COMMERCE BANCSHARES INC /MO/
Form 10-Q
August 06, 2010

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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 June 30, 2010
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<br>(State of Incorporation)<br>43-0889454<br>(IRS Employer Identification No.)<br>1000 Walnut,<br>Kansas City, MO<br>(Address of principal executive offices)<br>64106<br>(Zip Code)<br>(816) 234-2000<br>(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).

$$
\text { Yes } \mathrm{p} \quad \text { No o }
$$

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 o 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 July 30, 2010, the registrant had outstanding 83,373,888 shares of its $\$ 5$ par value common stock, registrant s only class of common stock.

## Commerce Bancshares, Inc. and Subsidiaries

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## PART I: FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

| ASSETS |  |  |
| :---: | :---: | :---: |
| Loans | \$ 9,735,049 | \$ 10,145,324 |
| Allowance for loan losses | $(197,538)$ | $(194,480)$ |
| Net loans | 9,537,511 | 9,950,844 |
| Loans held for sale | 489,826 | 345,003 |
| Investment securities: |  |  |
| Available for sale (\$531,358,000 and \$537,079,000 pledged in 2010 and |  |  |
| 2009, respectively, to secure structured repurchase agreements) | 6,649,890 | 6,340,975 |
| Trading | 17,245 | 10,335 |
| Non-marketable | 107,343 | 122,078 |
| Total investment securities | 6,774,478 | 6,473,388 |
| Federal funds sold and securities purchased under agreements to resell | 9,300 | 22,590 |
| Interest earning deposits with banks | 302,354 | 24,118 |
| Cash and due from banks | 339,990 | 417,126 |
| Land, buildings and equipment, net | 393,133 | 402,633 |
| Goodwill | 125,585 | 125,585 |
| Other intangible assets, net | 12,278 | 14,333 |
| Other assets | 394,856 | 344,569 |
| Total assets | \$ 18,379,311 | \$ 18,120,189 |

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## LIABILITIES AND EQUITY

Deposits:

Non-interest bearing demand
Savings, interest checking and money market
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

Total liabilities

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 83,523,479 shares in 2010 and $83,127,401$ shares in 2009
Capital surplus
Retained earnings
Treasury stock of 55,832 shares in 2010 and 22,328 shares in 2009, at cost
Accumulated other comprehensive income

Total Commerce Bancshares, Inc. stockholders equity $\quad \mathbf{1 , 9 8 7 , 4 4 7} \quad 1,884,228$
Non-controlling interest

Total equity

Total liabilities and equity

| $\mathbf{\$}$ | $\mathbf{1 , 6 6 6}, 649$ | $\$$ |
| ---: | ---: | ---: |
| $\mathbf{9 , 6 3 1 , 4 2 8}$ |  | $1,793,816$ |
|  | $\mathbf{1 , 6 7 7 , 2 5 1}$ |  |
|  | $\mathbf{1 , 5 1 0 , 8 1 9}$ |  |
|  |  | $1,402,912,332$ |
|  |  |  |

14,486,147
14,210,451

1,006,356
363,997
1,103,191
534,197
736,062
184,580

16,390,697
16,234,284

| $\mathbf{4 1 7 , 6 1 7}$ | 415,637 |
| ---: | ---: |
| $\mathbf{8 6 2 , 9 6 5}$ | 854,490 |
| $\mathbf{6 3 3 , 2 2 1}$ | 568,532 |
|  |  |
| $\mathbf{( 2 , 1 5 3 )}$ | $(838)$ |
| $\mathbf{7 5 , 7 9 7}$ | 46,407 |


| $\mathbf{1 , 9 8 7 , 4 4 7}$ | $1,884,228$ |
| ---: | ---: |
| $\mathbf{1 , 1 6 7}$ | 1,677 |

1,988,614
1,885,905
\$ 18,379,311
\$ 18,120,189

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 federal funds sold and securities purchased
under agreements to resell
under agreements to resell 13

201

185,057
198,992
373,126
392,866

## INTEREST EXPENSE

Interest on deposits:

| Savings, interest checking and money market | $\mathbf{7 , 7 1 1}$ | 7,978 | $\mathbf{1 4 , 8 0 7}$ | 16,031 |
| :--- | ---: | ---: | ---: | ---: |
| Time open and C.D. s of less than $\$ 100,000$ | $\mathbf{6 , 0 5 9}$ | 14,545 | $\mathbf{1 2 , 8 7 4}$ | 29,292 |
| Time open and C.D. s of $\$ 100,000$ and over | $\mathbf{3 , 5 6 2}$ | 9,915 | $\mathbf{7 , 4 8 5}$ | 21,215 |
| Interest on federal funds purchased and securities sold |  |  |  |  |
| under agreements to repurchase | $\mathbf{8 2 6}$ | 849 | $\mathbf{1 , 6 4 6}$ | 2,079 |
| Interest | $\mathbf{3 , 7 9 1}$ | 8,260 | $\mathbf{1 0 , 4 9 6}$ | 16,789 |


| Total interest expense | $\mathbf{2 1 , 9 4 9}$ | 41,547 | $\mathbf{4 7 , 3 0 8}$ | 85,406 |
| :--- | ---: | ---: | ---: | ---: |
|  |  |  |  |  |
| Net interest income | $\mathbf{1 6 3 , 1 0 8}$ | 157,445 | $\mathbf{3 2 5 , 8 1 8}$ | 307,460 |
| Provision for loan losses | $\mathbf{2 2 , 1 8 7}$ | 41,166 | $\mathbf{5 6 , 5 0 9}$ | 84,334 |
|  |  |  |  |  |
| Net interest income after provision for loan losses | $\mathbf{1 4 0 , 9 2 1}$ | 116,279 | $\mathbf{2 6 9 , 3 0 9}$ | 223,126 |
|  |  |  |  |  |
| NON-INTEREST INCOME |  |  |  |  |
| Bank card transaction fees | $\mathbf{3 7 , 6 5 9}$ | 30,105 | $\mathbf{7 0 , 1 4 9}$ | 57,273 |
| Deposit account charges and other fees | $\mathbf{2 5 , 4 7 2}$ | 26,935 | $\mathbf{4 9 , 4 5 3}$ | 52,527 |
| Trust fees | $\mathbf{2 0 , 3 5 8}$ | 19,355 | $\mathbf{3 9 , 6 7 6}$ | 38,228 |
| Bond trading income | $\mathbf{5 , 3 8 7}$ | 6,538 | $\mathbf{1 0 , 3 9 1}$ | 12,342 |
| Consumer brokerage services | $\mathbf{2 , 3 7 2}$ | 2,826 | $\mathbf{4 , 4 8 9}$ | 5,726 |

Loan fees and sales
Other
Total non-interest income
INVESTMENT SECURITIES GAINS (LOSSES),
NET
Impairment (losses) reversals on debt securities
Less noncredit-related losses (reversals) on securities
not expected to be sold
Net impairment losses
Realized gains (losses) on sales and fair value
adjustments

| $\mathbf{4 , 4 1 5}$ | $(10,080)$ | $\mathbf{5 , 7 1 0}$ | $(31,965)$ |
| ---: | ---: | ---: | ---: |
| $\mathbf{( 5 , 0 9 1 )}$ | 9,286 | $\mathbf{( 7 , 8 4 3 )}$ | 30,618 |
| $\mathbf{( 6 7 6 )}$ | $(794)$ | $(\mathbf{2 , 1 3 3 )}$ | $(1,347)$ |
| $\mathbf{1 , 3 3 6}$ | $(1,959)$ | $(\mathbf{8 7 2})$ | $(3,578)$ |
|  |  |  |  |
| $\mathbf{6 6 0}$ | $(2,753)$ | $\mathbf{( 3 , 0 0 5 )}$ | $(4,925)$ |

NON-INTEREST EXPENSE

Salaries and employee benefits
Net occupancy
Equipment
Supplies and communication
Data processing and software
Marketing
87,108

| 86,279 | $\mathbf{1 7 4 , 5 4 6}$ | 173,032 |
| ---: | ---: | ---: |
| 11,088 | $\mathbf{2 3 , 6 1 1}$ | 22,900 |
| 6,255 | $\mathbf{1 1 , 8 3 9}$ | 12,577 |
| 8,249 | $\mathbf{1 4 , 1 6 7}$ | 16,933 |
| 15,007 | $\mathbf{3 4 , 1 0 3}$ | 29,354 |
| 4,906 | $\mathbf{9 , 7 2 0}$ | 9,253 |
| 12,969 | $\mathbf{9 , 6 8 9}$ | 17,075 |
| 15,258 | $\mathbf{3 4 , 0 9 4}$ | 31,773 |

Deposit insurance
Other
Total non-interest expense

Income before income taxes
87,246
52,077 149,434
96,297
Less income taxes

Net income before non-controlling interest
Less non-controlling interest expense (income)
155,982
160,011
311,769
312,897
$\mathbf{1 1 , 5 1 3}$
$\mathbf{5 , 9 3 8}$
6,829
17,497
5,002
4,939
17,156
$(2,753)$
$(3,005)$
$(4,925)$
Net income before non-controlling interest
Less non-controlling interest expense (income)

27,428
15,257
45,805
28,849

Net income
\$ 59,734 \$ 36,968
\$ 103,904 \$ 67,804

| Net income per common share | basic | $\$$ | .72 | $\$$ | .46 | $\$$ | $\mathbf{1 . 2 5}$ | $\$$ | .84 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Net income per common share | diluted | $\$$ | $\mathbf{. 7 1}$ | $\$$ | .46 | $\$$ | $\mathbf{1 . 2 4}$ | $\$$ | .84 |

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY


[^0]

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | For the Six Months <br> (In thousands) <br> Ended June 30 |
| :--- | :---: | :---: |
| 2009 |  |

(Unaudited)

## OPERATING ACTIVITIES:

Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Provision for loan losses
Provision for depreciation and amortization
Amortization of investment security premiums, net
Investment securities losses, net(A)
Gain on sale of branch
Net gains on sales of loans held for sale
Originations of loans held for sale
Proceeds from sales of loans held for sale
Net increase in trading securities
Stock-based compensation
Increase in interest receivable
Increase (decrease) in interest payable
Increase (decrease) in income taxes payable
Net tax benefit related to equity compensation plans
Other changes, net

Net cash provided by operating activities
INVESTING ACTIVITIES:
Cash paid in branch sale
\$ 103,904 \$ 67,804
+
$\mathbf{5 6 , 5 0 9} \quad 84,334$
$\mathbf{2 4 , 8 6 4} \quad 25,436$
8,752
1,132
3,005 4,925
(644)

| $\mathbf{( 2 , 4 6 6})$ | $(4,600)$ |
| ---: | ---: |
| $(\mathbf{2 8 8 , 9 0 3})$ | $(276,352)$ |

146,747 110,886
$(\mathbf{2 , 1 2 1 )} \quad(9,628)$
3,386 3,237
(512)
$(2,211)$
$(\mathbf{3 , 8 2 9}) \quad 3,720$
$\mathbf{7 , 5 9 8} \quad(8,344)$
$(1,026)$
(80)

Proceeds from sales of investment securities(A)
64,087
$(3,494)$
Proceeds from maturities/pay downs of investment securities(A)
Purchases of investment securities(A)
Net decrease in loans
Purchases of land, buildings and equipment
ent
Sales of land, buildings and equipment
954,133 27,459

954,133
567,239
$(1,040,529)$
$(2,045,848)$
356,824
512,620
$(9,395)$
$(14,473)$
377
55

Net cash provided by (used in) investing activities
325,497
$(956,442)$

## FINANCING ACTIVITIES:

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| Net increase in non-interest bearing demand, savings, interest checking and money market deposits |  | 295,593 |  | 791,104 |
| :---: | :---: | :---: | :---: | :---: |
| Net decrease in time open and C.D. s |  | $(25,649)$ |  | (375) |
| Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase |  | $(96,835)$ |  | 147,584 |
| Repayment of long-term borrowings |  | $(372,065)$ |  | $(200,673)$ |
| Additional long-term borrowings |  |  |  | 100,000 |
| Net decrease in short-term borrowings |  |  |  | $(800,000)$ |
| Purchases of treasury stock |  | (943) |  | (391) |
| Issuance of stock under open market stock sale program, stock purchase and equity compensation plans |  | 5,671 |  | 36,881 |
| Net tax benefit related to equity compensation plans |  | 1,026 |  | 80 |
| Cash dividends paid on common stock |  | $(39,215)$ |  | $(36,774)$ |
| Net cash provided by (used in) financing activities |  | $(232,417)$ |  | 37,436 |
| Increase (decrease) in cash and cash equivalents |  | 187,810 |  | $(874,832)$ |
| Cash and cash equivalents at beginning of year |  | 463,834 |  | 1,299,356 |
| Cash and cash equivalents at June 30 | \$ | 651,644 | \$ | 424,524 |
| (A) Available for sale and non-marketable securities |  |  |  |  |
| Income tax net payments | \$ | 38,182 | \$ | 36,780 |
| Interest paid on deposits and borrowings | \$ | 51,137 | \$ | 81,672 |

See accompanying notes to consolidated financial statements.

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## Commerce Bancshares, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2010 (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). 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 2009 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 and six month periods ended June 30, 2010 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 2009 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 June 30, 2010 and December 31, 2009 are as follows.

|  | June 30 | December 31 |
| :--- | :---: | :---: |
| (In thousands) | $\mathbf{2 0 1 0}$ | 2009 |


| Business | $\mathbf{\$ 2 , 8 6 4 , 2 2 6}$ | $\$ 2,877,936$ |
| :--- | ---: | ---: |
| Real estate | construction and land | $\mathbf{5 4 5 , 3 3 6}$ |
| Real estate | business | $\mathbf{2 , 0 2 3 , 0 6 3}$ |
| Real estate | personal | $\mathbf{1 , 4 6 5 , 8 7 1}$ |
| Consumer | $\mathbf{1 , 2 5 2 , 3 8 9}$ | $2,104,030$ |
| Home equity | $\mathbf{4 8 4 , 6 0 1}$ | $1,537,687$ |
| Student | $\mathbf{3 1 7 , 5 1 4}$ | $1,333,763$ |
| Consumer credit card | $\mathbf{7 7 5 , 7 0 5}$ | 489,517 |
| Overdrafts | $\mathbf{6 , 3 4 4}$ | 331,698 |
|  |  | 799,503 |
|  |  | 6,080 |
| Total loans | $\mathbf{\$ 9 , 7 3 5 , 0 4 9}$ | $\$ 10,145,324$ |

At June 30, 2010, loans of $\$ 2.9$ 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 $\$ 1.4$ billion were pledged at the Federal

Reserve Bank as collateral for discount window borrowings.

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In addition to its basic portfolio, the Company originates other loans which it intends to sell in secondary markets. Loans classified as held for sale has historically consisted primarily of loans originated to students while attending colleges and universities, which are sold to various student loan agencies when the student graduates and the loan enters into repayment status. Much of the Company s origination activity ceased on July 1, 2010, as the federal government became the sole originator of federally subsidized student loans on that date. Other loans included as held for sale are certain fixed rate residential mortgage loans which are sold in the secondary market, generally within three months of origination. The following table presents information about loans held for sale, including impairment losses resulting from declines in fair value, which are further discussed in Note 13 on Fair Value Measurements. Previously recognized impairment losses amounting to $\$ 434$ thousand were reversed during the first six months of 2010, as certain impaired loans were sold.

| (In thousands) | $2010$ |  | $\begin{gathered} \text { December } 31 \\ 2009 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
| Balance outstanding: |  |  |  |  |
| Student loans, at cost | \$ | 482,047 | \$ | 335,358 |
| Residential mortgage loans, at cost |  | 8,173 |  | 10,473 |
| Valuation allowance on student loans |  | (394) |  | (828) |
| Total loans held for sale, at lower of cost or fair value | \$ | 489,826 | \$ | 345,003 |


|  | For the Six Months Ended June 30 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| (In thousands) |  | 2010 |  | 2009 |
| Net gains on sales: |  |  |  |  |
| Student loans | \$ | 1,689 |  | 3,221 |
| Residential mortgage loans |  | 777 |  | 1,379 |
| Total gains on sales of loans held for sale, net | \$ | 2,466 |  | 4,600 |

The table below shows the Company s investment in impaired loans at June 30, 2010 and December 31, 2009. 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. Restructured loans are largely comprised of certain business, construction and business real estate loans totaling $\$ 77.6$ million and $\$ 85.7$ million at

June 30, 2010 and December 31, 2009, respectively, and classified as substandard, which when renewed at maturity were at interest rates equal to or greater than the previous rates in effect. The new rates, however, were not judged to be market rates for new debt with similar risk, and thus these loans were classified as troubled debt restructurings. 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. However, because of their substandard classification they are also regarded as potential problem loans, as disclosed at both December 31, 2009 and June 30, 2010 in the Risk Elements of Loan Portfolio section of the following discussion. Troubled debt restructurings also include certain credit card loans under various debt management and assistance programs, which totaled $\$ 17.0$ million at June 30, 2010 and $\$ 16.0$ million at December 31, 2009.

| (In thousands) | June 30 <br> $\mathbf{2 0 1 0}$ | December 31 <br> 2009 |
| :--- | :---: | ---: |
| Non-accrual loans | $\mathbf{\$ 9 0 , 2 6 7}$ | $\$ 106,613$ |
| Restructured loans | $\mathbf{9 4 , 6 0 6}$ | 101,765 |
| Total impaired loans | $\mathbf{\$ 1 8 4 , 8 7 3}$ | $\$ 208,378$ |

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The Company s holdings of foreclosed real estate totaled $\$ 12.9$ million and $\$ 10.1$ million at June 30,2010 and December 31, 2009, respectively. Personal property acquired in repossession, generally autos and marine and recreational vehicles, totaled $\$ 11.1$ million and $\$ 14.5$ million at June 30, 2010 and December 31, 2009, 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.

The following is a summary of the allowance for loan losses.
$\left.\begin{array}{lccccc} & \text { For the Three Months Ended } \\ \text { June 30 }\end{array}\right)$

## 3. Investment Securities

Investment securities, at fair value, consisted of the following at June 30, 2010 and December 31, 2009.

|  | June 30 | December 31 |
| :--- | :---: | :---: |
| (In thousands) | $\mathbf{2 0 1 0}$ | 2009 |

Available for sale:

| U.S. government and federal agency obligations | $\mathbf{\$ 5 4 , 6 1 9}$ | $\$ 447,038$ |
| :--- | ---: | ---: |
| Government-sponsored enterprise obligations | $\mathbf{2 4 2 , 5 9 1}$ | 165,814 |
| State and municipal obligations | $\mathbf{9 4 6 , 0 5 2}$ | 939,338 |
| Agency mortgage-backed securities | $\mathbf{2 , 0 4 5 , 3 4 1}$ | $2,262,003$ |
| Non-agency mortgage-backed securities | $\mathbf{5 9 5 , 2 5 6}$ | 609,016 |
| Other asset-backed securities | $\mathbf{2 , 1 3 3 , 8 8 0}$ | $1,701,569$ |
| Other debt securities | $\mathbf{1 8 5 , 2 0 9}$ | 176,331 |
| Equity securities | $\mathbf{4 6 , 9 4 2}$ | 39,866 |
|  |  |  |
| Total available for sale | $\mathbf{6 , 6 4 9 , 8 9 0}$ | $6,340,975$ |
|  |  |  |
| Trading | $\mathbf{1 7 , 2 4 5}$ | 10,335 |
| Non-marketable | $\mathbf{1 0 7 , 3 4 3}$ | 122,078 |
|  |  |  |
| Total investment securities | $\mathbf{\$ 6 , 7 7 4 , 4 7 8}$ | $\$ 6,473,388$ |

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 (FRB) stock held for debt and regulatory purposes, which totaled $\$ 56.4$ million and $\$ 72.6$ million at June 30, 2010 and December 31, 2009, respectively. Investment in FRB 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 $\$ 50.9$ million and $\$ 49.5$ million at June 30, 2010 and December 31, 2009, respectively.

