

COMMERCE BANCSHARES INC /MO/
Form 10-K
February 22, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549
FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2012 — Commission File No. 0-2989

COMMERCE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Missouri (State of Incorporation) 1000 Walnut,	43-0889454 (IRS Employer Identification No.)
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Kansas City, MO (Address of principal executive offices) (816) 234-2000	64106 (Zip Code) (Zip Code)
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(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of class \$5 Par Value Common Stock	Name of exchange on which registered NASDAQ Global Select Market
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Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant 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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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 Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a 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 No

As of June 30, 2012, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$2,949,000,000.

As of February 8, 2013, there were 90,689,096 shares of Registrant’s \$5 Par Value Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s definitive proxy statement for its 2013 annual meeting of shareholders, which will be filed within 120 days of December 31, 2012, are incorporated by reference into Part III of this Report.

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PART I

Item 1. BUSINESS

General

Commerce Bancshares, Inc., a bank holding company as defined in the Bank Holding Company Act of 1956, as amended, was incorporated under the laws of Missouri on August 4, 1966. Through a second tier wholly-owned bank holding company, it owns all of the outstanding capital stock of Commerce Bank (the "Bank"), which is headquartered in Missouri. The Bank engages in general banking business, providing a broad range of retail, corporate, investment, trust, and asset management products and services to individuals and businesses. Commerce Bancshares, Inc. also owns, directly or through the Bank, various non-banking subsidiaries. Their activities include underwriting credit life and credit accident and health insurance, selling property and casualty insurance (relating to consumer loans made by the Bank), private equity investment, securities brokerage, mortgage banking, and leasing activities. A list of Commerce Bancshares, Inc.'s subsidiaries is included as Exhibit 21.

Commerce Bancshares, Inc. and its subsidiaries, (collectively, the "Company") is one of the nation's top 50 bank holding companies, based on asset size. At December 31, 2012, the Company had consolidated assets of \$22.2 billion, loans of \$9.8 billion, deposits of \$18.3 billion, and equity of \$2.2 billion. All of the Company's operations conducted by its subsidiaries are consolidated for purposes of preparing the Company's consolidated financial statements.

The Company's goal is to be the preferred provider of targeted financial services in its communities, based on strong customer relationships. It believes in building long-term relationships based on top quality service, a strong risk management culture, and a strong balance sheet with industry-leading capital levels. The Company operates under a super-community banking format which incorporates large bank product offerings coupled with deep local market knowledge, augmented by experienced, centralized support in select critical areas. The Company's focus on local markets is supported by an experienced team of managers assigned to each market and is also reflected in its financial centers and regional advisory boards, which are comprised of local business persons, professionals and other community representatives, who assist the Company in responding to local banking needs. In addition to this local market, community-based focus, the Company offers sophisticated financial products available at much larger financial institutions.

The Company's banking facilities are located throughout Missouri, Kansas, and central Illinois, as well as Tulsa, Oklahoma and Denver, Colorado. Its two largest markets include St. Louis and Kansas City, which serve as the central hubs for the entire Company.

The markets the Bank serves, being located in the lower Midwest, provide natural sites for production and distribution facilities and also serve as transportation hubs. The economy has been well-diversified in these markets with many major industries represented, including telecommunications, automobile, aircraft and general manufacturing, health care, numerous service industries, food production, and agricultural production and related industries. In addition, several of the Illinois markets are located in areas with some of the most productive farmland in the world. The real estate lending operations of the Bank are centered in its lower Midwestern markets. Historically, these markets have generally tended to be less volatile than in other parts of the country. While the decline in the national real estate market resulted in significantly higher real estate loan losses during recent years for the banking industry, management believes the diversity and nature of the Bank's markets has resulted in lower real estate loan losses in these markets and is a key factor in the Bank's relatively lower loan loss levels during this period.

From time to time, the Company evaluates the potential acquisition of various financial institutions. In addition, the Company regularly considers the potential disposition of certain of its assets and branches. The Company seeks merger or acquisition partners that are culturally similar, have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. The Company has not transacted any significant acquisitions or sales during the past several years.

The Company employed 4,270 persons on a full-time basis and 608 persons on a part-time basis at December 31, 2012. The Company provides a variety of benefit programs including a 401(k) plan as well as group life, health, accident, and other insurance. The Company also maintains training and educational programs designed to address the significant and changing regulations facing the financial services industry and prepare employees for positions of increasing responsibility.

