COMMERCE BANCSHARES INC /MO/
Form 10-Q
November 04, 2011
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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 September 30, 2011
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

## Missouri

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

$$
43-0889454
$$

(IRS Employer Identification No.)

64106
(Zip Code)
(816) 234-2000
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes p No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T
( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes p No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer p Accelerated filer o Non-accelerated filer o Smaller reporting company $£$ Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No b

As of October 25, 2011, the registrant had outstanding $84,692,732$ shares of its $\$ 5$ par value common stock, registrant's only class of common stock.

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## PART I: FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED BALANCE SHEETS

## ASSETS

Loans
Allowance for loan losses
Net loans
Loans held for sale
Investment securities:
Available for sale (\$420,348,000 and \$429,439,000 pledged in 2011 and 2010, respectively, to secure structured repurchase agreements)
Trading
Non-marketable
Total investment securities
Short-term federal funds sold and securities purchased under agreements to resell
Long-term securities purchased under agreements to resell
Interest earning deposits with banks
Cash and due from banks
Land, buildings and equipment, net
Goodwill
Other intangible assets, net
Other assets
Total assets
LIABILITIES AND EQUITY
Deposits:
Non-interest bearing
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 87,296,284 shares in 2011 and 86,788,322 shares in 2010
Capital surplus
Retained earnings
Treasury stock of $2,504,467$ shares in 2011 and 61,839 shares in 2010, at cost

| $9,278,066$ | $7,294,303$ |
| :--- | :--- |
| 9,695 | 11,710 |
| 111,808 | 103,521 |
| $9,399,569$ | $7,409,534$ |
| 11,400 | 10,135 |
| 850,000 | 450,000 |
| 133,419 | 122,076 |
| 424,861 | 328,464 |
| 368,965 | 383,397 |
| 125,585 | 125,585 |
| 8,452 | 10,937 |
| 391,756 | 385,016 |
| $\$ 20,638,668$ | $\$ 18,502,339$ |

111,808 103,521
9,399,569 7,409,534
11,400 10,135
850,000 450,000
133,419 122,076
424,861 328,464
368,965 383,397
125,585 125,585
8,452 10,937
391,756 385,016
\$20,638,668 \$18,502,339
\$5,003,587 \$4,494,028
8,416,839 7,846,831
1,204,896 1,465,050
1,388,755 1,279,112
16,014,077 15,085,021
1,057,728 982,827
111,869 112,273
1,325,029 298,754
$\left.\begin{array}{ll}- & - \\ & \\ 436,481 & 433,942 \\ 980,176 & 971,293 \\ 690,981 & 555,778 \\ (96,205 & ) \\ (2,371\end{array}\right)$

433,942
September 30, December 31, 20112010
(Unaudited)
(In thousands)

| $\$ 9,073,123$ | $\$ 9,410,982$ |  |
| :--- | :--- | :--- |
| $(188,038$ | $)$ | $(197,538$ |
| $8,885,085$ | $9,213,444$ |  |
| 39,576 | 63,751 |  |,

18,508,703 16,478,875

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Accumulated other comprehensive income 63,345
Total Commerce Bancshares, Inc. stockholders' equity 2,127,214 2,021,987
$\begin{array}{lll}\text { Non-controlling interest } & \text { 2,477 }\end{array}$
Total equity 2,129,965 2,023,464
Total liabilities and equity $\quad \$ 20,638,668 \quad \$ 18,502,339$
See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

INTEREST INCOME
Interest and fees on loans
Interest and fees on loans held for sale
Interest on investment securities
Interest on short-term federal funds sold and securities
purchased under
agreements to resell
Interest on long-term securities purchased under agreements to
resell
Interest on deposits with banks 21
Total interest income
INTEREST EXPENSE
Interest on deposits:
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

| For the Three Months Ended September 30 |  | For the Nine Months |  |
| :---: | :---: | :---: | :---: |
|  |  | Ended September 30 |  |
| 2011 | 2010 | 2011 | 2010 |
| (Unaudited) |  |  |  |
| \$ 114,731 | \$ 126,273 | \$349,877 | \$385,976 |
| 270 | 1,368 | 877 | 5,533 |
| 51,697 | 50,295 | 164,298 | 159,259 |
| 13 | 12 | 45 | 40 |
| 3,913 | 862 | 9,240 | 862 |
| 211 | 106 | 411 | 372 |
| 170,835 | 178,916 | 524,748 | 552,042 |

Interest on federal funds purchased and securities sold under agreements to repurchase
Interest on other borrowings
Total interest expense
Net interest income
Provision for loan losses
Net interest income after provision for loan losses

| 6,445 | 7,261 | 19,717 | 22,068 |
| :--- | :--- | :--- | :--- |
| 2,413 | 5,444 | 9,121 | 18,318 |
| 2,130 | 3,461 | 7,237 | 10,946 |
|  |  |  |  |
| 292 | 584 | 1,601 | 2,230 |

NON-INTEREST INCOME
Bank card transaction fees
Trust fees
Deposit account charges and other fees
Bond trading income
Consumer brokerage services
Loan fees and sales
Other
Total non-interest income
INVESTMENT SECURITIES GAINS (LOSSES), NET
Impairment (losses) reversals on debt securities
Noncredit-related losses (reversals) on securities not expected
to be sold
Net impairment losses
Realized gains on sales and fair value adjustments
Investment securities gains (losses), net
NON-INTEREST EXPENSE
Salaries and employee benefits
Net occupancy
Equipment
Supplies and communication

| 925 | 2,729 | 2,759 | 13,225 |
| :--- | :--- | :--- | :--- |
| 12,205 | 19,479 | 40,435 | 66,787 |
| 158,630 | 159,437 | 484,313 | 485,255 |
| 11,395 | 21,844 | 39,372 | 78,353 |

$147,235 \quad 137,593 \quad 444,941 \quad 406,902$

| 42,149 | 37,723 | 120,915 | 107,872 |
| :--- | :--- | :--- | :--- |
| 22,102 | 20,170 | 66,218 | 59,846 |
| 21,939 | 21,693 | 62,028 | 71,146 |
| 5,556 | 5,133 | 15,255 | 15,524 |
| 2,333 | 2,390 | 7,876 | 6,879 |
| 2,034 | 5,830 | 5,933 | 11,141 |
| 5,519 | 7,071 | 20,657 | 22,249 |
| 101,632 | 100,010 | 298,882 | 294,657 |


| $(1,200$ | $) 5,645$ | 2,986 | 11,355 |  |
| :--- | :--- | :--- | :--- | :--- |
| 369 | $(7,690$ | $)(4,741$ | $)(15,533$ | $)$ |
| $(831$ | $)(2,045$ | $)(1,755$ | $)(4,178$ | $)$ |
| 3,418 | 2,061 | 7,625 | 1,189 |  |
| 2,587 | 16 | 5,870 | $(2,989$ | $)$ |
|  |  |  |  |  |
| 85,700 | 85,442 | 257,315 | 259,988 |  |
| 11,510 | 12,086 | 34,760 | 35,697 |  |
| 5,390 | 5,709 | 16,669 | 17,548 |  |
| 5,674 | 6,724 | 16,898 | 20,891 |  |

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| Data processing and software | 16,232 | 16,833 | 50,230 | 50,936 |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Marketing | 4,545 | 5,064 | 13,298 | 14,784 |  |
| Deposit insurance | 2,772 | 4,756 | 10,443 | 14,445 |  |
| Indemnification obligation | - | - | $(1,359$ | $)(1,683$ |  |
| Other | 21,923 | 18,972 | 62,965 | 54,497 |  |
| Total non-interest expense | 153,746 | 155,586 | 461,219 | 467,103 |  |
| Income before income taxes | 97,708 | 82,033 | 288,474 | 231,467 |  |
| Less income taxes | 31,699 | 26,012 | 91,898 | 71,817 |  |
| Net income | 66,009 | 56,021 | 196,576 | 159,650 |  |
| Less non-controlling interest expense (income) | 657 | 136 | 1,737 | $(139$ | ) |
| Net income attributable to Commerce Bancshares, Inc. | $\$ 65,352$ | $\$ 55,885$ | $\$ 194,839$ | $\$ 159,789$ |  |
| Net income per common share - basic | $\$ .76$ | $\$ .63$ | $\$ 2.25$ | $\$ 1.82$ |  |
| Net income per common share - diluted | $\$ .76$ | $\$ .64$ | $\$ 2.24$ | $\$ 1.82$ |  |
| See accompanying notes to consolidated financial statements. |  |  |  |  |  |

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Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Commerce Bancshares, Inc. Shareholders
Accumulated

| Common | Capital | Retained | Treasury | Other Non-Controlling |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Stock | Surplus | Earnings | Stock | Comprehensiventerest |
|  |  |  |  | Income (Loss) |

(In thousands, except per share data)
(Unaudited)
Balance January 1, 2011
Net income
Change in unrealized gain (loss) related to available for sale securities for which a portion of an other-than-temporary
impairment has been recorded in earnings, net of tax
Change in unrealized gain (loss) on all other available for sale 48,422 48,422
securities, net of tax Amortization of pension loss, net of tax
Total comprehensive income
1,179
1,179

Distributions to non-controlling interest
Purchase of treasury stock
Issuance of stock under purchase and equity compensation plans Net tax benefit related to equity compensation plans
Stock-based compensation
Issuance of nonvested stock awards
Cash dividends paid ( $\$ .690$ per share)
Balance September 30, 2011
\$436,481 \$980,176 \$690,981 \$(96,205) \$ 115,781
\$ 2,751
\$2,129,965
Balance January 1, $2010 \quad \$ 415,637 \$ 854,490$ \$568,532 \$(838 )\$46,407 \$ 1,677 \$1,885,905
Net income
159,789
(139
) 159,650
Change in unrealized gain (loss) related to
available for sale securities for which a portion of an 12,46912,469
other-than-temporary impairment has been recorded in earnings, net of tax
Change in unrealized gain (loss)
on all other available for sale 35,274 35,274 securities, net of tax
Amortization of pension loss, net of tax1,054

| Total comprehensive income |  |  |  |  |  | 208,447 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Distributions to non-controlling interest |  |  |  |  | (372 | (372 |
| Purchase of treasury stock |  |  | (1,047 | ) |  | (1,047 |
| Issuance of stock under purchase and equity compensation plans | 5,439 |  | (199 | ) |  | 6,665 |
| Net tax benefit related to equity compensation plans | 1,174 |  |  |  |  | 1,174 |
| Stock-based compensation | 4,669 |  |  |  |  | 4,669 |
| Issuance of nonvested stock 765 | (526 |  | (239 | ) |  | - |
| Cash dividends paid (\$.671 per share) |  | (58,836 |  |  |  | (58,836 |
| Balance September 30, 2010 \$417,827 | \$865,246 | \$669,485 | \$ 2,323 | ) \$95,204 | \$ 1,166 | \$2,046,605 |
| See accompanying notes to consolidated f |  |  |  |  |  |  |

Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
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 (gains) losses, net(A)
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) decrease in interest receivable
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
For the Nine Months Ended
September 30

| $2011$ <br> (Unaudited) | 2010 |
| :---: | :---: |
| \$ 196,576 | \$ 159,650 |
| 39,372 | 78,353 |
| 35,281 | 36,891 |
| 9,406 | 16,835 |
| (5,870 | 2,989 |
| (1,554 | (6,656 |
| (41,231 | (316,641 |
| 67,065 | 420,391 |
| (2,941 ) | (15,901 ) |
| 3,614 | 4,669 |
| (1,077 | 1,654 |
| (4,393 | (6,632 |
| 14,863 | (3,514 |
| (1,025 | (1,174 |
| 3,011 | 34,954 |
| 311,097 | 405,868 |
| 11,699 | 77,678 |
| 1,968,848 | 1,650,002 |
| (2,926,445 ) | (2,270,478 ) |
| 288,987 | 363,764 |
| (500,000 ) | (350,000 |
| 100,000 | - |
| (16,135 | (13,161 |
| 2,288 | 394 |
| (1,070,758) | (541,801 |

## FINANCING ACTIVITIES:

Net increase in non-interest bearing, savings, interest checking and money market deposits
Net decrease in time open and C.D.'s
Long-term securities sold under agreements to repurchase
Repayment of long-term securities sold under agreements to repurchase
Net increase in short-term federal funds purchased and securities sold under agreements to repurchase
Repayment of long-term borrowings
Net increase in short-term borrowings
Purchases of treasury stock
Issuance of stock under stock purchase and equity compensation plans
Net tax benefit related to equity compensation plans
Cash dividends paid on common stock
Net cash provided by financing activities
Increase (decrease) in cash and cash equivalents
Proceeds from sales of investment securities(A)
Proceeds from maturities/pay downs of investment securities(A)
Purchases of investment securities(A)
Net decrease in loans
Long-term securities purchased under agreements to resell
Repayments of long-term securities purchased under agreements to resell
Purchases of land, buildings and equipment
Sales of land, buildings and equipment
Net cash used in investing activities
(1,070,758) (541,801 )
$\left.\begin{array}{lll}1,090,342 & 403,068 & \\ (150,511 & ) & (287,178\end{array}\right)$

| Cash and cash equivalents at beginning of year | 460,675 | 463,834 |
| :--- | :--- | :--- |
| Cash and cash equivalents at September 30 | $\$ 569,680$ | $\$ 420,912$ |
| (A) Available for sale and non-marketable securities |  |  |
| Income tax net payments | $\$ 76,795$ | $\$ 75,138$ |
| Interest paid on deposits and borrowings | $\$ 44,828$ | $\$ 73,419$ |
| Loans transferred to foreclosed real estate | $\$ 20,630$ | $\$ 11,140$ |

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011 (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 2010 data to conform to current year presentation. These included the reclassification of certain non-interest bearing deposits from money market accounts to non-interest bearing deposits, in order to more accurately present the Company's balances of non-interest bearing deposits. 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 nine month periods ended September 30, 2011 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 2010 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 September 30, 2011 and December 31, 2010 are as follows:
(In thousands)
Sept. 30, $2011 \quad$ Dec. 31, 2010
Commercial:
Business
Real estate - construction and land
Real estate - business
2,769,2
\$2,957,043
397,598
460,853

Personal Banking:
Real estate - personal
Revolving home equity
Consumer credit card
Overdrafts
Total loans
2,138,813
2,065,837

1,428,492
1,440,386
1,105,785
1,164,327
466,946 477,518
752,458 831,035
13,776 13,983
\$9,073,123
\$9,410,982

At September 30, 2011, loans of $\$ 3.0$ billion were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit obtained to secure public deposits. Additional loans of $\$ 1.2$ billion were pledged at the Federal Reserve Bank as collateral for discount window borrowings.

Allowance for loan losses

A summary of the activity in the allowance for loan losses during the three and nine months ended September 30, 2011 follows:
(In thousands)
For the Three Months
For the Nine Months
Ended September 30
Ended September 30
Commercial Personal ${ }_{\text {Banking }}^{\text {Potal }}$
Commercial $\begin{aligned} & \text { Personal } \\ & \text { Banking }\end{aligned}$
Total

| Balance at beginning of period | $\$ 127,263$ | $\$ 64,275$ | $\$ 191,538$ | $\$ 119,946$ | $\$ 77,592$ | $\$ 197,538$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Provision | 1,503 | 9,892 | 11,395 | 16,783 | 22,589 | 39,372 |
| Deductions: |  |  |  |  |  |  |
| $\quad$ Loans charged off | 4,047 | 14,831 | 18,878 | 14,357 | 47,512 | 61,869 |
| $\quad$ Less recoveries on loans | 514 | 3,469 | 3,983 | 2,861 | 10,136 | 12,997 |
| Net loans charged off | 3,533 | 11,362 | 14,895 | 11,496 | 37,376 | 48,872 |
| Balance at September 30, 2011 | $\$ 125,233$ | $\$ 62,805$ | $\$ 188,038$ | $\$ 125,233$ | $\$ 62,805$ | $\$ 188,038$ |

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A summary of the activity in the allowance for loan losses during the three and nine months ended September 30, 2010 follows:
(In thousands)
Balance at beginning of period
Provision for loan losses
Deductions:
Loans charged off
Less recoveries on loans
Net loans charged off
Balance at September 30, 2010

| For the Three | For the Nine |
| :--- | :--- |
| Months Ended | Months Ended |
| September 30 | September 30 |
| $\$ 197,538$ | $\$ 194,480$ |
| 21,844 | 78,353 |
|  |  |
| 26,079 | 88,417 |
| 4,235 | 13,122 |
| 21,844 | 75,295 |
| $\$ 197,538$ | $\$ 197,538$ |

The following table shows the balance in the allowance for loan losses and the related loan balance at September 30, 2011 and December 31, 2010, disaggregated on the basis of impairment methodology. Impaired loans evaluated under ASC 310-10-35 include loans on non-accrual status, which are individually evaluated for impairment, and other impaired loans deemed to have similar risk characteristics, which are collectively evaluated. All other loans are collectively evaluated for impairment under ASC 450-20.

| (In thousands) | Commercial | Personal <br> Banking | Total |
| :--- | :--- | :--- | :--- |
| September 30, 2011 |  |  |  |
| Allowance for loan losses: | $\$ 6,409$ | $\$ 3,687$ | $\$ 10,096$ |
| Impaired loans | 118,824 | 59,118 | 177,942 |
| All other loans |  |  |  |
| Loans outstanding: | 109,712 | 30,336 | 140,048 |
| Impaired loans | $5,195,954$ | $3,737,121$ | $8,933,075$ |
| All other loans |  |  |  |
| December 31, 2010 | $\$ 6,127$ | $\$ 3,243$ | $\$ 9,370$ |
| Allowance for loan losses: | 113,819 | 74,349 | 188,168 |
| Impaired loans | 118,532 | 26,828 | 145,360 |
| All other loans | $5,365,201$ | $3,900,421$ | $9,265,622$ |

Impaired loans
The table below shows the Company's investment in impaired loans at September 30, 2011 and December 31, 2010. These loans consist of loans on non-accrual status and other restructured loans whose terms have been modified and classified as troubled debt restructurings under ASC 310-40. The restructured loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession. They are largely comprised of certain business, construction and business real estate loans classified as substandard. Upon maturity, the loans renewed at interest rates judged not to be market rates for new debt with similar risk, and as a result were classified as troubled debt restructurings. These loans totaled $\$ 42.0$ million and $\$ 41.3$ million at September 30, 2011 and December 31, 2010, respectively. These restructured loans are performing in accordance with their modified terms, and because the Company believes it probable that all amounts due under the modified terms of the agreements will be collected, interest on these loans is being recognized on an accrual basis. Troubled debt restructurings also include certain credit card loans under various debt management and assistance programs, which totaled $\$ 22.1$ million at September 30, 2011 and $\$ 18.8$ million at December 31, 2010.
(In thousands)
Non-accrual loans
Restructured loans (accruing)
Total impaired loans

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The following table provides additional information about impaired loans held by the Company at September 30, 2011 and December 31, 2010, segregated between loans for which an allowance for credit losses has been provided and loans for which no allowance has been provided.
(In thousands)
Interest Income
Recognized *
For the Period
Ended
September 30, 2011

September 30, 2011
With no related allowance recorded:
Business
Real estate - construction and land
Real estate - business
Real estate - personal
With an allowance recorded:
Business

| $\$ 14,865$ | $\$ 19,104$ | $\$ 1,313$ | $\$ 72$ | $\$ 217$ |
| :--- | :--- | :--- | :--- | :--- |
| 36,677 | 51,349 | 2,552 | 192 | 575 |
| 22,882 | 27,192 | 2,544 | 174 | 522 |
| 8,128 | 10,696 | 764 | 8 | 24 |
| 22,147 | 22,147 | 2,923 | 484 | 1,451 |
| $\$ 104,699$ | $\$ 130,488$ | $\$ 10,096$ | $\$ 930$ | $\$ 2,789$ |
| $\$ 140,048$ | $\$ 187,426$ | $\$ 10,096$ | $\$ 930$ | $\$ 2,789$ |

December 31, 2010
With no related allowance recorded:
Business
Real estate - construction and land
Real estate - business
Real estate - personal
With an allowance recorded:
Business
Real estate - construction and land
Real estate - business
Real estate - personal
Consumer credit card
Total

| $\$ 3,544$ | $\$ 5,095$ | $\$-$ |
| :--- | :--- | :--- |
| 30,979 | 55,790 | - |
| 4,245 | 5,295 | - |
| 755 | 755 | - |
| $\$ 39,523$ | $\$ 66,935$ | $\$-$ |
|  |  |  |
| $\$ 18,464$ | $\$ 21,106$ | $\$ 1,665$ |
| 39,719 | 52,587 | 2,538 |
| 21,581 | 25,713 | 1,924 |
| 7,294 | 9,489 | 936 |
| 18,779 | 18,779 | 2,307 |
| $\$ 105,837$ | $\$ 127,674$ | $\$ 9,370$ |
| $\$ 145,360$ | $\$ 194,609$ | $\$ 9,370$ |

* Represents interest income recognized on impaired loans held at September 30, 2011. Interest shown is interest recognized on accruing restructured loans as noted above.

