

KEYCORP /NEW/
Form 10-Q
August 08, 2008

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

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended June 30, 2008
or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition Period From _____ To _____
Commission File Number 1-11302
(Exact name of registrant as specified in its charter)

Ohio

34-6542451

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

127 Public Square, Cleveland, Ohio

44114-1306

(Address of principal executive offices)

(Zip Code)

(216) 689-6300

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

Common Shares with a par value of \$1 each

494,657,020 Shares

(Title of class)

(Outstanding at July 31, 2008)

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

<i>dollars in millions</i>	June 30, 2008 (Unaudited)	December 31, 2007	June 30, 2007 (Unaudited)
ASSETS			
Cash and due from banks	\$ 1,912	\$ 1,814	\$ 1,818
Short-term investments	826	516	471
Trading account assets	1,483	1,056	994
Securities available for sale	8,312	7,860	7,819
Held-to-maturity securities (fair value: \$25, \$28 and \$37)	25	28	37
Other investments	1,559	1,538	1,602
Loans, net of unearned income of \$2,532 \$2,202 and \$2,146	75,855	70,823	66,692
Less: Allowance for loan losses	1,421	1,200	945
Net loans	74,434	69,623	65,747
Loans held for sale	1,833	4,736	4,546
Premises and equipment	748	681	600
Operating lease assets	1,089	1,128	1,110
Goodwill	1,598	1,252	1,202
Other intangible assets	146	123	110
Corporate-owned life insurance	2,917	2,872	2,822
Derivative assets	1,693	879	374
Accrued income and other assets	2,969	4,122	3,715
Total assets	\$ 101,544	\$ 98,228	\$ 92,967
LIABILITIES			
Deposits in domestic offices:			
NOW and money market deposit accounts	\$ 27,278	\$ 27,635	\$ 23,315
Savings deposits	1,809	1,513	1,613
Certificates of deposit (\$100,000 or more)	8,699	6,982	6,197
Other time deposits	12,541	11,615	11,832
Total interest-bearing	50,327	47,745	42,957
Noninterest-bearing	10,561	11,028	14,199
Deposits in foreign office ³ / ₄ interest-bearing	3,508	4,326	3,443
Total deposits	64,396	63,099	60,599
Federal funds purchased and securities sold under repurchase agreements	2,088	3,927	4,362
Bank notes and other short-term borrowings	5,985	5,861	2,476
Derivative liabilities	637	252	248
Accrued expense and other liabilities	4,626	5,386	5,000
Long-term debt	15,106	11,957	12,581

Total liabilities	92,838	90,482	85,266
SHAREHOLDERS EQUITY			
Preferred stock, \$1 par value; authorized 25,000,000 shares, none issued			
7.750% Noncumulative Perpetual Convertible Preferred Stock, Series A, \$1 par value, \$100 liquidation preference; authorized 7,475,000 shares, issued 6,500,000 shares	650		
Common shares, \$1 par value; authorized 1,400,000,000 shares; issued 576,995,163, 491,888,780 and 491,888,780 shares	577	492	492
Capital surplus	2,544	1,623	1,652
Retained earnings	7,461	8,522	8,720
Treasury stock, at cost (91,333,157, 103,095,907 and 102,527,008 shares)	(2,675)	(3,021)	(2,994)
Accumulated other comprehensive income (loss)	149	130	(169)
Total shareholders equity	8,706	7,746	7,701
Total liabilities and shareholders equity	\$ 101,544	\$ 98,228	\$ 92,967

See Notes to Consolidated Financial Statements (Unaudited).

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

<i>dollars in millions, except per share amounts</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
INTEREST INCOME				
Loans	\$ 717	\$ 1,176	\$ 1,840	\$ 2,337
Loans held for sale	20	82	107	157
Securities available for sale	111	106	220	206
Held-to-maturity securities			1	1
Trading account assets	10	7	23	14
Short-term investments	8	9	17	20
Other investments	14	15	26	28
Total interest income	880	1,395	2,234	2,763
INTEREST EXPENSE				
Deposits	347	447	775	880
Federal funds purchased and securities sold under repurchase agreements	15	59	43	108
Bank notes and other short-term borrowings	27	18	66	29
Long-term debt	133	185	279	381
Total interest expense	522	709	1,163	1,398
NET INTEREST INCOME				
Provision for loan losses	647	53	834	97
Net interest (loss) income after provision for loan losses	(289)	633	237	1,268
NONINTEREST INCOME				
Trust and investment services income	138	115	267	240
Service charges on deposit accounts	93	84	181	159
Investment banking and capital markets income	80	52	88	96
Operating lease income	68	66	137	130
Letter of credit and loan fees	51	45	88	83
Corporate-owned life insurance income	28	32	56	57
Electronic banking fees	27	25	51	49
Net gains (losses) from loan securitizations and sales	33	33	(68)	42
Net securities (losses) gains	(1)	2	2	(45)
Net (losses) gains from principal investing	(14)	90	(5)	119
Gain from redemption of Visa Inc. shares			165	
Gain from sale of McDonald Investments branch network				171
Other income	52	105	121	202
Total noninterest income	555	649	1,083	1,303

NONINTEREST EXPENSE

Personnel	404	411	813	839
Net occupancy	62	59	128	122
Computer processing	43	49	90	100
Operating lease expense	55	55	113	107
Professional fees	33	26	56	52
Equipment	23	24	47	49
Marketing	21	20	35	39
Other expense	140	171	231	291
Total noninterest expense	781	815	1,513	1,599

(LOSS) INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES

	(515)	467	(193)	972
Income taxes	611	130	715	277

(LOSS) INCOME FROM CONTINUING OPERATIONS

	(1,126)	337	(908)	695
Loss from discontinued operations, net of taxes of \$2 and \$7, respectively (see Note 3)		(3)		(11)

NET (LOSS) INCOME	\$ (1,126)	\$ 334	\$ (908)	\$ 684
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Net (loss) income applicable to common shares	\$ (1,126)	\$ 334	\$ (908)	\$ 684
Per common share:				
(Loss) income from continuing operations	\$ (2.70)	\$.86	\$ (2.23)	\$ 1.76
Net (loss) income	(2.70)	.85	(2.23)	1.73
Per common share assuming dilution:				
(Loss) income from continuing operations	\$ (2.70)	\$.85	\$ (2.23)	\$ 1.74
Net (loss) income	(2.70)	.84	(2.23)	1.71
Cash dividends declared per common share	\$.375	\$.365	\$.375	\$.73
Weighted-average common shares outstanding (000)	416,629	392,045	407,875	394,944
Weighted-average common shares and potential common shares outstanding (000)	416,629	396,918	407,875	400,180

See Notes to Consolidated Financial Statements (Unaudited).

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

	Preferred Common		Common			Accumulated	
	Stock Outstanding (000)	Shares Outstanding (000)	Capital Surplus	Retained Earnings	Treasury Stock at Cost	Other Comprehensive Income (Loss)	Other Comprehensive Income (Loss)
<i>dollars in millions, except per share amounts</i>							
BALANCE AT DECEMBER 31, 2006		399,153	\$ 492	\$ 1,602	\$ 8,377	\$ (2,584)	\$ (184)
Cumulative effect of adopting FSP 13-2, net of income taxes of (\$2)					(52)		
Cumulative effect of adopting FIN 48, net of income taxes of (\$1)					(1)		
BALANCE AT JANUARY 1, 2007					8,324		
Net income					684		\$ 684
Other comprehensive income:							
Net unrealized losses on securities available for sale, net of income taxes of (\$12) ^a						(19)	(19)
Net unrealized gains on derivative financial instruments, net of income taxes of \$6						10	10
Foreign currency translation adjustments						14	14
Net pension and postretirement benefit costs, net of income taxes						10	10
Total comprehensive income							\$ 699
Deferred compensation				27	(2)		
Cash dividends declared on common shares (\$0.73 per share)					(286)		
Common shares reissued for stock options and other employee benefit plans		4,209		23		117	
Common shares repurchased		(14,000)				(527)	
BALANCE AT JUNE 30, 2007		389,362	\$ 492	\$ 1,652	\$ 8,720	\$ (2,994)	\$ (169)
BALANCE AT DECEMBER 31, 2007		388,793	\$ 492	\$ 1,623	\$ 8,522	\$ (3,021)	\$ 130
Net loss					(908)		\$ (908)
Other comprehensive loss:							
Net unrealized gains on securities available for sale, net of income taxes of \$10 ^a						15	15
Net unrealized gains on derivative financial instruments, net of income taxes of \$1						1	1
Foreign currency translation adjustments						(1)	(1)
Net pension and postretirement benefit costs, net of income taxes						4	4

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<i>in millions</i>	Six months ended June 30,	
	2008	2007
OPERATING ACTIVITIES		
Net (loss) income	\$ (908)	\$ 684
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Provision for loan losses	834	97
Depreciation and amortization expense	217	209
Litigation reserve		42
Net securities losses (gains)	(2)	45
Liability to Visa	(64)	
Gain from redemption of Visa Inc. shares	(165)	
Gain from sale of McDonald Investments branch network		(171)
Gain related to MasterCard Incorporated shares		(40)
Gain from settlement of automobile residual value insurance litigation		(26)
Net losses (gains) from principal investing	5	(119)
Net losses (gains) from loan securitizations and sales	68	(42)
Loss from sale of discontinued operations		2
Proceeds from settlement of automobile residual value insurance litigation		279
Deferred income taxes	(151)	(56)
Net decrease (increase) in loans held for sale from continuing operations	48	(909)
Net increase in trading account assets	(427)	(82)
Other operating activities, net	371	(343)
NET CASH USED IN OPERATING ACTIVITIES	(174)	(430)
INVESTING ACTIVITIES		
Proceeds from redemption of Visa Inc. shares	165	
Proceeds from sale of McDonald Investments branch network, net of retention payments		199
Proceeds from sale of MasterCard Incorporated shares		40
Cash used in acquisitions, net of cash acquired	(184)	
Net increase in short-term investments	(244)	(143)
Purchases of securities available for sale	(793)	(3,955)
Proceeds from sales of securities available for sale	836	2,449
Proceeds from prepayments and maturities of securities available for sale	760	1,443
Purchases of held-to-maturity securities	(2)	
Proceeds from prepayments and maturities of held-to-maturity securities	4	4
Purchases of other investments	(306)	(363)
Proceeds from sales of other investments	111	213
Proceeds from prepayments and maturities of other investments	71	64
Net increase in loans, excluding acquisitions, sales and transfers	(1,560)	(1,309)
Purchases of loans	(18)	(56)
Proceeds from loan securitizations and sales	221	287
Purchases of premises and equipment	(87)	(58)
Proceeds from sales of premises and equipment	1	1
Proceeds from sales of other real estate owned	13	45

NET CASH USED IN INVESTING ACTIVITIES	(1,012)	(1,139)
FINANCING ACTIVITIES		
Net (decrease) increase in deposits	(509)	1,480
Net (decrease) increase in short-term borrowings	(2,505)	2,158
Net proceeds from issuance of long-term debt	3,900	39
Payments on long-term debt	(910)	(1,845)
Purchases of treasury shares		(527)
Net proceeds from issuance of common shares and preferred stock	1,601	
Net proceeds from reissuance of common shares	6	93
Tax benefits (under) over recognized compensation cost for stock-based awards	(1)	11
Cash dividends paid	(298)	(286)
NET CASH PROVIDED BY FINANCING ACTIVITIES	1,284	1,123
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	98	(446)
CASH AND DUE FROM BANKS AT BEGINNING OF PERIOD	1,814	2,264
CASH AND DUE FROM BANKS AT END OF PERIOD	\$ 1,912	\$ 1,818
Additional disclosures relative to cash flows:		
Interest paid	\$ 1,144	\$ 1,416
Income taxes paid	322	135
Noncash items:		
Assets acquired	\$ 2,810	
Liabilities assumed	2,648	
Loans transferred to portfolio from held for sale	3,284	
Loans transferred to held for sale from portfolio	429	
Loans transferred to other real estate owned	23	\$ 20

See Notes to Consolidated Financial Statements (Unaudited)

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Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

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

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

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

Consolidation of Variable Interest Entities, a variable interest entity (VIE) is consolidated if Key has a variable interest in the entity and is exposed to the majority of its expected losses and/or residual returns (i.e., Key is considered to be the primary beneficiary). Variable interests can include equity interests, subordinated debt, derivative contracts, leases, service agreements, guarantees, standby letters of credit, loan commitments, and other contracts, agreements and financial instruments. See Note 8 (Variable Interest Entities) on page 23 for information on Key's involvement with VIEs.

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

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

Management believes that the unaudited condensed consolidated interim financial statements reflect all adjustments of a normal recurring nature and disclosures that are necessary for a fair presentation of the results for the interim periods presented. Some previously reported results have been reclassified to conform to current reporting practices. The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year. The interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in Key's 2007 Annual Report to Shareholders.

Goodwill and Other Intangible Assets

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

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

Key's results for the second quarter of 2008 were adversely affected by after-tax charges of \$1.011 billion, resulting from a previously announced adverse federal court decision on the tax treatment of a Service Contract Lease transaction, and a substantial increase to the provision for loan losses. As a result of these charges, management tested Key's goodwill for impairment as of June 30, 2008, and determined that no impairment existed at that date.

Two primary assumptions are used in determining the fair value of Key's reporting units: Key's revenue growth rate and the future weighted-average cost of capital. Assuming that these assumptions remain unchanged, an incremental after-tax charge exceeding approximately \$700 million within the National Banking reporting unit would likely require additional impairment testing steps since the carrying amount of this unit would then exceed its fair value.

Derivatives

Effective January 1, 2008, Key adopted the accounting guidance in FASB Staff Position FIN 39-1, Amendment of FASB Interpretation 39, and as a result, also adopted the provisions of Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts. As a result of adopting this guidance, Key changed its accounting policy pertaining to the recognition of derivative assets and liabilities to take into account the impact of master netting agreements that allow Key to settle all derivative contracts held with a single counterparty on a net basis and to offset the net derivative position with the related cash collateral. Additional information regarding Key's adoption of this accounting guidance is provided in Note 14 (Derivatives and Hedging Activities), which begins on page 31, and under the heading Accounting Pronouncements Adopted in 2008 on page 9 of this note.

Fair Value Measurements

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

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

Key values its assets and liabilities in the principal market where it sells the particular asset or transfers the liability with the greatest volume and level of activity. In the absence of a principal market, the valuation is based on the most advantageous market for the asset or liability (i.e., the market where the asset could be sold or the liability transferred at a price that maximizes the amount to be received for the asset or minimizes the amount to be paid to transfer the liability).

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

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

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

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

All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy which gives the highest ranking to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest ranking to unobservable inputs (Level 3). Fair values for assets or liabilities classified as Level 2 are based on one or a combination of the following factors: (i) quoted prices for similar assets; (ii) observable inputs for the asset or liability, such as interest rates or yield curves; or (iii) inputs derived principally from or corroborated by observable market data. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Key considers an input to be significant if it drives 10% or more of the total fair value of a particular asset or liability. Assets and liabilities are considered to be fair valued on a recurring basis if fair value is measured regularly (i.e., daily, weekly, monthly or quarterly). Recurring valuation occurs at a minimum on the measurement date.

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

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

Additional information regarding fair value measurements and Key's adoption of SFAS No. 157 is provided in Note 15 (Fair Value Measurements), which begins on page 34, and under the heading Accounting Pronouncements Adopted in 2008 below.

Accounting Pronouncements Adopted in 2008

Fair value measurements. In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance applies only when other guidance requires or permits assets or liabilities to be measured at fair value; it does not expand the use of fair value in any new circumstances. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008, for Key). In February 2008, the FASB

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issued Staff Position FAS 157-2, which delayed the effective date of SFAS No. 157 for all nonfinancial assets and liabilities, except those recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008. However, early adoption of SFAS No. 157 for nonfinancial assets and liabilities within the scope of the new guidance is permitted. Key's January 1, 2008, adoption of SFAS No. 157 for all financial and nonfinancial assets and liabilities did not have a material effect on Key's financial condition or results of operations. Additional information regarding fair value measurements and Key's adoption of this accounting guidance is provided in Note 15 and under the heading "Fair Value Measurements" on page 8 of this note.

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

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

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

Accounting Pronouncements Pending Adoption at June 30, 2008

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

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

Noncontrolling interests. In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51. The new pronouncement requires all entities to report noncontrolling (minority) interests in subsidiaries as a component of shareholders' equity. SFAS No. 160 will be effective for fiscal years beginning after December 15, 2008 (January 1, 2009, for Key). Early adoption is prohibited. Management is evaluating the potential effect this guidance may have on Key's financial condition and results of operations.

