

**KeyCorp**  
**Basel III Pillar 3 Regulatory Capital Disclosures**  
**For the Quarterly Period Ended March 31, 2017**



# KeyCorp

## Basel III Pillar 3 Regulatory Capital Disclosures

For the quarterly period ended March 31, 2017

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## Forward-looking Statements

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

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

- deterioration of commercial real estate market fundamentals;
- defaults by Key’s loan counterparties or clients;
- adverse changes in credit quality trends;
- declining asset prices;
- Key’s concentrated credit exposure in commercial and industrial loans;
- the extensive and increasing regulation of the U.S. financial services industry;
- operational or risk management failures by Key or critical third parties;
- changes in accounting policies, standards, and interpretations;
- breaches of security or failures of Key’s technology systems due to technological or other factors and cybersecurity threats;
- negative outcomes from claims or litigation;
- the occurrence of natural or man-made disasters, conflicts, or terrorist attacks, or other adverse external events;
- evolving capital and liquidity standards under applicable regulatory rules;
- unanticipated changes in Key’s liquidity position, including but not limited to, changes in Key’s access to or the cost of funding and Key’s ability to secure alternative funding sources;
- downgrades in KeyCorp’s credit ratings or those of KeyBank;
- a reversal of the U.S. economic recovery due to financial, political or other shocks;
- Key’s ability to anticipate interest rate changes and manage interest rate risk;
- deterioration of economic conditions in the geographic regions where Key operates;
- the soundness of other financial institutions;
- tax reform and other changes in tax laws;
- Key’s ability to attract and retain talented executives and employees and to manage its reputational risks;
- Key’s ability to timely and effectively implement its strategic initiatives;
- increased competitive pressure due to industry consolidation;
- Key’s ability to adapt its products and services to industry standards and consumer preferences;
- unanticipated adverse effects of strategic partnerships or acquisitions and dispositions of assets or businesses;
- Key’s ability to realize the anticipated benefits of the First Niagara merger; and
- Key’s ability to develop and effectively use the quantitative models its relies upon in its business planning.

Any forward-looking statements made by Key or on Key’s behalf speak only as of the date they are made, and Key does not undertake any obligation to update any forward-looking statement to reflect the impact of subsequent events or circumstances. Before making an investment decision, you should carefully consider all risks and uncertainties disclosed in Key’s SEC filings, including its report on Form 10-Q for the quarter ended March 31, 2017, and subsequent reports on Forms 8-K, 10-Q, and 10-K and its registration statements under the Securities Act of 1933, as amended, all of which are or will upon filing be accessible on the SEC’s website at [www.sec.gov](http://www.sec.gov) and on Key’s website at [www.key.com/ir](http://www.key.com/ir).

## **SCOPE OF APPLICATION**

### **Introduction**

KeyCorp, organized in 1958 under the laws of the State of Ohio, is headquartered in Cleveland, Ohio. KeyCorp is a bank holding company (“BHC”) under the Bank Holding Company Act of 1956 (“BHCA”), as amended, and is one of the nation’s largest bank-based financial services companies, with consolidated total assets of \$134.5 billion and shareholders’ equity of \$15.0 billion at March 31, 2017. KeyCorp is the parent holding company for KeyBank National Association (“KeyBank”), its principal subsidiary, through which most of its banking services are provided. Key has two major business segments: Key Community Bank and Key Corporate Bank.

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

Key Corporate Bank is a full-service corporate and investment bank focused principally on serving the needs of middle market clients in seven industry sectors: consumer, energy, healthcare, industrial, public sector, real estate, and technology. Key Corporate Bank delivers a broad suite of banking and capital markets products to its clients, including syndicated finance, debt and equity capital markets, commercial payments, equipment finance, commercial mortgage banking, derivatives, foreign exchange, financial advisory, and public finance. Key Corporate Bank is also a significant servicer of commercial mortgage loans and a significant special servicer of commercial mortgage-backed securities. Key Corporate Bank delivers many of its product capabilities to clients of Key Community Bank.

As a BHC, KeyCorp is subject to regulation, supervision, and examination by the Federal Reserve Board (the “Federal Reserve”) under the BHCA. The Federal Reserve has established risk-based capital and leverage ratio requirements for BHCs, including KeyCorp. During July 2013, the Federal Reserve issued final rules implementing a strengthened set of capital requirements, known as Basel III, in the United States.

The Basel III Capital Framework, as described below, requires new regulatory capital disclosures under the third pillar of Basel III (“Pillar 3”). The purpose of the Pillar 3 disclosures is to provide key information relating to a bank’s regulatory capital, risk exposures, and risk management practices. This Pillar 3 report is designed to satisfy these requirements and should be read in conjunction with KeyCorp’s Annual Report on Form 10-K for the year ended December 31, 2016 (“2016 Form 10-K”), and KeyCorp’s Quarterly Report Form 10-Q for the quarterly period ended March 31, 2017 (“First Quarter 2017 Form 10-Q”), which have been filed with the U.S. Securities and Exchange Commission (“SEC”).

As used in this report, references to “Key” refer to the consolidated entity consisting of KeyCorp and its subsidiaries. The basis of consolidation used for regulatory reporting is consistent with that used under U.S. Generally Accepted Accounting Principles (“U.S. GAAP”). For more information about Key’s significant accounting policies, refer to Note 1 (“Summary of Significant Accounting Policies”) beginning on page 106 of Key’s 2016 Form 10-K.