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Total average impaired loans, shown in the table below, were $\$ 140.8$ million and $\$ 143.5$ million, respectively, during the three and nine month periods ended September 30, 2011, compared to total average impaired loans of $\$ 173.0$ million during the entire year ended December 31, 2010.
(In thousands)
Average impaired loans:
For the three months ended September 30, 2011
Non-accrual loans
Restructured loans (accruing)
Total
For the nine months ended September 30, 2011
Non-accrual loans
Restructured loans (accruing)
Total

| Commercial | Personal <br> Banking | Total |
| :--- | :--- | :--- |
|  |  |  |
| $\$ 68,554$ | $\$ 7,733$ | $\$ 76,287$ |
| 41,993 | 22,522 | 64,515 |
| $\$ 110,547$ | $\$ 30,255$ | $\$ 140,802$ |
|  |  |  |
| $\$ 70,962$ | $\$ 7,277$ | $\$ 78,239$ |
| 43,652 | 21,584 | 65,236 |
| $\$ 114,614$ | $\$ 28,861$ | $\$ 143,475$ |

Delinquent and non-accrual loans
The following table provides aging information on the Company's past due and accruing loans, in addition to the balances of loans on non-accrual status, at September 30, 2011 and December 31, 2010. As shown below, the September 30, 2011 balance of business real estate loans past due 30-89 days grew $\$ 47.8$ million as compared to December 31, 2010. This increase was largely due to six loans with balances ranging from $\$ 4.0$ million to $\$ 12.0$ million that were renewed or for which payment was received in October 2011.

|  | Current or Less Than 30-89 30 Days PastDays Past |  | 90 Days Past Due and Still | Non-accru |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Due | Due | Accruing |  | Total |
| September 30, 2011 |  |  |  |  |  |
| Commercial: |  |  |  |  |  |
| Business | \$2,738,215 | \$4,030 | \$676 | \$ 26,334 | \$2,769,255 |
| Real estate - construction and land | 364,757 | 5,837 | 697 | 26,307 | 397,598 |
| Real estate - business | 2,060,992 | 56,611 | 5,262 | 15,948 | 2,138,813 |
| Personal Banking: |  |  |  |  |  |
| Real estate - personal | 1,403,167 | 15,422 | 2,580 | 7,323 | 1,428,492 |
| Consumer | 1,091,709 | 12,011 | 2,065 | - | 1,105,785 |
| Revolving home equity | 464,739 | 1,382 | 825 | - | 466,946 |
| Consumer credit card | 734,431 | 10,028 | 7,999 | - | 752,458 |
| Overdrafts | 13,381 | 395 | - | - | 13,776 |
| Total | \$8,871,391 | \$105,716 | \$20,104 | \$ 75,912 | \$9,073,123 |
| December 31, 2010 |  |  |  |  |  |
| Commercial: |  |  |  |  |  |
| Business | \$2,927,403 | \$19,853 | \$854 | \$ 8,933 | \$2,957,043 |
| Real estate - construction and land | 400,420 | 7,464 | 217 | 52,752 | 460,853 |
| Real estate - business | 2,040,794 | 8,801 | - | 16,242 | 2,065,837 |
| Personal Banking: |  |  |  |  |  |
| Real estate - personal | 1,413,905 | 15,579 | 3,554 | 7,348 | 1,440,386 |
| Consumer | 1,145,561 | 15,899 | 2,867 | - | 1,164,327 |
| Revolving home equity | 475,764 | 929 | 825 | - | 477,518 |
| Consumer credit card | 806,373 | 12,513 | 12,149 | - | 831,035 |
| Overdrafts | 13,555 | 428 | - | - | 13,983 |
| Total | \$9,223,775 | \$81,466 | \$20,466 | \$ 85,275 | \$9,410,982 |

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Credit quality
The following table provides information about the credit quality of the Commercial loan portfolio, using the Company's internal rating system as an indicator. The information below was updated as of September 30, 2011 and December 31, 2010 for this indicator. The internal rating system is a series of grades reflecting management's risk assessment, based on its analysis of the borrower's financial condition. The "pass" category consists of a range of loan grades that reflect increasing, though still acceptable, risk. Movement of risk through the various grade levels in the "pass" category is monitored for early identification of credit deterioration. The "special mention" rating is attached to loans where the borrower exhibits material negative financial trends due to borrower specific or systemic conditions that, if left uncorrected, threaten its capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. It is a transitional grade that is closely monitored for improvement or deterioration. The "substandard" rating is applied to loans where the borrower exhibits well-defined weaknesses that jeopardize its continued performance and are of a severity that the distinct possibility of default exists. Loans are placed on "non-accrual" when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment.

Commercial Loans

September 30, 2011

| Pass | \$2,614,530 | \$ 304,192 | \$1,941,388 | \$4,860,110 |
| :---: | :---: | :---: | :---: | :---: |
| Special mention | 54,141 | 9,949 | 69,918 | 134,008 |
| Substandard | 74,250 | 57,150 | 111,559 | 242,959 |
| Non-accrual | 26,334 | 26,307 | 15,948 | 68,589 |
| Total | \$2,769,255 | \$ 397,598 | \$2,138,813 | \$5,305,666 |
| December 31, 2010 |  |  |  |  |
| Pass | \$2,801,328 | \$ 327,167 | \$1,878,005 | \$5,006,500 |
| Special mention | 67,142 | 29,345 | 77,527 | 174,014 |
| Substandard | 79,640 | 51,589 | 94,063 | 225,292 |
| Non-accrual | 8,933 | 52,752 | 16,242 | 77,927 |
| Total | \$2,957,043 | \$ 460,853 | \$2,065,837 | \$5,483,733 |

The credit quality of Personal Banking loans is monitored primarily on the basis of aging/delinquency, and this information is provided in the table in the above Delinquency section. In addition, FICO scores are obtained and updated on a quarterly basis for most of the loans in the Personal Banking portfolio. This is a published credit score designed to measure the risk of default by taking into account various factors from a person's financial history. The bank normally obtains a FICO score at the loan's origination and renewal dates, and updates are obtained on a quarterly basis. Excluded from the table below are approximately $\$ 350$ million in consumer and personal real estate loans, or $9 \%$ of the Personal Banking portfolio, for which FICO scores are not obtained because they are related to commercial activity. For the remainder of loans in the Personal Banking portfolio, the table below shows the percentage of balances outstanding at September 30, 2011 by FICO score.
Personal Banking Loans
\% of Loan Category
(In thousands)

| Real Estate - Consumer | Revolving <br> Home Equity Consumer <br> Personal Card |
| :--- | :--- |

September 30, 2011
FICO score:
Under 600

| 3.4 | $\% 8.6$ | $\% 2.7$ | $\% 5.0$ | $\%$ |
| ---: | :---: | ---: | :---: | :---: |
| 4.7 | 10.4 | 4.8 | 11.3 |  |

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| $660-719$ | 11.8 | 22.7 | 15.3 | 31.0 |  |
| :--- | :--- | :---: | :---: | :---: | :---: |
| $720-780$ | 30.4 | 26.5 | 27.2 | 29.4 |  |
| Over 780 | 49.7 | 31.8 | 50.0 | 23.3 |  |
| Total | 100.0 | $\% 100.0$ | $\% 100.0$ | $\% 100.0$ | $\%$ |

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Troubled debt restructurings
As mentioned above, the Company's impaired loans include loans which have been classified as troubled debt restructurings. The majority of troubled debt restructurings are classified as such upon renewal when the contractual interest rate of the new loan, which may be greater or less than the rate on the previous loan, was not judged to be a market rate for debt with similar risk. As a result, the financial effects of the modifications cannot readily be quantified. Restructured loans are placed on non-accrual status if the Company does not believe it probable that amounts due under the modified terms will be collected. Other restructured loans consist mainly of performing commercial loans and consumer credit loans under debt management programs, as mentioned above. The table below shows the outstanding balance of loans classified as troubled debt restructurings at September 30, 2011, in addition to the period end balances of restructured loans which the Company considers to have been in default at any time during the previous twelve months. For purposes of this disclosure, the Company considers "default" to mean 90 days or more past due as to interest or principal.

Balance 90 days past due at any
(In thousands)

Commercial:
Business
Real estate - construction and land
Real estate-business

| 39,119 | 11,805 |
| :--- | :--- |
| 18,467 | 1,595 |

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

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

The Company had commitments of $\$ 9.1$ million at September 30, 2011 to lend additional funds to borrowers with restructured loans.

Loans held for sale
In addition to the portfolio of loans which are intended to be held to maturity, the Company originates loans which it intends to sell in secondary markets. Loans classified as held for sale primarily consist of loans originated to students

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while attending colleges and universities. Most of this portfolio was sold in 2010 under contracts with the Federal Department of Education and various student loan agencies. Significant future student loan originations are not anticipated, because under statutory requirements effective July 1, 2010, the Company is prohibited from making federally guaranteed student loans. Also 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 an impairment valuation allowance resulting from declines in fair value below cost, which is further discussed in Note 13 on Fair Value Measurements. Sept. 30, Dec. 31,
(In thousands)
Balance outstanding:
Student loans, at cost 20112010

Residential mortgage loans, at cost
\$37,315 \$53,901
Valuation allowance on student loans
Total loans held for sale, at lower of cost or fair value
2,437 10,419
(176 ) (569 )
(In thousands)
Net gains on sales:
Student loans
Residential mortgage loans
Total gains on sales of loans held for sale, net
\$39,576 \$63,751
For the Nine Months
Ended September 30
20112010

Tal gin onsies of
\$382 \$5,347
1,172 1,309
\$1,554 \$6,656
The Company's holdings of foreclosed real estate totaled $\$ 23.8$ million and $\$ 12.0$ million at September 30, 2011 and December 31, 2010, respectively. Personal property acquired in repossession, generally autos and marine and recreational vehicles, totaled $\$ 4.1$ million and $\$ 10.4$ million at September 30, 2011 and December 31, 2010, respectively. These assets are carried at the lower of the amount recorded at acquisition date or the current fair value less estimated costs to sell.

## 3. Investment Securities

Investment securities, at fair value, consisted of the following at September 30, 2011 and December 31, 2010.
(In thousands)
Available for sale:
U.S. government and federal agency obligations

Government-sponsored enterprise obligations
State and municipal obligations
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Other asset-backed securities
Other debt securities
Equity securities
Total available for sale
Trading
Non-marketable
Total investment securities

Sept. 30, 2011 ${ }_{2010}^{\text {Dec. 31, }}$
\$360,102 \$455,537
264,550 201,895
1,259,384 1,119,485
4,295,194 2,491,199
353,229 455,790
2,537,251 2,354,260
167,633 176,964
40,723 39,173
9,278,066 7,294,303
9,695 11,710
111,808 103,521
\$9,399,569 \$7,409,534

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 $\$ 45.3$ million and $\$ 45.2$ million at September 30, 2011 and December 31, 2010, 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 $\$ 66.4$ million and $\$ 58.2$ million at September 30, 2011 and December 31, 2010, respectively.

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A summary of the available for sale investment securities by maturity groupings as of September 30, 2011 is shown below. The investment portfolio includes agency mortgage-backed securities, which are guaranteed by agencies such as the FHLMC, FNMA, GNMA and FDIC, in addition to non-agency mortgage-backed securities, which have no guarantee. Also included are certain other asset-backed securities, which are primarily collateralized by credit cards, automobiles, student loans, and commercial loans. These securities differ from traditional debt securities primarily in that they may have uncertain maturity dates and are priced based on estimated prepayment rates on the underlying collateral. The Company does not have exposure to subprime originated mortgage-backed or collateralized debt obligation instruments.
(Dollars in thousands)
U.S. government and federal agency obligations:

Within 1 year
After 1 but within 5 years
After 5 but within 10 years
Total U.S. government and federal agency obligations
Government-sponsored enterprise obligations:
Within 1 year
After 1 but within 5 years
After 5 but within 10 years
After 10 years
Total government-sponsored enterprise obligations
State and municipal obligations:
Within 1 year
After 1 but within 5 years
After 5 but within 10 years
After 10 years
Total state and municipal obligations
Mortgage and asset-backed securities:
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Other asset-backed securities
Total mortgage and asset-backed securities
Other debt securities:
Within 1 year $66,513 \quad 67,382$
$\begin{array}{lll}\text { After } 1 \text { but within } 5 \text { years } & 93,570 & 100,251\end{array}$
Total other debt securities
Equity securities
Total available for sale investment securities

| Amortized <br> Cost | Fair Value |
| :--- | :--- |
|  |  |
| $\$ 7,760$ | $\$ 8,115$ |
| 157,825 | 172,119 |
| 162,330 | 179,868 |
| 327,915 | 360,102 |
|  |  |
| 75,434 | 76,251 |
| 110,448 | 113,520 |
| 49,504 | 49,885 |
| 24,975 | 24,894 |
| 260,361 | 264,550 |
|  |  |
| 102,321 | 103,355 |
| 503,736 | 518,929 |
| 403,055 | 412,367 |
| 232,498 | 224,733 |
| $1,241,610$ | $1,259,384$ |
|  |  |
| $4,179,525$ | $4,295,194$ |
| 351,629 | 353,229 |
| $2,529,825$ | $2,537,251$ |
| $7,060,979$ | $7,185,674$ |
| 66,513 | 67,382 |
| 93,570 | 100,251 |
| 160,083 | 167,633 |
| 14,905 | 40,723 |
| $\$ 9,065,853$ | $\$ 9,278,066$ |

Included in U.S. government securities are $\$ 352.0$ million, at fair value, of U.S. Treasury inflation-protected securities (TIPS). Interest paid on these securities increases with inflation and decreases with deflation, as measured by the Consumer Price Index. Included in state and municipal obligations are $\$ 139.7$ million, at fair value, of auction rate securities, which were purchased from bank customers in 2008. Included in equity securities is common stock held by the holding company, Commerce Bancshares, Inc. (the Parent), with a fair value of $\$ 29.2$ million at September 30, 2011.

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For securities classified as available for sale, the following table shows the unrealized gains and losses (pre-tax) in accumulated other comprehensive income, by security type.
(In thousands)
September 30, 2011
U.S. government and federal agency obligations

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage and asset-backed securities:
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Other asset-backed securities
Total mortgage and asset-backed securities
Other debt securities
Equity securities
Total
December 31, 2010
U.S. government and federal agency obligations

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

|  |  |  |  |
| :--- | :--- | :--- | :--- |
| Amortized <br> Cost | Gross <br> UnrealizedUnrealizedFair Value <br> Gains |  | Losses |
|  |  |  |  |
| $\$ 327,915$ | $\$ 32,187$ | $\$-$ | $\$ 360,102$ |
| 260,361 | 4,270 | $(81$ | $) 264,550$ |
| $1,241,610$ | 29,692 | $(11,918$ | $) 1,259,384$ |
|  |  |  |  |
| $4,179,525$ | 115,984 | $(315$ | $) 4,295,194$ |
| 351,629 | 10,203 | $(8,603$ | $) 353,229$ |
| $2,529,825$ | 9,797 | $(2,371$ | $) 2,537,251$ |
| $7,060,979$ | 135,984 | $(11,289$ | $) 7,185,674$ |
| 160,083 | 7,550 | - | 167,633 |
| 14,905 | 25,818 | - | 40,723 |
| $\$ 9,065,853$ | $\$ 235,501$ | $\$(23,288) \$ 9,278,066$ |  |
|  |  |  |  |
| $\$ 434,878$ | $\$ 20,659$ | $\$-$ | $\$ 455,537$ |
| 200,061 | 2,364 | $(530$ | $) 201,895$ |
| $1,117,020$ | 19,108 | $(16,643$ | $) 1,119,485$ |
|  |  |  |  |
| $2,437,123$ | 57,516 | $(3,440$ | $) 2,491,199$ |
| 459,363 | 10,940 | $(14,513$ | $) 455,790$ |
| $2,342,866$ | 12,445 | $(1,051$ | $) 2,354,260$ |
| $5,239,352$ | 80,901 | $(19,004$ | $) 5,301,249$ |
| 165,883 | 11,081 | - | 176,964 |
| 7,569 | 31,604 | - | 39,173 |
| $\$ 7,164,763$ | $\$ 165,717$ | $\$(36,177) \$ 7,294,303$ |  |

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 September 30, 2011, the fair value of securities on this watch list was $\$ 241.4$ million.

