COMMERCE BANCSHARES INC /MO/
Form 10-Q
May 04, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark
One)
p QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission File No. 0-2989
COMMERCE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

## Missouri

(State of Incorporation)
1000 Walnut,
Kansas City, MO
(Address of principal executive offices)

$$
43-0889454
$$

(IRS Employer Identification No.)

64106
(Zip Code)
(816) 234-2000
(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 p No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T
( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes p No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer p Accelerated filer o Non-accelerated filer o Smaller reporting company $£$ Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No p

As of April 24, 2012, the registrant had outstanding $88,452,726$ shares of its $\$ 5$ par value common stock, registrant's only class of common stock.

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## PART I: FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED BALANCE SHEETS

## ASSETS

Loans
Allowance for loan losses
Net loans
Loans held for sale
Investment securities:
Available for sale ( $\$ 420,085,000$ and $\$ 418,046,000$ pledged in 2012 and 2011, respectively, to secure structured repurchase agreements)
Trading
Non-marketable
Total investment securities
Short-term federal funds sold and securities purchased under agreements to resell
Long-term securities purchased under agreements to resell


Interest earning deposits with banks
Cash and due from banks
9,120,399 9,224,702
34,178 17,853
120,734 115,832
9,275,311 9,358,387
40,925 11,870
850,000 850,000
$\begin{array}{lll}-381,462 & 465,828\end{array}$
$\begin{array}{lll}\text { Land, buildings and equipment, net } & 353,866 & 360,146\end{array}$
$\begin{array}{lll}\text { Goodwill } & 125,585 & 125,585\end{array}$
Other intangible assets, net
Other assets
7,070 7,714
Total assets
404,548 405,962
LIABILITIES AND EQUITY
Deposits:
Non-interest bearing
\$20,526,917 \$20,649,367

Savings, interest checking and money market
Time open and C.D.'s of less than $\$ 100,000$
Savings, interest checking and money marke
Time open and C.D.'s of less than $\$ 100,000$
Time open and C.D.'s of $\$ 100,000$ and over
Total deposits
Federal funds purchased and securities sold under agreements to repurchase
Other borrowings
Other liabilities
\$5,209,381 \$5,377,549
9,038,283 8,933,941
1,143,687 1,166,104
1,380,409 1,322,289
16,771,760 16,799,883
1,122,988 1,256,081
111,520 111,817
Total liabilities
321,443 311,225
Commerce Bancshares, Inc. stockholders' equity:
Preferred stock, \$1 par value
Authorized and unissued 2,000,000 shares
Common stock, $\$ 5$ par value
Authorized 100,000,000 shares; issued 89,277,398 shares in 2012 and 2011
Capital surplus
Retained earnings
18,327,711 18,479,006

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| Treasury stock of 587,906 shares in 2012 and 217,755 shares in 2011, at cost | $(22,872$ | $)(8,362$ |
| :--- | :--- | :--- |
| Accumulated other comprehensive income | 118,056 | 110,538 |
| Total Commerce Bancshares, Inc. stockholders' equity | $2,195,336$ | $2,166,047$ |
| Non-controlling interest | 3,870 | 4,314 |
| Total equity | $2,199,206$ | $2,170,361$ |
| Total liabilities and equity | $\$ 20,526,917$ | $\$ 20,649,367$ |

See accompanying notes to consolidated financial statements.
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Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)
INTEREST INCOME
Interest and fees on loans
Interest and fees on loans held for sale
Interest on investment securities
Interest on short-term federal funds sold and securities purchased under agreements to resell
Interest on long-term securities purchased under agreements to resell
Interest on deposits with banks
Total interest income
For the Three Months Ended March 31
20122011
(Unaudited)

INTEREST EXPENSE
Interest on deposits:
$\begin{array}{lll}\text { Savings, interest checking and money market } & 5,081 & 6,900\end{array}$
$\begin{array}{ll}\text { Time open and C.D.'s of less than } \$ 100,000 & \text { 2,106 }\end{array}$
$\begin{array}{ll}\text { Time open and C.D.'s of } \$ 100,000 \text { and over } & \text { 1,911 } 2,673\end{array}$
Interest on federal funds purchased and securities sold under agreements to repurchase $\quad 225 \quad 622$
Interest on other borrowings 906
$\begin{array}{lll}\text { Total interest expense } & 10,229 & 14,853\end{array}$
Net interest income
159,737 160,973
Provision for loan losses
Net interest income after provision for loan losses
8,165 15,789
NON-INTEREST INCOME
$\begin{array}{lll}\text { Bank card transaction fees } & 34,733 & 37,462\end{array}$
$\begin{array}{lrl}\text { Trust fees } & 21,572\end{array}$
$\begin{array}{lll}\text { Deposit account charges and other fees } & 19,336 & 19,300\end{array}$
Capital market fees $\quad 6,871 \quad 4,720$
Consumer brokerage services 2,526 2,663
$\begin{array}{ll}\text { Loan fees and sales } & 1,561 \\ 1,824\end{array}$
$\begin{array}{lll}\text { Other } & 6,742 & 8,365\end{array}$
Total non-interest income 94,583 95,906
INVESTMENT SECURITIES GAINS (LOSSES), NET
$\begin{array}{ll}\text { Impairment reversals on debt securities } & 5,587 \\ 6,305\end{array}$
Noncredit-related reversals on securities not expected to be sold $\quad(5,907)(6,579$
Net impairment losses
Realized gains on sales and fair value adjustments
(320) ) (274

Investment securities gains, net
4,360 1,601
NON-INTEREST EXPENSE
Salaries and employee benefits $\quad 89,543 \quad 87,392$
Net occupancy $11,260 \quad 12,037$
Equipment
5,189 5,577
Supplies and communication 5,613 5,532
$\begin{array}{ll}\text { Data processing and software } & 17,469\end{array}$

| Marketing | 3,822 | 4,258 |
| :--- | :--- | :--- |
| Deposit insurance | 2,520 | 4,891 |
| Indemnification obligation | - | $(1,359$ |
| Other | 15,045 | 19,165 |
| Total non-interest expense | 150,461 | 153,960 |
| Income before income taxes | 99,734 | 88,457 |
| Less income taxes | 32,920 | 27,507 |
| Net income | 66,814 | 60,950 |
| Less non-controlling interest expense | 1,015 | 497 |
| Net income attributable to Commerce Bancshares, Inc. | $\$ 65,799$ | $\$ 60,453$ |
| Net income per common share - basic | $\$ .74$ | $\$ .66$ |
| Net income per common share - diluted | $\$ .74$ | $\$ .66$ |

See accompanying notes to consolidated financial statements.
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Commerce Bancshares, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In thousands) | For the Three Months Ended March 31 |  |
| :---: | :---: | :---: |
|  |  |  |
|  | 2012 | 2011 |
|  | (Unaudited) |  |
| Net income | \$66,814 | \$60,950 |
| Other comprehensive income (loss): |  |  |
| Available for sale debt securities for which a portion of an other-than-temporary impairment (OTTI) has been recorded in earnings: |  |  |
| Unrealized holding gains subsequent to initial OTTI recognition | 5,420 | 6,475 |
| Income tax expense | (2,060 | ) $(2,461$ |
| Net unrealized gains on OTTI securities | 3,360 | 4,014 |
| Other available for sale investment securities: |  |  |
| Unrealized holding gains (losses) | 6,319 | (10,405 |
| Reclassification adjustment for gains included in net income | (342 | ) (176 |
| Net unrealized gains (losses) on securities | 5,977 | (10,581 |
| Income tax (expense) benefit | (2,271 | ) 4,021 |
| Net unrealized gains (losses) on other securities | 3,706 | (6,560 ) |
| Prepaid pension cost: |  |  |
| Amortization of accumulated pension loss | 730 | 540 |
| Income tax expense | (278 | ) (205 |
| Pension loss amortization | 452 | 335 |
| Other comprehensive income (loss) | 7,518 | (2,211 |
| Comprehensive income | 74,332 | 58,739 |
| Non-controlling interest expense | (1,015 | ) (497 |
| Comprehensive income attributable to Commerce Bancshares, Inc | \$73,317 | \$58,242 |

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Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Commerce Bancshares, Inc. Shareholders

| (In thousands, except per share data) | Common Stock | Capital <br> Surplus | Retained Earnings | Treasury Stock |  |  | $\stackrel{\text { ig }}{8}$ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  | Other Comprehe Income (L | Non-Con iventerest s) |  |
|  | (Unaudited) |  |  |  |  |  |  |
| Balance January 1, 2012 | \$446,387 | \$1,042,065 | \$575,419 | \$(8,362 | )\$110,538 | \$ 4,314 | \$2,170,361 |
| Net income |  |  | 65,799 |  |  | 1,015 | 66,814 |
| Other comprehensive income |  |  |  |  | 7,518 |  | 7,518 |
| Distributions to non-controlling interest |  |  |  |  |  | (1,459 | ) $(1,459$ |
| Purchase of treasury stock |  |  |  | (31,600 | ) |  | (31,600 |
| Issuance of stock under purchase and equity compensation plans |  | (3,065 | ) | 9,019 |  |  | 5,954 |
| Net tax benefit related to equity compensation plans |  | 649 |  |  |  |  | 649 |
| Stock-based compensation |  | 1,407 |  |  |  |  | 1,407 |
| Issuance of nonvested stock awards |  | (8,071 | ) | 8,071 |  |  | - |
| Cash dividends (\$.230 per share) |  |  | (20,438 |  |  |  | (20,438 |
| Balance March 31, 2012 | \$446,387 | \$1,032,985 | \$620,780 | \$(22,872 | )\$ 118,056 | \$ 3,870 | \$2,199,206 |
| Balance January 1, 2011 | \$433,942 | \$971,293 | \$555,778 | \$ 2,371 | )\$ 63,345 | \$ 1,477 | \$2,023,464 |
| Net income |  |  | 60,453 |  |  | 497 | 60,950 |
| Other comprehensive loss |  |  |  |  | (2,211 | ) | (2,211 |
| Distributions to non-controlling interest |  |  |  |  |  | (206 | (206 |
| Purchase of treasury stock |  |  |  | (4,311 | ) |  | (4,311 |
| Issuance of stock under purchase and equity compensation plans | 1,136 | 3,687 |  | 6,062 |  |  | 10,885 |
| Net tax benefit related to equity compensation plans |  | 717 |  |  |  |  | 717 |
| Stock-based compensation |  | 1,256 |  |  |  |  | 1,256 |
| Issuance of nonvested stock awards | 965 | (852 | ) | (113 | ) |  | - |
| Cash dividends (\$.219 per share) |  |  | (20,054 |  |  |  | (20,054 |
| Balance March 31, 2011 | \$436,043 | \$976,101 | \$596,177 | \$(733 | ) $\$ 61,134$ | \$ 1,768 | \$2,070,490 |

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands) | For the Three Months Ended March 31 |  |  |
| :---: | :---: | :---: | :---: |
|  | $2012$ <br> (Unaudited) |  | 2011 |
| OPERATING ACTIVITIES: |  |  |  |
| Net income | \$66,814 |  | \$60,950 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |
| Provision for loan losses | 8,165 |  | 15,789 |
| Provision for depreciation and amortization | 11,021 |  | 11,868 |
| Amortization of investment security premiums, net | 11,987 |  | 2,713 |
| Investment securities gains, net(A) | (4,040 | ) | (1,327 |
| Net gains on sales of loans held for sale | (358 | ) | (571 |
| Originations of loans held for sale | - |  | (15,789 |
| Proceeds from sales of loans held for sale | 21,699 |  | 26,751 |
| Net (increase) decrease in trading securities | (11,300 | ) | 2,009 |
| Stock-based compensation | 1,407 |  | 1,256 |
| (Increase) decrease in interest receivable | 3,825 |  | (1,245 |
| Increase in interest payable | 114 |  | 69 |
| Increase in income taxes payable | 23,496 |  | 27,052 |
| Net tax benefit related to equity compensation plans | (649 | ) | (717 |
| Other changes, net | (12,036 | ) | (26,838 |
| Net cash provided by operating activities | 120,145 |  | 101,970 |
| INVESTING ACTIVITIES: |  |  |  |
| Proceeds from sales of investment securities(A) | 6,986 |  | 11,202 |
| Proceeds from maturities/pay downs of investment securities(A) | 643,378 |  | 610,003 |
| Purchases of investment securities(A) | (558,651 | ) | (801,432 |
| Net (increase) decrease in loans | (81,658 | ) | 17,270 |
| Long-term securities purchased under agreements to resell | - |  | (350,000 |
| Repayments of long-term securities purchased under agreements to resell | - |  | 100,000 |
| Purchases of land, buildings and equipment | (5,393 | ) | (5,819 |
| Sales of land, buildings and equipment | 701 |  | 1,686 |
| Net cash provided by (used in) investing activities | 5,363 |  | (417,090 |
| FINANCING ACTIVITIES: |  |  |  |
| Net increase (decrease) in non-interest bearing, savings, interest checking and money market deposits | (84,876 | ) | 334,382 |
| Net increase in time open and C.D.'s | 35,703 |  | 162,628 |
| Net decrease in short-term federal funds purchased and securities sold under agreements to repurchase | (133,093 | ) | (59,813 |
| Repayment of long-term borrowings | (297 | ) | (301 |
| Purchases of treasury stock | (31,600 | ) | (4,311 |
| Issuance of stock under stock purchase and equity compensation plans | 5,954 |  | 10,885 |
| Net tax benefit related to equity compensation plans | 649 |  | 717 |
| Cash dividends paid on common stock | (1,074 | ) | (20,054 |
| Net cash provided by (used in) financing activities | (208,634 | ) | 424,133 |
| Increase (decrease) in cash and cash equivalents | (83,126 | ) | 109,013 |
| Cash and cash equivalents at beginning of year | 517,551 |  | 460,675 |

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| Cash and cash equivalents at March 31 | $\$ 434,425$ | $\$ 569,688$ |
| :--- | :--- | :--- |
| (A) Available for sale and non-marketable securities | $\$ 9,271$ | $\$ 455$ |
| Income tax payments, net | $\$ 10,115$ | $\$ 14,784$ |
| Interest paid on deposits and borrowings | $\$ 1,311$ | $\$ 16,246$ |
| Loans transferred to foreclosed real estate | $\$ 19,364$ | $\$-$ |

See accompanying notes to consolidated financial statements.
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Commerce Bancshares, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2012 (Unaudited)

## 1. Principles of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts of Commerce Bancshares, Inc. and all majority-owned subsidiaries (the Company). Most of the Company's operations are conducted by its subsidiary bank, Commerce Bank (the Bank). The consolidated financial statements in this report have not been audited. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to 2011 data to conform to current year presentation. In the opinion of management, all adjustments necessary to present fairly the financial position and the results of operations for the interim periods have been made. All such adjustments are of a normal recurring nature. The results of operations for the three month period ended March 31, 2012 are not necessarily indicative of results to be attained for the full year or any other interim periods.

The significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the 2011 Annual Report on Form 10-K.

## 2. Loans and Allowance for Loan Losses

Major classifications within the Company's held to maturity loan portfolio at March 31, 2012 and December 31, 2011 are as follows:
(In thousands)
Commercial:
Business
Real estate - construction and land
Real estate - business
Personal Banking:
Real estate - personal $\quad 1,428,777$
Consumer $\quad 1,113,481 \quad 1,114,889$
Revolving home equity 463,587
$\begin{array}{lll}\text { Consumer credit card } & 788,701\end{array}$
$\begin{array}{lll}\text { Overdrafts } & \text { 3,530 } & \text { 6,51 }\end{array}$
Total loans
Mar. 31, 2012
Dec. 31, 2011

At March 31, 2012, loans of $\$ 3.1$ billion were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit obtained to secure public deposits. Additional loans of $\$ 1.2$ billion were pledged at the Federal Reserve Bank as collateral for discount window borrowings.

Allowance for loan losses

A summary of the activity in the allowance for loan losses during the three months ended March 31, 2012 and 2011 follows:

|  | For the Three Months Ended March | For the Three Months Ended March |
| :--- | :--- | :--- |
| 31,2012 |  |  |
| (In thousands) | Commercial Personal | 31, 2011 |
| Banking |  |  |

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| Balance at January 1 | \$ 122,497 | \$62,035 | \$ 184,532 | \$119,946 | \$77,592 | \$ 197,538 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision | (3,198 | ) 11,363 | 8,165 | 13,465 | 2,324 | 15,789 |
| Deductions: |  |  |  |  |  |  |
| Loans charged off | 2,528 | 13,389 | 15,917 | 6,364 | 17,025 | 23,389 |
| Less recoveries on loans | 703 | 4,049 | 4,752 | 1,304 | 3,296 | 4,600 |
| Net loans charged off | 1,825 | 9,340 | 11,165 | 5,060 | 13,729 | 18,789 |
| Balance at March 31 | \$117,474 | \$64,058 | \$ 181,532 | \$128,351 | \$66,187 | \$ 194,538 |

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The following table shows the balance in the allowance for loan losses and the related loan balance at March 31, 2012 and December 31, 2011, disaggregated on the basis of impairment methodology. Impaired loans evaluated under ASC 310-10-35 include loans on non-accrual status, which are individually evaluated for impairment, and other impaired loans discussed below and deemed to have similar risk characteristics, which are collectively evaluated. All other loans are collectively evaluated for impairment under ASC 450-20.

| (In thousands) | Commercial | Personal <br> Banking | Total |
| :--- | :--- | :--- | :--- |
| March 31, 2012 |  |  |  |
| Allowance for loan losses: | $\$ 5,221$ | $\$ 4,751$ | $\$ 9,972$ |
| Impaired loans | 112,253 | 59,307 | 171,560 |
| All other loans |  |  |  |
| Loans outstanding: | 102,005 | 30,686 | 132,691 |
| Impaired loans | $5,398,560$ | $3,716,720$ | $9,115,280$ |
| All other loans |  |  |  |
| December 31, 2011 | $\$ 6,668$ | $\$ 4,090$ | $\$ 10,758$ |
| Allowance for loan losses: | 115,829 | 57,945 | 173,774 |
| Impaired loans | 108,167 | 31,088 | 139,255 |
| All other loans | $5,266,796$ | $3,771,427$ | $9,038,223$ |

Impaired loans
The table below shows the Company's investment in impaired loans at March 31, 2012 and December 31, 2011. These loans consist of loans on non-accrual status and other restructured loans whose terms have been modified and classified as troubled debt restructurings under ASC 310-40. The restructured loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession. They are largely comprised of certain business, construction and business real estate loans classified as substandard. Upon maturity, the loans renewed at interest rates judged not to be market rates for new debt with similar risk, and as a result were classified as troubled debt restructurings. These loans totaled $\$ 41.3$ million at both March 31, 2012 and December 31, 2011. These restructured loans are performing in accordance with their modified terms, and because the Company believes it probable that all amounts due under the modified terms of the agreements will be collected, interest on these loans is being recognized on an accrual basis. Troubled debt restructurings also include certain credit card loans under various debt management and assistance programs, which totaled $\$ 22.5$ million at March 31, 2012 and $\$ 22.4$ million at December 31, 2011.
(In thousands)
Non-accrual loans
Restructured loans (accruing)
Total impaired loans

Mar. 31, 2012
\$68,875
63,816
\$132,691
53,482
63,773
\$139,255

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The following table provides additional information about impaired loans held by the Company at March 31, 2012 and December 31, 2011, segregated between loans for which an allowance for credit losses has been provided and loans for which no allowance has been provided.

|  | Recorded <br> Investment | Unpaid <br> Principal <br> Balance | Related <br> Allowance |
| :--- | :--- | :--- | :--- |
| (In thousands) |  |  |  |
| March 31, 2012 | $\$ 16,179$ | $\$ 20,555$ | $\$-$ |
| With no related allowance recorded: | 18,303 | 40,607 | - |
| Business | 11,705 | 14,747 | - |
| Real estate - construction and land | 770 | 782 | - |
| Real estate - business | $\$ 46,957$ | $\$ 76,691$ | $\$-$ |
| Real estate - personal |  |  |  |
|  | $\$ 16,833$ | $\$ 20,030$ | $\$ 1,566$ |
| With an allowance recorded: | 25,948 | 27,629 | 2,540 |
| Business | 13,037 | 18,147 | 1,115 |
| Real estate - construction and land | 7,448 | 10,194 | 617 |
| Real estate - business | 22,468 | 22,468 | 4,134 |
| Real estate - personal | $\$ 85,734$ | $\$ 98,468$ | $\$ 9,972$ |
| Consumer credit card | $\$ 132,691$ | $\$ 175,159$ | $\$ 9,972$ |
|  |  |  |  |
| Total |  |  |  |
| December 31, 2011 | $\$ 19,759$ | $\$ 22,497$ | $\$-$ |
| With no related allowance recorded: | 8,391 | 22,746 | - |
| Business | 6,853 | 9,312 | - |
| Real estate - construction and land | 793 | 793 | - |
| Real estate - business | $\$ 35,796$ | $\$ 55,348$ | $\$-$ |
| Real estate - personal |  |  |  |
| With an allowance recorded: | $\$ 15,604$ | $\$ 19,286$ | $\$ 1,500$ |
| Business | 37,387 | 47,516 | 2,580 |
| Real estate - construction and land | 20,173 | 24,799 | 2,588 |
| Real estate - business | 7,867 | 10,671 | 795 |
| Real estate - personal | 22,428 | 22,428 | 3,295 |
| Consumer credit card | $\$ 103,459$ | $\$ 124,700$ | $\$ 10,758$ |
| Total | $\$ 139,255$ | $\$ 180,048$ | $\$ 10,758$ |