Throughout this report, certain financial measures may not be based on GAAP (“non-GAAP financial measures”). These non-GAAP financial measures may not be directly comparable to financial measures reported in Key’s 2016 Form 10-K and First Quarter 2017 Form 10-Q, and may not be directly comparable to similar measures used by other companies. Key’s non-GAAP financial measures are not required to be, and have not been, audited by its independent auditors. Key’s First Quarter 2017 Form 10-Q includes more information about non-GAAP financial measures, including reconciliations to the most directly comparable GAAP measures. Key’s historical SEC and regulatory filings are located in the Investor Relations section of its website at [www.key.com/IR](http://www.key.com/IR).

### **Basel III Capital Framework**

In December 2010, the Basel Committee released its final framework to strengthen international capital regulation of banks, and revised it in June 2011 and January 2014 (as revised, the “Basel III capital framework”). The Basel III capital framework requires higher and better-quality capital, better risk coverage, the introduction of a new leverage ratio as a backstop to the risk-based requirement, and measures to promote the buildup of capital that can be drawn down in periods of stress. The Basel III capital framework, among other things, introduces a new capital measure, “Common Equity Tier 1,” to be included in Tier 1 capital with other capital instruments meeting specified requirements, a capital conservation buffer, and a countercyclical capital buffer. The Basel III capital framework is being phased-in over a multi-year period.

In November 2011, the Basel Committee issued its final rule for a common equity surcharge on certain designated global systemically important banks (“G-SIBs”), which was revised in July 2013 (as revised, “Basel G-SIB framework”). Under the Basel G-SIB framework, a G-SIB is assessed a progressive 1.0% to 3.5% surcharge to the Common Equity Tier 1 capital conservation buffer based upon the bank’s systemic importance score. In July 2015, the Federal Reserve adopted a final rule to implement the common equity surcharge on U.S. G-SIBs. The final rule was effective December 1, 2015, although the surcharge will be phased in during the January 1, 2016, through January 1, 2019, period. Notably, this final rule applies to advanced approaches banking organizations, not “standardized approach” banking organizations like Key (as described below).

#### U.S. implementation of the Basel III capital framework

In October 2013, the federal banking regulators published the final Basel III capital framework for U.S. banking organizations (the “Regulatory Capital Rules”). The Regulatory Capital Rules generally implement in the U.S. the Basel III capital framework as described above. Under the Regulatory Capital Rules, certain large U.S.-domiciled BHCs and banks (each, an “advanced approaches banking organization”) must satisfy minimum qualifying criteria using organization-specific internal risk measures and management processes for calculating risk-based capital requirements as well as follow certain methodologies to calculate their total risk-weighted assets. Since neither KeyCorp nor KeyBank has at least \$250 billion in total consolidated assets or at least \$10 billion of total on-balance sheet foreign exposure, neither KeyCorp nor KeyBank is an advanced approaches banking organization. Instead, each of them is a “standardized approach banking organization.”

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

#### **Basis of Consolidation**

KeyCorp’s basis of consolidation for both financial and regulatory accounting purposes conforms with U.S. GAAP and includes the accounts of KeyCorp and its subsidiaries.

#### **Funds and Capital Transfer Restrictions**

For information regarding the restrictions on the transfer of funds and total capital within Key, see “Dividend restrictions” on page 14, “Bank transactions with affiliates” on page 17, and Note 4 (“Restrictions on Cash, Dividends, and Lending Activities”) on page 125, all in Key’s 2016 Form 10-K.

#### **Compliance with Capital Requirements**

At March 31, 2017, KeyCorp did not have any subsidiaries whose regulatory capital was less than the minimum required regulatory capital amount.

#### **Surplus of Insurance Subsidiaries**

An immaterial amount of surplus capital of insurance subsidiaries was included in total shareholders’ equity at March 31, 2017.

## **CAPITAL STRUCTURE**

### **Regulatory Capital Instruments**

Key's qualifying regulatory capital instruments consist of common stock, noncumulative perpetual preferred stock, trust preferred securities, and subordinated debt.

Holders of KeyCorp common stock are entitled to one vote for each common share held by them on each matter properly submitted to shareholders for their vote, consent, waiver, release, or other action. For additional information on the terms and conditions of Key's common stock, see Key's "Consolidated Balance Sheets" on page 4 of Key's First Quarter 2017 Form 10-Q.

KeyCorp noncumulative perpetual preferred stock ranks senior to KeyCorp common stock. Generally, for each series of preferred stock, so long as any share of preferred stock remains outstanding on any day during a dividend period, no dividend shall be declared or paid on any common stock and no shares of common stock shall be repurchased or redeemed, unless the full dividends for the immediately preceding dividend period on all outstanding shares of preferred stock have been declared and paid or declared and a sum sufficient for the payment of such dividends has been set aside. The holders of preferred stock do not have any voting rights other than those described in the corresponding section of KeyCorp's articles of incorporation. For additional terms and conditions of Key's outstanding preferred stock, see Note 18 ("Shareholders' Equity") on page 71 of Key's First Quarter 2017 Form 10-Q and Exhibit 3.1 ("Second Amended and Restated Articles of Incorporation of KeyCorp, effective August 1, 2016"), Exhibit 3.2 ("Amendment to Second Amended and Restated Articles of Incorporation of KeyCorp, effective September 7, 2016"), Exhibit 3.3 ("Amendment to Second Amended and Restated Articles of Incorporation of KeyCorp, effective December 8, 2016"), Exhibit 3.4 ("Second Amended and Restated Regulations of KeyCorp"), Exhibit 4.1 ("Form of Certificate representing Fixed-to-Floating Rate Perpetual Non-Cumulative Preferred Stock, Series D"), and Exhibit 4.4 ("Form of Certificate representing Fixed-to-Floating Rate Perpetual Non-Cumulative Preferred Stock, Series E") in Key's 2016 Form 10-K.