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Accounting for transfers of financial assets and repurchase financing transactions. In February 2008, the FASB issued Staff Position FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. This Staff Position provides guidance on accounting for a transfer of a financial asset and a repurchase financing, and presumes that an initial transfer of a financial asset and a repurchase financing are considered part of the same arrangement (linked transaction) under SFAS No. 140. However, if certain criteria are met, the initial transfer and repurchase financing shall be evaluated separately under SFAS No. 140. Staff Position FAS 140-3 will be effective for fiscal years beginning after November 15, 2008 (January 1, 2009, for Key), and for interim periods within those fiscal years. Early adoption is prohibited. Management is evaluating the potential effect this guidance may have on Key's financial condition and results of operations.

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

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

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

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

Table of Contents**2. Earnings Per Common Share**

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

<i>dollars in millions, except per share amounts</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
EARNINGS				
(Loss) income from continuing operations	\$ (1,126)	\$ 337	\$ (908)	\$ 695
Loss from discontinued operations, net of taxes		(3)		(11)
Net (loss) income	\$ (1,126)	\$ 334	\$ (908)	\$ 684
Net (loss) income applicable to common shares	\$ (1,126)	\$ 334	\$ (908)	\$ 684
WEIGHTED-AVERAGE COMMON SHARES				
Weighted-average common shares outstanding (000)	416,629	392,045	407,875	394,944
Effect of dilutive convertible preferred stock, common stock options and other stock awards (000)		4,873		5,236
Weighted-average common shares and potential common shares outstanding (000)	416,629	396,918	407,875	400,180
EARNINGS PER COMMON SHARE				
(Loss) income from continuing operations	\$ (2.70)	\$.86	\$ (2.23)	\$ 1.76
Loss from discontinued operations		(.01)		(.03)
Net (loss) income	(2.70)	.85	(2.23)	1.73
(Loss) income from continuing operations assuming dilution	\$ (2.70)	\$.85	\$ (2.23)	\$ 1.74
Loss from discontinued operations assuming dilution		(.01)		(.03)
Net (loss) income assuming dilution	(2.70)	.84	(2.23)	1.71

3. Acquisitions and Divestitures

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

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

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

Tuition Management Systems, Inc.

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

Table of Contents**Divestitures****Champion Mortgage**

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

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

<i>in millions</i>	Three months ended June 30, 2007	Six months ended June 30, 2007
Loss, net of taxes of (\$1) and (\$3), respectively ^a	\$ (2)	\$ (6)
Loss on disposal, net of taxes of (\$1)		(1)
Disposal transaction costs, net of taxes of (\$1) and (\$3), respectively	(1)	(4)
Loss from discontinued operations	\$ (3)	\$ (11)

(a) Includes after-tax charges of \$.07 million for the three-month period ended June 30, 2007, and \$.7 million for the six-month period ended June 30, 2007, determined by applying a matched funds transfer pricing methodology to the liabilities assumed necessary to support Champion's operations.

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

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

McDonald Investments branch network

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

Table of Contents**4. Line of Business Results****Community Banking**

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

Regional Banking also offers financial, estate and retirement planning, and asset management services to assist high-net-worth clients with their banking, trust, portfolio management, insurance, charitable giving and related needs.

Commercial Banking provides midsize businesses with products and services that include commercial lending, cash management, equipment leasing, investment and employee benefit programs, succession planning, access to capital markets, derivatives and foreign exchange.

National Banking

Real Estate Capital and Corporate Banking Services consists of two business units. Real Estate Capital is a national business that provides construction and interim lending, permanent debt placements and servicing, equity and investment banking, and other commercial banking products and services to developers, brokers and owner-investors. This unit deals primarily with nonowner-occupied properties (i.e., generally properties in which at least 50% of the debt service is provided by rental income from nonaffiliated third parties). Particular emphasis has been placed on providing clients with finance solutions through access to the capital markets.

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

Equipment Finance meets the equipment leasing needs of companies worldwide and provides equipment manufacturers, distributors and resellers with financing options for their clients. Lease financing receivables and related revenues are assigned to other lines of business (primarily Institutional and Capital Markets, and Commercial Banking) if those businesses are principally responsible for maintaining the relationship with the client.

Institutional and Capital Markets, through its KeyBanc Capital Markets unit, provides commercial lending, treasury management, investment banking, derivatives and foreign exchange, equity and debt underwriting and trading, and syndicated finance products and services to large corporations and middle-market companies.

Through its Victory Capital Management unit, Institutional and Capital Markets also manages or offers advice regarding investment portfolios for a national client base, including corporations, labor unions, not-for-profit organizations, governments and individuals. These portfolios may be managed in separate accounts, common funds or the Victory family of mutual funds.

Consumer Finance offers loans to consumers on a direct basis and an indirect basis through dealers. It also provides federal and private education loans to students and their parents, and processes tuition payments for private schools. Through its Commercial Floor Plan Lending unit, Consumer Finance finances inventory for automobile, recreation and marine dealers.

Other Segments

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

Table of Contents**Reconciling Items**

Total assets included under Reconciling Items primarily represent the unallocated portion of nonearning assets of corporate support functions. Charges related to the funding of these assets are part of net interest income and are allocated to the business segments through noninterest expense. Reconciling Items also includes intercompany eliminations and certain items that are not allocated to the business segments because they do not reflect their normal operations.

The table that spans pages 16 and 17 shows selected financial data for each major business group for the three- and six-month periods ended June 30, 2008 and 2007. This table is accompanied by supplementary information for each of the lines of business that make up these groups. The information was derived from the internal financial reporting system that management uses to monitor and manage Key's financial performance. U.S. generally accepted accounting principles (GAAP) guide financial accounting, but there is no authoritative guidance for management accounting the way management uses its judgment and experience to make reporting decisions. Consequently, the line of business results Key reports may not be comparable with line of business results presented by other companies.

The selected financial data are based on internal accounting policies designed to compile results on a consistent basis and in a manner that reflects the underlying economics of the businesses. According to Key's policies:

- ◆ Net interest income is determined by assigning a standard cost for funds used or a standard credit for funds provided based on their assumed maturity, prepayment and/or repricing characteristics. The net effect of this funds transfer pricing is charged to the lines of business based on the total loan and deposit balances of each line.
- ◆ Indirect expenses, such as computer servicing costs and corporate overhead, are allocated based on assumptions regarding the extent to which each line actually uses the services.
- ◆ Key's consolidated provision for loan losses is allocated among the lines of business primarily based on their actual net charge-offs, adjusted periodically for loan growth and changes in risk profile. The amount of the consolidated provision is based on the methodology that management uses to estimate Key's consolidated allowance for loan losses. This methodology is described in Note 1 (Summary of Significant Accounting Policies) under the heading Allowance for Loan Losses on page 67 of Key's 2007 Annual Report to Shareholders.
- ◆ Income taxes are allocated based on the statutory federal income tax rate of 35% (adjusted for tax-exempt interest income, income from corporate-owned life insurance, and tax credits associated with investments in low-income housing projects) and a blended state income tax rate (net of the federal income tax benefit) of 2.5%.
- ◆ Capital is assigned based on management's assessment of economic risk factors (primarily credit, operating and market risk) directly attributable to each line.

Developing and applying the methodologies that management uses to allocate items among Key's lines of business is a dynamic process. Accordingly, financial results may be revised periodically to reflect accounting enhancements, changes in the risk profile of a particular business or changes in Key's organizational structure.

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

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Three months ended June 30, <i>dollars in millions</i>	Community Banking		National Banking	
	2008	2007	2008	2007
SUMMARY OF OPERATIONS				
Net interest income (loss) (TE)	\$ 437	\$ 417	\$ (472) ^d	\$ 339
Noninterest income	222	214	346	273
Total revenue (TE) ^a	659	631	(126)	612
Provision for loan losses	44	21	609	32
Depreciation and amortization expense	34	33	73	71
Other noninterest expense	415	413	264	259
Income (loss) from continuing operations before income taxes (TE)	166	164	(1,072)	250
Allocated income taxes and TE adjustments	62	62	(402)	93
Income (loss) from continuing operations	104	102	(670)	157
Loss from discontinued operations, net of taxes				(3)
Net income (loss)	\$ 104	\$ 102	\$ (670)	\$ 154
Percent of consolidated income from continuing operations	N/M	30%	N/M	47%
Percent of total segments income from continuing operations	N/M	32	N/M	50
AVERAGE BALANCES^b				
Loans and leases	\$ 28,478	\$ 26,574	\$ 47,876	\$ 39,325
Total assets ^a	31,385	29,346	56,242	49,585
Deposits	49,948	46,126	12,289	12,082
OTHER FINANCIAL DATA				
Net loan charge-offs	\$ 38	\$ 26	\$ 486	\$ 27
Return on average allocated equity ^b	13.68%	16.57%	(51.60)%	15.12%
Return on average allocated equity	13.68	16.57	(51.60)	14.83
Average full-time equivalent employees	8,785	9,026	3,603	3,856

Six months ended June 30, <i>dollars in millions</i>	Community Banking		National Banking	
	2008	2007	2008	2007
SUMMARY OF OPERATIONS				
Net interest income (loss) (TE)	\$ 860	\$ 836	\$ (133) ^d	\$ 675
Noninterest income	428	602 ^c	447	532 ^d
Total revenue (TE) ^a	1,288	1,438	314	1,207
Provision for loan losses	62	35	778	62

Depreciation and amortization expense	69	69	148	140
Other noninterest expense	807	843	498	506
Income (loss) from continuing operations before income taxes (TE)	350	491	(1,110)	499
Allocated income taxes and TE adjustments	131	184	(416)	187
Income (loss) from continuing operations	219	307	(694)	312
Loss from discontinued operations, net of taxes				(11)
Net income (loss)	\$ 219	\$ 307	\$ (694)	\$ 301
Percent of consolidated income from continuing operations	N/M	44%	N/M	45%
Percent of total segments income from continuing operations	N/M	46	N/M	47
AVERAGE BALANCES ^b				
Loans and leases	\$ 28,303	\$ 26,514	\$ 46,013	\$ 39,085
Total assets ^a	31,227	29,317	56,230	49,003
Deposits	49,857	46,322	12,088	11,691
OTHER FINANCIAL DATA				
Net loan charge-offs	\$ 68	\$ 45	\$ 577	\$ 52
Return on average allocated equity ^b	14.57%	25.08%	(27.53)%	15.30%
Return on average allocated equity	14.57	25.08	(27.53)	14.76
Average full-time equivalent employees	8,750	9,242	3,680	4,070

(a) Substantially all revenue generated by Key's major business groups is derived from clients with residency in the United States. Substantially all long-lived assets, including premises and equipment, capitalized software and goodwill held by Key's major business groups are located in the United States.

(b) From continuing operations.

- (c) Community Banking's results for the first quarter of 2007 include a \$171 million (\$107 million after tax) gain from the February 9, 2007, sale of the McDonald Investments branch network. See Note 3 (Acquisitions and Divestitures), which begins on page 12, for more information pertaining to this transaction.
- (d) During the second quarter of 2008, National Banking's taxable-equivalent net interest income and net income were reduced by \$838 million and \$536 million, respectively, as a result of an adverse federal court decision on the tax treatment of a Service Contract Lease transaction. During the prior quarter, National Banking increased its tax reserves for certain lease in, lease out transactions and recalculated its lease income in accordance with prescribed accounting standards. These

actions reduced National Bankings taxable-equivalent revenue by \$34 million and its net income by \$21 million in the first quarter. National Bankings results for the first quarter of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation.

- (e) Other Segments results for the second quarter of 2007 include a \$26 million (\$16 million after tax) charge for litigation. This charge and the litigation referred to in note (f) below comprise the \$42 million charge recorded in connection with the Honsador litigation disclosed in Note 13 (Contingent Liabilities and Guarantees), which begins on page 29. Results for the first quarter of 2007 include a \$49 million (\$31 million after tax) loss from the repositioning of the securities portfolio.

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Other Segments		Total Segments		Reconciling Items		Key	
2008	2007	2008	2007	2008	2007	2008	2007
\$ (31)	\$ (20)	\$ (66)	\$ 736	\$ (34)	\$ (30)	\$ (100)	\$ 706
	121	568	608	(13)	41 ^f	555	649
(31)	101	502	1,344	(47)	11	455	1,355
		653	53	(6)		647	53
		107	104			107	104
8	33 ^e	687	705	(13)	6 ^f	674	711
(39)	68	(945)	482	(28)	5	(973)	487
(26)	13	(366)	168	519^f	(18)	153	150
(13)	55	(579)	314	(547)	23	(1,126)	337
			(3)				(3)
\$ (13)	\$ 55	\$ (579)	\$ 311	\$ (547)	\$ 23	\$ (1,126)	\$ 334
N/M	16%	N/M	93%	N/M	7%	N/M	100%
N/M	18	N/M	100	N/A	N/A	N/A	N/A
\$ 177	\$ 266	\$ 76,531	\$ 66,165	\$ 121	\$ 150	\$ 76,652	\$ 66,315
14,098	12,387	101,725	91,318	1,565	2,094	103,290	93,412
3,092	2,361	65,329	60,569	(197)	(172)	65,132	60,397
		\$ 524	\$ 53			\$ 524	\$ 53
N/M	N/M	(26.45)%	17.71%	N/M	N/M	(52.56)%	17.66%
N/M	N/M	(26.45)	17.54	N/M	N/M	(52.56)	17.50
43	43	12,431	12,925	5,733	5,963	18,164	18,888
Other Segments		Total Segments		Reconciling Items		Key	
2008	2007	2008	2007	2008	2007	2008	2007
\$ (58)	\$ (46)	\$ 669	\$ 1,465	\$ (65)	\$ (59)	\$ 604	\$ 1,406
53	128 ^e	928	1,262	155^f	41 ^f	1,083	1,303
(5)	82	1,597	2,727	90	(18)	1,687	2,709
		840	97	(6)		834	97
		217	209			217	209
17	43 ^e	1,322	1,392	(26)	(2) ^f	1,296	1,390

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(22)	39	(782)	1,029	122	(16)	(660)	1,013
(30)	(8)	(315)	363	563^f	(45)	248	318
8	47	(467)	666 (11)	(441)	29	(908)	695 (11)
\$ 8	\$ 47	\$ (467)	\$ 655	\$ (441)	\$ 29	\$ (908)	\$ 684
N/M	7%	N/M	96%	N/M	4%	N/M	100%
N/M	7	N/M	100	N/A	N/A	N/A	N/A
\$ 207	\$ 273	\$ 74,523	\$ 65,872	\$ 147	\$ 122	\$ 74,670	\$ 65,994
14,260	12,339	101,717	90,659	1,606	2,099	103,323	92,758
		61,945	58,013	3,764	2,068	65,709	60,081
		\$ 645	\$ 97			\$ 645	\$ 97
N/M	N/M	(10.90)%	19.06%	N/M	N/M	(21.40)%	18.35%
N/M	N/M	(10.90)	18.75	N/M	N/M	(21.40)	18.06
43	43	12,473	13,355	5,822	5,987	18,295	19,342

- (f) Reconciling Items for the second quarter of 2008 include a \$475 million charge to income taxes for the interest cost associated with the leveraged lease tax litigation. Reconciling Items for the prior quarter include a \$165 million (\$103 million after tax) gain from the partial redemption of Key's equity interest in Visa Inc. and a \$17 million charge to income taxes for the interest cost

associated with the increase to Key's tax reserves for certain lease in, lease out transactions. Reconciling Items for the second quarter of 2007 include a \$40 million (\$25 million after tax) gain related to MasterCard Incorporated shares, and a \$16 million (\$10 million after tax) charge for litigation.

