

KeyCorp - Where to Focus Relationship-Building Effort?

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Decision scope: A hypothetical review of where to prioritize relationship and deposit-pricing effort

Case convention: The assignment is hypothetical. KeyCorp has not disclosed a fixed budget, a formal mandate, or a management conflict for this decision.

The assignment

Imagine joining KeyCorp's strategy team at the start of March 2024. The team is preparing its next review of customer and deposit priorities. Where should it focus its next relationship-building effort: deepen commercial relationships and operating deposits; selectively defend consumer relationships through pricing or service; or use a differentiated approach based on relationship value, local competition and funding characteristics?

Key has publicly emphasized relationships, primacy and "quality deposits," while de-emphasizing nonrelationship business. Its recent results show different deposit trends in Consumer and Commercial, but both businesses faced higher deposit costs and lower taxable-equivalent net interest income. The public information does not reveal customer-level profitability or the marginal results of a pricing or service offer. How should the team choose what to test and what evidence should guide its next step? [P1] [P2] [P3]

Key's banking businesses

KeyCorp is a bank holding company. KeyBank National Association conducts the company's principal banking business. Consumer Bank serves households through a branch and digital network, while Commercial Bank serves businesses and other organizations through relationship banking, lending and financial services. KeyBanc Capital Markets provides investment banking and capital markets services to corporate and institutional clients. The consolidated company and KeyBank are not interchangeable scopes. [P1, Item 1, printed pp. 6-9]

At December 31, 2023, KeyBank reported 959 branches and 1,217 ATMs. Key described its retail presence as approximately 1,000 branches and 1,200 ATMs across 15 states. Its commercial capabilities and client reach extend beyond that branch footprint. [P2, printed pp. 8-9]

Recent results

For the fourth quarter of 2023, Key reported taxable-equivalent (TE) net interest income of \$928 million and a net interest margin of 2.07%, down 66 basis points from a year earlier.

Management attributed the year-over-year pressure to higher deposit and borrowing costs outpacing higher yields on earning assets, along with a shift from noninterest-bearing deposits toward higher-cost interest-bearing deposits. Quarter over quarter, TE NII rose \$5 million and NIM improved 6 basis points; management attributed some of the improvement to interest-rate-risk actions, elevated liquidity and a better funding mix. These are management explanations, not estimates of each factor's independent effect. [P2, printed p. 2]

Average total deposits in Q4 were \$145.076 billion, compared with \$145.666 billion in Q4 2022. The average deposit cost rose to 2.06% from 0.51%. Management attributed the year-over-year balance decline to changing client behavior in a higher-rate environment. Sequentially, average deposits rose \$251 million; management cited seasonal commercial balances, partly offset by lower other time and wholesale deposits. [P2, printed pp. 3-4]

Exhibit 1. Consumer and Commercial Bank, Q4 2023

Measure	Consumer Bank	Commercial Bank
Average deposits	\$84.856bn	\$56.897bn
Change in average deposits vs. Q4 2022	-2.9%	+4.6%
Q4 TE net interest income	\$558m	\$444m
Change in average TE NII vs. Q4 2022	-12.0%	-8.6%

Source: KeyCorp Q4/FY2023 earnings release and financial supplement, P2, Consumer and Commercial tables, printed pp. 7-8. Segment average balances and TE NII are not customer-level profitability or marginal offer returns. Management attributed Consumer deposit declines to changing behavior at higher rates and NII declines in both businesses largely to higher interest-bearing deposit costs and funding mix. [P2, printed pp. 7-9]

Commercial deposits grew year over year while Commercial NII fell. Consumer deposits and Consumer NII both declined. The figures raise different questions: whether Commercial growth accompanies valuable broader relationships, whether targeted Consumer offers could retain valuable households, and whether either strategy changes the overall cost and stability of funding. The public figures do not answer those questions.

Deposits, mix and the outlook

At year end, total deposits were \$145.6 billion, compared with \$142.6 billion a year earlier. Noninterest-bearing deposits declined from \$40.8 billion to \$30.7 billion, while time deposits increased from \$7.4 billion to \$14.8 billion. Key reported \$61.5 billion of uninsured deposits, or 42% of total deposits, compared with \$67.1 billion, or 47%, in 2022. These period-end figures differ from average balances and describe aggregate mix, not account-level behavior. [P1, Item 7, printed pp. 70-71]

Key reported a cumulative total interest-bearing deposit beta of 49% in Q4 2023, indexed to Q4 2021. The companywide measure is not a Consumer or Commercial beta and does not show how deposit volumes respond to a particular offer. [P3, slide 7]

For 2024, Key forecast average deposits flat to down 2%, TE NII down 2% to 5%, and average loans down 5% to 7%. Management expected deposit costs to peak in the first half and consumer betas to lag the first rate cuts. The general outlook blended forward curves dated December 31, 2023 and January 5, 2024; the separate December 31 curve assumption applied to the swap and Treasury maturity-tailwind calculation. These were forecasts as of the cutoff, not realized results. [P3, slides 13-15]

Choosing what to prioritize

The company's stated strategy includes relationship growth, primacy and quality deposits. In 2023, management reported growth of 4% in commercial clients and 3% in consumer relationship households. It also said it was de-emphasizing nonrelationship business. These statements establish strategic direction, but Key did not disclose a single public measure of "quality" or relationship-level returns. [P3, slide 3]

Three approaches merit consideration:

1. **Deepen commercial relationships.** Focus on operating deposits and broader services for business clients. The commercial deposit balance grew, but NII declined and public results do not show which clients or services drove relationship economics.
2. **Defend selected consumer relationships.** Use targeted pricing or service to retain households whose broader relationship may justify the cost. Consumer deposits declined, but public data do not show rate sensitivity, attrition by cohort or the value of retained customers.
3. **Differentiate by relationship and funding characteristics.** Tailor offers using relationship depth, local alternatives, deposit behavior and funding stability. This would require customer-level measures that are not in the public record.

Each approach involves trade-offs. Higher rates may retain or attract balances but also increase funding cost. Lower-priced deposits may be more attractive to the bank but can be more rate-sensitive, while broad relationship value may include lending, payments, treasury management or other services not visible in segment deposit totals. Commercial balances may also vary seasonally. The reported data are not enough to rank the approaches by return.

Decision prompt

Recommend where Key should focus its next relationship-building effort and what it should learn before expanding that effort. Identify the customer or relationship measures, pricing and service costs, funding characteristics, competitor evidence and safeguards needed to evaluate the choice. State the strongest counterargument to your recommendation. Separate reported facts, management explanations and forecasts from your assumptions. Do not treat segment NII, average deposit balances or the companywide beta as customer-level offer economics.

Sources and conventions

All information is limited to public materials available through February 29, 2024. "TE" means taxable-equivalent; forecasts and causal explanations are attributed to management. Average balances are not period-end balances. Academic research and instructor interpretation are reserved for the private teaching note.

- **P1:** KeyCorp 2023 Form 10-K, filed February 22, 2024; Item 1, printed pp. 6-9; Item 7, pp. 70-71.

- **P2:** KeyCorp Q4 and FY2023 earnings release and financial supplement, January 18, 2024; printed pp. 2-4, 7-9.
- **P3:** KeyCorp Q4 2023 Earnings Review, January 18, 2024; slides 3, 7, 13-15.