The adoption of the Basel III Regulatory Capital Rules changes the regulatory capital standards that apply to BHCs by phasing out the treatment of certain capital securities and cumulative preferred securities as eligible Tier 1 capital. The phase-out period, which began January 1, 2015, for standardized approach banking organizations such as KeyCorp, resulted in Key's trust preferred securities being treated only as Tier 2 capital starting in 2016. For additional information regarding the terms of Key's outstanding trust preferred securities, see Note 15 ("Trust Preferred Securities Issued by Unconsolidated Subsidiaries") on page 66 of Key's First Quarter 2017 Form 10-Q.

For terms and conditions of Key's outstanding subordinated debt, see Note 19 ("Long-Term Debt") beginning on page 191 of Key's 2016 Form 10-K and "Liquidity Programs" beginning on page 120 of Key's First Quarter 2017 Form 10-Q.

**Regulatory Capital Tiers**

The following table presents Key’s Common Equity Tier 1, Tier 1 Capital, Tier 2 Capital, and Total Capital at March 31, 2017. For more information on Key’s regulatory capital tiers, see Schedule HC-R, “Regulatory Capital” in Key’s FR Y-9C.

<i>in millions</i>	<b>March 31, 2017</b>
<b>COMMON EQUITY TIER 1</b>	
Common stock and related surplus	\$ 4,937
Retained earnings	9,584
Common equity minority interest	—
Accumulated other comprehensive income (loss)	(554)
Common Equity Tier 1 capital before adjustments and deductions	13,967
Adjustments and deductions from Common Equity Tier 1 Capital	
Less: Goodwill, net of deferred taxes	2,379
Intangible assets, net of deferred taxes	194
Deferred tax assets	11
Net unrealized gains (losses) on available-for-sale securities, net of deferred taxes	(179)
Accumulated gains (losses) on cash flow hedges, net of deferred taxes	(76)
Amounts in accumulated other comprehensive income (loss) attributed to pension and postretirement benefit costs, net of deferred taxes	(335)
Total Common Equity Tier 1 Capital	11,973
<b>TIER 1 CAPITAL</b>	
Additional Tier 1 capital instruments and related surplus	1,009
Tier 1 minority interest not included in Common Equity Tier 1 Capital	—
Additional Tier 1 capital before deductions	1,009
Less: Tier 1 capital deductions	3
Additional Tier 1 capital	1,006
Total Tier 1 capital	12,979
<b>TIER 2 CAPITAL</b>	
Tier 2 capital instruments and related surplus	1,409
Total capital minority interest not included in Tier 1 capital	—
Allowance for losses on loans and liability for losses on lending-related commitments	943
Unrealized gains on available-for-sale preferred stock classified as an equity security under GAAP and available-for-sale equity exposures includable in Tier 2 capital	—
Tier 2 capital before deductions	2,352
Less: Tier 2 capital deductions	—
Total Tier 2 capital	2,352
Total risk-based capital	<u>\$ 15,331</u>

## **CAPITAL ADEQUACY**

### **Capital Management and Planning**

Key's capital management framework is generally designed to ensure that Key maintains sufficient capital consistent with its risk profile and all applicable regulatory standards and guidelines. For further information on Key's capital management and capital adequacy, see the sections titled "Capital planning and stress testing" and "Capital adequacy" beginning on pages 12, and 67, respectively, of Key's 2016 Form 10-K and "Supervision and regulation" and "Capital" beginning on pages 82 and 109, respectively, of Key's First Quarter 2017 Form 10-Q.

The Federal Reserve's capital plan rule requires each U.S.-domiciled, top-tier BHC with total consolidated assets of at least \$50 billion (like KeyCorp) to develop and maintain a written capital plan supported by a robust internal capital adequacy process. The capital plan must be submitted annually to the Federal Reserve for supervisory review in connection with its annual Comprehensive Capital Analysis and Review ("CCAR"). The supervisory review includes an assessment of many factors, including Key's ability to maintain capital above each minimum regulatory capital ratio on a pro forma basis under expected and stressful conditions throughout the planning horizon.

The Federal Reserve's annual CCAR is an intensive assessment of the capital adequacy of large, complex U.S. BHCs and of the practices these BHCs use to assess their capital needs. The Federal Reserve expects BHCs subject to CCAR to have and maintain regulatory capital in an amount that is sufficient to withstand a severely adverse operating environment and, at the same time, be able to continue operations, maintain ready access to funding, meet obligations to creditors and counterparties, and provide credit intermediation.

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

Specifically, the final rule relieves covered BHCs from the qualitative assessment portion of the Federal Reserve's CCAR program and modifies the reporting requirements for these organizations by reducing the reporting requirements applicable to covered BHCs under the FR Y-14A and by raising the materiality thresholds for specific portfolio reporting requirements.

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

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

KeyCorp is also subject to the Federal Reserve's supervisory expectations for capital planning and capital positions as a large, noncomplex BHC as set forth in the Federal Reserve's guidance document issued on December 18, 2015 ("SR Letter 15-19"). Under SR Letter 15-19, the Federal Reserve identifies its core capital planning expectations regarding governance; risk management; internal controls; capital policy; capital positions; incorporating stressful conditions and events; and estimating impact on capital positions for large and noncomplex firms building upon the capital planning requirements under its capital plan and stress test rules. SR Letter 15-19 also provides detailed supervisory expectations on such a firm's capital planning processes.