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A summary of the available for sale investment securities by maturity groupings as of June 30, 2010 is shown below. The investment portfolio includes agency mortgage-backed securities, which are guaranteed by government-sponsored agencies such as the FHLMC, FNMA and GNMA, and non-agency mortgage-backed securities, which have no guarantee but are collateralized by residential mortgages. Also included are certain other asset-backed securities, which are primarily collateralized by credit cards, automobiles, 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.

|  | Amortized <br> (Dollars in thousands) | Fair <br> Value |  |
| :--- | ---: | ---: | ---: |
|  |  |  |  |
| U.S. government and federal agency obligations: |  |  |  |
| Within 1 year | 170,701 | $\$$ | 170,254 |
| After 1 but within 5 years | 48,452 | 51,544 |  |
| After 5 but within 10 years | 218,807 | 232,821 |  |
|  |  |  |  |
| Total U.S. government and federal agency obligations | 437,960 | 454,619 |  |
|  |  |  |  |
| Government-sponsored enterprise obligations: |  |  |  |
| Within 1 year | 70,899 | 71,802 |  |
| After 1 but within 5 years | 167,934 | 170,789 |  |
|  |  |  |  |
| Total government-sponsored enterprise obligations | 238,833 | 242,591 |  |
|  |  |  |  |
| State and municipal obligations: |  |  |  |
| Within 1 year | 111,192 | 112,264 |  |
| After 1 but within 5 years | 423,161 | 436,768 |  |
| After 5 but within 10 years | 146,647 | 149,890 |  |
| After 10 years | 255,368 | 247,130 |  |
|  |  |  |  |
| Total state and municipal obligations | 936,368 | 946,052 |  |
|  |  |  |  |
| Mortgage and asset-backed securities: | $1,970,154$ | $2,045,341$ |  |
| Agency mortgage-backed securities | 611,773 | 595,256 |  |
| Non-agency mortgage-backed securities | $2,119,944$ | $2,133,880$ |  |
| Other asset-backed securities |  |  |  |

Total mortgage and asset-backed securities
Other debt securities:
Within 1 year
After 1 but within 5 years
Total other debt securities
Equity securities

Total available for sale investment securities

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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.

|  |  | Gross | Gross |  |
| :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Amortized | Unrealized | Unrealized | Fair |

## June 30, 2010

| U.S. government and federal agency obligations | \$ | 437,960 | \$ | 17,112 | \$ | (453) | \$ | 454,619 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Government-sponsored enterprise obligations |  | 238,833 |  | 3,758 |  |  |  | 242,591 |
| State and municipal obligations |  | 936,368 |  | 22,423 |  | $(12,739)$ |  | 946,052 |
| Mortgage and asset-backed securities: |  |  |  |  |  |  |  |  |
| Agency mortgage-backed securities |  | 1,970,154 |  | 75,377 |  | (190) |  | 2,045,341 |
| Non-agency mortgage-backed securities |  | 611,773 |  | 11,951 |  | $(28,468)$ |  | 595,256 |
| Other asset-backed securities |  | 2,119,944 |  | 14,602 |  | (666) |  | 2,133,880 |
| Total mortgage and asset-backed securities |  | 4,701,871 |  | 101,930 |  | $(29,324)$ |  | 4,774,477 |
| Other debt securities |  | 172,021 |  | 13,188 |  |  |  | 185,209 |
| Equity securities |  | 12,924 |  | 34,018 |  |  |  | 46,942 |

Total $\quad \$ \quad 6,499,977 \quad \$ \quad 192,429 \quad \$ \quad(42,516) \quad \$ \quad 6,649,890$

December 31, 2009

| U.S. government and federal agency obligations | \$ | 436,607 | \$ | 10,764 | \$ | (333) | \$ | 447,038 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Government-sponsored enterprise obligations |  | 162,191 |  | 3,743 |  | (120) |  | 165,814 |
| State and municipal obligations |  | 917,267 |  | 25,099 |  | $(3,028)$ |  | 939,338 |
| Mortgage and asset-backed securities: |  |  |  |  |  |  |  |  |
| Agency mortgage-backed securities |  | 2,205,177 |  | 58,740 |  | $(1,914)$ |  | 2,262,003 |
| Non-agency mortgage-backed securities |  | 654,711 |  | 4,505 |  | $(50,200)$ |  | 609,016 |
| Other asset-backed securities |  | 1,685,691 |  | 17,143 |  | $(1,265)$ |  | 1,701,569 |
| Total mortgage and asset-backed securities |  | 4,545,579 |  | 80,388 |  | $(53,379)$ |  | 4,572,588 |
| Other debt securities |  | 164,402 |  | 11,929 |  |  |  | 176,331 |
| Equity securities |  | 11,285 |  | 28,581 |  |  |  | 39,866 |

Total
$\$ 6,237,331 \quad \$ \quad 160,504 \quad \$ \quad(56,860) \quad \$ 6,340,975$

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 June 30, 2010, the fair value of securities on this watch list was $\$ 244.0$ million.

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As of June 30, 2010, the Company had recorded other-than-temporary impairment (OTTI) on certain non-agency mortgage-backed securities having an aggregate fair value of $\$ 150.4$ million, which included an unrealized loss of $\$ 26.3$ million. The credit-related portion of the impairment totaled $\$ 4.6$ million and was recorded in earnings. The noncredit-related portion of the impairment totaled $\$ 21.7$ million on a pre-tax basis, and has been recognized in 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 | $3 \%-25 \%$ |
| Projected cumulative default | $11 \%-49 \%$ |
| Credit support | $1 \%-14 \%$ |
| Loss severity | $33 \%-57 \%$ |

The following table shows changes in the credit losses recorded in the six months ended June 30, 2010 and 2009, for which a portion of an OTTI was recognized in other comprehensive income.

|  | For the <br> Six Months <br> Ended June 30 |  |
| :--- | :---: | :---: | :---: |
| (In thousands) | $\mathbf{2 0 1 0}$ | 2009 |

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Securities with unrealized losses recorded in accumulated other comprehensive income are shown in the table below, along with the length of the impairment period. The table includes securities for which a portion of an OTTI has been recognized in other comprehensive income.

|  | Less than 12 months |  |  | 12 months or longer |  | Total |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Fair Value | Unrealized | Losses | Fair Value | Unrealized | Losses | Fair Value | | Unrealized |
| :---: |

June 30, 2010
U.S. government and federal agency obligations

| $\$ 167,495$ | $\$$ | 453 | $\$$ |  |  |  |  |  |  |
| ---: | :--- | ---: | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 57,288 |  | 1,537 |  | 83,290 |  | 11,202 |  | 140,578 |  |
|  |  |  |  | 12,739 |  |  |  |  |  |

Mortgage and asset-backed securities:
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Other asset-backed securities

Total mortgage and asset-backed securities

483,198
10,937
193,096 18,387
676,294
29,324

Total temporarily impaired securities


December 31, 2009


Total mortgage and asset-backed securities

Total temporarily impaired $\begin{array}{llllllllll}\text { securities } & \$ & 924,200 & \$ & 21,215 & \$ & 353,979 & \$ & 35,645 & \$ 1,278,179\end{array} \$ 56,860$

The total available for sale portfolio consisted of approximately 1,200 individual securities at June 30, 2010, with 103 securities in a loss position. Securities with temporary impairment totaled 88 , of which 22 securities, or $3 \%$ of the portfolio value, had been in a loss position for 12 months or longer.

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The Company s holdings of state and municipal obligations included gross unrealized losses of $\$ 12.7$ million at June 30, 2010. Of these losses, $\$ 12.6$ million related to ARS, which are discussed above, and $\$ 94$ thousand related to other state and municipal obligations. This portfolio, exclusive of ARS, totaled $\$ 793.9$ million at fair value, or $12.7 \%$ 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.

|  | Average | Average |
| :---: | :---: | :---: |
| $\%$ of | Life | Rating |
| Portfolio | (in years) | (Moody s) |

At June 30, 2010

| Texas | $12.9 \%$ | 5.5 | Aa1 |
| :--- | :---: | :---: | ---: |
| Illinois | 8.5 | 6.0 | Aa2 |
| Washington | 7.2 | 1.9 | Aa3 |
| Missouri | 7.2 | 3.7 | Aa 1 |
| Indiana | 5.7 | 2.1 | Aa 3 |
|  |  |  |  |
| General obligation |  |  |  |
| Housing | $29.2 \%$ | 3.9 | Aa 2 |
| Transportation | 20.6 | 5.9 | Aa 1 |
| Lease | 17.8 | 2.6 | $\mathrm{Aa3}$ |
| Refunded | 9.0 | 2.5 | Aa 2 |
|  | 7.2 | 2.3 | Aaa |

The remaining unrealized losses on the Company s investments are largely contained in the portfolio of non-agency mortgage-backed securities. These securities are not guaranteed by an outside agency and are dependent on payments received from the underlying mortgage collateral. While nearly all of these securities, at purchase date, were comprised of senior tranches and were highly rated by various rating agencies, the adverse housing market, liquidity pressures and overall economic climate has resulted in low fair values for these securities. Also, 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 Company continues to closely monitor the performance of these securities. Additional OTTI on these and other securities may arise in future periods due to further deterioration in expected cash flows, loss severities and delinquency levels of the securities underlying collateral, which would negatively affect the Company s financial results.

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

| (In thousands) | For the Six Months Ended June 30 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  | 2010 |  | 2009 |
| Proceeds from sales of available for sale securities | \$ | 64,087 |  | 23,220 |
| Proceeds from sales of non-marketable securities |  |  |  | 4,239 |
| Total proceeds | \$ | 64,087 |  | 27,459 |
| Available for sale: |  |  |  |  |
| Gains realized on sales | \$ | 1,920 |  | 82 |
| Losses realized on sales |  | (151) |  | (18) |
| Other-than-temporary impairment recognized on debt securities |  | $(2,133)$ |  | $(1,347)$ |
| Non-marketable: |  |  |  |  |
| Gains realized on sales |  |  |  | 205 |
| Losses realized on sales |  |  |  | (170) |
| Fair value adjustments, net |  | $(2,641)$ |  | $(3,677)$ |
| Investment securities losses, net | \$ | $(3,005)$ |  | $(4,925)$ |

At June 30, 2010, securities carried at $\$ 3.7$ billion were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowing capacity at the Federal Reserve Bank. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated $\$ 531.4$ million, while the remaining securities were pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral.

## 4. Goodwill and Other Intangible Assets

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

June 30, 2010
Gross
Carrying Accumulated Valuation Net
(In thousands) Amount AmortizationAllowance Amount

December 31, 2009

## Gross

Carrying Accumulated Valuation Net Amount Amortization Allowance Amount


Aggregate amortization expense on intangible assets was $\$ 911$ thousand and $\$ 1.0$ million, respectively, for the three month periods ended June 30, 2010 and 2009, and $\$ 1.8$ million and $\$ 2.1$ million for the six month periods ended June 30, 2010 and 2009. 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 June 30, 2010. The Company s actual amortization expense in any given period may

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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)

2010 \$ 3,426
2011 2,877
2012 2,321
2013
1,771
2014
1,289

Changes in the carrying amount of goodwill and net other intangible assets for the six month period ended June 30, 2010 is as follows.

| (In thousands) | Goodwill |  | Core Deposit Premium |  | Mortgage Servicing Rights |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at January 1, 2010 | \$ | 125,585 | \$ | 12,754 | \$ | 1,579 |
| Originations |  |  |  |  |  | 51 |
| Amortization |  |  |  | $(1,662)$ |  | (154) |
| Impairment |  |  |  |  |  | (290) |
| Balance at June 30, 2010 | \$ | 125,585 | \$ | 11,092 | \$ | 1,186 |

Goodwill allocated to the Company s operating segments at June 30, 2010 and December 31, 2009 is shown below.
(In thousands)
$\begin{array}{lrr}\text { Consumer segment } & \text { \$ } & 67,765 \\ \text { Commercial segment } & 57,074 \\ \text { Wealth segment } & 746\end{array}$

## 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.

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 June 30, 2010 that net liability was $\$ 3.4$ 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 $\$ 386.8$ million at June 30, 2010.

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

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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 June 30, 2010, believes sufficient collateral is available to cover potential swap losses. The Company receives a fee from the institution at the inception of the contract, which is recorded as a liability representing the fair value of the RPA. Any future changes in fair value, including those due to a change in the third party s creditworthiness, are 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 June 30, 2010, the liability recorded for guarantor RPAs was $\$ 320$ thousand, and the notional amount of the underlying swaps was $\$ 42.5$ 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. If an event of default on all contracts had occurred at June 30, 2010, the Company would have been required to make payments of approximately $\$ 3.9$ million.

At June 30, 2010, the Company had recorded a liability of $\$ 7.2$ million representing its obligation to share certain estimated litigation costs of Visa, Inc. (Visa). An escrow account has been established by Visa, and is being used to fund actual litigation settlements as they occur. The escrow account was funded initially with proceeds from an initial public offering, and subsequently with contributions by Visa. The Company s indemnification obligation is periodically adjusted to reflect changes in estimates of litigation costs, and is reduced as funding occurs in the escrow account. The Company currently anticipates that its proportional share of eventual escrow funding will more than offset its liability related to the Visa litigation.

## 6. Pension

The Company s pension cost is shown in the table below:

|  | For the | For the |
| :---: | :---: | :---: |
|  | Three Months | Six Months |
| Ended June 30 |  |  |


| Service cost benefits earned during the period | $\mathbf{\$}$ | $\mathbf{1 8 3}$ | $\$$ | 268 | $\mathbf{\$}$ | $\mathbf{3 6 6}$ | $\$$ | 536 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Interest cost on projected benefit obligation |  | $\mathbf{1 , 3 6 7}$ |  | 1,363 |  | $\mathbf{2 , 7 3 4}$ | 2,726 |  |
| Expected return on plan assets |  | $(\mathbf{1 , 6 4 0})$ |  | $(1,599)$ | $\mathbf{( 3 , 2 8 0 )}$ | $(3,197)$ |  |  |
| Amortization of unrecognized net loss |  | $\mathbf{5 6 7}$ |  | 675 | $\mathbf{1 , 1 3 4}$ | 1,350 |  |  |
|  |  |  |  |  |  |  |  |  |
| Net periodic pension cost | $\$$ | $\mathbf{4 7 7}$ | $\$$ | 707 | $\mathbf{\$}$ | $\mathbf{9 5 4}$ | $\$$ | 1,415 |

Substantially all benefits under the Company s defined benefit pension plan were frozen effective January 1, 2005. During the first six months of 2010, 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 2010 .

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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 unvested 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 unvested share-based awards and for common stock. Income per share attributable to common stock is shown in the table below. Unvested share-based awards are further discussed in Note 12.

| (In thousands, except per share data) | For the Three Months Ended June 30 |  |  |  | For the Six Months Ended June 30 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2010 |  | 2009 |  | 2010 |  | 2009 |
| Basic income per common share: |  |  |  |  |  |  |  |  |
| Net income attributable to Commerce Bancshares, Inc. | \$ | 59,734 | \$ | 36,968 | \$ | 103,904 | \$ | 67,804 |
| Less income allocated to unvested restricted stockholders |  | 331 |  | 168 |  | 565 |  | 302 |
| Net income available to common stockholders | \$ | 59,403 | \$ | 36,800 | \$ | 103,339 | \$ | 67,502 |
| Distributed income | \$ | 19,505 | \$ | 18,429 | \$ | 38,992 | \$ | 36,603 |
| Undistributed income | \$ | 39,898 | \$ | 18,371 | \$ | 64,347 | \$ | 30,899 |
| Weighted average common shares outstanding |  | 82,990 |  | 80,251 |  | 82,932 |  | 79,872 |
| Distributed income per share | \$ | . 23 | \$ | . 23 | \$ | . 47 | \$ | . 46 |
| Undistributed income per share |  | . 49 |  | . 23 |  | . 78 |  | . 38 |
| Basic income per common share | \$ | . 72 | \$ | . 46 | \$ | 1.25 | \$ | . 84 |
| Diluted income per common share: |  |  |  |  |  |  |  |  |
| Net income attributable to Commerce Bancshares, Inc. | \$ | 59,734 | \$ | 36,968 | \$ | 103,904 | \$ | 67,804 |
| Less income allocated to unvested restricted stockholders |  | 329 |  | 167 |  | 563 |  | 301 |
| Net income available to common stockholders | \$ | 59,405 | \$ | 36,801 | \$ | 103,341 | \$ | 67,503 |
| Distributed income | \$ | 19,505 |  | 18,429 | \$ | 38,992 |  | 36,603 |


| Undistributed income | \$ | 39,900 | \$ | 18,372 | \$ | 64,349 | \$ | 30,900 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Weighted average common shares outstanding |  | 82,990 |  | 80,251 |  | 82,932 |  | 79,872 |
| Net effect of the assumed exercise of stock-based awards based on the treasury stock method using the average market price for the respective periods |  | 395 |  | 273 |  | 423 |  | 296 |
| Weighted average diluted common shares outstanding |  | 83,385 |  | 80,524 |  | 83,355 |  | 80,168 |
| Distributed income per share | \$ | . 23 | \$ | . 23 | \$ | . 47 | \$ | . 46 |
| Undistributed income per share |  | . 48 |  | . 23 |  | . 77 |  | . 38 |
| Diluted income per common share | \$ | . 71 | \$ | . 46 | \$ | 1.24 | \$ | . 84 |

## 8. Other Comprehensive Income

Activity in other comprehensive income for the three and six months ended June 30, 2010 and 2009 is shown in the table below. The first component of other comprehensive income is the unrealized holding gains and losses on available for sale securities. These gains and losses have been separated into two groups in the table below, as required by current accounting guidance for other-than-temporary impairment (OTTI) on debt securities. Under this guidance, credit-related losses on debt securities with OTTI are recorded in current earnings, while the noncredit-related portion of the overall gain or loss in fair value is recorded in other comprehensive income (loss). Changes in the noncredit-related gain or loss in fair value of these securities, after OTTI was initially recognized, are shown separately in the table below. The remaining unrealized holding gains and losses shown in the table apply to available for sale investment securities for which OTTI has not been recorded (and include holding gains and losses on certain securities prior to the recognition of OTTI).

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In the calculation of other comprehensive income, certain reclassification adjustments are made to avoid double counting gains and losses that are included as part of net income for a period that also had been included as part of other comprehensive income in that period or earlier periods. These reclassification amounts are shown separately in the table below.