Total average impaired loans for the three month periods ending March 31, 2012 and 2011 are shown in the table below.
(In thousands)
Average impaired loans:
For the Three Months Ended March 31, 2012

| Non-accrual loans | $\$ 67,564$ | $\$ 7,409$ | $\$ 74,973$ |
| :--- | :--- | :--- | :--- |
| Restructured loans (accruing) | 40,226 | 23,554 | 63,780 |
| Total | $\$ 107,790$ | $\$ 30,963$ | $\$ 138,753$ |

For the Three Months Ended March 31, 2011
Non-accrual loans
\$75,302 $\quad \$ 7,027 \quad \$ 82,329$
Restructured loans (accruing)
42,936 20,528 63,464
Total
\$118,238 \$27,555 \$145,793

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The table below shows interest income recognized during the three month periods ending March 31, 2012 and 2011 for impaired loans held at the end of each respective period. This interest relates to accruing restructured loans, as discussed above.

|  | For the Three <br> Months Ended <br> March 31 |  |
| :--- | :--- | :--- |
| (In thousands) | 2012 | 2011 |
| Interest income recognized on impaired loans: |  |  |
| Business | $\$ 105$ | $\$ 101$ |
| Real estate - construction and land | 250 | 260 |
| Real estate - business | 54 | 96 |
| Real estate - personal | 14 | 18 |
| Consumer credit card | 326 | 395 |
| Total | $\$ 749$ | $\$ 870$ |

Delinquent and non-accrual loans

The following table provides aging information on the Company's past due and accruing loans, in addition to the balances of loans on non-accrual status, at March 31, 2012 and December 31, 2011.

| Current or | 90 Days |  |
| :--- | :--- | :--- |
| Less Than | $30-89$ | Past Due |
| 30 Days PastDays Past and Still | Non-accrual |  |
| Due Due Accruing |  |  |

March 31, 2012
Commercial:
Business
Real estate - construction and land
Real estate - business
Personal Banking:
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Overdrafts
Total

| $\$ 2,893,883$ | $\$ 5,430$ | $\$ 782$ | $\$ 20,142$ | $\$ 2,920,237$ |
| :--- | :--- | :--- | :--- | :--- |
| 341,369 | 14,068 | 150 | 21,055 | 376,642 |
| $2,168,501$ | 12,892 | 1,638 | 20,655 | $2,203,686$ |
|  |  |  |  |  |
| $1,437,273$ | 11,020 | 3,151 | 7,023 | $1,458,467$ |
| $1,101,279$ | 10,511 | 1,691 | - | $1,113,481$ |
| 445,990 | 911 | 1,268 | - | 448,169 |
| 707,328 | 8,683 | 7,748 | - | 723,759 |
| 3,223 | 307 | - | - | 3,530 |

December 31, 2011
Commercial:
Business
Real estate - construction and land
Real estate - business
Personal Banking:
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Overdrafts
Total

| $\$ 2,777,578$ | $\$ 4,368$ | $\$ 595$ | $\$ 25,724$ | $\$ 2,808,265$ |
| :--- | :--- | :--- | :--- | :--- |
| 362,592 | 1,113 | 121 | 22,772 | 386,598 |
| $2,151,822$ | 8,875 | 29 | 19,374 | $2,180,100$ |
|  |  |  |  |  |
| $1,406,449$ | 11,671 | 3,045 | 7,612 | $1,428,777$ |
| $1,096,742$ | 15,917 | 2,230 | - | $1,114,889$ |
| 461,941 | 1,003 | 643 | - | 463,587 |
| 769,922 | 10,484 | 8,295 | - | 788,701 |
| 6,173 | 388 | - | - | 6,561 |
| $\$ 9,033,219$ | $\$ 53,819$ | $\$ 14,958$ | $\$ 75,482$ | $\$ 9,177,478$ |

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Credit quality
The following table provides information about the credit quality of the Commercial loan portfolio, using the Company's internal rating system as an indicator. The internal rating system is a series of grades reflecting management's risk assessment, based on its analysis of the borrower's financial condition. The "pass" category consists of a range of loan grades that reflect increasing, though still acceptable, risk. Movement of risk through the various grade levels in the "pass" category is monitored for early identification of credit deterioration. The "special mention" rating is attached to loans where the borrower exhibits negative financial trends due to borrower specific or systemic conditions that, if left uncorrected, threaten its capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. It is a transitional grade that is closely monitored for improvement or deterioration. The "substandard" rating is applied to loans where the borrower exhibits well-defined weaknesses that jeopardize its continued performance and are of a severity that the distinct possibility of default exists. Loans are placed on "non-accrual" when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment.
Commercial Loans
(In thousands)
March 31, 2012
Pass
Special mention
Substandard
Non-accrual
Total
December 31, 2011
Pass
Special mention
Substandard
Non-accrual
Total

|  | Real <br> Estate-Construction | Real <br> Estate- <br> Business |  | Total |
| :--- | :--- | :--- | :--- | :--- |

The credit quality of Personal Banking loans is monitored primarily on the basis of aging/delinquency, and this information is provided in the table in the above Delinquency section. In addition, FICO scores are obtained and updated on a quarterly basis for most of the loans in the Personal Banking portfolio. This is a published credit score designed to measure the risk of default by taking into account various factors from a person's financial history. The bank normally obtains a FICO score at the loan's origination and renewal dates, and updates are obtained on a quarterly basis. Excluded from the table below are approximately $\$ 221.0$ million in personal real estate loans and $\$ 140.2$ million in consumer loans, or $9.6 \%$ of the Personal Banking portfolio, for which FICO scores are not obtained because they are related to commercial activity. For the remainder of loans in the Personal Banking portfolio, the table below shows the percentage of balances outstanding at March 31, 2012 by FICO score.

Personal Banking Loans

| \% of Loan Category |  |
| :--- | :--- | :--- |
| Real Estate - Consumer | Revolving <br> Home Equity Consumer |
| Personal Card |  |

March 31, 2012
FICO score:
Under 600

$$
\% 5.2 \quad \%
$$

600-659
$3.3 \quad \% 8.5$

$$
\% 2.5
$$

660-719

$$
\begin{aligned}
& 4.7 \\
& 11.7
\end{aligned}
$$

$$
11.6
$$

$$
12.2
$$

23.8

$$
17.8
$$

33.0

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720-780
Over 780
Total
$\begin{array}{llll}31.1 & 25.6 & 29.3 & 28.1\end{array}$
$\begin{array}{llll}49.2 & 30.5 & 45.2 & 21.5\end{array}$
100.0 \% 100.0 \% $100.0 \quad \% 100.0$ \%

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Troubled debt restructurings
As mentioned above, the Company's impaired loans include loans which have been classified as troubled debt restructurings. The majority of troubled debt restructurings are classified as such upon renewal when the contractual interest rate of the new loan, which may be greater or less than the rate on the previous loan, was not judged to be a market rate for debt with similar risk. As a result, the financial effects of the modifications cannot readily be quantified. Restructured loans are placed on non-accrual status if the Company does not believe it probable that amounts due under the modified terms will be collected. Other restructured loans consist mainly of performing commercial loans and consumer credit loans under debt management programs, as mentioned above. The table below shows the outstanding balances at March 31, 2012 of loans classified as troubled debt restructurings, in addition to the outstanding balances of these restructured loans which the Company considers to have been in default at any time during the previous twelve months. For purposes of this disclosure, the Company considers "default" to mean 90 days or more past due as to interest or principal.
(In thousands)

Commercial:
Business
Real estate - construction and land
Real estate - business
Personal Banking:
Real estate - personal
Consumer credit card
Total restructured loans

March 31, 2012
\$22,586
38,439
8,216
3,164
22,468
\$94,873

Balance 90 days past due at any time during previous 12 months
\$-
9,506
1,595
-
6,698
\$17,799

The determination of the allowance for loan losses related to troubled debt restructurings depends on the collectability of principal and interest, according to the repayment terms. As mentioned above, the majority of troubled debt restructurings were classified as such when the loans were renewed at an interest rate not judged to be market, and as such, the modified terms did not change estimated collectability under the terms of the contract. The allowance for loan losses for troubled debt restructurings on non-accrual status is determined by individual evaluation using the same process as loans on non-accrual status which are not classified as troubled debt restructurings. Those restructured loans which management expects to collect under contractual terms, and which are maintained on accruing status, are generally risk-rated as substandard. The allowance for loan losses related to accruing restructured loans is determined by collective evaluation because the loans have similar risk characteristics. Collective evaluation, which is the same process used for other substandard loans, considers historical loss experience and current economic factors.

If a troubled debt restructuring defaults and is already on non-accrual status, the allowance for loan loss continues to be determined based on individual evaluation, using discounted expected cash flows or the fair value of collateral. If a substandard, accruing, troubled debt restructuring defaults, the loan's risk rating is downgraded to non-accrual status and the loan's related allowance for loan loss is determined based on individual evaluation.

The Company had commitments of $\$ 5.8$ million at March 31, 2012 to lend additional funds to borrowers with restructured loans.

Loans held for sale

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In addition to the portfolio of loans which are intended to be held to maturity, the Company has, in previous periods, originated loans intended to be sold in secondary markets. These historically consisted of student loans and certain fixed rate residential mortgage loans. Under statutory requirements effective mid-2010, the Company was prohibited from originating new federally guaranteed student loans, and the balance below represents the remaining unsold portion of these loans. Also, the Company recently chose to retain fixed rate mortgages, and currently does not hold these types of loans for sale.

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The following table presents information about loans held for sale, including an impairment valuation allowance resulting from declines in fair value below cost, which is further discussed in Note 12 on Fair Value Measurements. Mar. 31, Dec. 31,
(In thousands) 20122011
Balance outstanding:
Student loans, at cost $\quad \$ 9,844 \quad \$ 28,706$
Residential mortgage loans, at cost - 2,545
Valuation allowance on student loans (171 ) (175 )
Total loans held for sale, at lower of cost or fair value $\$ 9,673 \quad \$ 31,076$
(In thousands)
Net gains on sales:
Student loans
Residential mortgage loans
Total gains on sales of loans held for sale, net

For the Three Months
Ended March 31
20122011
\$309 \$68
$49 \quad 503$
\$358 \$571

The Company's holdings of foreclosed real estate totaled $\$ 18.6$ million and $\$ 18.3$ million at March 31, 2012 and December 31, 2011, respectively. Personal property acquired in repossession, generally autos and marine and recreational vehicles, totaled $\$ 3.5$ million and $\$ 4.2$ million at March 31, 2012 and December 31, 2011, respectively. These assets are carried at the lower of the amount recorded at acquisition date or the current fair value less estimated costs to sell.

## 3. Investment Securities

Investment securities, at fair value, consisted of the following at March 31, 2012 and December 31, 2011.

| (In thousands) | Mar. 31, 2012 Dec. 31, |  |
| :--- | :--- | :--- |
| Available for sale: |  |  |
| U.S. government and federal agency obligations | $\$ 368,662$ | $\$ 364,665$ |
| Government-sponsored enterprise obligations | 277,924 | 315,698 |
| State and municipal obligations | $1,326,867$ | $1,245,284$ |
| Agency mortgage-backed securities | $3,866,456$ | $4,106,059$ |
| Non-agency mortgage-backed securities | 294,221 | 316,902 |
| Asset-backed securities | $2,817,492$ | $2,693,143$ |
| Other debt securities | 123,355 | 141,260 |
| Equity securities | 45,422 | 41,691 |
| Total available for sale | $9,120,399$ | $9,224,702$ |
| Trading | 34,178 | 17,853 |
| Non-marketable | 120,734 | 115,832 |
| Total investment securities | $\$ 9,275,311$ | $\$ 9,358,387$ |

Most of the Company's investment securities are classified as available for sale, and this portfolio is discussed in more detail below. Securities which are classified as non-marketable include Federal Home Loan Bank (FHLB) stock and Federal Reserve Bank stock held for debt and regulatory purposes, which totaled $\$ 45.3$ million at both March 31, 2012 and December 31, 2011. Investment in Federal Reserve Bank stock is based on the capital structure of the investing bank, and investment in FHLB stock is tied to the level of borrowings from the FHLB. Non-marketable
securities also include private equity investments, which amounted to $\$ 75.4$ million and $\$ 70.5$ million at March 31, 2012 and December 31, 2011, respectively.

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A summary of the available for sale investment securities by maturity groupings as of March 31, 2012 is shown below. The investment portfolio includes agency mortgage-backed securities, which are guaranteed by agencies such as the FHLMC, FNMA, GNMA and FDIC, in addition to non-agency mortgage-backed securities, which have no guarantee. Also included are certain other asset-backed securities, which are primarily collateralized by credit cards, automobiles, student loans, and commercial loans. These securities differ from traditional debt securities primarily in that they may have uncertain maturity dates and are priced based on estimated prepayment rates on the underlying collateral. The Company does not have exposure to subprime originated mortgage-backed or collateralized debt obligation instruments.

| (In thousands) | Amortized <br> Cost | Fair Value |
| :--- | :--- | :--- |
| U.S. government and federal agency obligations: |  |  |
| Within 1 year | $\$ 7,856$ | $\$ 8,011$ |
| After 1 but within 5 years | 186,985 | 208,287 |
| After 5 but within 10 years | 133,940 | 152,364 |
| Total U.S. government and federal agency obligations | 328,781 | 368,662 |
| Government-sponsored enterprise obligations: | 31,111 | 31,230 |
| Within 1 year | 108,983 | 112,296 |
| After 1 but within 5 years | 12,114 | 12,219 |
| After 5 but within 10 years | 122,904 | 122,179 |
| After 10 years | 275,112 | 277,924 |
| Total government-sponsored enterprise obligations |  |  |
| State and municipal obligations: | 82,630 | 83,542 |
| Within 1 year | 542,924 | 561,698 |
| After 1 but within 5 years | 471,973 | 484,430 |
| After 5 but within 10 years | 210,317 | 197,197 |
| After 10 years | $1,307,844$ | $1,326,867$ |
| Total state and municipal obligations |  |  |
| Mortgage and asset-backed securities: | $3,742,525$ | $3,866,456$ |
| Agency mortgage-backed securities | 287,375 | 294,221 |
| Non-agency mortgage-backed securities | $2,815,676$ | $2,817,492$ |
| Asset-backed securities | $6,845,576$ | $6,978,169$ |
| Total mortgage and asset-backed securities | 47,999 | 49,544 |
| Other debt securities: | 63,858 |  |
| Within 1 year | 5,974 |  |
| After 1 but within 5 years | 5,974 |  |
| After 5 but within 10 years | 117,831 | 123,355 |
| Total other debt securities | 21,252 |  |
| Equity securities | $\$ 5,896,396$ | $\$ 9,120,399$ |
| Total available for sale investment securities |  |  |

Included in U.S. government securities are $\$ 360.5$ million, at fair value, of U.S. Treasury inflation-protected securities (TIPS). Interest paid on these securities increases with inflation and decreases with deflation, as measured by the Consumer Price Index. Included in state and municipal obligations are $\$ 129.9$ million, at fair value, of auction rate securities, which were purchased from bank customers in 2008. Included in equity securities is common stock held by the holding company, Commerce Bancshares, Inc. (the Parent), with a fair value of $\$ 27.5$ million at March 31, 2012.

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For securities classified as available for sale, the following table shows the unrealized gains and losses (pre-tax) in accumulated other comprehensive income, by security type.
(In thousands)
March 31, 2012
U.S. government and federal agency obligations

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage and asset-backed securities:
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Asset-backed securities
Total mortgage and asset-backed securities
Other debt securities
Equity securities
Total
December 31, 2011
U.S. government and federal agency obligations

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage and asset-backed securities:
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Asset-backed securities
Total mortgage and asset-backed securities
Other debt securities
Equity securities
Total

| Amortized <br> Cost | Gross Gross |  |  |
| :---: | :---: | :---: | :---: |
|  | UnrealizedUnrealizedFair Value |  |  |
|  | Gains | Losses |  |
| \$328,781 | \$39,881 | \$- | \$368,662 |
| 275,112 | 3,580 | (768 | ) 277,924 |
| 1,307,844 | 36,873 | (17,850 | ) 1,326,867 |
| 3,742,525 | 124,282 | (351 | ) 3,866,456 |
| 287,375 | 10,288 | (3,442 | ) 294,221 |
| 2,815,676 | 8,409 | (6,593 | ) 2,817,492 |
| 6,845,576 | 142,979 | (10,386 | ) $6,978,169$ |
| 117,831 | 5,524 | - | 123,355 |
| 21,252 | 24,170 | - | 45,422 |
| \$8,896,396 | \$253,007 | \$(29,004 | ) \$9,120,399 |
| \$328,530 | \$36,135 | \$- | \$364,665 |
| 311,529 | 4,169 | - | 315,698 |
| 1,220,840 | 35,663 | (11,219 | ) $1,245,284$ |
| 3,989,464 | 117,088 | (493 | ) 4,106,059 |
| 315,752 | 8,962 | (7,812 | ) 316,902 |
| 2,692,436 | 7,083 | (6,376 | ) 2,693,143 |
| 6,997,652 | 133,133 | (14,681 | ) $7,116,104$ |
| 135,190 | 6,070 | - | 141,260 |
| 18,354 | 23,337 | - | 41,691 |
| \$9,012,095 | \$238,507 | \$ 25,900 | ) \$9,224,702 |

The Company's impairment policy requires a review of all securities for which fair value is less than amortized cost. Special emphasis and analysis is placed on securities whose credit rating has fallen below A3/A-, whose fair values have fallen more than $20 \%$ below purchase price for an extended period of time, or have been identified based on management's judgment. These securities are placed on a watch list, and for all such securities, detailed cash flow models are prepared which use inputs specific to each security. Inputs to these models include factors such as cash flow received, contractual payments required, and various other information related to the underlying collateral (including current delinquencies), collateral loss severity rates (including loan to values), expected delinquency rates, credit support from other tranches, and prepayment speeds. Stress tests are performed at varying levels of delinquency rates, prepayment speeds and loss severities in order to gauge probable ranges of credit loss. At March 31, 2012, the fair value of securities on this watch list was $\$ 211.5$ million.

As of March 31, 2012, the Company had recorded other-than-temporary impairment (OTTI) on certain non-agency mortgage-backed securities, part of the watch list mentioned above, which had an aggregate fair value of $\$ 118.3$ million. The credit-related portion of the impairment totaled $\$ 10.4$ million and was recorded in earnings. The noncredit-related portion of the impairment totaled $\$ 1.5$ million on a pre-tax basis, and has been recognized in accumulated other comprehensive income. The Company does not intend to sell these securities and believes it is not more likely than not that it will be required to sell the securities before the recovery of their amortized cost bases.

