May 14, 2013

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: File Reference No. 2013-220

Dear Director,

We are writing in response to your invitation to comment on the FASB’s Proposed Accounting Standards Update entitled Recognition and Measurement of Financial Assets and Financial Liabilities ("Exposure Draft").

KeyCorp ("Key"), headquartered in Cleveland, Ohio, is a bank-based financial services company that, at March 31, 2013, had assets of approximately $89 billion. We appreciate the opportunity to comment on this Exposure Draft. We support the efforts of the FASB to ensure that useful information is provided in the financial statements while taking into account the operational feasibility and costs for preparers to comply with accounting and disclosure requirements.

As of March 31, 2013, Key had approximately $701 million in trading assets, $13.5 billion in securities available for sale, $3.7 billion in held-to-maturity securities, $52.6 billion in loans net of unearned income, and $434 million in loans held for sale. These financial instruments represent approximately 80% of Key’s total assets (excluding Key’s equity-method investments and discontinued operations). In addition, Key had approximately 875,000 committed and outstanding loans as of March 31, 2013.

Key takes pride in providing detailed, timely and comprehensive financial information to the investment community. Key also supports standards and interpretations that clearly result in reliable and relevant information that can improve investor understanding and allow for more informed decisions. Therefore, this proposed guidance is of great interest to Key, especially since it could have a significant impact on Key’s balance sheet, income statement and financial statement disclosures.

Key supports the objective of the Exposure Draft to provide financial statement users with information about an entity’s involvement in financial instruments and to reduce the complexity in accounting for those instruments. Key agrees with the Board’s goal to develop a consistent and comprehensive framework for classifying financial assets based on how an entity expects to benefit from the respective cash flows. However, the Exposure Draft does not meet the stated objective and goal. Key has concerns with many aspects of the Exposure Draft and does not believe that it provides any substantial enhancements to the accounting for or disclosure of financial assets and liabilities.

Our general comments regarding this Exposure Draft are provided below.
**Business Model**

Key conceptually agrees with the business model approach, whereby an entity classifies a financial asset based on how the asset will be managed. This approach best reflects management’s strategy for the assets and their cash flows and provides useful information to financial statement users on future cash flows and the impact on an entity’s income statement.

We also believe that the three categories (amortized cost, fair value through OCI, and fair value through net income) are inclusive of multiple management strategies and allow for comparability among organizations. Key believes that the amortized cost category should be most prevalently utilized with loan portfolios and debt securities that are held for the collection of cash flows, which is an established asset/liability management strategy within financial institutions.

The Exposure Draft provides examples of when it would and would not be appropriate to sell instruments out of the amortized cost category. The FASB should consider minimizing or eliminating altogether the examples and instead focus on the principle that sales from the amortized cost category should only occur as a result of a change in management’s intent. Entities should have the ability to determine how frequently certain events occur and support their decisions as to whether those events are consistent with the objective of the amortized cost classification. Relying on professional judgment is the most appropriate approach to determine the classification and measurement of financial instruments, which is consistent with the Exposure Draft’s removal of the tainting concept.

If the FASB intends to issue the guidance with the examples in the Exposure Draft, the following items need to be addressed:

- To maximize the collection of cash flows, an entity should be allowed to sell financial assets when there is an expected loss, not just an incurred loss. Waiting until an instrument becomes nonperforming for disposition does not meet the objective of maximizing cash flows. This concept is also consistent with the FASB’s Proposed Accounting Standards Update entitled *Financial Instruments – Credit Losses*. In addition, entities should be allowed to sell financial assets in the amortized cost category to manage concentration risk, which will also result in entities maximizing the collection of cash flows if there are known concerns with certain industries or geographic regions.
- The Exposure Draft also precludes selling financial assets out of the amortized cost category if a regulator requires the financial institution to sell or transfer certain debt instruments, while the action is allowable when a regulator requires all financial institutions to sell or transfer certain debt instruments. Selling or transferring financial assets in both situations should be allowable since they both represent a change in regulatory guidance and are consistent with the objective of the amortized cost classification.