As of September 30, 2011, the Company had recorded other-than-temporary impairment (OTTI) on certain non-agency mortgage-backed securities, part of the watch list mentioned above, which had an aggregate fair value of $\$ 134.7$ million. The credit-related portion of the impairment totaled $\$ 9.3$ million and was recorded in earnings. The noncredit-related portion of the impairment totaled $\$ 7.6$ million on a pre-tax basis, and has been recognized in accumulated other comprehensive income. The Company does not intend to sell these securities and believes it is not more likely than not that it will be required to sell the securities before the recovery of their amortized cost bases.

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

| Significant Inputs | Range |
| :--- | :--- |
| Prepayment CPR | $6 \%-25 \%$ |
| Projected cumulative default | $11 \%-56 \%$ |
| Credit support | $0 \%-18 \%$ |
| Loss severity | $33 \%-57 \%$ |

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The following table shows changes in the credit losses recorded in the nine months ended September 30, 2011 and 2010, for which a portion of an OTTI was recognized in other comprehensive income.

|  |  |  | For the Nine <br> Months Ended |
| :--- | :--- | :--- | :--- | :--- | :--- |
| September 30 |  |  |  |
| (In thousands) |  |  |  |

The total available for sale portfolio consisted of approximately 1,500 individual securities at September 30, 2011. The portfolio included 199 securities, having an aggregate fair value of $\$ 1.3$ billion that were in a loss position at September 30, 2011. Securities identified as other-than-temporarily impaired which have been in a loss position for 12 months or longer totaled $\$ 111.7$ million at fair value, or $1.2 \%$ of the total available for sale portfolio value. Securities with temporary impairment which have been in a loss position for 12 months or longer totaled $\$ 205.5$ million, or $2.2 \%$ of the total portfolio value.

The Company's holdings of state and municipal obligations included gross unrealized losses of $\$ 11.9$ million at September 30, 2011. Of these losses, $\$ 11.1$ million related to auction rate securities (ARS) and $\$ 802$ thousand related to other state and municipal obligations. This portfolio, exclusive of ARS, totaled $\$ 1.1$ billion at fair value, or $12.1 \%$ of total available for sale securities. The average credit quality of the portfolio, excluding ARS, is Aa2 as rated by Moody's.

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The portfolio is diversified in order to reduce risk, and information about the largest holdings, by state and economic sector, is shown in the table below.

At September 30, 2011

| Texas | $11.2 \%$ | 5.5 | Aa1 |
| :--- | :--- | :--- | :--- |
| Florida | 8.4 | 5.0 | Aa3 |
| Washington | 7.4 | 3.3 | Aa2 |
| Illinois | 5.2 | 5.3 | Aa2 |
| Ohio | 4.8 | 5.3 | Aa1 |
| General obligation | $26.3 \%$ | 4.0 | Aa2 |
| Housing | 19.5 | 4.5 | Aa1 |
| Transportation | 15.9 | 4.0 | Aa3 |
| Lease | 13.1 | 3.8 | Aa3 |
| Limited Tax | 5.8 | 5.3 | Aa1 |

The remaining unrealized losses on the Company's investments, as shown in the preceding tables, 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 virtually all of these securities, at purchase date, were comprised of senior tranches and were highly rated by various rating agencies, the adverse housing market 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 losses 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.

The following table presents proceeds from sales of securities and the components of investment securities gains and losses which have been recognized in earnings.
$\left.\begin{array}{lll} & \begin{array}{l}\text { For the Nine } \\ \text { Months Ended }\end{array} \\ & \begin{array}{lll}\text { September } 30\end{array} \\ \text { (In thousands) } & 2011 & 2010 \\ \text { Proceeds from sales of available for sale securities } & \$ 11,202 & \$ 77,493 \\ \text { Proceeds from sales of non-marketable securities } & 497 & 185 \\ \text { Total proceeds } & \$ 11,699 & \$ 77,678 \\ \text { Available for sale: } & & \$ 177 \\ \text { Gains realized on sales } & \$ 2,684 \\ \text { Losses realized on sales } \\ \text { Other-than-temporary impairment recognized on debt securities } & - & (151)\end{array}\right)$

At September 30, 2011, securities carried at $\$ 3.9$ billion were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowings at the FRB and FHLB. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated $\$ 420.3$ million, while the remaining securities were pledged under agreements pursuant to which the secured parties may not
sell or re-pledge the collateral. Except for obligations of various government-sponsored enterprises such as FNMA, FHLB and FHLMC, no investment in a single issuer exceeds $10 \%$ of stockholders' equity.

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4. Goodwill and Other Intangible Assets

The following table presents information about the Company's intangible assets which have estimable useful lives.
(In thousands)
Amortizable intangible assets:
Core deposit premium
Mortgage servicing rights Total $\$ 28,813 \$(20,010) \$(351) \$ 8,452$

December 31, 2010
Gross
Carrying Accumulated Valuation Net Amount Amortization Allowance Amount

| \$25,720 | \$ (18, 164 | ) \$ - | \$7,556 | \$25,720 | \$ (16,108 | ) \$ - | \$9,612 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 3,093 | (1,846 | ) $(351$ | ) 896 | 3,082 | (1,572 | ) (185 | ) 1,325 |
| \$28,813 | \$ (20,010 | ) \$ (351 | ) \$8,452 | \$28,802 | \$ $(17,680$ | ) \$ (185 | ) \$ 10,937 |

Aggregate amortization expense on intangible assets was $\$ 766$ thousand and $\$ 864$ thousand, respectively, for the three months ended September 30, 2011 and 2010, and $\$ 2.3$ million and $\$ 2.7$ million for the nine months ended September 30, 2011 and 2010. 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 September 30, 2011. The Company's actual amortization expense in any given period may be different from the estimated amounts depending upon the acquisition of intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions.
(In thousands)
2011 \$2,846
2012 2,296
2013 1,757
2014 1,281
2015 938

Changes in the carrying amount of goodwill and net other intangible assets for the nine months ended September 30, 2011 are as follows.

| (In thousands) | Goodwill | Core Deposit Premium | Mortgage Servicing Rights |
| :---: | :---: | :---: | :---: |
| Balance January 1, 2011 | \$ 125,585 | \$9,612 | \$ 1,325 |
| Originations | - | - | 11 |
| Amortization | - | (2,056 | ) (274 |
| Impairment | - | - | (166 |
| Balance September 30, 2011 | \$ 125,585 | \$7,556 | \$896 |

Goodwill allocated to the Company's operating segments at September 30, 2011 and December 31, 2010 is shown below.
(In thousands)
Consumer segment \$67,765
Commercial segment 57,074
Wealth segment 746
Total goodwill \$125,585

## 5. Guarantees

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

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 September 30, 2011 that net liability was $\$ 5.1$ 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 $\$ 322.7$ million at September 30, 2011.

The Company periodically enters into risk participation agreements (RPAs) as a guarantor to other financial institutions, in order to mitigate those institutions' credit risk associated with interest rate swaps with third parties. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. These interest rate swaps are normally collateralized (generally with real property, inventories and equipment) by the third party, which limits the credit risk associated with the Company's RPAs. The third parties usually have other borrowing relationships with the Company. The Company monitors overall borrower collateral, and at September 30, 2011, believes sufficient collateral is available to cover potential swap losses. The RPAs are carried at fair value throughout their term, with all changes in fair value, including those due to a change in the third party's creditworthiness, recorded in current earnings. The terms of the RPAs, which correspond to the terms of the underlying swaps, range from 5 to 10 years. At September 30, 2011, the liability recorded for guarantor RPAs was $\$ 152$ thousand, and the notional amount of the underlying swaps was $\$ 40.8$ 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 September 30, 2011, the Company would have been required to make payments of approximately $\$ 4.1$ million.

At December 31, 2010, the Company carried a liability of $\$ 4.4$ million representing its obligation to share certain estimated litigation costs of Visa, Inc. (Visa). An escrow account established by Visa is used to fund actual litigation settlements as they occur. The escrow account was funded initially with proceeds from an initial public offering and subsequently funded 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. Additional funding occurred during March 2011 when Visa contributed $\$ 400$ million to the escrow account. As a result, the Company reduced its obligation by $\$ 1.4$ million at that time, bringing the liability to its current balance of $\$ 3.1$ million. 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 amount of net pension cost is shown in the table below:
(In thousands)
Service cost - benefits earned during the period
Interest cost on projected benefit obligation
Expected return on plan assets
Amortization of unrecognized net loss
Net periodic pension cost

| For the Three Months | For the Nine Months  <br> Ended September 30  |  | Ended September 30 |  |
| :--- | :--- | :--- | :--- | :---: |
| 2011 | 2010 | 2011 | 2010 |  |
| $\$ 126$ | $\$ 184$ | $\$ 302$ | $\$ 550$ |  |
| 2,605 | 1,420 | 5,329 | 4,154 |  |
| $(3,378$ | $)(1,640$ | $(6,728$ | $)(4,920$ |  |
| 821 | 566 | 1,901 | 1,700 |  |
| $\$ 174$ | $\$ 530$ | $\$ 804$ | $\$ 1,484$ |  |

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Substantially all benefits accrued under the Company's defined benefit pension plan were frozen effective January 1, 2005, and the remaining benefits were frozen effective January 1, 2011. During the first nine months of 2011, 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 2011.

## 7. Common Stock

Presented below is a summary of the components used to calculate basic and diluted income per share. The Company applies the two-class method of computing income per share, as nonvested share-based awards that contain nonforfeitable rights to dividends are considered securities which participate in undistributed earnings with common stock. The two-class method requires the calculation of separate income per share amounts for the nonvested share-based awards and for common stock. Income per share attributable to common stock is shown in the table below. Nonvested share-based awards are further discussed in Note 12.
(In thousands, except per share data)
Basic income per common share:
Net income attributable to Commerce Bancshares, Inc.
Less income allocated to nonvested restricted stockholders
Net income available to common stockholders
Distributed income
Undistributed income
Weighted average common shares outstanding
Distributed income per share
Undistributed income per share
Basic income per common share
Diluted income per common share:
Net income attributable to Commerce Bancshares, Inc.
Less income allocated to nonvested restricted stockholders
Net income available to common stockholders
Distributed income
Undistributed income
Weighted average common shares outstanding
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
Weighted average diluted common shares outstanding
Distributed income per share
Undistributed income per share
Diluted income per common share

| For the Three |  |  |  |
| :---: | :---: | :---: | :---: |
| Months Ended September 30 |  | For the Nine Months Ended September 30 |  |
|  |  |  |  |
| 2011 | 2010 | 2011 | 2010 |
| \$65,352 | \$55,885 | \$ 194,839 | \$159,789 |
| 486 | 306 | 1,391 | 871 |
| \$64,866 | \$55,579 | \$ 193,448 | \$158,918 |
| \$ 19,381 | \$19,514 | \$59,197 | \$58,506 |
| \$45,485 | \$36,065 | \$ 134,251 | \$ 100,412 |
| 85,216 | 87,192 | 86,070 | 87,117 |
| \$. 23 | \$. 22 | \$. 69 | \$. 67 |
| . 53 | . 41 | 1.56 | 1.15 |
| \$.76 | \$. 63 | \$2.25 | \$1.82 |
| \$65,352 | \$55,885 | \$ 194,839 | \$159,789 |
| 486 | 305 | 1,388 | 868 |
| \$64,866 | \$55,580 | \$ 193,451 | \$158,921 |
| \$ 19,381 | \$ 19,514 | \$59,197 | \$58,506 |
| \$45,485 | \$36,066 | \$ 134,254 | \$ 100,415 |
| 85,216 | 87,192 | 86,070 | 87,117 |
| 248 | 368 | 334 | 418 |
| 85,464 | 87,560 | 86,404 | 87,535 |
| \$. 23 | \$. 22 | \$. 69 | \$. 67 |
| . 53 | . 42 | 1.55 | 1.15 |
| \$.76 | \$.64 | \$2.24 | \$1.82 |

The diluted income per common share computations for the nine months ended September 30, 2011 and September 30, 2010 excluded 813 thousand and 1.7 million, respectively, in unexercised stock options and stock appreciation rights because their inclusion would have been anti-dilutive to income per share.

## 8. Other Comprehensive Income

Activity in other comprehensive income (loss) for the three and nine months ended September 30, 2011 and 2010 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

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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.
(In thousands)
Available for sale debt securities for which a
portion of OTTI has been recorded in earnings:
Unrealized holding gains (losses) subsequent to initial OTTI recognition
Income tax (expense) benefit
Net unrealized gains (losses)
Other available for sale investment securities:
Unrealized holding gains
Reclassification adjustment for gains included in net income
Net unrealized gains on securities
Income tax expense
Net unrealized gains
Prepaid pension cost:
Amortization of accumulated pension loss
Income tax expense
Pension loss amortization
Other comprehensive income

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The table below presents selected financial information by segment and reconciliations of combined segment totals to consolidated totals. There were no material intersegment revenues among the three segments.

## (In thousands)

Three Months Ended September 30, 2011
Net interest income
Provision for loan losses
Non-interest income
Investment securities gains, net
Non-interest expense
Income before income taxes
Nine Months Ended September 30, 2011
Net interest income
Provision for loan losses
Non-interest income
Investment securities gains, net
Non-interest expense
Income before income taxes
Three Months Ended September 30, 2010
Net interest income
Provision for loan losses
Non-interest income
Investment securities gains, net
Non-interest expense
Income before income taxes
Nine Months Ended September 30, 2010
Net interest income
Provision for loan losses
Non-interest income
Investment securities losses, net
Non-interest expense
Income before income taxes

| Consumer CommercialWealth |  |  | Segment Totals | Other/ Elimination |  | Consolidated <br> Totals |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 69,972 | \$ 72,007 | \$9,725 | \$151,704 | \$ 6,926 |  | \$ 158,630 |  |
| (10,827 | ) $(3,445$ | ) (583 | ) (14,855 | ) 3,460 |  | (11,395 | ) |
| 35,850 | 41,757 | 25,296 | 102,903 | (1,271 |  | 101,632 |  |
|  |  |  |  | 2,587 |  | 2,587 |  |
| (64,829 | ) (56,574 | ) (21,238 | )(142,641 | ) (11,105 |  | (153,746 |  |
| \$30,166 | \$ 53,745 | \$13,200 | \$97,111 | \$ 597 |  | \$ 97,708 |  |
| 213,580 | \$ 209,686 | \$28,962 | \$452,22 | \$ 32,085 |  | \$ 484,313 |  |
| (36,158 | ) (11,942 | ) (611 | ) (48,711 | )9,339 |  | (39,372 | ) |
| 102,657 | 121,212 | 76,711 | 300,580 | (1,698 |  | 298,882 |  |
| - | - | - | - | 5,870 |  | 5,870 |  |
| (203,215 ) | ) (165,767 | ) (66,552 | ) (435,5 | ) (25,685 |  | (461,219 | ) |
| \$76,864 | \$ 153,189 | \$38,510 | \$268,563 | \$ 19,911 |  | \$ 288,474 |  |
| \$75,101 | \$ 68,462 | \$9,462 | \$153,025 | \$ 6,412 |  | \$ 159,437 |  |
| 7,554 | ) (3,448 | ) (817 | ) $(21,819$ | ) (25 |  | (21,844 | ) |
| 38,679 | 38,015 | 23,570 | 100,264 | (254 |  | 100,010 |  |
|  |  |  |  | 16 |  | 16 |  |
| (73,452 | )(55,817 | ) $(21,290$ | ) (150,559 | ) (5,027 |  | (155,586 | ) |
| \$22,774 | \$ 47,212 | \$ 10,925 | \$80,911 | \$ 1,122 |  | \$ 82,033 |  |
| \$236,578 | \$ 196,133 | \$28,274 | \$460,985 | \$ 24,270 |  | \$ 485,255 |  |
| (54,545 | ) (19,569 | ) (1,038 | ) (75,152 | ) (3,201 | ( | (78,353 | ) |
| 112,576 | 112,366 | 69,292 | 294,234 | 423 |  | 294,657 |  |
|  |  | - |  | (2,989 |  | (2,989 | ) |
| (221,189) | ) (165,232 | ) (64,567 | ) (450,988 | ) (16,115 |  | (467,103 | ) |
| \$73,420 | \$ 123,698 | \$31,961 | \$229,079 | \$ 2,388 |  | \$ 231,467 |  |

The information presented above was derived from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. This information is based on internal management accounting policies, which have been developed to reflect the underlying economics of the businesses. The policies address the methodologies applied in connection with funds transfer pricing and assignment of overhead costs among segments. Funds transfer pricing was used in the determination of net interest income by assigning a standard cost (credit) for funds used (provided) by assets and liabilities based on their maturity, prepayment and/or repricing characteristics.

The segment activity, as shown above, includes both direct and allocated items. Amounts in the "Other/Elimination" column include activity not related to the segments, such as that relating to administrative functions, the investment securities portfolio, and the effect of certain expense allocations to the segments. The provision for loan losses in this category contains the difference between 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.

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## 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)
Interest rate swaps
Interest rate caps
Credit risk participation agreements
Foreign exchange contracts:
Forward contracts
September 30, December 31,
20112010
\$500,548 \$498,071
30,236 31,736
43,441 40,661

Option contracts
Mortgage loan commitments
Mortgage loan forward sale contracts
Total notional amount

|  |  |
| :--- | :--- |
| 70,149 | 25,867 |
| 3,224 | - |
| 18,096 | 12,125 |
| 21,918 | 24,112 |
| $\$ 687,612$ | $\$ 632,572$ |

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 September 30, 2011, the Company had entered into three interest rate swaps with a notional amount of $\$ 14.8$ million, included in the table above, which are designated as fair value hedges of certain fixed rate loans. Gains and losses on these derivative instruments, as well as the offsetting loss or gain on the hedged loans attributable to the hedged risk, are recognized in current earnings. These gains and losses are reported in interest and fees on loans in the accompanying statements of income. The table below shows gains and losses related to fair value hedges.
(In thousands)
Gain (loss) on interest rate swaps
Gain (loss) on loans
Amount of hedge ineffectiveness

| For the Three |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Months Ended <br> September 30 |  | For the Nine Months Ended September 30 |  |  |
|  |  |  |  |  |
| 2011 | 2010 |  | 2011 | 2010 |
| \$(101 | )\$ (208 | ) | \$(31 | ) \$ (598 |
| 101 | 205 |  | 37 | 577 |
| \$- | \$(3 |  | \$6 | \$(21 |

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 September 30, 2011 was $\$ 485.7$ million. The Company is party to master netting arrangements; however, the Company does not offset assets and liabilities under these arrangements. Collateral, usually in the form of marketable securities, is posted by the counterparty with liability positions, in accordance with contract thresholds. At September 30, 2011, the Company had
net liability positions with its financial institution counterparties totaling $\$ 20.5$ million and had posted $\$ 19.7$ million in collateral.