The second component of other comprehensive income is pension gains and losses that arise during the period but are not recognized as components of net periodic benefit cost, and corresponding adjustments when these gains and losses are subsequently amortized to net periodic benefit cost.

|  | For the | For the |
| :---: | :---: | :---: |
|  | Three Months | Six Months |
| (In thousands) | Ended June 30 | Ended June 30 |
|  | $\mathbf{2 0 1 0}$ | 2009 |

Available for sale debt securities for which a portion of OTTI has been recorded in earnings:
Unrealized holding gains subsequent to initial OTTI recognition Income tax expense

| $\$$ | $\mathbf{5 , 6 6 5}$ | $\$$ | 1,603 | $\$$ | $\mathbf{1 1 , 9 6 7}$ | $\$$ |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| $(\mathbf{( 2 , 1 5 3 )}$ |  | $(610)$ |  | $(\mathbf{4 , 5 4 7 )}$ |  | $(905)$ |


| Net unrealized gains | 3,512 | 993 | 7,420 | 1,476 |
| :---: | :---: | :---: | :---: | :---: |
| Other available for sale investment securities: |  |  |  |  |
| Unrealized holding gains | 23,693 | 50,981 | 36,073 | 75,024 |
| Reclassification adjustment for gains included in net income | $(1,362)$ | (56) | $(1,770)$ | (64) |
| Net unrealized gains on securities | 22,331 | 50,925 | 34,303 | 74,960 |
| Income tax expense | $(8,486)$ | $(19,351)$ | $(13,036)$ | $(28,485)$ |
| Net unrealized gains | 13,845 | 31,574 | 21,267 | 46,475 |
| Prepaid pension cost: |  |  |  |  |
| Amortization of accumulated pension loss | 567 | 675 | 1,134 | 1,350 |
| Income tax expense | (215) | (250) | (431) | (500) |
| Pension loss amortization | 352 | 425 | 703 | 850 |

At June 30, 2010, accumulated other comprehensive income was $\$ 75.8$ million, net of tax. It was comprised of $\$ 13.5$ million in unrealized holding losses on available for sale debt securities for which a portion of OTTI has been recorded in earnings, $\$ 106.4$ million in unrealized holding gains on other available for sale securities, and $\$ 17.1$ million in accumulated pension loss.

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## 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, consumer debit and credit bank cards, and student lending. 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 Wealth segment provides traditional trust and estate tax planning, advisory and discretionary investment management, as well as brokerage services, and the Private Banking product portfolio.

The following table 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.

(In thousands) $\quad$ Consumer $\quad$ Commercial $\quad$ Wealth $\quad$\begin{tabular}{c}
Segment <br>
Totals

$\quad$

Other/ <br>
Elimination

 

Consolidated <br>
Totals
\end{tabular}

Three Months Ended
June 30, 2010:

| Net interest income | \$ | 80,420 | \$ | 63,871 | \$ | 11,006 | \$ | 155,297 | \$ | 7,811 | \$ | 163,108 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan losses |  | $(17,713)$ |  | $(4,193)$ |  | (163) |  | $(22,069)$ |  | (118) |  | $(22,187)$ |
| Non-interest income |  | 39,599 |  | 33,506 |  | 29,207 |  | 102,312 |  | (665) |  | 101,647 |
| Investment securities gains, net |  |  |  |  |  |  |  |  |  | 660 |  | 660 |
| Non-interest expense |  | $(73,738)$ |  | $(51,120)$ |  | $(26,679)$ |  | $(151,537)$ |  | $(4,445)$ |  | $(155,982)$ |
| Income before income taxe | \$ | 28,568 | \$ | 42,064 | \$ | 13,371 | \$ | 84,003 | \$ | 3,243 | \$ | 87,246 |

Three Months Ended
June 30, 2009:

| Net interest income | $\$$ | 83,003 | $\$$ | 60,495 | $\$$ | 10,356 | $\$$ | 153,854 | $\$$ | 3,591 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan losses | $(21,801)$ | $(14,089)$ | $(4)$ | $(35,894)$ | $(5,272)$ | $(41,166)$ |  |  |  |  |
| Non-interest income | 40,730 | 27,175 | 29,961 | 97,866 | 696 | 98,562 |  |  |  |  |
| Investment securities losses, |  |  |  |  |  |  |  |  |  |  |
| net |  |  |  |  |  | $(2,753)$ | $(2,753)$ |  |  |  |
| Non-interest expense | $(80,194)$ | $(49,428)$ | $(27,683)$ | $(157,305)$ | $(2,706)$ | $(160,011)$ |  |  |  |  |

Income before income taxes $\begin{array}{lllllllllll} & \$ 21,738 & \$ & 24,153 & \$ & 12,630 & \$ & 58,521 & \$ & (6,444) & \$\end{array}$

## Six Months Ended June 30, <br> 2010:

| Net interest income | \$ | 161,433 | \$ | 126,062 | \$ | 21,089 | \$ | 308,584 | \$ | 17,234 | \$ | 325,818 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan losses |  | $(36,991)$ |  | $(16,121)$ |  | (221) |  | $(53,333)$ |  | $(3,176)$ |  | $(56,509)$ |
| Non-interest income |  | 74,029 |  | 63,654 |  | 56,693 |  | 194,376 |  | 523 |  | 194,899 |
| Investment securities losses, net |  |  |  |  |  |  |  |  |  | $(3,005)$ |  | $(3,005)$ |
| Non-interest expense |  | $(146,873)$ |  | $(101,305)$ |  | $(53,452)$ |  | $(301,630)$ |  | $(10,139)$ |  | $(311,769)$ |
| Income before income taxes | \$ | 51,598 | \$ | 72,290 | \$ | 24,109 | \$ | 147,997 | \$ | 1,437 | \$ | 149,434 |

Six Months Ended June 30, 2009:

| Net interest income | $\$$ | 166,939 | $\$$ | 113,773 | $\$$ | 20,087 | $\$$ | 300,799 | $\$$ | 6,661 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan losses |  | $(42,420)$ |  | $(28,262)$ |  | $(275)$ |  | $(70,957)$ | $(13,377)$ |  |
| Non-interest income |  | 76,167 |  | 53,714 |  | 58,892 |  | 188,773 |  | 2,220 |
| N |  |  |  | $190,934)$ |  |  |  |  |  |  |
| Non |  |  |  |  |  |  |  |  |  |  |

Investment securities losses, net
$(4,925)$
Non-interest expense ( $\quad(153,018) \quad(96,544) \quad(53,881) \quad(303,443) \quad(9,454) \quad(312,897)$

Income before income taxes $\$ 47,668 \quad \$ \quad 42,681 \quad \$ \quad 24,823 \quad \$ \quad 115,172 \quad \$(18,875) \quad \$ \quad 96,297$

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

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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 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. In the second quarter of 2010, due to the prospect of continual low historical rates, the Company determined that the internal interest rate ascribed to business units for providing non-contractual deposit funds should be lowered to reflect present economic conditions. The resulting change to segment net interest income lowered total segment contribution and redistributed income among segments. The information for prior periods in the table above has been revised to incorporate these changes in order to provide comparable data.

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 loan charge-offs and recoveries 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. 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, mortgage loan commitments and forward sales contracts result from the Company s mortgage banking operation, in which fixed rate personal real estate loans are originated and sold to other institutions. The Company also contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps. The Company s risks and responsibilities as guarantor are further discussed in Note 5 on Guarantees.

| (In thousands) | June 30 | December 31 |  |
| :--- | ---: | ---: | ---: |
|  | $\mathbf{2 0 1 0}$ | 2009 |  |
| Interest rate swaps | $\mathbf{5 4 1 , 2 2 6}$ | $\$$ | 503,530 |
| Interest rate caps | $\mathbf{3 2 , 2 3 6}$ | 16,236 |  |
| Credit risk participation agreements | $\mathbf{6 3 , 4 5 3}$ | 53,246 |  |
| Foreign exchange contracts: | $\mathbf{2 4 , 3 4 0}$ | 17,475 |  |
| Forward contracts | $\mathbf{2 , 9 2 0}$ |  |  |
| Option contracts | $\mathbf{1 5 , 5 9 4}$ | 9,767 |  |
| Mortgage loan commitments | $\mathbf{2 3 , 9 2 5}$ | 19,986 |  |

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 June 30, 2010, the Company had entered into three interest rate swaps with a notional amount of $\$ 16.3$ million, 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

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loans in the accompanying statements of income. The table below shows gains and losses related to fair value hedges.


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-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 June 30, 2010 was $\$ 524.9$ million. The Company is party to master netting arrangements with its institutional counterparties; however, the effect of offsetting assets and liabilities under these arrangements is not significant. Collateral exchanges typically involve marketable securities.

The Company s interest rate swap arrangements with other 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 aggregate fair value of interest rate swap contracts with credit risk-related contingent features that were in a liability position on June 30,2010 was $\$ 21.4$ million, for which the Company had posted collateral of $\$ 19.5$ million. Most of these features require contract settlement, which if triggered on June 30, 2010 would have required a cash disbursement of $\$ 1.7$ million, in addition to collateral posted.

The banking customer counterparties are engaged in a variety of businesses, including real estate, building materials, communications, consumer products, and manufacturing. The manufacturing group is the largest, with a combined notional amount of $33.0 \%$ of the total customer swap portfolio. If this group of manufacturing counterparties failed to perform, and if the underlying collateral proved to be of no value, the Company would incur a loss of $\$ 5.5$ million, based on amounts at June 30, 2010.

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The fair values of the Company s derivative instruments are shown in the table below. Information about the valuation methods used to determine fair value is provided in Note 13 on Fair Value Measurements.

|  | Asset Derivatives |  |  | Liability Derivatives |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Bune 30 | Dec. 31 |  | June 30 | Dec. 31 |  |
| Balance | $\mathbf{2 0 1 0}$ | 2009 | Balance | $\mathbf{2 0 1 0}$ | 2009 |  |
| (In thousands) | Sheet |  | Sheet |  |  |  |
|  | Location | Fair Value | Location | Fair Value |  |  |

Derivatives designated as hedging instruments: Interest rate swaps

Total derivatives designated as hedging instruments

Derivatives not designated as hedging instruments:
Interest rate swaps

Interest rate caps
Credit risk participation agreements
Foreign exchange contracts:
Forward contracts
Option contracts
Mortgage loan commitments
Mortgage loan forward sale contracts

| Other assets | $\$ 21,679$ | $\$ 16,898$ | Other liabilities | $\mathbf{\$ 2 1 , 7 8 6 )}$ | $\$(16,898)$ |
| :--- | ---: | ---: | ---: | :--- | ---: | ---: |
| Other assets | $\mathbf{1 0 4}$ | 239 | Other liabilities | $\mathbf{( 1 0 4 )}$ | $(239)$ |
| Other assets | $\mathbf{1 2 3}$ | 140 | Other liabilities | $\mathbf{( 3 2 0 )}$ | $(239)$ |
|  |  |  |  |  |  |
| Other assets | $\mathbf{7 8 1}$ | 415 | Other liabilities | $\mathbf{( 2 4 6 )}$ | $(295)$ |
| Other assets <br> Other assets | $\mathbf{3 6 9}$ |  | Other liabilities | $\mathbf{( 3 )}$ |  |
| Other assets | $\mathbf{4}$ | 184 | Other liabilities |  | $(16)$ |
| Other liabilities | $\mathbf{( 1 8 6 )}$ | $(5)$ |  |  |  |

## Total derivatives not designated as hedging

 instruments \$ 22,963 \$ 17,920 \$ (22,645) \$ (17,692)Total derivatives

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

| (In thousands) | 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 June 30 |  | For the Six Months Ended June 30 |  |  |  |
|  |  | 2010 | 2009 |  | 2010 |  | 2009 |
| Derivatives in fair value hedging relationships: |  |  |  |  |  |  |  |
| Interest rate swaps | Interest and fees on loans | \$ (309) | \$ 558 |  | (390) |  | 633 |
| Total |  | \$ (309) | \$ 558 |  | (390) |  | 633 |
| Derivatives not designated as hedging instruments: |  |  |  |  |  |  |  |
| Interest rate swaps | Other non-interest income | \$ 269 | \$ (88) | \$ | 459 |  | 124 |
| Interest rate caps | Other non-interest income | 32 | 5 |  | 32 |  | 5 |
| Credit risk participation agreements | Other non-interest income | 8 | 4 |  | 13 |  | 9 |
| Foreign exchange contracts: |  |  |  |  |  |  |  |
| Forward contracts | Other non-interest income | 138 | 29 |  | 414 |  | (12) |
| Option contracts | Other non-interest income |  |  |  |  |  |  |
| Mortgage loan commitments | Loan fees and sales | 156 | (377) |  | 240 |  | (77) |
| Mortgage loan forward sale contracts | Loan fees and sales | (259) | 562 |  | (361) |  | 356 |
| Total |  | \$ 344 | \$ 135 |  | 797 |  | 405 |

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## 11. Income Taxes

For the second quarter of 2010, income tax expense amounted to $\$ 27.4$ million compared to $\$ 15.3$ million in the second quarter of 2009. The effective income tax rate for the Company, including the effect of non-controlling interest, was $31.5 \%$ in the current quarter compared to $29.2 \%$ in the same quarter last year. For the six months ended June 30, 2010 and 2009, income tax expense amounted to $\$ 45.8$ million and $\$ 28.8$ million, resulting in effective income tax rates of $30.6 \%$ and $29.8 \%$, respectively. Effective tax rates were higher in 2010 compared to 2009 mainly due to changes in the mix of taxable and non-taxable income on higher pre-tax income.

## 12. Stock-Based Compensation

Stock-based compensation expense that has been charged against income was $\$ 1.5$ million and $\$ 1.6$ million in the three months ended June 30, 2010 and 2009, respectively, and $\$ 3.4$ million and $\$ 3.2$ million in the six months ended June 30, 2010 and 2009, respectively. The Company has historically issued stock-based compensation in the form of options, stock appreciation rights (SARs) and nonvested stock. During 2009 and the first six months of 2010, stock-based compensation has been issued mainly in the form of nonvested stock awards.

The 2010 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 June 30, 2010 and changes during the six month period then ended is presented below.

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

SARs and stock options are granted with an exercise price equal to the market price of the Company s stock at the date of grant and have 10 -year contractual terms. SARs, which the Company granted in 2006 and subsequent years, vest on a graded basis over 4 years of continuous service. 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. 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. No SARs or options were granted during the first six months of 2010.

A summary of option activity during the first six months of 2010 is presented below.


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A summary of SAR activity during the first six months of 2010 is presented below.

| (Dollars in thousands, except per share data) | Shares | Weighted <br> Average <br> Exercise <br> Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
| :---: | :---: | :---: | :---: | :---: |
| Outstanding at January 1, 2010 | 1,669,753 | \$ 41.71 |  |  |
| Granted |  |  |  |  |
| Forfeited | $(7,256)$ | 40.57 |  |  |
| Expired | $(5,943)$ | 42.13 |  |  |
| Exercised | $(1,436)$ | 39.07 |  |  |
| Outstanding at June 30, 2010 | 1,655,118 | \$ 41.68 | 6.7 years | \$ |

## 13. 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.

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## 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.

## 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.

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## 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 June 30, 2010, the Company held certain auction rate securities (ARS) in its available for sale portfolio, totaling $\$ 152.1$ million. Nearly all of these securities were purchased from customers during the third quarter of 2008. The auction process by which the ARS are normally priced has not functioned since the first quarter of 2008, and the fair value of these securities cannot be based on observable market prices due to the illiquidity in the market. The fair values of the ARS are estimated using a discounted cash flows analysis. Estimated cash flows are based on mandatory interest rates paid under failing auctions and projected over an estimated market recovery period. The cash flows are discounted at an estimated market rate reflecting adjustments for liquidity premium and nonperformance risk. Because many 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 strading portfolio are priced by averaging several broker quotes for identical instruments, and are classified as Level 2 measurements.

## Private equity investments

These securities are held by the Company s venture capital subsidiaries and are included in non-marketable investment securities in the consolidated balance sheets. Valuation of these nonpublic investments requires significant management judgment due to the absence of quoted market prices. Each quarter, valuations are performed utilizing available market data and other factors. Market data includes published trading multiples for private equity investments of similar size. The multiples are considered in conjunction with current operating performance, future expectations, financing and sales transactions, and other investment-specific issues. The Company applies its valuation methodology consistently from period to period, and believes that its methodology is similar to that used by other market participants. These fair value measurements are classified as Level 3.

## 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

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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 an internally developed methodology which uses significant unobservable 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 carrying values of assets and liabilities measured at fair value on a recurring basis at June 30, 2010 and December 31, 2009. There were no transfers among levels during the first six months of 2010.