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The following table presents Key’s risk-weighted assets, Common Equity Tier 1 capital ratio, Tier 1 risk-based capital ratio, Total risk-based capital ratio, and Tier 1 leverage ratio at March 31, 2017. For more information on Key’s risk-weighted assets, see Schedule HC-R, “Regulatory Capital” in Key’s FR Y-9C.

	<b>March 31,</b>
	<b>2017</b>
<i>dollars in millions</i>	
<b>RISK-WEIGHTED ASSETS <sup>(a)</sup></b>	
<b>On-balance sheet</b>	
Exposures to depository institutions, foreign banks, and credit unions	\$ 188
Exposures to government-sponsored enterprises	3,072
Exposures to public sector entities	1,894
Corporate exposures	56,758
Statutory multifamily mortgages and pre-sold construction loans	491
Residential mortgage exposures	11,725
Other retail exposures	6,881
High volatility commercial real estate	2,571
Past due loans	653
Other assets	7,930
Securitization exposures	68
Equity exposures	2,323
Total on-balance sheet exposures	94,554
<b>Off-balance sheet and market risk</b>	
Unused commitments with an original maturity of less than one year	1,489
Unused commitments with an original maturity of more than one year	13,362
Derivatives	571
Letters of credit	8,327
All other off balance sheet liabilities	1,667
Market risk-weighted assets	882
Total off-balance sheet and market risk exposures	26,298
Total risk-weighted assets	<u>\$ 120,852</u>
Total assets for the leverage ratio	<u>\$ 132,260</u>
<b>CAPITAL RATIOS</b>	
Common Equity Tier 1	9.91%
Tier 1 risk-based capital	10.74
Total risk-based capital	12.69
Tier 1 leverage	9.81

(a) This table does not present the quantitative disclosures required under the capital rules for any exposure category with respect to which Key has no related activity.

The table below lists KeyBank’s Common Equity Tier 1 capital ratio, Tier 1 risk-based capital ratio, Total risk-based capital ratio, and Tier 1 leverage ratio at March 31, 2017.

	<b>March 31,</b>
	<b>2017</b>
Common Equity Tier 1	11.02%
Tier 1 risk-based capital	11.02
Total risk-based capital	12.64
Tier 1 leverage	9.73

**CAPITAL CONSERVATION BUFFER**

The following table discloses Key’s capital conservation buffer, eligible retained income, and limitations on distributions and discretionary bonus payments under the capital conservation buffer framework at March 31, 2017.

<i>dollars in millions</i>	<b>March 31, 2017</b>
Capital conservation buffer <sup>(a)</sup>	4.69%
Eligible retained income <sup>(b)</sup>	\$ 359
Limitations on distributions and discretionary bonus payments under the capital conservation buffer framework <sup>(c)</sup>	No payout limitation applies

- (a) A Federal Reserve regulated institution’s capital conservation buffer is equal to the lowest of the following ratios, calculated as of the last day of the previous calendar quarter based on the Federal Reserve regulated institution’s most recent Call Report, for a state member bank, or FR Y-9C, for a bank holding company or savings and loan holding company, as applicable:
- a. The Federal Reserve regulated institution’s Common Equity Tier 1 capital ratio minus the Federal Reserve regulated institution’s minimum Common Equity Tier 1 capital ratio requirement under 12 C.F.R. §217.10;
  - b. The Federal Reserve regulated institution’s Tier 1 risk-based capital ratio minus the Federal Reserve regulated institution’s minimum Tier 1 risk-based capital ratio requirement under 12 C.F.R. §217.10; and
  - c. The Federal Reserve regulated institution’s Total risk-based capital ratio minus the Federal Reserve regulated institution’s minimum Total risk-based capital ratio requirement under 12 C.F.R. §217.10;

Key’s capital conservation buffer at March 31, 2017, was based upon the Total risk-based capital ratio.

- (b) The eligible retained income of a Federal Reserve regulated institution is the Federal Reserve regulated institution’s net income for the four calendar quarters preceding the current calendar quarter, based on the Federal Reserve regulated institution’s quarterly Call Report, for a state member bank, or the FRY-9C, for a bank holding company or savings and loan holding company, as applicable, net of any distributions and associated tax effects not already reflected in net income.
- (c) Payouts are reviewed and approved by the Federal Reserve through the Capital Plan submitted annually through the CCAR process. Key received no objection to its 2016 Capital Plan.

## **RISK MANAGEMENT**

### **Overview**

Like all financial services companies, Key engages in business activities and assumes the related risks. Key's risk management activities are focused on ensuring it properly identifies, measures, and manages such risks across the entire enterprise to maintain safety and soundness and maximize profitability.

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

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

For further information on Key's risk management organization, policies, and processes, see "Risk Management" beginning on page 112 of Key's First Quarter 2017 Form 10-Q.

**CREDIT RISK: GENERAL DISCLOSURES**

**Overview**

Key manages credit risk exposure through a multifaceted program. The Credit Risk Committee approves both retail and commercial credit policies. These policies are communicated throughout the organization to foster a consistent approach to granting credit.

Key’s credit risk management team is responsible for credit approval, is independent of Key’s lines of business, and consists of senior officers who have extensive experience in structuring and approving loans. Only credit risk management members are authorized to grant significant exceptions to credit policies. It is not unusual to make exceptions to established policies when mitigating circumstances dictate, but most major lending units have been assigned specific thresholds to keep exceptions at an acceptable level based upon portfolio and economic considerations.

