months ended June 30, 2017, and June 30, 2016. During these periods, none of our significant portfolios daily trading VaR numbers exceeded their VaR limits. Only one of our significant portfolios stress VaR number exceeded the stress VaR limit on May 4, 2017. This was an immaterial stress VaR limit breach for Fixed Income portfolio. We followed our escalation procedures and the breach was immediately remediated during the same business day.

Figure 27. VaR for Significant Portfolios of Covered Positions

	2017 Three months ended June 30,				2016 Three months ended June 30,			
in millions	High	Low	Mean	June 30,	High	Low	Mean	June 30,
Trading account assets:								
Fixed income	$1.3	$ .4	$ .7	$ .6	$1.2	$ .4	$ .6	$ .4
Derivatives:								
Interest rate	$ .1	$ .1	$ .1	$ .1	$ .2	$ —	$ .1	$ .1
Credit	1.5	.2	.6	.3	.2	—	.1	.2

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 $4.5 million at June 30, 2017, and $2.7 million at June 30, 2016. Figure 28 summarizes our stressed VaR for significant portfolios of covered positions for the three months ended June 30, 2017, and June 30, 2016, as used for market risk capital charge calculation purposes.

Figure 28. Stressed VaR for Significant Portfolios of Covered Positions

	2017				2016			
	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	$4.0	$1.7	$ 2.7	$2.9	$2.9	$1.1	$ 1.8	$1.2
Derivatives:								
Interest rate	$ .3	$ .2	$ .2	$ .3	$ .3	$ .1	$ .1	$ .2
Credit	2.6	.4	1.1	.8	.8	.1	.2	.8

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 amount, 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

Table of Contents

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 customer 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.

- Reprice risk is the exposure to changes in the level of 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 indices and occurs when floating-rate assets and floating-rate liabilities reprice at the same time, but in response to different market factors or indices.

- Yield curve risk is the exposure to nonparallel 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.

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.

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, and balance sheet growth projections based on a most likely macroeconomic view. While simulation modeling assumes that residual risk exposures are managed within the risk appetite and Board approved policy limits, the results also reflect management's desired interest rate risk positioning. Achieving the current modeled position typically requires purchases of investment securities to replace security cash flows and the execution of new interest rate swaps to replace maturing interest rate swaps. The simulation model estimates the amount of net interest income at risk by simulating the change in net interest income that would occur if interest rates were to gradually increase or decrease over the next 12 months. Our standard rate scenarios encompass a gradual, parallel increase or decrease of 200 basis points, but due to the low interest rate environment, we have modified the standard decrease scenario to a gradual, parallel decrease of 125 basis points over eight months with no change over the following four 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.

Figure 29 presents the results of the simulation analysis at June 30, 2017, and June 30, 2016. At June 30, 2017, our simulated impact to changes in interest rates was modestly asset–sensitive. In June 2017, the Federal Reserve increased the range for the

Table of Contents

Federal Funds Target Rate, which led to an increase in the magnitude of the declining rate scenario to 125 basis points. Tolerance levels for risk management require the development of remediation plans to maintain residual risk within tolerance if simulation modeling demonstrates that a gradual, parallel 200 basis point increase or 125 basis point decrease in interest rates over the next 12 months would adversely affect net interest income over the same period by more than 5.5%. As a result of the change in the Federal Reserve's June 2017 interest rate increase, our modeled exposure to declining rates increased. As shown in Figure 29, we are operating within these levels as of June 30, 2017.

Figure 29. Simulated Change in Net Interest Income

June 30, 2017		
Basis point change assumption (short-term rates)	-125	+200
Tolerance level	-5.50 %	-5.50 %
Interest rate risk assessment	-4.94 %	.91 %
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 %

Simulation analysis produces a sophisticated estimate of interest rate exposure based on judgments related to assumptions input into the model. We tailor certain assumptions to the specific interest rate environment and yield curve shape being modeled, and validate those assumptions on a regular basis. 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, changes in management's desired interest rate risk positioning, investment, funding and hedging activities, and repercussions from unanticipated or unknown events.