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

As of June 30, 2010
Assets:
Available for sale securities:

| U.S. government and federal agency obligations | $\mathbf{\$}$ | $\mathbf{4 5 4 , 6 1 9}$ | $\$$ | $\mathbf{4 4 7 , 2 0 4}$ | $\mathbf{\$ 7 , 4 1 5}$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Government-sponsored enterprise obligations |  | $\mathbf{2 4 2 , 5 9 1}$ |  | $\mathbf{2 4 2 , 5 9 1}$ |  |
| State and municipal obligations | $\mathbf{9 4 6 , 0 5 2}$ |  | $\mathbf{7 9 3 , 9 0 9}$ | $\mathbf{1 5 2 , 1 4 3}$ |  |
| Agency mortgage-backed securities | $\mathbf{2 , 0 4 5 , 3 4 1}$ |  | $\mathbf{2 , 0 4 5 , 3 4 1}$ |  |  |
| Non-agency mortgage-backed securities | $\mathbf{5 9 5 , 2 5 6}$ |  | $\mathbf{5 9 5 , 2 5 6}$ |  |  |
| Other asset-backed securities | $\mathbf{2 , 1 3 3 , 8 8 0}$ |  | $\mathbf{2 , 1 3 3 , 8 8 0}$ |  |  |
| Other debt securities | $\mathbf{1 8 5 , 2 0 9}$ |  | $\mathbf{1 8 5 , 2 0 9}$ |  |  |
| Equity securities | $\mathbf{4 6 , 9 4 2}$ | $\mathbf{2 9 , 4 2 9}$ | $\mathbf{1 7 , 5 1 3}$ |  |  |
| Trading securities | $\mathbf{1 7 , 2 4 5}$ |  | $\mathbf{1 7 , 2 4 5}$ |  |  |
| Private equity investments | $\mathbf{4 6 , 2 5 7}$ |  |  | $\mathbf{4 6 , 2 5 7}$ |  |
| Derivatives* | $\mathbf{2 2 , 9 6 3}$ |  | $\mathbf{2 2 , 5 6 7}$ | $\mathbf{3 9 6}$ |  |
| Assets held in trust | $\mathbf{3 , 6 1 9}$ | $\mathbf{3 , 6 1 9}$ |  |  |  |


| Total assets | $\mathbf{6 , 7 3 9 , 9 7 4}$ | $\mathbf{4 8 0 , 2 5 2}$ | $\mathbf{6 , 0 6 0 , 9 2 6}$ | $\mathbf{1 9 8 , 7 9 6}$ |
| :--- | :---: | :---: | :---: | :---: |
| Liabilities: |  |  |  |  |
| Derivatives* | $\mathbf{2 3 , 5 8 9}$ |  |  |  |
|  |  |  |  |  |
| Total liabilities | $\$$ | $\mathbf{2 3 , 8 8 9}$ | $\$$ | $\$$ |

As of December 31, 2009
Assets:
Available for sale securities:
U.S. government and federal agency obligations $\quad \$ \quad 447,038 \quad \$ 447,038$ \$
$\begin{array}{lll}\text { Government-sponsored enterprise obligations } & 165,814 & 165,814\end{array}$


* 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 <br> Significant Unobservable Inputs <br> (Level 3) |  |
| :---: | :---: | :---: |
| (In thousands) | State and | Private |
| Municipal | Equity |  |
| Obligations | Investments | Derivatives Total |

For the three months ended June 30, 2010:

| Balance at March 31, 2010 | \$ | 158,111 | \$ | 45,124 | \$ | (15) | \$ | 203,220 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total gains or losses (realized/unrealized): |  |  |  |  |  |  |  |  |
| Included in earnings |  |  |  | (25) |  | (95) |  | (120) |
| Included in other comprehensive income |  | $(4,920)$ |  |  |  |  |  | $(4,920)$ |
| Purchases, issuances, and settlements, net |  | $(1,048)$ |  | 1,158 |  |  |  | 110 |
| Balance at June 30, 2010 | \$ | 152,143 | \$ | 46,257 | \$ | (110) | \$ | 198,290 |
| 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 June 30, 2010 | \$ |  | \$ | (25) | \$ | 95 | \$ | 70 |

For the six months ended June 30, 2010:

| Balance at January 1, 2010 | \$ | 167,836 | \$ | 44,827 | \$ | 108 | \$ | 212,771 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total gains or losses (realized/unrealized): |  |  |  |  |  |  |  |  |
| Included in earnings |  |  |  | $(2,641)$ |  | (108) |  | $(2,749)$ |
| Included in other comprehensive income |  | $(13,407)$ |  |  |  |  |  | $(13,407)$ |
| Purchases, issuances, and settlements, net |  | $(2,286)$ |  | 4,071 |  | (110) |  | 1,675 |
| Balance at June 30, 2010 | \$ | 152,143 | \$ | 46,257 | \$ | (110) | \$ | 198,290 |

Total gains or losses for the six months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2010

## For the three months ended June 30, 2009:

Balance at March 31, 2009
Total gains or losses (realized/unrealized): Included in earnings
Included in other comprehensive income Purchases, issuances, and settlements, net

Balance at June 30, 2009

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 June 30, 2009

For the six months ended June 30, 2009:

| Balance at January 1, 2009 | \$ | 167,996 | \$ | 49,494 | \$ | 64 | \$ | 217,554 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total gains or losses (realized/unrealized): |  |  |  |  |  |  |  |  |
| Included in earnings |  |  |  | $(2,877)$ |  | 288 |  | $(2,589)$ |
| Included in other comprehensive income |  | 2,553 |  |  |  |  |  | 2,553 |
| Purchases, issuances, and settlements, net |  | (286) |  | $(3,597)$ |  | (105) |  | $(3,988)$ |
| Balance at June 30, 2009 | \$ | 170,263 | \$ | 43,020 | \$ | 247 | \$ | 213,530 |

Total gains or losses for the six months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2009

| $\$ 171,413$ | $\$$ | 48,284 | $\$$ | 58 | $\$$ | 219,755 |
| ---: | ---: | ---: | ---: | ---: | ---: | ---: |
|  |  | $(1,325)$ |  | 189 |  | $(1,136)$ |
| $(808)$ |  |  |  |  | $(808)$ |  |
| $(342)$ | $(3,939)$ |  |  |  | $(4,281)$ |  |

\$ 170,263 \$ 43,020 \$ 247 \$ 213,530
\$ $\$ \quad(1,325) \quad \$ \quad 407 \quad \$$
(918)
$(3,988)$
\$ 170,263 \$ 43,020 \$ 247 \$ 213,530
$\$ \quad \$ \quad(2,877) \quad \$ \quad 412 \quad \$$
$(2,465)$

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

|  |  | Investment <br> Securities |
| :---: | :---: | :---: |
| (In thousands) |  | Other |

For the three months ended June 30, 2010:

Total gains or losses included in earnings

Change in unrealized gains or losses relating to assets still held at June 30, 2010

For the six months ended June 30, 2010:

Total gains or losses included in earnings

Change in unrealized gains or losses relating to assets still held at June 30, 2010
\$

Change in unrealized gains or losses relating to assets still held at June 30, 2009

| $\$$ | 403 | $\$$ | 9 | $\$ 2,877)$ | $\$(2,465)$ |
| :--- | :--- | :--- | :--- | :--- | :--- |

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 June 30, 2010 and 2009 are shown in the table below.

## Loans held for sale

Loans held for sale are carried at the lower of cost or fair value. The portfolio consists primarily of student loans, and to a lesser extent, residential real estate loans. The Company s student loans are contracted for sale with the Federal Department of Education (DOE) and various investors in the secondary market. Beginning in 2008, the secondary market for student loans was disrupted by liquidity concerns.

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Consequently, several investors have been unable to consistently purchase loans under existing contractual terms. Loans under contract to these investors have been evaluated using a fair value measurement method based on a discounted cash flows analysis, which was classified as Level 3 and resulted in an impairment reserve of $\$ 828$ thousand at December 31, 2009. During the first six months of 2010, $\$ 434$ thousand of this reserve was reversed as certain of the related loans were sold. The remainder of the identified portfolio, for which performance concern remains, was carried at $\$ 12.6$ million at June 30, 2010. The measurement of fair value for the remaining student loans, most of which will be sold to the DOE, is based on the specific prices mandated in the underlying sale contracts, the estimated exit price, and is classified as Level 2. Fair value measurements on mortgage loans held for sale are based on quoted market prices for similar loans in the secondary market and are 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.

## 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, 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

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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.

For assets measured at fair value on a nonrecurring basis during the first six months of 2010 and 2009, and still held as of June 30, 2010 and 2009, the following table provides the adjustments to fair value recognized during the respective periods, the level of valuation assumptions used to determine each adjustment, and the carrying value of the related individual assets or portfolios at June 30, 2010 and 2009.

|  |  |  | alue Measur | nts Using |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Quoted |  |  |  |
|  |  | Prices in |  |  |  |
|  |  | Active |  |  | Total Gains |
|  |  | Markets for | Significant Other | Significant | (Losses) <br> Recognized |
|  |  | Identical | Observable | Unobservable | During the Six |
|  |  | Assets | Inputs | Inputs | Months Ended |
| (In thousands) | Fair Value | (Level | (Level 2) | (Level 3) | June 30 |

As of June 30, 2010
Loans
Mortgage servicing righ
Foreclosed assets

As of June 30, 2009
Loans
Private equity investments
\$ 60,103 \$ \$ \$ 60,103 \$
Mortgage servicing rights
2,250
Foreclosed assets
1,365
$1,440 \quad 1,440$
$(27,478)$

| \$ | $\mathbf{3 0 , 8 7 7}$ | $\$$ | $\$$ | $\mathbf{3 0 , 8 7 7}$ | $\$$ |
| ---: | ---: | ---: | ---: | ---: | ---: |
| $\mathbf{1 , 1 8 6}$ |  |  |  | $\mathbf{1 , 1 8 6}$ |  |
| $\mathbf{8 , 1 5 6}$ |  |  |  | $\mathbf{8 , 1 5 6}$ |  |

$(9,201)$
$(1,813)$

## 14. 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 value 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 .

## Investment Securities

A detailed description of the fair value measurement of the debt and equity instruments in the available for sale and trading sections of the investment security portfolio is provided in Note 13 on Fair Value

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Measurements. A schedule of available for sale securities by category and maturity is provided in Note 3 on Investment Securities.

## Federal Funds Sold and Securities Purchased under Agreements to Resell, Interest Earning Deposits With Banks and Cash and Due From Banks

The carrying amounts of federal funds sold and securities purchased under agreements to resell, interest earning deposits with banks, and cash and due from banks approximate fair value. Federal funds sold and securities purchased under agreements to resell generally mature in 90 days or less.

## Accrued Interest Receivable/Payable

The carrying amounts of accrued interest receivable and accrued interest payable approximate their fair values because of the relatively short time period between the accrual period and the expected receipt or payment due date.

## Derivative Instruments

A detailed description of the fair value measurement of derivative instruments is provided in Note 13 on Fair Value Measurements. Fair values are generally estimated using observable market prices or pricing models.

## 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. The fair value of 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.

## Borrowings

The fair value of short-term borrowings such as federal funds purchased and securities sold under agreements to repurchase, which generally mature or reprice within 90 days, approximates their carrying value. The fair value of long-term structured repurchase agreements and other long-term debt is estimated by discounting contractual maturities using an estimate of the current market rate for similar instruments.

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The estimated fair values of the Company s financial instruments are as follows:

|  | June 30, 2010 <br> Estimated <br> Carrying <br> Amount | Fair Value |
| :--- | ---: | ---: |
| (In thousands) |  |  |
|  |  |  |
| Financial Assets | $10,224,875$ | $\$ 10,262,604$ |
| Loans, including held for sale | $6,649,890$ | $6,649,890$ |
| Available for sale investment securities | 17,245 | 17,245 |
| Trading securities | 107,343 | 107,343 |
| Non-marketable securities | 9,300 | 9,300 |
| Federal funds sold and securities purchased under agreements to resell | 75,065 | 75,065 |
| Accrued interest receivable | 22,963 | 22,963 |
| Derivative instruments | 339,990 | 339,990 |
| Cash and due from banks | 302,354 | 302,354 |
| Interest earning deposits with banks |  |  |
|  |  |  |
|  |  |  |
| Financial Liabilities | $1,666,649$ | $\$$ |
| Non-interest bearing demand deposits | $9,631,428$ | $1,666,649$ |
| Savings, interest checking and money market deposits | $3,188,070$ | $9,631,428$ |
| Time open and C.D. s | $1,006,356$ | $1,006,592$ |
| Federal funds purchased and securities sold under agreements to repurchase | 363,997 | 385,971 |
| Other borrowings | 17,741 | 17,741 |
| Accrued interest payable | 23,889 | 23,889 |

## 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

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.

## 15. Pending Litigation

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On April 6, 2010 a suit was filed against Commerce Bank, N.A. (the Bank) in the U.S. District Court for the Western District of Missouri by a customer alleging that overdraft fees relating to debit card transactions have been unfairly assessed by the Bank. The suit seeks class-action status for Bank customers who may have been similarly affected. A second suit alleging the same facts and also seeking class-action status was filed on June 4, 2010 in Missouri state court. Since these cases are in a very early stage, a probable outcome is presently not determinable.

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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 2009 Annual Report on Form 10-K. Results of operations for the three and six month periods ended June 30, 2010 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 , variatio 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 judgments are necessary when financial 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 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 methodologies used in establishing the allowance is provided in the Provision and Allowance for Loan Losses section of this discussion.

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## 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, 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 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 13 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 can be derived from observable data. Such securities totaled approximately $\$ 6.0$ billion, or $90.5 \%$ of the available for sale portfolio at June 30, 2010, and were classified as Level 2 measurements. The Company also holds $\$ 152.1$ million in auction rate securities. These were classified as Level 3 measurements, as no market currently exists for these securities, and fair values were derived from internally generated cash flow valuation models which used unobservable inputs which were 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) must be recognized in current earnings. If neither condition is met, but the Company does not expect to recover the amortized cost basis, the Company must determine 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, must be 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 must consider available information about the collectability of the security, including information about past events, current conditions, and reasonable forecasts, which includes 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 June 30, 2010, non-agency guaranteed mortgage-backed securities with a par value of $\$ 178.0$ million were identified as other than temporarily impaired. The credit-related impairment loss on these securities amounted to $\$ 4.6$ million, which was recorded in the consolidated income statement in investment securities gains (losses), net. The noncredit-related loss on these securities, which was recorded in other comprehensive income, was $\$ 21.7$ million on a pre-tax basis.

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 are reported at fair value, and totaled $\$ 50.9$ million at June 30, 2010. Changes in fair value are reflected in current earnings, and reported in investment securities gains (losses), net in the consolidated income statements. Because there is no observable market data for these securities, their fair values are internally developed using
available information and management s judgment, and 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

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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.

## Selected Financial Data

## Per Share Data


(1) Includes loans held for sale.

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(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 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).

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## Results of Operations

## Summary

| (Dollars in thousands) | Three Months Ended June 30 |  |  |  |  | Six Months Ended June 30 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 |  | \% Change | 2010 |  | 2009 |  | \% <br> Change |
|  |  |  |  |  |  |  |  |  |  |  |
| Net interest income | \$ | 163,108 | \$ | 157,445 | 3.6\% | \$ | 325,818 | \$ | 307,460 | 6.0\% |
| Provision for loan losses |  | $(22,187)$ |  | $(41,166)$ | (46.1) |  | $(56,509)$ |  | $(84,334)$ | (33.0) |
| Non-interest income |  | 101,647 |  | 98,562 | 3.1 |  | 194,899 |  | 190,993 | 2.0 |
| Investment securities gains (losses), net |  | 660 |  | $(2,753)$ | N.M. |  | $(3,005)$ |  | $(4,925)$ | (39.0) |
| Non-interest expense |  | $(155,982)$ |  | $(160,011)$ | (2.5) |  | $(311,769)$ |  | $(312,897)$ | (.4) |
| Income taxes |  | $(27,428)$ |  | $(15,257)$ | 79.8 |  | $(45,805)$ |  | $(28,849)$ | 58.8 |
| Non-controlling interest (expense) income |  | (84) |  | 148 | N.M. |  | 275 |  | 356 | (22.8) |
| Net income | \$ | 59,734 | \$ | 36,968 | 61.6\% | \$ | 103,904 | \$ | 67,804 | 53.2\% |

For the quarter ended June 30, 2010, net income amounted to $\$ 59.7$ million, an increase of $\$ 22.8$ million, or $61.6 \%$, compared to the second quarter of the previous year. For the current quarter, the annualized return on average assets was $1.33 \%$, the annualized return on average equity was $12.21 \%$, and the efficiency ratio was $58.48 \%$. Diluted earnings per share was $\$ .71$, an increase of $54.3 \%$ compared to $\$ .46$ per share in the second quarter of 2009 . Compared to the second quarter of last year, net interest income increased $\$ 5.7$ million, or $3.6 \%$, due to lower rates paid on interest bearing deposits and higher average balances of investment securities, partly offset by lower loan balances and investment yields. In addition, non-interest income increased $\$ 3.1$ million, mainly due to $25.1 \%$ growth in bank card transaction fees. Compared to the same period last year, non-interest expense decreased $\$ 4.0$ million, or $2.5 \%$, which included declines of $\$ 8.0$ million in deposit insurance expense and $\$ 1.4$ million in supplies and communication costs, partly offset by a $\$ 2.5$ million increase in data processing and software costs and the reversal of certain Visa litigation charges of $\$ 1.7$ million. The provision for loan losses totaled $\$ 22.2$ million for the current quarter, representing a decrease of $\$ 19.0$ million from the second quarter of 2009.

Net income for the first six months of 2010 was $\$ 103.9$ million, an increase of $\$ 36.1$ million, or $53.2 \%$, over the same period in the previous year. For the first six months of 2010, the annualized return on average assets was $1.16 \%$, the annualized return on average equity was $10.79 \%$, and the efficiency ratio was $59.47 \%$. Diluted earnings per share was $\$ 1.24$, an increase of $47.6 \%$ over $\$ .84$ per share in the same period last year. Compared to the first six months of 2009, net interest income grew $\$ 18.4$ million, or $6.0 \%$. Non-interest income grew $\$ 3.9$ million, or $2.0 \%$, largely due to an increase of $\$ 12.9$ million in bank card transaction fees, which was partially offset by smaller declines in deposit account fees, bond trading income, consumer brokerage services, and loan fees and sales. Non-interest expense remained well-controlled, declining $\$ 1.1$ million compared to the same period last year. The provision for loan losses
totaled $\$ 56.5$ million, down $\$ 27.8$ million, or $33.0 \%$, compared to the same period last year.

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## 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 thousads) | Three Months Ended June 30, 2010 vs. 2009 Change due to |  |  | Six Months Ended June 30, 2010 vs. 2009 |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | Chan | due to |
|  | Average Volume | Average <br> Rate | Total | Average Volume | Average Rate |

Interest income, fully taxable equivalent basis:
Loans
Loans held for sale
Investment securities:
U.S. government and federal agency securities
State and municipal obligations
Mortgage and asset-backed securities
Other securities

| $\$(11,265)$ | $\$$ | $(1,235)$ | $\$(12,500)$ | $\$(23,274)$ | $\$$ | $(568)$ | $\$(23,842)$ |
| :---: | :---: | :---: | :---: | :---: | :---: | ---: | ---: |
| 165 | 133 | 298 | 352 | $(1,582)$ | $(1,230)$ |  |  |


| 3,851 | $(52)$ | 3,799 | 8,013 | $(2,180)$ |
| :---: | ---: | ---: | ---: | ---: |
| $(171)$ | $(765)$ | $(936)$ | 1,761 | $(982)$ |
|  |  |  |  |  |
| 6,564 | $(10,973)$ | $(4,409)$ | 24,564 | $(24,660)$ |
| $(198)$ | $(280)$ | $(478)$ | 100 | $(187)$ |

5,833
779

Total interest on investment securities

$$
10,046
$$

$$
(12,070)
$$

$$
(2,024) \quad 34,438
$$

$$
(28,009)
$$

$$
6,429
$$

Federal funds sold and securities purchased under agreements to resell
(28) 5
(23) (172) 50 (122)

Interest earning deposits with banks
27

121
148
(236)
(236)

Total interest income
$(1,055) \quad(13,046)$
$(14,101)$
11,108
$(30,109)$
$(19,001)$

Interest expense:
Deposits:
Savings
14
(45)
(31) 31 (103)
(72)

Interest checking and money market

$$
\begin{array}{cc}
1,611 & (1,847)  \tag{236}\\
(2,479) & (6,007
\end{array}
$$

3,162
$(4,563)$
$(4,314)$
$(1,152)$
$(16,418)$

Time open \& C.D. s of less than \$100,000
Time open \& C.D. s of $\$ 100,000$ and over

Total interest on deposits

$$
(2,217) \quad(4,136) \quad(6,353) \quad(5,442) \quad(8,288)
$$

$(13,730)$
$(3,071) \quad(12,035)$
$(15,106)$
$(6,812)$
$(24,560)$
$(31,372)$

Federal funds purchased and securities sold under agreements to repurchase

| 101 | $(124)$ | $(23)$ | 247 | $(680)$ |
| :---: | :---: | ---: | :---: | :---: |
| $(3,514)$ | $(961)$ | $(4,475)$ | $(5,536)$ | $(755)$ |

Other borrowing

Total interest expense
$(6,484)$
$(13,120)$
$(19,604)$
$(12,101) \quad(25,995)$
$(38,096)$

Net interest income, fully taxable $\begin{array}{lllllllllllll}\text { equivalent basis } & \$ & 5,429 & \$ & 74 & \$ & 5,503 & \$ & 23,209 & \$ & (4,114) & \$ & 19,095\end{array}$

Net interest income for the second quarter of 2010 was $\$ 163.1$ million, a $\$ 5.7$ million, or $3.6 \%$, increase over the second quarter of 2009. The increase in net interest income was primarily the result of lower interest expense on interest bearing deposits and other borrowings due to lower average rates and balances, which were partly offset by lower earnings on the loan and investment securities portfolios. The Company s tax

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equivalent net interest rate margin was $3.97 \%$ for the second quarter of 2010 compared to $3.91 \%$ in the second quarter of 2009 .