Competition

The Company faces intense competition from hundreds of financial service providers. It competes with national and state banks for deposits, loans and trust accounts, and with savings and loan associations and credit unions for deposits and consumer lending products. In addition, the Company competes with other financial intermediaries such as securities brokers and dealers, personal loan companies, insurance companies, finance companies, and certain governmental agencies. With the passage of the

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Gramm-Leach-Bliley Financial Modernization Act of 1999, competition has increased over time from institutions not subject to the same regulatory restrictions as domestic banks and bank holding companies. The Company generally competes on the basis of customer service and responsiveness to customer needs, reputation, interest rates on loans and deposits, lending limits, and customer convenience, such as location of offices. The Company has approximately 13% of the deposit market share in Kansas City and approximately 9% of the deposit market share in St. Louis.

Operating Segments

The Company is managed in three operating segments. The Consumer segment includes the retail branch network, consumer installment lending, personal mortgage banking, consumer debit and credit bank card activities. It provides services through a network of 204 full-service branches, a widespread ATM network of 403 machines, and the use of alternative delivery channels such as extensive online banking and telephone banking services. In 2012, this retail segment contributed 23% of total segment pre-tax income. The Commercial segment provides a full array of corporate lending, merchant and commercial bank card products, leasing, and international services, as well as business and government deposit and cash management services. Fixed income investments are sold to individuals and institutional investors through the Capital Markets Group, which is also included in this segment. In 2012, the Commercial segment contributed 63% of total segment pre-tax income. The Wealth segment provides traditional trust and estate tax planning services, brokerage services, and advisory and discretionary investment portfolio management services to both personal and institutional corporate customers. This segment also manages the Company's family of proprietary mutual funds, which are available for sale to both trust and general retail customers. At December 31, 2012, the Wealth segment managed investments with a market value of \$17.0 billion and administered an additional \$13.3 billion in non-managed assets. Additional information relating to operating segments can be found on pages 45 and 88.

Government Policies

The Company's operations are affected by federal and state legislative changes, by the United States government, and by policies of various regulatory authorities, including those of the numerous states in which they operate. These include, for example, the statutory minimum legal lending rates, domestic monetary policies of the Board of Governors of the Federal Reserve System, United States fiscal policy, international currency regulations and monetary policies, the U.S. Patriot Act, and capital adequacy and liquidity constraints imposed by federal and state bank regulatory agencies.

Supervision and Regulation

The following information summarizes existing laws and regulations that materially affect the Company's operations. It does not discuss all provisions of these laws and regulations and it does not include all laws and regulations that affect the Company presently or may affect the Company in the future.

General

The Company, as a bank holding company, is primarily regulated by the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956 (BHC Act). Under the BHC Act, the Federal Reserve Board's prior approval is required in any case in which the Company proposes to acquire all or substantially all of the assets of any bank, acquire direct or indirect ownership or control of more than 5% of the voting shares of any bank, or merge or consolidate with any other bank holding company. With certain exceptions, the BHC Act also prohibits the Company from acquiring direct or indirect ownership or control of more than 5% of any class of voting shares of any non-banking company. Under the BHC Act, the Company may not engage in any business other than managing and controlling banks or furnishing certain specified services to subsidiaries and may not acquire voting control of non-banking companies unless the Federal Reserve Board determines such businesses and services to be closely related to banking. When reviewing bank acquisition applications for approval, the Federal Reserve Board considers, among other things, the Bank's record in meeting the credit needs of the communities it serves in accordance with the Community Reinvestment Act of 1977, as amended (CRA). Under the terms of the CRA, banks have a continuing obligation, consistent with safe and sound operation, to help meet the credit needs of their communities, including

providing credit to individuals residing in low- and moderate-income areas. The Bank has a current CRA rating of “outstanding”.

The Company is required to file with the Federal Reserve Board various reports and additional information the Federal Reserve Board may require. The Federal Reserve Board also makes regular examinations of the Company and its subsidiaries. The Company’s banking subsidiary is a state chartered Federal Reserve member bank and is subject to regulation, supervision and examination by the Federal Reserve Bank of Kansas City and the State of Missouri Division of Finance. The Bank is also subject to regulation by the Federal Deposit Insurance Corporation (FDIC). In addition, there are numerous other federal and state laws and regulations which control the activities of the Company and the Bank, including requirements and limitations relating to capital and reserve requirements, permissible investments and lines of business, transactions with affiliates, loan limits, mergers and acquisitions, issuance of securities, dividend payments, and extensions of credit. If the Company fails to comply with these or other applicable laws and regulations, it may be subject to civil monetary penalties, imposition of cease and desist orders or other

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written directives, removal of management and, in certain circumstances, criminal penalties. This regulatory framework is intended primarily for the protection of depositors and the preservation of the federal deposit insurance funds, not for the protection of security holders. Statutory and regulatory controls increase a bank holding company's cost of doing business and limit the options of its management to employ assets and maximize income.

