

KEYCORP /NEW/  
Form 10-Q  
August 08, 2007

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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, 2007  
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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

390,382,146 Shares

(Title of class)

(Outstanding at July 31, 2007)

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

<i>dollars in millions</i>	<b>June 30, 2007 (Unaudited)</b>	<b>December 31, 2006</b>	<b>June 30, 2006 (Unaudited)</b>
<b>ASSETS</b>			
Cash and due from banks	\$ 1,818	\$ 2,264	\$ 2,814
Short-term investments	1,632	1,407	1,577
Securities available for sale	7,819	7,827	7,140
Investment securities (fair value: \$37, \$42 and \$45)	37	41	44
Other investments	1,602	1,352	1,379
Loans, net of unearned income of \$2,146, \$2,136 and \$2,078	66,692	65,826	67,408
Less: Allowance for loan losses	945	944	956
Net loans	65,747	64,882	66,452
Loans held for sale	4,546	3,637	4,189
Premises and equipment	600	595	557
Operating lease assets	1,110	1,124	1,043
Goodwill	1,202	1,202	1,372
Other intangible assets	110	120	132
Corporate-owned life insurance	2,822	2,782	2,732
Derivative assets	1,160	1,091	1,016
Accrued income and other assets	3,871	4,013	4,347
Total assets	\$ 94,076	\$ 92,337	\$ 94,794
<b>LIABILITIES</b>			
Deposits in domestic offices:			
NOW and money market deposit accounts	\$ 23,315	\$ 24,340	\$ 25,291
Savings deposits	1,613	1,642	1,751
Certificates of deposit (\$100,000 or more)	6,197	5,941	5,224
Other time deposits	11,832	11,956	11,542
Total interest-bearing deposits	42,957	43,879	43,808
Noninterest-bearing deposits	14,199	13,553	13,268
Deposits in foreign office <sup>3</sup> / <sub>4</sub> interest-bearing	3,443	1,684	3,762
Total deposits	60,599	59,116	60,838
Federal funds purchased and securities sold under repurchase agreements	4,362	3,643	3,654
Bank notes and other short-term borrowings	2,631	1,192	2,360
Derivative liabilities	1,119	922	1,156
Accrued expense and other liabilities	5,083	5,228	4,999
Long-term debt	12,581	14,533	14,050

Total liabilities	<b>86,375</b>	84,634	87,057
<b>SHAREHOLDERS EQUITY</b>			
Preferred stock, \$1 par value; authorized 25,000,000 shares, none issued			
Common shares, \$1 par value; authorized 1,400,000,000 shares; issued 491,888,780 shares	<b>492</b>	492	492
Capital surplus	<b>1,652</b>	1,602	1,577
Retained earnings	<b>8,720</b>	8,377	8,199
Treasury stock, at cost (102,527,008, 92,735,595 and 89,217,117 shares)	<b>(2,994)</b>	(2,584)	(2,411)
Accumulated other comprehensive loss	<b>(169)</b>	(184)	(120)
Total shareholders equity	<b>7,701</b>	7,703	7,737
Total liabilities and shareholders equity	<b>\$ 94,076</b>	\$ 92,337	\$ 94,794

See Notes to Consolidated Financial Statements (Unaudited).

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

<i>dollars in millions, except per share amounts</i>	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>INTEREST INCOME</b>				
Loans	\$ 1,176	\$ 1,136	\$ 2,337	\$ 2,196
Loans held for sale	82	73	157	141
Investment securities		1	1	1
Securities available for sale	106	84	206	167
Short-term investments	16	16	34	31
Other investments	15	17	28	42
Total interest income	<b>1,395</b>	1,327	<b>2,763</b>	2,578
<b>INTEREST EXPENSE</b>				
Deposits	447	378	880	708
Federal funds purchased and securities sold under repurchase agreements	59	20	108	40
Bank notes and other short-term borrowings	18	27	29	51
Long-term debt	185	198	381	381
Total interest expense	<b>709</b>	623	<b>1,398</b>	1,180
<b>NET INTEREST INCOME</b>				
Provision for loan losses	53	23	97	62
Net interest income after provision for loan losses	<b>633</b>	681	<b>1,268</b>	1,336
<b>NONINTEREST INCOME</b>				
Trust and investment services income	115	139	240	274
Service charges on deposit accounts	84	77	159	149
Investment banking and capital markets income	52	57	96	117
Operating lease income	66	56	130	108
Letter of credit and loan fees	45	45	83	85
Corporate-owned life insurance income	32	26	57	51
Electronic banking fees	25	27	49	51
Net gains from loan securitizations and sales	33	10	42	20
Net securities gains (losses)	2	4	(45)	5
Gain on sale of McDonald Investments branch network			171	
Other income	195	104	321	166
Total noninterest income	<b>649</b>	545	<b>1,303</b>	1,026
<b>NONINTEREST EXPENSE</b>				
Personnel	411	427	839	827
Net occupancy	59	59	122	120