TE = Taxable
Equivalent

N/A = Not
Applicable

N/M = Not
Meaningful

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Supplementary information (Community Banking lines of business)

Three months ended June 30, <i>dollars in millions</i>	Regional Banking		Commercial Banking	
	2008	2007	2008	2007
Total revenue (TE)	\$ 557	\$ 537	\$ 102	\$ 94
Provision for loan losses	25	20	19	1
Noninterest expense	401	396	48	50
Net income	82	75	22	27
Average loans and leases	19,608	18,471	8,870	8,103
Average deposits	46,246	42,725	3,702	3,401
Net loan charge-offs	33	20	5	6
Net loan charge-offs to average loans	.68%	.43%	.23%	.30%
Nonperforming assets at period end	\$ 157	\$ 114	\$ 61	\$ 34
Return on average allocated equity	15.06%	17.38%	10.21%	14.67%
Average full-time equivalent employees	8,439	8,655	346	371

Six months ended June 30, <i>dollars in millions</i>	Regional Banking		Commercial Banking	
	2008	2007	2008	2007
Total revenue (TE)	\$ 1,087	\$ 1,253	\$ 201	\$ 185
Provision for loan losses	39	38	23	(3)
Noninterest expense	785	814	91	98
Net income	165	251	54	56
Average loans and leases	19,540	18,485	8,763	8,029
Average deposits	46,211	42,890	3,646	3,432
Net loan charge-offs	62	38	6	7
Net loan charge-offs to average loans	.64%	.41%	.14%	.18%
Nonperforming assets at period end	\$ 157	\$ 114	\$ 61	\$ 34
Return on average allocated equity	15.21%	29.11%	12.90%	15.49%
Average full-time equivalent employees	8,402	8,870	348	372

Supplementary information (National Banking lines of business)

Three months ended June 30, <i>dollars in millions</i>	Real Estate Capital and Corporate Banking Services		Equipment Finance		Institutional and Capital Markets		Consumer Finance	
	2008	2007	2008	2007	2008	2007	2008	2007
Total revenue (TE)	\$ 233	\$ 214	\$ (694)	\$ 150	\$ 231	\$ 159	\$ 104	\$ 89
Provision for loan losses	366	8	36	16	36		171	8
Noninterest expense	68	92	89	94	128	99	52	45
(Loss) income from continuing operations	(126)	71	(512)	25	42	38	(74)	23
Net (loss) income	(126)	71	(512)	25	42	38	(74)	20

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Average loans and leases ^a	17,086	13,713	10,326	10,609	7,897	6,566	12,567	8,437
Average loans held for sale ^a	616	1,246	51	10	494	463	121	2,658
Average deposits ^a	10,460	9,447	21	16	1,384	2,072	424	547
Net loan charge-offs	376	3	28	16	5		77	8
Net loan charge-offs to average loans ^a	8.85%	.09%	1.09%	.60%	.25%		2.46%	.38%
Nonperforming assets at period end	\$ 779	\$ 110	\$ 105	\$ 60	\$ 26	\$ 22	\$ 82	\$ 38
Return on average allocated equity ^a	(23.69)%	20.43%	(225.30)%	11.43%	13.61%	13.92%	(32.07)%	11.56%
Return on average allocated equity	(23.69)	20.43	(225.30)	11.43	13.61	13.92	(32.07)	10.05
Average full-time equivalent employees	1,228	1,293	837	895	931	992	607	676

**Real Estate Capital
and
Corporate Banking**

Institutional and

Six months ended June 30,
dollars in millions

	Services		Equipment Finance		Capital Markets		Consumer Finance	
	2008	2007	2008	2007	2008	2007	2008	2007
Total revenue (TE)	\$ 310	\$ 403	\$ (593)	\$ 282	\$ 389	\$ 316	\$ 208	\$ 206
Provision for loan losses	410	9	60	29	53		255	24
Noninterest expense	129	176	186	181	229	200	102	89
(Loss) income from continuing operations	(143)	136	(525)	45	67	73	(93)	58
Net (loss) income	(143)	136	(525)	45	67	73	(93)	47
Average loans and leases ^a	16,785	13,675	10,461	10,544	7,765	6,559	11,002	8,307
Average loans held for sale ^a	803	1,196	41	7	525	302	1,738	2,643
Average deposits ^a	10,124	8,996	17	14	1,421	2,122	526	559
Net loan charge-offs	413	4	52	29	7	1	105	18
Net loan charge-offs to average loans ^a	4.95%	.06%	1.00%	.55%	.18%	.03%	1.92%	.44%
Nonperforming assets at period end	\$ 779	\$ 110	\$ 105	\$ 60	\$ 26	\$ 22	\$ 82	\$ 38
Return on average allocated equity ^a	(14.31)%	20.18%	(115.01)%	10.41%	11.05%	13.49%	(20.24)%	14.81%
Return on average allocated equity	(14.31)	20.18	(115.01)	10.41	11.05	13.49	(20.24)	12.00
Average full-time equivalent employees	1,230	1,285	848	890	934	1,024	668	871

(a) From continuing operations.

TE = Taxable Equivalent

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5. Securities

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

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

Held-to-maturity securities. These are debt securities that Key has the intent and ability to hold until maturity. Debt securities are carried at cost, adjusted for amortization of premiums and accretion of discounts using the interest method. This method produces a constant rate of return on the adjusted carrying amount. Other securities held in the held-to-maturity portfolio are foreign bonds and preferred equity securities.

The amortized cost, unrealized gains and losses, and approximate fair value of Key's securities available for sale and held-to-maturity securities are presented in the following tables. Gross unrealized gains and losses are represented by the difference between the amortized cost and the fair value of securities on the balance sheet as of the dates indicated. Accordingly, the amount of these gains and losses may change in the future as market conditions improve or worsen.

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<i>in millions</i>	June 30, 2008			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	\$ 18			\$ 18
States and political subdivisions	92		\$ 1	91
Collateralized mortgage obligations	6,309	\$ 69	28	6,350
Other mortgage-backed securities	1,583	10	9	1,584
Retained interests in securitizations	153	34		187
Other securities	82	6	6	82
Total securities available for sale	\$ 8,237	\$ 119	\$ 44	\$ 8,312

HELD-TO-MATURITY SECURITIES

States and political subdivisions	\$ 8			\$ 8
Other securities	17			17
Total held-to-maturity securities	\$ 25			\$ 25

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

HELD-TO-MATURITY SECURITIES

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

<i>in millions</i>	June 30, 2007			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
SECURITIES AVAILABLE FOR SALE				
U.S. Treasury, agencies and corporations	\$ 18			\$ 18
States and political subdivisions	13			13
Collateralized mortgage obligations	6,421	\$ 3	\$ 111	6,313
Other mortgage-backed securities	1,133	2	22	1,113
Retained interests in securitizations	146	47		193
Other securities	150	19		169
Total securities available for sale	\$ 7,881	\$ 71	\$ 133	\$ 7,819
HELD-TO-MATURITY SECURITIES				
States and political subdivisions	\$ 17			\$ 17
Other securities	20			20
Total held-to-maturity securities	\$ 37			\$ 37

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

Key's loans by category are summarized as follows:

<i>in millions</i>	June 30, 2008	December 31, 2007	June 30, 2007
Commercial, financial and agricultural	\$ 25,929	\$ 24,797	\$ 21,814
Commercial real estate:			
Commercial mortgage	10,737	9,630	8,629
Construction	7,849	8,102	8,214
Total commercial real estate loans	18,586^a	17,732	16,843
Commercial lease financing	9,610	10,176	10,138
Total commercial loans	54,125	52,705	48,795
Real estate residential mortgage	1,928	1,594	1,572
Home equity:			
Community Banking	9,851	9,655	9,736
National Banking	1,153	1,262	1,143
Total home equity loans	11,004	10,917	10,879
Consumer other Community Banking	1,261	1,298	1,366
Consumer other National Banking:			
Marine	3,634	3,637	3,444
Education	3,584^b	331	327
Other	319	341	309
Total consumer other National Banking	7,537	4,309	4,080
Total consumer loans	21,730	18,118	17,897
Total loans	\$ 75,855	\$ 70,823	\$ 66,692

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

portfolio to held-for-sale status.

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

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

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

<i>in millions</i>	June 30, 2008	December 31, 2007	June 30, 2007
Commercial, financial and agricultural	\$ 212	\$ 250	\$ 76
Real estate commercial mortgage	994	1,219	1,613
Real estate construction	398 ^a	35	172
Commercial lease financing	42	1	22
Real estate residential mortgage	79	47	39
Home equity		1	
Education	103 ^b	3,176	2,616
Automobile	5	7	8
Total loans held for sale	\$ 1,833	\$ 4,736	\$ 4,546

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

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

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

<i>in millions</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Balance at beginning of period	\$ 1,298	\$ 944	\$ 1,200	\$ 944
Charge-offs	(554)	(72)	(702)	(136)
Recoveries	30	19	57	39
Net loans charged off	(524)	(53)	(645)	(97)
Provision for loan losses from continuing operations	647	53	834	97
Allowance related to loans acquired, net			32	
Foreign currency translation adjustment		1		1
Balance at end of period	\$ 1,421	\$ 945	\$ 1,421	\$ 945

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

<i>in millions</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Balance at beginning of period	\$ 53	\$ 45	\$ 80	\$ 53
(Credit) provision for losses on lending-related commitments	(2)	6	(29)	(2)
Charge-offs		(1)		(1)
Balance at end of period ^a	\$ 51	\$ 50	\$ 51	\$ 50

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

7. Mortgage Servicing Assets

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

<i>in millions</i>	Six months ended	
	June 30,	
	2008	2007
Balance at beginning of period	\$ 313	\$ 247

Servicing retained from loan sales	9	10
Purchases	3	55
Amortization	(53)	(40)
Balance at end of period	\$ 272	\$ 272
Fair value at end of period	\$ 426	\$ 371

The fair value of mortgage servicing assets is determined by calculating the present value of future cash flows associated with servicing the loans. This calculation uses a number of assumptions that are based on current market conditions. Primary economic assumptions used to measure the fair value of Key's mortgage servicing assets at June 30, 2008, and 2007, are as follows:

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

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

Contractual fee income from servicing commercial mortgage loans totaled \$32 million and \$34 million for the six-month periods ended June 30, 2008 and 2007, respectively. The amortization of servicing assets for each year, as shown in the preceding table, is recorded as a reduction to fee income. Both the contractual fee income and the amortization are recorded in other income on the income statement.

8. Variable Interest Entities

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

<i>in millions</i>	Consolidated VIEs		Unconsolidated VIEs	
	Total Assets	Total Assets	Maximum Exposure to Loss	
June 30, 2008				
Low-income housing tax credit (LIHTC) funds	\$ 261	\$ 158		
LIHTC investments	N/A	720	\$	287

N/A = Not Applicable

The noncontrolling interests associated with the consolidated LIHTC guaranteed funds are considered mandatorily redeemable instruments and are recorded in accrued expense and other liabilities on the balance sheet. The FASB has indefinitely deferred the measurement and recognition provisions of SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, for mandatorily redeemable noncontrolling interests associated with finite-lived subsidiaries, such as Key's LIHTC guaranteed funds. Key currently accounts for these interests as minority interests and adjusts the financial statements each period for the investors' share of the funds profits and losses. At June 30, 2008, the settlement value of these noncontrolling interests was estimated to be between \$233 million and \$272 million, while the recorded value, including reserves, totaled \$274 million.

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

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

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

Impaired loans totaled \$628 million at June 30, 2008, compared to \$519 million at December 31, 2007, and \$137 million at June 30, 2007. Impaired loans had an average balance of \$733 million for the second quarter of 2008 and \$124 million for the second quarter of 2007.

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

<i>in millions</i>	June 30, 2008	December 31, 2007	June 30, 2007
Impaired loans	\$ 628	\$ 519	\$ 137
Other nonaccrual loans	186	168	139
Total nonperforming loans	814^a	687	276
Nonperforming loans held for sale	342^a	25	4
Other real estate owned (OREO)	26	21	27
Allowance for OREO losses	(2)	(2)	(2)
OREO, net of allowance	24	19	25
Other nonperforming assets ^b	30	33	73
Total nonperforming assets	\$ 1,210	\$ 764	\$ 378
Impaired loans with a specifically allocated allowance	\$ 564	\$ 426	\$ 53
Specifically allocated allowance for impaired loans	166	126	23
Accruing loans past due 90 days or more	\$ 367	\$ 231	\$ 181
Accruing loans past due 30 through 89 days	852	843	623

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

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

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

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

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

KeyCorp owns the outstanding common stock of business trusts that issued corporation-obligated mandatorily redeemable preferred capital securities. The trusts used the proceeds from the issuance of their capital securities and common stock to buy debentures issued by KeyCorp. These debentures are the trusts' only assets; the interest payments from the debentures finance the distributions paid on the capital securities.

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

- required distributions on the capital securities;
- the redemption price when a capital security is redeemed; and
- the amounts due if a trust is liquidated or terminated.

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

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

<i>dollars in millions</i>	Capital Securities, Net of Discount ^a	Common Stock	Principal Amount of Debentures, Net of Discount ^b	Interest Rate of Capital Securities and Debentures ^c	Maturity of Capital Securities and Debentures
June 30, 2008					
KeyCorp Capital I	\$ 197	\$ 8	\$ 201	3.438%	2028
KeyCorp Capital II	181	8	178	6.875	2029
KeyCorp Capital III	230	8	208	7.750	2029
KeyCorp Capital V	167	5	189	5.875	2033
KeyCorp Capital VI	74	2	80	6.125	2033
KeyCorp Capital VII	239	8	265	5.700	2035
KeyCorp Capital VIII	258		273	7.000	2066
KeyCorp Capital IX	500		501	6.750	2066
KeyCorp Capital X	726		729	8.000	2068
Union State Capital I	20	1	21	9.580	2027
Union State Statutory II	20		20	6.479	2031
Union State Statutory IV	10		10	5.513	2034
Total	\$ 2,622	\$ 40	\$ 2,675	6.814%	
December 31, 2007	\$ 1,848	\$ 39	\$ 1,896	6.599%	

June 30, 2007	\$	1,718	\$	39	\$	1,838	6.608%
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- (a) The capital securities must be redeemed when the related debentures mature, or earlier if provided in the governing indenture. Each issue of capital securities carries an interest rate identical to that of the related debenture. Included in certain capital securities at June 30, 2008, December 31, 2007, and June 30, 2007, are basis adjustments of \$39 million, \$55 million and (\$75) million, respectively, related to fair value hedges. See Note 19 (Derivatives and Hedging Activities), which begins on page 100 of Key s 2007 Annual Report to Shareholders, for an explanation of fair value hedges.
- (b) KeyCorp has the right to

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

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

will be the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Union State Capital I are redeemed before they mature, the redemption price will be 104.31% of the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Union State Statutory II are redeemed before they mature, the redemption price will be 106.00% of the principal amount, plus any accrued but unpaid interest. If the debentures purchased by Capital II or Capital III are redeemed before they mature, the redemption price will be the greater of: (a) the principal amount, plus any accrued but unpaid interest or (b) the sum of the present values of principal and interest payments discounted at the Treasury Rate (as defined in the applicable indenture), plus 20 basis points

(25 basis points for Capital III), plus any accrued but unpaid interest. When debentures are redeemed in response to tax or capital treatment events, the redemption price generally is slightly more favorable to KeyCorp. Included in the principal amount of debentures at June 30, 2008, December 31, 2007, and June 30, 2007, are adjustments relating to hedging with financial instruments totaling \$52 million, \$64 million and \$6 million, respectively.

- (c) The interest rates for Capital II, Capital III, Capital V, Capital VI, Capital VII, Capital VIII, Capital IX, Capital X and Union State Capital I are fixed. Capital I has a floating interest rate equal to three-month LIBOR plus 74 basis points that reprices quarterly. Union State

Statutory II has a floating interest rate equal to three-month LIBOR plus 358 basis points that reprices quarterly. Union State Statutory IV has a floating interest rate equal to three-month LIBOR plus 280 basis points that reprices quarterly. The rates shown as the totals at June 30, 2008, December 31, 2007, and June 30, 2007, are weighted-average rates.

11. Employee Benefits

Pension Plans

The components of net pension cost and the amount recognized in comprehensive income (loss) for all funded and unfunded plans are as follows:

<i>in millions</i>	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Service cost of benefits earned	\$ 13	\$ 12	\$ 26	\$ 26
Interest cost on projected benefit obligation	16	14	32	29
Expected return on plan assets	(24)	(22)	(47)	(44)
Amortization of prior service cost	1		1	
Amortization of losses	3	6	6	14
Curtailment gain				(3)
Net pension cost	\$ 9	\$ 10	\$ 18	\$ 22

Other Postretirement Benefit Plans

Key sponsors a contributory postretirement healthcare plan that covers substantially all active and retired employees hired before 2001 who meet certain eligibility criteria. Retirees' contributions are adjusted annually to reflect certain cost-sharing provisions and benefit limitations. Key also sponsors life insurance plans covering certain grandfathered employees. These plans are principally noncontributory. Separate Voluntary Employee Beneficiary Association trusts are used to fund the healthcare plan and one of the life insurance plans.