**Contractual Cash Flow Characteristics**

The first test in classifying financial assets is based on whether the terms of the financial assets give rise on specific dates to cash flows that are solely payments of principal and interest on the principal amount outstanding ("SPPI test"). Key believes that the SPPI test has the potential to become quite complex and time consuming and result in many standard financial assets failing the SPPI test. There are also inconsistencies in the examples provided within the Exposure Draft that will make it difficult to implement as written.

Financial institutions incorporate different terms into contractual lending agreements for different reasons, whether it is based on customer need, customer’s credit risk, market pricing, customer relationship, competition from other institutions, or management of the institution’s asset/liability risk. Terms can
include such items as principal and interest only loans, floating rates, prepayment and extension options (lender and/or customer), interest rate caps, interest rate resets, and contingencies should certain events occur. The rates can be tied to LIBOR, prime rate or other indices and include different tenors, and can be adjusted by the lender or customer based on certain circumstances. Principal and interest payments can start and stop at different intervals, which only alter the timing of cash flows. Most of these terms are standard practice in the banking industry, and are especially prevalent in commercial loans that are highly individualized. While the economics and cash flow scenarios may differ under these various terms, the financial institution will still collect principal and interest on the principal amount outstanding. Per the Exposure Draft, many of these loans will fail the SPPI test, which will force entities to record loans at fair value through net income, even when the business model suggests that the instruments will be held for collection of contractual cash flows. This result could create significant volatility within a financial institution’s income statement, which directly impacts regulatory capital ratios. Based on tolerances, management at financial institutions may begin to limit the number of terms or loan products offered to reduce the risk of volatility, which will decrease the number of options available for consumers and commercial entities.

Under the Exposure Draft, if such terms exist that modify the economic relationship between principal and interest, entities are required to consider the cash flows of a comparable or “benchmark” instrument that does not contain the modification. The benchmark instrument should have the same credit quality and same contractual terms, except for the term being analyzed. In conducting the assessment, entities must also consider variables that would impact future cash flows, such as interest rate curve changes over the life of the instrument, under reasonably possible scenarios. There will be a considerable amount of judgment applied to defining a benchmark instrument, market terms and possible scenarios for the cash flow analysis. These points will be considerably difficult to define during an economic downturn. Considering the amount of loans that a financial institution may originate at any point in time, the process of analyzing cash flows for loans with non-standard terms will be burdensome and time consuming, especially at the time of implementation. This result is coupled with the fact that many contractual terms are within the loan agreement itself (i.e., prepayment and extension options, contingencies) and not separately tracked in loan systems and therefore will have to be manually gathered and tracked.

As an alternative, Key suggests that the FASB retain the concept of clearly and closely related per the embedded derivative guidance in ASC 815, Derivatives and Hedging. This accounting guidance has been in practice for a number of years, it is well understood by financial statement users and preparers as well as auditors, and there is sufficient, detailed guidance and examples available. Key believes that this methodology will lead to accounting results that are better aligned with the FASB’s intentions, whereby an entity’s typical financial instruments originated or purchased in the ordinary course of business will pass the SPPI test. Retaining the embedded derivative guidance and allowing for the bifurcation of financial assets will provide consistent accounting treatment of embedded derivatives for both financial assets and liabilities.

Another concern with the SPPI test relates to loans purchased at a discount that contain a prepayment option. The Exposure Draft defines principal as the amount transferred by the holder at initial recognition. Even if the prepayment amount represents unpaid principal and interest, an entity may fail the SPPI test because in the event of a call, the return may represent more than just principal and interest. Key believes that this is an unintended consequence of the Exposure Draft.