We also perform regular stress tests and sensitivity analyses on the model inputs that could materially change the resulting risk assessments. Assessments are performed using different shapes of the yield curve, including steepening or flattening of the yield curve, changes in credit spreads, immediate changes in market interest rates, and changes in the relationship of money market interest rates. Assessments are also performed on changes to the following assumptions: loan and deposit balances, the pricing of deposits without contractual maturities, changes in lending spreads, prepayments on loans and securities, investment, funding and hedging activities, and liquidity and capital management strategies.

The results of additional assessments indicate that net interest income could increase or decrease from the base simulation results presented in Figure 29. 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 modeling is sensitive to the volume of fixed-rate assets and liabilities incorporated. The modeling currently assumes approximately $24.7 billion of investment security purchases and swap executions over the next three years. For every immediate reduction in fixed-rate assets of $1 billion, the modeled benefit to rising rates would increase by approximately 30 basis points. The low level of interest rates increases the uncertainty of assumptions for deposit balance behavior and deposit repricing relationships to market interest rates. 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, with the modeled betas varying by customer segment and product type. Recent deposit repricing has been lower than our modeled assumptions. In the modeling, if the deposit beta for the first 25 basis point increase in the Federal Funds Target Rate was zero, then returned to the standard modeled betas for the next 175 basis points of rate increases, our modeled asset sensitive benefit would increase by approximately 200 basis points. The sensitivity testing of assumptions supports our confidence that actual results are likely to be within 100 basis points of modeled results.

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. Treasury discretionary activities related to funding, investing, and hedging may also change as a result of changes in customer business flows, or changes in management's desired interest rate risk positioning. 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

Table of Contents

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 125 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, 2017.

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 30 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 8 (“Derivatives and Hedging Activities”).

Figure 30. Portfolio Swaps by Interest Rate Risk Management Strategy

dollars in millions	June 30, 2017 Notional Amount	Fair Value	Weighted-Average Maturity (Years)	Receive Rate	Pay Rate	June 30, 2016 Notional Amount	Fair Value
Receive fixed/pay variable — conventional A/LM [(a)]	$15,800	$(67)	1.8	1.1 %	1.1%	$14,630	$165
Receive fixed/pay variable — conventional debt	9,178	64	2.9	1.6	1.1	8,005	353
Pay fixed/receive variable — conventional debt	50	(6)	11.0	1.1	3.6	50	(12)
Total portfolio swaps	$25,028	$(9) [(b), (c)]	2.2	1.3 %	1.1%	$22,685	$506 [(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 $89 million and $54 million at June 30, 2017, and June 30, 2016, respectively.
(c) Excludes variation margin payments for CME-cleared trades of $34 million at June 30, 2017.

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's Enhanced Prudential Standards and the OCC's Heightened Standards for Large Insured National Banks.

Table of Contents

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.

Our credit ratings at June 30, 2017, are shown in Figure 31. We believe these credit ratings, under normal conditions in the capital markets, would enable KeyCorp or KeyBank to issue fixed income securities to investors.

Figure 31. Credit Ratings

June 30, 2017	Short-Term Borrowings	Long-Term Deposits	Senior Long-Term Debt	Subordinated Long-Term Debt	Capital Securities	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 Ratings, Inc.	F1	N/A	A-	BBB+	BB+	BB
DBRS, Inc.	R-2(high)	N/A	BBB(high)	BBB	BBB	BB(high)
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 Ratings, Inc.	F1	A	A-	BBB+	N/A	N/A
DBRS, Inc.	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 place 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. 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, 2017, totaled $23.4 billion, consisting of $20.9 billion of unpledged securities, $352 million of securities available for secured funding at the FHLB, and $2.2 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, 2017, our unused borrowing capacity secured by loan collateral was $23.4 billion at the Federal

Table of Contents

Reserve Bank of Cleveland and $6.0 billion at the FHLB. During the second quarter of 2017, Key's outstanding FHLB of Cincinnati advances were increased by $343 million as term advances were added.

Final U.S. liquidity coverage ratio

Under the Liquidity Coverage Rules, we are required to calculate the Modified LCR for Key. For the second quarter of 2017, 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 modify product offerings to enhance or optimize our liquidity position.