The components of net postretirement benefit (income) cost and the amount recognized in comprehensive income (loss) for all funded and unfunded plans are as follows:

Other Postretirement Benefits

<i>in millions</i>	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Service cost of benefits earned	\$ 1	\$ 3	\$ 1	\$ 4
Interest cost on accumulated postretirement benefit obligation	1	2	2	3
Expected return on plan assets	(1)	(1)	(2)	(2)
Amortization of unrecognized:				
Transition obligation		2		2
Prior service benefit	(1)		(1)	
Cumulative net gain	(1)		(1)	
Net postretirement benefit (income) cost	\$ (1)	\$ 6	\$ (1)	\$ 7

Table of Contents**12. Income Taxes****Lease Financing Transactions**

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

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

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

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

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

Although the Court decision applies only to the AWG Leasing Litigation, under applicable accounting guidance, the decision has implications for the timing of the recognition of tax benefits on Key's entire portfolio of LILO, QTE and Service Contract Leases. Therefore, management has updated its assessment of Key's tax position in accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes. As a result, during the second quarter of 2008, Key increased the amount of its unrecognized tax benefits associated with all of the leases under challenge by the IRS by \$2.15 billion.

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This amount has not been reduced by existing tax deposits of \$200 million. Key also recorded a related \$475 million charge to the provision for income taxes for the interest cost associated with the contested leases. Key has not recognized any charge for penalties or interest on penalties that the IRS has asserted or may assert in the future. The increase in unrecognized tax benefits associated with the contested leases necessitated a recalculation of Key's lease income under FASB Staff Position No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction. This resulted in a \$536 million reduction of Key's second quarter 2008 after-tax earnings, including a \$359 million reduction to lease income and a \$177 million increase to the provision for income taxes. Of this amount, approximately \$365 million will be taken back into earnings over the remaining lives of the affected leases. The remaining \$171 million represents the reversal of the tax benefits previously recorded as a result of applying a lower tax rate to a portion of these transactions that are managed by a foreign subsidiary in a lower tax jurisdiction. These tax benefits will be recorded only if they are ultimately realized in the future in the course of Key's ongoing challenge of the tax treatment.

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

While Key has recognized the effects of the adverse Court decision for financial statement purposes, management continues to believe that the tax treatment Key applied to its leveraged lease transactions complied with all tax laws, regulations and judicial authorities in effect at the time, and Key has appealed the adverse trial court decision. As permitted under FASB Interpretation No. 48, it is Key's policy to recognize interest and penalties related to unrecognized tax benefits in income tax expense. During the six months ended June 30, 2008, Key recognized \$762 million of pre-tax interest, of which \$760 million (\$475 million, after tax) was attributable to the increase in unrecognized tax benefits associated with its LILO, QTE and Service Contract Lease transactions. Key's liability for accrued interest payable was \$804 million at June 30, 2008.

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

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

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

Honsador litigation. In November 2004, Key Principal Partners, LLC (KPP), a Key affiliate, was sued in Hawaii state court in connection with KPP's investment in a Hawaiian business. On May 23, 2007, in the case of *Honsador Holdings LLC v. KPP*, the jury returned a verdict in favor of the plaintiffs. On June 13, 2007, the state court entered a final judgment in favor of the plaintiffs in the amount of \$38.25 million. During the three months ended June 30, 2007, Key established a \$42 million reserve for the verdict, legal costs and other expenses associated with this lawsuit. As previously reported, Key has filed a notice of appeal with the Intermediate Court of Appeals for the State of Hawaii (the ICA), and the appeal is currently pending before the ICA.

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

Guarantees

Key is a guarantor in various agreements with third parties. The following table shows the types of guarantees that Key had outstanding at June 30, 2008. Information pertaining to the basis for determining the liabilities recorded in connection with these guarantees is included in Note 1 (Summary of Significant Accounting Policies) under the heading Guarantees on page 69 of Key's 2007 Annual Report to Shareholders.

<i>in millions</i>	Maximum Potential Undiscounted Future Payments	Liability Recorded
Financial guarantees:		
Standby letters of credit	\$ 14,911	\$ 40
Recourse agreement with FNMA	632	5
Return guarantee agreement with LIHTC investors	272	54
Written interest rate caps ^a	159	21
Default guarantees	23	1
Total	\$ 15,997	\$ 121

(a) As of June 30, 2008, the weighted-average interest rate of written interest rate caps was 2.7%, and the weighted-average strike rate was

5.1%. Maximum potential undiscounted future payments were calculated assuming a 10% interest rate.

Standby letters of credit. Many of Key's lines of business issue standby letters of credit to address clients' financing needs. These instruments obligate Key to pay a specified third party when a client fails to repay an outstanding loan or debt instrument, or fails to perform some contractual nonfinancial obligation. Any amounts drawn under standby letters of credit are treated as loans: they bear interest (generally at variable rates) and pose the same credit risk to Key as a loan. At June 30, 2008, Key's standby letters of credit had a remaining weighted-average life of approximately 2.2 years, with remaining actual lives ranging from less than one year to as many as ten years.

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Recourse agreement with Federal National Mortgage Association. KeyBank participates as a lender in the Federal National Mortgage Association (FNMA) Delegated Underwriting and Servicing program. As a condition to FNMA s delegation of responsibility for originating, underwriting and servicing mortgages, KeyBank has agreed to assume a limited portion of the risk of loss during the remaining term on each commercial mortgage loan KeyBank sells to FNMA. Accordingly, KeyBank maintains a reserve for such potential losses in an amount estimated by management to approximate the fair value of KeyBank s liability. At June 30, 2008, the outstanding commercial mortgage loans in this program had a weighted-average remaining term of 7.5 years, and the unpaid principal balance outstanding of loans sold by KeyBank as a participant in this program was approximately \$2.0 billion. The maximum potential amount of undiscounted future payments that KeyBank may be required to make under this program is equal to approximately one-third of the principal balance of loans outstanding at June 30, 2008. If KeyBank is required to make a payment it would have an interest in the collateral underlying the commercial mortgage loan on which the loss occurred.

Return guarantee agreement with LIHTC investors. Key Affordable Housing Corporation (KAHC), a subsidiary of KeyBank, offered limited partnership interests to qualified investors. Partnerships formed by KAHC invested in low-income residential rental properties that qualify for federal LIHTCs under Section 42 of the Internal Revenue Code. In certain partnerships, investors pay a fee to KAHC for a guaranteed return that is based on the financial performance of the property and the property s confirmed LIHTC status throughout a fifteen-year compliance period. If KAHC defaults on its obligation to provide the guaranteed return, Key is obligated to make any necessary payments to investors. In October 2003, management elected to discontinue new partnerships under this program. Additional information regarding these partnerships is included in Note 8 (Variable Interest Entities) on page 23. No recourse or collateral is available to offset Key s guarantee obligation other than the underlying income stream from the properties. These guarantees have expiration dates that extend through 2018. Key meets its obligations pertaining to the guaranteed returns generally by distributing tax credits and deductions associated with the specific properties.

As shown in the table on page 29, KAHC maintained a reserve in the amount of \$54 million at June 30, 2008, which management believes will be sufficient to cover estimated future obligations under the guarantees. The maximum exposure to loss reflected in the table represents undiscounted future payments due to investors for the return on and of their investments. In accordance with FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, the amount of all fees received in consideration for any return guarantee agreements entered into or modified with LIHTC investors on or after January 1, 2003, has been recognized as a component of the recorded liability.

Written interest rate caps. In the ordinary course of business, Key writes interest rate caps for commercial loan clients that have variable rate loans with Key and wish to limit their exposure to interest rate increases. At June 30, 2008, these caps had a weighted-average life of approximately 2.1 years.

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

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

Table of Contents**Other Off-Balance Sheet Risk**

Other off-balance sheet risk stems from financial instruments that do not meet the definition of a guarantee as specified in Interpretation No. 45 and from other relationships.

Liquidity facilities that support asset-backed commercial paper conduits. Key provides liquidity facilities to several unconsolidated third-party commercial paper conduits. These facilities obligate Key to provide funding if there is a disruption in credit markets or other factors exist that preclude the issuance of commercial paper by the conduits. The liquidity facilities, all of which expire by November 10, 2010, obligate Key to provide aggregate funding of up to \$1.1 billion, with individual facilities ranging from \$10 million to \$127 million. The aggregate amount available to be drawn is based on the amount of current commitments to borrowers and totaled \$837 million at June 30, 2008. Key's commitments to provide liquidity are periodically evaluated by management.

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

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

14. Derivatives and Hedging Activities

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

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

Derivative assets and liabilities are recorded at fair value on the balance sheet, after taking into account the effects of master netting agreements. These agreements allow Key to settle all derivative contracts held with a single counterparty on a net basis, and to offset net derivative positions with the related cash collateral. As a result, Key could have derivative contracts with negative fair values included in derivative assets on the balance sheet and contracts with positive fair values included in derivative liabilities.

At June 30, 2008, Key had \$309 million of derivative assets and a \$142 million debit balance in derivative liabilities that relate to contracts entered into for hedging purposes. As of the same date, Key had trading derivative assets of \$1.4 billion and trading derivative liabilities of \$779 million.

Table of Contents**Counterparty Credit Risk**

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

<i>in millions</i>	June 30, 2008	December 31, 2007	June 30, 2007
Interest rate	\$ 693	\$ 850	\$ 156
Foreign exchange	245	492	278
Energy	889	52	8
Credit	37	13	3
Equity	25	34	52
Derivative assets before cash collateral	1,889	1,441	497
Less: Related cash collateral	196	562	123
Total derivative assets	\$ 1,693	\$ 879	\$ 374

Like other financial instruments, derivatives contain an element of credit risk—the possibility that Key will incur a loss because a counterparty, which may be a bank or a broker/dealer, fails to meet its contractual obligations. This risk is measured as the expected positive replacement value of contracts. To mitigate credit risk, Key deals exclusively with counterparties that have high credit ratings.

Key uses two additional means to manage exposure to credit risk on derivative contracts. First, Key generally enters into bilateral collateral and master netting agreements. These agreements provide for the net settlement of all contracts with a single counterparty in the event of default. Second, Key's Credit Administration department monitors credit risk exposure to the counterparty on each contract to determine appropriate limits on Key's total credit exposure and decide whether to demand collateral. If Key determines that collateral is required, it is generally collected immediately. Key generally holds collateral in the form of cash and highly rated securities issued by the U.S. Treasury, government sponsored enterprises or the Government National Mortgage Association. The cash collateral netted against derivative assets on the balance sheet was \$196 million at June 30, 2008, \$562 million at December 31, 2007, and \$123 million at June 30, 2007. The cash collateral netted against derivative liabilities was \$531 million at June 30, 2008, \$254 million at December 31, 2007, and \$134 million at June 30, 2007.

At June 30, 2008, Key was party to derivative contracts with 58 different counterparties. These derivatives include interest rate swaps and caps, credit derivatives, foreign exchange contracts, equity derivatives and energy derivatives. Among these were contracts entered into to offset the risk of loss associated with contracts entered into to accommodate clients. Key had aggregate exposure of \$456 million on these instruments to 34 of the 58 counterparties. However, at June 30, 2008, Key held approximately \$290 million in pooled collateral to mitigate that exposure, resulting in net exposure of \$166 million. The largest exposure to an individual counterparty was approximately \$209 million, which is secured with approximately \$186 million in collateral.

Asset and Liability Management

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

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

<i>in millions</i>	December 31, 2007	2008 Hedging Activity	Reclassification of Gains to Net Income	June 30, 2008
Accumulated other comprehensive income (loss) resulting from cash flow hedges	\$ 103	\$ 55	\$ (54)	\$ 104

Key reclassifies gains and losses from accumulated other comprehensive income (loss) to earnings when a hedged item causes Key to pay variable-rate interest on debt, receive variable-rate interest on commercial loans, or sell or securitize commercial real estate loans. If interest rates, yield curves and notional amounts remain at current levels, management expects to reclassify an estimated \$54 million of net gains on derivative instruments from accumulated other comprehensive income (loss) to earnings during the next twelve months. The maximum length of time over which forecasted transactions are hedged is twenty years.

Credit Risk Management

Key uses credit derivatives $\frac{3}{4}$ primarily credit default swaps $\frac{3}{4}$ to mitigate credit risk by transferring a portion of the risk associated with the underlying extension of credit to a third party. These instruments are also used to manage portfolio concentration and correlation risks. At June 30, 2008, the notional amount of credit default swaps purchased by Key was \$1.3 billion. Key also provides credit protection to other lenders through the sale of credit default swaps. These transactions may generate fee income and can diversify overall exposure to credit loss. At June 30, 2008, the notional amount of credit default swaps sold by Key was \$203 million.

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

Trading Portfolio

Key's trading portfolio includes:

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

The fair values of these trading portfolio items are included in derivative assets or derivative liabilities on the balance sheet. Adjustments to the fair values are included in investment banking and capital markets income on the income statement. Key has established a reserve in the amount of \$19 million at June 30, 2008, which management believes will be sufficient to cover estimated future losses on the trading portfolio in the event of client default. Additional information pertaining to Key's trading portfolio is summarized in Note 19 of Key's 2007 Annual Report to Shareholders.

Table of Contents**15. Fair Value Measurements**

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

Fair Value Determination

As defined in SFAS No. 157, fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants in Key's principal market. Key has established and documented its process for determining the fair values of its assets and liabilities, where applicable. Fair value is based on quoted market prices, when available, for identical or similar assets or liabilities. In the absence of quoted market prices, management determines the fair value of Key's assets and liabilities using valuation models or third-party pricing services, both of which rely on market-based parameters when available, such as interest rate yield curves, option volatilities and credit spreads, or unobservable inputs. Unobservable inputs may be based on management's judgment, assumptions and estimates related to credit quality, liquidity, interest rates and other relevant inputs.

Valuation adjustments, such as those pertaining to counterparty and Key's own credit quality and liquidity, may be necessary to ensure that assets and liabilities are recorded at fair value. Credit valuation adjustments are made when market pricing is not indicative of the counterparty's credit quality. Most classes of derivative contracts are valued using internally-developed models based on market-standard derivative pricing conventions, which rely primarily on observable market inputs, such as interest rate yield curves and volatilities. Market convention implies a credit rating of double-A equivalent in the pricing of derivative contracts, which assumes all counterparties have the same creditworthiness. In determining the fair value of derivatives, management applies cash collateral and/or a default reserve to reflect the credit quality of the counterparty.

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

- the amount of time since the last relevant valuation;
- whether there is an actual trade or relevant external quote available at the measurement date; and
- volatility associated with the primary pricing components.

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

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

Table of Contents**Fair Value Hierarchy**

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

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

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

Qualitative Disclosures of Valuation Techniques

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

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

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

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

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Derivatives. Exchange-traded derivatives are valued using quoted prices and, therefore, are classified as Level 1. Only a few types of derivatives are exchange-traded; thus, the majority of Key's derivative positions are valued using internally-developed models that use observable market inputs. These derivative contracts are classified as Level 2 and include interest rate swaps, options and credit default swaps. Market convention implies a credit rating of double-A equivalent in the pricing of derivative contracts, which assumes all counterparties have the same creditworthiness. In order to reflect the actual exposure on Key's derivative contracts related to both counterparty and Key's own creditworthiness, management records a fair value adjustment in the form of a reserve. The credit component is valued on a counterparty-by-counterparty basis and considers master netting agreements and collateral.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

June 30, 2008

<i>in millions</i>	Level 1	Level 2	Level Adjustments ^a	Netting	Total
ASSETS MEASURED ON A RECURRING BASIS					
Trading account assets	\$ 6	\$ 753	\$ 724		\$ 1,483
Securities available for sale	66	8,055	3		8,124
Other investments	33		1,191		1,224
Derivative assets	265	2,881	9	\$ (1,462)	1,693
Accrued income and other assets	5	125			130
Total assets on a recurring basis at fair value	\$ 375	\$ 11,814	\$ 1,927	\$ (1,462)	\$ 12,654
LIABILITIES MEASURED ON A RECURRING BASIS					
Bank notes and other short-term borrowings	\$ 16	\$ 336			\$ 352
Derivative liabilities	269	2,164	\$ 1	\$ (1,797)	637
Accrued expense and other liabilities	1	48			49
Total liabilities on a recurring basis at fair value	\$ 286	\$ 2,548	\$ 1	\$ (1,797)	\$ 1,038

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

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

Changes in Level 3 Fair Value Measurements

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

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<i>in millions</i>	Six months ended June 30, 2008			
	Trading Account Assets	Securities Available for Sale	Other Investments	Derivative Instruments^a
Balance at beginning of period	\$ 338	\$ 4	\$ 1,161	\$ 6
(Losses) gains:				
Included in earnings	(38) ^b	1 ^c	1 ^d	2 ^b
Included in other comprehensive income		(1)		
Purchases, sales, issuances and settlements	424	(1)	29	
Balance at end of period	\$ 724	\$ 3	\$ 1,191	\$ 8
Unrealized (losses) gains included in earnings	\$ (29) ^b	\$ (1) ^c	\$ (43) ^d	\$ 2 ^b

(a) Amount represents Level 3 derivative assets less Level 3 derivative liabilities.