Total interest income, on a tax equivalent basis (T/E), decreased $\$ 14.1$ million, or $6.92 \%$, from the second quarter of 2009. Interest income on loans (T/E) declined $\$ 12.5$ million, primarily due to a decrease of $\$ 1.0$ billion, or $9.7 \%$, in average loan balances. The decrease in average loans compared to the second quarter of 2009 occurred in all categories except consumer credit cards, as loan demand remained weak and commercial line of credit usage remained low. Interest income from consumer loans decreased from the second quarter of 2009 due to a decline of $15.2 \%$, or $\$ 227.6$ million, in average consumer loans coupled with a 15 basis point decrease in average rates earned. Included in the decrease in average consumer loan balances was a decline in marine and RV loans of $\$ 148.1$ million, as loan paydowns exceeded new loan originations. Average business loans decreased $\$ 379.1$ million and average business real estate loans decreased $\$ 145.6$ million compared to the second quarter of 2009. Additionally, average construction loan balances decreased $\$ 182.6$ million and average personal real estate loan balances decreased $\$ 112.3$ million compared to second quarter 2009. Interest income on investment securities (T/E) decreased $\$ 2.0$ million from the second quarter of 2009. This decrease resulted mainly from a 103 basis point decline in average rates earned, partly offset by a $\$ 1.2$ billion, or $23.9 \%$, increase in average balances. The average yield on the investment portfolio declined to $3.67 \%$ compared to $4.70 \%$ during the second quarter of 2009, reducing interest income by $\$ 12.1$ million. Most of the offsetting growth in average balances occurred in mortgage and asset-backed securities and U.S. Treasury inflation-protected securities (TIPS), which increased by $\$ 740.7$ million and $\$ 425.8$ million, respectively. The average tax equivalent yield on total interest earning assets was $4.49 \%$ in the second quarter of 2010 compared to $4.91 \%$ in the second quarter of 2009 .

Total interest expense decreased $\$ 19.6$ million, or $47.2 \%$, compared to the second quarter of 2009 , primarily due to a $\$ 15.1$ million decrease in interest expense on interest bearing deposits, coupled with a $\$ 4.5$ million decrease in interest expense on other borrowings. The decrease in interest expense on deposits resulted from a 131 basis point decrease in average rates paid on certificates of deposit less than $\$ 100,000$ and a 90 basis point decrease in average rates paid on certificates of deposit greater than $\$ 100,000$, coupled with a decrease of $\$ 1.1$ billion, or $26.8 \%$ in total average certificate of deposit balances. Interest expense on other borrowings declined mainly due to lower FHLB advances, which declined $\$ 357.0$ million, or $41.9 \%$. The overall average rate incurred on all interest bearing liabilities decreased to $.59 \%$ in the second quarter of 2010 compared to $1.12 \%$ in the second quarter of 2009.

Net interest income for the first six months of 2010 was $\$ 325.8$ million compared to $\$ 307.5$ million for the same period in 2009. For the six months of 2010, the net yield on total interest earning assets on a tax equivalent basis was $4.00 \%$ compared to $3.87 \%$ in the first six months of 2009 . The increase in net interest income for the first six months in 2010 compared to the same period in 2009 reflected trends similar to the quarterly discussion above. Interest expense decreased $\$ 38.1$ million, or $44.6 \%$, which was partially offset by a decrease in interest income (T/E) of $\$ 19.0$ million, or $4.7 \%$.

Total interest income (T/E) for the first six months of 2010 decreased from the same period last year primarily due to lower interest earned on the loan portfolio, partially offset by a slight increase in interest earned on investment securities. Loan interest income (T/E) declined $\$ 23.8$ million, largely due to a $\$ 1.1$ billion, or $9.9 \%$, decline in total average loan balances. As noted above, declines occurred in all loan categories except consumer credit card loans. Investment securities interest income (T/E) increased $\$ 6.4$ million and resulted from an increase in average investment securities balances of $\$ 1.7$ billion, or $38.3 \%$, partially offset by a 114 basis point decrease in average rates earned.

The decrease of $\$ 38.1$ million in interest expense for the six months of 2010 compared to the same period in the prior year was primarily due to a decrease of 51 basis points in the average rate incurred on total interest bearing deposits. A $\$ 1.1$ billion decline in average certificates of deposit balances, which carry higher interest rates, also lowered interest expense. These effects were partly offset by a $\$ 1.5$ billion increase in average interest checking and money market
deposit balances. Additionally, average balances of other borrowings, which is mostly comprised of FHLB borrowings, decreased $\$ 421.8$ million, or $40.6 \%$, contributing to the decrease in interest expense. For the first six months of 2010, the overall cost of interest bearing liabilities decreased 52 basis points to $.64 \%$ compared to $1.16 \%$ in the same period in the prior year.

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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) | Three Months Ended June 30 |  |  |  |  | Six Months Ended June 30 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2010 |  | 2009 |  | \% Change | 2010 |  | 2009 |  | \% |
|  |  |  | Change |  |  |  |  |  |
| Bank card transaction fees | \$ | 37,659 |  |  | \$ | 30,105 | 25.1\% | \$ | 70,149 | \$ | 57,273 | 22.5\% |
| Deposit account charges and other fees |  | 25,472 |  | 26,935 | (5.4) |  | 49,453 |  | 52,527 | (5.9) |
| Trust fees |  | 20,358 |  | 19,355 | 5.2 |  | 39,676 |  | 38,228 | 3.8 |
| Bond trading income |  | 5,387 |  | 6,538 | (17.6) |  | 10,391 |  | 12,342 | (15.8) |
| Consumer brokerage services |  | 2,372 |  | 2,826 | (16.1) |  | 4,489 |  | 5,726 | (21.6) |
| Loan fees and sales |  | 3,472 |  | 3,733 | (7.0) |  | 5,311 |  | 6,694 | (20.7) |
| Other |  | 6,927 |  | 9,070 | (23.6) |  | 15,430 |  | 18,203 | (15.2) |
| Total non-interest income | \$ | 101,647 | \$ | 98,562 | 3.1\% | \$ | 194,899 | \$ | 190,993 | 2.0\% |

Non-interest income as a \% of total revenue*
$\mathbf{3 8 . 4 \%} \quad 38.5 \%$
37.4\%
$38.3 \%$

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

For the second quarter of 2010 , total non-interest income amounted to $\$ 101.6$ million compared with $\$ 98.6$ million in the same quarter last year, which was an increase of $\$ 3.1$ million, or $3.1 \%$. Bank card fees for the quarter increased $\$ 7.6$ million, or $25.1 \%$, over the second quarter of last year, primarily due to continued growth in transaction fees earned on corporate card, debit card and merchant activity, which grew by $64.9 \%, 14.0 \%$ and $12.1 \%$, respectively. The growth in corporate card fees continued to result from both new customer transactions and increased volumes from existing customers. Debit card fees in the current quarter comprised $38.7 \%$ of total bank card fees, while corporate card fees comprised $33.2 \%$ of total fees. Trust fees for the quarter increased $\$ 1.0$ million, or $5.2 \%$, over the same quarter last year and resulted from growth in both personal and institutional trust business, but continued to be negatively affected by low interest rates on money market investments held in trust accounts. Deposit account fees declined $\$ 1.5$ million, or $5.4 \%$, from the same period last year as a result of a $7.8 \%$ decline in overdraft fee income. Corporate cash management fees, which comprised $32.1 \%$ of total deposit account fees in the current quarter, were essentially flat compared to the same period in the previous year. Bond trading income for the current quarter totaled $\$ 5.4$ million, a decrease of $\$ 1.2$ million, or $17.6 \%$. Consumer brokerage services revenue decreased $\$ 454$ thousand, or $16.1 \%$, mainly due to a $47.1 \%$ decline in money market mutual fund fees. Loan fees and sales revenue decreased $\$ 261$ thousand, or $7.0 \%$, due to lower gains on student loan sales but partly offset by higher loan commitment fees. Other
non-interest income for the current quarter decreased $\$ 2.1$ million, or $23.6 \%$, from the same quarter last year, partly due to an impairment charge of $\$ 969$ thousand on a downtown Kansas City office building which is vacant and held for sale. In addition, cash sweep commissions and equipment rental income declined in the current quarter. Partly offsetting these declines were higher fees from sales of interest rate swaps and international letters of credit.

Non-interest income for the six months ended June 30 , 2010 was $\$ 194.9$ million compared to $\$ 191.0$ million in the first six months of 2009 , resulting in an increase of $\$ 3.9$ million, or $2.0 \%$. Bank card fees increased $\$ 12.9$ million, or $22.5 \%$, as a result of growth of $56.9 \%, 13.1 \%$, and $12.0 \%$ in corporate card, debit card, and merchant fees, respectively. Deposit account fees decreased $\$ 3.1$ million, or $5.9 \%$, due to an $8.9 \%$ decline in overdraft fee revenue. Trust fee income increased $\$ 1.4$ million as a result of growth in personal and institutional trust fees, offset by lower corporate fees. Consumer brokerage revenue declined $\$ 1.2$ million, or $21.6 \%$, mainly due to lower mutual fund fees. Bond trading income declined $\$ 2.0$ million, or $15.8 \%$, due to lower sales volume, while loan fees and sales decreased by $\$ 1.4$ million, largely due to a $\$ 1.5$ million decline in gains on student loan sales. Other non-interest income decreased $\$ 2.8$ million and included declines in cash sweep commissions and equipment rental income, in addition to the impairment

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charge mentioned above. These decreases were partially offset by higher tax credit sales income and letters of credit fees.

## Investment Securities Gains (Losses), Net

Net gains and losses on investment securities which were recognized in earnings during the three and six months ended June 30, 2010 and 2009 are shown in the table below. Net securities gains of $\$ 660$ thousand were recorded in the second quarter of 2010, while net securities losses of $\$ 3.0$ million were recorded in the first six months of 2010 . 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 $\$ 178.0$ million at June 30, 2010. During the current quarter, additional credit-related impairment losses of $\$ 676$ thousand were recorded, bringing the total credit-related impairment losses during the first six months of 2010 to $\$ 2.1$ million. The cumulative credit-related impairment loss on these securities, recorded in earnings, amounted to $\$ 4.6$ million, while the cumulative noncredit-related loss on these securities, which has been recorded in other comprehensive income (loss), was $\$ 21.7$ 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 venture capital 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 reported as non-controlling interest in the consolidated income statement, resulting in income of \$430 thousand for the first six months of 2010 and $\$ 609$ thousand for the same period last year.

| (In thousands) | Three Months Ended June 30 |  |  |  | Six Months Ended June 30 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 010 |  | 2009 |  | 2010 |  | 2009 |
| Available for sale: |  |  |  |  |  |  |  |  |
| Municipal bonds | \$ | 480 | \$ | (2) | \$ | 888 | \$ |  |
| Corporate bonds |  | 498 |  | (17) |  | 498 |  | (11) |
| Non-agency mortgage-backed bonds |  | 383 |  |  |  | 383 |  |  |
| Other asset-backed bonds |  |  |  | 75 |  |  |  | 75 |
| OTTI losses on non-agency mortgage-backed bonds |  | (676) |  | (794) |  | $(2,133)$ |  | $(1,347)$ |
| Non-marketable: |  |  |  |  |  |  |  |  |
| Private equity investments |  | (25) |  | $(2,015)$ |  | $(2,641)$ |  | $(3,642)$ |
| Total investment securities gains (losses), net | \$ | 660 | \$ | $(2,753)$ | \$ | $(3,005)$ | \$ | $(4,925)$ |

## Non-Interest Expense

|  | Three Months Ended June 30 |  |  | Six Months Ended June 30 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  | \% |
| (Dollars in thousands) | $\mathbf{2 0 1 0}$ | 2009 | Change | $\mathbf{2 0 1 0}$ | 2009 | Change |


| Salaries and employee benefits | $\mathbf{\$ 8 7 , 1 0 8}$ | $\$$ | 86,279 | $1.0 \%$ | $\mathbf{\$ 1 7 4 , 5 4 6}$ | $\$ 173,032$ | $.9 \%$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Net occupancy | $\mathbf{1 1 , 5 1 3}$ |  | 11,088 | 3.8 | $\mathbf{2 3 , 6 1 1}$ | 22,900 | 3.1 |
| Equipment | $\mathbf{5 , 9 3 8}$ |  | 6,255 | $(5.1)$ | $\mathbf{1 1 , 8 3 9}$ | 12,577 | $(5.9)$ |
| Supplies and communication | $\mathbf{6 , 8 2 9}$ | 8,249 | $(17.2)$ | $\mathbf{1 4 , 1 6 7}$ | 16,933 | $(16.3)$ |  |
| Data processing and software | $\mathbf{1 7 , 4 9 7}$ |  | 15,007 | 16.6 | $\mathbf{3 4 , 1 0 3}$ | 29,354 | 16.2 |
| Marketing | $\mathbf{5 , 0 0 2}$ | 4,906 | 2.0 | $\mathbf{9 , 7 2 0}$ | 9,253 | 5.0 |  |
| Deposit insurance | $\mathbf{4 , 9 3 9}$ | 12,969 | $(61.9)$ | $\mathbf{9 , 6 8 9}$ | 17,075 | $(43.3)$ |  |
| Other | $\mathbf{1 7 , 1 5 6}$ | 15,258 | 12.4 | $\mathbf{3 4 , 0 9 4}$ | 31,773 | 7.3 |  |
|  |  |  |  |  |  |  |  |
| Total non-interest expense | $\$ \mathbf{1 5 5 , 9 8 2}$ | $\$ 160,011$ | $(2.5) \%$ | $\$ \mathbf{3 1 1 , 7 6 9}$ | $\$ 312,897$ | $(.4) \%$ |  |

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Non-interest expense for the second quarter of 2010 amounted to $\$ 156.0$ million, a decrease of $\$ 4.0$ million, or $2.5 \%$, compared with $\$ 160.0$ million recorded in the second quarter of last year. Salaries and benefits expense was well controlled in the current quarter, increasing $\$ 829$ thousand, or $1.0 \%$, over the same quarter last year, but included additional 401 K plan expense of $\$ 1.6$ million tied to improved Company performance. Full-time equivalent employees totaled 5,051 at June 30, 2010 compared to 5,181 at June 30, 2009. Occupancy costs increased $\$ 425$ thousand, or $3.8 \%$, over the same quarter last year, primarily due to higher real estate tax expense. Equipment expense decreased $\$ 317$ thousand, or $5.1 \%$, from the same quarter last year due to lower depreciation expense on data processing equipment. Supplies and communication expense declined $\$ 1.4$ million, or $17.2 \%$, due to lower courier, supplies and telecommunication costs, while marketing costs increased slightly. Data processing and software costs increased $\$ 2.5$ million, or $16.6 \%$, mainly as a result of higher bank card processing costs (related to higher bank card revenues), higher student loan servicing costs and other upgraded IT related systems. FDIC insurance expense totaled $\$ 4.9$ million, a decrease of $\$ 8.0$ million, or $61.9 \%$, from the same period last year due to a special assessment levied by the FDIC in the second quarter of 2009 which did not reoccur in 2010 . Other non-interest expense increased $\$ 1.9$ million, or $12.4 \%$, over the same quarter last year due to higher write-downs and holding costs on foreclosed real estate and personal property, in addition to higher legal and professional fees. These increases to expense were partly offset by a $\$ 1.7$ million reduction in an indemnification obligation relating to Visa litigation.

For the first six months of 2010, non-interest expense amounted to $\$ 311.8$ million, a decrease of $\$ 1.1$ million, or $.4 \%$, compared with $\$ 312.9$ million in the same period last year. Salaries and benefits expense grew $\$ 1.5$ million overall due to a $.9 \%$ rise in salaries expense and higher 401 K expense, partly offset by lower health care costs. Occupancy costs increased $\$ 711$ thousand, or $3.1 \%$, primarily resulting from higher real estate taxes and higher seasonal maintenance costs. Equipment costs decreased $\$ 738$ thousand mainly due to lower depreciation on data processing equipment. Supplies and communication expense declined $\$ 2.8$ million, or $16.3 \%$ due to lower courier and telecommunication costs. Data processing and software costs grew $\$ 4.7$ million, largely due to the same factors noted in the quarterly comparison. Deposit insurance decreased $\$ 7.4$ million mainly due to the special assessment by the FDIC in 2009. Other non-interest expense increased $\$ 2.3$ million and included higher write-downs and other expenses on foreclosed property, legal and professional fees, and bank card related expenses. These increases to expense were partially offset by the Visa indemnification reversal mentioned above.

## Provision and Allowance for Loan Losses

(In thousands)
Provision for loan losses

| Three Months Ended |  |  |
| :---: | :---: | :---: |
| June 30 | March 31 | June 30 |
| $\mathbf{2 0 1 0}$ | 2010 | 2009 |

## Six Months Ended June 30 <br> 2010 <br> 2009

\$ 22,187 \$ 34,322 \$ 41,166 \$ 56,509 \$ 84,334

Net loan charge-offs (recoveries):
Business
Real estate-construction and land
Real estate-business
Consumer credit card
Consumer
Home equity
Student

| $\mathbf{2 , 2 2 3}$ | 267 | 2,378 | $\mathbf{2 , 4 9 0}$ | 6,220 |
| ---: | ---: | ---: | ---: | ---: |
| $\mathbf{4 8 0}$ | 10,966 | 10,373 | $\mathbf{1 1 , 4 4 6}$ | 19,599 |
| $\mathbf{1 , 0 2 2}$ | 431 | 1,033 | $\mathbf{1 , 4 5 3}$ | 1,809 |
| $\mathbf{1 2 , 3 3 8}$ | 13,065 | 13,214 | $\mathbf{2 5 , 4 0 3}$ | 23,977 |
| $\mathbf{4 , 7 4 3}$ | 5,524 | 8,476 | $\mathbf{1 0 , 2 6 7}$ | 17,809 |
| $\mathbf{6 5 0}$ | 580 | 96 | $\mathbf{1 , 2 3 0}$ | 396 |
|  | 3 | 2 | $\mathbf{3}$ | 2 |

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|  | Three Months Ended |  |  | Six Months Ended June 30 |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | June 30 | March 31 | June 30 |  |  |
|  | 2010 | 2010 | 2009 | 2010 | 2009 |
| Annualized net loan charge-offs*: |  |  |  |  |  |
| Business | . $31 \%$ | .04\% | .29\% | .18\% | .38\% |
| Real estate-construction and land | . 34 | 7.02 | 5.54 | 3.84 | 5.04 |
| Real estate-business | . 20 | . 08 | . 19 | . 14 | . 17 |
| Consumer credit card | 6.71 | 6.95 | 7.60 | 6.83 | 6.75 |
| Consumer | 1.50 | 1.71 | 2.27 | 1.61 | 2.33 |
| Home equity | . 54 | . 48 | . 08 | . 51 | . 16 |
| Real estate-personal | . 14 | . 05 | . 05 | . 10 | . 10 |
| Overdrafts | 12.71 | 12.11 | 11.47 | 12.40 | 9.02 |
| Total annualized net loan charge-offs | .91\% | 1.27\% | 1.33\% | 1.09\% | 1.30\% |

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 reserves needed for pools of loans with similar risk characteristics.