Additional information about the LCR is included in the "Supervision and regulation" section under the heading "Liquidity requirements" 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, 2017, our loan-to-deposit ratio was 87%) which we calculate as total loans, loans held for sale, and nonsecuritized discontinued loans, divided by domestic 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 19 ("Long-Term Debt") beginning on page 191 of our 2016 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 June 9, 2017, KeyBank issued $600 million of 2.40% Senior Bank Notes due June 9, 2022, 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. KeyCorp generally issues term debt to supplement dividends from KeyBank to manage our liquidity position at or above our targeted levels. The parent company generally maintains cash in an amount sufficient to meet projected debt maturities over at least the next 24 months. At June 30, 2017, KeyCorp held $2.3 billion in cash, 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 and other non-bank subsidiaries, 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

Table of Contents

declaration. During the second quarter of 2017, KeyBank paid $125 million in dividends to KeyCorp. As of June 30, 2017, KeyBank had regulatory capacity to pay $746 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. 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 28 of our 2016 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 $166 million of cash, cash equivalents, and short-term investments in international tax jurisdictions as of June 30, 2017. 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, 2017.

The Consolidated Statements of Cash Flows summarize our sources and uses of cash by type of activity for the six-month periods ended June 30, 2017, and June 30, 2016.

Credit risk management

Credit risk is the risk of loss arising from an obligor’s inability or failure to meet contractual payment or performance terms. Like other financial services institutions, 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. Significant policies are reviewed periodically with our Executive Risk Management Committee and the Risk Committee of our Board of Directors on a prescribed schedule. 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 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 monitor 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 $2.1 billion. However, internal hold limits generally restrict the largest exposures to less than 20% of that amount. As of June 30, 2017, we had nine client relationships with loan commitments net of credit default swaps of more than $200 million. The average amount outstanding on these nine individual net obligor commitments was $51 million at June 30, 2017. 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 excess 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, 2017, we used credit default swaps with a notional amount of $183 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, 2017, 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, 2017, the ALLL was $870 million, or 1.01% of period-end loans, compared to $858 million, or 1.00%, at December 31, 2016. The allowance includes $36 million that was specifically allocated for impaired loans of $391 million at June 30, 2017, compared to $37 million that was specifically allocated for impaired loans of $501 million at December 31, 2016. For more information about impaired loans, see Note 5 (“Asset Quality”). At June 30, 2017, the ALLL was 171.6% of nonperforming loans, compared to 137.3% at December 31, 2016.

Selected asset quality statistics for each of the past five quarters are presented in Figure 32. The factors that drive these statistics are discussed in the remainder of this section.

Figure 32. Selected Asset Quality Statistics from Continuing Operations

	2017		2016		
dollars in millions	Second	First	Fourth	Third	Second
Net loan charge-offs	$66	$58	$72	$44	$ 43
Net loan charge-offs to average total loans	.31 %	.27 %	.34 %	.23 %	.28 %
Allowance for loan and lease losses	$870	$870	$858	$865	$ 854
Allowance for credit losses (a)	918	918	913	918	904
Allowance for loan and lease losses to period-end loans	1.01 %	1.01 %	1.00 %	1.01 %	1.38 %
Allowance for credit losses to period-end loans	1.06	1.07	1.06	1.07	1.46
Allowance for loan and lease losses to nonperforming loans (b)	171.6	151.8	137.3	119.6	138.0
Allowance for credit losses to nonperforming loans (b)	181.1	160.2	146.1	127.0	146.0
Nonperforming loans at period end (b)	$507	$573	$625	$723	$ 619
Nonperforming assets at period end (b)	556	623	676	760	637
Nonperforming loans to period-end portfolio loans (b)	.59 %	.67 %	.73 %	.85 %	1.00 %
Nonperforming assets to period-end portfolio loans plus OREO and other nonperforming assets (b)	.64	.72	.79	.89	1.03

(a)

Includes the ALLL plus the liability for credit losses on lending-related unfunded commitments.