In addition to its regulatory powers, the Federal Reserve Bank affects the conditions under which the Company operates by its influence over the national supply of bank credit. The Federal Reserve Board employs open market operations in U.S. government securities and oversees changes in the discount rate on bank borrowings, changes in the federal funds rate on overnight inter-bank borrowings, and changes in reserve requirements on bank deposits in implementing its monetary policy objectives. These methods are used in varying combinations to influence the overall level of the interest rates charged on loans and paid for deposits, the price of the dollar in foreign exchange markets, and the level of inflation. The monetary policies of the Federal Reserve have a significant effect on the operating results of financial institutions, most notably on the interest rate environment. In view of changing conditions in the national economy and in the money markets, as well as the effect of credit policies of monetary and fiscal authorities, no prediction can be made as to possible future changes in interest rates, deposit levels or loan demand, or their effect on the financial statements of the Company.

The financial industry operates under laws and regulations that are under constant review by various agencies and legislatures and are subject to sweeping change. The Company currently operates as a bank holding company, as defined by the Gramm-Leach-Bliley Financial Modernization Act of 1999 (GLB Act), and the Bank qualifies as a financial subsidiary under the Act, which allows it to engage in investment banking, insurance agency, brokerage, and underwriting activities that were not available to banks prior to the GLB Act. The GLB Act also included privacy provisions that limit banks' abilities to disclose non-public information about customers to non-affiliated entities.

The Company must also comply with the requirements of the Bank Secrecy Act (BSA). The BSA is designed to help fight drug trafficking, money laundering, and other crimes. Compliance is monitored by the Federal Reserve. The BSA was enacted to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity. Since its passage, the BSA has been amended several times. These amendments include the Money Laundering Control Act of 1986, which made money laundering a criminal act, as well as the Money Laundering Suppression Act of 1994 which required regulators to develop enhanced examination procedures and increased examiner training to improve the identification of money laundering schemes in financial institutions.

The USA PATRIOT Act, established in 2001, substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing, and the regulations include significant penalties for non-compliance.

Subsidiary Bank

Under Federal Reserve policy, the bank holding company, Commerce Bancshares, Inc. (the "Parent"), is expected to act as a source of financial strength to its bank subsidiary and to commit resources to support it in circumstances when it might not otherwise do so. In addition, loans by a bank holding company to any of its subsidiary banks are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

Deposit Insurance

Substantially all of the deposits of the Bank are insured up to the applicable limits by the Bank Insurance Fund of the FDIC, generally up to \$250,000 per depositor, for each account ownership category. The Bank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC for Bank Insurance Fund member institutions. The FDIC established a risk-based assessment system under which institutions are classified and pay premiums according to their perceived risk to the federal deposit insurance funds. In February 2011, under the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the FDIC issued a final rule changing its assessment base from total domestic deposits to average total assets minus average tangible equity. The rule altered other adjustments in the current assessment system for heavy use of unsecured liabilities, secured liabilities and brokered deposits, and added an adjustment for holdings of unsecured bank debt. For banks with more than \$10 billion in assets, the FDIC's new rule changed the assessment rate, abandoning the previous method for determining premiums, and instead relying on a scorecard designed to measure financial performance and ability to withstand stress, in addition to measuring the FDIC's exposure should the bank fail. The new rule was effective for quarters beginning April 1, 2011. Because the Company has maintained a strong balance sheet with solid amounts of capital and has not offered many of the complex financial

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products that were prevalent in the marketplace, the risk-based FDIC insurance assessments under the new methods were less than amounts calculated under the old assessment methods. Accordingly, the Company's FDIC insurance expense in 2012 was \$10.4 million, a decrease of \$2.7 million as compared to FDIC expense in 2011. In late 2009, member institutions were required to prepay their quarterly FDIC premiums. The Bank made a prepayment of \$68.7 million in 2009, and the current unused balance at December 31, 2012 was \$25.4 million. A refund of the unused balance is expected to be received in the second quarter of 2013.