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

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

For more information on Key’s credit risk management policies, see the sections titled “Nonperforming Loans,” “Impaired Loans,” “Allowance for Loan and Lease Losses,” and “Liability for Credit Losses on Lending-Related Commitments” in Note 1 (“Summary of Significant Accounting Policies”) beginning on page 106 of Key’s 2016 Form 10-K and “Credit risk management” beginning on page 121 of Key’s First Quarter 2017 Form 10-Q. For more information on Key’s remaining contractual maturity delineation of contractual obligations and other off-balance sheet commitments, see “Contractual obligations” beginning on page 69 of Key’s 2016 Form 10-K. For information regarding geographic location of commercial real estate loans, see the section titled “Commercial real estate loans” beginning on page 102 of Key’s First Quarter 2017 Form 10-Q.

The following table presents the geographic diversity of Key Community Bank’s deposits, loans and leases, commercial loans, home equity loans, and other loans and leases at March 31, 2017.

Quarter ended March 31, 2017 <i>dollars in millions</i>	Geographic Region												Total
	Washington	Oregon/ Alaska	Rocky Mountains	Indiana/ Northwest Ohio/ Michigan	Central/ Southwest Ohio	East Ohio/ Western Pennsylvania	Atlantic	Western New York	Eastern New York	New England	NonRegion <sup>(a)</sup>		
Average deposits	\$ 7,966	\$ 5,106	\$ 5,445	\$ 5,370	\$ 3,525	\$ 12,349	\$ 7,124	\$ 10,141	\$ 10,455	\$ 7,031	\$ 4,881	\$ 79,393	
Percent of total	10.0%	6.4%	6.9%	6.8%	4.4%	15.5%	9.0%	12.8%	13.2%	8.9%	6.1%	100.0%	
Average loans and leases	\$ 3,281	\$ 2,778	\$ 3,275	\$ 2,857	\$ 1,539	\$ 4,968	\$ 3,438	\$ 3,519	\$ 3,953	\$ 2,720	\$ 14,708	\$ 47,036	
Percent of total	7.0%	5.9%	6.9%	6.1%	3.3%	10.5%	7.3%	7.5%	8.4%	5.8%	31.3%	100.0%	
Average commercial loans	\$ 1,218	\$ 1,394	\$ 1,632	\$ 1,577	\$ 980	\$ 3,272	\$ 2,296	\$ 1,959	\$ 2,254	\$ 1,783	\$ 5,410	\$ 23,775	
Percent of total	5.1%	5.9%	6.9%	6.6%	4.1%	13.8%	9.6%	8.2%	9.5%	7.5%	22.8%	100.0%	
Average home equity loans	\$ 1,815	\$ 1,244	\$ 1,454	\$ 1,008	\$ 446	\$ 1,361	\$ 1,027	\$ 1,292	\$ 1,497	\$ 677	\$ 635	\$ 12,456	
Percent of total	14.6%	10.0%	11.7%	8.1%	3.6%	10.9%	8.2%	10.4%	12.0%	5.4%	5.1%	100.0%	
Average other loans and leases	\$ 248	\$ 140	\$ 189	\$ 272	\$ 113	\$ 335	\$ 115	\$ 268	\$ 202	\$ 260	\$ 8,663	\$ 10,805	
Percent of total	2.3%	1.3%	1.7%	2.5%	1.0%	3.1%	1.1%	2.5%	1.9%	2.4%	80.2%	100.0%	

(a) Represents deposit and loan and lease products centrally managed outside of Key’s ten Key Community Bank regions.

Key’s management evaluates credit exposures based on Key’s two major loan categories: commercial loans and consumer loans. Within these two major categories of loans are various detailed loan categories. To provide a more consistent view of how Key views its credit exposure, Key feels that it is helpful to shareholders to present financial information based on this view of Key’s credit exposure. The following table presents Key’s total exposure by loan type, loans past due 90 days and

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greater on nonaccrual, loans past due 90 days and greater that are accruing, and total past due and nonperforming loans at March 31, 2017.

March 31, 2017 <i>in millions</i>	Total Loans	90 and Greater Days Past Due Nonperforming	90 and Greater Days Past Due Accrual	Total Past Due and Nonperforming Loans
<b>LOAN TYPE</b>				
Commercial and industrial	\$ 40,112	\$ 258	\$ 24	\$ 389
Commercial real estate:				
Commercial mortgage	15,260	32	11	78
Construction	2,270	2	—	2
Total commercial real estate loans	17,530	34	11	80
Commercial lease financing	4,665	5	6	31
Total commercial loans	<u>\$ 62,307</u>	<u>\$ 297</u>	<u>\$ 41</u>	<u>\$ 500</u>
Real estate - residential mortgage				
Home equity loans	12,541	207	14	290
Consumer direct loans	1,735	3	5	20
Credit cards	1,037	3	11	26
Consumer indirect loans	2,998	9	4	47
Total consumer loans	<u>\$ 23,818</u>	<u>\$ 276</u>	<u>\$ 38</u>	<u>\$ 464</u>
Total loans	<u>\$ 86,125</u>	<u>\$ 573</u>	<u>\$ 79</u>	<u>\$ 964</u>

The following table presents Key's nonperforming loans with no related allowance and nonperforming loans with a related allowance at March 31, 2017.