**Beneficial Interests in Securitized Financial Assets**

The SPPI test for beneficial interests in securitized financial assets is overly burdensome and will most likely not result in differences from current accounting. While the underlying pool information should be available, it will be extremely time consuming to evaluate the cash flow characteristics for the pool in each beneficial interest owned by an entity. These types of financial instruments are held by financial institutions in large quantities as part of asset/liability and liquidity management and to meet regulatory
requirements. Key suggests that the SPPI test for beneficial interests in securitized financial assets only include the first condition listed in the Exposure Draft, whereby the contractual terms of the beneficial interest give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. This change will remove the requirements to perform a detailed analysis of the underlying pool as well as analyze the credit risk in the underlying pool, which is a credit impairment concept and not mentioned in the SPPI test for other financial assets.

Equity Method Investments

The Exposure Draft would require equity method investments with potential exit strategies and a defined timeline for exit to be classified as held for sale. This guidance would require Key to measure certain limited life investments, such as investments in low-income housing tax credit (LIHTC) funds, at fair value through net income. Key does not have the intent to sell these investments prior to their contractual maturity, nor is there a market to sell these types of investments, thereby creating difficulties in determining their fair values. The guidance in the Exposure Draft should be changed so that equity method investments are only classified as held for sale when management has the intent and ability to sell the investments.

Financial Assets Subsequently Identified for Sale

There may be occasions when an entity subsequently decides to sell a financial asset that has been measured in the amortized cost category. Per the Exposure Draft, the financial asset will remain in the amortized cost category. If the fair value of the financial asset is below the carrying amount, then impairment for the difference should be recorded in net income. If the fair value of the financial asset is greater than the carrying amount, no entry is recorded. This proposed guidance is inconsistent with the proposed accounting for financial assets in the fair value through OCI category and the fair value through net income category. For these two categories, the financial assets are recorded at fair value, which takes into account gains and losses. If a financial asset will be held for sale, then it should be measured at fair value with the change in fair value recorded in net income. The financial asset should then be classified in the fair value through net income category, not the amortized cost category.

Financial Liabilities

Key agrees that financial liabilities should be measured at amortized cost, and if the liability is recorded at fair value, then changes due to an entity’s own credit risk should be recorded through OCI rather than through net income. Key also supports the concept that a nonrecourse financial liability should follow the same classification as the related financial assets that will be used to settle the liability. However, it is important to note that nonrecourse financial liabilities cannot be measured by using only the factors used in measuring the related financial assets. The liabilities tend to have some contractual terms that are different from the related financial assets, which will create a difference in how they are measured from both a fair value and amortized cost perspective.

Loan Commitments, Revolving Lines of Credit and Commercial Letters of Credit

Under the current guidance in ASC 815, Derivatives and Hedging, commitments to originate mortgage loans that will be held for sale are recorded at fair value, and changes in fair value are recorded in income. The Exposure Draft expands this guidance to include all loan commitments, revolving lines of credit and commercial letters of credit and further states that these items will be classified in accordance with the underlying loan if the probability of exercise is not remote. Entities will need to conduct the SPPI and business model tests at the commitment stage and before any loan, line of credit or letter of credit has been funded or drawn upon. As previously discussed, many standard loans will fail the SPPI test, and consequently, there will be a significant number of commitments, lines of credit and letters of credit classified as fair value through net income, even though there may be no intent to sell the underlying loan
upon funding. This result will add to the potential volatility in a financial institution’s income statement. If the future loan classification is important to financial statement users, Key suggests that the information be disclosed in the notes to the financial statements, rather than recorded on the balance sheet.

**Presentation and Disclosure**

The Exposure Draft requires that fair value be parenthetically disclosed for financial assets and liabilities measured at amortized cost in the balance sheet. In addition, the FASB’s Proposed Accounting Standards Update entitled *Financial Instruments – Credit Losses* requires that net amortized cost be disclosed parenthetically in the balance sheet for financial assets measured at fair value through OCI as well as the expected credit losses for financial assets measured at amortized cost. On the balance sheet, financial assets and liabilities will be grouped separately by the three measurement categories, and financial assets initially classified as amortized cost but subsequently identified for sale as well as equity method investments held for sale will have separate line items. All of this amortized cost, fair value and expected credit loss information crowded on the balance sheet will be confusing for financial statement users, and should instead be moved to a footnote disclosure. The face of the balance sheet should represent information based on how an entity’s assets and liabilities are managed and recorded in the entity’s books and records.