Loans subject to individual evaluation are defined by the Company as impaired, and generally consist of business, construction, commercial real estate and personal real estate loans on non-accrual status or loans modified or restructured under troubled debt restructuring. These loans are evaluated individually for impairment, and in conjunction with current economic conditions and loss experience, allowances are estimated. Loans not individually evaluated are aggregated and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic factors, loan risk ratings and industry concentrations.

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 process of determining adequate levels of the allowance for loan losses is subject to regular review by the Company s Credit Administration personnel and outside regulators.

Net loan charge-offs for the second quarter of 2010 amounted to $\$ 22.2$ million, compared with $\$ 31.3$ million in the prior quarter and $\$ 36.0$ million in the second quarter of last year. The $\$ 9.1$ million decrease in net loan charge-offs in the second quarter of 2010 compared to the previous quarter was mainly the result of lower loan losses on construction loans of $\$ 10.5$ million, coupled with lower losses on consumer banking and consumer credit card loans of $\$ 781$ thousand and $\$ 727$ thousand, respectively. Net loan charge-offs on business loans increased $\$ 2.0$ million over the previous quarter but remained low at $.31 \%$ of average business loans outstanding. The ratio of annualized total net loan charge-offs to total average loans was $.91 \%$ in the current quarter, compared to $1.3 \%$ in both the previous quarter
and the same quarter last year.
For the second quarter of 2010, annualized net charge-offs on average consumer credit card loans amounted to $6.71 \%$, compared with $6.95 \%$ in the previous quarter and $7.60 \%$ in the same period last year. Consumer loan net charge-offs for the quarter amounted to $1.50 \%$ of average consumer loans, compared to $1.71 \%$ in the previous quarter and $2.27 \%$ in the same quarter last year.

The provision for loan losses for the current quarter totaled $\$ 22.2$ million, matching net loan charge-offs for the quarter. The current quarter provision was $\$ 12.1$ million lower than the previous quarter and $\$ 19.0$ million lower than the same quarter last year. The amount of the provision in each quarter was determined by management s review and analysis of the adequacy of the allowance for loan losses, involving all the activities and factors described above regarding that process. The provision in the current quarter was influenced by lower incurred losses within the loan portfolio and lower overall loan balances.

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Net charge-offs during the first six months of 2010 were $\$ 53.5$ million compared to $\$ 71.0$ million in the same period of 2009. The $\$ 17.5$ million decrease was due to declines in net charge-offs of business loans of $\$ 3.7$ million, construction loans of $\$ 8.2$ million and consumer loans of $\$ 7.5$ million. The decreases were slightly offset by an increase in the net charge-offs in consumer credit cards of $\$ 1.4$ million and home equity loans of $\$ 834$ thousand. The provision for loan losses was $\$ 56.5$ million in the first six months of 2010 compared to $\$ 84.3$ million in the same period in 2009.

The allowance for loan losses at June 30, 2010 totaled $\$ 197.5$ million, and was unchanged from the previous quarter. At June 30, 2010, the allowance was $2.03 \%$ of total loans, excluding loans held for sale, and $219 \%$ of total non-accrual loans. The Company considers the allowance for loan losses adequate to cover losses inherent in the loan portfolio at June 30, 2010.

## 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.

|  | June 30 <br> (Dollars in thousands) | December 31 <br> 2010 |  |
| :--- | ---: | ---: | ---: |
|  |  |  |  |
| Non-accrual loans: | $\mathbf{1 0 , 9 2 5}$ | $\$$ | 12,874 |
| Business | $\mathbf{5 3 , 3 2 6}$ | 62,509 |  |
| Real estate construction and land | $\mathbf{1 7 , 5 2 3}$ | 21,756 |  |
| Real estate business | $\mathbf{8 , 4 9 3}$ | 9,384 |  |
| Real estate personal |  | 90 |  |
| Consumer | $\mathbf{9 0 , 2 6 7}$ | 106,613 |  |
|  |  |  |  |
| Total non-accrual loans | $\mathbf{1 2 , 9 2 0}$ |  |  |
|  |  | 10,057 |  |
| Foreclosed real estate | $\mathbf{1 0 3 , 1 8 7}$ | $\$$ | 116,670 |
|  |  |  |  |
| Total non-performing assets | $\mathbf{1 . 0 6 \%}$ |  |  |
|  | $\mathbf{5 6 \%}$ | $1.15 \%$ |  |
| Non-performing assets as a percentage of total loans |  | $.64 \%$ |  |

Loans past due 90 days and still accruing interest:

| Business | \$ | 698 | \$ | 3,672 |
| :---: | :---: | :---: | :---: | :---: |
| Real estate construction and land |  | 1,255 |  | 1,184 |
| Real estate business |  | 933 |  | 402 |
| Real estate personal |  | 4,833 |  | 3,102 |
| Consumer |  | 1,224 |  | 2,045 |
| Home equity |  | 858 |  | 878 |
| Student |  | 17,073 |  | 14,346 |
| Consumer credit card |  | 15,441 |  | 17,003 |
| Total loans past due 90 days and still accruing interest | \$ | 42,315 | \$ | 42,632 |

Non-accrual loans, which are also considered to be impaired, totaled $\$ 90.3$ million at June 30, 2010, and decreased $\$ 16.3$ million from amounts recorded at December 31, 2009. The decline from December 31, 2009 occurred mainly in construction and land real estate and business real estate non-accrual loans, which decreased $\$ 9.2$ million and $\$ 4.2$ million, respectively. At June 30, 2010, non-accrual loans were comprised

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mainly of construction and land real estate loans (59.1\%), business real estate loans (19.4\%) and business loans $(12.1 \%)$. Foreclosed real estate increased $\$ 2.9$ million to a balance of $\$ 12.9$ million at June 30, 2010.

Total loans past due 90 days or more and still accruing interest amounted to $\$ 42.3$ million as of June 30 , 2010, which included $\$ 17.1$ million in federally guaranteed student loans. The balance of loans 90 days past due or more decreased slightly when compared to December 31, 2009, resulting mainly from decreases of $\$ 3.0$ million in business and $\$ 1.6$ million in consumer credit card loan delinquencies, offset by increases of $\$ 2.7$ million and $\$ 1.7$ million in student loan and personal real estate loan delinquencies, respectively.

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 primarily 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 $\$ 279.9$ million at June 30, 2010 compared with $\$ 319.9$ million at December 31, 2009, resulting in a decrease of $\$ 40.0$ million, or $12.5 \%$. The decrease was largely due to declines of $\$ 38.7$ million in construction and land real estate loans and $\$ 13.5$ million in business loans, partially offset by an increase of $\$ 15.8$ million in business real estate loans.

|  | June 30 | December 31 |
| :--- | :---: | :---: |
| (In thousands) | $\mathbf{2 0 1 0}$ | 2009 |

Potential problem loans:

| Business | \$ | 79,739 | \$ | 93,256 |
| :---: | :---: | :---: | :---: | :---: |
| Real estate construction and land |  | 76,556 |  | 115,251 |
| Real estate business |  | 114,782 |  | 98,951 |
| Real estate personal |  | 8,396 |  | 12,013 |
| Consumer |  | 397 |  | 409 |
| Total potential problem loans | \$ | 279,870 | \$ | 319,880 |

At June 30, 2010, the Company had identified approximately $\$ 121.5$ 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, $\$ 26.9$ million have been placed on non-accrual status. Of the remaining $\$ 94.6$ million, approximately $\$ 77.6$ million were commercial loans (business, construction and business real estate) classified as substandard, which were renewed at interest rates equal to or higher than the previous rates in effect. The new rates, however, 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 $\$ 17.0$ million in troubled debt restructurings were composed of certain credit card loans under various debt management and assistance programs.

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Within the total loan portfolio, certain sectors are considered at higher risk due to their contractual features and collateral values that could increase credit exposure in the present economic environment. Additional information about the major types of loans in these categories and their risk feature is provided below. Loan-to-value (LTV) ratio information was generally calculated using valuations at loan origination date.

## Real Estate Construction and Land Loans

The Company s portfolio of construction loans, as shown in the table below, amounted to $5.6 \%$ of total loans outstanding at June 30, 2010. Balances in this portfolio decreased $\$ 119.8$ million, or $18.0 \%$, since December 31, 2009, mainly a reflection of the slower economy. Also contributing to the decline in balances were $\$ 11.0$ million in net loan charge offs in the first quarter of 2010, whereas in the second quarter of 2010 there was vastly improved loss experience, with only $\$ 480$ thousand in net loan charge offs.

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|  | June 30 |  | \% of <br> Total | December 31 |  | \% of |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total |  |  |  |  |  |  |

## Real Estate Business Loans

Total business real estate loans were $\$ 2.0$ billion at June 30, 2010 and comprised $20.8 \%$ 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 $50 \%$ of these loans were for owner-occupied real estate properties, which present lower risk profiles.

| (In thousands) | June 30 |  | \% of Total | $\begin{aligned} & \% \text { of } \\ & \text { Total } \end{aligned}$ | December 31 |  | \% of Total | \% of <br> Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Loans |  | 2009 | Loans |  |
| Owner-occupied |  | 1,019,186 |  | 50.4\% | 10.5\% | \$ | 1,101,870 | 52.4\% | 10.9\% |
| Industrial |  | 97,000 | 4.8 | 1.0 |  | 142,745 | 6.8 | 1.4 |
| Office |  | 258,897 | 12.8 | 2.6 |  | 214,408 | 10.2 | 2.1 |
| Retail |  | 200,709 | 9.9 | 2.1 |  | 210,619 | 10.0 | 2.1 |
| Multi-family |  | 134,055 | 6.6 | 1.4 |  | 112,664 | 5.3 | 1.1 |
| Farm |  | 125,425 | 6.2 | 1.3 |  | 131,245 | 6.2 | 1.3 |
| Hotels |  | 107,078 | 5.3 | 1.1 |  | 115,056 | 5.5 | 1.1 |
| Other |  | 80,713 | 4.0 | . 8 |  | 75,423 | 3.6 | . 7 |
| Total real estate business |  |  |  |  |  |  |  |  |
| loans |  | 2,023,063 | 100.0\% | 20.8\% | \$ | 2,104,030 | 100.0\% | 20.7\% |

## Real Estate Personal Loans

The Company s $\$ 1.5$ billion personal real estate loan portfolio is composed of loans collateralized with residential real estate. Included in this portfolio are personal real estate loans made to commercial customers, totaling $\$ 247.7$ million at June 30, 2010. The remainder of the personal real estate portfolio, totaling $\$ 1.2$ billion at June 30, 2010, is comprised of conventional mortgage loans to the retail customer base. In order to reduce risk exposure, the Company does not offer option ARM or junior lien mortgage products within this larger group. Only $1.8 \%$ were structured with interest only payments. Loans originated with interest only payments were not made to qualify the borrower for a lower payment amount. These loans are 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. The Company has $\$ 169.6$ million, or $13.9 \%$, of the loans in this group with no mortgage insurance that also have an LTV greater than $80 \%$ as of June 30, 2010 compared to $\$ 182.8$ million, or $14.4 \%$, at December 31, 2009. The decrease was mainly due to increased customer refinancings.

## Revolving Home Equity Loans

The Company also has $\$ 484.6$ million in revolving home equity loans at June 30, 2010, that are generally collateralized by residential real estate. Most of these loans ( $95.7 \%$ ) 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 June 30, 2010, the outstanding principal of loans with an LTV higher than $80 \%$ was

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$\$ 81.7$ million compared to $\$ 86.7$ million as of December 31, 2009. Loan balances over 30 days past due with interest only payments within the revolving home equity loan portfolio amounted to $\$ 1.2$ million, or $.3 \%$, at June 30,2010 compared to $\$ 2.1$ million, or $.4 \%$ at December 31, 2009.

## Fixed Rate Home Equity Loans

The Company also offers a fixed rate home equity loan product, typically for home repair or remodeling. This product is an alternative for individuals who want to finance a specific project or purchase, and decide to lock in a specific monthly payment over a defined period. This portfolio of loans approximated $\$ 139.8$ million and $\$ 132.7$ million at June 30, 2010 and December 31, 2009, respectively. At the end of the second quarter of 2010, $\$ 44.3$ million of this portfolio had an LTV over $80 \%$, down slightly from $\$ 44.9$ million at the end of 2009.

At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, such loans totaled less than $8 \%$ of the outstanding balance of fixed rate home equity loans at June 30, 2010. Since 2008, the Company has limited the offering of fixed rate home equity loans with LTV ratios over $90 \%$. As a result, $\$ 4.3$ million in new fixed rate home equity loans were written with LTV ratios over $90 \%$ during the first six months of 2010, mainly to high net worth individuals.

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 in the first six months of 2010 of $\$ 716$ thousand, $\$ 1.2$ million and $\$ 299$ 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 loan products, which is defined as those offerings made to customers with a FICO score below 650, and has purchased no brokered loans.

## Other Consumer Loans

Within the consumer loan portfolio are several direct and indirect product lines, comprised of automobile and marine and recreational vehicles (RV). Outstanding balances for these loans were $\$ 970.5$ million and $\$ 1.1$ billion at June 30, 2010 and December 31, 2009, respectively. The balances over 30 days past due amounted to $\$ 12.8$ million at June 30, 2010 compared to $\$ 22.4$ million at the end of 2009. For the six months ended June 30, 2010, $\$ 81.4$ million of new loans, mostly automobile loans, were originated, compared to $\$ 159.9$ million during the full year of 2009 . The Company experienced rapid growth in marine and RV loans outstanding during 2006 through 2008. However, due to continuing weak credit and economic conditions, this loan product offering was curtailed in mid 2008.

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at June 30, 2010 of $\$ 775.7$ million in consumer credit card loans outstanding, approximately $\$ 162.5$ million, or $20.9 \%$, carried a low introductory rate. Within the next six months, $\$ 100.8$ 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.

## Income Taxes

Income tax expense was $\$ 27.4$ million in the second quarter of 2010 , compared to $\$ 18.4$ million in the first quarter of 2010 and $\$ 15.3$ million in the second quarter of 2009. The Company s effective income tax rate, including the effect of non-controlling interest, was $31.5 \%$ in the second quarter of 2010 , compared with $29.4 \%$ in the first quarter of 2010 and $29.2 \%$ in the second quarter of 2009 . Additionally, income tax expense was $\$ 45.8$ million in the first six months
of 2010 compared to $\$ 28.8$ million in the previous year, resulting in effective income tax rates, including the effect of non-controlling interest, of $30.6 \%$ and $29.8 \%$, respectively. Effective tax rates were higher in 2010 compared to 2009 mainly due to changes in the mix of taxable and non-taxable income on higher pre-tax income.

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## Financial Condition

## Balance Sheet

Total assets of the Company were $\$ 18.4$ billion at June 30, 2010 compared to $\$ 18.1$ billion at December 31, 2009 . Earning assets (excluding fair value adjustments on investment securities) amounted to $\$ 17.2$ billion at June 30, 2010 consisting of $60 \%$ in loans and $39 \%$ in investment securities, compared to $\$ 16.9$ billion at December 31, 2009.

At June 30, 2010, total loans, excluding loans held for sale, decreased $\$ 410.3$ million, or $4.0 \%$, compared with balances at December 31, 2009. The decrease occurred across all loan categories. Construction loans and business real estate loans declined $\$ 200.7$ million. Personal real estate loans decreased $\$ 71.8$ million and consumer loans, mainly comprised of automobile and marine and RV loans, declined $\$ 81.4$ million. The decrease in loan balances was the result of principal loan pay-downs exceeding new loan originations for these products as borrowers continue to react to the difficult economy by reducing line of credit usage and overall debt levels, resulting in lower origination demand. Also, the Company has ceased most marine and RV lending.

Loans held for sale, comprised mostly of student loans, increased $\$ 144.8$ million compared to December 31, 2009 due to new loan originations. Regulatory changes effective July 2010 preclude the Company from continuing to make federally guaranteed student loans. The Company sold $\$ 218.0$ million of student loans in July 2010, recording a gain of $\$ 3.3$ million at that time, and expects to sell most of the remaining held for sale loans later this year.

Available for sale investment securities, excluding fair value adjustments, increased $\$ 262.6$ million, or $4.2 \%$, at June 30, 2010 compared to December 31, 2009. U.S. government and federal agency securities increased $\$ 78.0$ million, or $13.0 \%$, and other asset-backed securities increased $\$ 434.3$ million, or $25.8 \%$. These increases were partially offset by a decrease in mortgage-backed securities of $\$ 278.0$ million. At June 30, 2010, the duration of the available for sale investment portfolio was 1.6 years and maturities of approximately $\$ 1.9$ billion are expected to occur during the next twelve months. In July 2010, the Company purchased $\$ 500.0$ million of mortgage-backed securities in the TBA market, which settle in August through October 2010.

Interest earning deposits with banks, representing balances with the Federal Reserve Bank, totaled $\$ 302.4$ million at June 30, 2010, an increase of $\$ 278.2$ million over amounts recorded at December 31, 2009. This increase resulted from keeping temporary excess cash at the Federal Reserve until such balances can be reinvested to improve earning asset yields.

Deposits at June 30, 2010 totaled $\$ 14.5$ billion, a $\$ 275.7$ million, or $1.9 \%$, increase compared to $\$ 14.2$ billion at December 31, 2009. This increase was primarily due to higher interest bearing demand deposits (savings, interest checking and money market accounts), which increased $\$ 428.5$ million, or $4.7 \%$. Certificates of deposit less than $\$ 100,000$ decreased $\$ 124.1$ million, or $6.9 \%$, from balances at the previous year end, while certificates of deposit greater than $\$ 100,000$ increased $\$ 98.4$ million, or $7.0 \%$. Non-interest bearing demand deposits decreased $\$ 127.2$ million, or $7.1 \%$.

The Company s short-term borrowings of federal funds purchased and securities sold under agreements to repurchase were $\$ 1.0$ billion at June 30, 2010, an $8.8 \%$ decline compared to $\$ 1.1$ billion at the previous year end. At June 30, 2010, the Company s other borrowings, consisting mainly of advances from the FHLB, decreased $\$ 372.1$ million, or $50.5 \%$, from December 31, 2009 mainly due to maturities of these advances.