(b) Realized and unrealized gains and losses on trading account assets and derivative instruments are reported in investment banking and capital markets income on the income statement.

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

- (d) Other investments consist of principal investments, and private equity and mezzanine investments. Realized and unrealized gains and losses on principal investments are reported in net (losses) gains from principal investments on the income statement. Realized and unrealized gains and losses on private equity and mezzanine investments are reported in investment banking and capital markets income on the income statement.

Assets Measured at Fair Value on a Nonrecurring Basis

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

June 30, 2008

in millions

	Level 1	Level 2	Level 3	Total
ASSETS MEASURED ON A NONRECURRING BASIS				
Securities available for sale			\$ 4	\$ 4
Other investments		\$ 1		1
Loans held for sale			752	752
Accrued income and other assets		3	27	30
Total assets on a nonrecurring basis at fair value		\$ 4	\$ 783	\$ 787

Through Key's quarterly analysis of its commercial loan portfolio, management determined that certain adjustments were necessary to record the portfolio at the lower of cost or fair value in accordance with GAAP. While some loans were impaired as a result of current market conditions, other loans recovered some of the value that was previously written down. After adjustments, these loans totaled \$368 million at June 30, 2008. Valuation of these loans is performed using an internal model which relies on market data from sales of similar assets, including credit spreads, interest rate curves and risk profiles, as well as Key's own assumptions about the exit market for the loans. The valuation methodology employed is based on Level 3 inputs. Key's loans held for sale, which are measured at fair value on a nonrecurring basis, also include the \$384 million of commercial real estate loans transferred from the loan portfolio to held-for-sale status in June 2008. The fair value of these loans was measured using nonbinding broker quotes obtained through a third party.

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Other real estate owned and other repossessed properties are valued based on appraisals and third-party price opinions, less estimated selling costs. Assets that are acquired through, or in lieu of, loan foreclosures are recorded as held for sale initially at the lower of the loan balance or fair value upon the date of foreclosure. Subsequent to foreclosure, valuations are updated periodically, and the assets may be marked down further, reflecting a new cost basis. These assets, which totaled \$18 million at June 30, 2008, are considered to be nonrecurring items in the fair value hierarchy. Current market conditions, including lower prepayments, interest rates and expected recovery rates have impacted Key's modeling assumptions pertaining to education lending-related servicing rights and residual interests, and consequently resulted in write-downs of these instruments. These instruments are included in accrued income and other assets and securities available for sale respectively, in the preceding table.

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Report of Independent Registered Public Accounting Firm

Shareholders and Board of Directors

KeyCorp

We have reviewed the condensed consolidated balance sheets of KeyCorp and subsidiaries (Key) as of June 30, 2008 and 2007, and the related condensed consolidated statements of income, for the three- and six-month periods then ended, and the condensed consolidated statement of changes in shareholders equity and cash flows for the six-month periods ended June 30, 2008 and 2007. These financial statements are the responsibility of Key s management. We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Key as of December 31, 2007, and the related consolidated statements of income, changes in shareholders equity, and cash flows for the year then ended not presented herein, and in our report dated February 22, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio
August 7, 2008

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

This section generally reviews the financial condition and results of operations of KeyCorp and its subsidiaries for the quarterly and year-to-date periods ended June 30, 2008 and 2007. Some tables may include additional periods to comply with disclosure requirements or to illustrate trends in greater depth. When you read this discussion, you should also refer to the consolidated financial statements and related notes that appear on pages 3 through 38. A description of Key's business is included under the heading "Description of Business" on page 14 of Key's 2007 Annual Report to Shareholders. This description does not reflect the reorganization within some of Key's lines of business that took effect on January 1, 2008. For a current description of Key's lines of business, see Note 4 ("Line of Business Results"), which begins on page 14.

Terminology

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

- .. **KeyCorp** refers solely to the parent holding company.
- .. **KeyBank** refers to KeyCorp's subsidiary bank, KeyBank National Association.
- .. **Key** refers to the consolidated entity consisting of KeyCorp and its subsidiaries.
- .. In November 2006, Key sold the subprime mortgage loan portfolio held by the Champion Mortgage finance business and announced a separate agreement to sell Champion's origination platform. As a result of these actions, Key has accounted for this business as a **discontinued operation**. We use the phrase **continuing operations** in this document to mean all of Key's business other than Champion. Key completed the sale of Champion's origination platform in February 2007.
- .. Key engages in **capital markets activities** primarily through business conducted by the National Banking group. These activities encompass a variety of products and services. Among other things, Key trades securities as a dealer, enters into derivative contracts (both to accommodate clients' financing needs and for proprietary trading purposes), and conducts transactions in foreign currencies (both to accommodate clients' needs and to benefit from fluctuations in exchange rates).
- .. All earnings per share data included in this discussion are presented on a **diluted** basis, which takes into account all common shares outstanding as well as potential common shares that could result from the conversion of preferred stock to common shares, the exercise of outstanding stock options and other stock awards. Some of the financial information tables also include **basic** earnings per share, which takes into account only common shares outstanding.
- .. For regulatory purposes, capital is divided into two classes. Federal regulations prescribe that at least one-half of a bank or bank holding company's **total risk-based capital** must qualify as **Tier 1**. Both total and Tier 1 capital serve as bases for several measures of capital adequacy, which is an important indicator of financial stability and condition. You will find a more detailed explanation of total and Tier 1 capital and how they are calculated in the section entitled "Capital," which begins on page 72.

Forward-looking statements

This report may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements about Key's long-term goals, financial condition, results of operations, earnings, levels of net loan charge-offs and nonperforming assets, interest rate exposure and profitability. These statements usually can be identified by the use of forward-looking

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language such as our goal, our objective, our plan, will likely result, expects, plans, anticipates, intends, believes, estimates or other similar words, expressions or conditional verbs such as will, would, could and should. Forward-looking statements express management's current expectations, forecasts of future events or long-term goals and, by their nature, are subject to assumptions, risks and uncertainties. Although management believes that the expectations, forecasts and goals reflected in these forward-looking statements are reasonable, actual results could differ materially for a variety of reasons, including the following factors:

- .. Interest rates could change more quickly or more significantly than management expects, which may have an adverse effect on Key's financial results.
- .. Trade, monetary and fiscal policies of various governmental bodies may affect the economic environment in which Key operates, as well as its financial condition and results of operations.
- .. Changes in the stock markets, public debt markets and other capital markets, including continued disruption in the fixed income markets, could adversely affect Key's ability to raise capital or other funding for liquidity and business purposes, as well as its revenues from client-based underwriting, investment banking and other capital markets-driven businesses.
- .. Recent problems in the housing markets, including issues related to the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and related conditions in the financial markets, or other issues, such as the high price of oil or other commodities, could cause further deterioration in general economic conditions, or in the condition of the local economies or industries in which Key has significant operations or assets, and, among other things, materially impact credit quality in existing portfolios and/or Key's ability to generate loans in the future.
- .. Increasing interest rates or further weakening economic conditions could constrain borrowers' ability to repay outstanding loans or diminish the value of the collateral securing those loans. Additionally, the allowance for loan losses may be insufficient if the estimates and judgments management used to establish that allowance prove to be inaccurate.
- .. Increased competitive pressure among financial services companies may adversely affect Key's ability to market its products and services.
- .. It could take Key longer than anticipated to implement strategic initiatives, including those designed to grow revenue or manage expenses; Key may be unable to implement certain initiatives; or the initiatives may be unsuccessful.
- .. Acquisitions and dispositions of assets, business units or affiliates could adversely affect Key in ways that management has not anticipated.
- .. Key may experience operational or risk management failures due to technological or other factors.
- .. Changes in accounting principles or in tax laws, rules and regulations could have an adverse effect on Key's financial results or its capital.
- .. Key may become subject to new legal obligations or liabilities, or the unfavorable resolution of pending litigation may have an adverse effect on its financial results or its capital.
- ..

Key may become subject to new or heightened regulatory practices, requirements or expectations which may impede its profitability.

- “ Terrorist activities or military actions could disrupt the economy and the general business climate, which may have an adverse effect on Key’s financial results or condition and that of its borrowers.

Table of Contents**Long-term goals**

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

Economic overview

During the second quarter of 2008, the U.S. consumer faced inflationary pressures and a weakening labor market. Consumer prices in June 2008 rose 5.0% from June 2007, up from a 4.0% annual increase in March 2008. Energy costs increased by 24.7% from the same month one year ago, as the price of oil rose from \$102 per barrel at March 31, 2008, to \$140 per barrel at June 30, 2008. Employment also softened during the second quarter as the economy lost 191,000 jobs, which brought the number of jobs lost since December 2007 to 438,000. The average unemployment rate for the quarter rose to 5.3%, compared to the first quarter average of 4.9% and the 2007 average of 4.6%.

Although consumer confidence dropped to a 28-year low, the consumer did show signs of resiliency, due in part to tax rebate checks that the government began to disburse in early May. Consumer spending during the second quarter rose at an average monthly rate of .6%, compared to an average monthly rate of .3% in the first quarter and .5% in 2007.

The downward trend in real estate values and home sales continued into the second quarter of 2008. June new home sales were down 33% and existing home sales were down 15% from the respective sales levels reported for the same month last year, while the median price of existing homes fell by more than 6%. The number of homes available for sale was further elevated by home foreclosures, which rose by 53% from the number of foreclosures experienced in June 2007. As of June 30, an estimated one out of every 501 homes was in some stage of foreclosure. Decreasing home sales and a rising inventory of homes for sale slowed the pace of new home construction, as housing starts and building permits were down more than 20% from June 2007.

Write-downs caused by distressed real estate values and increasing loan losses further strained already diminished capital levels at financial institutions, forcing many to raise additional capital, often at substantially higher costs than experienced in recent years. For regional banking institutions such as Key, access to the capital markets for unsecured term debt continues to be severely restricted, with investors requiring historically wide spreads over risk-free U.S. Treasury obligations to make new investments.

In response to the continued disruptions in the credit markets, softening labor markets, further housing declines and weak economic growth, during the second quarter of 2008 the Federal Reserve lowered the federal funds target rate to 2.00% from 2.25%. However, increases occurred in most national money market interest rates as the market anticipated that the Federal Reserve may eventually have to increase interest rates to address the increasing risk of inflation. The benchmark two-year Treasury yield increased to 2.62% at June 30, 2008, from 1.59% at March 31, 2008. The ten-year Treasury yield began the quarter at 3.41% and closed the second quarter at 3.97%.

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

Key's Community Banking group serves consumers and small to mid-sized businesses by offering a variety of deposit, investment, lending and wealth management products and services. These products and services are provided through a 14-state branch network organized into four geographic regions as defined by management: Northwest, Rocky Mountains, Great Lakes and Northeast. Figure 1 shows the geographic diversity of the Community Banking group's average core deposits, commercial loans and home equity loans.

Table of Contents**Figure 1. Community Banking Geographic Diversity**

Three months ended June 30, 2008	Geographic Region					Total
	Northwest	Rocky Mountains	Great Lakes	Northeast	Nonregion ^a	
<i>dollars in millions</i>						
Average core deposits	\$ 9,662	\$ 3,523	\$ 14,112	\$ 13,069	\$ 1,615	\$ 41,981
Percent of total	23.0%	8.4%	33.6%	31.1%	3.9%	100.0%
Average commercial loans	\$ 4,264	\$ 2,095	\$ 4,860	\$ 3,175	\$ 1,362	\$ 15,756
Percent of total	27.1%	13.3%	30.8%	20.2%	8.6%	100.0%
Average home equity loans	\$ 2,777	\$ 1,312	\$ 2,917	\$ 2,632	\$ 128	\$ 9,766
Percent of total	28.4%	13.4%	29.9%	27.0%	1.3%	100.0%

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

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

The diversity of Key's commercial real estate lending business based on industry type and location is shown in Figure 19 on page 65. The homebuilder loan portfolio within the National Banking group has been adversely affected by the downturn in the U.S. housing market. As a result of deteriorating market conditions in the residential properties segment of Key's commercial real estate construction portfolio, principally in Florida and southern California, Key has experienced a significant increase in the level of its nonperforming assets since mid-2007. As previously reported, during the second quarter of 2008, Key initiated a process to reduce its exposure in this segment of its loan portfolio through the planned sale of certain loans. Although Key's actions in this regard resulted in additional net charge-offs and a higher provision for loan losses for the second quarter, the sale of these loans, once closed, is expected to reduce the level of Key's total nonperforming assets. Management anticipates that the majority of the loan sales will close in the third quarter. Additional information pertaining to the planned loan sales is included in the Credit risk management section, which begins on page 81.

In recent quarters, results for the National Banking group have also been affected adversely by volatility in the capital markets, leading to declines in the market values at which certain assets (primarily commercial real estate loans and securities held for sale or trading) are recorded. During the first quarter of 2008, management placed hedges on Key's remaining previously unhedged commercial real estate mortgage loans held for sale to protect against further declines in market values that may result from changes in credit spreads and other market-driven factors. These actions, along with improved execution and market conditions, contributed to a more favorable performance from Key's capital markets-driven businesses in the second quarter of 2008.

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

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

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

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

Management relies heavily on the use of judgment, assumptions and estimates to make a number of core decisions, including accounting for the allowance for loan losses; loan securitizations; contingent liabilities, guarantees and income taxes; derivatives and related hedging activities; and assets and liabilities that involve valuation methodologies. A brief discussion of each of these areas appears on pages 17 through 19 of Key's 2007 Annual Report to Shareholders. Information related to the results of Key's goodwill impairment testing conducted as of June 30, 2008, is included in Note 1 (Basis of Presentation) under the heading Goodwill and Other Intangible Assets on page 7. Effective January 1, 2008, Key adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. In the absence of quoted market prices, management determines the fair value of Key's assets and liabilities using internally-developed models which are based on management's judgment, assumptions and estimates regarding credit quality, liquidity, interest rates and other relevant inputs. Key's adoption of this accounting guidance and the process used in determining fair values is more fully described in Note 1 (Basis of Presentation) under the heading Fair Value Measurements on page 8, and Note 15 (Fair Value Measurements), which begins on page 34.

At June 30, 2008, \$12.7 billion, or 12%, of Key's total assets were measured at fair value on a recurring basis. Approximately 96% of these assets were classified as Level 1 or Level 2 within the fair value hierarchy. At June 30, 2008, \$1.0 billion, or 1%, of Key's total liabilities were measured at fair value on a recurring basis. Substantially all of these liabilities were classified as Level 1 or Level 2.

At June 30, 2008, \$787 million, or 1%, of Key's total assets were measured at fair value on a nonrecurring basis. Less than 1% of these assets were classified as Level 1 or Level 2. At June 30, 2008, there were no liabilities measured at fair value on a nonrecurring basis.

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

For the second quarter of 2008, Key recorded a loss of \$1.126 billion from continuing operations, or \$2.70 per common share. These results compare to income from continuing operations of \$337 million, or \$.85 per diluted common share, for the second quarter of 2007, and \$218 million, or \$.54 per diluted common share, for the first quarter of 2008.

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Key's results for both the second and first quarters of 2008 include additional charges associated with certain leveraged lease financing transactions being challenged by the Internal Revenue Service (IRS). Second quarter results include after-tax charges of \$1.011 billion, or \$2.43 per common share, resulting from a previously announced adverse federal court decision on the tax treatment of a Service Contract Lease transaction a decision that the company has appealed. During the first quarter of 2008, Key increased its tax reserves for certain lease in, lease out (LILO) transactions and recalculated its lease income in accordance with prescribed accounting standards, resulting in after-tax charges of \$38 million, or \$.10 per common share.