The parenthetical disclosure of fair value information on the balance sheet will create an unacceptable timing issue related to Key’s earning release. Key currently utilizes a third party valuation provider to calculate fair value for certain financial instruments, such as deposits, portfolio loans and Key’s own debt. The fair value information is typically not available at the time the earnings release is issued, which is typically several weeks before the financial statements are issued and filed with the SEC. Including fair value information on the balance sheet is not feasibly possible given the short timeframe in which our earnings release is prepared and distributed. Even if it would be feasibly possible, it will create an unnecessary burden and significant additional costs and effort for our internal personnel as well as our third party valuation provider to make this information available sooner.

The Exposure Draft also requires that interest income and expense, changes in the credit losses for current period, and realized gains and losses be disclosed in separate line items in the income statement for financial instruments measured at amortized cost and those measured at fair value through OCI. Realized and unrealized gains or losses on financial instruments for financial instruments measured at fair value through net income also need to be shown separately in the income statement. Key does not believe that financial statement users have a need for this level of disaggregated detail on the face of the financial statements. This level of detail, if even necessary, would be more appropriate to include in the notes to the financial statements.

ASC 820, *Fair Value Measurement*, requires a significant number of disclosures related to assets and liabilities recorded at fair value on a recurring and nonrecurring basis. The Exposure Draft is requiring similar disclosures for financial instruments measured at amortized cost. Key believes that this information is not useful to financial statement users, since it is not representative of how an entity’s financial instruments are managed in the normal course of business.

**Implementation**

Key agrees with the proposed transition by means of a cumulative-effect adjustment as of the beginning of the first reporting period in which the guidance is effective. If the final standard incorporates all the requirements per the Exposure Draft, financial institutions will need several years to implement the guidance. Financial institutions have a significant number of financial assets in the form of loans and debt securities that will need to be analyzed on an individual basis for the SPPI test and then on a portfolio basis for the business model test. As previously stated, many loan terms (i.e. those that do not impact rates, maturity, or payment terms) are not entered into a loan system and can only be found by
manually reviewing the loan agreement itself, which will need to be performed for hundreds of thousands of loans. As noted previously, Key had approximately 875,000 committed and outstanding loans as of March 31, 2013. This will be an extremely burdensome and time consuming task to review the applicable loan files. In addition, many financial institutions have multiple loan systems in which to gather data. Financial institutions will then need to perform a cash flow analysis for a significant number of loans for the SPPI test. Financial institutions will also need to conduct the SPPI test on a significant number of beneficial interests, through the gathering and review of underlying pool data and analysis of credit risk exposure. Implementation will take a considerable amount of time.

Conclusion

As noted above, Key supports the FASB’s objective to present financial statement users with useful information about an entity’s financial instruments and to make the accounting for these instruments less complex. However, the Exposure Draft as proposed does not meet those objectives. In many cases, financial statement users will be presented with an overwhelming amount of information, some of which may not be representative of how an entity manages its financial instruments. The proposed SPPI test is overly complex and will be burdensome to implement and require a significant amount of judgment. While the business model test is representative of how financial assets should be classified for accounting purposes, the eligibility to sell financial assets from the amortized cost category is too rule-based, and the related accounting is inconsistent with other financial assets held for sale. The end result will lead to more financial assets being recorded at fair value through net income, which will create volatility in the income statement and financial institutions’ regulatory capital ratios. In the final analysis, Key does not believe that the Exposure Draft as proposed will result in a significant, if any, enhancement in the accounting for financial assets and liabilities.

We appreciate the opportunity to comment on this Exposure Draft and hope that our comments are helpful in developing any final accounting guidance that may result from this proposal.

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We welcome the opportunity to discuss this issue in more detail. Please feel free to contact Chuck Mainbourgh, Director of SEC Reporting and Accounting Policy, at 216-689-4082 or me at 216-689-7841.

Sincerely,

Robert L. Morris
Executive Vice President &
Chief Accounting Officer