The credit portion of the loss on these securities was based on the cash flows projected to be received over the estimated life of the securities, discounted to present value, and compared to the current amortized cost bases of the securities. Significant inputs to the cash flow models used to calculate the credit losses on these securities included the following:

| Significant Inputs | Range |
| :--- | :--- |
| Prepayment CPR | $0 \%-31 \%$ |
| Projected cumulative default | $13 \%-57 \%$ |
| Credit support | $0 \%-17 \%$ |
| Loss severity | $33 \%-57 \%$ |

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The following table shows changes in the credit losses recorded in the three months ended March 31, 2012 and 2011, for which a portion of an OTTI was recognized in other comprehensive income.
(In thousands)
Balance at January 1
Credit losses on debt securities for which impairment was previously recognized
Increase in expected cash flows that are recognized over remaining life of security
Balance at March 31

For the Three Months
Ended March 31
20122011
\$9,931 $\$ 7,542$
$320 \quad 274$
(38 ) -
\$10,213 \$7,816

Securities with unrealized losses recorded in accumulated other comprehensive income are shown in the table below, along with the length of the impairment period.

|  | Less than 12 months |  | 12 months or longer |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Fair Valu | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| March 31, 2012 |  |  |  |  |  |  |
| Government-sponsored enterprise obligations | \$82,149 | \$ 768 | \$- | \$- | \$82,149 | \$768 |
| State and municipal obligations | 148,038 | 1,582 | 87,350 | 16,268 | 235,388 | 17,850 |
| Mortgage and asset-backed securities: |  |  |  |  |  |  |
| Agency mortgage-backed securities | 60,464 | 351 | - | - | 60,464 | 351 |
| Non-agency mortgage-backed securities | 4,602 | 115 | 72,198 | 3,327 | 76,800 | 3,442 |
| Asset-backed securities | 708,365 | 4,897 | 96,157 | 1,696 | 804,522 | 6,593 |
| Total mortgage and asset-backed securities | 773,431 | 5,363 | 168,355 | 5,023 | 941,786 | 10,386 |
| Total | \$1,003,618 | \$7,713 | \$255,705 | \$21,291 | \$ 1,259,323 | \$29,004 |
| December 31, 2011 |  |  |  |  |  |  |
| State and municipal obligations | \$65,962 | \$ 712 | \$110,807 | \$ 10,507 | \$176,769 | \$ 11,219 |
| Mortgage and asset-backed securities: |  |  |  |  |  |  |
| Agency mortgage-backed securities | 72,019 | 493 | - | - | 72,019 | 493 |
| Non-agency mortgage-backed securities | 23,672 | 784 | 118,972 | 7,028 | 142,644 | 7,812 |
| Asset-backed securities | 1,236,526 | 4,982 | 87,224 | 1,394 | 1,323,750 | 6,376 |
| Total mortgage and asset-backed securities | 1,332,217 | 6,259 | 206,196 | 8,422 | 1,538,413 | 14,681 |
| Total | \$1,398,179 | \$ 6,971 | \$317,003 | \$ 18,929 | \$ 1,715,182 | \$25,900 |

The total available for sale portfolio consisted of approximately 1,550 individual securities at March 31, 2012. The portfolio included 181 securities, having an aggregate fair value of $\$ 1.3$ billion, that were in a loss position at March 31, 2012. Securities identified as other-than-temporarily impaired which have been in a loss position for 12 months or longer totaled $\$ 60.7$ million at fair value, or $.7 \%$ of the total available for sale portfolio value. Securities with temporary impairment which have been in a loss position for 12 months or longer totaled $\$ 195.0$ million, or $2.1 \%$ of the total portfolio value.

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The Company's holdings of state and municipal obligations included gross unrealized losses of $\$ 17.9$ million at March 31, 2012. Of these losses, $\$ 16.5$ million related to auction rate securities (ARS) and $\$ 1.3$ million related to other state and municipal obligations. This portfolio, exclusive of ARS, totaled $\$ 1.2$ billion at fair value, or $13.1 \%$ of total available for sale securities. The average credit quality of the portfolio, excluding ARS, is Aa2 as rated by Moody's. The portfolio is diversified in order to reduce risk, and information about the largest holdings, by state and economic sector, is shown in the table below.

At March 31, 2012

| Texas | $10.1 \%$ | 5.3 | Aa1 |
| :--- | :--- | :--- | :--- |
| Florida | 9.1 | 4.7 | Aa3 |
| Washington | 6.2 | 4.0 | Aa2 |
| Illinois | 4.9 | 6.0 | Aa3 |
| Ohio | 4.9 | 5.1 | Aa2 |
| General obligation | $27.5 \%$ | 4.5 | Aa2 |
| Housing | 20.0 | 4.6 | Aa1 |
| Transportation | 14.5 | 4.0 | Aa3 |
| Lease | 13.9 | 3.7 | Aa3 |
| Limited Tax | 6.4 | 5.1 | Aa 2 |

The remaining unrealized losses on the Company's investments, as shown in the preceding tables, are largely contained in the categories of non-agency mortgage-backed and other asset-backed securities. These securities are not guaranteed by an outside agency and are dependent on payments received from the underlying collateral. While virtually all of these securities, at purchase date, were comprised of senior tranches and were highly rated by various rating agencies, changes in interest rates, the adverse housing market, liquidity pressures, and overall economic climate has resulted in low fair values for certain of these securities. As mentioned above, the Company maintains a watch list comprised mostly of these securities, and has recorded OTTI losses on certain of these securities.

The following table presents proceeds from sales of securities and the components of investment securities gains and losses which have been recognized in earnings.

|  | For the Three <br> Months Ended |
| :--- | :--- | :--- |
| March 31 |  |

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At March 31, 2012, securities carried at $\$ 4.2$ billion were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowings at the Federal Reserve Bank and FHLB. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated $\$ 420.1$ million, while the remaining securities were pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral. Except for obligations of various government-sponsored enterprises such as FNMA, FHLB and FHLMC, no investment in a single issuer exceeds $10 \%$ of stockholders' equity.

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## 4. Goodwill and Other Intangible Assets

The following table presents information about the Company's intangible assets which have estimable useful lives.


Aggregate amortization expense on intangible assets was $\$ 684$ thousand and $\$ 813$ thousand, respectively, for the three months ended March 31, 2012 and 2011. The following table shows the estimated annual amortization expense for the next five fiscal years. This expense is based on existing asset balances and the interest rate environment as of March 31, 2012. The Company's actual amortization expense in any given period may be different from the estimated amounts depending upon the acquisition of intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions.

| (In thousands) | $\$ 2,300$ |
| :--- | :--- |
| 2012 | 1,758 |
| 2013 | 1,281 |
| 2014 | 937 |
| 2015 | 625 |

Changes in the carrying amount of goodwill and net other intangible assets for the three month period ended March 31, 2012 is as follows.

| (In thousands) | Goodwill | Core Deposit <br> Premium | Mortgage <br> Servicing <br> Rights |
| :--- | :--- | :--- | :--- |
| Balance January 1, 2012 | $\$ 125,585$ | $\$ 6,970$ | $\$ 744$ |
| Amortization | - | $(586$ | $)(98$ |
| Impairment reversal | - | - | 40 |
| Balance March 31, 2012 | $\$ 125,585$ | $\$ 6,384$ | $\$ 686$ |

Goodwill allocated to the Company's operating segments at March 31, 2012 and December 31, 2011 is shown below.
(In thousands)
Consumer segment \$67,765
Commercial segment 57,074
Wealth segment 746
Total goodwill \$125,585

## 5. Guarantees

The Company, as a provider of financial services, routinely issues financial guarantees in the form of financial and performance standby letters of credit. Standby letters of credit are contingent commitments issued by the Company generally to guarantee the payment or performance obligation of a customer to a third party. While these represent a potential outlay by the Company, a significant amount of the commitments may expire without being drawn upon. The Company has recourse against the customer for any amount it is required to pay to a third party under a standby letter of credit. The letters of credit are subject to the same credit policies, underwriting standards and approval process as loans made by the Company. Most of the standby letters of credit are secured, and in the event of nonperformance by the customers, the Company has rights to the underlying collateral, which could include commercial real estate, physical plant and property, inventory, receivables, cash and marketable securities.

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Upon issuance of standby letters of credit, the Company recognizes a liability for the fair value of the obligation undertaken, which is estimated to be equivalent to the amount of fees received from the customer over the life of the agreement. At March 31, 2012 that net liability was $\$ 5.2$ million, which will be accreted into income over the remaining life of the respective commitments. The contractual amount of these letters of credit, which represents the maximum potential future payments guaranteed by the Company, was $\$ 366.3$ million at March 31, 2012.

The Company periodically enters into risk participation agreements (RPAs) as a guarantor to other financial institutions, in order to mitigate those institutions' credit risk associated with interest rate swaps with third parties. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. These interest rate swaps are normally collateralized (generally with real property, inventories and equipment) by the third party, which limits the credit risk associated with the Company's RPAs. The third parties usually have other borrowing relationships with the Company. The Company monitors overall borrower collateral, and at March 31, 2012, believes sufficient collateral is available to cover potential swap losses. The RPAs are carried at fair value throughout their term, with all changes in fair value, including those due to a change in the third party's creditworthiness, recorded in current earnings. The terms of the RPAs, which correspond to the terms of the underlying swaps, range from 5 to 10 years. At March 31, 2012, the liability recorded for guarantor RPAs was $\$ 115$ thousand, and the notional amount of the underlying swaps was $\$ 37.3$ million. The maximum potential future payment guaranteed by the Company cannot be readily estimated but is dependent upon the fair value of the interest rate swaps at the time of default. The Company's loss exposure at March 31,2012 , before considering collateral coverage, was approximately $\$ 3.5$ million.

## 6. Pension

The amount of net pension cost for the three months ended March 31, 2012 and 2011 is shown in the table below:
For the Three Months
Ended March 31
(In thousands)
Service cost - benefits earned during the period
Interest cost on projected benefit obligation
Expected return on plan assets
$2012 \quad 2011$

Amortization of unrecognized net loss
\$ 103 \$88

Net periodic pension cost
1,287 1,362
$(1,645)(1,675$
730
540
$\$ 475 \quad \$ 315$

Substantially all benefits accrued under the Company's defined benefit pension plan were frozen effective January 1 , 2005, and the remaining benefits were frozen effective January 1, 2011. During the first three months of 2012, the Company made no funding contributions to its defined benefit pension plan and made minimal funding contributions to a supplemental executive retirement plan (the CERP), which carries no segregated assets. The Company has no plans to make any further contributions, other than those related to the CERP, during the remainder of 2012.

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## 7. Common Stock

Presented below is a summary of the components used to calculate basic and diluted income per share. The Company applies the two-class method of computing income per share, as nonvested share-based awards that contain nonforfeitable rights to dividends are considered securities which participate in undistributed earnings with common stock. The two-class method requires the calculation of separate income per share amounts for the nonvested share-based awards and for common stock. Income per share attributable to common stock is shown in the table below. Nonvested share-based awards are further discussed in Note 11.

|  | For the Three <br> Months Ended |  |
| :--- | :--- | :--- |
|  | March 31 <br> (In thousands, except per share data) | 2012 |
| Basic income per common share: |  | 2011 |
| Net income attributable to Commerce Bancshares, Inc. | $\$ 65,799$ | $\$ 60,453$ |
| Less income allocated to nonvested restricted stockholders | 562 | 404 |
| Net income available to common stockholders | $\$ 65,237$ | $\$ 60,049$ |
| Distributed income | $\$ 20,247$ | $\$ 19,907$ |
| Undistributed income | $\$ 44,990$ | $\$ 40,142$ |
| Weighted average common shares outstanding | 88,221 | 90,791 |
| Distributed income per share | $\$ .23$ | $\$ .22$ |
| Undistributed income per share | .51 | .44 |
| Basic income per common share | $\$ .74$ | $\$ .66$ |
| Diluted income per common share: | $\$ 65,799$ | $\$ 60,453$ |
| Net income attributable to Commerce Bancshares, Inc. | 561 | 403 |
| Less income allocated to nonvested restricted stockholders | $\$ 65,238$ | $\$ 60,050$ |
| Net income available to common stockholders | $\$ 20,247$ | $\$ 19,907$ |
| Distributed income | $\$ 44,991$ | $\$ 40,143$ |
| Undistributed income | 88,221 | 90,791 |
| Weighted average common shares outstanding |  |  |
| Net effect of the assumed exercise of stock-based awards - based on | 335 | 387 |
| the treasury stock method using the average market price for the respective periods | 88,556 | 91,178 |
| Weighted average diluted common shares outstanding | $\$ .23$ | $\$ .22$ |
| Distributed income per share | .51 | .44 |
| Undistributed income per share | $\$ .74$ | $\$ .66$ |

The diluted income per common share computations for the three months ended March 31, 2011 excluded 861 thousand in unexercised stock options and stock appreciation rights because their inclusion would have been anti-dilutive to income per share. Nearly all unexercised options and rights were dilutive for the comparable period in 2012.

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## 8. Accumulated Other Comprehensive Income

The table below shows the accumulated balances for components of other comprehensive income, net of tax. The largest component is the unrealized holding gains and losses on available for sale securities. Unrealized gains and losses on debt securities for which an other-than-temporary impairment (OTTI) has been recorded in current earnings are shown separately below. The other component is pension gains and losses that arise during the period but are not recognized as components on net periodic benefit cost, and corresponding adjustments when these gains and losses are subsequently amortized to net periodic benefit cost.

|  | Unrealized Gains (Losses) <br> on Securities |  | Total <br> Accumulated |  |
| :--- | :--- | :--- | :--- | :--- |
| (In thousands) | OTTI | Other |  | Pension LossOther <br> Comprehensive <br> Income |
| Balance January 1, 2012 | $\$(4,321$ | $) \$ 136,137$ | $\$(21,278$ | $) \$ 110,538$ |
| Current period other comprehensive income | 3,360 | 3,706 | 452 | 7,518 |
| Balance March 31, 2012 | $(961$ | $) 139,843$ | $(20,826$ | $) 118,056$ |
| Balance January 1, 2011 | $(7,469$ | $) 87,784$ | $(16,970$ | $) 63,345$ |
| Current period other comprehensive income (loss) | 4,014 | $(6,560$ | $) 335$ | $(2,211$ |
| Balance March 31, 2011 | $\$(3,455$ | $) \$ 81,224$ | $\$(16,635$ | $\$ 61,134$ |

## 9. Segments

The Company segregates financial information for use in assessing its performance and allocating resources among three operating segments: Consumer, Commercial and Wealth. The Consumer segment includes the consumer portion of the retail branch network (loans, deposits, and other personal banking services), indirect and other consumer financing, and consumer debit and credit bank cards. The Commercial segment provides corporate lending (including the Small Business Banking product line within the branch network), leasing, international services, and business, government deposit, and related commercial cash management services, as well as merchant and commercial bank card products. The Commercial segment includes the Capital Markets Group, which sells fixed income securities and provides investment safekeeping and bond accounting services. The Wealth segment provides traditional trust and estate tax planning, advisory and discretionary investment management, and brokerage services, and includes the Private Banking product portfolio.

The table below presents selected financial information by segment and reconciliations of combined segment totals to consolidated totals. There were no material intersegment revenues among the three segments. Management periodically makes changes to methods of assigning costs and income to its business segments to better reflect operating results. If appropriate, these changes are reflected in prior year information presented below.
(In thousands)
Three Months Ended March 31, 2012
Net interest income
Provision for loan losses
Non-interest income
Investment securities gains, net
Non-interest expense
Income before income taxes
Three Months Ended March 31, 2011

| Consumer CommercialWealth | Segment <br> Totals | Other/ <br> Elimination | Consolidated <br> Totals |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $\left.\begin{array}{ccccccl}\$ 69,093 & \$ 71,629 & \$ 9,757 & \$ 150,479 & \$ 9,258 & \$ 159,737 & \\ (9,307 & )(1,831 & )(42 & )(11,180 & ) 3,015 & (8,165 & ) \\ 27,188 & 42,894 & 26,155 & 96,237 & (1,654 & 94,583 & \\ - & - & - & - & 4,040 & 4,040 & \\ (66,136 & )(55,949 & )(22,763 & )(144,848)(5,613 & (150,461 & ) \\ \$ 20,838 & \$ 56,743 & \$ 13,107 & \$ 90,688 & \$ 9,046 & \$ 99,734\end{array}\right)$ |  |  |  |

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Net interest income
Provision for loan losses
Non-interest income
Investment securities gains, net
Non-interest expense
Income before income taxes

| $\$ 70,948$ | $\$ 68,831$ | $\$ 9,549$ | $\$ 149,328$ | $\$ 11,645$ | $\$ 160,973$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $(13,637$ | $)(5,118$ | $)(28$ | $)(18,783$ | $) 2,994$ | $(15,789$ | $)$ |
| 31,994 | 39,146 | 25,186 | 96,326 | $(420$ | $)$ | 95,906 |
| - | - | - | - | 1,327 | 1,327 |  |
| $(69,512$ | $)(56,836$ | $)(22,314$ | $)(148,662)(5,298$ | $)$ |  |  |
| $(153,960$ | $)$ |  |  |  |  |  |
| $\$ 19,793$ | $\$ 46,023$ | $\$ 12,393$ | $\$ 78,209$ | $\$ 10,248$ | $\$ 88,457$ |  |

The information presented above was derived from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. This information is based on internal management accounting policies, which have been developed to reflect the underlying economics of the businesses. The policies address the methodologies applied in connection with funds transfer pricing and assignment of overhead costs among segments. Funds transfer pricing was used in

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the determination of net interest income by assigning a standard cost (credit) for funds used (provided) by assets and liabilities based on their maturity, prepayment and/or repricing characteristics.

The segment activity, as shown above, includes both direct and allocated items. Amounts in the "Other/Elimination" column include activity not related to the segments, such as that relating to administrative functions, the investment securities portfolio, and the effect of certain expense allocations to the segments. The provision for loan losses in this category contains the difference between net loan charge-offs assigned directly to the segments and the recorded provision for loan loss expense. Included in this category's net interest income are earnings of the investment portfolio, which are not allocated to a segment.

The performance measurement of the operating segments is based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. The information is also not necessarily indicative of the segments' financial condition and results of operations if they were independent entities.

## 10. Derivative Instruments

The notional amounts of the Company's derivative instruments are shown in the table below. These contractual amounts, along with other terms of the derivative, are used to determine amounts to be exchanged between counterparties and are not a measure of loss exposure. The largest group of notional amounts relate to interest rate swaps, which are discussed in more detail below. The Company also contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps through risk participation agreements. The Company's risks and responsibilities as guarantor are further discussed in Note 5 on Guarantees.

Through its International Department, the Company enters into foreign exchange contracts consisting mainly of contracts to purchase or deliver foreign currencies for customers at specific future dates. Also, the Company's past practice of originating and selling fixed rate personal real estate loans to other institutions resulted in mortgage loan commitments and forward sales contracts. In mid 2011, the Company curtailed the sales of these types of loans and, at March 31, 2012, did not hold such loans for sale.

| (In thousands) | $\begin{aligned} & \text { March 31, } \\ & 2012 \end{aligned}$ | $\begin{aligned} & \text { December 31, } \\ & 2011 \end{aligned}$ |
| :---: | :---: | :---: |
| Interest rate swaps | \$490,916 | \$486,207 |
| Interest rate caps | 29,236 | 29,736 |
| Credit risk participation agreements | 41,678 | 41,414 |
| Foreign exchange contracts | 73,942 | 80,535 |
| Mortgage loan commitments | - | 1,280 |
| Mortgage loan forward sale contracts | - | 3,650 |
| Total notional amount | \$635,772 | \$642,822 |

The Company's interest rate risk management strategy includes the ability to modify the repricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. At March 31, 2012, the Company had entered into three interest rate swaps with a notional amount of $\$ 14.2$ million, included in the table above, which are designated as fair value hedges of certain fixed rate loans. Gains and losses on these derivative instruments, as well as the offsetting loss or gain on the hedged loans attributable to the hedged risk, are recognized in current earnings. These gains and losses are reported in interest and fees on loans in the accompanying statements of income. The table below shows gains and losses related to fair value hedges.
$\left.\begin{array}{lll} & \begin{array}{l}\text { For the Three } \\ \text { Months Ended }\end{array} \\ & \text { March } 31 \\ \text { (In thousands) } & 2012 & 2011 \\ \text { Gain (loss) on interest rate swaps } & \$ 88 & \$ 187 \\ \text { Gain (loss) on loans } & (85 & )(181\end{array}\right)$

The Company's other derivative instruments are accounted for as free-standing derivatives, and changes in their fair value are recorded in current earnings. These instruments include interest rate swap contracts sold to customers who wish to modify their interest rate sensitivity. These swaps are offset by matching contracts purchased by the Company from other financial institutions. Because of the matching terms of the offsetting contracts, in addition to collateral provisions which mitigate the impact of non-

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performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings. The notional amount of these types of swaps at March 31, 2012 was $\$ 476.7$ million. The Company is party to master netting arrangements with several other financial institutions; however, the Company does not offset assets and liabilities under these arrangements for balance sheet presentation, as the effect of offsetting is not significant. Collateral, usually in the form of marketable securities, is posted by the counterparty with liability positions, in accordance with contract thresholds. At March 31, 2012, the Company had net liability positions with its financial institution counterparties totaling $\$ 17.9$ million and had posted $\$ 17.4$ million in collateral.