Excluding the lease financing charges recorded in the first and second quarters, Key had a loss from continuing operations of \$115 million, or \$.28 per common share, for the second quarter of 2008, compared to income from continuing operations of \$337 million, or \$.85 per diluted common share, for the second quarter of 2007, and \$256 million, or \$.64 per diluted common share, for the first quarter of 2008.

For the first six months of 2008, Key reported a loss from continuing operations of \$908 million, or \$2.23 per common share. Adjusting for the lease financing charges, Key had income from continuing operations of \$141 million, or \$.34 per diluted common share, compared to \$695 million, or \$1.74 per diluted common share, for the first half of 2007.

Key reported a net loss of \$1.126 billion, or \$2.70 per common share, for the second quarter of 2008, compared to net income of \$334 million, or \$.84 per diluted common share, for the second quarter of 2007, and \$218 million, or \$.54 per diluted common share, for the first quarter of 2008. For the first half of 2008, Key reported a net loss of \$908 million, or \$2.23 per common share, compared to net income of \$684 million, or \$1.71 per diluted common share, for the same period last year.

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

Figure 2. Results of Operations

<i>dollars in millions, except per share amounts</i>	Three months ended			Six months ended	
	6-30-08	3-31-08	6-30-07	6-30-08	6-30-07
SUMMARY OF OPERATIONS					
(Loss) income from continuing operations	\$ (1,126)	\$ 218	\$ 337	\$ (908)	\$ 695
Loss from discontinued operations, net of taxes ^a			(3)		(11)
Net (loss) income	\$ (1,126)	\$ 218	\$ 334	\$ (908)	\$ 684
Net (loss) income applicable to common shares	\$ (1,126)	\$ 218	\$ 334	\$ (908)	\$ 684
PER COMMON SHARE ASSUMING DILUTION					
(Loss) income from continuing operations	\$ (2.70)	\$.54	\$.85	\$ (2.23)	\$ 1.74
Loss from discontinued operations ^a			(.01)		(.03)
Net (loss) income	\$ (2.70)	\$.54	\$.84	\$ (2.23)	\$ 1.71
PERFORMANCE RATIOS					
From continuing operations:					
Return on average total assets	(4.38)%	.85%	1.45%	(1.77)%	1.51%
Return on average common equity	(53.35)	10.38	17.66	(21.57)	18.35
Return on average total equity	(52.56)	10.38	17.66	(21.40)	18.35
From consolidated operations:					

Return on average total assets	(4.38)%	.85%	1.43%	(1.77)%	1.49%
Return on average common equity	(53.35)	10.38	17.50	(21.57)	18.06
Return on average total equity	(52.56)	10.38	17.50	(21.40)	18.06

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

In addition to the lease financing charges, Key's results for the second quarter of 2008 were adversely affected by a higher provision for loan losses. The increased provision resulted from the company's previously reported efforts to reduce its exposure to the residential properties segment of its commercial real estate construction loan portfolio through the planned sale of assets, and actions taken to bolster the

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allowance for loan losses. Key's provision for loan losses for the second quarter of 2008 was \$647 million, compared to \$53 million for the same period one year ago. The current quarter's provision exceeded net loan charge-offs by \$123 million and increased Key's reserve for loan losses to \$1.421 billion, or 1.87% of period-end loans. Additional information pertaining to the planned sale of assets is presented in the section entitled "Credit risk management," which begins on page 81.

Key took aggressive steps in the second quarter to further strengthen its capital position, due in large part to the impact of the lease accounting charges. Including shares issued in July under an over allotment option, the company raised \$1.74 billion of additional capital through the issuance of preferred stock and common shares. Further, Key's Board of Directors announced its intention to reduce the dividend on Key's common shares by 50% to an annualized dividend of \$.75 per share commencing with the dividend payable in the third quarter of 2008. Management believes these actions will position the company to respond to future business opportunities and are prudent steps in light of the challenging economic environment.

During the second quarter of 2008, Key experienced positive trends in several of its fee-based businesses, most notably trust and investment services, and the investment banking, syndications and capital markets businesses. Expenses continued to be well-controlled and the company benefited from the actions taken in the first quarter to reduce exposure to future market volatility. Key also continued to gain traction in its Community Banking model. While working through this difficult credit cycle, management intends to continue to focus on Key's relationship business model, carefully manage expenses and upgrade delivery platforms to maintain Key's readiness to respond to business opportunities as they emerge.

As shown in Figure 3, the comparability of Key's earnings for the current, prior and year-ago quarters is affected by several significant items.

Figure 3. Significant Items Affecting the Comparability of Earnings

	Three months ended June 30, 2008			Three months ended March 31, 2008			Three months ended June 30, 2007		
	Pre-tax Amount	After-tax Amount	Impact on EPS	Pre-tax Amount	After-tax Amount	Impact on EPS	Pre-tax Amount	After-tax Amount	Impact on EPS
<i>in millions, except per share amounts</i>									
Charge related to leveraged lease tax litigation	\$ (359)	\$ (1,011)	\$ (2.43)	\$ (3)	\$ (38)	\$ (.10)			
Gain from redemption of Visa Inc. shares				165	103	.26			
Realized and unrealized gains (losses) on loan and securities portfolios held for sale or trading	62	39	.09	(128)	(80)	(.20)	\$ 51	\$ 32	\$.08
Litigation reserve							(42)	(26)	(.07)
Gains related to MasterCard Incorporated shares							40	25	.06

EPS = Earnings per diluted common share

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

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Key's financial performance for each of the past five quarters is summarized in Figure 4.

Figure 4. Selected Financial Data

Amounts in millions, except per share amounts	2008		2007		Six months ended June 30, 2008		Six months ended June 30, 2007
	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	2008	
INCOME STATEMENT							
Net income	\$ 880	\$ 1,354	\$ 1,447	\$ 1,434	\$ 1,395	\$ 2,234	\$ 2,234
Net expense	522	641	737	740	709	1,163	1,163
Interest income	358 ^a	713 ^a	710	694	686	1,071 ^a	1,071 ^a
Provision for loan losses	647	187	363	69	53	834	834
Interest income	555	528	488	438	649	1,083	1,083
Interest expense	781	732	896	753	815	1,513	1,513
Income from continuing operations							
Income taxes	(515)	322	(61)	310	467	(193)	(193)
Income from continuing operations	(1,126)	218	22	224	337	(908)	(908)
Income (loss) from discontinued operations, net of income taxes			3	(14)	(3)		
Income (loss) from discontinued operations, net of income taxes	(1,126) ^a	218 ^a	25	210	334	(908) ^a	(908) ^a
Income (loss) from discontinued operations, net of income taxes applicable to common shareholders	(1,126)	218	25	210	334	(908)	(908)
PER SHARE DATA							
Income from continuing operations	\$ (2.70)	\$.55	\$.06	\$.58	\$.86	\$ (2.23)	\$ (2.23)
Income from discontinued operations			.01	(.03)	(.01)		
Income (loss) from discontinued operations	(2.70)	.55	.06	.54	.85	(2.23)	(2.23)
Income from continuing operations							
Income (loss) from discontinued operations	(2.70)	.54	.06	.57	.85	(2.23)	(2.23)
Income (loss) from discontinued operations			.01	(.03)	(.01)		
Income (loss) from discontinued operations assuming dilution	(2.70) ^a	.54 ^a	.06	.54	.84	(2.23) ^a	(2.23) ^a
Dividends paid	.375	.375	.365	.365	.365	.75	.75
Book value at period end	16.59	21.48	19.92	20.12	19.78	16.59	16.59
Book value at period end	13.00	17.07	16.39	16.76	16.41	13.00	13.00
Market price:							
Market price	26.12	27.23	34.05	37.09	38.96	27.23	27.23
Market price	10.00	19.00	21.04	31.38	34.15	10.00	10.00
Market price	10.98	21.95	23.45	32.33	34.33	10.98	10.98
Weighted-average common shares							
Weighted-average common shares ending (000)	416,629	399,121	388,940	389,319	392,045	407,875	394,000
Weighted-average common shares and potential common shares outstanding (000)	416,629	399,769	389,911	393,164	396,918	407,875	400,000
ASSETS AND LIABILITIES							
Assets	\$ 75,855	\$ 76,444	\$ 70,823	\$ 68,999	\$ 66,692	\$ 75,855	\$ 66,692
Liabilities	89,893	89,719	86,557	84,838	82,161	89,893	82,161

Assets	101,544	101,492	98,228	96,137	92,967	101,544	92,967
Liabilities	64,396	64,702	63,099	63,714	60,599	64,396	60,599
Long-term debt	15,106	14,337	11,957	11,549	12,581	15,106	12,581
Equity of non-shareholders	8,056	8,592	7,746	7,820	7,701	8,056	7,701
Equity of shareholders	8,706	8,592	7,746	7,820	7,701	8,706	7,701

PERFORMANCE RATIOS**continuing operations:**

Return on average total assets	(4.38)%	.85%	.09%	.93%	1.45%	(1.77)%	1.45%
Return on average common equity	(53.35)	10.38	1.11	11.50	17.66	(21.57)	18.15
Return on average total equity	(52.56)	10.38	1.11	11.50	17.66	(21.40)	18.15
Interest margin (taxable equivalent)	(.44)	3.14	3.48	3.40	3.46	1.35	3.46

consolidated operations:

Return on average total assets	(4.38) %^a	.85 %^a	.10%	.88%	1.43%	(1.77) %^a	1.43%
Return on average common equity	(53.35)^a	10.38^a	1.26	10.79	17.50	(21.57)^a	18.15
Return on average total equity	(52.56)^a	10.38^a	1.26	10.79	17.50	(21.40)^a	18.15
Interest margin (taxable equivalent)	(.44)^a	3.14^a	3.48	3.40	3.46	1.35^a	3.46

TOTAL RATIOS AT PERIOD END

Debt to assets	8.57%	8.47%	7.89%	8.13%	8.28%	8.57%	8.28%
Debt to tangible assets	6.98	6.85	6.58	6.87	6.97	6.98	6.97
Debt to risk-based capital	8.53	8.33	7.44	7.94	8.14	8.53	8.14
Debt to risk-based capital	12.41	12.34	11.38	11.76	12.15	12.41	12.15
Debt to equity	9.34	9.15	8.39	8.96	9.11	9.34	9.11

NET AND BROKERAGE ASSETS

Assets under management	\$ 80,998	\$ 80,453	\$ 85,442	\$ 88,100	\$ 85,592	\$ 80,998	\$ 85,592
Managed and brokerage assets	29,905	30,532	33,918	33,273	33,485	29,905	33,485

OTHER DATA

Large full-time equivalent employees	18,164	18,426	18,500	18,567	18,888	18,295	19,000
Full-time employees	985	985	955	954	954	985	954

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

- (a) See Figure 5 for computations of certain earnings data and performance ratios, excluding charges related to the tax treatment of certain leveraged lease financing transactions disallowed by

the IRS. Figure 5
reconciles
certain GAAP
performance
measures to the
corresponding
non-GAAP
measures and
provides a basis
for
period-to-period
comparisons.

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As a result of an adverse federal court decision on Key's tax treatment of a Service Contract Lease transaction entered into by AWG Leasing Trust, in which Key is a partner, Key recorded after-tax charges of \$1.011 billion, or \$2.43 per common share, during the second quarter of 2008. Additionally, during the first quarter of 2008, Key increased its tax reserves for certain LILLO transactions and recalculated its lease income in accordance with prescribed accounting standards, resulting in after-tax charges of \$38 million, or \$.10 per common share. Figure 5 below presents computations of certain earnings data and performance ratios, excluding these charges (non-GAAP), reconciles the GAAP performance measures to the corresponding non-GAAP measures and provides a basis for period-to-period comparisons. Non-GAAP financial measures have inherent limitations, are not required to be uniformly applied and are not audited. Non-GAAP financial measures should not be considered in isolation, or as a substitute for analyses of results as reported under GAAP.

Figure 5. GAAP to Non-GAAP Reconciliations

<i>dollars in millions, except per share amounts</i>		Three months ended		Six
		6-30-08	3-31-08	months ended 6-30-08
NET INCOME				
Net (loss) income (GAAP)	A	\$ (1,126)	\$ 218	\$ (908)
Charges related to leveraged lease tax litigation, after tax		1,011	38	1,049
Net (loss) income, excluding charges related to leveraged lease tax litigation (non-GAAP)	B	\$ (115)	\$ 256	\$ 141
Weighted-average common shares and potential common shares outstanding (000)	C	416,629	399,769	407,875
PER COMMON SHARE				
Net (loss) income assuming dilution (GAAP)	A/C	\$ (2.70)	\$.54	\$ (2.23)
Net (loss) income, excluding charges related to leveraged lease tax litigation assuming dilution (non-GAAP)	B/C	(.28)	.64	.34
PERFORMANCE RATIOS				
Return on average total assets: ^a				
Average total assets	D	\$ 103,290	\$ 103,356	\$ 103,323
Return on average total assets (GAAP)	A/D	(4.38)%	.85%	(1.77)%
Return on average total assets, excluding charges related to leveraged lease tax litigation (non-GAAP)	B/D	(.45)	1.00	.27
Return on average common equity: ^a				
Average common equity	E	\$ 8,489	\$ 8,445	\$ 8,467
Return on average common equity (GAAP)	A/E	(53.35)%	10.38%	(21.57)%
Return on average common equity, excluding charges related to leveraged lease tax litigation (non-GAAP)	B/E	(5.45)	12.19	3.35

Return on average total equity: ^a

Average total equity	F	\$ 8,617	\$ 8,445	\$ 8,531
Return on average total equity (GAAP)	A/F	(52.56)%	10.38%	(21.40)%
Return on average total equity, excluding charges related to leveraged lease tax litigation (non-GAAP)	B/F	(5.37)	12.19	3.32

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

Net interest income (GAAP)		\$ 358	\$ 713	\$ 1,071
Charges related to leveraged lease tax litigation, pre-tax		359	3	362

Net interest income, excluding charges related to leveraged lease tax litigation (non-GAAP)		\$ 717	\$ 716	\$ 1,433
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Net interest income/margin (TE):

Net interest (loss) income (TE) (as reported)		\$ (100)	\$ 704	\$ 604
Charges related to leveraged lease tax litigation, pre-tax (TE)		838	34	872

Net interest income, excluding charges related to leveraged lease tax litigation (TE) (adjusted basis)		\$ 738	\$ 738	\$ 1,476
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Net interest margin (TE) (as reported) ^a		(.44)%	3.14%	1.35%
Impact of charges related to leveraged lease tax litigation, pre-tax (TE) ^a		3.76	.15	1.95

Net interest margin, excluding charges related to leveraged lease tax litigation (TE) (adjusted basis) ^a		3.32%	3.29%	3.30%
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(a) Income statement amount has been annualized in calculation of percentage.

TE = Taxable Equivalent

GAAP = U.S. generally accepted accounting principles

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Financial outlook

Although difficult to project in this turbulent economy, considering current and anticipated conditions in the financial markets, the impact of the lease accounting adjustment and the continuation of competitive pricing for deposits, management expects that in the second half of 2008 Key will experience:

- .. a taxable-equivalent net interest margin in the range of 3.15% to 3.20%;
- .. stable to reduced loan balances;
- .. a low single digit percentage increase in core deposits;
- .. net loan charge-offs in the range of 1.20% to 1.60% of average loans;
- .. a low single digit percentage increase in expenses; and
- .. an effective tax rate of approximately 34% to 36% on a taxable-equivalent basis. This estimate includes an interest accrual of approximately \$32 million to \$34 million per quarter related to disputed taxes on the leveraged lease financing portfolio.

Strategic developments

Management initiated a number of specific actions during 2008 and 2007 to support Key's corporate strategy.

- .. On January 1, 2008, Key acquired U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York. The acquisition doubles Key's branch penetration in the attractive Lower Hudson Valley area. Assets and deposits acquired in this transaction were assigned to both the Community Banking and National Banking groups.
- .. On December 20, 2007, Key announced its decision to exit dealer-originated home improvement lending activities, which involve prime loans but are largely out-of-footprint. Key also announced that it will cease offering Payroll Online services, which are not of sufficient size to provide economies of scale to compete profitably. Additionally, Key has moved to cease conducting business with nonrelationship homebuilders outside of its 14-state Community Banking footprint.
- .. On October 1, 2007, Key acquired Tuition Management Systems, Inc., one of the nation's largest providers of outsourced tuition planning, billing, counseling and payment services. Headquartered in Warwick, Rhode Island, Tuition Management Systems serves more than 700 colleges, universities, elementary and secondary educational institutions. The combination of the payment plan systems and technology in place at Tuition Management Systems and the array of payment plan products offered by Key's Consumer Finance line of business created one of the largest payment plan providers in the nation.
- .. On February 9, 2007, McDonald Investments Inc., a wholly owned subsidiary of KeyCorp, sold its branch network, which included approximately 570 financial advisors and field support staff, and certain fixed assets. Key retained the corporate and institutional businesses, including Institutional Equities and Equity Research, Debt Capital Markets and Investment Banking. In addition, KeyBank continues to operate the Wealth Management, Trust and Private Banking businesses. On April 16, 2007, Key renamed the registered broker/dealer through which its corporate and institutional investment banking and securities businesses operate to KeyBanc Capital Markets Inc.