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

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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 $19.2 \%$ 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 $\$ 3.2$ million, based on amounts at September 30, 2011.

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

|  | Asset Derivatives |  |  | Liability Derivatives |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Balance Sheet | Sept. 30, | $\begin{aligned} & \text { Dec. 31, } \\ & 2010 \end{aligned}$ | Balance Sheet | $\begin{aligned} & \text { Sept. 30, } \\ & 2011 \end{aligned}$ | $\begin{aligned} & \text { Dec. 31, } \\ & 2010 \end{aligned}$ |
| (In thousands) | Location | Fair Value |  | Location | Fair Value |  |
| Derivatives designated as hedging instruments: |  |  |  |  |  |  |
| Interest rate swaps | Other assets |  | \$- | Other <br> liabilities | \$(1,190 | ) \$(1,159 ) |
| Total derivatives designated as hedging instruments |  | \$- | \$- |  | \$(1,190 | ) \$(1,159 ) |
| Derivatives not designated as hedging instruments: |  |  |  |  |  |  |
| Interest rate swaps | Other assets | \$20,425 | \$17,712 | Other liabilities | \$(20,64 | 6) $\$(17,799)$ |
| Interest rate caps | Other assets | 14 | 84 | Other liabilities | (14 | )(84 ) |
| Credit risk participation agreements | Other assets |  | - | Other liabilities | (152 | )(130 ) |
| Foreign exchange contracts: |  |  |  |  |  |  |
| Forward contracts | Other assets | 1,508 | 492 | Other liabilities | (1,400 | )(359 ) |
| Option contracts | Other assets |  | - | Other liabilities | (2 | )- |
| Mortgage loan commitments | Other assets | 286 | 101 | Other <br> liabilities | (1 | )(30 ) |
| Mortgage loan forward sale contracts | Other assets | 33 | 434 | Other liabilities | (79 | ) (23 ) |
| Total derivatives not designated as hedging instruments |  | \$22,277 | \$18,823 |  | \$(22,29 | ) \$(18,425) |
| Total derivatives |  | \$22,277 | \$18,823 |  | \$(23,48 | ) \$ $(19,584)$ |

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

| Location of Gain or <br> (Loss) Recognized in | Amount of Gain or (Loss) <br> Income on Derivative | Recognized in Income on <br> Derivative <br> For the Three <br> Months Ended | For the Nine <br> Months Ended |
| :--- | :--- | :--- | :--- |
|  | September 30 <br> 2011$\quad$September 30 |  |  |
|  | 2010 | 2011 | 2010 |

Total
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 Total
$\$(101) \$(208) \$(31) \$(598)$
Other non-interest income
Other non-interest _ _ _ 32
income
Other non-interest income

| Other non-interest <br> income | $(177$ | $)(293$ | $)(24$ | $) 121$ |
| :--- | :--- | :--- | :--- | :--- |
| Other non-interest |  |  |  |  |
| income | - | - | - | - |
| Loan fees and sales | 185 | 43 | 214 | 283 |
| Loan fees and sales | $(25$ | $) 151$ | $(457$ | $)(210$ |
|  | $\$ 180$ | $\$ 31$ | $\$ 521$ | $\$ 828$ |

## 11. Income Taxes

For the third quarter of 2011 , income tax expense amounted to $\$ 31.7$ million compared to $\$ 26.0$ million in the third quarter of 2010. The effective tax rate for the Company, including the effect of non-controlling interest, was $32.7 \%$ in the current quarter compared to $31.8 \%$ in the same quarter last year. For the nine months ended September 30, 2011 and 2010, income tax expense amounted to $\$ 91.9$ million and $\$ 71.8$ million, resulting in effective tax rates of $32.0 \%$ and $31.0 \%$, respectively.

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## 12. Stock-Based Compensation

Stock-based compensation expense that has been charged against income was $\$ 1.2$ million and $\$ 1.3$ million in the three months ended September 30, 2011 and 2010, respectively, and $\$ 3.6$ million and $\$ 4.7$ million in the nine months ended September 30, 2011 and 2010, respectively. The Company has historically issued stock-based compensation in the form of options, stock appreciation rights (SARs) and nonvested stock. During 2010 and the first nine months of 2011, stock-based compensation was issued solely in the form of nonvested stock awards.

The 2011 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 September 30, 2011, and changes during the nine 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.

A summary of option activity during the first nine months of 2011 is presented below.
(Dollars in thousands, except per share data)
Outstanding at January 1, 2011
Granted
Forfeited
Expired
Exercised
Outstanding at September 30, 2011

| Shares |  | Weighted <br> Average <br> Remaining <br> Contractual Term | Aggregate <br> Intrinsic <br> Value |
| :---: | :---: | :---: | :---: |
|  | Weighted <br> Average <br> Exercise <br> Price |  |  |
| 1,806,110 | \$30.96 |  |  |
| - | - |  |  |
| - | - |  |  |
| - | - |  |  |
| (496,754 | )29.04 |  |  |
| 1,309,356 | \$31.69 | 2.1 years | \$4,533 |

A summary of SAR activity during the first nine months of 2011 is presented below.

|  | Shares | Weighted <br> Average <br> Exercise | Weighted <br> Average <br> Remaining <br> Contractual Value |
| :--- | :--- | :--- | :--- |
| Intregate |  |  |  |

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Expired
$(12,628) 40.41$
Exercised
Outstanding at September 30, 2011
(36,768 ) 38.63
$1,656,761 \quad \$ 39.72$
5.4 years $\$ 7$

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## 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.

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

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

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

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

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

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

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

## Other debt securities

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

## Equity securities

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

At September 30, 2011, the Company held in its available for sale portfolio certain auction rate securities (ARS) totaling $\$ 139.7$ million. The auction process by which the ARS are normally priced has not functioned since 2008, and due to the illiquidity in the market, the fair value of these securities cannot be based on observable market prices. The fair values of the ARS are estimated using a discounted cash flows analysis. 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's trading portfolio are priced by averaging several broker quotes for similar instruments and are classified as Level 2 measurements.

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

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investments requires significant management judgment. 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 trends. Based on the unobservable nature of this adjustment, these measurements are classified as Level 3.

The Company's contracts related to credit risk guarantees are valued under a proprietary model which uses significant 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 September 30, 2011 and December 31, 2010 carrying values of assets and liabilities measured at fair value on a recurring basis. There were no transfers among levels during the first nine months of 2011 or the twelve months ended December 31, 2010.
(In thousands)

September 30, 2011
Assets:
Available for sale securities:

| U.S. government and federal agency obligations | $\$ 360,102$ | $\$ 352,597$ | $\$ 7,505$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- |
| Government-sponsored enterprise obligations | 264,550 | - | 264,550 | - |
| State and municipal obligations | $1,259,384$ | - | $1,119,660$ | 139,724 |
| Agency mortgage-backed securities | $4,295,194$ | - | $4,295,194$ | - |
| Non-agency mortgage-backed securities | 353,229 | - | 353,229 | - |
| Other asset-backed securities | $2,537,251$ | - | $2,537,251$ | - |
| Other debt securities | 167,633 | - | 167,633 | - |
| Equity securities | 40,723 | 26,731 | 13,992 | - |
| Trading securities | 9,695 | - | 9,695 | - |
| Private equity investments | 63,048 | - | - | 63,048 |
| Derivatives * | 22,277 | - | 21,949 | 328 |
| Assets held in trust | 4,168 | 4,168 | - | - |
| Total assets | $\$ 9,377,254$ | $\$ 383,496$ | $\$ 8,790,658$ | $\$ 203,100$ |
| Liabilities: | $\$ 23,484$ | $\$-$ | $\$ 23,252$ | $\$ 232$ |
| Derivatives * | $\$ 23,484$ | $\$-$ | $\$ 23,252$ | $\$ 232$ |
| Total liabilities |  |  |  |  |
| December 31, 2010 |  |  |  |  |
| Assets: | $\$ 455,537$ | $\$ 448,087$ | $\$ 7,450$ | $\$-$ |
| Available for sale securities: | 201,895 | - | 201,895 | - |
| U.S. government and federal agency obligations | $1,119,485$ | - | 969,396 | 150,089 |
| Government-sponsored enterprise obligations | $2,491,199$ | - | $2,491,199$ | - |
| State and municipal obligations | 455,790 | - | 455,790 | - |
| Agency mortgage-backed securities | $2,354,260$ | - | $2,354,260$ | - |
| Non-agency mortgage-backed securities | 176,964 | - | 176,964 | - |
| Other asset-backed securities | 39,173 | 22,900 | 16,273 | - |
| Other debt securities | 11,710 | - | 11,710 | - |
| Equity securities | 53,860 | - | - | 53,860 |
| Trading securities | 18,823 | - | 18,288 | 535 |
| Private equity investments | 4,213 | 4,213 | - | - |
| Derivatives * | $\$ 7,382,909$ | $\$ 475,200$ | $\$ 6,703,225$ | $\$ 204,484$ |
| Assets held in trust | $\$ 19,584$ | $\$-$ | $\$ 19,401$ | $\$ 183$ |
| Total assets | $\$ 19,584$ | $\$-$ | $\$ 19,401$ | $\$ 183$ |
| Liabilities: |  |  |  |  |

December 31, 2010
Assets:
Available for sale securities:

| U.S. government and federal agency obligations | $\$ 360,102$ | $\$ 352,597$ | $\$ 7,505$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- |
| Government-sponsored enterprise obligations | 264,550 | - | 264,550 | - |
| State and municipal obligations | $1,259,384$ | - | $1,119,660$ | 139,724 |
| Agency mortgage-backed securities | $4,295,194$ | - | $4,295,194$ | - |
| Non-agency mortgage-backed securities | 353,229 | - | 353,229 | - |
| Other asset-backed securities | $2,537,251$ | - | $2,537,251$ | - |
| Other debt securities | 167,633 | - | 167,633 | - |
| Equity securities | 40,723 | 26,731 | 13,992 | - |
| Trading securities | 9,695 | - | 9,695 | - |
| Private equity investments | 63,048 | - | - | 63,048 |
| Derivatives * | 22,277 | - | 21,949 | 328 |
| Assets held in trust | 4,168 | 4,168 | - | - |
| Total assets | $\$ 9,377,254$ | $\$ 383,496$ | $\$ 8,790,658$ | $\$ 203,100$ |
| Liabilities: | $\$ 23,484$ | $\$-$ | $\$ 23,252$ | $\$ 232$ |
| Derivatives * | $\$ 23,484$ | $\$-$ | $\$ 23,252$ | $\$ 232$ |
| Total liabilities |  |  |  |  |
| December 31, 2010 |  |  |  |  |
| Assets: | $\$ 455,537$ | $\$ 448,087$ | $\$ 7,450$ | $\$-$ |
| Available for sale securities: | 201,895 | - | 201,895 | - |
| U.S. government and federal agency obligations | $1,119,485$ | - | 969,396 | 150,089 |
| Government-sponsored enterprise obligations | $2,491,199$ | - | $2,491,199$ | - |
| State and municipal obligations | 455,790 | - | 455,790 | - |
| Agency mortgage-backed securities | $2,354,260$ | - | $2,354,260$ | - |
| Non-agency mortgage-backed securities | 176,964 | - | 176,964 | - |
| Other asset-backed securities | 39,173 | 22,900 | 16,273 | - |
| Other debt securities | 11,710 | - | 11,710 | - |
| Equity securities | 53,860 | - | - | 53,860 |
| Trading securities | 18,823 | - | 18,288 | 535 |
| Private equity investments | 4,213 | 4,213 | - | - |
| Derivatives * | $\$ 7,382,909$ | $\$ 475,200$ | $\$ 6,703,225$ | $\$ 204,484$ |
| Assets held in trust | $\$ 19,584$ | $\$-$ | $\$ 19,401$ | $\$ 183$ |
| Total assets | $\$ 19,584$ | $\$-$ | $\$ 19,401$ | $\$ 183$ |
| Liabilities: |  |  |  |  |

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

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

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The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

| Fair Value Measurements Using |  |  |  |
| :---: | :---: | :---: | :---: |
| Significant Unobservable Inputs (Level 3) |  |  |  |
| State and Private |  |  |  |
| Municipal Equity DerivativesTotal ObligationSnvestments |  |  |  |
|  |  |  |  |
| \$ 141,940 | \$ 61,173 | \$ (288 | ) \$202,825 |
| - | 2,921 | 384 | 3,305 |
| (1,028 | )- | - | (1,028 ) |
| (1,300 | )- | - | (1,300 ) |
| 112 | - | - | 112 |
| - | 75 | - | 75 |
| - | (1,121 | ) - | (1,121 ) |
| \$139,724 | \$ 63,048 | \$ 96 | \$202,868 |
| \$- | \$ 2,921 | \$ 237 | \$3,158 |
| \$ 150,089 | \$ 53,860 | \$352 | \$204,301 |
| - | 6,951 | 16 | 6,967 |
| (2,639 | )- | - | (2,639 ) |
| (8,243 | )- | - | (8,243 ) |
| 517 | - | - | 517 |
| - | 3,314 | - | 3,314 |
| - | (1,121 | ) - | (1,121 ) |
| - | 44 | - | 44 |
| - | - | 79 | 79 |
| - | - | (351 | ) (351 ) |
| \$139,724 | \$ 63,048 | \$ 96 | \$202,868 |
| \$- | \$ 7,026 | \$ 223 | \$7,249 |
| \$ 152,143 | \$ 46,257 | \$ (110 | ) \$ 198,290 |
| - | 1,352 | 187 | 1,539 |
| 3,269 | - | - | 3,269 |
| (1,450 | )- | - | (1,450 |
| 137 | - | - | 137 |
| - | 3,453 | - | 3,453 |
| - | (271 | ) - | (271 ) |
| - | 6 | - | 6 |
| - | - | (21 | ) (21 ) |
| \$ 154,099 | \$ 50,797 | \$ 56 | \$204,952 |

For the three months ended September 30, 2011
Balance June 30, 2011
Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income
Investment securities called
Discount accretion
Purchase of private equity securities
Sale / paydown of private equity securities
Balance September 30, 2011
Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at
September 30, 2011
For the nine months ended September 30, 2011
Balance January 1, 2011
Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income

Investment securities called
Discount accretion
Purchase of private equity securities
Sale / paydown of private equity securities
Capitalized interest/dividends
Purchase of risk participation agreement
Sale of risk participation agreement
Balance September 30, 2011
Total gains or losses for the nine months included in earnings
attributable to the
change in unrealized gains or losses relating to assets still held at
September 30, 2011
For the three months ended September 30, 2010
Balance June 30, 2010
Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income

Investment securities called
Discount accretion
Purchase of private equity securities
Sale / paydown of private equity securities
Capitalized interest/dividends
Sales of risk participation agreements
Balance September 30, 2010

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 September 30, 2010
For the nine months ended September 30, 2010
Balance January 1, 2010
Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income
Investment securities called
Discount accretion
Purchase of private equity securities - 7, 7,
Sale / paydown of private equity securities $\quad$ - $\quad(271 \quad$ ) - $\quad$ (271 )
$\begin{array}{lllll}\text { Capitalized interest/dividends } & - & 173 & - & 173\end{array}$
Sales of risk participation agreements - $\quad$ - $\quad$ (131 ) (131)
Balance September 30, 2010
\$ 154,099 \$ 50,797 \$ $56 \quad \$ 204,952$
Total gains or losses for the nine months included in earnings attributable to the
change in unrealized gains or losses relating to assets still held at September 30, 2010

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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:
(In thousands)

For the three months ended September 30, 2011
Total gains or losses included in earnings
Change in unrealized gains or losses relating to assets still held at September 30, 2011
For the nine months ended September 30, 2011
Total gains or losses included in earnings
Change in unrealized gains or losses relating to assets still held at
September 30, 2011
For the three months ended September 30, 2010
Total gains or losses included in earnings $\quad \$ 194 \quad \$(7 \quad) \$ 1,352 \quad \$ 1,539$
Change in unrealized gains or losses relating to assets still held at
September 30, 2010
For the nine months ended September 30, 2010
Total gains or losses included in earnings $\quad \$ 73 \quad \$ 6 \quad \$(1,289) \$(1,210)$
Change in unrealized gains or losses relating to assets still held at September 30, 2010

| Loan Fees and Sales | Other <br> Non-Interest <br> Income | Investment Securities |  |
| :---: | :---: | :---: | :---: |
|  |  | st Gains <br> (Losses), <br> Net | Total |
| \$160 | \$ 224 | \$2,921 | \$3,305 |
| \$239 | \$ (2) | ) \$2,921 | \$3,158 |
| \$(243 | )\$ 259 | \$6,951 | \$6,967 |
| \$239 | \$ (16 ) | ) \$7,026 | \$7,249 |
| \$194 | \$ (7 ) | ) \$1,352 | \$1,539 |
| \$281 | \$ 11 | \$1,352 | \$ 1,644 |
| \$73 | \$ 6 | \$(1,289 | ) \$ (1,210 |
| \$281 | \$ 28 | \$(1,089 | ) \$ 780 |

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 September 30, 2011 and 2010 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 has historically consisted primarily of student loans, and to a lesser extent, residential real estate loans. Most of the Company's student loan portfolio was sold under contract to the Federal Department of Education and various student loan agencies during 2010. A portion of the student loan portfolio is under contract to agencies which have been unable to consistently purchase loans under existing contractual terms. These loans have been evaluated using a fair value measurement method based on a discounted cash flows analysis, which is classified as Level 3. The fair value of these loans was $\$ 6.7$ million at September 30, 2011, net of an impairment reserve of $\$ 176$ thousand. The measurement of fair value for other student

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

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## Mortgage servicing rights

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

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

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

## Foreclosed assets

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

## Long-lived assets

In accordance with ASC 360-10-35, investments in branch facilities and various office buildings are written down to estimated fair value, or estimated fair value less cost to sell if the property is held for sale. Fair value is estimated in a process which considers current local commercial real estate market conditions and the judgment of the sales agent on pricing and sales strategy. These fair value measurements are classified as Level 3.

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For assets measured at fair value on a nonrecurring basis during the first nine months of 2011 and 2010 and still held as of September 30, 2011 and 2010, 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 September 30, 2011 and 2010.


## 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 Measurements. A schedule of investment 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 short-term 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 classified as short-term generally mature in 90 days or less. The fair value of long-term securities purchased under agreements to resell is estimated by discounting contractual maturities using an estimate of the current market rate for similar instruments.

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.

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## Derivative Instruments

A 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.