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## Liquidity and Capital Resources

## Liquidity Management

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

| (In thousands) | $\begin{gathered} \text { June } 30 \\ 2010 \end{gathered}$ |  | March 31 2010 |  | $\begin{gathered} \text { December } 31 \\ 2009 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Liquid assets: |  |  |  |  |  |  |
| Federal funds sold | \$ | 9,300 | \$ | 500 | \$ | 22,590 |
| Securities purchased under agreements to resell |  |  |  |  |  |  |
| Available for sale investment securities |  | 6,649,890 |  | 6,256,242 |  | 6,340,975 |
| Balances at the Federal Reserve Bank |  | 302,354 |  | 7,818 |  | 24,118 |
| Total | \$ | 6,961,544 | \$ | 6,264,560 | \$ | 6,387,683 |

Federal funds sold and securities purchased under agreements to resell totaled $\$ 9.3$ million at June 30, 2010. These investments normally have overnight maturities and are used for general daily liquidity purposes. Interest earning balances at the Federal Reserve Bank, which also have overnight maturities, totaled $\$ 302.4$ million at June 30, 2010. The average interest rate earned on these balances during the first six months of 2010 was 25 basis points. The fair value of the available for sale investment portfolio was $\$ 6.6$ billion at June 30, 2010 and included an unrealized net gain of $\$ 149.9$ million. The total net unrealized gain included gains of $\$ 72.6$ million on mortgage and asset-backed securities, $\$ 16.7$ million on U.S. government securities, $\$ 9.7$ million on state and municipal obligations, and $\$ 13.2$ million on corporate debt. An additional $\$ 34.0$ million unrealized gain was included in the fair value of common stock held by the Parent.

The portfolio includes maturities of approximately $\$ 1.9$ 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 June 30, 2010, total investment securities pledged for these purposes were as follows:

|  |  |
| :--- | :---: |
| (In thousands) | June 30 |
| 2010 |  |

Investment securities pledged for the purpose of securing:
Federal Reserve Bank borrowings
\$ 972,951
FHLB borrowings and letters of credit 315,454
Securities sold under agreements to repurchase ..... 1,325,058
Other deposits ..... 1,089,964
Total pledged securities ..... 3,703,427
Unpledged and available for pledging ..... 2,006,788
Ineligible for pledging ..... 939,675
Total available for sale securities, at fair value ..... \$ 6,649,890

Liquidity is also available from the Company s large base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At June 30, 2010, such deposits totaled $\$ 11.3$ billion and represented $78.0 \%$ 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 $\$ 1.5$ billion at

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June 30, 2010. These accounts are normally considered more volatile and higher costing, and comprised $10.4 \%$ of total deposits at June 30, 2010.

| (In thousands) | $\begin{gathered} \text { June } 30 \\ 2010 \end{gathered}$ |  | $\begin{gathered} \text { March } 31 \\ 2010 \end{gathered}$ |  | $\begin{gathered} \text { December } 31 \\ 2009 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Core deposit base: |  |  |  |  |  |  |
| Non-interest bearing demand | \$ | 1,666,649 | \$ | 1,583,090 | \$ | 1,793,816 |
| Interest checking |  | 626,667 |  | 610,819 |  | 735,870 |
| Savings and money market |  | 9,004,761 |  | 8,886,150 |  | 8,467,046 |
| Total | \$ | 11,298,077 | \$ | 11,080,059 | \$ | 0,996,732 |

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) | $\begin{gathered} \text { June } 30 \\ 2010 \end{gathered}$ |  | $\begin{gathered} \text { March } 31 \\ 2010 \end{gathered}$ |  | $\begin{gathered} \text { December } 31 \\ 2009 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Borrowings: |  |  |  |  |  |  |
| Federal funds purchased | \$ | 23,685 | \$ | 73,965 | \$ | 62,130 |
| Securities sold under agreements to repurchase |  | 982,671 |  | 924,808 |  | 1,041,061 |
| FHLB advances |  | 356,359 |  | 723,849 |  | 724,386 |
| Subordinated debentures |  |  |  |  |  | 4,000 |
| Other long-term debt |  | 7,638 |  | 7,658 |  | 7,676 |
| Total | \$ | 1,370,353 | \$ | 1,730,280 |  | 1,839,253 |

Federal funds purchased and securities sold under agreements to repurchase are generally borrowed overnight, and amounted to $\$ 1.0$ billion at June 30, 2010. 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 $\$ 482.7$ million at June 30,2010 , and structured repurchase agreements of $\$ 500.0$ million purchased from an upstream financial institution. The Company also borrows on a secured basis through advances from the FHLB, which totaled $\$ 356.4$ million at June 30, 2010. Most of these advances have fixed interest rates and mature in 2010 through 2017. Other outstanding long-term borrowings relate mainly to the

Company s leasing activities and private equity investments.

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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 June 30, 2010:

June 30, 2010
Federal

## (In thousands)

FHLB Reserve
\$ 2,013,834 \$ 1,831,655
Collateral value pledged
Advances outstanding
Letters of credit issued
$(547,476)$

## Available for future advances

\$ 1,109,999 \$ 1,831,655

In addition to those mentioned above, several other sources of liquidity are available. The subsidiary bank has strong long-term deposit ratings from Moody s and Standard \& Poor s of Aa2 and A+, respectively. Additionally, the Company s sound commercial paper rating of A-1 from Standard \& Poor s and 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 debt offerings. Financing may also include the issuance of common or preferred stock. As mentioned below, the Company concluded a stock sale program in the third quarter of 2009 which generated $\$ 100.0$ million in gross sales proceeds.

Cash and cash equivalents (defined as Cash and due from banks , Federal funds sold and securities purchased under agreements to resell, and Interest earning deposits with banks as segregated in the accompanying balance sheets) was $\$ 651.6$ million at June 30, 2010 compared to $\$ 463.8$ million at December 31, 2009. The $\$ 187.8$ million increase included changes in the various cash flows resulting from the operating, investing and financing activities of the Company, as shown in the accompanying statement of cash flows for June 30, 2010. Operating activities include net income adjusted for certain non-cash items, in addition to changes in the levels of loans held for sale and securities held for trading purposes. During the first six months of 2010, operating activities provided cash of $\$ 94.7$ million, partly due to activity in these portfolios. Investing activities, which occur mainly in the loan and investment securities portfolios, provided cash of $\$ 325.5$ million. Most of the cash inflow was due to $\$ 1.0$ billion in proceeds from sales, maturities and pay downs of investment securities and a $\$ 356.8$ million decline in the loan portfolio, partly offset by $\$ 1.0$ billion in purchases of investment securities. Financing activities used cash of $\$ 232.4$ million, resulting mainly from repayments of $\$ 372.1$ million on long-term borrowings and a $\$ 96.8$ million decrease in overnight borrowings, which was partly offset by an increase of $\$ 269.9$ million in deposit accounts. 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

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cash flow needs.

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## 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:

| Minimum |  |  |  |
| :---: | :---: | :---: | :---: |
| Ratios |  |  |  |
| for |  |  |  |
| (Dollars in thousands) | June 30 | December 31 | Well-Capitalized |
| Banks |  |  |  |

Risk-adjusted assets
Tier I risk-based capital
Total risk-based capital
Tier I risk-based capital ratio
Total risk-based capital ratio
Tier I leverage ratio

| $\$ \mathbf{1 2 , 6 1 4 , 8 5 6}$ | $\$$ | $13,105,948$ |  |
| ---: | ---: | ---: | ---: |
| $\mathbf{1 , 7 8 0 , 4 9 2}$ | $1,708,901$ |  |  |
| $\mathbf{1 , 9 5 3 , 9 8 8}$ | $1,885,978$ |  |  |
| $\mathbf{1 4 . 1 1 \%}$ | $13.04 \%$ | $6.00 \%$ |  |
| $\mathbf{1 5 . 4 9 \%}$ | $14.39 \%$ | $10.00 \%$ |  |
| $\mathbf{1 0 . 0 1 \%}$ |  | $9.58 \%$ | $5.00 \%$ |

The Company maintains a treasury stock buyback program, and in February 2008 was authorized by the Board of Directors to repurchase up to $3,000,000$ shares of its common stock. Since 2008, the Company has elected to substantially reduce its market purchases of treasury stock in order to preserve its cash and capital position. Accordingly, during the quarter ended June 30, 2010, the Company purchased only 1,566 shares of treasury stock, in connection with its equity compensation plan, at an average cost of $\$ 41.14$ per share. At June 30, 2010, $2,838,118$ shares remained available for purchase under the current Board authorization.

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 paid a per share cash dividend of $\$ .235$ in the first quarter of 2010 , which was a $2.6 \%$ increase compared to the fourth quarter of 2009 , and maintained the same payout in the second quarter of 2010.

## Common Equity Offering

On February 27, 2009, the Company entered into an equity distribution agreement with a broker dealer, acting as the Company s sales agent, relating to the offering of the Company s common stock. Sales of these shares were made by means of brokers transactions on or through the Nasdaq Global Select Market, trading facilities of national securities associations or alternative trading systems, block transactions and such other transactions as agreed upon by the Company and the sales agent, at market prices prevailing at the time of the sale or at prices related to the prevailing market prices. On July 31, 2009, the Company terminated the offering.

Total shares sold under the offering amounted to $2,894,773$. Total gross proceeds for the entire offering were $\$ 100.0$ million, with an average sale price of $\$ 34.55$ per share, and total commissions paid to the sales agent for the sale of these shares were $\$ 1.5$ million. After payment of commissions and SEC, legal and accounting fees relating to the offering, net proceeds for the entire offering totaled $\$ 98.2$ million, with average net sale proceeds of $\$ 33.91$ per share.

## Commitments, Off-Balance Sheet Arrangements and Contingencies

Various commitments and contingent liabilities arise in the normal course of business, which are not required to be recorded on the balance sheet. The most significant of these are loan commitments, which at June 30, 2010 totaled $\$ 6.9$ billion (including approximately $\$ 3.3$ billion in unused approved credit card lines). In addition, the Company enters into standby and commercial letters of credit. These contracts amounted to $\$ 386.8$ million and $\$ 23.5$ million, respectively, at June 30, 2010. Since 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 $\$ 3.4$ million at June 30, 2010.

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The Company has committed to borrow $\$ 400.0$ million under structured repurchase agreements in August 2010. These borrowings have a floating interest rate based upon a CMS rate and will mature in 2013 through 2014. They will largely replace several other structured repurchase agreements which will mature in August 2010. These types of borrowings are secured with marketable securities.

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 six months of 2010, purchases and sales of tax credits amounted to $\$ 20.6$ million and $\$ 27.6$ million, respectively, and at June 30, 2010, outstanding purchase commitments totaled $\$ 127.7$ million.

The Parent has additional funding commitments arising from investments in private equity concerns, classified as non-marketable securities in the accompanying balance sheets, which total $\$ 1.3$ million at June 30, 2010. In addition, the Parent expects to fund $\$ 27.9$ million to venture capital 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.

A complaint was filed seeking monetary damages and injunctive relief in the United States District Court for the Western District of Missouri on April 6, 2010 which alleges that Commerce Bank breached its contractual obligation of good faith and fair dealing and was unjustly enriched through the manner by which it charged overdraft fees for certain debit card purchases. The plaintiff seeks to establish a class comprised of all persons or entities with accounts that incurred these allegedly improper overdraft fees on debit card transactions for an unspecified period of time. The case has been transferred to the United States District Court for the Southern District of Florida where nearly identical lawsuits against more than thirty other banks are currently pending. A suit alleging the same facts and also seeking class-action status was filed in Missouri state court on June 4, 2010. The Company believes the claims to be without merit and intends to defend these actions vigorously.

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## Segment Results

The table below is a summary of segment pre-tax income results for the first six months of 2010 and 2009. The information for 2009 has been revised to reflect changes in the funds transfer pricing as mentioned in Note 9 to the consolidated financial statements.

(In thousands) Consumer Commercial $\quad$ Wealth $\quad$\begin{tabular}{c}
Segment <br>
Totals

$\quad$

Other/
\end{tabular} Consolidated

| Six Months Ended June 30, 2010: |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Net interest income | \$ | 161,433 | \$ | 126,062 | \$ | 21,089 | \$ | 308,584 | \$ | 17,234 | \$ | 325,818 |
| Provision for loan |  |  |  |  |  |  |  |  |  |  |  |  |
| losses |  | $(36,991)$ |  | $(16,121)$ |  | (221) |  | $(53,333)$ |  | $(3,176)$ |  | $(56,509)$ |
| Non-interest income |  | 74,029 |  | 63,654 |  | 56,693 |  | 194,376 |  | 523 |  | 194,899 |
| Investment securities |  |  |  |  |  |  |  |  |  |  |  |  |
| losses, net |  |  |  |  |  |  |  |  |  | $(3,005)$ |  | $(3,005)$ |
| Non-interest expense |  | $(146,873)$ |  | $(101,305)$ |  | $(53,452)$ |  | $(301,630)$ |  | $(10,139)$ |  | $(311,769)$ |

Income before income

| taxes | $\$$ | 51,598 | $\$$ | 72,290 | $\$$ | 24,109 | $\$$ | 147,997 | $\$$ | 1,437 | $\$$ | 149,434 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Six Months Ended June 30, 2009:

| Net interest income | $\$$ | 166,939 | $\$$ | 113,773 | $\$$ | 20,087 | $\$$ | 300,799 | $\$$ |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Provision for loan |  |  |  | 6,661 | $\$$ | 307,460 |  |  |  |
| losses | $(42,420)$ | $(28,262)$ | $(275)$ |  | $(70,957)$ | $(13,377)$ | $(84,334)$ |  |  |
| Non-interest income | 76,167 | 53,714 | 58,892 | 188,773 | 2,220 | 190,993 |  |  |  |
| Investment securities |  |  |  |  |  | $(4,925)$ | $(4,925)$ |  |  |
| losses, net |  |  |  |  |  | $(3,454)$ | $(312,897)$ |  |  |
| Non-interest expense | $(153,018)$ | $(96,544)$ | $(53,881)$ | $(303,443)$ | $(9,4)$ |  |  |  |  |

Income before income
$\begin{array}{llllllllllll}\text { taxes } & \$ & 47,668 & \$ & 42,681 & \$ & 24,823 & \$ 115,172 & \$(18,875) & \$ & 96,297\end{array}$

Increase (decrease) in income before income taxes:
$\begin{array}{lllllllllllllll}\text { Amount } & \$ & 3,930 & \$ & 29,609 & \$ & (714) & \$ & 32,825 & \$ & 20,312 & \$ & 53,137\end{array}$

| Percent | $8.2 \%$ | $69.4 \%$ | $(2.9) \%$ | $28.5 \%$ | N.M. | $55.2 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |

## Consumer

For the six months ended June 30, 2010, income before income taxes for the Consumer segment increased $\$ 3.9$ million, or $8.2 \%$, over the first six months of 2009. This increase was mainly due to a decline of $\$ 6.1$ million, or $4.0 \%$, in non-interest expense, coupled with a decline of $\$ 5.4$ million in net loan charge-offs. Net interest income declined $\$ 5.5$ million due to a $\$ 15.3$ million decrease in net allocated funding credits assigned to the Consumer segment s loan and deposit portfolios and a $\$ 13.2$ million decrease in loan interest income, partly offset by a decline of $\$ 23.0$ million in deposit interest expense. Non-interest income decreased $\$ 2.1$ million, or $2.8 \%$, from the first six months of 2009 mainly due to declines in deposit account fees (mainly overdraft charges) and mortgage banking revenue, in addition to lower gains on the sales of student loans. These declines were partly offset by an increase in bank card fee income (primarily debit card fees). The decline in non-interest expense was largely due to lower FDIC insurance expense, teller services expense and loan servicing fees, partly offset by higher marketing expense and corporate management fees. Net loan charge-offs totaled $\$ 37.0$ million, a $\$ 5.4$ million decrease from the first six months of 2009 , which was due mainly to lower losses on marine and RV and other consumer loans, partly offset by higher consumer credit card loan losses.

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## Commercial

For the six months ended June 30, 2010, income before income taxes for the Commercial segment increased $\$ 29.6$ million, or $69.4 \%$, compared to the same period in the previous year. Net interest income increased $\$ 12.3$ million, or $10.8 \%$, due to higher net allocated funding credits of $\$ 21.4$ million and a decrease in deposit interest expense of $\$ 1.6$ million, which were partly offset by a $\$ 10.7$ million decline in loan interest income. Net loan charge-offs in this segment totaled $\$ 16.1$ million in the first six months of 2010, a decrease of $\$ 12.1$ million from the first six months of 2009. During 2010, lower charge-offs occurred on construction and business loans. Non-interest income increased by $\$ 9.9$ million, or $18.5 \%$, over the previous year due to higher bank card fees (mainly corporate card). Smaller increases occurred in loan commitment fees and tax credit sales income, which were partly offset by lower cash sweep commissions. Non-interest expense increased $\$ 4.8$ million, or $4.9 \%$, over the previous year, mainly due to an increase in bank card fee expense and higher write-downs and holding costs on foreclosed real estate and personal property. These increases were partly offset by lower costs for FDIC insurance and deposit account processing.

## Wealth

Wealth segment pre-tax profitability for the six months ended June 30, 2010 decreased $\$ 714$ thousand, or $2.9 \%$, from the same period in the previous year. Net interest income increased $\$ 1.0$ million, or $5.0 \%$, and was impacted by a $\$ 6.8$ million decline in deposit interest expense, offset by a $\$ 4.5$ million decrease in assigned net funding credits and a $\$ 1.3$ million decrease in loan interest income. Non-interest income declined $\$ 2.2$ million, or $3.7 \%$, from the prior year due to lower bond trading income, brokerage fees and cash sweep commissions, partly offset by higher trust fee income. Non-interest expense decreased $\$ 429$ thousand, mainly due to lower FDIC insurance expense, partly offset by higher corporate management fees.

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 excess of the total provision over charge-offs is not allocated to a business segment, and is included in this category. The pre-tax profitability of this category was higher than in the previous period by $\$ 20.3$ million. This increase was mainly due to a decline in the unallocated loan loss provision of $\$ 10.2$ million. In addition, net interest income in this category, related to earnings of the investment portfolio and interest expense on borrowings not allocated to a segment, increased $\$ 10.6$ million and unallocated amounts related to investment securities losses decreased $\$ 1.9$ million.

The regular annual review on January 1, 2010 for goodwill impairment indicated that the fair value of each segment was substantially in excess of its carrying value. No triggering events were subsequently identified which required a review during the first six months of 2010.

## Regulatory Changes Affecting Student Lending

In the past, the Company has originated federally guaranteed student loans from various colleges and universities in its markets which it holds for sale in its loan portfolio. In March 2010, the federal government passed legislation that made the federal government the sole originator of federally subsidized student loans beginning July 1, 2010. These new rules effectively require the Company to cease all new origination activities for federal Stafford and Plus student loans as of July 1, 2010. The existing student loans held for sale continue to be sold as in the past under existing sales contracts.

## Regulatory Changes Affecting Overdraft Fees

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In late 2009, the Federal Reserve issued new regulations, effective July 1, 2010, which generally prohibit financial institutions from assessing fees for paying ATM and one-time debit card transactions that overdraw consumer accounts unless the consumer affirmatively consents to the financial institution s overdraft practices. As a result, without such consent, the Company will not permit ATM or one-time debit card transactions if they would overdraw a customer s account. As it is not expected that all customers will provide such consent, it is likely that these new regulations will result in lower deposit fee income in the second half of

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2010 and in 2011. The Company has begun to implement new procedures to solicit and capture required customer consents and effective July 1, 2010, began prohibiting such ATM and one-time debit card transactions causing overdrafts, unless an opt-in consent has been received. In concert with the rest of the industry, the Company is also developing other products and has begun offering some deposit accounts with monthly fees as a means to mitigate some of the effects of these new rules. The Company estimates that the impact of these new regulations during the second half of 2010 will reduce pre-tax deposit fee income by as much as $\$ 13$ million. The Company estimates that the full year impact of these regulations will cost between $\$ 16$ million and $\$ 21$ million on a pre-tax basis.