Many of the Company's interest rate swap contracts with large financial institutions contain contingent features relating to debt ratings or capitalization levels. Under these provisions, if the Company's debt rating falls below investment grade or if the Company ceases to be "well-capitalized" under risk-based capital guidelines, certain counterparties can require immediate and ongoing collateralization on interest rate swaps in net liability positions, or can require instant settlement of the contracts. The Company maintains debt ratings and capital well above these minimum requirements.

The banking customer counterparties are engaged in a variety of businesses, including real estate, building materials, communications, consumer products, and manufacturing. At March 31, 2012, the largest loss exposures were in the groups related to real estate, education and manufacturing. If the counterparties in these groups failed to perform, and if the underlying collateral proved to be of no value, the Company estimates that it would incur losses of $\$ 3.8$ million (real estate and building materials), $\$ 3.4$ million (education) and $\$ 2.8$ million (manufacturing) at March 31, 2012.

The fair values of the Company's derivative instruments, whose notional amounts are listed above, are shown in the table below. Information about the valuation methods used to determine fair value is provided in Note 12 on Fair Value Measurements.

|  | Asset Derivatives |  |  | Liability Derivatives |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Balance <br> Sheet <br> Location | $\begin{aligned} & \text { Mar. 31, } \\ & 2012 \\ & \text { Fair Va } \end{aligned}$ | $\begin{aligned} & \text { Dec. 31, } \\ & 2011 \end{aligned}$ lue | Balance <br> Sheet <br> Location | Mar. 31 2012 Fair V | $\begin{aligned} & \text { Dec. 31, } \\ & 2011 \\ & \text { alue } \end{aligned}$ |
| Interest rate swaps | Other asset | \$- | \$- | Other liabilities | \$(965 | ) \$(1,053 ) |
| Total derivatives designated as hedging instruments |  | \$- | \$- |  | \$(965 | ) \$(1,053 ) |
| Derivatives not designated as hedging instruments: |  |  |  |  |  |  |
| Interest rate swaps | Other asset | \$17,701 | \$ 19,051 | Other liabilities | \$(17,8 | ) (19,157) |
| Interest rate caps | Other asset |  | 11 | Other liabilities | (6 | )(11 |
| Credit risk participation agreements | Other asset |  | 9 | Other liabilities | (115 | ) (141 |
| Foreign exchange contracts | Other asset | 1,069 | 2,440 | Other liabilities | (1,113 | )(2,343 ) |
| Mortgage loan commitments | Other asset |  | 20 | Other liabilities | - | - |
| Mortgage loan forward sale contracts | Other asset | - | 6 | Other liabilities | - | (17 ) |
| Total derivatives not designated as hedging instruments |  | \$18,785 | \$21,537 |  | \$(19,1 | 1) \$(21,669) |

The effects of derivative instruments on the consolidated statements of income are shown in the table below.

|  | Location of Gain or (Loss) Recognized in Income on Derivative | Amount of Gain or (Loss) Recognized in Income on Derivative For the Three Months Ended March 31 |  |
| :---: | :---: | :---: | :---: |
| (In thousands) |  | 2012 | 2011 |
| Derivatives in fair value hedging relationships: |  |  |  |
| Interest rate swaps | Interest and fees on loans | \$88 | \$187 |
| Total |  | \$88 | \$187 |
| Derivatives not designated as hedging instruments: |  |  |  |
| Interest rate swaps | Other non-interest income | \$117 | \$389 |
| Interest rate caps | Other non-interest income | - | - |
| Credit risk participation agreements | Other non-interest income | (2 | $) 6$ |
| Foreign exchange contracts | Other non-interest income | (140 | ) 164 |
| Mortgage loan commitments | Loan fees and sales | (20 | )44 |
| Mortgage loan forward sale contracts | Loan fees and sales | 11 | (413 |
| Total |  | \$(34 | )\$190 |

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## 11. Stock-Based Compensation

The Company normally issues most of its annual stock-based compensation awards during the first quarter. Stock-based compensation has historically been issued in the form of options, stock appreciation rights (SARs) and nonvested stock. During the past several years, including the first quarter of 2012, stock-based compensation has been issued solely in the form of nonvested stock awards. The stock-based compensation expense that has been charged against income was $\$ 1.4$ million and $\$ 1.3$ million in the three months ended March 31, 2012 and 2011, respectively.

The 2012 stock awards generally vest in 5 to 7 years and contain restrictions as to transferability, sale, pledging, or assigning, among others, prior to the end of the vesting period. Dividend and voting rights are conferred upon grant. A summary of the status of the Company's nonvested share awards as of March 31, 2012, and changes during the three month period then ended, is presented below.

|  |  | Weighted <br> Average <br> Grant Date |
| :--- | :--- | :--- |
| Fair Value |  |  |

In previous years, SARs and stock options have also been granted, with exercise prices equal to the market price of the Company's stock at the date of grant. SARs, which the Company granted in 2006 through 2009, vest on a graded basis over 4 years of continuous service and have 10 -year contractual terms. All SARs must be settled in stock under provisions of the plan. Stock options, which were granted in 2005 and previous years, vest on a graded basis over 3 years of continuous service and also have 10 -year contractual terms. In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of SARs and options on date of grant.

A summary of option activity during the first three months of 2012 is presented below.

|  | Shares | Weighted <br> Average <br> Exercise <br> Price | Weighted <br> Average <br> Remaining <br> Contractual |
| :--- | :--- | :--- | :--- |
| Aggregate |  |  |  |
| Intrinsic |  |  |  |

A summary of SAR activity during the first three months of 2012 is presented below.

|  |  | Weighted <br> Average | Weighted <br> Average <br> Remaining Aggregate |
| :--- | :--- | :--- | :--- |

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Granted

-     - 

Forfeited
Expired
Exercised
Outstanding at March 31, 2012
(12,766 ) 35.63
$1,726,360 \quad \$ 37.84 \quad 4.9$ years $\$ 4,622$

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## 12. Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain financial and nonfinancial assets and liabilities and to determine fair value disclosures. Various financial instruments such as available for sale and trading securities, certain non-marketable securities relating to private equity activities, and derivatives are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets and liabilities on a nonrecurring basis, such as loans held for sale, mortgage servicing rights and certain other investment securities. These nonrecurring fair value adjustments typically involve lower of cost or fair value accounting, or write-downs of individual assets.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value. For accounting disclosure purposes, a three-level valuation hierarchy of fair value measurements has been established. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:
Level 1 - inputs to the valuation methodology are quoted prices for identical assets or liabilities in active markets. Level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and inputs that are observable for the assets or liabilities, either directly or indirectly (such as interest rates, yield curves, and prepayment speeds). Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value. These may be internally developed, using the Company's best information and assumptions that a market participant would consider. When determining the fair value measurements for assets and liabilities required or permitted to be recorded or disclosed at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to observable market data for similar assets and liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets, and the Company must use alternative valuation techniques to derive an estimated fair value measurement.

Valuation methods for instruments measured at fair value on a recurring basis
Following is a description of the Company's valuation methodologies used for instruments measured at fair value on a recurring basis:

## Available for sale investment securities

For available for sale securities, changes in fair value, including that portion of other-than-temporary impairment unrelated to credit loss, are recorded in other comprehensive income. As mentioned in Note 3 on Investment Securities, the Company records the credit-related portion of other-than-temporary impairment in current earnings. This portfolio comprises the majority of the assets which the Company records at fair value. Most of the portfolio, which includes government-sponsored enterprise, mortgage-backed and asset-backed securities, are priced utilizing industry-standard models that consider various assumptions, including time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace. These measurements are classified as Level 2 in the fair value hierarchy. Where quoted prices are available in an active market, the measurements are classified as Level 1. Most of the Level 1 measurements apply to common stock and U.S. Treasury obligations.

Valuation methods and inputs, by class of security:
U.S. government and federal agency obligations
U.S. treasury bills, bonds and notes, including TIPS, are valued using live data from active market makers and inter-dealer brokers. Valuations for stripped coupon and principal issues are derived from yield curves generated from various dealer contacts and live data sources.

Government-sponsored enterprise obligations
Government-sponsored enterprise obligations are evaluated using cash flow valuation models. Inputs used are live market data, cash settlements, Treasury market yields, and floating rate indices such as LIBOR, CMT, and Prime.

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State and municipal obligations, excluding auction rate securities
A yield curve is generated and applied to bond sectors, and individual bond valuations are extrapolated. Inputs used to generate the yield curve are bellwether issue levels, established trading spreads between similar issuers or credits, historical trading spreads over widely accepted market benchmarks, new issue scales, and verified bid information. Bid information is verified by corroborating the data against external sources such as broker-dealers, trustees/paying agents, issuers, or non-affiliated bondholders.

Mortgage and asset-backed securities
Collateralized mortgage obligations and other asset-backed securities are valued at the tranche level. For each tranche valuation, the process generates predicted cash flows for the tranche, applies a market based (or benchmark) yield/spread for each tranche, and incorporates deal collateral performance and tranche level attributes to determine tranche-specific spreads to adjust the benchmark yield. Tranche cash flows are generated from new deal files and prepayment/default assumptions. Tranche spreads are based on tranche characteristics such as average life, type, volatility, ratings, underlying collateral and performance, and prevailing market conditions. The appropriate tranche spread is applied to the corresponding benchmark, and the resulting value is used to discount the cash flows to generate an evaluated price.

Valuation of agency pass-through securities, typically issued under GNMA, FNMA, FHLMC, and SBA programs, are primarily derived from information from the To Be Announced (TBA) market. This market consists of generic mortgage pools which have not been received for settlement. Snapshots of the TBA market, using live data feeds distributed by multiple electronic platforms, and in conjunction with other indices, are used to compute a price based on discounted cash flow models.

Other debt securities
Other debt securities are valued using active markets and inter-dealer brokers as well as bullet spread scales and option adjusted spreads. The spreads and models use yield curves, terms and conditions of the bonds, and any special features (i.e., call or put options, redemption features, etc.).

## Equity securities

Equity securities are priced using the market prices for each security from the major stock exchanges or other electronic quotation systems. These are generally classified as Level 1 measurements. Stocks which trade infrequently are classified as Level 2.

At March 31, 2012, the Company held in its available for sale portfolio certain auction rate securities (ARS) totaling $\$ 129.9$ million. The auction process by which the ARS are normally priced has not functioned since 2008, and due to the illiquidity in the market, the fair value of these securities cannot be based on observable market prices. The fair values of the ARS are estimated using a discounted cash flows analysis which is discussed more fully in the Level 3 Inputs section of this note. Because several of the inputs significant to the measurement are not observable, these measurements are classified as Level 3 measurements.

## Trading securities

The securities in the Company's trading portfolio are priced by averaging several broker quotes for similar instruments and are classified as Level 2 measurements.

Private equity investments
These securities are held by the Company's private equity subsidiaries and are included in non-marketable investment securities in the consolidated balance sheets. Due to the absence of quoted market prices, valuation of these nonpublic

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investments requires significant management judgment. These fair value measurements, which are discussed in the Level 3 Inputs section of this note, are classified as Level 3.

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Derivatives

The Company's derivative instruments include interest rate swaps, foreign exchange forward contracts, commitments and sales contracts related to personal mortgage loan origination activity, and certain credit risk guarantee agreements. When appropriate, the impact of credit standing, as well as any potential credit enhancements such as collateral, has been considered in the fair value measurement.

Valuations for interest rate swaps are derived from proprietary models whose significant inputs are readily observable market parameters, primarily yield curves. The results of the models are constantly validated through comparison to active trading in the marketplace. These fair value measurements are classified as Level 2.

Fair value measurements for foreign exchange contracts are derived from a model whose primary inputs are quotations from global market makers and are classified as Level 2.

The fair values of mortgage loan commitments and forward sales contracts on the associated loans are based on quoted prices for similar loans in the secondary market. However, these prices are adjusted by a factor which considers the likelihood that a commitment will ultimately result in a closed loan. This estimate is based on the Company's historical data and its judgment about future economic trends. Based on the unobservable nature of this adjustment, these measurements are classified as Level 3.

The Company's contracts related to credit risk guarantees are valued under a proprietary model which uses significant थnobservable inputs and assumptions about the creditworthiness of the counterparty to the guaranteed interest rate swap contract. Consequently, these measurements are classified as Level 3.

Assets held in trust

Assets held in an outside trust for the Company's deferred compensation plan consist of investments in mutual funds. The fair value measurements are based on quoted prices in active markets and classified as Level 1 . The Company has recorded an asset representing the total investment amount. The Company has also recorded a corresponding nonfinancial liability, representing the Company's liability to the plan participants.

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The table below presents the March 31, 2012 and December 31, 2011 carrying values of assets and liabilities measured at fair value on a recurring basis. There were no transfers among levels during the first three months of 2012 or the twelve months ended December 31, 2011.
(In thousands)

|  |  |  |  |
| :--- | :--- | :--- | :--- |
|  | Fair Value Measurements Using <br>  <br> Quoted Prices <br> in Active |  |  |
| Significant |  |  |  |
| Total Fair | Markets for | Other | Significant |
| Value | Identical | Observable | Unobservable |
|  | Assets | Inputs | Inputs |
|  | (Level 1) | (Level 2) | (Level 3) |
|  |  |  |  |

March 31, 2012
Assets:
Available for sale securities:

| U.S. government and federal agency obligations | $\$ 368,662$ | $\$ 361,150$ | $\$ 7,512$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- |
| Government-sponsored enterprise obligations | 277,924 | - | 277,924 | - |
| State and municipal obligations | $1,326,867$ | - | $1,196,994$ | 129,873 |
| Agency mortgage-backed securities | $3,866,456$ | - | $3,866,456$ | - |
| Non-agency mortgage-backed securities | 294,221 | - | 294,221 | - |
| Other asset-backed securities | $2,817,492$ | - | $2,817,492$ | - |
| Other debt securities | 123,355 | - | 123,355 | - |
| Equity securities | 45,422 | 32,225 | 13,197 | - |
| Trading securities | 34,178 | - | 34,178 | - |
| Private equity investments | 72,121 | - | - | 72,121 |
| Derivatives * | 18,785 | - | 18,776 | 9 |
| Assets held in trust | 5,375 | 5,375 | - | - |
| Total assets | $\$ 9,250,858$ | $\$ 398,750$ | $\$ 8,650,105$ | $\$ 202,003$ |
| iabilities: |  |  |  |  |
| Derivatives * | $\$ 20,076$ | $\$-$ | $\$ 19,961$ | $\$ 115$ |
| Total liabilities | $\$ 20,076$ | $\$-$ | $\$ 19,961$ | $\$ 115$ |

December 31, 2011
Assets:
Available for sale securities:

| U.S. government and federal agency obligations | $\$ 364,665$ | $\$ 357,155$ | $\$ 7,510$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- |
| Government-sponsored enterprise obligations | 315,698 | - | 315,698 | - |
| State and municipal obligations | $1,245,284$ | - | $1,109,663$ | 135,621 |
| Agency mortgage-backed securities | $4,106,059$ | - | $4,106,059$ | - |
| Non-agency mortgage-backed securities | 316,902 | - | 316,902 | - |
| Other asset-backed securities | $2,693,143$ | - | $2,693,143$ | - |
| Other debt securities | 141,260 | - | 141,260 | - |
| Equity securities | 41,691 | 27,808 | 13,883 | - |
| Trading securities | 17,853 | - | 17,853 | - |
| Private equity investments | 66,978 | - | - | 66,978 |
| Derivatives * | 21,537 | - | 21,502 | 35 |
| Assets held in trust | 4,506 | 4,506 | - | - |
| Total assets | $\$ 9,335,576$ | $\$ 389,469$ | $\$ 8,743,473$ | $\$ 202,634$ |
| iabilities: | $\$ 2,722$ | $\$-$ | $\$ 22,564$ | $\$ 158$ |
| Derivatives * | $\$ 22,722$ | $\$-$ | $\$ 22,564$ | $\$ 158$ |

* The fair value of each class of derivative is shown in Note 10.

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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:
Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
State and Private
Municipal Equity DerivativesTotal
ObligationSnvestments
For the three months ended March 31, 2012
Balance January 1, 2012
Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income
Investment securities called
Discount accretion
Purchase of private equity securities
Sale / paydown of private equity securities
Capitalized interest/dividends
Purchase of risk participation agreement
Balance March 31, 2012

| $\$ 135,621$ | $\$ 66,978$ | $\$(123$ | $)$ | $\$ 202,476$ |
| :--- | :--- | :--- | :--- | :--- |
| - | 4,125 | $(11$ | $) 4,114$ |  |
| $(5,458$ | $)-$ | - | $(5,458$ | $)$ |
| $(350$ | $)-$ | - | $(350$ | $)$ |
| 60 | - | - | 60 |  |
| - | 3,275 | - | 3,275 |  |
| - | $(2,434$ | - | $(2,434$ | $)$ |
| - | 177 | - | 177 |  |
| - | - | 28 | 28 |  |
| $\$ 129,873$ | $\$ 72,121$ | $\$(106$ | $) \$ 201,888$ |  |

Total gains or losses for the three months included in earnings attributable to the
change in unrealized gains or losses relating to assets still held at
March 31, 2012
For the three months ended March 31, 2011
Balance January 1, 2011
Total gains or losses (realized/unrealized):
Included in earnings
$\$-\quad \$ 4,125 \quad \$(2 \quad) \$ 4,123$

Included in other comprehensive income
Investment securities called
Discount accretion
Purchase of private equity securities
Sale / paydown of private equity securities
Capitalized interest/dividends
Sales of risk participation agreements
Balance March 31, 2011
Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at March 31, 2011

Gains and losses on the Level 3 assets and liabilities in the table above are reported in the following income categories:


Change in unrealized gains or losses relating to assets still held at March $\$$ 31, 2012
For the three months ended March 31, 2011

| Total gains or losses included in earnings | $\$(369$ | $) \$ 6$ | $\$ 1,425$ | $\$ 1,062$ |
| :--- | ---: | ---: | ---: | ---: |
| Change in unrealized gains or losses relating to assets still held at March | $\$ 113$ | $\$ 6$ | $\$ 1,425$ | $\$ 1,544$ | 31, 2011

$\$(2 \quad) \$ 4,125 \quad \$ 4,123$

Level 3 Inputs

As shown above, the Company's significant Level 3 measurements which employ unobservable inputs that are readily quantifiable pertain to ARS, held in the state and municipal portfolio, and private equity investments.
Information about these inputs is presented in the table and discussions below.
Quantitative Information about Level 3 Fair Value Measurements

| Auction rate securities | Valuation Technique | Unobservable Input | Range |
| :---: | :---: | :---: | :---: |
|  | Discounted cash flow | Estimated market recovery period | 5 years |
|  |  | Estimated market rate | 2.7\%-4.6\% |
| Private equity investments | Market comparable companies | EBITDA multiple | 4.0\%-5.5\% |

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The fair values of ARS are estimated using a discounted cash flows analysis in which estimated cash flows are based on mandatory interest rates paid under failing auctions and projected over an estimated market recovery period. Under normal conditions, ARS traded in weekly auctions and were considered liquid investments. The Company's estimate of when these auctions might resume is highly judgmental and subject to variation depending on current and projected market conditions. Few auctions of these securities have been held since 2008, and most sales have been privately arranged. Estimated cash flows during the period over which the Company expects to hold the securities are discounted at an estimated market rate reflecting adjustments for liquidity premium and nonperformance risk. These securities are comprised of bonds issued by various states and municipalities for healthcare and student lending purposes, and market rates are derived for each type. An increase in the holding period alone would result in a higher fair value measurement, while an increase in the estimated market rate (the discount rate) alone would result in a lower fair value measurement.

The fair values of the Company's private equity investments are based on a determination of fair value of the investee company less exit costs and preference payments assuming the sale of the investee company. Investee companies are normally non-public entities. The fair value of the investee company is determined by reference to the investee's total earnings before interest, depreciation/amortization, and income taxes (EBITDA) multiplied by an EBITDA factor. EBITDA is normally determined based on a trailing prior period adjusted for specific factors including current economic outlook, investee management, and specific unique circumstances such as sales order information, major customer status, regulatory changes, etc. The EBITDA multiple is based on management's review of published trading multiples for recent private equity transactions and other judgments, and is derived for each individual investee. The value of the investee company is then reduced to reflect appropriate assumed selling and liquidation costs. The fair value of the Company's investment (which is usually a partial interest in the investee company) is then calculated based on its ownership percentage in the investee company.

Valuation methods for instruments measured at fair value on a nonrecurring basis
Following is a description of the Company's valuation methodologies used for other financial and nonfinancial instruments measured at fair value on a nonrecurring basis.