March 31, 2017 <i>in millions</i>	Loans With No Related Allowance	Loans With Related Allowance
<b>LOAN TYPE</b>		
Commercial and industrial	\$ 152	\$ 85
Commercial real estate:		
Commercial mortgage	1	15
Total commercial real estate loans	1	15
Total commercial loans	<u>\$ 153</u>	<u>\$ 100</u>
Real estate - residential mortgage		
Home equity loans	20	30
Consumer direct loans	60	64
Credit cards	—	3
Consumer indirect loans	—	3
Total consumer loans	<u>\$ 82</u>	<u>\$ 133</u>
Total loans	<u>\$ 235</u>	<u>\$ 233</u>

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The changes in the ALLL by loan category for the period ended March 31, 2017, is as follows:

<i>in millions</i>	ALLL at				ALLL at	
	December 31, 2016	Provision	Charge-offs	Recoveries	March 31, 2017	
<b>LOAN TYPE</b>						
Commercial and industrial	\$ 508	\$ 31	\$ (32)	\$ 5	\$ 512	
Commercial mortgage	144	2	—	—	146	
Construction	22	6	—	1	29	
Total commercial real estate loans	166	8	—	1	175	
Commercial lease financing	42	3	(7)	2	40	
Total commercial loans	\$ 716	\$ 42	\$ (39)	\$ 8	\$ 727	
Real estate - residential mortgage	\$ 17	\$ (3)	\$ 2	\$ 2	\$ 18	
Home equity loans	54	4	(8)	3	53	
Consumer direct loans	24	9	(10)	1	24	
Credit cards	38	10	(11)	1	38	
Consumer indirect loans	9	8	(11)	4	10	
Total consumer loans	\$ 142	\$ 28	\$ (38)	\$ 11	\$ 143	
Total loans	\$ 858	\$ 70 <sup>(a)</sup>	\$ (77)	\$ 19	\$ 870	

(a) Excludes a credit for losses on lending-related commitments of \$7 million.

## **GENERAL DISCLOSURE FOR COUNTERPARTY CREDIT RISK-RELATED EXPOSURES**

### **Overview**

Counterparty credit risk is the risk arising from the possibility that a counterparty may default on amounts owed on a derivative transaction. This risk is measured as the expected positive replacement value of the contracts. Key uses several means to mitigate and manage exposure to credit risk on derivative contracts.

### **Counterparty Credit Risk Exposures for Derivatives**

Key monitors counterparty credit risk exposure on each contract to determine appropriate limits on its total credit exposure across all product types. Key also reviews its collateral positions on a daily basis and exchanges collateral with its counterparties in accordance with standard International Swaps and Derivatives Association documentation, central clearing rules, and other related agreements. To address the risk of default associated with the uncollateralized contracts, Key has established a credit valuation adjustment that it estimates to be the potential future losses on amounts due from client counterparties in the event of default. Key generally holds collateral in the form of cash and highly rated securities issued by the U.S. Treasury and government-sponsored enterprises including Ginnie Mae.

### **Counterparty Credit Risk Exposure for Securities Financing Agreements**

Like other financing transactions, securities financing agreements contain an element of credit risk. To mitigate and manage credit risk exposure, Key generally enters into master netting agreements and other collateral arrangements that gives Key the right, in the event of default, to liquidate collateral held and to offset receivables and payables with the same counterparty. Additionally, Key establishes and monitors limits on its counterparty credit risk exposure by product type. For the reverse repurchase agreements, Key monitors the value of the underlying securities Key receives from counterparties and either requests additional collateral or returns a portion of the collateral based on the value of those securities. Key generally holds collateral in the form of highly rated securities issued by the U.S. Treasury and fixed income securities. In addition, Key may need to provide collateral to counterparties under Key's repurchase agreements. With the exception of collateral pledged against customer sweep repurchase agreements, the collateral Key pledges and receives can generally be sold or repledged by the secured parties without restriction.

### **Impact on Derivatives of Key Credit Rating Downgrade**

For information on the impact of a credit rating downgrade on KeyBank or KeyCorp, see the section titled "Credit Risk Contingent Features" in Note 8 ("Derivatives and Hedging Activities") beginning on page 53 of Key's First Quarter 2017 Form 10-Q.

### **Derivative Counterparty Credit Risk Exposures**

For information regarding derivative counterparty credit risk exposures, including the fair value of derivative assets, the credit valuation adjustment, and the impact of netting contracts and the offsetting of collateral held, see the section titled "Counterparty Credit Risk" in Note 8 ("Derivatives and Hedging Activities") beginning on page 51 of Key's First Quarter 2017 Form 10-Q.

### **Credit Derivative Notional Amounts**

For information on the notional amounts of purchased and sold credit derivatives by product type, see Schedule HC-L, "Derivatives and Off-Balance Sheet Items" in Key's FR Y-9C, "Consolidated Financial Statements for Holding Companies" for the period ended March 31, 2017.

## **CREDIT RISK MITIGATION**

### **Overview**

Key is a buyer and, under limited circumstances, may be a seller of credit protection through the credit derivative market. Key purchases credit derivatives to manage the credit risk associated with specific commercial lending and swap obligations as well as exposures to debt securities. Key may also sell credit derivatives, mainly single-name credit default swaps, to offset its purchased credit default swap position prior to maturity.