Table of Contents**Line of Business Results**

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

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

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

<i>dollars in millions</i>	Three months ended June 30,				Six months ended June 30,			
	2008	2007	Change Amount	Change Percent	2008	2007	Change Amount	Change Percent
REVENUE FROM CONTINUING OPERATIONS (TE)								
Community Banking ^a	\$ 659	\$ 631	\$ 28	4.4%	\$ 1,288	\$ 1,438	\$ (150)	(10.4)%
National Banking ^b	(126)	612	(738)	N/M	314	1,207	(893)	(74.0)
Other Segments ^c	(31)	101	(132)	N/M	(5)	82	(87)	N/M
Total Segments	502	1,344	(842)	(62.6)	1,597	2,727	(1,130)	(41.4)
Reconciling Items ^d	(47)	11	(58)	N/M	90	(18)	108	N/M
Total	\$ 455	\$ 1,355	\$ (900)	(66.4)%	\$ 1,687	\$ 2,709	\$ (1,022)	(37.7)%
(LOSS) INCOME FROM CONTINUING OPERATIONS								
Community Banking ^a	\$ 104	\$ 102	\$ 2	2.0%	\$ 219	\$ 307	\$ (88)	(28.7)%
National Banking ^b	(670)	157	(827)	N/M	(694)	312	(1,006)	N/M
Other Segments ^c	(13)	55	(68)	N/M	8	47	(39)	(83.0)
Total Segments	(579)	314	(893)	N/M	(467)	666	(1,133)	N/M
Reconciling Items ^d	(547)	23	(570)	N/M	(441)	29	(470)	N/M
Total	\$ (1,126)	\$ 337	\$ (1,463)	N/M	\$ (908)	\$ 695	\$ (1,603)	N/M

(a) Community Banking's results

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

- (b) During the second quarter of 2008, National Banking's taxable-equivalent net interest income and net income were reduced by \$838 million and \$536 million, respectively, as a result of an adverse federal court decision on the tax treatment of a Service Contract Lease transaction. During the prior quarter, National Banking increased its tax reserves for certain LIFO transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced National Banking's taxable-equivalent revenue by \$34 million and its

net income by \$21 million in the first quarter. National Bankings results for the first quarter of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation.

- (c) Other Segments results for the second quarter of 2007 include a \$26 million (\$16 million after tax) charge for litigation. This charge and the litigation charge referred to in note (d) below comprise the \$42 million charge recorded in connection with the Honsador litigation. Other Segments results for the first quarter of 2007 include a \$49 million (\$31 million after tax) loss from the repositioning of the securities portfolio.
- (d) Reconciling Items for the second quarter of 2008 include a \$475 million charge to income taxes for the interest cost associated with the leveraged lease tax litigation.

Reconciling Items for the prior quarter include a \$165 million (\$103 million after tax) gain from the partial redemption of Key's equity interest in Visa Inc. and a \$17 million charge to income taxes for the interest cost associated with the increase to Key's tax reserves for certain LIFO transactions.

Reconciling Items for the second quarter of 2007 include a \$40 million (\$25 million after tax) gain related to MasterCard Incorporated shares, and a \$16 million (\$10 million after tax) charge for litigation.

TE = Taxable Equivalent

N/M = Not Meaningful

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

As shown in Figure 7, Community Banking recorded net income of \$104 million for the second quarter of 2008, compared to \$102 million for the year-ago quarter. Increases in both net interest income and noninterest income accounted for the improvement, but were substantially offset by a higher provision for loan losses.

Taxable-equivalent net interest income rose by \$20 million, or 5%, from the second quarter of 2007. The increase was attributable to a \$1.9 billion, or 7%, rise in average earning assets, due largely to growth in the commercial loan portfolio, and a \$3.8 billion, or 8%, increase in average deposits. Both loans and deposits experienced organic growth and benefited from the January 1 acquisition of U.S.B. Holding Co., Inc. described below. The positive effect of this growth was offset in part by the impact of tighter loan and deposit spreads.

Noninterest income increased by \$8 million, or 4%, from the same period one year ago, reflecting strong growth in bank channel investment product sales income and deposit service charge income.

The provision for loan losses rose by \$23 million, or 110%, compared to the second quarter of 2007, reflecting a \$12 million increase in net loan charge-offs and the remainder a provision for general weakness in the economy.

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

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

Figure 7. Community Banking

<i>dollars in millions</i>	Three months ended		Change		Six months ended		Change	
	June 30, 2008	2007	Amount	Percent	June 30, 2008	2007	Amount	Percent
SUMMARY OF OPERATIONS								
Net interest income (TE)	\$ 437	\$ 417	\$ 20	4.8%	\$ 860	\$ 836	\$ 24	2.9%
Noninterest income	222	214	8	3.7	428	602 ^a	(174)	(28.9)
Total revenue (TE)	659	631	28	4.4	1,288	1,438	(150)	(10.4)
Provision for loan losses	44	21	23	109.5	62	35	27	77.1
Noninterest expense	449	446	3	.7	876	912	(36)	(3.9)
Income before income taxes (TE)	166	164	2	1.2	350	491	(141)	(28.7)
Allocated income taxes and TE adjustments	62	62			131	184	(53)	(28.8)
Net income	\$ 104	\$ 102	\$ 2	2.0%	\$ 219	\$ 307	\$ (88)	(28.7)%
Percent of consolidated income from continuing operations	N/M	30%	N/A	N/A	N/M	44%	N/A	N/A

AVERAGE BALANCES

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Loans and leases	\$ 28,478	\$ 26,574	\$ 1,904	7.2%	\$ 28,303	\$ 26,514	\$ 1,789	6.7%
Total assets	31,385	29,346	2,039	6.9	31,227	29,317	1,910	6.5
Deposits	49,948	46,126	3,822	8.3	49,857	46,322	3,535	7.6
Assets under management at period end	\$ 19,366	\$ 21,061	\$ (1,695)	(8.0)%	\$ 19,366	\$ 21,061	\$ (1,695)	(8.0)%

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

TE = Taxable Equivalent

N/M = Not Meaningful

N/A = Not Applicable

Table of Contents**ADDITIONAL COMMUNITY BANKING DATA**

<i>dollars in millions</i>	Three months ended				Six months ended			
	June 30,		Change		June 30,		Change	
	2008	2007	Amount	Percent	2008	2007	Amount	Percent
AVERAGE DEPOSITS OUTSTANDING								
NOW and money market deposit accounts	\$ 19,656	\$ 18,970	\$ 686	3.6%	\$ 19,761	\$ 19,292	\$ 469	2.4%
Savings deposits	1,804	1,619	185	11.4	1,779	1,619	160	9.9
Certificates of deposits (\$100,000 or more)	6,661	4,709	1,952	41.5	6,548	4,630	1,918	41.4
Other time deposits	12,735	12,038	697	5.8	12,756	12,044	712	5.9
Deposits in foreign office	1,306	1,046	260	24.9	1,281	1,002	279	27.8
Noninterest-bearing deposits	7,786	7,744	42	.5	7,732	7,735	(3)	
Total deposits	\$ 49,948	\$ 46,126	\$ 3,822	8.3%	\$ 49,857	\$ 46,322	\$ 3,535	7.6%
HOME EQUITY LOANS								
Average balance	\$ 9,766	\$ 9,660						
Weighted-average loan-to-value ratio	70%	70%						
Percent first lien positions	55	58						
OTHER DATA								
On-line households/household penetration	759,003 / 45%	723,955 / 44%						
Branches	985	954						
Automated teller machines	1,479	1,450						

National Banking summary of continuing operations

As shown in Figure 8, National Banking recorded a loss of \$670 million from continuing operations for the second quarter of 2008, compared to income of \$157 million from continuing operations for the same period last year. During the second quarter of 2008, National Banking's net interest income was adversely affected by a federal court ruling on the tax treatment of a segment of Key's leveraged lease financing portfolio as further described below. Also contributing to the less favorable results compared to the year-ago quarter were a substantially higher provision for loan losses and an increase in noninterest expense, offset in part by significant growth in noninterest income. National Banking's taxable-equivalent net interest income for the second quarter of 2008 was reduced significantly as a result of an adverse federal court ruling on the company's tax treatment of a Service Contract Lease transaction entered into by AWG Leasing Trust, in which Key is a partner. As a result of this ruling, under Financial Accounting Standards Board (FASB) Staff Position No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction, National Banking recalculated its lease income from inception for this particular transaction, as well as any other lease financing transactions being contested by the IRS. Excluding the additional charges associated with these actions, taxable-equivalent net interest income grew by \$27 million, or 8%, from the second quarter of 2007 as a result of increases in average earning assets and deposits, offset in part by tighter loan and deposit spreads and a higher level of nonperforming assets. Average

loans and leases grew by \$8.6 billion, or 22%, while average deposits rose by \$207 million, or 2%, from the year-ago quarter.

Noninterest income increased by \$73 million, or 27%, reflecting higher income from several fee-based businesses. Income from investment banking and capital markets activities rose by \$35 million, while trust and investment services income was up \$23 million. Increases in income from tuition payment plan processing, as well as syndication and other loan-related fees also contributed to the improvement.

The provision for loan losses rose by \$577 million, due primarily to a higher level of net loan charge-offs recorded in the commercial real estate portfolio. National Banking's provision for loan losses for the second quarter of 2008 exceeded its net loan charge-offs by \$123 million, as the company continued to build reserves.

Table of Contents**Figure 8. National Banking**

<i>dollars in millions</i>	Three months ended		Change		Six months ended		Change	
	June 30, 2008	2007	Amount	Percent	June 30, 2008	2007	Amount	Percent
SUMMARY OF OPERATIONS								
Net interest (loss) income (TE)	\$ (472) ^a	\$ 339	\$ (811)	N/M	\$ (133) ^a	\$ 675	\$ (808)	N/M
Noninterest income	346	273	73	26.7%	447	532 ^a	(85)	(16.0)%
Total revenue (TE)	(126)	612	(738)	N/M	314	1,207	(893)	(74.0)
Provision for loan losses	609	32	577	N/M	778	62	716	N/M
Noninterest expense	337	330	7	2.1	646	646		
(Loss) income from continuing operations before income taxes (TE)	(1,072)	250	(1,322)	N/M	(1,110)	499	(1,609)	N/M
Allocated income taxes and TE adjustments	(402)	93	(495)	N/M	(416)	187	(603)	N/M
(Loss) income from continuing operations	(670)	157	(827)	N/M	(694)	312	(1,006)	N/M
Loss from discontinued operations, net of taxes		(3)	3	100.0%		(11)	11	100.0%
Net (loss) income	\$ (670)	\$ 154	\$ (824)	N/M	\$ (694)	\$ 301	\$ (995)	N/M
Percent of consolidated income from continuing operations	N/M	47%	N/A	N/A	N/M	45%	N/A	N/A
AVERAGE BALANCES FROM CONTINUING OPERATIONS								
Loans and leases	\$ 47,876	\$ 39,325	\$ 8,551	21.7%	\$ 46,013	\$ 39,085	\$ 6,928	17.7%
Loans held for sale	1,282	4,377	(3,095)	(70.7)	3,107	4,148	(1,041)	(25.1)
Total assets	56,242	49,585	6,657	13.4	56,230	49,003	7,227	14.7
Deposits	12,289	12,082	207	1.7	12,088	11,691	397	3.4
Assets under management at period end	\$ 61,632	\$ 64,531	\$ (2,899)	(4.5)%	\$ 61,632	\$ 64,531	\$ (2,899)	(4.5)%

(a) During the second quarter of 2008, National Banking's taxable-equivalent net interest income

and net income were reduced by \$838 million and \$536 million, respectively, as a result of an adverse federal court decision on the tax treatment of a Service Contract Lease transaction. During the prior quarter, National Banking increased its tax reserves for certain LIFO transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced National Banking's taxable-equivalent revenue by \$34 million and its net income by \$21 million in the first quarter. National Banking's results for the first quarter of 2007 include a \$26 million (\$17 million after tax) gain from the settlement of the residual value insurance litigation.

TE = Taxable Equivalent

N/M = Not Meaningful

N/A = Not Applicable

Other Segments

Other segments consist of Corporate Treasury and Key's Principal Investing unit. These segments generated a net loss of \$13 million for the second quarter of 2008, compared to net income of \$55 million for the same period last year. These results reflect net losses of \$14 million from principal investing in the second quarter of 2008, compared to net

gains of \$90 million for the year-ago quarter.

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Results of Operations

Net interest income

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

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

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

Figure 10, which spans pages 57 and 58, shows the various components of Key's balance sheet that affect interest income and expense, and their respective yields or rates over the past five quarters. The net interest margin, which is an indicator of the profitability of the earning assets portfolio, is calculated by dividing net interest income by average earning assets. This figure also presents a reconciliation of taxable-equivalent net interest income for each of the past five quarters to net interest income reported in accordance with GAAP.

Key's taxable-equivalent net interest income for the second quarter of 2008 was reduced significantly as a result of an adverse federal court decision on the company's tax treatment of a Service Contract Lease transaction entered into by AWG Leasing Trust, in which Key is a partner. The Court decision, which Key has appealed, applies only to the single AWG Leasing transaction. Notwithstanding the appeal, management believes that the applicable accounting guidance requires Key to recalculate lease income recognized on all leveraged leases being contested by the IRS, not just the single leveraged lease subject to the Court decision. Under FASB Staff Position No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction, Key has recalculated the lease income recognized from inception for all of the contested leases. Key's second quarter results also reflect a \$475 million charge to income taxes for the interest cost associated with the contested tax liabilities. These actions reduced Key's taxable-equivalent net interest income and net interest margin for the second quarter of 2008 by \$838 million and 376 basis points, respectively, and reduced Key's earnings by \$1.011 billion, or \$2.43 per common share. A basis point is equal to one one-hundredth of a percentage point, meaning 376 basis points equal 3.76%.

As previously reported, Service Contract Leases, LILO transactions discussed on the following page and Qualified Technological Equipment Leases represent a portion of Key's overall leveraged lease financing portfolio, and the tax deductions for some of these transactions are being challenged by the IRS. Additional information related to these lease financing transactions and the status of Key's response to the IRS disallowance and federal tax court decision is included in Note 12 (Income Taxes), which begins on page 27.

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The impact of the leveraged lease accounting charges on the components of Key's interest income and related yields for the second quarter of 2008 are shown in Figure 9.

**Figure 9. Second Quarter 2008 Adjusted Interest and Yields
From Continuing Operations**

<i>dollars in millions</i>	As Reported			Adjusted Basis		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
Total commercial loans	\$ 54,932	\$ (83)	(.58)%	\$ 54,932	\$ 755	5.52%
Total earning assets	89,742	422	1.89	89,742	1,260	5.63
Total interest-bearing liabilities	77,172	522	2.75	77,172	522	2.75
Interest rate spread (TE)			(.86)%			2.88%
Net interest (loss) income (TE) and net interest margin (TE)		(100)	(.44)%		738	3.32%
TE adjustment		(458)			21	
Net interest income		\$ 358			\$ 717	

TE = Taxable Equivalent

Excluding the charges associated with the leveraged lease tax litigation, Key's taxable-equivalent net interest income was \$738 million for the second quarter of 2008, compared to \$706 million for the year-ago quarter. Average earning assets rose by \$8.2 billion, or 10%, due primarily to growth in commercial loans and the January 1 acquisition of U.S.B. Holding Co., Inc., which added approximately \$1.5 billion to Key's loan portfolio. The growth in commercial loans was due in part to the higher demand for credit caused by the volatile capital markets environment. The adjusted net interest margin for the current quarter declined to 3.32% from 3.46% for the second quarter of 2007. The reduction was attributable largely to tighter loan and deposit spreads caused by competitive pricing, and a higher level of nonperforming assets.