## Collateral dependent impaired loans

While the overall loan portfolio is not carried at fair value, the Company periodically records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral dependent loans when establishing the allowance for loan losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. In determining the value of real estate collateral, the Company relies on external appraisals and assessment of property values by its internal staff. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgments based on the experience and expertise of internal specialists. Because many of these inputs are not observable, the measurements are classified as Level 3. Changes in fair value recognized for partial charge-offs of loans and loan impairment reserves on loans held by the Company at March 31, 2012 and 2011 are shown in the table below.

Loans held for sale
Loans held for sale are carried at the lower of cost or fair value. At March 31, 2012, this portfolio consisted of student loans. Most of the portfolio is under contract to agencies which have been unable to consistently purchase loans under existing contractual terms. These loans have been evaluated using a fair value measurement method based on a discounted cash flows analysis, which is classified as Level 3. The fair value of these loans was $\$ 6.6$ million at March 31, 2012, net of an impairment reserve of $\$ 171$ thousand. The measurement of fair value for other student

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loans is based on the specific prices mandated in the underlying sale contracts and the estimated exit price and is classified as Level 2.

Private equity investments and restricted stock
These assets are included in non-marketable investment securities in the consolidated balance sheets. They include investments in private equity concerns held by the Parent company which are carried at cost, reduced by other-than-temporary impairment. These investments are periodically evaluated for impairment based on their estimated fair value as determined by review of available information, most of which is provided as monthly or quarterly internal financial statements, annual audited financial statements, investee tax returns, and in certain situations, through research into and analysis of the assets and investments held by those private equity concerns.
Restricted stock consists of stock issued by the Federal Reserve Bank and FHLB which is held by the bank subsidiary as required for regulatory purposes. Generally, there are restrictions on the sale and/or liquidation of these investments, and they are carried at cost, reduced by other-than-temporary impairment. Fair value measurements for these securities are classified as Level 3.

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Mortgage servicing rights
The Company initially measures its mortgage servicing rights at fair value and amortizes them over the period of estimated net servicing income. They are periodically assessed for impairment based on fair value at the reporting date. Mortgage servicing rights do not trade in an active market with readily observable prices. Accordingly, the fair value is estimated based on a valuation model which calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, market discount rates, cost to service, float earnings rates, and other ancillary income, including late fees. The fair value measurements are classified as Level 3.

Goodwill and core deposit premium
Valuation of goodwill to determine impairment is performed on an annual basis, or more frequently if there is an event or circumstance that would indicate impairment may have occurred. The process involves calculations to determine the fair value of each reporting unit on a stand-alone basis. A combination of formulas using current market multiples, based on recent sales of financial institutions within the Company's geographic marketplace, is used to estimate the fair value of each reporting unit. That fair value is compared to the carrying amount of the reporting unit, including its recorded goodwill. Impairment is considered to have occurred if the fair value of the reporting unit is lower than the carrying amount of the reporting unit. The fair value of the Company's common stock relative to its computed book value per share is also considered as part of the overall evaluation. These measurements are classified as Level 3.

Core deposit premiums are recognized at the time a portfolio of deposits is acquired. Core deposit premiums are recognized using valuation techniques which calculate the present value of the estimated net cost savings attributable to the core deposit base, relative to alternative costs of funds and tax benefits, if applicable, over the expected remaining economic life of the depositors. Subsequent evaluations are made when facts or circumstances indicate potential impairment may have occurred. The Company uses estimates of discounted future cash flows, comparisons with alternative sources for deposits, consideration of income potential generated in other product lines by current customers, geographic parameters, and other demographics to estimate a current fair value of a specific deposit base. If the calculated fair value is less than the carrying value, impairment is considered to have occurred. This measurement is classified as Level 3.

## Foreclosed assets

Foreclosed assets consist of loan collateral which has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including auto, marine and recreational vehicles. Foreclosed assets are recorded as held for sale initially at the lower of the loan balance or fair value of the collateral less estimated selling costs. Subsequent to foreclosure, valuations are updated periodically, and the assets may be marked down further, reflecting a new cost basis. Fair value measurements may be based upon appraisals, third-party price opinions, or internally developed pricing methods. These measurements are classified as Level 3.

Long-lived assets
In accordance with ASC 360-10-35, investments in branch facilities and various office buildings are written down to estimated fair value, or estimated fair value less cost to sell if the property is held for sale. Fair value is estimated in a process which considers current local commercial real estate market conditions and the judgment of the sales agent on pricing and sales strategy. These fair value measurements are classified as Level 3. The loss recognized in the first quarter of 2012 resulted primarily from the Company's decision to market certain property adjacent to an office
building in downtown Kansas City, also held for sale, which required a write-down to fair value less selling costs.
For assets measured at fair value on a nonrecurring basis during the first three months of 2012 and 2011 and still held as of March 31, 2012 and 2011, the following table provides the adjustments to fair value recognized during the respective periods, the level of valuation inputs used to determine each adjustment, and the carrying value of the related individual assets or portfolios at March 31, 2012 and 2011.

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| (In thousands) | Fair Value | Fair Value Measurements Using |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Quoted <br> Prices in <br> Active <br> Markets for <br> Identical <br> Assets <br> (Level 1) | Significant <br> Other <br> Observable <br> Inputs <br> (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) Recognized During the Three Months Ended Mar. 31 |
| March 31, 2012 |  |  |  |  |  |
| Loans | \$ 19,579 | \$- | \$- | \$ 19,579 | \$(1,208 ) |
| Mortgage servicing rights | 686 | - | - | 686 | 40 |
| Foreclosed assets | 330 | - | - | 330 | (50 ) |
| Long-lived assets | 4,647 | - | - | 4,647 | (3,000 ) |
| March 31, 2011 |  |  |  |  |  |
| Loans | \$41,091 | \$- | \$- | \$ 41,091 | \$(5,458 ) |
| Mortgage servicing rights | 1,281 | - | - | 1,281 | 51 |
| Foreclosed assets | 2,301 | - | - | 2,301 | (288 ) |
| Long-lived assets | 3,300 | - | - | 3,300 | (1,000 ) |

## 13. Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments held by the Company, in addition to a discussion of the methods used and assumptions made in computing those estimates, are set forth below.

## Loans

The fair values of loans are estimated by discounting the expected future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC 820 "Fair Value Measurements and Disclosures". Expected future cash flows for each individual loan are based on contractual features, and for loans with optionality, such as variable rates and prepayment features, are based on a multi-rate path process. Each loan's expected future cash flows are discounted using the LIBOR/swap curve plus an appropriate spread. For business, construction and business real estate loans, internally-developed pricing spreads are developed which are based on loan type, term and credit score. The spread for personal real estate loans is generally based on newly originated loans with similar characteristics. For consumer loans, the spread is calculated at loan origination as part of the Bank's funds transfer pricing process (also mentioned in Note 8), which is indicative of individual borrower credit worthiness. All consumer credit card loans are discounted at the same spread, depending on whether the rate is variable or fixed. Each of these measurements is classified as Level 3 in the fair value hierarchy, described in Note 12.

Loans Held for Sale
A description of the fair value measurement of loans held for sale is provided in Note 12.

## Investment Securities

A description of the fair value measurement of the debt and equity instruments in the investment security portfolio is provided in Note 12.

Federal Funds Purchased and Sold, Interest Earning Deposits With Banks and Cash and Due From Banks The carrying amounts of federal funds purchased and sold, interest earning deposits with banks, and cash and due from banks equals fair value, as these instruments are payable on demand or mature overnight. Because of their

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nature, they are considered Level 1 measurements.
Securities Purchased/Sold under Agreements to Resell/Repurchase
The fair values of these investments and borrowings are estimated by discounting contractual maturities using an estimate of the current market rate for similar instruments. The fair value measurement is classified as Level 3.

Derivative Instruments
A description of the fair value measurement of derivative instruments is provided in Note 12.
Deposits
The fair value of deposits with no stated maturity is equal to the amount payable on demand. Such deposits include savings and interest and non-interest bearing demand deposits. These fair value estimates do not recognize any benefit the Company receives as a result of being able to administer, or control, the pricing of these accounts. Because they are payable on demand,

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they are classified as Level 1 in the fair value hierarchy. The fair value of time open and certificates of deposit is based on the discounted value of cash flows, taking early withdrawal optionality into account. Discount rates are based on the Company's approximate cost of obtaining similar maturity funding in the market. The measurement of time open and certificates of deposit is classified as Level 3.

Other Borrowings
The fair value of other borrowings, which consists of long-term debt, is estimated by discounting contractual maturities using an estimate of the current market rate for similar instruments. This fair value measurement is classified as Level 3.

The estimated fair values of the Company's financial instruments are as follows:
(In thousands)
Financial Assets
Loans:
Business
Real estate - construction and land
Real estate - business
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Overdrafts
Loans held for sale
Investment securities:
Available for sale
Trading
Non-marketable
Federal funds sold
Securities purchased under agreements to resell
Interest earning deposits with banks
Cash and due from banks
Derivative instruments
Financial Liabilities
Non-interest bearing deposits
Savings, interest checking and money market deposits
Time open and certificates of deposit
Federal funds purchased
Securities sold under agreements to repurchase
Other borrowings
Derivative instruments

| March 31, 2012 | December 31, 2011 |  |  |
| :--- | :--- | :--- | :--- |
| Carrying | Estimated | Carrying | Estimated |
| Amount | Fair Value | Amount | Fair Value |


| $\$ 2,920,237$ | $\$ 2,933,184$ | $\$ 2,808,265$ | $\$ 2,820,005$ |
| :--- | :--- | :--- | :--- |
| 376,642 | 379,239 | 386,598 | 388,723 |
| $2,203,686$ | $2,228,049$ | $2,180,100$ | $2,197,535$ |
| $1,458,467$ | $1,497,628$ | $1,428,777$ | $1,485,028$ |
| $1,113,481$ | $1,141,300$ | $1,114,889$ | $1,136,798$ |
| 448,169 | 455,468 | 463,587 | 471,086 |
| 723,759 | 737,158 | 788,701 | 780,808 |
| 3,530 | 3,530 | 6,561 | 6,561 |
| 9,673 | 9,684 | 31,076 | 33,279 |
|  |  |  |  |
| $9,120,399$ | $9,120,399$ | $9,224,702$ | $9,224,702$ |
| 34,178 | 34,178 | 17,853 | 17,853 |
| 120,734 | 120,734 | 115,832 | 115,832 |
| 40,925 | 40,925 | 11,870 | 11,870 |
| 850,000 | 864,157 | 850,000 | 864,089 |
| 12,038 | 12,038 | 39,853 | 39,853 |
| 381,462 | 381,462 | 465,828 | 465,828 |
| 18,785 | 18,785 | 21,537 | 21,537 |


| $\$ 5,209,381$ | $\$ 5,209,381$ | $\$ 5,377,549$ | $\$ 5,377,549$ |
| :--- | :--- | :--- | :--- |
| $9,038,283$ | $9,038,283$ | $8,933,941$ | $8,933,941$ |
| $2,524,096$ | $2,531,391$ | $2,488,393$ | $2,493,727$ |
| 110,845 | 110,845 | 153,330 | 153,330 |
| $1,012,143$ | $1,010,437$ | $1,102,751$ | $1,099,883$ |
| 111,520 | 124,894 | 111,817 | 126,397 |
| 20,076 | 20,076 | 22,722 | 22,722 |

Off-Balance Sheet Financial Instruments
The fair value of letters of credit and commitments to extend credit is based on the fees currently charged to enter into similar agreements. The aggregate of these fees is not material.

Limitations

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Fair value estimates are made at a specific point in time based on relevant market information. They do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for many of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, risk characteristics and economic conditions. These estimates are subjective, involve uncertainties, and cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company's 2011 Annual Report on Form 10-K. Results of operations for the three month period ended March 31, 2012 are not necessarily indicative of results to be attained for any other period.

## Forward Looking Information

This report may contain "forward-looking statements" that are subject to risks and uncertainties and include information about possible or assumed future results of operations. Many possible events or factors could affect the future financial results and performance of the Company. This could cause results or performance to differ materially from those expressed in the forward-looking statements. Words such as "expects", "anticipates", "believes", "estimates", variations of such words and other similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in, or implied by, such forward-looking statements. Readers should not rely solely on the forward-looking statements and should consider all uncertainties and risks discussed throughout this report. Forward-looking statements speak only as of the date they are made. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events. Such possible events or factors include: changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, governmental legislation and regulation, fluctuations in interest rates, changes in liquidity requirements, demand for loans in the Company's market area, and competition with other entities that offer financial services.

## Critical Accounting Policies

The Company's consolidated financial statements are prepared based on the application of certain accounting policies, some of which require numerous estimates and strategic or economic assumptions that may prove inaccurate or be subject to variations which may significantly affect the Company's reported results and financial position for the current period or future periods. The use of estimates, assumptions, and judgment is necessary when assets and liabilities are required to be recorded at, or adjusted to reflect, fair value. Current economic conditions may require the use of additional estimates, and some estimates may be subject to a greater degree of uncertainty due to the current instability of the economy. The Company has identified several policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for loan losses, the valuation of certain investment securities, and accounting for income taxes.

Allowance for Loan Losses
The Company performs periodic and systematic detailed reviews of its loan portfolio to assess overall collectability. The level of the allowance for loan losses reflects the Company's estimate of the losses inherent in the loan portfolio at any point in time. While these estimates are based on substantive methods for determining allowance requirements, actual outcomes may differ significantly from estimated results, especially when determining allowances for business, lease, construction and business real estate loans. These loans are normally larger and more complex, and their collection rates are harder to predict. Personal loans, including personal mortgage, credit card and consumer loans, are
individually smaller and perform in a more homogenous manner, making loss estimates more predictable. Further discussion of the methodology used in establishing the allowance is provided in the Provision and Allowance for Loan Losses section of this discussion.

Valuation of Investment Securities
The Company carries its investment securities at fair value and employs valuation techniques which utilize observable inputs when those inputs are available. These observable inputs reflect assumptions market participants would use in pricing the security and are developed based on market data obtained from sources independent of the Company. When such information is not available, the Company employs valuation techniques which utilize unobservable inputs, or those which reflect the Company's own assumptions about market participants, based on the best information available in the circumstances. These valuation methods typically involve cash flow and other financial modeling techniques. Changes in underlying factors, assumptions, estimates, or other inputs to the valuation techniques could have a material impact on the Company's future financial condition and results of

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operations. Assets and liabilities carried at fair value inherently result in more financial statement volatility. Under the fair value measurement hierarchy, fair value measurements are classified as Level 1 (quoted prices), Level 2 (based on observable inputs) or Level 3 (based on unobservable, internally-derived inputs), as discussed in more detail in Note 12 to the consolidated financial statements. Most of the available for sale investment portfolio is priced utilizing industry-standard models that consider various assumptions which are observable in the marketplace, or which can be derived from observable data. Such securities totaled approximately $\$ 8.6$ billion, or $94.3 \%$ of the available for sale portfolio at March 31, 2012 and were classified as Level 2 measurements. The Company also holds $\$ 129.9$ million in auction rate securities. These were classified as Level 3 measurements, as no liquid market currently exists for these securities, and fair values were derived from internally generated cash flow valuation models which used unobservable inputs significant to the overall measurement.

Changes in the fair value of available for sale securities, excluding credit losses relating to other-than-temporary impairment, are reported in other comprehensive income. The Company periodically evaluates the available for sale portfolio for other-than-temporary impairment. Evaluation for other-than-temporary impairment is based on the Company's intent to sell the security and whether it is likely that it will be required to sell the security before the anticipated recovery of its amortized cost basis. If either of these conditions is met, the entire loss (the amount by which the amortized cost exceeds the fair value) is recognized in current earnings. If neither condition is met, but the Company does not expect to recover the amortized cost basis, the Company determines whether a credit loss has occurred. This credit loss is the amount by which the amortized cost basis exceeds the present value of cash flows expected to be collected from the security. The credit loss, if any, is recognized in current earnings, while the remainder of the loss, related to all other factors, is recognized in other comprehensive income.

The estimation of whether a credit loss exists and the period over which the security is expected to recover requires significant judgment. The Company considers available information about the collectability of the security, including information about past events, current conditions, and reasonable forecasts, which include payment structure, prepayment speeds, expected defaults, and collateral values. Changes in these factors could result in additional impairment, recorded in current earnings, in future periods.

At March 31, 2012, certain non-agency guaranteed mortgage-backed securities with a par value of $\$ 131.7$ million were identified as other-than-temporarily impaired. The cumulative credit-related impairment loss on these securities amounted to $\$ 10.2$ million, which was recorded in the consolidated statements of income.

The Company, through its direct holdings and its Small Business Investment subsidiaries, has numerous private equity investments, categorized as non-marketable securities in the accompanying consolidated balance sheets. These investments totaled $\$ 75.4$ million at March 31, 2012, and most are carried at fair value. Changes in fair value are reflected in current earnings and reported in investment securities gains (losses), net, in the consolidated statements of income. Because there is no observable market data for these securities, their fair values are internally developed using available information and management's judgment, and they are classified as Level 3 measurements. Although management believes its estimates of fair value reasonably reflect the fair value of these securities, key assumptions regarding the projected financial performance of these companies, the evaluation of the investee company's management team, and other economic and market factors may affect the amounts that will ultimately be realized from these investments.

## Accounting for Income Taxes

Accrued income taxes represent the net amount of current income taxes which are expected to be paid attributable to operations as of the balance sheet date. Deferred income taxes represent the expected future tax consequences of events that have been recognized in the financial statements or income tax returns. Current and deferred income taxes are reported as either a component of other assets or other liabilities in the consolidated balance sheets, depending on
whether the balances are assets or liabilities. Judgment is required in applying generally accepted accounting principles in accounting for income taxes. The Company regularly monitors taxing authorities for changes in laws and regulations and their interpretations by the judicial systems. The aforementioned changes, and changes that may result from the resolution of income tax examinations by federal and state taxing authorities, may impact the estimate of accrued income taxes and could materially impact the Company's financial position and results of operations.

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| Selected Financial Data |  |  |
| :---: | :---: | :---: |
|  | Three Months Ended March 31, |  |
|  | 2012 | 2011 |
| Per Share Data |  |  |
| Net income per common share - basic | \$.74 | \$. 66 |
| Net income per common share - diluted | . 74 | . 66 |
| Cash dividends | . 230 | . 219 |
| Book value | 24.83 | 22.64 |
| Market price | 40.52 | 38.51 |
| Selected Ratios |  |  |
| (Based on average balance sheets) |  |  |
| Loans to deposits ${ }^{(1)}$ | 55.53 | \% 62.47 |
| Non-interest bearing deposits to total deposits | 30.93 | 29.20 |
| Equity to loans ${ }^{(1)}$ | 23.86 | 21.62 |
| Equity to deposits | 13.25 | 13.51 |
| Equity to total assets | 10.74 | 11.06 |
| Return on total assets | 1.29 | 1.32 |
| Return on total equity | 12.04 | 11.95 |
| (Based on end-of-period data) |  |  |
| Non-interest income to revenue ${ }^{(2)}$ | 37.19 | 37.34 |
| Efficiency ratio ${ }^{(3)}$ | 58.91 | 59.64 |
| Tier I risk-based capital ratio | 14.85 | 14.75 |
| Total risk-based capital ratio | 16.19 | 16.12 |
| Tangible common equity to assets ratio ${ }^{(4)}$ | 10.12 | 10.24 |
| Tier I leverage ratio | 9.70 | 10.27 |

(1) Includes loans held for sale.
(2) Revenue includes net interest income and non-interest income.
(3) The efficiency ratio is calculated as non-interest expense (excluding intangibles amortization) as a percent of revenue.
(4) The tangible common equity ratio is calculated as stockholders' equity reduced by goodwill and other intangible assets (excluding mortgage servicing rights) divided by total assets reduced by goodwill and other intangible assets (excluding mortgage servicing rights).