Computer processing	<b>49</b>	49	<b>100</b>	105
Operating lease expense	<b>55</b>	45	<b>107</b>	86
Professional fees	<b>26</b>	40	<b>52</b>	73
Equipment	<b>24</b>	26	<b>49</b>	52
Marketing	<b>20</b>	23	<b>39</b>	38
Other expense	<b>171</b>	129	<b>291</b>	249
Total noninterest expense	<b>815</b>	798	<b>1,599</b>	1,550
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>				
	<b>467</b>	428	<b>972</b>	812
Income taxes	<b>130</b>	125	<b>277</b>	235
<b>INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>				
	<b>337</b>	303	<b>695</b>	577
(Loss) income from discontinued operations, net of taxes of (\$2), \$4, (\$7) and \$10, respectively (see Note 3)	<b>(3)</b>	5	<b>(11)</b>	15
<b>INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>				
	<b>334</b>	308	<b>684</b>	592
Cumulative effect of accounting change, net of taxes (see Note 1)				5
<b>NET INCOME</b>	<b>\$ 334</b>	<b>\$ 308</b>	<b>\$ 684</b>	<b>\$ 592</b>
Per common share:				
Income from continuing operations before cumulative effect of accounting change	<b>\$ .86</b>	<b>\$ .75</b>	<b>\$ 1.76</b>	<b>\$ 1.42</b>
Income before cumulative effect of accounting change	<b>.85</b>	<b>.76</b>	<b>1.73</b>	<b>1.46</b>
Net income	<b>.85</b>	<b>.76</b>	<b>1.73</b>	<b>1.47</b>
Per common share assuming dilution:				
Income from continuing operations before cumulative effect of accounting change	<b>\$ .85</b>	<b>\$ .74</b>	<b>\$ 1.74</b>	<b>\$ 1.40</b>
Income before cumulative effect of accounting change	<b>.84</b>	<b>.75</b>	<b>1.71</b>	<b>1.44</b>
Net income	<b>.84</b>	<b>.75</b>	<b>1.71</b>	<b>1.45</b>
Cash dividends declared per common share	<b>\$ .365</b>	<b>\$ .345</b>	<b>\$ .73</b>	<b>\$ .69</b>
Weighted-average common shares outstanding (000)	<b>392,045</b>	404,528	<b>394,944</b>	405,949
Weighted-average common shares and potential common shares outstanding (000)	<b>396,918</b>	410,559	<b>400,180</b>	411,842

See Notes to Consolidated Financial Statements (Unaudited).

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

	Common Share Outstanding (000)	Common Shares	Capital Surplus	Retained Earnings	Accumulated		
					Treasury Stock at Cost	Other Comprehensive Loss	
<i>dollars in millions, except per share amounts</i>							
<b>BALANCE AT DECEMBER 31, 2005</b>	406,624	\$ 492	\$ 1,534	\$ 7,882	\$ (2,204)	\$ (106)	
Net income				597			\$ 597
Other comprehensive income (losses):							
Net unrealized losses on securities available for sale, net of income taxes of (\$33) <sup>a</sup>						(55)	(55)
Net unrealized gains on derivative financial instruments, net of income taxes of \$5						9	9
Net unrealized losses on common investments held in employee welfare benefits trust, net of income taxes						(1)	(1)
Foreign currency translation adjustments						33	33
Total comprehensive income							\$ 583
Deferred compensation				19			
Cash dividends declared on common shares (\$.69 per share)				(280)			
Issuance of common shares for stock options and other employee benefit plans	6,048		24		158		
Repurchase of common shares	(10,000)				(365)		
<b>BALANCE AT JUNE 30, 2006</b>	402,672	\$ 492	\$ 1,577	\$ 8,199	\$ (2,411)	\$ (120)	
<b>BALANCE AT DECEMBER 31, 2006</b>	399,153	\$ 492	\$ 1,602	\$ 8,377	\$ (2,584)	\$ (184)	
Cumulative effect of adopting FSP 13-2, net of income taxes of (\$2) (see Note 1)				(52)			
Cumulative effect of adopting FIN 48, net of income taxes of (\$1) (see Note 1)				(1)			
<b>BALANCE AT JANUARY 1, 2007</b>				<b>8,324</b>			
Net income				<b>684</b>			\$ <b>684</b>
Other comprehensive income (losses):							
Net unrealized losses on securities available for sale, net of income taxes of (\$12) <sup>a</sup>						(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 (\$ .73 per share)						(286)				
Issuance of common shares for stock options and other employee benefit plans	4,209			23					117	
Repurchase of common shares	(14,000)								(527)	
<b>BALANCE AT JUNE 30, 2007</b>	<b>389,362</b>	<b>\$ 492</b>	<b>\$ 1,652</b>	<b>\$ 8,720</b>	<b>\$ (2,994)</b>	<b>\$ (169)</b>				

(a) Net of reclassification adjustments.

See Notes to Consolidated Financial Statements (Unaudited).

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**Table of Contents****Consolidated Statements of Cash Flows (Unaudited)**

<i>in millions</i>	<b>Six months ended June 30,</b>	
	<b>2007</b>	<b>2006</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 684	\$ 597
Adjustments to reconcile net income to net cash used in operating activities:		
Provision for loan losses	97	63
Depreciation and amortization expense	209	190
Litigation reserve	42	
Net securities (gains) losses	45	(5)
Gain from sale of McDonald Investments branch network	(171)	
Gains related to MasterCard Incorporated shares	(40)	(9)
Gain from settlement of automobile residual value insurance litigation	(26)	
Net gains from principal investing	(119)	(20)
Net gains from loan securitizations and sales	(42)	(20)
Loss from sale of discontinued operations	2	
Proceeds from settlement of automobile residual value insurance litigation	279	
Deferred income taxes	(56)	(195)
Net increase in loans held for sale	(909)	(808)
Net (increase) decrease in trading account assets	(82)	47
Other operating activities, net	(343)	(250)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(430)</b>	<b>(410)</b>
<b>INVESTING ACTIVITIES</b>		
Cash used in acquisitions, net of cash acquired		(34)
Proceeds from sale of McDonald Investments branch network, net of retention payments	199	
Proceeds from sale of Mastercard Incorporated shar		