Compared to the first quarter of 2008, Key's taxable-equivalent net interest income and net interest margin were essentially unchanged, after excluding the effects of charges recorded in connection with leveraged lease transactions in both periods. During the first quarter of 2008, Key increased its tax reserves for certain LILO transactions and recalculated its income under FASB Staff Position No. 13-2. These actions reduced Key's taxable-equivalent net interest income and net interest margin for the first quarter of 2008 by \$34 million and 15 basis points, respectively, and reduced Key's earnings by \$38 million, or \$.10 per diluted common share. On an adjusted basis, Key had taxable-equivalent net interest income of \$738 million and a net interest margin of 3.29% for the first quarter of 2008. Over the remainder of the year, management expects Key's net interest margin to be in the range of 3.15% to 3.20%. Management believes the effects of the lease financing accounting adjustment recorded in the second quarter and the continuation of competitive pressure on deposit pricing will offset the impact of more favorable yields on new assets.

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

- “ During the first quarter of 2008, Key increased its loan portfolio (primarily commercial real estate and consumer loans) through the acquisition of U.S.B. Holding Co., Inc., the holding company for Union State Bank, a 31-branch state-chartered commercial bank headquartered in Orangeburg, New York.
- “ Key sold commercial real estate loans of \$965 million during the first six months of 2008 and \$3.8 billion (\$238 million through a securitization) during all of 2007. Since some of these loans have been sold with limited recourse (i.e., there is a risk that Key will be held accountable for certain events or representations made in the sales agreements), Key established and has maintained a loss reserve in an amount estimated by management to be appropriate. More information about the related recourse agreement is provided in Note 13 (Contingent Liabilities and Guarantees) under the heading Recourse agreement with Federal National Mortgage Association on page 30.
- “ Key sold education loans of \$110 million during the first half of 2008 and \$247 million during all of 2007. In March 2008, Key transferred \$3.3 billion of education loans from held-for-sale status to the held-to-maturity loan portfolio. The secondary markets for these loans have been adversely affected by market liquidity issues, prompting the company's decision to move them to a held-to-maturity classification.
- “ Key sold other loans (primarily residential mortgage loans) totaling \$483 million during the six months of 2008 and \$1.2 billion during all of 2007.

Table of Contents**Figure 10. Average Balance Sheets, Net Interest Income and Yields/Rates
From Continuing Operations**

<i>dollars in millions</i>	Second Quarter 2008			First Quarter 2008		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
ASSETS						
Loans: ^{a,b}						
Commercial, financial and agricultural	\$ 26,057	\$ 352	5.42%	\$ 25,411	\$ 392	6.21%
Real estate commercial mortgage	10,593	156	5.91	10,283	175	6.84
Real estate construction	8,484	118	5.61	8,468	134	6.36
Commercial lease financing	9,798	(709)	(28.94) ^c	10,004	98	3.91 ^c
Total commercial loans	54,932	(83)	(.58)	54,166	799	5.93
Real estate residential	1,918	30	6.12	1,916	30	6.29
Home equity:						
Community Banking	9,765	140	5.78	9,693	154	6.38
National Banking	1,200	23	7.68	1,260	24	7.74
Total home equity loans	10,965	163	5.99	10,953	178	6.54
Consumer other Community Banking	1,271	33	10.34	1,305	34	10.59
Consumer other National Banking:						
Marine	3,646	56	6.26	3,646	58	6.31
Education	3,595	53	5.88	363	7	8.04
Other	325	7	8.21	339	7	8.32
Total consumer other National Banking	7,566	116	6.16	4,348	72	6.61
Total consumer loans	21,720	342	6.32	18,522	314	6.81
Total loans	76,652	259	1.37	72,688	1,113	6.15
Loans held for sale	1,356	20	5.94	4,984	87	7.01
Securities available for sale ^{a,d}	8,315	111	5.40	8,419	110	5.28
Held-to-maturity securities ^a	25		11.47	29	1	11.02
Trading account assets	1,041	10	3.88	1,075	13	4.84
Short-term investments	773	8	3.83	1,165	9	3.18
Other investments ^d	1,580	14	3.09	1,552	12	3.05
Total earning assets	89,742	422	1.89	89,912	1,345	6.01
Allowance for loan losses	(1,338)			(1,236)		
Accrued income and other assets	14,886			14,680		
Total assets	\$ 103,290			\$ 103,356		
LIABILITIES AND SHAREHOLDERS EQUITY						

NOW and money market deposit accounts	\$ 27,158	102	1.51	\$ 26,996	139	2.07
Savings deposits	1,815	1	.27	1,865	3	.62
Certificates of deposit (\$100,000 or more) ^e	8,670	88	4.09	8,072	95	4.72
Other time deposits	12,751	135	4.27	12,759	146	4.59
Deposits in foreign office	4,121	21	1.95	5,853	45	3.13
Total interest-bearing deposits	54,515	347	2.56	55,545	428	3.10
Federal funds purchased and securities sold under repurchase agreements	3,267	15	1.86	3,863	28	2.91
Bank notes and other short-term borrowings	4,770	27	2.26	4,934	39	3.22
Long-term debt ^{e, f}	14,620	133	3.87	13,238	146	4.71
Total interest-bearing liabilities	77,172	522	2.75	77,580	641	3.36
Noninterest-bearing deposits	10,617			10,741		
Accrued expense and other liabilities	6,884			6,590		
Preferred stock	128					
Common shareholders' equity	8,489			8,445		
Total shareholders' equity	8,617			8,445		
Total liabilities and shareholders' equity	\$ 103,290			\$ 103,356		
Interest rate spread (TE)			(.86)%			2.65%
Net interest (loss) income (TE) and net interest margin (TE)		(100) ^c	(.44)% ^c		704 ^c	3.14% ^c
TE adjustment ^a		(458)			(9)	
Net interest income, GAAP basis		\$ 358			\$ 713	

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

- (a) Interest income on tax-exempt securities and loans has been adjusted to a taxable-equivalent basis using the statutory federal income tax rate of 35%.
- (b) For purposes of these computations, nonaccrual loans are included in average loan balances.
- (c) During the second quarter of 2008, Key's taxable-equivalent net interest income and net income were reduced by \$838 million and \$1.011 billion, respectively, as a result of an adverse federal court decision on Key's tax treatment of a Service Contract Lease transaction. Excluding this reduction, the taxable-equivalent yield on Key's commercial lease financing portfolio would have been 5.25% for the second quarter of 2008, and Key's taxable-equivalent net interest margin would have been 3.32%. During the prior quarter, Key increased its tax

reserves for certain LILO transactions and recalculated its lease income in accordance with prescribed accounting standards. These actions reduced Key's first quarter 2008 taxable-equivalent net interest income and net income by \$34 million and \$38 million, respectively. Excluding this reduction, the taxable-equivalent yield on Key's commercial lease financing portfolio would have been 5.27% for the first quarter of 2008, and Key's taxable-equivalent net interest margin would have been 3.29%.

Table of Contents**Figure 10. Average Balance Sheets, Net Interest Income and Yields/Rates
From Continuing Operations (Continued)**

Fourth Quarter 2007			Third Quarter 2007			Second Quarter 2007		
Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
\$ 23,825	\$ 419	6.98%	\$ 22,393	\$ 410	7.25%	\$ 21,856	\$ 401	7.36%
9,351	175	7.42	8,855	172	7.69	8,565	165	7.75
8,192	153	7.42	8,285	167	8.01	8,243	167	8.09
10,252	171	6.65	10,172	147	5.80	10,096	142	5.62
51,620	918	7.06	49,705	896	7.16	48,760	875	7.19
1,596	27	6.72	1,586	26	6.68	1,472	24	6.57
9,658	168	6.92	9,690	175	7.14	9,660	172	7.15
1,259	24	7.77	1,193	24	7.85	1,092	21	7.86
10,917	192	7.02	10,883	199	7.22	10,752	193	7.22
1,308	35	10.73	1,342	36	10.66	1,370	37	10.64
3,608	58	6.34	3,506	55	6.32	3,323	52	6.26
329	8	9.47	332	8	9.65	329	8	9.56
339	7	8.66	326	7	8.92	309	7	9.18
4,276	73	6.76	4,164	70	6.79	3,961	67	6.76
18,097	327	7.20	17,975	331	7.33	17,555	321	7.33
69,717	1,245	7.10	67,680	1,227	7.20	66,315	1,196	7.23
4,748	89	7.53	4,731	91	7.59	4,415	82	7.50
7,858	115	5.89	7,825	106	5.45	7,793	106	5.45
30	1	6.24	36		6.43	39		6.72
1,042	12	4.40	1,055	11	4.39	813	7	3.58
1,226	13	3.94	633	5	3.32	671	9	4.93
1,589	12	3.02	1,563	12	2.99	1,541	15	3.68
86,210	1,487	6.86	83,523	1,452	6.92	81,587	1,415	6.95
(966)			(942)			(942)		
13,547			12,581			12,767		
\$ 98,791			\$ 95,162			\$ 93,412		

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\$ 25,687	197	3.05	\$ 24,190	209	3.41	\$ 22,953	179	3.14
1,523	1	.19	1,581		.19	1,633	1	.19
6,887	86	4.98	6,274	80	5.06	6,237	79	5.03
11,455	135	4.68	11,512	136	4.68	12,047	141	4.70
5,720	64	4.42	4,540	57	5.00	3,600	47	5.20
51,272	483	3.74	48,097	482	3.98	46,470	447	3.85
4,194	45	4.23	4,470	55	4.85	4,748	59	5.04
4,233	45	4.15	2,539	30	4.70	1,771	18	4.14
11,851	164	5.72	11,801	173	5.89	12,909	185	5.83
71,550	737	4.11	66,907	740	4.40	65,898	709	4.33
12,948			14,424			13,927		
6,405			6,106			5,933		
7,888			7,725			7,654		
7,888			7,725			7,654		
\$ 98,791			\$ 95,162			\$ 93,412		
		2.75%			2.52%			2.62%
	750	3.48%		712	3.40%		706	3.46%
	40			18			20	
\$ 710			\$ 694			\$ 686		

- (d) Yield is calculated on the basis of amortized cost.
- (e) Rate calculation excludes basis adjustments related to fair value hedges.
- (f) Results from continuing operations exclude the dollar amount of liabilities assumed necessary to support interest-earning assets held by the discontinued Champion

Mortgage finance business.
The interest expense related
to these liabilities, which
also is excluded from
continuing operations, was
calculated using a matched
funds transfer pricing
methodology.

TE = Taxable Equivalent

GAAP = U.S. generally accepted accounting principles

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Figure 11 shows how the changes in yields or rates, and average balances from the prior year affected net interest income. The section entitled Financial Condition, which begins on page 65, contains more discussion about changes in earning assets and funding sources.

Figure 11. Components of Net Interest (Loss) Income Changes

<i>in millions</i>	From three months ended June 30, 2007 to three months ended June 30, 2008			From six months ended June 30, 2007 to six months ended June 30, 2008		
	Average Volume	Yield/ Rate	Net Change	Average Volume	Yield/ Rate	Net Change
INTEREST INCOME						
Loans	\$ 162	\$ (1,099)	\$ (937)	\$ 280	\$ (1,286)	\$ (1,006)
Loans held for sale	(48)	(14)	(62)	(35)	(15)	(50)
Securities available for sale	7	(2)	5	18	(3)	15
Trading account assets	2	1	3	6	3	9
Short-term investments	1	(2)	(1)	5	(8)	(3)
Other investments		(1)	(1)	2	(4)	(2)
Total interest income (TE)	124	(1,117)	(993)	276	(1,313)	(1,037)
INTEREST EXPENSE						
NOW and money market deposit accounts	28	(105)	(77)	53	(168)	(115)
Savings deposits					2	2
Certificates of deposit (\$100,000 or more)	27	(18)	9	49	(21)	28
Other time deposits	8	(14)	(6)	16	(14)	2
Deposits in foreign office	6	(32)	(26)	31	(53)	(22)
Total interest-bearing deposits	69	(169)	(100)	149	(254)	(105)
Federal funds purchased and securities sold under repurchase agreements	(15)	(29)	(44)	(17)	(48)	(65)
Bank notes and other short-term borrowings	20	(11)	9	49	(12)	37
Long-term debt	22	(74)	(52)	18	(120)	(102)
Total interest expense	96	(283)	(187)	199	(434)	(235)
Net interest (loss) income (TE)	\$ 28	\$ (834)	\$ (806)	\$ 77	\$ (879)	\$ (802)

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

TE = Taxable Equivalent

Noninterest income

Key's noninterest income was \$555 million for the second quarter of 2008, compared to \$649 million for the year-ago quarter. For the first six months of the year, noninterest income was \$1.1 billion, representing a decrease of \$220 million, or 17%, from the first six months of 2007.

As shown in Figure 13, the decrease from the year-ago quarter was attributable largely to net losses of \$14 million from principal investing in the second quarter of 2008, compared to net gains of \$90 million for the same period last year. Additionally, results for the second quarter of 2007 benefited from a \$40 million gain related to the sale of MasterCard Incorporated shares. These factors were offset in part by higher income from several fee-based businesses. Income from investment banking and capital markets activities rose by \$28 million, trust and investment services income was up \$23 million, and income from deposit service charges grew by \$9 million.

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The trend in the major components of Key's fee-based income over the past five quarters is shown in Figure 12.

Figure 12. Fee-Based Income Major Components

<i>in millions</i>	2008			2007	
	Second	First	Fourth	Third	Second
Trust and investment services income	\$ 138	\$ 129	\$ 131	\$ 119	\$ 115
Service charges on deposit accounts	93	88	90	88	84
Investment banking and capital markets income	80	8	12	9	52
Operating lease income	68	69	72	70	66
Letter of credit and loan fees	51	37	58	51	45
Corporate-owned life insurance income	28	28	37	27	32
Electronic banking fees	27	24	25	25	25

For the year-to-date period, the decrease in noninterest income reflected several significant items. During the first quarter of 2008, Key recorded a \$165 million gain from the partial redemption of Visa Inc. shares. Results for the first half of 2007 included the \$40 million gain related to the sale of MasterCard Incorporated shares, a \$171 million gain associated with the sale of the McDonald Investments branch network, a \$26 million gain from the settlement of the automobile residual value insurance litigation and a \$49 million loss recorded in connection with the repositioning of the securities portfolio.

Excluding the significant items discussed above, Key's noninterest income was \$918 million for the first six months of 2008, representing a \$197 million, or 18%, decrease from the same period last year. As shown in Figure 13, Key recorded net losses of \$5 million from principal investing in the first six months of 2008, compared to net gains of \$119 million for the first half of 2007. Additionally, Key had net losses from loan sales and write-downs of \$68 million in the current year, compared to net gains of \$42 million through the first six months of 2007. The reduction in noninterest income attributable to these factors was substantially offset by increases of \$22 million in income from deposit service charges and \$27 million in income from trust and investment services. Last year's results included \$16 million of trust and investment services income generated by the McDonald Investments branch network. Adjusting for this revenue, trust and investment services income rose by \$43 million, or 19%, driven by growth in institutional asset management income, and income from brokerage commissions and fees.

Figure 13. Noninterest Income

<i>dollars in millions</i>	Three months ended				Six months ended			
	June 30,		Change		June 30,		Change	
	2008	2007	Amount	Percent	2008	2007	Amount	Percent
Trust and investment services income	\$ 138	\$ 115	\$ 23	20.0%	\$ 267	\$ 240	\$ 27	11.3%
Service charges on deposit accounts	93	84	9	10.7	181	159	22	13.8
Investment banking and capital markets income	80	52	28	53.8	88	96	(8)	(8.3)
Operating lease income	68	66	2	3.0	137	130	7	5.4
Letter of credit and loan fees	51	45	6	13.3	88	83	5	6.0
	28	32	(4)	(12.5)	56	57	(1)	(1.8)

Corporate-owned life insurance income								
Electronic banking fees	27	25	2	8.0	51	49	2	4.1
Net gains (losses) from loan securitizations and sales	33	33			(68)	42	(110)	N/M
Net securities (losses) gains	(1)	2	(3)	N/M	2	(45)	47	N/M
Net (losses) gains from principal investing	(14)	90	(104)	N/M	(5)	119	(124)	N/M
Gain from redemption of Visa Inc. shares					165		165	N/M
Gain from sale of McDonald Investments branch network						171	(171)	(100.0)
Other income:								
Insurance income	20	15	5	33.3	35	29	6	20.7
Loan securitization servicing fees	5	6	(1)	(16.7)	9	11	(2)	(18.2)
Credit card fees	3	3						