Results of Operations
Summary
(Dollars in thousands)
Net interest income
Provision for loan losses
Non-interest income
Investment securities gains, net
Non-interest expense
Income taxes
Non-controlling interest expense

| Three Months Ended March 31, |  | Increase (Decrease) |  |
| :---: | :---: | :---: | :---: |
| 2012 | 2011 | Amount | Percent |
| \$ 159,737 | \$160,973 | \$(1,236 | ) (.8 )\% |
| (8,165 | ) (15,789 ) | (7,624 | ) (48.3 |
| 94,583 | 95,906 | (1,323 | ) (1.4 |
| 4,040 | 1,327 | 2,713 | N.M. |
| (150,461 | ) (153,960) | (3,499 | ) (2.3 |
| (32,920 | ) (27,507 ) | 5,413 | 19.7 |
| (1,015 | ) (497 | 518 | N.M. |

$\begin{array}{llllll}\text { Net income attributable to Commerce Bancshares, Inc. } & \$ 65,799 & \$ 60,453 & \$ 5,346 & 8.8 & \%\end{array}$
For the quarter ended March 31, 2012, net income attributable to Commerce Bancshares, Inc. (net income) amounted to $\$ 65.8$ million, an increase of $\$ 5.3$ million, or $8.8 \%$, compared to the first quarter of the previous year. For the current quarter, the annualized return on average assets was $1.29 \%$, the annualized return on average equity was $12.04 \%$, and the efficiency ratio was $58.91 \%$. Diluted earnings per share was $\$ .74$, an increase of $12.1 \%$ compared to $\$ .66$ per share in the first quarter of 2011.

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Net income for the first quarter of 2012 compared to the same period last year included a decline of $\$ 7.6$ million, or $48.3 \%$, in the provision for loan losses. Net interest income declined $\$ 1.2$ million, or $.8 \%$, due to lower earnings on the Company's loan and investment portfolios, partly offset by lower expense incurred on deposits. Non-interest income decreased $\$ 1.3$ million, or $1.4 \%$, due to a decline of $\$ 2.7$ million in bank card transaction fees (the effect of new debit card fee regulations effective late in 2011), and a $\$ 3.0$ million write-down on a former office property held for sale. These declines were partly offset by an increase of $\$ 2.2$ million in capital market fees. Net securities gains increased $\$ 2.7$ million, mainly due to fair value adjustments on private equity investments. Non-interest expense decreased $\$ 3.5$ million, or $2.3 \%$, compared to the same period last year due to declines of $\$ 2.4$ million in deposit insurance expense and $\$ 4.1$ million in other non-interest expense, partly offset by a $\$ 2.2$ million increase in salaries and employee benefits. In addition, a $\$ 1.4$ million reduction in a Visa indemnification obligation was recorded in the first quarter of 2011, and a similar expense reduction did not re-occur in the first quarter of 2012.

## Net Interest Income

The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates. Changes not solely due to volume or rate changes are allocated to rate.

Analysis of Changes in Net Interest Income
(In thousands)
Interest income, fully taxable equivalent basis:
Loans
Loans held for sale
Investment securities:
U.S. government and federal agency securities

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage-backed securities
Asset-backed securities
Other securities
Total interest on investment securities
Short-term federal funds sold and securities purchased under agreements to resell
Long-term securities purchased under agreements to resell
Interest earning deposits with banks
Total interest income
Three Months Ended March
31, 2012 vs. 2011
Change due to
Average Average
Volume Rate Total
\$(2,752) \$(3,816 ) \$(6,568)
$(238) 45 \quad(193)$
$(1,017)(1,395)(2,412)$
384 (33 ) 351
1,734 (1,350 ) 384
12,329 (11,022 ) 1,307
1,577 (1,851 ) (274 )
126 (243 ) (117 )
15,133 (15,894 ) (761 )

Interest expense:
Deposits:
Savings
Interest checking and money market
Time open \& C.D.'s of less than $\$ 100,000$
Time open \& C.D.'s of $\$ 100,000$ and over Total interest on deposits
$17 \quad(10 \quad) 7$

1,083 1,030 2,113
(36 ) $1 \quad(35 \quad)$

13,207 (18,644 )(5,437)

Federal funds purchased and securities sold under agreements to repurchase
144 (541 ) (397 )
$\left.\begin{array}{llll}\text { Other borrowings } & \left(\begin{array}{lll}3 & )(6) & (9)\end{array}\right) \\ \text { Total interest expense } & 303 & (4,927 & )(4,624\end{array}\right)$

Net interest income for the first quarter of 2012 was $\$ 159.7$ million, a $\$ 1.2$ million decrease from the first quarter of 2011. On a tax equivalent (T/E) basis, net interest income totaled $\$ 165.7$ million, down from $\$ 167.9$ million in the previous quarter and down from $\$ 166.5$ million in the same quarter last year. This decline from the same period last year was mainly the result of lower loan yields and loan balances, in conjunction with lower rates paid on deposits. The Company's net interest rate margin was $3.45 \%$ for the first quarter of 2012, compared to $3.44 \%$ in the previous quarter and $3.85 \%$ in the first quarter of 2011.

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Total interest income (T/E) decreased $\$ 5.4$ million, or 3.0\%, from the first quarter of 2011. Interest income on loans, including loans held for sale, declined $\$ 6.8$ million due to a decrease of $\$ 277.9$ million, or $2.9 \%$, in average loan balances, coupled with a decrease in average rates earned. The overall average rate earned on total loans was $4.94 \%$ compared to $5.13 \%$ in the first quarter of 2011 . Average business loans and average construction and land loans decreased $\$ 158.6$ million and $\$ 71.1$ million, respectively, and, coupled with a decrease in average rates earned on these loans, caused a $\$ 3.0$ million decrease in interest income. Average business real estate loans increased $\$ 103.5$ million, or $5.0 \%$, the impact of which was offset by a decrease of 35 basis points in the average rate earned on those loans. Interest income from personal real estate loans decreased $\$ 1.4$ million, or $7.9 \%$, primarily due to a 42 basis point decrease in the average rate earned. Interest income from consumer loans decreased $\$ 1.9$ million due to a 54 basis point decrease in the average rate earned coupled with a decrease in average balances of $\$ 39.2$ million, or $3.4 \%$. Reflected in the decrease in consumer average loan balances was a decrease of $\$ 113.1$ million in marine and RV loans as that portfolio continues to pay down (since the Company no longer originates these types of loans), which was partially offset by an increase in auto loan balances. Average consumer credit card loans decreased $\$ 44.2$ million compared to the first quarter of 2011, while the average rate earned on these balances increased to $11.78 \%$ from 10.92\%.

Interest income on investment securities (T/E) was $\$ 58.3$ million during the first quarter of 2012 compared to $\$ 59.0$ million during the same period last year. The average balance of the total portfolio increased $\$ 1.8$ billion, or $25.1 \%$, compared to the first quarter of 2011. This growth mainly occurred in mortgage and asset-backed securities, which increased by $\$ 1.3$ billion and $\$ 440.6$ million, respectively. The effect of higher balances was largely offset by lower overall average yields, which declined to $2.56 \%$ compared to $3.28 \%$ during the first quarter of 2011. The current quarter also included a decrease of $\$ 2.6$ million in interest earned on inflation-protected securities.

The average balances of long-term securities purchased under agreements to resell increased $\$ 282.2$ million, or $49.7 \%$, over the first quarter of 2011 , while the average rate earned increased 48 basis points, together contributing an increase in interest income of $\$ 2.1$ million.

The average tax equivalent yield on total interest earning assets was $3.66 \%$ in the first quarter of 2012 compared to $4.20 \%$ in the first quarter of 2011.

Total interest expense decreased $\$ 4.6$ million, or $31.1 \%$, compared to the first quarter of 2011, primarily due to a $\$ 4.2$ million decrease in interest expense on interest bearing deposits. The decrease in interest expense on deposits resulted primarily from a 13 basis point decrease in average rates paid on interest checking and money market accounts, coupled with a 29 basis point decrease in average rates paid on time open and certificates of deposit. Also, average time open and certificate of deposit balances decreased $\$ 259.6$ million, which was offset by an increase of $\$ 887.8$ million in average money market account balances. The overall average rate incurred on all interest bearing liabilities decreased to $.32 \%$ in the first quarter of 2012 compared to $.51 \%$ in the first quarter of 2011.

Summaries of average assets and liabilities and the corresponding average rates earned/paid appear on the last page of this discussion.

## Non-Interest Income

(Dollars in thousands)
Bank card transaction fees
Trust fees
Deposit account charges and other fees
Capital market fees

| Three Months Ended <br> March 31, | Increase <br> (Decrease) |  |  |
| :--- | :--- | :--- | :--- |
| 2012 | 2011 | Amount Percent |  |
| $\$ 34,733$ | $\$ 37,462$ | $\$(2,729)(7.3$ | $) \%$ |
| 22,814 | 21,572 | 1,242 | 5.8 |
| 19,336 | 19,300 | 36 | .2 |
| 6,871 | 4,720 | 2,151 | 45.6 |


| Consumer brokerage services | 2,526 | 2,663 | $(137$ | $)(5.1$ | $)$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Loan fees and sales | 1,561 | 1,824 | $(263$ | $)(14.4$ | $)$ |
| Other | 6,742 | 8,365 | $(1,623$ | $)(19.4$ | $)$ |
| Total non-interest income | $\$ 94,583$ | $\$ 95,906$ | $\$(1,323)(1.4$ | $) \%$ |  |
| Non-interest income as a \% of total revenue* | 37.2 | $\% 37.3$ | $\%$ |  |  |

* Total revenue includes net interest income and non-interest income.

For the first quarter of 2012, total non-interest income amounted to $\$ 94.6$ million compared with $\$ 95.9$ million in the same quarter last year, which was a decrease of $\$ 1.3$ million, or $1.4 \%$. Bank card fees for the quarter declined $\$ 2.7$ million, or $7.3 \%$, from the first quarter of last year, as a result of a decline in debit card interchange fees of $\$ 5.9$ million, or $41.4 \%$ (mainly the effect

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of new pricing limitations effective in late 2011), but was partly offset by growth in corporate card fees of $\$ 2.3$ million, or $16.8 \%$. Corporate card and debit card fees for the current quarter totaled $\$ 15.7$ million and $\$ 8.4$ million, respectively. Merchant fees grew by $15.1 \%$ due to a new sales focus, and totaled $\$ 5.7$ million for the quarter. Trust fees for the quarter increased $\$ 1.2$ million, or $5.8 \%$, over the same quarter last year resulting mainly from growth in both personal and institutional trust fees. Deposit account fees increased slightly, as corporate cash management and other personal account fees grew by $\$ 925$ thousand, while overdraft fees declined $\$ 888$ thousand, or $9.6 \%$. Capital market fees for the current quarter totaled $\$ 6.9$ million, an increase of $\$ 2.2$ million, or $45.6 \%$, as a result of growth in sales of mainly fixed income securities to correspondent banks and other commercial customers. Consumer brokerage services revenue decreased by $\$ 137$ thousand, or $5.1 \%$, mainly due to a decline in variable annuity commissions. Loan fees and sales revenue was down $\$ 263$ thousand, or $14.4 \%$, from the same period last year mainly due to lower mortgage banking revenue and commercial loan commitment fees. Other non-interest income for the current quarter decreased $\$ 1.6$ million from the same quarter last year and included a fair value loss of $\$ 3.0$ million on an office building and adjacent land, which formerly housed the Bank's operations center, and is currently held for sale. This decline was partly offset by a net gain recorded upon the insurance settlement on the Joplin tornado loss and a gain on the sale of a branch property in central Missouri.

Investment Securities Gains (Losses), Net

Net gains and losses on investment securities which were recognized in earnings during the three months ended March 31,2012 and 2011 are shown in the table below. Net securities gains amounted to $\$ 4.0$ million in the first quarter of 2012, compared to gains of $\$ 1.3$ million in the same quarter last year. Included in these gains and losses are credit-related impairment losses on certain non-agency guaranteed mortgage-backed securities which have been identified as other-than-temporarily impaired. These identified securities had a total par value of $\$ 131.7$ million at March 31, 2012. During the current quarter, additional credit-related impairment losses of $\$ 320$ thousand were recorded, bringing the cumulative credit-related impairment loss on these securities, recorded in earnings, to $\$ 10.4$ million. Also shown below are net gains and losses relating to non-marketable private equity investments, which are primarily held by the Parent's majority-owned private equity subsidiaries. These include fair value adjustments, in addition to gains and losses realized upon disposition. The portion of this activity attributable to minority interests is included in non-controlling interest in the consolidated statements of income, and resulted in expense of $\$ 817$ thousand during the first quarter of 2012 and $\$ 338$ thousand during the same period last year.
(In thousands)
Available for sale:
Municipal bonds
Agency mortgage-backed bonds
OTTI losses on non-agency mortgage-backed bonds
Non-marketable:
Private equity investments
Total investment securities gains, net

| Three Months Ended March |  |
| :--- | :---: |
| 31, |  |
| 2012 | 2011 |
| $\$-$ | $\$ 176$ |
| 342 | - |
| $(320$ | $)(274$ |
| 4,018 | 1,425 |
| $\$ 4,040$ | $\$ 1,327$ |

## Non-Interest Expense

(Dollars in thousands)
Salaries and employee benefits
Net occupancy
Equipment

| Three Months Ended <br> March 31, | Increase <br> (Decrease) |
| :--- | :--- | :--- | :--- |
| $\left.\begin{array}{lllll}2012 & 2011 & \text { Amount Percent } \\ \$ 89,543 & \$ 87,392 & \$ 2,151 & 2.5 & \% \\ 11,260 & 12,037 & (777 & )(6.5 & ) \\ 5,189 & 5,577 & (388 & )(7.0\end{array}\right)$ |  |

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| Supplies and communication | 5,613 | 5,532 | 81 | 1.5 |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Data processing and software | 17,469 | 16,467 | 1,002 | 6.1 |  |
| Marketing | 3,822 | 4,258 | $(436$ | $)(10.2$ | $)$ |
| Deposit insurance | 2,520 | 4,891 | $(2,371$ | $(48.5$ | $)$ |
| Indemnification obligation | - | $(1,359$ | $)$ | 1,359 | N.M. |
| Other | 15,045 | 19,165 | $(4,120$ | $(21.5$ | $)$ |
| Total non-interest expense | $\$ 150,461$ | $\$ 153,960$ | $\$(3,499)(2.3$ | $) \%$ |  |

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Non-interest expense for the first quarter of 2012 amounted to $\$ 150.5$ million, a decrease of $\$ 3.5$ million, or $2.3 \%$, compared with $\$ 154.0$ million in the first quarter of last year. Salaries and benefits expense increased $\$ 2.2$ million, or $2.5 \%$, mainly due to higher incentive compensation of $\$ 725$ thousand and higher medical costs, payroll taxes, and 401K expense, which totaled $\$ 817$ thousand. Full-time equivalent employees totaled 4,713 at March 31, 2012 compared to 4,814 at March 31, 2011. Occupancy and equipment expense declined $\$ 777$ thousand and $\$ 388$ thousand, respectively, partly due to the mild 2012 winter and lower depreciation costs. Supplies and communication expense increased slightly, while marketing costs decreased $\$ 436$ thousand, or $10.2 \%$. Data processing and software costs increased $\$ 1.0$ million, or $6.1 \%$, partly due to processing charges on higher corporate card volume. FDIC insurance expense decreased $\$ 2.4$ million, or $48.5 \%$, as a result of new assessment rules which became effective in the second quarter of 2011 . Other non-interest expense decreased $\$ 4.1$ million, or $21.5 \%$, from the same quarter last year, and included a decline of $\$ 1.1$ million due to incentives associated with new bank card network agreements which became effective in the current quarter. In addition, expense on foreclosed real estate and other repossessed property declined $\$ 852$ thousand, mainly due to lower losses on fair value adjustments in the first quarter of 2012. Other non-interest expense also included a decline in regulatory fees of $\$ 609$ thousand, which resulted from the Bank's conversion from a national association to a state charter in mid 2011. In the first quarter of 2011, other non-interest expense included a termination fee of $\$ 910$ thousand on the cancellation of a securities resell agreement and expense of $\$ 877$ thousand related to the donation of appreciated securities.

Provision and Allowance for Loan Losses
(In thousands)
Provision for loan losses
Net loan charge-offs:
Business
Real estate-construction and land
Real estate-business
Consumer credit card
Consumer
Revolving home equity
Real estate-personal
Overdrafts
Total net loan charge-offs

| Three Months Ended |  |  |
| :--- | :--- | :--- |
| Mar. 31, | Dec. 31, | Mar. 31, |
| 2012 | 2011 | 2011 |
| $\$ 8,165$ | $\$ 12,143$ | $\$ 15,789$ |
|  |  |  |
| 110 | 650 | 2,010 |
| 220 | 2,624 | 1,986 |
| 1,495 | 731 | 1,064 |
| 6,173 | 6,986 | 9,038 |
| 2,631 | 2,682 | 4,013 |
| 360 | 884 | 367 |
| 69 | 798 | 274 |
| 107 | 294 | 37 |
| $\$ 11,165$ | $\$ 15,649$ | $\$ 18,789$ |

Annualized net loan charge-offs*:

| Business | .02 | $\% .09$ | $\% .27$ |
| :--- | :--- | :---: | :---: |
| Real estate-construction and land | .23 | 2.69 | 1.78 |
| Real estate-business | .28 | .13 | .21 |
| Consumer credit card | 3.40 | 3.78 | 4.73 |
| Consumer | .96 | .96 | 1.42 |
| Revolving home equity | .32 | .75 | .31 |
| Real estate-personal | .02 | .22 | .08 |
| Overdrafts | 5.67 | 16.43 | 2.11 |
| Total annualized net loan charge-offs | .49 | $\% .68$ | $\% .81$ |

[^0]Three Months Ended

| Mar. 31, | Dec. 31, | Mar. 31, |
| :--- | :--- | :--- |
| 2012 | 2011 | 2011 |

\%.68 \%.81 \%

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The Company has an established process to determine the amount of the allowance for loan losses, which assesses the risks and losses inherent in its portfolio. This process provides an allowance consisting of a specific allowance component based on certain individually evaluated loans and a general component based on estimates of allowances for pools of loans.

Loans subject to individual evaluation generally consist of business, construction, business real estate and personal real estate loans on non-accrual status, and include troubled debt restructurings that are on non-accrual status. These non-accrual loans are evaluated individually for impairment based on factors such as payment history, borrower financial condition, collateral, current economic conditions and loss experience. For collateral dependent loans, appraisals on collateral (including exit costs) are normally obtained annually but discounted based on date last received and market conditions, so values are conservative and reasonable. From these evaluations of expected cash flows and collateral values, allowances are determined.

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Loans which are not individually evaluated are segregated by loan type and sub-type, and are collectively evaluated. These loans include commercial loans (business, construction and business real estate) which have been graded pass, special mention or substandard and all personal banking loans, except personal real estate loans on non-accrual status. These loans also include certain troubled debt restructurings, which are collectively evaluated because they have similar risk characteristics. Allowances determined for personal banking loans, which are generally smaller balance homogeneous type loans, use consistent methodologies which consider historical and current loss trends, delinquencies and current economic conditions. Allowances for commercial type loans, which are generally larger and more complex in structure with more unpredictable loss characteristics, use methods which consider historical and current loss trends, current loan grades, delinquencies, industry concentrations, economic conditions throughout the Company's markets as monitored by Company credit officers, and general economic conditions.

The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses is based upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in delinquencies, portfolio risk ratings, levels of non-performing assets, and prevailing regional and national economic conditions. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company's senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The Company's subsidiary bank continues to be subject to examination by several regulatory agencies, and examinations are conducted throughout the year, targeting various segments of the loan portfolio for review. Note 1 in the 2011 Annual Report on Form 10-K contains additional discussion on the allowance and charge-off policies.

Net loan charge-offs in the first quarter of 2012 amounted to $\$ 11.2$ million, compared with $\$ 15.6$ million in the prior quarter and $\$ 18.8$ million in the first quarter of last year. The $\$ 4.5$ million decrease in net loan charge-offs in the first quarter of 2012 compared to the previous quarter was mainly the result of lower construction and land, consumer credit card, and personal real estate loan losses, which decreased by $\$ 2.4$ million, $\$ 813$ thousand, and $\$ 729$ thousand, respectively, reflecting improved credit trends. Business and revolving home equity net loan charge-offs also declined by $\$ 540$ thousand and $\$ 524$ thousand, respectively. Net loan losses on business real estate loans increased $\$ 764$ thousand during the quarter and totaled $\$ 1.5$ million at quarter-end. The ratio of annualized net loan charge-offs to total average loans was $.49 \%$ in the current quarter compared to $.68 \%$ in the previous quarter and $.81 \%$ in the same quarter last year.

For the first quarter of 2012, annualized net charge-offs on average consumer credit card loans amounted to $3.40 \%$, compared with $3.78 \%$ in the previous quarter and $4.73 \%$ in the same period last year. Consumer loan net charge-offs for the quarter amounted to $.96 \%$ of average consumer loans, which was unchanged from the previous quarter, as compared to $1.42 \%$ in the same quarter last year.