The estimated fair values of the Company's financial instruments are as follows:
(In thousands)
Financial Assets
Loans, including held for sale
September 30, 2011
Carrying Estimated
Amount Fair Value

Available for sale investment securities
\$9,112,699 \$9,244,410
Trading securities
Non-marketable securities
Short-term federal funds sold and securities purchased under agreements to resell
Long-term securities purchased under agreements to resell
Interest earning deposits with banks
9,278,066 9,278,066

Cash and due from banks
9,695 9,695
$111,808 \quad 111,808$
11,400 11,400
850,000 867,502
$\begin{array}{lll}\text { Accrued interest receivable } & 63,589 & 63,589\end{array}$
133,419 133,419
$\begin{array}{ll}\text { Derivative instruments } & \text { 22,277 }\end{array}$
Financial Liabilities
Non-interest bearing deposits $\quad \$ 5,003,587 \$ 5,003,587$
Savings, interest checking and money market deposits $\quad 8,416,839 \quad 8,416,839$
Time open and C.D.'s
Federal funds purchased and securities sold under agreements to repurchase
Other borrowings
Accrued interest payable
2,593,651 2,603,135

Derivative instruments
1,057,728 1,055,980
111,869 126,449
7,715 $\quad 7,715$
23,484 23,484

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.

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## 15. Legal Proceedings

The Company has various lawsuits pending at September 30, 2011, arising in the normal course of business. While some matters pending against the Company specify damages claimed by plaintiffs, others do not seek a specified amount of damages or are at very early stages of the legal process. The Company records a loss accrual for all legal matters for which it deems a loss is probable and can be reasonably estimated. Some legal matters, which are at early stages in the legal process, have not yet progressed to the point where a loss amount can be estimated. For those legal matters in which the Company is able to estimate a range of possible loss and where such loss is reasonably possible (less than probable), the Company believes that their resolution could result in an additional loss of up to $\$ 4$ million in future periods in excess of amounts accrued through September 30, 2011. This estimate is based on a preliminary review of the claims and evidence of settlements entered into by other defendants in similar cases and is subject to adjustment as facts related to the claims are developed. The Company believes it has substantial defenses to these claims and anticipates the claims will be resolved without material loss.

On April 6, 2010, a suit was filed against Commerce Bank (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, and has been transferred to the U.S. District Court for the Southern District of Florida for pre-trial proceedings as part of the multi-district litigation referred to as In re Checking Account Overdraft Litigation. A second suit alleging the same facts and also seeking class-action status was filed on June 4, 2010 in Missouri state court, but has been stayed in deference to the earlier filed suit.

## 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 2010 Annual Report on Form 10-K. Results of operations for the three and nine month periods ended September 30, 2011 are not necessarily indicative of results to be attained for any other period.

## Forward Looking Information

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

Critical Accounting Policies

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

## Allowance for Loan Losses

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

## Valuation of Investment Securities

The Company carries its investment securities at fair value and employs valuation techniques which utilize observable inputs when those inputs are available. These observable inputs reflect assumptions market participants would use in pricing the security and are developed based on market data obtained from sources independent of the Company. When such information is not available, the Company employs valuation techniques which utilize unobservable inputs, or those which reflect the Company's own assumptions about market participants, based on the best information available in the circumstances. These valuation methods typically involve cash flow and other financial modeling techniques. Changes in underlying factors, assumptions, estimates, or other inputs to the valuation techniques could have a material impact on the Company's future financial condition and results of 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 which can be derived from observable data. Such securities totaled approximately $\$ 8.8$ billion, or $94.4 \%$ of the available for sale portfolio at September 30, 2011 and were classified as Level 2 measurements. The Company also holds $\$ 139.7$ 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 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 include payment structure, prepayment speeds, expected defaults, and collateral values. Changes in these factors could result in additional impairment, recorded in current earnings, in future periods.

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At September 30, 2011, non-agency guaranteed mortgage-backed securities with a par value of $\$ 153.2$ million were identified as other-than-temporarily impaired. The credit-related impairment loss on these securities amounted to $\$ 9.3$ million, which was recorded in the consolidated income statements in investment securities gains (losses), net. The noncredit-related loss on these securities, which was recorded in other comprehensive income, was $\$ 7.6$ 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 totaled $\$ 66.4$ million at September 30, 2011, and most are carried at fair value. Changes in fair value are reflected in current earnings and reported in investment securities gains (losses), net, in the consolidated 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 they are classified as Level 3 measurements. Although management believes its estimates of fair value reasonably reflect the fair value of these securities, key assumptions regarding the projected financial performance of these companies, the evaluation of the investee company's management team, and other economic and market factors may affect the amounts that will ultimately be realized from these investments.

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## 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

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2011 | 2010 |  | 2011 | 2010 |
| Per Share Data |  |  |  |  |  |
| Net income per common share - basic | \$.76 | \$. 63 |  | \$2.25 | \$1.82 |
| Net income per common share - diluted | . 76 | . 64 |  | 2.24 | 1.82 |
| Cash dividends | . 230 | . 224 |  | . 690 | . 671 |
| Book value |  |  |  | 25.15 | 23.37 |
| Market price |  |  |  | 34.75 | 35.80 |
| Selected Ratios |  |  |  |  |  |
| (Based on average balance sheets) |  |  |  |  |  |
| Loans to deposits ${ }^{(1)}$ | 58.29 | \%68.88 | \% | 60.27 | \%71.88 |
| Non-interest bearing deposits to total deposits | 30.49 | 28.86 |  | 29.75 | 28.26 |
| Equity to loans ${ }^{(1)}$ | 23.35 | 20.18 |  | 22.54 | 19.17 |
| Equity to deposits | 13.61 | 13.90 |  | 13.59 | 13.78 |
| Equity to total assets | 10.85 | 10.84 |  | 11.03 | 10.81 |
| Return on total assets | 1.32 | 1.19 |  | 1.37 | 1.17 |
| Return on total equity | 12.15 | 10.98 |  | 12.41 | 10.85 |
| (Based on end-of-period data) |  |  |  |  |  |
| Non-interest income to revenue ${ }^{(2)}$ | 39.05 | 38.55 |  | 38.16 | 37.78 |
| Efficiency ratio ${ }^{(3)}$ | 58.71 | 59.58 |  | 58.57 | 59.49 |
| Tier I risk-based capital ratio |  |  |  | 14.58 | 14.27 |
| Total risk-based capital ratio |  |  |  | 15.92 | 15.64 |
| Tangible common equity to assets ratio ${ }^{(4)}$ |  |  |  | 9.72 | 10.26 |
| Tier I leverage ratio |  |  |  | 9.74 | 9.93 |

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

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## Results of Operations



For the quarter ended September 30, 2011, net income attributable to Commerce Bancshares, Inc. amounted to \$65.4 million, an increase of $\$ 9.5$ million, or $16.9 \%$, compared to the third quarter of the previous year. For the current quarter, the annualized return on average assets was $1.32 \%$, the annualized return on average equity was $12.15 \%$, and the efficiency ratio was $58.71 \%$. Diluted earnings per share was $\$ .76$, an increase of $18.8 \%$ compared to $\$ .64$ per share in the third quarter of 2010. Compared to the third quarter of last year, net interest income decreased $\$ 807$ thousand, or $.5 \%$, due to lower interest earned on loans, which was partly offset by higher earnings on investment securities and securities purchased under agreements to resell and lower expense incurred on deposits and borrowings. Non-interest income increased $\$ 1.6$ million, or $1.6 \%$, and included growth in bank card and trust fee income. Compared to the same period last year, non-interest expense decreased $\$ 1.8$ million, or $1.2 \%$, which included declines of $\$ 2.0$ million in deposit insurance expense and $\$ 1.1$ million in supplies and communication costs, partly offset by a $\$ 3.0$ million increase in other non-interest expense. The provision for loan losses totaled $\$ 11.4$ million for the current quarter, representing a decrease of $\$ 10.4$ million from the third quarter of 2010.

Net income attributable to Commerce Bancshares, Inc. for the first nine months of 2011 was $\$ 194.8$ million, an increase of $\$ 35.1$ million, or $21.9 \%$, over the same period in the previous year. For the first nine months of 2011, the annualized return on average assets was $1.37 \%$, the annualized return on average equity was $12.41 \%$, and the efficiency ratio was $58.57 \%$. Diluted earnings per share was $\$ 2.24$, an increase of $23.1 \%$ over $\$ 1.82$ per share in the same period last year. Compared to the first nine months of 2010, net interest income decreased slightly, with trends similar to the quarterly comparison above. Non-interest income grew $\$ 4.2$ million, or $1.4 \%$, largely due to increases of $\$ 13.0$ million in bank card transaction fees and $\$ 6.4$ million in trust fees, which were partially offset by a $\$ 9.1$ million decline in deposit account fees and a $\$ 5.2$ million decline in loan fees and sales. Non-interest expense declined $\$ 5.9$ million compared to the same period last year due to decreases of $\$ 2.7$ million in salaries and benefits expense, $\$ 4.0$ million in supplies and communication costs and $\$ 4.0$ million in deposit insurance expense, which were partially offset by an $\$ 8.5$ million increase in other non-interest expense. The provision for loan losses totaled $\$ 39.4$ million, down $\$ 39.0$ million compared to the same period last year.

On June 29, 2011, the Company's sole bank subsidiary (the Bank), formerly a national banking association, became a state chartered Federal Reserve member bank. The Bank's main regulator changed from the Office of the Comptroller of the Currency to both the Federal Reserve Bank of Kansas City and the Missouri Division of Finance. The Bank's deposits continue to be fully insured by the FDIC in accordance with applicable laws and regulations. As a result of this change, the Company expects to reduce its annual examination fees by approximately $\$ 1.5$ million.

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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 thousands)
Interest income, fully taxable equivalent basis:
Loans
Loans held for sale
Investment securities:
U.S. government and federal agency securities

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage and asset-backed securities
Other securities
Total interest on investment securities

| Three Months Ended |  |  | Nine Months Ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| September 30, 2011 vs. 2010 |  |  | September 30, 2011 vs. 2010 |  |  |
| Change | due to |  | Change d | due to |  |
| Average | Average |  | Average | Average |  |
| Volume | Rate | Total | Volume | Rate | Total |
| \$(5,606 | ) \$(5,776 | ) \$(11,382) | \$(15,278 | ) \$ 20,110 | ) $\$(35,388)$ |
| (1,181 | ) 83 | (1,098 ) | (4,903 | )247 | (4,656 |
| (296 | ) 1,930 | 1,634 | (1,168 | ) 9,247 | 8,079 |
| 146 | 527 | 673 | 443 | 321 | 764 |
| 2,318 | (979 | ) 1,339 | 8,193 | (2,439 | ) 5,754 |
| 8,026 | (8,759 | ) (733 ) | 22,187 | (29,312 | ) (7,125 |
| (113 | ) (1,207 | ) (1,320 ) | (818 | ) 56 | (762 |
| 10,081 | (8,488 | ) 1,593 | 28,837 | (22,127 | ) 6,710 |

Short-term federal funds sold and securities purchased under agreements to resell
Long-term securities purchased under agreements to resell
Interest earning deposits with banks
Total interest income

| 7 | $(6$ | $) 1$ | 22 | $(17$ | $) 5$ |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 2,813 | 238 | 3,051 | 8,652 | $(274$ | $) 8,378$ |
| 98 | 7 | 105 | 33 | 6 | 39 |
| 6,212 | $(13,942)(7,730$ | $)$ | 17,363 | $(42,275$ | $)(24,912)$ |

Interest expense:
Deposits:
Savings
Interest checking and money market
Time open \& C.D.'s of less than $\$ 100,000$
Time open \& C.D.'s of $\$ 100,000$ and over
Total interest on deposits
Federal funds purchased and securities sold under agreements to repurchase
Other borrowings
Total interest expense
Net interest income, fully taxable equivalent basis
$\left.\begin{array}{lllllll}21 & 40 & 61 & 45 & 130 & 175 & \\ 1,023 & (1,900 & )(877 & ) & 2,963 & (5,489 & )(2,526\end{array}\right)$

Net interest income for the third quarter of 2011 was $\$ 158.6$ million (not tax equated), an $\$ 807$ thousand decrease from the third quarter of 2010. The decrease in net interest income was primarily the result of lower interest income earned on loans, due to lower average rates and lower average balances, partly offset by a decline in interest expense incurred on deposits and other borrowings coupled with higher interest income earned on investment securities and securities purchased under agreements to resell. The Company's tax equivalent net interest rate margin was $3.51 \%$ for the third quarter of 2011 compared to $3.75 \%$ in the third quarter of 2010.

Total interest income, on a tax equivalent basis (T/E), decreased $\$ 7.7$ million, or $4.2 \%$, from the third quarter of 2010. Interest income on loans (T/E, including held for sale) declined $\$ 12.5$ million due to a decrease of $\$ 871.1$ million, or

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$8.7 \%$, in average loan balances, coupled with a 14 basis point decrease in average rates earned. The decrease in average loans compared to the third quarter of 2010 included a decrease of $\$ 573.7$ million in average student loans, contributing to a decrease in interest income of $\$ 3.0$ million. The majority of this portfolio was sold in the fourth quarter of 2010. Interest income from consumer loans decreased from the third quarter of 2010 due to a decline of $10.5 \%$, or $\$ 129.5$ million, in average consumer loans coupled with a 45 basis point decrease in average rates earned. Included in the decrease in average consumer loan balances was a decline in marine and
recreational vehicle (RV) loans of $\$ 124.1$ million, resulting from the Company's decision to exit the marine/RV loan origination business. Average business loans decreased $\$ 102.7$ million and the average rate earned decreased 26 basis points, as demand remains weak and usage on lines of credit continues at low levels. Business real estate loans increased $6.2 \%$, or $\$ 124.5$ million, over the third quarter of 2010, which was offset by a decrease in the average rate earned of 36 basis points. Demand for personal real estate and construction loans continues to be negatively affected by housing industry weakness. Average construction loan balances decreased $\$ 118.0$ million, which was slightly offset by an increase in average rates earned. Average personal real estate loan balances decreased $\$ 20.9$ million compared to the third quarter of 2010 and experienced a decrease of 38 basis points in average rates earned.

Interest income on investment securities (T/E) increased $\$ 1.6$ million over the third quarter of 2010. This increase resulted mainly from a $\$ 1.4$ million increase in inflation income earned on TIPS, coupled with increases in average balances in state and municipal obligations and mortgage and asset-backed securities of $\$ 203.1$ million and $\$ 1.1$ billion, respectively. These increases were partially offset by decreases in average rates earned on mortgage and asset-backed securities, which lowered interest income by $\$ 8.8$ million. During the third quarter of 2011, the Company purchased approximately $\$ 1.3$ billion of agency mortgage-backed securities with forward settlement dates, of which approximately $\$ 1.0$ billion will settle in the fourth quarter of 2011. Since interest does not accrue on these bonds until the actual settlement date, the effect of these forward purchases was to increase quarterly average earning assets by $\$ 284.0$ million and reduce income by $\$ 1.5$ million compared to estimated normal settlement. Because the market awards a lower price to forward settled securities, the Company will earn approximately 14 basis points more on these securities over their estimated lives. The Company began investing in long-term securities purchased under agreements to resell in the second half of 2010 to diversify its investment portfolio. The average balance in this category increased $\$ 650.7$ million to $\$ 850.0$ million during the third quarter of 2011 and contributed $\$ 3.1$ million in interest income. The average tax equivalent yield on total interest earning assets was $3.77 \%$ in the third quarter of 2011 compared to $4.19 \%$ in the third quarter of 2010.

Total interest expense decreased $\$ 7.3$ million, or $37.3 \%$, compared to the third quarter of 2010, due to a $\$ 5.2$ million decrease in interest expense on interest bearing deposits, coupled with a $\$ 1.8$ million decrease in interest expense on other borrowings. The decrease in interest expense on deposits resulted from a 22 basis point decrease in average rates paid. Average balances of interest checking and money market accounts increased $\$ 962.3$ million, or $14.2 \%$, while average certificates of deposit decreased $\$ 455.2$ million, or $14.9 \%$. Interest expense on other borrowings declined mainly due to lower average FHLB advances, which declined $\$ 237.7$ million, or $69.5 \%$, due to scheduled maturities of advances and the early pay off of $\$ 125.0$ million in the fourth quarter of 2010. The overall average rate incurred on all interest bearing liabilities decreased to $.40 \%$ in the third quarter of 2011 compared to $.66 \%$ in the third quarter of 2010.

Net interest income for the first nine months of 2011 was $\$ 484.3$ million compared to $\$ 485.3$ million for the same period in 2010. For the first nine months of 2011, the net yield on total interest earning assets on a tax equivalent basis was $3.73 \%$ compared to $3.91 \%$ in the first nine months of 2010 . The components of net interest income for the first nine months in 2011 compared to the same period in 2010 reflected trends similar to the quarterly discussion above.

Total interest income (T/E) for the first nine months of 2011 decreased $\$ 24.9$ million from the same period last year primarily due to lower interest income earned on the loan portfolio, partially offset by increases in interest income earned on investment securities and securities purchased under agreements to resell. Loan interest income (T/E, including loans held for sale) declined $\$ 40.0$ million, largely due to a $\$ 953.3$ million, or $9.3 \%$, decline in total average loan balances. As noted above, student loans declined due to the sale of the majority of the portfolio in the fourth quarter of 2010. Decreases in consumer, construction and personal real estate loans followed the same trends noted above, while business and business real estate loan balances increased slightly. Investment securities interest income (T/E) increased $\$ 6.7$ million and resulted from an increase in average investment securities balances of $\$ 1.1$ billion, or $17.4 \%$, partially offset by a 40 basis point decrease in average rates earned. Included in the increase in investment securities interest income was a $\$ 7.6$ million increase in inflation income earned on TIPS. Interest income on long-term securities purchased under agreements to resell increased $\$ 8.4$ million in the first nine months of 2011
compared to the prior period.
The decrease of $\$ 26.4$ million in interest expense for the first nine months of 2011 compared to the same period in the prior year was due to a $\$ 15.3$ million, or $29.7 \%$, decrease in interest expense on interest bearing deposits, coupled with a $\$ 10.5$ million, or $79.1 \%$, decrease in interest expense on other borrowings. The decrease in interest expense on deposits primarily resulted from a 23 basis point decrease in average rates paid. Average balances of other borrowings, which is mostly comprised of FHLB borrowings, decreased $\$ 415.6$ million, or $78.8 \%$, due to scheduled maturities of advances and an early pay off, as noted above. For the first nine months of 2011, the overall cost of interest bearing liabilities decreased 30 basis points to $.45 \%$ compared to $.75 \%$ in the same period in the prior year.