Payment of Dividends

The Federal Reserve Board may prohibit the payment of cash dividends to shareholders by bank holding companies if their actions constitute unsafe or unsound practices. The principal source of the Parent's cash revenues is cash dividends paid by the Bank. The amount of dividends paid by the Bank in any calendar year is limited to the net profit of the current year combined with the retained net profits of the preceding two years, and permission must be obtained from the Federal Reserve Board for dividends exceeding these amounts. The payment of dividends by the Bank may also be affected by factors such as the maintenance of adequate capital.

Capital Adequacy

The Company is required to comply with the capital adequacy standards established by the Federal Reserve. These capital adequacy guidelines generally require bank holding companies to maintain minimum total capital equal to 8% of total risk-adjusted assets and off-balance sheet items (the "Total Risk-Based Capital Ratio"), with at least one-half of that amount consisting of Tier I, or core capital, and the remaining amount consisting of Tier II, or supplementary capital. Tier I capital for bank holding companies generally consists of the sum of common shareholders' equity, qualifying non-cumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual preferred stock and minority interests in the equity accounts of consolidated subsidiaries, less goodwill and other non-qualifying intangible assets. Tier II capital generally consists of hybrid capital instruments, term subordinated debt and, subject to limitations, general allowances for loan losses. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics.

In addition, the Federal Reserve also requires bank holding companies to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization's Tier I capital to its total consolidated quarterly average assets (as defined for regulatory purposes), net of the allowance for loan losses, goodwill and certain other intangible assets. The minimum leverage ratio for bank holding companies is 4%. At December 31, 2012, the Bank was "well-capitalized" under regulatory capital adequacy standards, as further discussed on page 91.

In June 2012, the Federal Reserve released for comment a proposal to enact in the United States the international agreement referred to as Basel III. Capital and liquidity standards consistent with Basel III will be formally implemented in the United States through a series of rules. The proposed rules include higher capital requirements and would raise minimum capital levels, redefine the significant inputs to the capital ratio calculation, and be phased in over a period of years from 2013 through 2019. The initial comment period for the proposed rules ended in October 2012, and in November 2012, the effective date for initial Basel III implementation was delayed. A new implementation date has yet to be announced. The Company believes its current capital ratios would be higher than those required in the Basel III proposal issued by the Federal Reserve.

Recent Significant Legislation Affecting the Company

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 and requires rulemaking and reports over the next several years. Among its many provisions, the Dodd-Frank Act established a new council of "systemic risk" regulators, created a new consumer protection division within the Federal Reserve, empowers the Federal Reserve to supervise the largest, most complex financial companies, allows the government to seize and liquidate failing financial companies, and gives regulators new powers to oversee the

derivatives market.

In June 2011, the Federal Reserve, under the provisions of 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 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 compared to previous market rates. The 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 rules apply to bank issuers with more than \$10 billion in assets and took effect in phases, with the base fee cap effective October 1, 2011 and the network exclusivity rule effective on April 1, 2012.

The Dodd-Frank Act also established the Consumer Financial Protection Bureau (CFPB) and authorizes it to supervise certain consumer financial services companies and large depository institutions and their affiliates for consumer protection purposes.

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Subject to the provisions of the Act, the CFPB has responsibility to implement, examine for compliance with, and enforce “Federal consumer financial law.” As a depository institution, the Company will be subject to examinations by the CFPB, which will focus on the Company’s ability to detect, prevent, and correct practices that present a significant risk of violating the law and causing consumer harm.

In October 2012, the Federal Reserve, as required by the Dodd-Frank Act, approved new stress testing regulations applicable to certain financial companies with total consolidated assets of more than \$10 billion but less than \$50 billion. The rule requires that these financial companies, including Commerce Bancshares, conduct stress tests on an annual basis. The stress tests will have an as-of date of September 30, 2013 using scenarios provided by the Federal Reserve in November of the same year, and the Company is required to submit regulatory reports to the Federal Reserve on its stress tests by March 31, 2014. During June 2015, the Company will be required to make public disclosures of the results of tests performed as of September 30, 2014.

Available Information

The Company’s principal offices are located at 1000 Walnut, Kansas City, Missouri (telephone number 816-234-2000). The Company makes available free of charge, through its Web site at www.commercebank.com, reports filed with the Securities and Exchange Commission as soon as reasonably practicable after the electronic filing. These filings include the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports.

Statistical Disclosure

The information required by Securities Act Guide 3 — “Statistical Disclosure by Bank Holding Companies” is located on the pages noted below.

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