(b) Nonperforming loan balances exclude $835 million, $812 million, $865 million, $959 million, and $11 million of PCI loans at June 30, 2017, March 31, 2017, December 31, 2016, September 30, 2016, and June 30, 2016, respectively. The June 30, 2017 PCI loan balances increased from the March 31, 2017 balances, as a result of the finalization of the First Niagara Acquisition Date loan valuation, which increased the PCI Acquisition Date fair value by $105 million from the provisional estimate recorded in the 2016 10-K.

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 109 of our 2016 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

Table of Contents

allowance to the loan. 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, 2017, represents our best estimate of the probable credit losses inherent in the loan portfolio at that date.

As shown in Figure 33, our ALLL from continuing operations increased by $12 million, or 1.4%, from December 31, 2016. 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 $24 million, or 3.3%, from December 31, 2016, primarily because of loan growth in certain segments of the commercial loan portfolio as well as credit quality migration. Our consumer ALLL decreased by $12 million, or 8.4%, from December 31, 2016, primarily due to continued improvement in credit quality metrics, including improved delinquency trends, which have decreased expected loss rates. These trends align with the continued stability in the economy and labor markets, proactive credit risk management practices, and strong credit quality originations.

Our liability for credit losses on lending-related commitments decreased by $7 million from December 31, 2016, to $48 million at June 30, 2017. When combined with our ALLL, our total allowance for credit losses represented 1.06% of period-end loans at June 30, 2017, and December 31, 2016.

Figure 33. Allocation of the Allowance for Loan Lease Losses

dollars in millions	June 30, 2017 Amount	Percent of Allowance to Total Allowance		Percent of Loan Type to Total Loans		December 31, 2016 Amount	Percent of Allowance to Total Allowance		Percent of Loan Type to Total Loans	
Commercial and industrial	$528	60.7	%	47.3	%	$508	59.2	%	46.2	%
Commercial real estate:										
Commercial mortgage	144	16.6		17.1		144	16.8		17.6	
Construction	28	3.2		2.5		22	2.6		2.7	
Total commercial real estate loans	172	19.8		19.6		166	19.4		20.3	
Commercial lease financing	40	4.6		5.5		42	4.9		5.4	
Total commercial loans	740	85.1		72.4		716	83.5		71.9	
Real estate — residential mortgage	9	1.0		6.4		17	2.0		6.5	
Home equity loans	42	4.8		14.4		54	6.3		14.7	
Consumer direct loans	25	2.9		2.0		24	2.8		2.1	
Credit cards	44	5.1		1.2		38	4.4		1.3	
Consumer indirect loans	10	1.1		3.6		9	1.0		3.5	
Total consumer loans	130	14.9		27.6		142	16.5		28.1	
Total loans [(a)]	$870	100.0	%	100.0	%	$858	100.0	%	100.0	%

(a) Excludes allocations of the ALLL related to the discontinued operations of the education lending business in the amount of $21 million, and $24 million at June 30, 2017, and December 31, 2016, respectively.

Our provision for credit losses was $66 million for the second quarter of 2017, compared to $52 million for the second quarter of 2016. Compared to the first six months of 2016, oil and gas prices have stabilized, leading to improved credit quality metrics. 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.

Net loan charge-offs

Net loan charge-offs for the second quarter of 2017 totaled $66 million, or .31% of average loans, compared to net loan charge-offs of $43 million, or .28%, for the same period last year. Figure 34 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 35.

Over the past 12 months, net loan charge-offs increased $23 million. This increase is attributable to growth in our loan portfolio and lower levels of recoveries coupled with high levels of charge-offs over the same period.

Table of Contents

Figure 34. Net Loan Charge-offs from Continuing Operations [(a)]

	2017		2016		
dollars in millions	Second	First	Fourth	Third	Second
Commercial and industrial	$38	$27	$37	$15	$32
Real estate — Commercial mortgage	3	—	2	(1)	(4)
Real estate — Construction	—	(1)	—	8	—
Commercial lease financing	1	5	—	5	1
Total commercial loans	42	31	39	27	29
Real estate — Residential mortgage	3	(4)	2	—	1
Home equity loans	4	5	4	2	3
Consumer direct loans	6	9	8	5	4
Credit cards	10	10	9	8	7
Consumer indirect loans	1	7	10	2	(1)
Total consumer loans	24	27	33	17	14
Total net loan charge-offs	$66				