The provision for loan losses for the current quarter totaled $\$ 8.2$ million, a decrease of $\$ 4.0$ million from the previous quarter and $\$ 7.6$ million lower than in the same period last year. The current quarter provision for loan losses was $\$ 3.0$ million less than net loan charge-offs for the current quarter, thereby reducing the allowance to $\$ 181.5$ million. At March 31, 2012 the allowance for loan losses was $1.96 \%$ of total loans, excluding loans held for sale, and was $264 \%$ of total non-accrual loans.

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## Risk Elements of Loan Portfolio

The following table presents non-performing assets and loans which are past due 90 days and still accruing interest. Non-performing assets include non-accruing loans and foreclosed real estate. Loans are placed on non-accrual status when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment. Loans that are 90 days past due as to principal and/or interest payments are generally placed on non-accrual, unless they are both well-secured and in the process of collection, or they are consumer loans that are exempt under regulatory rules from being classified as non-accrual.

| (Dollars in thousands) | March 31, <br> 2012 | December 31, <br> 2011 |
| :--- | :--- | :--- |
| Non-accrual loans: |  |  |
| Business | $\$ 20,142$ | $\$ 25,724$ |
| Real estate - construction and land | 21,055 | 22,772 |
| Real estate - business | 20,655 | 19,374 |
| Real estate - personal | 7,023 | 7,612 |
| Total non-accrual loans | 68,875 | 75,482 |
| Foreclosed real estate | 18,585 | 18,321 |
| Total non-performing assets | $\$ 87,460$ | $\$ 93,803$ |
| Non-performing assets as a percentage of total loans | .95 | $\% 1.02$ |
| Non-performing assets as a percentage of total assets | .43 | $\% .45$ |
| Loans past due 90 days and still accruing interest: |  | $\%$ |
| Business | $\$ 782$ | $\$ 595$ |
| Real estate - construction and land | 150 | 121 |
| Real estate - business | 1,638 | 29 |
| Real estate - personal | 3,151 | 3,045 |
| Consumer | 1,691 | 2,230 |
| Revolving home equity | 1,268 | 643 |
| Consumer credit card | 7,748 | 8,295 |
| Total loans past due 90 days and still accruing interest | $\$ 16,428$ | $\$ 14,958$ |

Non-accrual loans, which are also classified as impaired, totaled $\$ 68.9$ million at March 31, 2012, and decreased $\$ 6.6$ million from amounts recorded at December 31, 2011. The decline from December 31, 2011 occurred mainly in business non-accrual loans, which decreased $\$ 5.6$ million. At March 31, 2012, non-accrual loans were comprised mainly of construction and land ( $30.6 \%$ ), business real estate ( $30.0 \%$ ), and business ( $29.2 \%$ ) loans. Foreclosed real estate increased $\$ 264$ thousand to a balance of $\$ 18.6$ million at March 31, 2012. Total loans past due 90 days or more and still accruing interest amounted to $\$ 16.4$ million as of March 31, 2012, an increase of $\$ 1.5$ million when compared to December 31, 2011, resulting mainly from an increase in business real estate loan delinquencies.

In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. They are classified as substandard under the Company's internal rating system. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, they may never become non-performing. Such loans totaled $\$ 202.0$ million at March 31, 2012 compared with $\$ 250.7$ million at December 31, 2011, resulting in a decrease of $\$ 48.7$ million, or $19.4 \%$. The change in potential problem loans was largely due to decreases of $\$ 21.6$ million in business loans, $\$ 20.5$ million in business real estate loans and $\$ 6.1$ million in construction and land real estate loans.

| (In thousands) | March 31, <br> 2012 | December 31, <br> 2011 |
| :--- | :--- | :--- |
| Potential problem loans: |  |  |
| Business | $\$ 53,580$ | $\$ 75,213$ |
| Real estate - construction and land | 48,637 | 54,696 |
| Real estate - business | 93,154 | 113,652 |
| Real estate - personal | 6,375 | 6,900 |
| Consumer | 206 | 208 |
| Total potential problem loans | $\$ 201,952$ | $\$ 250,669$ |

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At March 31, 2012, the Company had identified approximately $\$ 94.9$ million of loans whose terms have been modified or restructured under a troubled debt restructuring. These loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession, as defined by accounting guidance. Of this balance, $\$ 31.1$ million have been placed on non-accrual status. Of the remaining $\$ 63.8$ million, approximately $\$ 41.3$ million were commercial loans (business, construction and business real estate) classified as substandard, which were renewed at interest rates that were not judged to be market rates for new debt with similar risk. These loans are performing under their modified terms, and the Company believes it probable that all amounts due under the modified terms of the agreements will be collected. However, because of their substandard classification, they are included as potential problem loans in the table above. An additional $\$ 22.5$ million in troubled debt restructurings were composed of certain credit card loans under various debt management and assistance programs. These restructured loans are considered impaired loans for purposes of determining the allowance for loan losses, as discussed in the Summary of Significant Accounting Policies in the Company's 2011 Annual Report on Form 10-K.

## Loans with Special Risk Characteristics

Management relies primarily on an internal risk rating system, in addition to delinquency status, to assess risk in the loan portfolio, and these statistics are presented in Note 2 to the consolidated financial statements. However, certain types of loans are considered at high risk of loss due to their terms, location, or special conditions. Additional information about the major types of loans in these categories and their risk features are provided below. Information based on loan-to-value (LTV) ratios was generally calculated with valuations at loan origination date. The Company does not attempt to obtain updated appraisals or valuations unless the loans become significantly delinquent or are in the process of being foreclosed upon.

## Real Estate - Construction and Land Loans

The Company's portfolio of construction and land loans, as shown in the table below, amounted to $4.1 \%$ of total loans outstanding at March 31, 2012. Balances in this portfolio decreased $\$ 10.0$ million, or $2.6 \%$, since December 31, 2011, which was mainly a reflection of weak loan demand in the housing sector.

| (Dollars in thousands) | $\begin{aligned} & \text { March 31, } \\ & 2012 \end{aligned}$ | \% of Total | \% of <br> Total <br> Loans | December 2011 | \% of |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Residential land and land development | \$70,077 | 18.6 | \%. 7 | \% \$ 70,708 | 18.3 | \%.8 | \% |
| Residential construction | 72,879 | 19.4 | . 8 | 70,009 | 18.1 | . 7 |  |
| Commercial land and land development | 88,192 | 23.4 | 1.0 | 97,379 | 25.2 | 1.1 |  |
| Commercial construction | 145,494 | 38.6 | 1.6 | 148,502 | 38.4 | 1.6 |  |
| Total real estate - construction and land loans | \$376,642 | 100.0 | \%4.1 | \% \$ 386,598 | 100.0 | \%4.2 | \% |

## Real Estate - Business Loans

Total business real estate loans were $\$ 2.2$ billion at March 31, 2012 and comprised $23.8 \%$ of the Company's total loan portfolio. These loans include properties such as manufacturing and warehouse buildings, small office and medical buildings, churches, hotels and motels, shopping centers, and other commercial properties. Approximately $49 \%$ of these loans were for owner-occupied real estate properties, which present lower risk profiles.


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| Office | 262,120 | 11.9 | 2.8 | 270,200 | 12.3 | 3.0 |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Retail | 228,049 | 10.3 | 2.4 | 226,447 | 10.4 | 2.5 |  |
| Multi-family | 175,526 | 8.0 | 1.9 | 174,285 | 8.0 | 1.9 |  |
| Hotels | 135,867 | 6.2 | 1.5 | 119,039 | 5.5 | 1.3 |  |
| Farm | 116,459 | 5.3 | 1.3 | 121,966 | 5.6 | 1.3 |  |
| Industrial | 103,986 | 4.7 | 1.1 | 98,092 | 4.5 | 1.1 |  |
| Other | 111,333 | 5.0 | 1.2 | 112,419 | 5.2 | 1.2 |  |
| Total real estate - business loans | $\$ 2,203,686$ | 100.0 | $\% 23.8$ | $\% \$ 2,180,100$ | 100.0 | $\% 23.8$ | $\%$ |

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Real Estate - Personal Loans
The Company's $\$ 1.5$ billion personal real estate loan portfolio is composed mainly of residential first mortgage real estate loans. As shown on page 41, the loss rates in both 2012 and 2011 have remained low and at March 31, 2012, past due loans have declined slightly compared to December 31, 2011. Also, as shown in Note $2,8.0 \%$ of this portfolio has FICO scores of less than 660. Approximately $\$ 15.0$ million of personal real estate loans were structured with interest only payments. These loans are typically made to high net-worth borrowers and generally have low LTV ratios or have additional collateral pledged to secure the loan, and therefore, they are not perceived to represent above normal credit risk. At March 31, 2012, the Company had loans with no mortgage insurance that also have an original LTV greater than $80 \%$ totaling $\$ 140.3$ million, compared to $\$ 142.6$ million at December 31, 2011.

## Revolving Home Equity Loans

The Company also has $\$ 448.2$ million in revolving home equity loans at March 31, 2012 that are generally collateralized by residential real estate. Most of these loans ( $94.4 \%$ ) are written with terms requiring interest only monthly payments. These loans are offered in three main product lines: LTV up to $80 \%, 80 \%$ to $90 \%$, and $90 \%$ to $100 \%$. As of March 31, 2012, the outstanding principal of loans with an original LTV higher than $80 \%$ was $\$ 67.1$ million compared to $\$ 70.2$ million as of December 31, 2011. Total revolving home equity loan balances over 30 days past due were $\$ 2.2$ million at March 31, 2012 compared to $\$ 1.6$ million at December 31, 2011. Approximately $7.7 \%$ of the portfolio has FICO scores below 660.

## Fixed Rate Home Equity Loans

In addition to the residential real estate mortgage and the revolving home equity products mentioned above, the Company offers a third choice to those consumers desiring a fixed rate home equity loan with a fixed maturity date. The fixed rate home equity loan is typically used to finance a specific home repair or remodeling project. This portfolio of loans approximated $\$ 143.3$ million and $\$ 142.0$ million at March 31, 2012 and December 31, 2011, respectively. At the end of the first quarter of 2012, $\$ 39.4$ million of this portfolio had an LTV over $80 \%$, up slightly over $\$ 37.9$ million at the end of 2011.

At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, such loans totaled less than $4 \%$ of the outstanding balance of fixed rate home equity loans at March 31, 2012. The Company has limited the offering of fixed rate home equity loans with LTV ratios over $90 \%$ during the past several years, and only $\$ 290$ thousand in new fixed rate home equity loans were written with these LTV ratios during the first three months of 2012.

Management does not believe these loans collateralized by real estate (personal real estate, revolving home equity, and fixed rate home equity) represent any unusual concentrations of risk, as evidenced by net charge-offs on these loans in the first three months of 2012 of $\$ 69$ thousand, $\$ 360$ thousand and $\$ 36$ thousand, respectively. The amount of any increased potential loss on high LTV agreements relates mainly to amounts advanced that are in excess of the $80 \%$ collateral calculation, not the entire approved line. The Company currently offers no subprime first mortgage or home equity loans. These are characterized as new loans to customers with FICO scores below 650 for home equity loans, 660 for government-insured first mortgages, and 680 for all other conventional first mortgages. The Company does not purchase brokered loans.

## Other Consumer Loans

Within the consumer loan portfolio are several direct and indirect product lines, comprised mainly of loans secured by automobiles and marine, and RVs. Outstanding balances for these loans were $\$ 777.7$ million at both March 31, 2012
and December 31, 2011. The balances over 30 days past due amounted to $\$ 7.6$ million at March 31, 2012 compared to $\$ 13.0$ million at the end of 2011. For the three months ended March 31, 2012, $\$ 76.1$ million of new loans, the majority being automobile loans, were originated, compared to $\$ 223.8$ million during the full year of 2011. The Company has curtailed new marine and RV loans since 2008, and at March 31, 2012, outstanding balances totaled $\$ 395.3$ million. The loss ratios experienced for marine and RV loans have been higher than for other consumer loan products in recent years, and the annualized ratios were $2.5 \%$ and $2.3 \%$ in the first three months of 2012 and 2011, respectively.

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at March 31, 2012 of $\$ 723.8$ million in consumer credit card loans outstanding, approximately $\$ 108.5$ million, or $15.0 \%$, carried a low introductory rate. Within the next six months, $\$ 56.5$ million of these loans are scheduled to convert to the ongoing higher contractual rate. To mitigate some of the risk involved with this credit card product, the Company performs credit checks and detailed analysis of the customer borrowing profile before approving the loan application. Management believes that the risks in the consumer loan portfolio are reasonable and the anticipated loss ratios are within acceptable parameters.

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Income Taxes
Income tax expense was $\$ 32.9$ million in the first quarter of 2012, compared to $\$ 29.5$ million in the fourth quarter of 2011 and $\$ 27.5$ million in the first quarter of 2011. The Company's effective tax rate, including the effect of non-controlling interest, was $33.3 \%$ in the first quarter of 2012 , compared with $32.4 \%$ in the fourth quarter of 2011 and $31.3 \%$ in the first quarter of 2011. The change in the effective tax rate for the first quarter of 2012 compared to the first and fourth quarters of 2011 was primarily due to changes in the mix of taxable and non-taxable income during those periods and changes in state and local taxes.

## Financial Condition

Balance Sheet
Total assets of the Company were $\$ 20.5$ billion at March 31, 2012 compared to $\$ 20.6$ billion at December 31, 2011. Earning assets (excluding fair value adjustments on investment securities) amounted to $\$ 19.2$ billion at March 31, 2012, compared to $\$ 19.3$ billion at December 31, 2011, and consisted of $48 \%$ in loans and $47 \%$ in investment securities.

During the first quarter of 2012, average loans, including loans held for sale, increased $\$ 70.8$ million, or $.8 \%$, compared to the previous quarter. Also, these same loans decreased $\$ 277.9$ million, or $2.9 \%$, this quarter compared to the same period last year. The increase in average loans compared to the previous quarter was mainly due to increases in business, business real estate and personal real estate loans of $\$ 74.4$ million, $\$ 22.8$ million, and $\$ 20.2$ million, respectively, which were partly offset by declines in loans held for sale and revolving home equity loans. Within the consumer loan portfolio, marine and RV loans continued to run off this quarter by approximately $\$ 24.0$ million on average; however, consumer auto loans increased $\$ 16.8$ million due to higher new loan originations. Additionally, the demand for construction loans continues to be affected by the weak housing industry, and overall, these loans declined by $1.6 \%$ this quarter.

Total available for sale investment securities (excluding fair value adjustments) averaged $\$ 9.0$ billion this quarter, down $\$ 146.0$ million compared to the previous quarter. The decrease in the average balance was mainly the result of maturities and pay downs totaling $\$ 643.4$ million in the first quarter of 2012, offset by purchases of new securities of $\$ 558.7$ million during the current quarter. At March 31, 2012, the duration of the investment portfolio was 2.3 years, and maturities of approximately $\$ 1.6$ billion are expected to occur during the next 12 months.

Total average deposits increased $\$ 270.2$ million, or $1.7 \%$, during the first quarter of 2012 compared to the previous quarter. This increase in average deposits resulted mainly from growth in money market deposit balances of $\$ 232.0$ million. Also, average certificate of deposit balances increased $\$ 46.3$ million. The average loans to deposits ratio in the current quarter was $55.5 \%$, compared to $56.0 \%$ in the previous quarter.

During the current quarter, the Company's average borrowings increased $\$ 139.6$ million compared to the previous quarter. This increase was mainly due to higher customer repurchase agreement balances.

## Liquidity and Capital Resources

## Liquidity Management

The Company's most liquid assets are comprised of available for sale investment securities, federal funds sold, securities purchased under agreements to resell (resell agreements), and balances at the Federal Reserve Bank, as follows:

| (In thousands) | March 31, 2012 | March 31, 2011 | December 31, <br> 2011 |
| :--- | :--- | :--- | :--- |
| Liquid assets: |  |  |  |
| Available for sale investment securities | $\$ 9,120,399$ | $\$ 7,499,577$ | $\$ 9,224,702$ |
| Federal funds sold | 40,925 | 3,600 | 11,870 |
| Long-term securities purchased under agreements to resell | 850,000 | 700,000 | 850,000 |
| Balances at the Federal Reserve Bank | 12,038 | 203,940 | 39,853 |
| Total | $\$ 10,023,362$ | $\$ 8,407,117$ | $\$ 10,126,425$ |

Federal funds sold, which are sold to the Company's correspondent bank customers and have overnight maturities, totaled $\$ 40.9$ million as of March 31, 2012. Long-term resell agreements, maturing later in 2012 through 2014, totaled $\$ 850.0$ million at March 31, 2012. Under these agreements, the Company holds marketable securities as collateral, which totaled $\$ 971.4$ million

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in fair value at March 31, 2012. Interest earning balances at the Federal Reserve Bank, which also have overnight maturities and are used for general liquidity purposes, totaled $\$ 12.0$ million at March 31, 2012. The fair value of the available for sale investment portfolio was $\$ 9.1$ billion at March 31, 2012 and included an unrealized net gain in fair value of $\$ 224.0$ million. The total net unrealized gain included gains of $\$ 132.6$ million on mortgage and asset-backed securities, $\$ 39.9$ million on U.S. government securities and $\$ 19.0$ million on state and municipal obligations. An additional $\$ 24.2$ million unrealized gain was included in the fair value of common stock held by the Parent.

The portfolio includes maturities of approximately $\$ 1.6$ billion over the next 12 months, which offer substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits, securities sold under agreements to repurchase, trust funds, letters of credit issued by the FHLB, and borrowing capacity at the Federal Reserve Bank. At March 31, 2012, total investment securities pledged for these purposes were as follows:
(In thousands)
March 31, 2012
Investment securities pledged for the purpose of securing:
Federal Reserve Bank borrowings \$609,112
FHLB borrowings and letters of credit 91,731
Securities sold under agreements to repurchase 1,795,945
Other deposits 1,706,853
Total pledged securities 4,203,641
Unpledged and available for pledging 4,441,775
Ineligible for pledging 474,983
Total available for sale securities, at fair value $\$ 9,120,399$
Liquidity is also available from the Company's large base of core customer deposits, defined as non-interest bearing, interest checking, savings, and money market deposit accounts. At March 31, 2012, such deposits totaled $\$ 14.2$ billion and represented $85.0 \%$ of total deposits. These core deposits are normally less volatile, often with customer relationships tied to other products offered by the Company, promoting long lasting relationships and stable funding sources. Time open and certificates of deposit of $\$ 100,000$ and over totaled $\$ 1.4$ billion at March 31, 2012. These accounts are normally considered more volatile and higher costing and comprised $8.2 \%$ of total deposits at March 31, 2012.
(In thousands)
Core deposit base:
Non-interest bearing
Interest checking
Savings and money market
Total

| March 31, 2012 | March 31, 2011 | December 31, <br> 2011 |
| :--- | :--- | :--- |
| $\$ 5,209,381$ $\$ 4,558,630$ | $\$ 5,377,549$ |  |
| 759,561 | 736,003 | 968,430 |
| $8,278,722$ | $7,338,052$ | $7,965,511$ |
| $\$ 14,247,664$ | $\$ 12,632,685$ | $\$ 14,311,490$ |

Other important components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are mainly comprised of federal funds purchased, securities sold under agreements to repurchase, and advances from the FHLB, as follows:
(In thousands)
Borrowings:
Federal funds purchased
Securities sold under agreements to repurchase
FHLB advances

March 31, 2012
March 31, 2011

| $\$ 110,845$ | $\$ 42,223$ | $\$ 153,330$ |
| :--- | :--- | :--- |
| $1,012,143$ | 880,791 | $1,102,751$ |
| 104,005 | 104,395 | 104,302 |


| Other debt | 7,515 | 7,577 | 7,515 |
| :--- | :--- | :--- | :--- |
| Total | $\$ 1,234,508$ | $\$ 1,034,986$ | $\$ 1,367,898$ |

Federal funds purchased are unsecured overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved lines of credit. Securities sold under agreements to repurchase are secured by a portion of the Company's investment portfolio and are comprised of both non-insured customer funds totaling $\$ 612.1$ million, which generally mature overnight, and structured repurchase agreements of $\$ 400.0$ million. The structured repurchase agreements have variable rates and mature in 2013 and 2014. The Company also borrows on a secured basis through advances from the FHLB, which

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totaled $\$ 104.0$ million at March 31, 2012. These advances have fixed interest rates and most mature in 2017. Other outstanding long-term borrowings, totaling $\$ 7.5$ million, relate to the Company's private equity investment activity and mature later in 2012.