Single-name credit default swaps are bilateral contracts whereby the seller agrees, for a premium, to provide protection against the credit risk of a specific entity (the “reference entity”) in connection with a specific debt obligation. The protected credit risk is related to adverse credit events, such as bankruptcy, failure to make payments, and acceleration or restructuring of obligations, identified in the credit derivative contract. As the seller of a single-name credit derivative, Key may settle in one of two ways if the underlying reference entity experiences a predefined credit event. Key may be required to pay the purchaser the difference between the par value and the market price of the debt obligation (cash settlement) or receive the specified referenced asset in exchange for payment of the par value (physical settlement). If Key effects a physical settlement and receives its portion of the related debt obligation, it will join other creditors in the liquidation process, which may enable Key to recover a portion of the amount paid under the credit default swap contract. Key also may purchase offsetting credit derivatives for the same reference entity from third parties that will permit it to recover the amount it pays should a credit event occur.

A traded credit default swap index represents a position on a basket or portfolio of reference entities. As a seller of protection on a credit default swap index, Key would be required to pay the purchaser if one or more of the entities in the index had a credit event. Upon a credit event, the amount payable is based on the percentage of the notional amount allocated to the specific defaulting entity.

In a risk participation agreement transaction, the lead participant has a swap agreement with a customer. The lead participant (purchaser of protection) then enters into a risk participation agreement with a counterparty (seller of protection), under which the counterparty receives a fee to accept a portion of the lead participant’s credit risk. If the customer defaults on the swap contract, the counterparty to the risk participation agreement must reimburse the lead participant for the counterparty’s percentage of the positive fair value of the customer swap as of the default date. If the customer swap has a negative fair value, the counterparty has no reimbursement requirements. If the customer defaults on the swap contract and the seller fulfills its payment obligations under the risk participation agreement, the seller is entitled to a *pro rata* share of the lead participant’s claims against the customer under the terms of the swap agreement.

For more information on Key’s credit derivatives and credit risk mitigation policies, see the sections titled “Counterparty Credit Risk” and “Credit Derivatives” in Note 8 (“Derivatives and Hedging Activities”) beginning on pages 51 and 52, respectively, of Key’s First Quarter 2017 Form 10-Q.



**SECURITIZATION**

As a normal course of business Key does not securitize any of its own assets, nor does it invest in any securitization that would be considered a securitization under the Basel III rules. Key's only exposure to securitizations for Basel III purposes are through investments contained within its corporate-owned life insurance/bank-owned life insurance portfolio, and through a small portfolio of securities that were acquired through previous acquisitions. Key's total risk-weighted asset impact from securitizations at March 31, 2017, is displayed in the table below.

<b>March 31, 2017</b> <i>in millions</i>	<b>On-Balance Sheet Amount</b>	<b>Risk-Weighted Asset Amount</b>
Securities <sup>(a)</sup>	—	—
Other assets <sup>(b)</sup>	\$ 68	\$ 68
<b>Total</b>	<b>\$ 68</b>	<b>\$ 68</b>

- (a) The securities portfolio is only \$23,000 with a risk-weighted asset amount of \$288,000.  
(b) Other assets include Key's corporate-owned life insurance/bank-owned life insurance portfolio.

**EQUITIES NOT SUBJECT TO SUBPART F OF THIS PART (THE MARKET RISK RULE)**

**Overview**

Key’s equity investments that are not subject to the Market Risk Rule are entered into for strategic business reasons or regulatory purposes. For more information on the valuation, treatment, and realized and unrealized gains and losses of these equity securities, see the section titled “Qualitative Disclosures of Valuation Techniques” in Note 6 (“Fair Value Measurements”) and Note 7 (“Securities”) beginning on pages 30 and 43, respectively, in Key’s First Quarter 2017 Form 10-Q.

The following table presents the carrying and fair values and the associated exposure and risk-weighted asset amounts of Key’s equity investments that are not subject to the Market Risk Rule at March 31, 2017.

<b>March 31, 2017</b>			
<i>in millions</i>		<b>Carrying Value</b>	<b>Fair Value</b>
Non-publicly traded	\$	2,908	\$ 2,908
Publicly traded		3	3
<b>Total</b>	<b>\$</b>	<b>2,911</b>	<b>\$ 2,911</b>

<b>March 31, 2017</b>			
<i>in millions</i>		<b>Exposure Amount <sup>(a)</sup></b>	<b>Risk-Weighted Asset Amount</b>
<b>Risk-Weights</b>			
0%	\$	354	—
20%		259	\$ 52
50%		124	62
100%		2,150	2,150
150%		15	23
400%		9	36
<b>Total</b>	<b>\$</b>	<b>2,911</b>	<b>\$ 2,323</b>

(a) Exposure amount includes \$953 million of separate and hybrid account Key corporate-owned life insurance/bank-owned life insurance assets.

**INTEREST RATE RISK FOR NONTRADING ACTIVITIES****Overview**

Most of Key’s nontrading market risk is derived from interest rate fluctuations and its impacts on Key’s traditional loan and deposit products, as well as investments, hedging relationships, long-term debt, and certain short-term borrowings. Interest rate risk, which is inherent in the banking industry, is measured by the potential for fluctuations in net interest income and the economic value of equity (“EVE”). Such fluctuations may result from changes in interest rates and differences in the repricing and maturity characteristics of interest-earning assets and interest-bearing liabilities. Key manages the exposure to changes in net interest income and the EVE in accordance with its risk appetite and within Board-approved policy limits.

Interest rate risk positions are influenced by a number of factors including the balance sheet positioning that arises out of consumer preferences for loan and deposit products, economic conditions, the competitive environment within Key’s markets, changes in market interest rates that affect client activity, and Key’s hedging, investing, funding, and capital positions. The primary components of interest rate risk exposure consist of reprice risk, basis risk, yield curve risk, and option risk.

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

For more information on Key’s interest rate risk and nontrading market risk, see “Market risk management” beginning on page 113 of Key’s First Quarter 2017 Form 10-Q.