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 September 30, |  |  |  | Nine Months Ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2011 | 2010 | \% Cha |  | 2011 | 2010 | \% Ch |  |
| Bank card transaction fees | \$42,149 | \$37,723 | 11.7 | \% | \$120,915 | \$ 107,872 | 12.1 | \% |
| Trust fees | 22,102 | 20,170 | 9.6 |  | 66,218 | 59,846 | 10.6 |  |
| Deposit account charges and other fees | 21,939 | 21,693 | 1.1 |  | 62,028 | 71,146 | (12.8 | ) |
| Bond trading income | 5,556 | 5,133 | 8.2 |  | 15,255 | 15,524 | (1.7 | ) |
| Consumer brokerage services | 2,333 | 2,390 | (2.4 | ) | 7,876 | 6,879 | 14.5 |  |
| Loan fees and sales | 2,034 | 5,830 | (65.1 | ) | 5,933 | 11,141 | (46.7 | ) |
| Other | 5,519 | 7,071 | (21.9 | ) | 20,657 | 22,249 | (7.2 | ) |
| Total non-interest income | \$101,632 | \$ 100,010 | 1.6 | \% | \$298,882 | \$294,657 | 1.4 | \% |
| Non-interest income as a \% of total revenue* | 39.0 | \%38.5 | \% |  | 38.2 | \%37.8 | \% |  |

For the third quarter of 2011 , total non-interest income amounted to $\$ 101.6$ million compared with $\$ 100.0$ million in the same quarter last year, which was an increase of $\$ 1.6$ million, or $1.6 \%$. Bank card fees for the quarter increased $\$ 4.4$ million, or $11.7 \%$, over the third quarter of last year, primarily due to continued growth in transaction fees earned on corporate card, debit card and merchant activity, which grew by $21.8 \%, 6.6 \%$ and $12.3 \%$, respectively. The growth in corporate card fees resulted from continued expansion in transaction volumes from existing customers and activity from new customers, while merchant sales volumes continued to be strong this quarter. Debit card fees, totaling $\$ 15.5$ million in the current quarter, also reflected continued volume growth and comprised $36.8 \%$ of total bank card fees, while corporate card fees, totaling $\$ 15.2$ million, comprised $36.0 \%$ of total fees. As a result of new Federal Reserve regulations for pricing debit card transactions, which were effective October 1, 2011, the Company estimates that debit card revenues will decline approximately $\$ 7.0$ million in the fourth quarter of 2011 . Trust fees for the quarter increased $\$ 1.9$ million, or $9.6 \%$, over the same quarter last year, which resulted from growth of $10.7 \%$ in personal trust fees, but continued to be negatively affected by low interest rates on money market investments held in trust accounts. Deposit account fees increased $\$ 246$ thousand, or $1.1 \%$, over the same period last year as a result of higher overdraft fees, which grew by $\$ 404$ thousand, or $3.6 \%$. Corporate cash management fees, which comprised $35.3 \%$ of total deposit account fees in the current quarter, declined $\$ 454$ thousand compared to the same period in the previous year. Bond trading income for the current quarter totaled $\$ 5.6$ million, an increase of $\$ 423$ thousand, or $8.2 \%$, over the same period last year on higher securities sales to correspondent banks. Consumer brokerage services revenue decreased slightly, while loan fees and sales revenue decreased $\$ 3.8$ million, or $65.1 \%$, mainly due to a decline of $\$ 3.7$ million in gains on student loan sales. Revenues in this category during the current year consisted mainly of mortgage banking and commercial loan commitment fees, as the Company exited from the student lending business last year. Other non-interest income included write downs during the current quarter totaling $\$ 1.7$ million on various banking properties held for sale.

Non-interest income for the nine months ended September 30, 2011 was $\$ 298.9$ million compared to $\$ 294.7$ million in the first nine months of 2010 , resulting in an increase of $\$ 4.2$ million, or $1.4 \%$. Bank card fees increased $\$ 13.0$ million, or $12.1 \%$, as a result of growth of $21.5 \%, 8.3 \%$, and $9.1 \%$ in corporate card, debit card, and merchant fees, respectively. Trust fee income increased $\$ 6.4$ million, or $10.6 \%$, as a result of growth in personal and institutional trust fees. Deposit account fees decreased $\$ 9.1$ million, or $12.8 \%$, due to the effect of overdraft regulations limiting overdraft fees, which were not effective until the second half of 2010. Consumer brokerage revenue increased $\$ 997$ thousand, or $14.5 \%$, which resulted primarily from higher advisory fees. Bond trading income declined $\$ 269$ thousand, or $1.7 \%$, due to lower sales volume, while loan fees and sales decreased by $\$ 5.2$ million, or $46.7 \%$, due to the decline in student lending. Other non-interest income declined $\$ 1.6$ million, or $7.2 \%$, partly due to the write downs on banking properties, as mentioned above. Also included were declines in check sales fees and ATM fees, partly offset by higher tax credit sales income.

Investment Securities Gains (Losses), Net
Net gains and losses on investment securities which were recognized in earnings during the three and nine months ended September 30, 2011 and 2010 are shown in the table below. Net securities gains of $\$ 2.6$ million were recorded in the third quarter of 2011, while net securities gains of $\$ 5.9$ million were recorded in the first nine months of 2011. 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 $\$ 153.2$ million at September 30, 2011. During the current quarter, additional credit-related impairment losses of $\$ 831$ thousand were recorded, bringing the total credit-related impairment losses during the first nine months of 2011 to $\$ 1.8$ million. The cumulative credit-related impairment

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loss on these securities recorded in earnings amounted to $\$ 9.3$ 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 expense of $\$ 1.4$ million for the first nine months of 2011 and income of $\$ 302$ thousand for the same period last year.

|  | Three Months Ended Sept. 30, |  | Nine Months Ended Sept.30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | 2011 | 2010 |  | 2011 | 2010 |
| Available for sale: |  |  |  |  |  |
| Municipal bonds | \$- | \$280 |  | \$177 | \$1,168 |
| Corporate bonds | - | - |  | - | 498 |
| Agency mortgage-backed bonds | - | 484 |  | - | 484 |
| Non-agency mortgage-backed bonds | - | - |  | - | 383 |
| OTTI losses on non-agency mortgage-backed bonds | (831 | ) (2,045 | ) | (1,755 | ) (4,178 |
| Non-marketable: |  |  |  |  |  |
| Private equity investments | 3,418 | 1,297 |  | 7,448 | (1,344 |
| Total investment securities gains (losses), net | \$2,587 | \$16 |  | \$5,870 | \$(2,989 |

Non-Interest Expense

| (Dollars in thousands) | 2011 | 2010 | $\%$ | $\%$ | Change | 2011 |  | 2010 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Salaries and employee benefits | $\$ 85,700$ | $\$ 85,442$ | .3 | $\%$ | $\$ 257,315$ | $\$ 259,988$ | $(1.0$ | $) \%$ |
| Net occupancy | 11,510 | 12,086 | $(4.8$ | $)$ | 34,760 | 35,697 | $(2.6$ | $)$ |
| Equipment | 5,390 | 5,709 | $(5.6$ | $)$ | 16,669 | 17,548 | $(5.0$ | $)$ |
| Supplies and communication | 5,674 | 6,724 | $(15.6$ | $)$ | 16,898 | 20,891 | $(19.1$ | $)$ |
| Data processing and software | 16,232 | 16,833 | $(3.6$ | $)$ | 50,230 | 50,936 | $(1.4$ | $)$ |
| Marketing | 4,545 | 5,064 | $(10.2$ | $)$ | 13,298 | 14,784 | $(10.1$ | $)$ |
| Deposit insurance | 2,772 | 4,756 | $(41.7$ | $)$ | 10,443 | 14,445 | $(27.7$ | $)$ |
| Indemnification obligation | - | - | - |  | $(1,359$ | $)(1,683$ | $) 19.3$ |  |
| Other | 21,923 | 18,972 | 15.6 |  | 62,965 | 54,497 | 15.5 |  |
| Total non-interest expense | $\$ 153,746$ | $\$ 155,586$ | $(1.2$ | $) \%$ | $\$ 461,219$ | $\$ 467,103$ | $(1.3$ | $) \%$ |

Non-interest expense for the third quarter of 2011 amounted to $\$ 153.7$ million, a decrease of $\$ 1.8$ million, or $1.2 \%$, compared with $\$ 155.6$ million recorded in the third quarter of last year. Compared to the third quarter of last year, salaries and benefits expense increased slightly, mainly due to higher incentives which increased $\$ 1.5$ million, offset by a decline of $18.5 \%$ in medical insurance costs. Also, full-time equivalent employees totaled 4,762 at September 30, 2011 compared to 5,011 at September 30, 2010. Occupancy costs decreased $\$ 576$ thousand, or $4.8 \%$, from the same quarter last year, primarily due to lower outside services and depreciation expense. Equipment expense decreased $\$ 319$ thousand, or $5.6 \%$, from the same quarter last year due to lower rental expense for furniture and equipment. Supplies and communication expense declined $\$ 1.1$ million, or $15.6 \%$, to $\$ 5.7$ million, reflecting continued effects of reducing paper supplies, customer checks, and telephone and network costs. Data processing and software costs decreased $\$ 601$ thousand, or $3.6 \%$, mainly due to lower bank card processing costs, while marketing costs decreased $10.2 \%$. Costs for FDIC insurance expense totaled $\$ 2.8$ million, a decrease of $\$ 2.0$ million, or $41.7 \%$, from the same period last year as a result of new assessment rules which became effective in the second quarter of 2011. Other non-interest expense increased $\$ 3.0$ million, or $15.6 \%$, over the same quarter last year and included a $\$ 5.9$ million accrual related to potential loss contingencies for litigation. Other expense also included a decline of $\$ 1.8$ million on foreclosed property expense, partly due to lower losses on fair value adjustments in 2011.

For the first nine months of 2011, non-interest expense amounted to $\$ 461.2$ million, a decrease of $\$ 5.9$ million, or $1.3 \%$, compared with $\$ 467.1$ million in the same period last year. Salaries and benefits expense declined $\$ 2.7$ million, or $1.0 \%$, due to lower salary expense, stock-based compensation, 401 k plan expense and medical insurance costs, partly offset by higher incentive compensation. Occupancy costs decreased $\$ 937$ thousand, or $2.6 \%$, primarily resulting from lower real estate taxes and outside services expense. Equipment costs decreased $\$ 879$ thousand, or $5.0 \%$, mainly due to lower equipment rental and service contract expense. Supplies and communication expense declined $\$ 4.0$ million, or $19.1 \%$, due to lower costs for customer checks, postage,
paper supplies and telephone and network costs. Data processing and software costs decreased $\$ 706$ thousand, or $1.4 \%$, largely due to lower student loan servicing costs, which was partly offset by higher bank card processing costs. Deposit insurance decreased $\$ 4.0$ million, or $27.7 \%$, mainly as a result of the new assessment rules. Other non-interest expense increased $\$ 8.5$ million, largely due to litigation accruals of $\$ 10.9$ million, while costs for foreclosed property declined $\$ 4.5$ million.

Provision and Allowance for Loan Losses

| (In thousands) | Three Months Ended |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{aligned} & \text { Sept. 30, } \\ & 2011 \end{aligned}$ | $\begin{aligned} & \text { June } 30 \text {, } \\ & 2011 \end{aligned}$ | $\begin{aligned} & \text { Sept. 30, } \\ & 2010 \end{aligned}$ | 2011 | 2010 |  |
| Provision for loan losses | \$ 11,395 | \$12,188 | 8 \$21,844 | \$39,372 | \$78,353 |  |
| Net loan charge-offs (recoveries): |  |  |  |  |  |  |
| Business | 889 | 1,439 | 582 | 4,338 | 3,072 |  |
| Real estate-construction and land | 1,215 | 1,125 | 1,971 | 4,326 | 13,417 |  |
| Real estate-business | 1,429 | 339 | 776 | 2,832 | 2,229 |  |
| Consumer credit card | 7,103 | 8,490 | 12,592 | 24,631 | 37,995 |  |
| Consumer | 3,232 | 2,229 | 4,914 | 9,474 | 15,184 |  |
| Revolving home equity | 72 | 344 | 276 | 783 | 1,506 |  |
| Real estate-personal | 673 | 1,027 | 379 | 1,974 | 1,095 |  |
| Overdrafts | 282 | 195 | 354 | 514 | 797 |  |
| Total net loan charge-offs | \$14,895 | \$15,188 | 8 \$21,844 | \$48,872 | \$75,295 |  |
|  | Three Months Ended |  |  | Nine Months Ended September 30, |  |  |
|  | $\begin{aligned} & \text { Sept. 30, } \\ & 2011 \end{aligned}$ | $\begin{aligned} & \text { June } 30, \\ & 2011 \end{aligned}$ | $\begin{aligned} & \text { Sept. 30, } \\ & 2010 \end{aligned}$ | 2011 | 2010 |  |
| Annualized net loan charge-offs*: |  |  |  |  |  |  |
| Business | . 13 \% | $\% .20$ \% | \%. 08 \% | . 20 | \%. 14 | \% |
| Real estate-construction and land | 1.17 | 1.05 | 1.47 | 1.34 | 3.11 |  |
| Real estate-business | . 27 | . 06 | . 15 | . 18 | . 15 |  |
| Consumer credit card | 3.83 | 4.58 | 6.55 | 4.38 | 6.73 |  |
| Consumer | 1.16 | . 80 | 1.58 | 1.13 | 1.60 |  |
| Revolving home equity | . 06 | . 29 | . 23 | . 22 | . 41 |  |
| Real estate-personal | . 19 | . 29 | . 10 | . 18 | . 10 |  |
| Overdrafts | 16.13 | 11.75 | 21.07 | 9.96 | 15.17 |  |
| Total annualized net loan charge-offs | . 65 \% | \%. 66 | \%. 89 \% | . 71 | \% 1.03 | \% |

* as a percentage of average loans (excluding loans held for sale)

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.

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

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Loans which are not individually evaluated are segregated by loan type and sub-type and are collectively evaluated. These loans include commercial loans (business, construction and business real estate) which have been graded pass, special mention or substandard and all personal banking loans, except personal real estate loans on non-accrual status. These loans also include certain troubled debt restructurings, which are collectively evaluated because they have similar risk characteristics. Allowances determined for personal banking loans, which are generally smaller balance homogeneous type loans, use consistent methodologies

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which consider historical and current loss trends, delinquencies and current economic conditions. Allowances for commercial type loans, which are generally larger and more complex in structure with more unpredictable loss characteristics, use methods which consider historical and current loss trends, current loan grades, delinquencies, industry concentrations, economic conditions throughout the Company's markets as monitored by Company credit officers, and general economic conditions.
The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses is based upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in portfolio risk ratings, levels of non-performing assets, and prevailing regional and national economic conditions. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company's senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The Company's subsidiary bank continues to be subject to examination by several regulatory agencies, and examinations are conducted throughout the year, targeting various segments of the loan portfolio for review. Note 1 in the 2010 Annual Report on Form 10-K contains additional discussion on the allowance and charge-off policies.

Net loan charge-offs for the third quarter of 2011 amounted to $\$ 14.9$ million, compared with $\$ 15.2$ million in the prior quarter and $\$ 21.8$ million in the third quarter of last year. The $\$ 293$ thousand decrease in net loan charge-offs in the third quarter of 2011 compared to the previous quarter was mainly the result of continued improved delinquency and loss rates in consumer credit card, business, and personal real estate loans, where net loan charge-offs declined by $\$ 1.4$ million, $\$ 550$ thousand and $\$ 354$ thousand, respectively. Consumer net loan charge-offs increased $\$ 1.0$ million over the previous quarter, mainly the result of higher marine and RV loan losses. Additionally, business real estate net loan charge-offs increased $\$ 1.1$ million. The ratio of annualized total net loan charge-offs to total average loans was $.65 \%$ in the current quarter, compared to $.66 \%$ in the previous quarter and $.89 \%$ in the third quarter of last year.

For the third quarter of 2011, annualized net charge-offs on average consumer credit card loans amounted to $3.83 \%$, compared with $4.58 \%$ in the previous quarter and $6.55 \%$ in the same period last year. Annualized net charge-offs on consumer loans were $1.16 \%$ in the third quarter of 2011 , up from $.80 \%$ in the previous quarter but still lower than $1.58 \%$ in the third quarter of 2010.

The provision for loan losses for the current quarter totaled $\$ 11.4$ million, a decrease of $\$ 793$ thousand from the previous quarter and $\$ 10.4$ million lower than in the same period last year. The current quarter provision for loan losses was $\$ 3.5$ million less than net loan charge-offs for the current quarter, thereby reducing the allowance to $\$ 188.0$ million at September 30, 2011. The amount of the provision in each quarter was determined in the process described above. The provision in the current quarter was influenced by lower incurred losses within the loan portfolio and lower overall loan balances.

Net charge-offs during the first nine months of 2011 were $\$ 48.9$ million compared to $\$ 75.3$ million in the same period of 2010. The $\$ 26.4$ million decrease was due to declines in net charge-offs of consumer credit card loans of $\$ 13.4$ million, construction loans of $\$ 9.1$ million, and consumer loans of $\$ 5.7$ million. The provision for loan losses was $\$ 39.4$ million in the first nine months of 2011 compared to $\$ 78.4$ million in the same period in 2010.

The allowance for loan losses at September 30, 2011 totaled $\$ 188.0$ million, compared to $\$ 191.5$ million at June 30, 2011. At September 30, 2011, the allowance was $2.07 \%$ of total loans, excluding loans held for sale, and $247.7 \%$ of total non-accrual loans. The Company considers the allowance for loan losses adequate to cover losses inherent in the loan portfolio at September 30, 2011.