The Company pledges certain assets, including loans and investment securities, to both the Federal Reserve Bank and the FHLB as security to establish lines of credit and borrow from these entities. Based on the amount and type of collateral pledged, the FHLB establishes a collateral value from which the Company may draw advances against the collateral. Also, this collateral is used to enable the FHLB to issue letters of credit in favor of public fund depositors of the Company. The Federal Reserve Bank also establishes a collateral value of assets pledged to support borrowings from the discount window. The following table reflects the collateral value of assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company at March 31, 2012:
(In thousands)
Collateral value pledged
Advances outstanding
Letters of credit issued
Available for future advances
March 31, 2012

|  | Federal |  |  |
| :--- | :--- | :--- | :--- |
| FHLB | Reserve | Total |  |
| $\$ 1,906,697$ | $\$ 1,373,517$ | $\$ 3,280,214$ |  |
| $(104,005$ | $)-$ | $(104,005$ | $)$ |
| $(117,933$ | $)-$ | $(117,933$ | $)$ |
| $\$ 1,684,759$ | $\$ 1,373,517$ | $\$ 3,058,276$ |  |

In addition to those mentioned above, several other sources of liquidity are available. The Bank has strong issuer ratings from Standard \& Poor's and Moody's of A and Aa2, respectively. Additionally, the Parent's sound commercial paper rating of P-1 from Moody's would help ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been issued or outstanding during the past ten years. The Company has no subordinated debt or hybrid instruments which could affect future borrowing capacity. Because of its lack of significant long-term debt, the Company believes that it could generate additional liquidity through its Capital Markets Group from sources such as jumbo certificates of deposit or privately placed corporate debt. Financing may also include the issuance of common or preferred stock.

The cash flows from the operating, investing and financing activities of the Company resulted in a net decrease in cash and cash equivalents of $\$ 83.1$ million during the first three months of 2012 , as reported in the consolidated statements of cash flows on page 7 of this report. Operating activities, consisting mainly of net income adjusted for certain non-cash items, provided cash flow of $\$ 120.1$ million and has historically been a stable source of funds. Investing activities, which occur mainly in the loan and investment securities portfolios, provided cash of \$5.4 million. These activities included $\$ 643.4$ million in maturities and pay downs of investment securities, which were partly offset by $\$ 558.7$ million in purchases of investment securities and a net increase in loans of $\$ 81.7$ million. Financing activities used cash of $\$ 208.6$ million, resulting mainly from a net decrease of $\$ 133.1$ million in short-term federal funds purchased and securities sold under agreements to repurchase, a net decrease of $\$ 49.2$ million in deposit accounts, and purchases of treasury stock of $\$ 31.6$ million. Future short-term liquidity needs arising from daily operations are not expected to vary significantly, and the Company believes it will be able to meet these cash flow needs.

## Capital Management

The Company and its bank subsidiary maintain strong regulatory capital ratios, which exceed the well-capitalized guidelines under federal banking regulations. Information about the Company's risk-based capital is shown below: (Dollars in thousands) March 31, 2012 December 31, Minimum Ratios 2011 for

|  |  |  | Well-Capitalized <br> Banks |  |
| :--- | :--- | :--- | :--- | :--- |
| Risk-adjusted assets | $\$ 13,136,560$ | $\$ 13,115,261$ |  |  |
| Tier I risk-based capital | $1,951,109$ | $1,928,690$ |  |  |
| Total risk-based capital | $2,126,420$ | $2,103,401$ |  |  |
| Tier I risk-based capital ratio | 14.85 | $\% 14.71$ | $\% 6.00$ | $\%$ |
| Total risk-based capital ratio | 16.19 | $\% 16.04$ | $\% 10.00$ | $\%$ |
| Tier I leverage ratio | 9.70 | $\% 9.55$ | $\% 5.00$ | $\%$ |

The Company maintains a treasury stock buyback program, and during the quarter ended March 31, 2012, the Company purchased 810,642 shares of treasury stock at an average cost of $\$ 38.98$ per share. Shares remaining available under the current Board authorization totaled 2,188,658 as of March 31, 2012.

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The Company's common stock dividend policy reflects its earnings outlook, desired payout ratios, the need to maintain adequate capital levels, and alternative investment options. The Company declared a per share cash dividend of $\$ .230$ in the first quarter of 2012 , which was a $5.0 \%$ increase compared to the fourth quarter of 2011.

Commitments, Off-Balance Sheet Arrangements and Contingencies
In the normal course of business, various commitments and contingent liabilities arise which are not required to be recorded on the balance sheet. The most significant of these are loan commitments, which at March 31, 2012 totaled $\$ 7.5$ billion (including approximately $\$ 3.6$ billion in unused approved credit card lines). In addition, the Company enters into standby and commercial letters of credit. These contracts amounted to $\$ 366.3$ million and $\$ 12.4$ million, respectively, at March 31, 2012. As many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. The carrying value of the guarantee obligations associated with the standby letters of credit, which has been recorded as a liability on the balance sheet, amounted to $\$ 5.2$ million at March 31, 2012.

The Company regularly purchases various state tax credits arising from third-party property redevelopment. While most of the tax credits are resold to third parties, some are periodically retained for use by the Company. During the first three months of 2012 , purchases and sales of tax credits amounted to $\$ 15.4$ million and $\$ 5.9$ million, respectively, and at March 31, 2012, outstanding purchase commitments totaled $\$ 120.2$ million.

The Parent has additional funding commitments arising from directly-held investments in private equity concerns, classified as non-marketable securities in the accompanying balance sheets, which total $\$ 1.3$ million at March 31, 2012. In addition, the Parent expects to fund $\$ 8.9$ million to private equity subsidiaries over the next several years. Management does not anticipate any material losses arising from commitments and contingent liabilities and believes there are no material commitments to extend credit that represent risks of an unusual nature.

## Segment Results

The table below is a summary of segment pre-tax income results for the first three months of 2012 and 2011.

| (Dollars in thousands) | Consumer |  | Commerci |  | Wealth |  | Segment Totals |  | Other/ <br> Eliminatio |  | Consolidated Totals |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Three Months Ended March 31, 2012 |  |  |  |  |  |  |  |  |  |  |  |  |
| Net interest income | \$69,093 |  | \$71,629 |  | \$9,757 |  | \$150,479 |  | \$9,258 |  | \$159,737 |  |
| Provision for loan losses | (9,307 | ) | (1,831 | ) | (42 | ) | (11,180 | ) | 3,015 |  | \$ (8,165 |  |
| Non-interest income | 27,188 |  | 42,894 |  | 26,155 |  | 96,237 |  | (1,654 | ) | 94,583 |  |
| Investment securities gains, net | - |  | - |  | - |  | - |  | 4,040 |  | 4,040 |  |
| Non-interest expense | (66,136 | ) | (55,949 | ) | (22,763 | ) | (144,848 | ) | (5,613 | ) | (150,461 |  |
| Income before income taxes | \$20,838 |  | \$56,743 |  | \$13,107 |  | \$90,688 |  | \$9,046 |  | \$99,734 |  |
| Three Months Ended March 31, 2011 |  |  |  |  |  |  |  |  |  |  |  |  |
| Net interest income | \$70,948 |  | \$68,831 |  | \$9,549 |  | \$149,328 |  | \$ 11,645 |  | \$ 160,973 |  |
| Provision for loan losses | (13,637 | ) | (5,118 | ) | (28 | ) | (18,783 | ) | 2,994 |  | (15,789 |  |
| Non-interest income | 31,994 |  | 39,146 |  | 25,186 |  | 96,326 |  | (420 | ) | 95,906 |  |
| Investment securities gains, net | - |  | - |  | - |  | - |  | 1,327 |  | 1,327 |  |
| Non-interest expense | (69,512 | ) | (56,836 | ) | (22,314 | ) | (148,662 | ) | (5,298 | ) | (153,960 |  |
| Income before income taxes | \$19,793 |  | \$46,023 |  | \$ 12,393 |  | \$78,209 |  | \$ 10,248 |  | \$88,457 |  |

Increase (decrease) in income before income taxes:

| Amount | $\$ 1,045$ | $\$ 10,720$ | $\$ 714$ | $\$ 12,479$ | $\$(1,202$ | $)$ | $\$ 11,277$ |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Percent | 5.3 | $\% 23.3$ | $\% 5.8$ | $\% 16.0$ | $\%(11.7$ | $) \% 12.7$ | $\%$ |  |

Consumer
For the three months ended March 31, 2012, income before income taxes for the Consumer segment increased $\$ 1.0$ million, or $5.3 \%$, over the first quarter of 2011. This increase was mainly due to a decline of $\$ 4.3$ million in the provision for loan losses and a $\$ 3.4$ million, or $4.9 \%$, decrease in non-interest expense. These declines were partly offset by a decrease of $\$ 1.9$ million, or $2.6 \%$, in net interest income, coupled with a decline of $\$ 4.8$ million, or $15.0 \%$, in non-interest income. Net interest income declined due to a $\$ 2.7$ million decrease in loan interest income and a $\$ 2.3$ million decrease in net allocated funding credits assigned to the

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Consumer segment's loan and deposit portfolios, partly offset by a decline of $\$ 3.2$ million in deposit interest expense. Non-interest income decreased mainly due to declines in bank card fee income (primarily in debit card fees). Non-interest expense declined from the first quarter of 2011 due to lower FDIC insurance expense, corporate management fees and bank card related expenses. The provision for loan losses totaled $\$ 9.3$ million, a $\$ 4.3$ million decrease from the first quarter of 2011, which was due mainly to lower losses on consumer credit card loans and other consumer loans.

## Commercial

For the three months ended March 31, 2012, income before income taxes for the Commercial segment increased $\$ 10.7$ million, or $23.3 \%$, compared to the same period in the previous year, mainly due to a lower provision for loan losses and growth in net interest income and non-interest income. Net interest income increased $\$ 2.8$ million, or $4.1 \%$, due to higher net allocated funding credits of $\$ 5.9$ million, partly offset by a $\$ 3.8$ million decline in loan interest income. The provision for loan losses in this segment totaled $\$ 1.8$ million in the first three months of 2012, a decrease of $\$ 3.3$ million from the first three months of 2011. During 2012, net charge-offs on construction loans declined $\$ 1.8$ million and net charge-offs on business loans decreased $\$ 1.7$ million. Non-interest income increased by $\$ 3.7$ million, or $9.6 \%$, over the previous year due to growth in capital market fees and bank card fees (mainly corporate card). Non-interest expense decreased $\$ 887$ thousand from the previous year, mainly due to declines in FDIC insurance expense and foreclosed real estate and other repossessed property expense, partly offset by higher bank card related expenses.

Wealth
Wealth segment pre-tax profitability for the three months ended March 31, 2012 increased $\$ 714$ thousand, or 5.8\%, over the same period in the previous year. Net interest income increased $\$ 208$ thousand, or $2.2 \%$, and was impacted by a $\$ 469$ thousand decline in deposit interest expense, offset by a $\$ 256$ thousand decrease in loan interest income. Non-interest income increased $\$ 969$ thousand, or $3.8 \%$, over the prior year due to higher trust fees. Non-interest expense increased $\$ 449$ thousand, or $2.0 \%$, mainly due to higher salaries and benefits expense.

The Other/Elimination category in the preceding table includes the activity of various support and overhead operating units of the Company, in addition to the investment securities portfolio and other items not allocated to the segments. In accordance with the Company's transfer pricing policies, the difference between the total provision and total net charge-offs is not allocated to a business segment, and is included in this category. The pre-tax profitability of this category was lower than in the previous period by $\$ 1.2$ million. This decrease was partly due to a decline in net interest income in this category, related to earnings of the investment portfolio and interest expense on borrowings not allocated to a segment, which decreased $\$ 2.4$ million. In addition, unallocated non-interest income declined by $\$ 1.2$ million, while unallocated amounts related to investment securities gains increased $\$ 2.7$ million.

## Regulatory Changes Affecting the Banking Industry

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was signed into law. The Dodd-Frank Act is sweeping legislation intended to overhaul regulation of the financial services industry. Among its many provisions are rules which establish a new council of "systemic risk" regulators, create a new consumer protection division within the Federal Reserve, empower the Federal Reserve to supervise the largest, most complex financial companies, allow the government to seize and liquidate failing financial companies, and give regulators new powers to oversee the derivatives market. The Dodd-Frank Act also mandated new rules on debit card interchange fees, as discussed further below.

Because the Company has maintained a strong balance sheet with solid amounts of capital and has not offered many of the complex financial products that were prevalent in the marketplace, there are a number of provisions within the Dodd-Frank Act, including higher capital standards and improved lending transparency, that management does not expect to negatively affect the Company's future results. New risk-based FDIC rules for insurance assessments have lowered costs for the Company. However, other provisions in the Dodd-Frank Act, such as limitations on debit card fees and the potential for higher costs due to increased regulatory and compliance burdens, will likely lower revenues or raise costs to the Company. The provisions of the Dodd-Frank Act are so extensive that full implementation may require several years, and an assessment of its full effect on the Company is not possible at this time.

In June 2011, the Federal Reserve, as required by the Dodd-Frank Act, approved a final debit card interchange rule that significantly limits the amount of debit card interchange fees charged by banks. The new rule caps an issuer's base fee at 21 cents per transaction and allows additional fees to help cover fraud losses. The new pricing is a reduction of approximately $45 \%$ when

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compared to current market rates. The new rule also limits network exclusivity, requiring issuers to ensure that a debit card transaction can be carried on two unaffiliated networks: one signature-based and one PIN-based. The new rules apply to bank issuers with more than $\$ 10$ billion in assets and took effect October 1, 2011. As a result of this rule, the Company's debit card interchange fee revenue for the first quarter 2012 declined $\$ 5.9$ million, or $41.4 \%$, from the first quarter 2011.

## Impact of Recently Issued Accounting Standards

Fair Value Measurements In May 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs". The ASU contains guidance on the application of the highest and best use and valuation premise concepts, the measurement of fair values of instruments classified in shareholders' equity, the measurement of fair values of financial instruments that are managed within a portfolio, and the application of premiums and discounts in a fair value measurement. It also requires additional disclosures about fair value measurements, including information about the unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy, the sensitivity of recurring fair value measurements within Level 3 to changes in unobservable inputs and the interrelationships between those inputs, and the categorization by level of the fair value hierarchy for items that are not measured at fair value but for which the fair value is required to be disclosed. These amendments were applied prospectively, effective January 1, 2012, and their application did not have a significant effect on the Company's consolidated financial statements.

Repurchase Agreements In April 2011, the FASB issued ASU 2011-03, "Reconsideration of Effective Control for Repurchase Agreements". The guidance in the ASU is intended to improve the accounting for repurchase agreements and other similar agreements. Specifically, the ASU modifies the criteria for determining when these transactions would be recorded as a financing arrangement as opposed to a purchase or sale arrangement with a commitment to resell or repurchase. It removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. This new guidance was effective January 1, 2012, and the adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

Other Comprehensive Income In June 2011, the FASB issued ASU 2011-05, "Presentation of Comprehensive Income". The ASU increases the prominence of other comprehensive income in financial statements by requiring comprehensive income to be reported in either a single statement or in two consecutive statements which report both net income and other comprehensive income. It eliminates the option to report the components of other comprehensive income in the statement of changes in equity. The ASU was effective for periods beginning January 1 , 2012 and required retrospective application. The ASU did not change the components of other comprehensive income, the timing of items reclassified to net income, or the net income basis for income per share calculations. The Company has chosen to present net income and other comprehensive income in two consecutive statements in the accompanying consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". The amendments are being made to allow the Board time to consider whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. Until the Board has reached a resolution, entities are required to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05.

Goodwill In September 2011, the FASB issued ASU 2011-08, "Testing Goodwill for Impairment". The ASU allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative
goodwill impairment test. Previous guidance required, on an annual basis, testing goodwill for impairment by comparing the fair value of a reporting unit to its carrying amount (including goodwill). As a result of this amendment, an entity will not be required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The ASU was effective for annual and interim goodwill impairment tests performed for periods beginning January 1, 2012. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

Balance Sheet In December 2011, the FASB issued ASU 2011-11, "Disclosures about Offsetting Assets and Liabilities". The ASU is a joint requirement by the FASB and International Accounting Standards Board to enhance current disclosures and increase comparability of GAAP and International Financial Reporting Standards (IFRS) financial statements. Under the ASU, an entity will be required to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet, as well as instruments and transactions subject to an agreement similar to a master netting agreement. The scope of the ASU includes derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The ASU is effective for annual and interim periods beginning January 1, 2013. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

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AVERAGE BALANCE SHEETS - AVERAGE RATES AND YIELDS
Three Months Ended March 31, 2012 and 2011
First Quarter 2012
(Dollars in thousands)
ASSETS:
Loans:

| Business | (A) | $\$ 2,893,973$ | $\$ 25,326$ | 3.52 | $\%$ | $\$ 3,052,611$ | $\$ 27,465$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |


(A) Stated on a tax equivalent basis using a federal income tax rate of $35 \%$.

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## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk management focuses on maintaining consistent growth in net interest income within Board-approved policy limits. The Company primarily uses earnings simulation models to analyze net interest sensitivity to movement in interest rates. The Company performs monthly simulations which model interest rate movements and risk in accordance with changes to its balance sheet composition. For further discussion of the Company's market risk, see the Interest Rate Sensitivity section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2011 Annual Report on Form 10-K.

The table below shows the effect that gradual rising interest rates over a twelve month period would have on the Company's net interest income given a static balance sheet.


As shown above, under the above scenarios at March 31, 2012, a gradual increase in interest rates of 100 basis points is expected to increase net interest income by $\$ 6.3$ million, or $1.0 \%$ and a rise of 200 basis points is expected to increase net interest income by $\$ 7.7$ million, or $1.3 \%$. Under a 300 basis point rising rate scenario, net income would increase by $\$ 5.4$ million, or $.9 \%$. Due to the already low interest rate environment, the Company did not model falling rate scenarios.

Compared with the rising rate scenarios modeled at December 31, 2011, further increases in net income are projected under rising rates at March 31, 2012. This is primarily due to a decrease in anticipated levels of federal funds purchased used in the March 31, 2012 projections. These borrowings have overnight maturities and so perform as variable rate liabilities. Significant increases in these borrowings, as projected in the year end simulations, were not assumed at March 31, 2012, as lower cost, less rate sensitive funding sources were available in the projections. As a result, interest expense was lower which allowed net interest income to increase from the previous quarter's results. During the first quarter of 2012, the average change in other balance sheet assets and liabilities, such as loans (increased $\$ 70.8$ million), available for sale investment securities (decreased $\$ 146.0$ million) and interest bearing deposits (increased $\$ 311.0$ million), also tended to make the Company more asset-sensitive at March 31, 2012. The Company believes that its approach to interest rate risk has appropriately considered its susceptibility to both rising and falling rates and has adopted strategies which minimized impacts to overall interest rate risk.

## Item 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of March 31, 2012. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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## PART II: OTHER INFORMATION

## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth information about the Company's purchases of its $\$ 5$ par value common stock, its only class of stock registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended.

## Period

January 1 - 31, 2012
February 1 - 29, 2012
March 1 - 31, 2012
Total

| Total |  | Total Number of | Maximum Number <br> Number of |
| :--- | :---: | :--- | :--- |
| Average <br> Price Paid | Shares Purchased as <br> Shares | that May Yet Be |  |
| per Share | Announced Program | Purchased Under the |  |
| Purchased |  | $2,998,364$ |  |
| 936 | $\$ 38.12$ | 936 | $2,493,326$ |
| 505,038 | $\$ 39.07$ | 505,038 | $2,188,658$ |
| 304,668 | $\$ 38.84$ | 304,668 | $2,188,658$ |
| 810,642 | $\$ 38.98$ | 810,642 |  |

In November 2011, the Board of Directors approved the purchase of up to $3,000,000$ shares of the Company's common stock. At March 31, 2012, 2,188,658 shares remained available to be purchased under the current authorization.

Item 6. EXHIBITS
See Index to Exhibits

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMMERCE BANCSHARES, INC.
By /s/ JAMES L. SWARTS
James L. Swarts
Vice President \& Secretary
Date: May 4, 2012

By /s/ JEFFERY D. ABERDEEN<br>Jeffery D. Aberdeen<br>Controller<br>(Chief Accounting Officer)

Date: May 4, 2012

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INDEX TO EXHIBITS
31.1 - Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2 - Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 - Certifications of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101 - Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Changes in Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text and in detail*
*As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

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[^0]:    * as a percentage of average loans (excluding loans held for sale)