**Simulation analysis**

The primary tool we use to measure our interest rate risk is simulation analysis. For purposes of this analysis, Key estimates the net interest income based on the current and projected composition of its on- and off-balance sheet positions, accounting for recent and anticipated trends in customer activity. The analysis also incorporates assumptions for the current and projected interest rate environments, and balance sheet growth projections based on a most likely macroeconomic view. While simulation modeling assumes that residual risk exposures are managed within the risk appetite and Board approved policy limits, the results also reflect management’s desired interest rate risk positioning. Achieving the current modeled position typically requires purchases of investment securities to replace security cash flows and the execution of new interest rate swaps to replace maturing interest rate swaps. The simulation model estimates the amount of net interest income at risk by simulating the change in net interest income that would occur if interest rates were to gradually increase or decrease over the next 12 months. Key’s standard rate scenarios encompass a gradual, parallel increase or decrease of 200 basis points, but due to the low interest rate environment, we have modified the standard decrease scenario to a gradual, parallel decrease of 100 basis points over six months with no change over the following six months. After calculating the amount of net interest income at risk to interest rate changes, Key compares that amount with the base case of an unchanged interest rate environment.

The following table presents the results of the simulation analysis at March 31, 2017. At March 31, 2017, Key’s simulated impact to changes in interest rates was modestly asset sensitive. Tolerance levels for risk management require the development of remediation plans to maintain residual risk within tolerance if simulation modeling demonstrates that a gradual, parallel 200 basis point increase or 100 basis point decrease in interest rates over the next 12 months would adversely affect net interest income over the same period by more than 5.5%. In March 2017, the Federal Reserve increased the range for the Federal Funds Target Rate, which led to an increase in the magnitude of the declining rate scenario to 100 basis points. As a result of the change, Key’s modeled exposure to declining rates increased. The modeled exposure depends on the relationships of interest rates on Key’s interest earning assets and interest bearing liabilities. As shown in following table, Key is operating within these levels as of March 31, 2017.

**March 31, 2017**

Basis point change assumption (short-term rates)	-100	+200
Tolerance level	-5.50 %	-5.50 %
Interest rate risk assessment	-4.03 %	1.05 %

Simulation analysis produces a sophisticated estimate of interest rate exposure based on judgments related to assumption input into the model. Key tailors assumptions to the specific interest rate environment and yield curve shape being modeled, and validate those assumptions on a regular basis. However, actual results may differ from those derived in simulation analysis due to unanticipated changes to the balance sheet composition, customer behavior, product pricing, market interest rates, changes in management's desired interest rate risk positioning, investment, funding and hedging activities, and repercussions from unanticipated or unknown events.

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

The results of additional assessments indicate that net interest income could increase or decrease from the base simulation results presented in the table above. Net interest income is highly dependent on the timing, magnitude, frequency, and path of interest rate increases and the associated assumptions for deposit repricing relationships, lending spreads, and the balance behavior of transaction accounts. The modeling is sensitive to the volume of fixed rate assets and liabilities incorporated. The modeling currently assumes approximately \$23.5 billion of investment security purchases and swap executions over the next three years. For every immediate reduction in fixed rate assets of \$1 billion, the modeled benefit to rising rates would increase by approximately 30 basis points. The low level of interest rates increases the uncertainty of assumptions for deposit balance behavior and deposit repricing relationships to market interest rates. Key's historical deposit repricing betas in the last rising rate cycle ranged between 50% and 60% for interest-bearing deposits, and Key continues to make similar assumptions in its modeling, with the modeled betas varying by customer segment and product type. Recent deposit repricing has been lower than Key's modeled assumptions. In the modeling, if the deposit beta for the first 25 basis point move in the Fed Funds Target Rate was zero, then returned to the standard modeled betas for the next 175 basis points of rate increases, Key's modeled asset sensitive benefit would increase by approximately 200 basis points. The sensitivity testing of assumptions supports Key's confidence that actual results are likely to be within 100 basis points of modeled results.

Key's current interest rate risk position could fluctuate to higher or lower levels of risk depending on the competitive environment and client behavior that may affect the actual volume, mix, maturity, and repricing characteristics of loan and deposit flows. Treasury discretionary activities related to funding, investing, and hedging may also change as a result of changes in customer business flows, or changes in management's desired interest rate risk positioning. As changes occur to both the configuration of the balance sheet and the outlook for the economy, management proactively evaluates hedging opportunities that may change Key's interest rate risk profile.

Key also conducts simulations that measure the effect of changes in market interest rates in the second and third years of a three-year horizon. These simulations are conducted in a manner similar to those based on a 12-month horizon.

**REFERENCES TO THE CORPORATION'S SEC FILINGS**

Key's SEC filings include important information that may assist readers' understanding of the disclosures made in this report. Specific references to Key's SEC filings are listed below.

<b>Pillar 3 Requirement</b>	<b>Description</b>	<b>First Quarter 2017</b>		
		<b>Pillar 3 Report</b>	<b>Form 10-Q</b>	<b>2016 Form 10-K</b>
		<b>Disclosure Begins on Page</b>		
Scope of Application	Introduction	3		106
	Funds and Capital Transfer Restrictions	4		14, 17, 125
Capital Structure	Regulatory Capital Instruments	5	4, 66, 71, 120	191, Exhibit 3.1, 3.2, 3.3, 3.4, 4.1 and 4.4
Capital Adequacy	Capital Management and Planning	7	82, 109	12, 67
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