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## Risk Elements of Loan Portfolio

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

Lon-performing assets as a percentage of total 90 days and still accruing interest:
Business
Real estate - construction and land
Real estate - business
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Total loans past due 90 days and still accruing interest

| September 30,June 30, <br> 2011  | 2011 | December 31, <br> 2010 |  |
| :--- | :--- | :--- | :--- |
| $\$ 26,334$ | $\$ 26,030$ | $\$ 8,933$ |  |
| 26,307 | 28,709 | 52,752 |  |
| 15,948 | 16,780 | 16,242 |  |
| 7,323 | 8,198 | 7,348 |  |
| 75,912 | 79,717 | 85,275 |  |
| 23,813 | 23,551 | 12,045 |  |
| $\$ 99,725$ | $\$ 103,268$ | $\$ 97,320$ |  |
| 1.10 | $\% 1.12$ | $\% 1.03$ | $\%$ |
| .48 | $\% .53$ | $\% .53$ | $\%$ |
|  |  |  |  |
| $\$ 676$ | $\$ 755$ | $\$ 854$ |  |
| 697 | 871 | 217 |  |
| 5,262 | 6,564 | - |  |
| 2,580 | 4,561 | 3,554 |  |
| 2,065 | 1,488 | 2,867 |  |
| 825 | 760 | 825 |  |
| 7,999 | 8,599 | 12,149 |  |
| $\$ 20,104$ | $\$ 23,598$ | $\$ 20,466$ |  |

Non-accrual loans, which are also classified as impaired, totaled $\$ 75.9$ million at September 30, 2011, which was a decrease of $\$ 3.8$ million from amounts recorded at June 30, 2011 and a decrease of $\$ 9.4$ million from December 31, 2010. At September 30, 2011, non-accrual loans were comprised mainly of construction and land real estate loans ( $34.7 \%$ ), business loans $(34.7 \%$ ) and business real estate loans ( $21.0 \%$ ). Foreclosed real estate increased to $\$ 23.8$ million at September 30, 2011, compared to $\$ 23.6$ million at June 30, 2011 and $\$ 12.0$ million at December 31, 2010. Total loans past due 90 days or more and still accruing interest amounted to $\$ 20.1$ million as of September 30, 2011, and decreased $\$ 3.5$ million and $\$ 362$ thousand compared to balances at June 30, 2011 and December 31, 2010, 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 $\$ 250.6$ million at September 30, 2011 compared with $\$ 233.5$ million at December 31, 2010, resulting in an increase of $\$ 17.1$ million, or $7.3 \%$. The increase occurred mainly in business real estate loans, due to a downgrade in credit ratings on a number of loans during the Company's normal review process.

| Potential problem loans: |  |  |
| :--- | :--- | :--- |
| Business | $\$ 74,250$ | $\$ 79,640$ |
| Real estate - construction and land | 57,150 | 51,589 |
| Real estate - business | 111,559 | 94,063 |
| Real estate - personal | 7,632 | 7,910 |
| Consumer | 39 | 284 |
| Total potential problem loans | $\$ 250,630$ | $\$ 233,486$ |

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At September 30, 2011, the Company had identified approximately $\$ 101.0$ 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, $\$ 36.9$ million have been placed on non-accrual status. Of the remaining $\$ 64.1$ million, approximately $\$ 42.0$ million were commercial loans (business, construction and business real estate) classified as substandard, which were renewed at interest rates that were not judged to be market rates for new debt with similar risk. These loans are performing under their modified terms, and the Company believes it probable that all amounts due under the modified terms of the agreements will be collected. However, because of their substandard classification, they are included as potential problem loans in the table above. An additional $\$ 22.1$ million in troubled debt restructurings were composed of certain credit card loans under various debt management and assistance programs. These restructured loans are considered impaired loans for purposes of determining the allowance for loan losses, as discussed in the Summary of Significant Accounting Policies in the Company's 2010 Annual Report on Form 10-K.

## Loans with Special Risk Characteristics

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

## Real Estate - Construction and Land Loans

The Company's portfolio of construction loans, as shown in the table below, amounted to $4.4 \%$ of total loans outstanding at September 30, 2011. Balances in this portfolio decreased $\$ 63.3$ million, or $13.7 \%$, since December 31, 2010, which is mainly a reflection of the slower economy. Also contributing to the decline in balances were $\$ 4.3$ million in net loan charge-offs in the first nine months of 2011.

| (In thousands) | $\begin{aligned} & \text { September 30, } \\ & 2011 \end{aligned}$ | \% of Tota | \% of <br> Total <br> Loans | $\begin{aligned} & \text { December 31 } \\ & 2010 \end{aligned}$ |  | $\%$ of Total tal Loans |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Residential land and land development | \$82,894 | 20.9 | \%.9 | \% \$ 112,963 | 24.5 | \% 1.2 |
| Residential construction | 70,121 | 17.6 | . 8 | 80,516 | 17.5 | . 9 |
| Commercial land and land development | 96,676 | 24.3 | 1.1 | 115,106 | 25.0 | 1.2 |
| Commercial construction | 147,907 | 37.2 | 1.6 | 152,268 | 33.0 | 1.6 |
| Total real estate - construction and land loans | \$397,598 | 100.0 | \% 4.4 | \% \$ 460,853 | 100.0 | \%4.9 |

## Real Estate - Business Loans

Total business real estate loans were $\$ 2.1$ billion at September 30, 2011 and comprised $23.6 \%$ of the Company's total loan portfolio. These loans include properties such as manufacturing and warehouse buildings, small office and medical buildings, churches, hotels and motels, shopping centers, and other commercial properties. Approximately $49 \%$ of these loans were for owner-occupied real estate properties, which present lower risk profiles.

| (In thousands) | $\begin{aligned} & \text { September 30, } \\ & 2011 \end{aligned}$ | \% of Total | \% of <br> Total <br> Loans | $\begin{aligned} & \text { December 31, } \\ & 2010 \end{aligned}$ | \% of | \% of <br> Total tal Loans |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Owner-occupied | \$ 1,044,077 | 48.8 | \% 11.5 | \% \$990,892 | 48.0 | \% 10.5 |
| Office | 264,334 | 12.4 | 2.9 | 254,882 | 12.4 | 2.7 |
| Retail | 227,417 | 10.6 | 2.5 | 226,418 | 11.0 | 2.4 |
| Multi-family | 154,777 | 7.2 | 1.7 | 143,051 | 6.9 | 1.5 |

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| Hotels | 120,788 | 5.7 | 1.3 | 108,127 | 5.2 | 1.2 |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Farm | 114,278 | 5.3 | 1.3 | 120,388 | 5.8 | 1.3 |  |
| Industrial | 94,471 | 4.4 | 1.1 | 118,159 | 5.7 | 1.3 |  |
| Other | 118,671 | 5.6 | 1.3 | 103,920 | 5.0 | 1.1 |  |
| Total real estate - business loans | $\$ 2,138,813$ | 100.0 | $\% 23.6$ | $\% \$ 2,065,837$ | 100.0 | $\% 22.0$ | $\%$ |

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Real Estate - Personal Loans
The Company's $\$ 1.4$ billion personal real estate loan portfolio is composed mainly of residential first mortgage real estate loans. As shown on page 43, the loss rates in both 2011 and 2010 have remained low, and at September 30, 2011 loans past due 90 days or more have declined compared to December 31, 2010. Also, as shown in Note 2, 8.1\% of this portfolio has low FICO scores of less than 660 . Approximately $\$ 17.0$ million of these loans were structured with interest only payments. These loans are typically made to high net-worth borrowers and generally have low LTV ratios or have additional collateral pledged to secure the loan and, therefore, they are not perceived to represent above normal credit risk. At September 30, 2011, the Company had loans with no mortgage insurance that also have an original LTV greater than $80 \%$ totaling $\$ 146.3$ million, compared to $\$ 154.8$ million at December 31, 2010.

## Revolving Home Equity Loans

The Company also has $\$ 466.9$ million in revolving home equity loans at September 30, 2011 that are generally collateralized by residential real estate. Most of these loans ( $94.7 \%$ ) 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 September 30, 2011, the outstanding principal of loans with an original LTV higher than $80 \%$ was $\$ 72.8$ million compared to $\$ 78.9$ million as of December 31, 2010. Total revolving home equity loan balances over 30 days past due were $\$ 2.2$ million at September 30, 2011 compared to $\$ 1.8$ million at December 31, 2010. Approximately $7.5 \%$ of the portfolio has FICO scores below 660.

## Fixed Rate Home Equity Loans

In addition to the residential real estate mortgage and the revolving home equity products mentioned above, the Company offers a third choice to those consumers desiring a fixed rate home equity loan with a fixed maturity date. The fixed rate home equity loan is typically used to finance a specific home repair or remodeling project. This portfolio of loans approximated $\$ 133.2$ million and $\$ 132.7$ million at September 30, 2011 and December 31, 2010, respectively. At the end of the third quarter of 2011, $\$ 36.4$ million of this portfolio had an original LTV over $80 \%$, down from $\$ 39.3$ million at the end of 2010.

At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, such loans totaled less than $5 \%$ of the outstanding balance of fixed rate home equity loans at September 30, 2011. The Company has limited the offering of fixed rate home equity loans with original LTV ratios over $90 \%$ during the past several years, and only $\$ 2.2$ million in new fixed rate home equity loans were written with these LTV ratios during the first nine months of 2011.

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 nine months of 2011 of $\$ 2.0$ million, $\$ 783$ thousand and $\$ 675$ thousand, respectively. The amount of any increased potential loss on high LTV agreements relates mainly to amounts advanced that are in excess of the $80 \%$ collateral calculation, not the entire approved line. The Company currently offers no subprime first mortgage or home equity loans. These are characterized as new loans to customers with FICO scores below 650 for home equity loans, 660 for government-insured first mortgages, and 680 for all other conventional first mortgages. The Company does not purchase brokered loans.

## Other Consumer Loans

Within the consumer loan portfolio are several direct and indirect product lines, comprised mainly of loans secured by automobiles and marine and RVs. Outstanding balances for these loans were $\$ 808.8$ million and $\$ 882.7$ million at September 30, 2011 and December 31, 2010, respectively. The balances over 30 days past due amounted to $\$ 9.3$ million at September 30, 2011 compared to $\$ 15.1$ million at the end of 2010. For the nine months ended September

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30, 2011, $\$ 186.4$ million of new loans, mostly automobile loans, were originated, compared to $\$ 187.1$ million during the full year of 2010.

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at September 30, 2011 of $\$ 752.5$ million in consumer credit card loans outstanding, approximately $\$ 131.3$ million, or $17.5 \%$, carried a low introductory rate. Within the next six months, $\$ 68.8$ 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.

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## Income Taxes

Income tax expense was $\$ 31.7$ million in the third quarter of 2011, compared to $\$ 32.7$ million in the second quarter of 2011 and $\$ 26.0$ million in the third quarter of 2010. The Company's effective tax rate, including the effect of non-controlling interest, was $32.7 \%$ in the third quarter of 2011 , compared with $32.1 \%$ in the second quarter of 2011 and $31.8 \%$ in the third quarter of 2010 . Additionally, income tax expense was $\$ 91.9$ million in the first nine months of 2011 compared to $\$ 71.8$ million for the same period during the previous year, resulting in effective tax rates, including the effect of non-controlling interest, of $32.0 \%$ and $31.0 \%$, respectively. The change in the effective tax rate for the first nine months of 2011 compared to the same period in 2010 is primarily due to changes in the mix of taxable and non-taxable income during those periods.

## Financial Condition

## Balance Sheet

Total assets of the Company were $\$ 20.6$ billion at September 30, 2011 compared to $\$ 18.5$ billion at December 31, 2010. Earning assets (excluding fair value adjustments on investment securities) amounted to $\$ 19.3$ billion at September 30, 2011 consisting of $48 \%$ in investment securities and $47 \%$ in loans, compared to $\$ 17.3$ billion at December 31, 2010.

At September 30, 2011, total loans, including loans held for sale, decreased $\$ 362.0$ million, or $3.8 \%$, compared with balances at December 31, 2010. Business loans declined $\$ 187.8$ million as demand for business loans remains weak. Construction and personal real estate loans decreased $\$ 63.3$ million and $\$ 11.9$ million, respectively, reflecting the continued housing industry weakness. Business real estate loans increased $\$ 73.0$ million, or $3.5 \%$, compared with balances at December 31, 2010. Consumer credit card loans decreased $\$ 78.6$ million. Consumer loans, mainly comprised of automobile and marine and RV loans, declined $\$ 58.5$ million, primarily due to a decrease in marine and RV loans of $\$ 90.4$ million, as the Company has ceased most marine and RV lending. Partly offsetting the marine and RV loan decline was an increase in other consumer loans of $\$ 31.9$ million.

Available for sale investment securities, excluding fair value adjustments, increased $\$ 1.9$ billion, or $26.5 \%$, at September 30, 2011 compared to December 31, 2010. The increase was mainly the result of purchases of agency mortgage-backed, other asset-backed and municipal securities totaling $\$ 1.5$ billion, $\$ 417.7$ million and $\$ 118.3$ million, respectively, in the third quarter of 2011. Included in these purchases were approximately $\$ 1.3$ billion of agency mortgage-backed securities with forward settlement dates, of which approximately $\$ 1.0$ billion will settle in the fourth quarter of 2011. At September 30, 2011, the duration of the available for sale investment portfolio was 2.2 years, and maturities of approximately $\$ 1.5$ billion are expected to occur during the next twelve months. During the first nine months of 2011, total long-term securities purchased under agreements to resell increased $\$ 400.0$ million to $\$ 850.0$ million at September 30, 2011. These agreements, which are collateralized and due from other large financial institutions, mature within the next three years.

Deposits at September 30, 2011 totaled $\$ 16.0$ billion, a $\$ 929.1$ million, or $6.2 \%$, increase compared to $\$ 15.1$ billion at December 31, 2010. This growth was primarily the result of increases of $\$ 509.6$ million non-interest bearing deposits, $\$ 627.3$ million in money market accounts, and $\$ 109.6$ million in certificates of deposit over $\$ 100,000$. These increases were partly offset by declines of $\$ 260.2$ million in certificates of deposit under $\$ 100,000$ and $\$ 110.4$ million in interest checking balances. Certain non-interest bearing deposit accounts, which were previously included in interest bearing money market deposit totals, were reclassified to non-interest bearing deposits effective January 1, 2011. All prior periods have been revised to reflect this reclassification. The effect of this reclassification at December 31, 2010 was to increase the balance of non-interest bearing deposits by $\$ 2.3$ billion.

Other liabilities increased $\$ 1.0$ billion, primarily due to the purchase of mortgage-backed securities with settlement dates in the fourth quarter of 2011 as discussed above.

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

| (In thousands) | September 30, <br> 2011 | June 30, 2011 | December 31, <br> 2010 |
| :--- | :--- | :--- | :--- |
| Liquid assets: | $\$ 9,278,066$ | $\$ 7,717,634$ | $\$ 7,294,303$ |
| Available for sale investment securities | 11,400 | 10,845 | 10,135 |
| Federal funds sold | 850,000 | 850,000 | 450,000 |
| Long-term securities purchased under agreements to resell | 83,419 | 535,696 | 122,076 |
| Balances at the Federal Reserve Bank | 130, |  |  |
| Total | $\$ 10,272,885$ | $\$ 9,114,175$ | $\$ 7,876,514$ |

Federal funds sold, which are sold to the Company's correspondent bank customers and have overnight maturities, totaled $\$ 11.4$ million as of September 30, 2011. Long-term resell agreements, maturing between 2012 and 2014, totaled $\$ 850.0$ million at September 30, 2011. Under these agreements, the Company holds marketable securities as collateral, which totaled $\$ 892.2$ million in fair value at September 30, 2011. Interest earning balances at the Federal Reserve Bank, which also have overnight maturities and are used for general liquidity purposes, totaled $\$ 133.4$ million at September 30, 2011. The fair value of the available for sale investment portfolio was $\$ 9.3$ billion at September 30, 2011 and included an unrealized net gain of $\$ 212.2$ million. The total net unrealized gain included gains of $\$ 124.7$ million on mortgage and asset-backed securities, $\$ 32.2$ million on U.S. government securities, $\$ 17.8$ million on state and municipal obligations, and $\$ 7.6$ million on corporate debt. An additional $\$ 25.8$ million unrealized gain was included in the fair value of common stock held by the Parent.

The portfolio includes maturities of approximately $\$ 1.5$ billion over the next 12 months, which offers 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 September 30, 2011, total investment securities pledged for these purposes were as follows:

| (In thousands) | September 30, |
| :--- | :--- |
| Investment securities pledged for the purpose of securing: | 2011 |
| Federal Reserve Bank borrowings | $\$ 576,725$ |
| FHLB borrowings and letters of credit | 130,803 |
| Securities sold under agreements to repurchase | $1,820,390$ |
| Other deposits | $1,392,477$ |
| Total pledged securities | $3,920,395$ |
| Unpledged and available for pledging | $3,768,745$ |
| Ineligible for pledging | $1,588,926$ |
| Total available for sale securities, at fair value | $\$ 9,278,066$ |

Liquidity is also available from the Company's large base of core customer deposits, defined as non-interest bearing, interest checking, savings, and money market deposit accounts. At September 30, 2011, such deposits totaled $\$ 13.4$ billion and represented $83.8 \%$ of total deposits. These core deposits are normally less volatile, often with customer relationships tied to other products offered by the Company, promoting long lasting relationships and stable funding sources. Time open and certificates of deposit of $\$ 100,000$ and over totaled $\$ 1.4$ billion at September 30, 2011. These accounts are normally considered more volatile and higher costing, and they comprised $8.7 \%$ of total deposits at

September 30, 2011.
(In thousands)

Core deposit base:
Non-interest bearing
Interest checking
Savings and money market
Total

| September 30, <br> 2011 | June 30, 2011 | December 31, <br> 2010 |
| :--- | :--- | :--- |
| $\$ 5,003,587$ $\$ 4,834,750$ $\$ 4,494,028$ <br> 707,946   | 722,549 | 818,359 |
| $7,708,893$ | $7,417,440$ | $7,028,472$ |
| $\$ 13,420,426$ | $\$ 12,974,739$ | $\$ 12,340,859$ |

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

September 30, 2011 June 30, 2011 December 31, 2010

| $\$ 1,530$ | $\$ 11,692$ | $\$ 4,910$ |
| :--- | :--- | :--- |
| $1,056,198$ | $1,270,778$ | 977,917 |
| 104,333 | 104,364 | 104,675 |
| 7,536 | 7,565 | 7,598 |
| $\$ 1,169,597$ | $\$ 1,394,399$ | $\$ 1,095,100$ |

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 $\$ 656.2$ million at September 30, 2011, and structured repurchase agreements of $\$ 400.0$ million. The structured repurchase agreements mature in 2013 and 2014, while the remaining repurchase agreements are borrowed on an overnight basis. The Company also borrows on a secured basis through advances from the FHLB, which totaled $\$ 104.3$ million at September 30, 2011. These advances have fixed interest rates, and most mature in 2017. Other outstanding borrowings relate mainly to the Company's private equity investments.

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 September 30, 2011:

September 30, 2011
(In thousands)
Collateral value pledged
Advances outstanding
Letters of credit issued
Available for future advances

|  | Federal |  |  |
| :--- | :--- | :--- | :--- |
| FHLB | Reserve | Total |  |
| $\$ 1,885,259$ | $\$ 1,363,100$ | $\$ 3,248,359$ |  |
| $(104,333$ | $)-$ | $(104,333$ | $)$ |
| $(239,207$ | $)-$ | $(239,207$ | $)$ |
| $\$ 1,541,719$ | $\$ 1,363,100$ | $\$ 2,904,819$ |  |

In addition to those mentioned above, several other sources of liquidity are available. The Company has strong long-term deposit ratings from Standard \& Poor's and Moody's of A+ and Aa2, respectively. Additionally, its sound commercial paper rating of A-1 from Standard \& Poor's and P-1 from Moody's would help ensure the ready marketability of the Company's commercial paper, should the need arise. No commercial paper has been issued or outstanding during the past ten years. Neither the Company nor its banking subsidiary has any 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.