## Regulatory Changes Affecting the Banking Industry

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law. This new extensive and complex legislation contains many new provisions affecting the banking industry, including:

1. Creation of a new Bureau of Consumer Financial Protection
2. Determination of debit card interchange rates by the Federal Reserve
3. New regulation over derivative instruments
4. Establishment of new powers enabling federal regulators to seize and dismantle troubled financial firms
5. Phase outs of certain forms of trust preferred debt and hybrids previously counted as bank capital
6. Increases to FDIC deposit coverage, increased bank premiums, and numerous other provisions affecting such things as financial institution regulation, oversight of certain non-banking organizations, investor protection, etc.

Many provisions of this new legislation require further study and new rules to be written by banking regulators in the months to come. As such, the effect of the new legislation on the Company cannot presently be determined.

## Impact of Recently Issued Accounting Standards

Fair Value Measurements In April 2009, the FASB issued additional guidance on reliance on transaction prices or quoted prices when estimating fair value when market volume and activity have significantly decreased. The guidance reaffirms the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. It provides a two-step process to determine whether there has been a significant decrease in the volume and level of activity for an asset or liability when compared with normal market activity for the asset or liability, and whether a transaction is not orderly. If it is determined that there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity, transactions or quoted prices may not be determinative of fair value. Accordingly, further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value. The Company adopted the guidance in March 2009, and its application did not result in a change in valuation techniques and related inputs.

In January 2010, the FASB issued ASU 2010-06, Improving Disclosures about Fair Value Measurements , which requires additional disclosures related to transfers among fair value hierarchy levels and the activity of Level 3 assets and liabilities. This ASU also provides clarification for the disaggregation of fair value measurements of assets and liabilities, and the discussion of inputs and valuation techniques used for fair value measurements. The new disclosures and clarification were effective January 1, 2010, except for the disclosures related to the activity of Level 3 financial instruments. Those disclosures are effective January 1, 2011. The adoption of ASU 2010-06 did not have a
significant effect on the Company s consolidated financial statements.

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Accounting for Transfers of Financial Assets The FASB issued additional guidance in June 2009 with the objective of providing greater transparency about transfers of financial assets and a transferor s continuing involvement. The new guidance limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire original financial asset, or when the transferor has continuing involvement with the transferred asset. It establishes conditions for reporting a transfer of a portion of a financial asset as a sale. Also, it eliminates the exception for qualifying special purpose entities from consolidation guidance, and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred assets. The new accounting requirements must be applied to transactions occurring on or after January 1, 2010. Their adoption did not have a significant effect on the Company s consolidated financial statements.

Variable Interest Entities In June 2009, the FASB issued new accounting guidance related to variable interest entities. This guidance replaces a quantitative-based risks and rewards calculation for determining which entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which entity has the power to direct the activities of a variable interest entity that most significantly impact its economic performance and the obligation to absorb its losses or the right to receive its benefits. This guidance requires reconsideration of whether an entity is a variable interest entity when any changes in facts or circumstances occur such that the holders of the equity investment at risk, as a group, lose the power to direct the activities of the entity that most significantly impact the entity s economic performance. It also requires ongoing assessments of whether a variable interest holder is the primary beneficiary of a variable interest entity. In February 2010, the FASB issued ASU 2010-10, Amendments for Certain Investment Funds , which deferred the application of this new guidance for interests in certain investment entities, such as mutual funds, private equity funds, hedge funds, venture capital funds, and real estate investment trusts, and clarified other aspects of the guidance. Entities qualifying for this deferral will continue to apply the previously existing consolidation guidance. The guidance and its amendment were effective on January 1, 2010, and their adoption did not have a significant effect on the Company s financial statements.

Credit Quality of Financing Receivables and the Allowance for Credit Losses In July 2010, the FASB issued new guidance which is expected to facilitate the evaluation of the nature of credit risk inherent in an entity s loan portfolio, how that risk influences the allowance for credit losses, and the changes and reasons for those changes in the allowance. The guidance requires disclosures about the activity in the allowance, non-accrual and impaired loan status, credit quality indicators, past due information, modifications, and significant purchases and sales. Much of the disclosure is required on a disaggregated level, by portfolio segment or class basis. These disclosures are effective for the Company s December 31, 2010 financial statements and the adoption is not expected to have a significant effect on the Company s financial statements.

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## AVERAGE BALANCE SHEETS AVERAGE RATES AND YIELDS

Three Months Ended June 30, 2010 and 2009

|  |  | uarter 2 |  |  | Quarter 2 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Interest | Avg. Rates |  | Interest | Avg. <br> Rates |
|  | Average | Income/ | Earned/ | Average | Income/ | Earned/ |
| (Dollars in thousands) | Balance | Expense | Paid | Balance | Expense | Paid |


| ASSETS: |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans: |  |  |  |  |  |  |  |  |  |  |
| Business ${ }^{(A)}$ | \$ | 2,880,616 | \$ | 28,194 | 3.93\% | \$ | 3,259,712 | \$ | 30,984 | $3.81 \%$ |
| Real estate construction and |  |  |  |  |  |  |  |  |  |  |
| land |  | 568,417 |  | 5,531 | 3.90 |  | 750,983 |  | 6,558 | 3.50 |
| Real estate business |  | 2,028,799 |  | 25,709 | 5.08 |  | 2,174,443 |  | 27,375 | 5.05 |
| Real estate personal |  | 1,484,155 |  | 19,410 | 5.25 |  | 1,596,413 |  | 22,101 | 5.55 |
| Consumer |  | 1,270,243 |  | 21,293 | 6.72 |  | 1,497,806 |  | 25,672 | 6.87 |
| Home equity |  | 482,847 |  | 5,199 | 4.32 |  | 498,083 |  | 5,374 | 4.33 |
| Student |  | 322,010 |  | 1,907 | 2.38 |  | 347,239 |  | 2,261 | 2.61 |
| Consumer credit card |  | 737,798 |  | 22,668 | 12.32 |  | 697,542 |  | 22,086 | 12.70 |
| Overdrafts |  | 6,817 |  |  |  |  | 8,603 |  |  |  |
| Total loans |  | 9,781,702 |  | 129,911 | 5.33 |  | 10,830,824 |  | 142,411 | 5.27 |
| Loans held for sale |  | 557,032 |  | 2,261 | 1.63 |  | 513,789 |  | 1,963 | 1.53 |
| Investment securities: |  |  |  |  |  |  |  |  |  |  |
| U.S. government and federal agency |  | 668,454 |  | 4,998 | 3.00 |  | 158,664 |  | 1,199 | 3.03 |
| State and municipal obligations ${ }^{(A)}$ |  | 893,224 |  | 10,852 | 4.87 |  | 906,402 |  | 11,788 | 5.22 |
| Mortgage and asset-backed securities |  | 4,389,863 |  | 37,998 | 3.47 |  | 3,649,150 |  | 42,407 | 4.66 |
| Other marketable securities ${ }^{(\mathrm{A})}$ |  | 192,647 |  | 2,186 | 4.55 |  | 193,280 |  | 2,604 | 5.40 |
| Trading securities ${ }^{(\mathrm{A})}$ |  | 19,545 |  | 143 | 2.93 |  | 19,273 |  | 150 | 3.12 |
| Non-marketable securities ${ }^{(4)}$ |  | 113,601 |  | 1,206 | 4.26 |  | 138,405 |  | 1,259 | 3.65 |
| Total investment securities |  | 6,277,334 |  | 57,383 | 3.67 |  | 5,065,174 |  | 59,407 | 4.70 |

Federal funds sold and securities purchased under agreements to resell

6,840
13
.76
25,853
36
.56

Interest earning deposits with banks

321,763 201 .25 212,930 53 . 10

| Total interest earning assets | $\mathbf{1 6 , 9 4 4 , 6 7 1}$ | $\mathbf{1 8 9 , 7 6 9}$ | $\mathbf{4 . 4 9}$ | $16,648,570$ | 203,870 | 4.91 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Less allowance for loan losses (195,889)
Unrealized gain (loss) on investment securities Cash and due from banks Land, buildings and equipment, net

397,485
Other assets $\quad \mathbf{4 0 0 , 5 2 9}$
\$ 18,058,043
Total assets
133,387
377,860
\$ 17,574,625

LIABILITIES AND
EQUITY:
Interest bearing 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 bearing deposits

Borrowings:
Federal funds purchased and securities sold under agreements to repurchase Other borrowings ${ }^{(B)}$

Total borrowings

Total interest bearing liabilities

1,026,763
502,191

1,528,954
4,611
1.21

1,836,400
9,109
1.99

> 979,768

860,819

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Non-interest bearing demand deposits

| Other liabilities | $\mathbf{1 9 8 , 9 0 9}$ | 167,510 |
| :--- | ---: | ---: |
| Equity | $\mathbf{1 , 9 6 2 , 3 5 0}$ | $1,664,000$ |

Total liabilities and equity $\$ \mathbf{1 8 , 0 5 8}, 043$ ..... \$ 17,574,625
Net interest margin (T/E) \$ 167,826 ..... \$ 162,323
Net yield on interest earningassets
$3.97 \%$$3.91 \%$
(A) Stated on a tax equivalent basis using a federal income tax rate of $35 \%$.
(B) Interest expense capitalized on construction projects is not deducted from the interest expense shown above.

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## AVERAGE BALANCE SHEETS AVERAGE RATES AND YIELDS

Six Months Ended June 30, 2010 and 2009

|  | Six Months 2010 |  | Six Months 2009 |  | Avg. |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Avg. |  | Interest | Rates |  |
| (Dollars in thousands) | Average | Income/ | Rates | Earned/ | Average | Income/ | Earned/


| ASSETS: |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Loans: |  |  |  |  |  |  |  |  |  |  |
| Business ${ }^{(A)}$ | \$ | 2,855,661 | \$ | 54,947 | 3.88\% | \$ | 3,299,890 | \$ | 60,730 | $3.71 \%$ |
| Real estate construction and |  |  |  |  |  |  |  |  |  |  |
| land |  | 600,891 |  | 11,799 | 3.96 |  | 783,527 |  | 13,274 | 3.42 |
| Real estate business |  | 2,058,291 |  | 51,461 | 5.04 |  | 2,157,634 |  | 54,298 | 5.07 |
| Real estate personal |  | 1,505,088 |  | 39,555 | 5.30 |  | 1,608,561 |  | 44,959 | 5.64 |
| Consumer |  | 1,288,275 |  | 43,662 | 6.83 |  | 1,538,405 |  | 52,622 | 6.90 |
| Home equity |  | 485,654 |  | 10,385 | 4.31 |  | 501,433 |  | 10,735 | 4.32 |
| Student |  | 325,349 |  | 3,755 | 2.33 |  | 350,427 |  | 5,481 | 3.15 |
| Consumer credit card |  | 750,292 |  | 46,333 | 12.45 |  | 715,924 |  | 43,640 | 12.29 |
| Overdrafts |  | 7,207 |  |  |  |  | 8,496 |  |  |  |
| Total loans |  | 9,876,708 |  | 261,897 | 5.35 |  | 10,964,297 |  | 285,739 | 5.26 |
| Loans held for sale |  | 520,600 |  | 4,165 | 1.61 |  | 488,772 |  | 5,395 | 2.23 |
| Investment securities: |  |  |  |  |  |  |  |  |  |  |
| U.S. government and federal agency |  | 637,473 |  | 8,224 | 2.60 |  | 146,353 |  | 2,391 | 3.29 |
| State and municipal obligations ${ }^{(\mathrm{A})}$ |  | 895,845 |  | 22,022 | 4.96 |  | 827,250 |  | 21,243 | 5.18 |
| Mortgage and asset-backed securities |  | 4,423,241 |  | 78,548 | 3.58 |  | 3,239,999 |  | 78,644 | 4.89 |
| Other marketable securities ${ }^{(\mathrm{A})}$ |  | 186,917 |  | 4,273 | 4.61 |  | 167,864 |  | 4,650 | 5.59 |
| Trading securities ${ }^{(\mathrm{A})}$ |  | 16,682 |  | 242 | 2.92 |  | 17,926 |  | 273 | 3.07 |
| Non-marketable securities ${ }^{(4)}$ |  | 118,491 |  | 3,005 | 5.11 |  | 139,817 |  | 2,684 | 3.87 |
| Total investment securities |  | 6,278,649 |  | 116,314 | 3.74 |  | 4,539,209 |  | 109,885 | 4.88 |

Federal funds sold and securities
purchased under agreements
to resell
Interest earning deposits with
banks
banks

| $\mathbf{7 , 0 3 1}$ | $\mathbf{2 8}$ | $\mathbf{. 8 0}$ | 67,639 | 150 | .45 |
| ---: | ---: | ---: | ---: | ---: | ---: |
| $\mathbf{2 1 5 , 5 4 0}$ | $\mathbf{2 6 6}$ | $\mathbf{. 2 5}$ | 405,698 | 502 | .25 |
|  |  |  |  |  |  |
| $\mathbf{6 , 8 9 8 , 5 2 8}$ | $\mathbf{3 8 2 , 6 7 0}$ | $\mathbf{4 . 5 7}$ | $16,465,615$ | 401,671 | 4.92 |

Less allowance for loan losses
$(196,313)$
Unrealized gain (loss) on investment securities

130,522
$(175,578)$

Cash and due from banks
Land, buildings and equipment, net

399,839
Other assets
406,847
\$ 18,010,249
\$ 17,384,394

## LIABILITIES AND EQUITY:

Interest bearing deposits:

| Savings | $\mathbf{4 7 5 , 9 3 4}$ | $\mathbf{2 5 1}$ | $\mathbf{. 1 1}$ | $\$$ | 434,782 | 323 | .15 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Interest checking and money <br> market | $\mathbf{9 , 6 6 0 , 7 0 2}$ | $\mathbf{1 4 , 5 5 6}$ | $\mathbf{. 3 0}$ | $8,172,528$ | 15,708 | .39 |  |
| Time open \& C.D. s of less <br> than $\$ 100,000$ | $\mathbf{1 , 7 3 4 , 3 6 7}$ | $\mathbf{1 2 , 8 7 4}$ | $\mathbf{1 . 5 0}$ | $2,111,146$ | 29,292 | 2.80 |  |
| Time open \& C.D. s of <br> $\$ 100,000$ and over | $\mathbf{1 , 3 2 3 , 3 8 1}$ | $\mathbf{7 , 4 8 5}$ | $\mathbf{1 . 1 4}$ | $2,048,138$ | 21,215 | 2.09 |  |

Total interest bearing deposits

13,194,384
35,166
. 54
12,766,594 66,538
1.05

Borrowings:
Federal funds purchased and securities sold under

| agreements to repurchase | $\mathbf{1 , 0 9 5 , 8 0 7}$ | $\mathbf{1 , 6 4 6}$ | $\mathbf{. 3 0}$ | 978,717 | 2,079 | .43 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: |
| Other borrowings $^{(\mathrm{B})}$ | $\mathbf{6 1 7 , 9 1 3}$ | $\mathbf{1 0 , 4 9 8}$ | $\mathbf{3 . 4 3}$ | $1,039,719$ | 16,789 | 3.26 |
|  |  |  |  |  |  |  |
| Total borrowings | $\mathbf{1 , 7 1 3 , 7 2 0}$ | $\mathbf{1 2 , 1 4 4}$ | $\mathbf{1 . 4 3}$ | $2,018,436$ | 18,868 | 1.89 |

Total interest bearing

| liabilities | $\mathbf{1 4 , 9 0 8 , 1 0 4}$ | $\mathbf{4 7 , 3 1 0}$ | $\mathbf{. 6 4 \%}$ | $14,785,030$ | 85,406 | $1.16 \%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

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Non-interest bearing demand deposits

963,201 816,452
Other liabilities
196,467
151,328
Equity
1,942,477
1,631,584

Total liabilities and equity $\$ \mathbf{1 8 , 0 1 0 , 2 4 9} \$ 17,384,394$

Net interest margin (T/E)
\$ 335,360
\$ 316,265

Net yield on interest earning assets
(A) Stated on a tax equivalent basis using a federal income tax rate of 35\%.
(B) Interest expense capitalized on construction projects is not deducted from the interest expense shown above.

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## Item 3. OUANTITATIVE AND OUALITATIVE 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 2009 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.

| (Dollars in millions) | June 30, 2010 |  | March 31, 2010 |  | December 31, 2009 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \$ \text { Change } \\ \text { in } \\ \text { Net } \end{gathered}$ | \% Change in | \$ Change in | \% Change in | \$ Change in | \% Change in |
|  | Interest <br> Income | Net Interest Income | Net Interest Income | Net Interest Income | Net Interest Income | Net Interest Income |
| 300 basis points rising | \$ 24.1 | 3.85\% | \$ 16.9 | 2.58\% | \$ 21.6 | 3.22\% |
| 200 basis points rising | 19.8 | 3.16 | 14.8 | 2.27 | 17.3 | 2.57 |
| 100 basis points rising | 11.3 | 1.80 | 8.7 | 1.33 | 10.6 | 1.58 |

As shown above, under the rising rate scenarios presented, net interest income would increase in a range of $\$ 12.1$ million ( 100 basis point rising scenario) to $\$ 26.6$ million ( 300 basis point rising scenario). The Company did not model a 100 basis point falling scenario due to the already low interest rate environment. Under rising rate models, the potential increase in net interest income is higher in the current quarter compared to the previous quarter. During the second quarter of 2010, available for sale securities increased $\$ 393.6$ million. Although these assets earn fixed rates, they were funded by an increase in lower fixed rate deposit balances, thus tending to increase net interest income. Period end loans, where most variable rate assets reside, declined $\$ 150.8$ million from the prior quarter, lowering somewhat the beneficial effect of rising rates. However, long-term borrowings, most of which had carried higher interest rates, decreased $\$ 367.5$ million from the previous quarter end, which had a positive impact on projected net interest income. Borrowings were reduced during the quarter because of both the decrease in loan funding requirements and the increase in deposits. Total deposits increased $\$ 481.4$ million over the previous quarter end, with much of the growth in C.D. s over $\$ 100,000$ that usually have shorter maturities and reprice faster. Deposit balances overall have a smaller impact on net interest income when rates are rising, due to lower overall rates and fewer accounts that carry variable rates moving in sequence with market rates.

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 Exchange Act Rules 13a-15(e) and 15d-15(e)) as of June 30, 2010. 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 not any significant 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 Exchange Act.

|  | Total <br> Number <br> of Shares <br> Purchased | Average <br> Price Paid <br> per Share | Total Number of <br> Shares Purchased <br> as part of Publicly <br> Announced Program | Maximum Number that <br> May Yet Be Purchased <br> Under the Program |
| :--- | :---: | :---: | :---: | :---: |
| Period | 1,564 | $\$ 41.14$ | 1,564 | $2,838,120$ |
| April 1 | 30,2010 | 2 | $\$ 41.42$ | 2 |

In February 2008, the Board of Directors approved the purchase of up to $3,000,000$ shares of the Company s common stock. At June 30, 2010, 2,838,118 shares remain 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<br>James L. Swarts<br>Vice President \& Secretary

Date: August 6, 2010

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

Date: August 6, 2010

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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 *

* As provided in Rule $406 T$ of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.


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