

June 17, 2009

Research Update:

KeyCorp Ratings Lowered To 'BBB+/A-2' From 'A-/A-2'; Outlook Negative

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Overview

- We expect KeyCorp's credit losses to continue to rise and continue to pressure capitalization levels, despite its recent successful raising of capital; profit levels should be muted through 2010.
- We have lowered KeyCorp's long-term counterparty credit rating to 'BBB+' from 'A-'. The outlook is negative.
- The negative outlook reflects our expectation for potential further deterioration in credit quality beyond our current expectations.

Rating Action

On June 17, 2009, Standard & Poor's Ratings Services lowered its rating on KeyCorp to 'BBB+/A-2' from 'A-/A-2'. The outlook is negative. At the same time, we lowered our ratings on KeyBank N.A. Cleveland, the company's primary subsidiary, to 'A-/A-2' from 'A/A-1'. All ratings were removed from CreditWatch, where they were placed on May 4, 2009, in conjunction with our review of U.S. banks.

Rationale

The rating downgrade largely results from our expectation that the company's net losses will continue to rise, thus depressing profitability and constraining its capital buildup. We view negatively the deterioration across KeyCorp's various loan portfolios, including real estate construction, commercial mortgages, and commercial loans. In addition, KeyCorp fared unfavorably relative to certain peers in our credit stress testing, which is one component of our analysis, taking into consideration the bank's completed and planned capital actions.

This rating action is consistent with our view that industry risk within the financial services sector is even higher than we had earlier expected. Specifically, we believe that the U.S. banking system's credit outlook will continue to weaken and that the economic environment will remain tepid for some time.

The rating downgrade also reflects our view of KeyCorp's weakening operating performance in recent quarters. Its non-GAAP (generally accepted accounting principles) net losses were \$301 million in first-quarter 2009, compared with net losses of \$224 million in fourth-quarter 2008. We expect net losses to persist over the next several quarters, as we see elevated loan loss provisions and depressed net interest margins. We think the company's operating performance continues to lag certain peers, despite positive reductions in noninterest expenses. Still, the ratings are supported by our view that KeyCorp's overall liquidity position is satisfactory--somewhat

weaker than peers at its primary bank based on its loan-to-deposit ratio, but strong at the holding company.

We think its troubled assets and the pace of deterioration are high. Nonperforming assets rose to 2.70% as of March 31, 2009, up from 1.91% at year-end 2008 and 1.46% a year earlier. The construction and land loan portfolio (about 8.5% of total loans as of March 31, 2009) consists mostly of commercial construction loans, which are so far holding up better than residential construction loans. Still, the company is experiencing credit deterioration across its various portfolios, most notably in its real estate construction, commercial mortgage, and commercial, financial, and agricultural (CF&A) loan portfolios. We also expect more deterioration within its loans held for sale and exit loan portfolios, including auto and marine loans. Total exposure in these portfolios has declined significantly, but still represents a significant proportion of total loans. The company's significant exposure to several depressed state economies which we believe negatively impacts the credit profile.

While KeyCorp fared unfavorably relative to certain peers in our credit stress testing, we anticipate it will satisfy the government's \$1.8 billion requirement under its Supervisory Capital Assessment Program (SCAP) through a combination of equity issuances, preferred exchanges, capital gains, and other measures. We think these capital actions partially address the decline in tangible capital levels in recent quarters and will absorb the net losses, which we expect over the next several quarters.

Outlook

The negative outlook reflects our belief that KeyCorp's operating performance will remain under pressure for some time, particularly with regard to its credit and earnings risk. The current ratings incorporate our expectation that KeyCorp will successfully satisfy SCAP's capital requirements. If the bank's credit quality or operating performance deteriorates beyond our current expectations, we could lower the rating further. On the other hand, if KeyCorp returns to profitability earlier than we now anticipate as a result of stabilizing credit quality, then we could raise the outlook to stable. We view an upgrade of the ratings as less likely in the near term.

Related Research

- "Credit Stress Testing For Financial Institutions," April 29, 2009.
- "Stress Testing U.S. Financial Institutions," April 29, 2009.
- "What Stress Tests Reveal about U.S. Banks' Capital Needs," May 1, 2009.
- "Ratings On 23 Financial Institutions Placed On CreditWatch Negative," May 4, 2009.
- "KeyCorp," Dec. 30, 2008.

Ratings List

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
KeyCorp		

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Counterparty Credit Rating	BBB+/Negative/A-2	A-/Watch Neg/A-2
Downgraded; CreditWatch/Outlook Action	To	From
Key Equipment Finance Inc. KeyBank N.A. Cleveland Counterparty Credit Rating	A-/Negative/A-2	A/Watch Neg/A-1
KeyBank N.A. Cleveland Certificate Of Deposit Local Currency	A-/A-2	A/Watch Neg/A-1
KeyCorp Senior Unsecured Preferred Stock	BBB+ BB	A-/Watch Neg BB+/Watch Neg
KEYCORP Capital VII Preferred Stock	BB	BB+/Watch Neg
KEYCORP Capital V Preferred Stock	BB	BB+/Watch Neg
KEYCORP Capital VI Preferred Stock	BB	BB+/Watch Neg
KeyBank N.A. Cleveland Senior Unsecured Subordinated	A- BBB+	A/Watch Neg A-/Watch Neg
KeyCorp Capital I Preferred Stock	BB	BB+/Watch Neg
KeyCorp Capital II Preference Stock	BB	BB+/Watch Neg
KeyCorp Capital III Preferred Stock	BB	BB+/Watch Neg
KeyCorp Capital IX Preferred Stock	BB	BB+/Watch Neg
KeyCorp Capital VIII Preferred Stock	BB	BB+/Watch Neg
KeyCorp Capital X Preferred Stock	BB	BB+/Watch Neg
Ratings Affirmed		
KeyCorp		

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Senior Unsecured	AAA	
KeyBank N.A. Cleveland		
Senior Unsecured	AAA	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	From
KeyCorp		
Commercial Paper	A-2	A-2/Watch Neg

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