Cash and cash equivalents (defined as "Cash and due from banks", "Short-term federal funds sold and securities purchased under agreements to resell", and "Interest earning deposits with banks" as segregated in the accompanying balance sheets) was $\$ 569.7$ million at September 30, 2011 compared to $\$ 460.7$ million at December 31, 2010. The $\$ 109.0$ 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 September 30, 2011. 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 nine months of 2011, operating activities provided cash of $\$ 311.1$ million. Investing activities, which occur mainly in the loan and investment securities portfolios, used cash of $\$ 1.1$ billion. Most of the cash outflow was due to $\$ 2.9$ billion in purchases of investment securities and purchases of $\$ 500.0$ million in long-term securities purchased under agreements to resell. These outflows were partially offset by $\$ 2.0$ billion in maturities and pay downs of investment securities, repayments of $\$ 100.0$ million in long-term securities purchased under agreements to resell, and a net decline in loans of $\$ 289.0$ million. Financing activities provided cash of $\$ 868.7$ million, resulting from increases of $\$ 939.8$ million in deposit accounts and $\$ 74.9$ million in short-term federal

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funds purchased and securities sold under agreements to repurchase, partially offset by $\$ 101.1$ million in purchases of treasury stock and cash dividends paid of $\$ 59.6$ million. Future short-term liquidity needs arising from daily operations are not expected to vary significantly, and the Company believes it will be able to meet these cash flow needs.

## Capital Management

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

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

| September 30, <br> 2011 | December 31, <br> 2010 |
| :--- | :--- |
| $\$ 12,924,431$ | $\$ 12,717,868$ |
| $1,883,960$ | $1,828,965$ |
| $2,057,471$ | $2,002,646$ |
| 14.58 | $\% 14.38$ |
| 15.92 | $\% 15.75$ |
| 9.74 | $\% 10.17$ |

for Well-Capitalized Banks
\$12,924,431 \$12,717,868
2,057,471 2,002,646
14.58 \% 14.38

| $\% 6.00$ | $\%$ |
| :--- | :--- |
| $\% 10.00$ | $\%$ |
| $\% 5.00$ | $\%$ |

The Company maintains a stock buyback program, and in July 2011 the Board of Directors approved the future purchase of up to $3,000,000$ shares of stock. During the quarter ended September 30, 2011, the Company purchased $2,175,885$ shares of stock in the market at an average cost of $\$ 38.04$ per share. At September 30, 2011, 824,115 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 $\$ .23$ in the first quarter of 2011, which was a $2.7 \%$ increase compared to the fourth quarter of 2010, and maintained the same payout in the second and third quarters of 2011.

Commitments, Off-Balance Sheet Arrangements and Contingencies
In the normal course of business, various commitments and contingent liabilities arise which are not required to be recorded on the balance sheet. The most significant of these are loan commitments, which at September 30, 2011 totaled $\$ 7.5$ billion (including approximately $\$ 3.5$ billion in unused approved credit card lines). In addition, the Company enters into standby and commercial letters of credit. These contracts amounted to $\$ 322.7$ million and $\$ 12.8$ million, respectively, at September 30, 2011. As many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. The carrying value of the guarantee obligations associated with the standby letters of credit, which has been recorded as a liability on the balance sheet, amounted to $\$ 5.1$ million at September 30, 2011.

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 nine months of 2011, purchases and sales of tax credits amounted to $\$ 39.8$ million and $\$ 35.6$ million, respectively, and at September 30, 2011, outstanding purchase commitments totaled $\$ 100.1$ 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 September 30, 2011. In addition, the Parent expects to fund $\$ 18.7$ 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.

On April 6, 2010 a suit was filed against Commerce Bank (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. For further information, refer to Note 15 in the consolidated financial statements.

## Segment Results

The table below is a summary of segment pre-tax income results for the first nine months of 2011 and 2010.

| (In thousands) | Consumer |  | Commerci |  | Wealth |  | Segment <br> Totals |  | Other/ <br> Elimination | Consolidat <br> Totals |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Nine Months Ended September 30, 2011 |  |  |  |  |  |  |  |  |  |  |  |
| Net interest income | \$213,580 |  | \$209,686 |  | \$28,962 |  | \$452,228 |  | \$32,085 | \$484,313 |  |
| Provision for loan losses | (36,158 | ) | (11,942 | ) | (611 | ) | (48,711 |  | 9,339 | \$(39,372 | ) |
| Non-interest income | 102,657 |  | 121,212 |  | 76,711 |  | 300,580 |  | (1,698 | ) 298,882 |  |
| Investment securities gains, net | - |  | - |  | - |  | - |  | 5,870 | 5,870 |  |
| Non-interest expense | (203,215 | ) | (165,767 | ) | (66,552 | ) | (435,534 |  | (25,685 | ) $(461,219$ | ) |
| Income before income taxes | \$76,864 |  | \$153,189 |  | \$38,510 |  | \$268,563 |  | \$19,911 | \$288,474 |  |
| Nine Months Ended September 30,$2010$ |  |  |  |  |  |  |  |  |  |  |  |
| Net interest income | \$236,578 |  | \$ 196,133 |  | \$28,274 |  | \$460,985 |  | \$24,270 | \$485,255 |  |
| Provision for loan losses | (54,545 | ) | (19,569 | ) | (1,038 | ) | (75,152 | ) | (3,201 | ) $(78,353$ | ) |
| Non-interest income | 112,576 |  | 112,366 |  | 69,292 |  | 294,234 |  | 423 | 294,657 |  |
| Investment securities losses, net | - |  | - |  | - |  | - |  | (2,989 | ) $(2,989$ | ) |
| Non-interest expense | (221,189 | ) | (165,232 | ) | (64,567 | ) | (450,988 |  | (16,115 | ) (467,103 | ) |
| Income before income taxes | \$73,420 |  | \$123,698 |  | \$31,961 |  | \$229,079 |  | \$2,388 | \$231,467 |  |
| Increase in income before income taxes: |  |  |  |  |  |  |  |  |  |  |  |
| Amount | \$3,444 |  | \$29,491 |  | \$6,549 |  | \$39,484 |  | \$17,523 | \$57,007 |  |
| Percent | 4.7 |  | \%23.8 |  | \%20.5 |  | 17.2 | \% | N.M | M. 24.6 |  |

## Consumer

For the nine months ended September 30, 2011, income before income taxes for the Consumer segment increased $\$ 3.4$ million, or $4.7 \%$, over the first nine months of 2010 . This increase was mainly due to declines of $\$ 18.4$ million in the provision for loan losses and $\$ 18.0$ million in non-interest expense. Partly offsetting these effects was a decline of $\$ 23.0$ million, or $9.7 \%$, in net interest income, coupled with a decline of $\$ 9.9$ million in non-interest income. Net interest income declined due to a $\$ 30.1$ million decrease in loan interest income and a $\$ 5.9$ million decrease in net allocated funding credits assigned to the Consumer segment's loan and deposit portfolios, partly offset by a decline of $\$ 12.9$ million in deposit interest expense. The decline in loan interest income included a $\$ 10.2$ million decrease in student loan interest, resulting from the Company's sale of most of the student loan portfolios in 2010, and a $\$ 6.3$ million decline in interest on marine and RV loans. Non-interest income decreased mainly due to a decline in deposit account fees (mainly overdraft charges), 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). Non-interest expense declined $8.1 \%$ from the previous year due mainly to lower supplies expense, deposit account processing expense, teller services expense and FDIC insurance expense, partly offset by higher building rental expense. The provision for loan losses totaled $\$ 36.2$ million, an $\$ 18.4$ million decrease from the first nine months of 2010 , which was due mainly to lower losses on consumer credit card loans, marine and RV loans, and other consumer loans.

## Commercial

For the nine months ended September 30, 2011, income before income taxes for the Commercial segment increased $\$ 29.5$ million, or $23.8 \%$, compared to the same period in the previous year, mainly due to a lower provision for loan losses and growth in net interest income and non-interest income. Net interest income increased $\$ 13.6$ million, or $6.9 \%$, due to higher net allocated funding credits of $\$ 20.5$ million, partly offset by a $\$ 7.9$ million decline in loan interest income. The provision for loan losses in this segment totaled $\$ 11.9$ million in the first nine months of 2011, a
decrease of $\$ 7.6$ million from the first nine months of 2010. During 2011, net charge-offs on construction loans declined $\$ 9.1$ million, while net charge-offs on business loans increased $\$ 1.8$ million. Non-interest income increased by $\$ 8.8$ million, or $7.9 \%$, over the previous year due to growth in bank card fees (mainly corporate card), partly offset by lower deposit account fees. Non-interest expense increased $\$ 535$ thousand over the previous year, mainly due to increases in bank card related expenses and deposit account cash management expense, partly offset by a decline in foreclosed real estate and other repossessed property expense.

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## Wealth

Wealth segment pre-tax profitability for the nine months ended September 30, 2011 increased $\$ 6.5$ million, or $20.5 \%$, over the same period in the previous year. Net interest income increased $\$ 688$ thousand, or $2.4 \%$, and was impacted by a $\$ 1.6$ million increase in assigned net funding credits and a $\$ 1.1$ million decline in deposit interest expense, offset by a $\$ 2.1$ million decrease in loan interest income. Non-interest income increased $\$ 7.4$ million, or $10.7 \%$, over the prior year due to higher trust and brokerage fees. Non-interest expense increased $\$ 2.0$ million, or $3.1 \%$, mainly due to higher fraud losses and salary expense.

The Other/Elimination category in the preceding table includes the activity of various support and overhead operating units of the Company, in addition to the investment securities portfolio and other items not allocated to the segments. In accordance with the Company's transfer pricing policies, the difference between the total provision and total net charge-offs is not allocated to a business segment, and is included in this category. The pre-tax profitability of this category was higher than in the previous period by $\$ 17.5$ million. This increase was mainly due to a decline in the unallocated loan loss provision of $\$ 12.5$ 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 $\$ 7.8$ million, and unallocated amounts related to investment securities gains increased $\$ 8.9$ million. These effects were partly offset by a $\$ 9.6$ million increase in unallocated non-interest expense, consisting mainly of accruals in 2011 related to potential loss contingencies for pending litigation.

## Regulatory Changes Affecting the Banking Industry

In March 2010, legislation was passed which expanded Pell Grants and Perkins Loan programs and required all colleges and universities to convert to direct lending programs with the U.S. government as of July 1, 2010. Previously, colleges and universities had the choice of participating in either direct lending with the U.S. government or a program whereby loans were originated by banks but guaranteed by the U.S. government. The Company terminated its guaranteed student loan origination business effective July 1, 2010 and sold most of its student loan portfolios in 2010.

The Federal Reserve issued new regulations, effective July 1, 2010, which prohibited 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. The Company implemented new procedures to solicit and capture required customer consents and, effective July 1, 2010, prohibited such ATM and one-time debit card transactions causing overdrafts, unless an opt-in consent has been received. As not all customers provided such consent, these new regulations resulted in lower deposit fee income in the second half of 2010. Overdraft fees decreased $\$ 9.0$ million during the first nine months of 2011 as compared to the same period in the prior year, and most of this decrease related to these new regulations.

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

Because the Company has maintained a strong balance sheet with solid amounts of capital and has not offered many of the complex financial products that were prevalent in the marketplace, there are a number of provisions within the Dodd-Frank Act, including higher capital standards, improved lending transparency and risked-based FDIC insurance assessments, that management does not expect to negatively affect the Company's future results. However, other provisions in the Dodd-Frank Act, such as limitations on debit card fees (mentioned below) and the potential for

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higher costs due to increased regulatory and compliance burdens, will likely lower revenues or raise costs to the Company. The provisions of the Dodd-Frank Act are so extensive that full implementation may require several years, and an assessment of its full effect on the Company is not possible at this time.

In June 2011, the Federal Reserve, as required by the Dodd-Frank Act, approved a final debit card interchange rule that significantly limits the amount of debit card interchange fees charged by banks. The new rule caps an issuer's base fee at 21 cents per transaction and allows additional fees to help cover fraud losses. The new pricing is a reduction of approximately $45 \%$ when compared to current market rates. The new rule also limits network exclusivity, requiring issuers to ensure that a debit card transaction can be carried on two unaffiliated networks: one signature-based and one PIN-based. The new rules apply to bank issuers with more than $\$ 10$ billion in assets and took effect October 1, 2011. As a result of this rule, the Company estimates that debit card revenues will decline approximately $\$ 7.0$ million in the fourth quarter of 2011.

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Impact of Recently Issued Accounting Standards
Fair Value Measurements 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 were effective January 1, 2011, and did not have a significant effect on the Company's consolidated financial statements.

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

Credit Quality of Financing Receivables and the Allowance for Credit Losses In July 2010, the FASB issued ASU 2010-20, "Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses". This guidance is intended 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 ASU requires disclosures about the activity in the allowance, non-accrual and impaired loan status, credit quality indicators, past due information, loan modifications, and significant loan purchases and sales. Much of the disclosure is required on a disaggregated level by portfolio segment or class basis. The required disclosures are included in Note 2 in the accompanying consolidated financial statements and did not have a significant effect on the financial statements.

Troubled Debt Restructurings In April 2011, the FASB issued ASU 2011-02, "A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring". The ASU seeks to create consistency in the application of U.S. GAAP for identifying and evaluating debt restructurings. It clarifies existing guidance on a creditor's evaluation of whether it has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The ASU specifically addresses how the debtor's access to funds at a market interest rate, increases in the contractual interest rate, and payment delays should be considered when determining whether a concession has been granted. The ASU was effective July 1, 2011 and requires disclosure of modifications occurring since January 1, 2011 which have been newly identified as troubled debt restructurings under the new guidance. Because the Company has generally applied the ASU's guidance in identifying troubled debt restructurings in the past, no new troubled debt restructurings have been identified as a result of the adoption of the ASU.

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

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

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

AVERAGE BALANCE SHEETS - AVERAGE RATES AND YIELDS
Three Months Ended September 30, 2011 and 2010
Third Quarter 2011
Third Quarter 2010

|  |  |  | Avg. | Average |
| :--- | :--- | :--- | :--- | :--- |$\quad$| Average |
| :--- |
| (Dollars in thousands) |$\quad$| Interest | Rates |
| :--- | :--- |$\quad$| Avg. |
| :--- |
| Rates |

ASSETS:
Loans:


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| Total interest bearing deposits | $10,894,521$ | 10,988 | .40 | $10,335,198$ | 16,166 | .62 |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Borrowings: <br> Federal funds purchased and |  |  |  |  |  |  |  |  |
| securities sold |  |  |  |  |  |  |  |  |$\quad$| $\quad$ under agreements to repurchase | $1,016,623$ | 292 | .11 | $1,023,961$ | 584 | .23 |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $\quad$ Other borrowings | 111,930 | 925 | 3.28 | 350,328 | 2,729 | 3.09 |  |
| Total borrowings | $1,128,553$ | 1,217 | .43 | $1,374,289$ | 3,313 | .96 |  |
| Total interest bearing liabilities | $12,023,074$ | 12,205 | .40 | $\%$ | $11,709,487$ | 19,479 | .66 |
| Non-interest bearing deposits | $4,778,780$ |  |  | $4,192,026$ |  |  |  |
| Other liabilities | 728,974 |  |  | 700,754 |  |  |  |
| Equity | $2,133,236$ |  |  | $2,019,039$ |  |  |  |
| Total liabilities and equity | $\$ 19,664,064$ | $\$ 164,317$ |  | $\$ 18,621,306$ |  |  |  |
| Net interest margin (T/E) |  |  | 3.51 | $\%$ |  | $\$ 164,773$ |  |
| Net yield on interest earning assets |  |  |  |  |  | 3.75 | $\%$ |

(A) Stated on a tax equivalent basis using a federal income tax rate of $35 \%$.
(B)This portfolio was sold during October 2010.

AVERAGE BALANCE SHEETS - AVERAGE RATES AND YIELDS
Nine Months Ended September 30, 2011 and 2010
Nine Months 2011
(Dollars in thousands)

| Average | Interest | Avg. | Rates |
| :--- | :--- | :--- | :--- | Average

Avg. Balance Income/Expense ${ }_{\text {Eates }}^{\text {Ratne }}$ ASSETS:
Loans:

| Business ${ }^{(4)}$ | \$2,941,359 | \$ 79,523 | 3.61 | \% | \$2,876,601 | \$ 83,017 | 3.86 | \% |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Real estate - construction and land | 431,082 | 14,426 | 4.47 |  | 577,160 | 17,145 | 3.97 |  |
| Real estate - business | 2,101,859 | 76,534 | 4.87 |  | 2,038,142 | 77,171 | 5.06 |  |
| Real estate - personal | 1,438,106 | 52,430 | 4.87 |  | 1,486,826 | 58,318 | 5.24 |  |
| Consumer | 1,121,194 | 53,106 | 6.33 |  | 1,270,031 | 64,357 | 6.78 |  |
| Revolving home equity | 470,074 | 14,984 | 4.26 |  | 485,445 | 15,669 | 4.32 |  |
| Student ${ }^{\text {(B) }}$ | - | - | - |  | 321,912 | 5,665 | 2.35 |  |
| Consumer credit card | 751,109 | 62,993 | 11.21 |  | 754,570 | 68,042 | 12.06 |  |
| Overdrafts | 6,903 | - | - |  | 7,025 | - | - |  |
| Total loans | 9,261,686 | 353,996 | 5.11 |  | 9,817,712 | 389,384 | 5.30 |  |
| Loans held for sale | 50,678 | 877 | 2.31 |  | 447,948 | 5,533 | 1.65 |  |
| Investment securities: |  |  |  |  |  |  |  |  |
| U.S. government and federal agency | 367,708 | 15,204 | 5.53 |  | 439,991 | 7,125 | 2.17 |  |
| Government-sponsored enterprise obligations | 235,502 | 4,297 | 2.44 |  | 209,268 | 3,533 | 2.26 |  |
| State and municipal obligations ${ }^{(\mathrm{A})}$ | 1,152,988 | 38,982 | 4.52 |  | 924,925 | 33,228 | 4.80 |  |
| Mortgage and asset-backed securities | 5,629,684 | 107,055 | 2.54 |  | 4,651,629 | 114,180 | 3.28 |  |
| Other marketable securities ${ }^{(A)}$ | 173,722 | 6,221 | 4.79 |  | 185,586 | 6,660 | 4.80 |  |
| Trading securities ${ }^{(\mathrm{A})}$ | 20,087 | 409 | 2.72 |  | 18,651 | 405 | 2.90 |  |
| Non-marketable securities ${ }^{(\mathrm{A})}$ | 106,495 | 5,273 | 6.62 |  | 115,365 | 5,600 | 6.49 |  |
| Total investment securities | 7,686,186 | 177,441 | 3.09 |  | 6,545,415 | 170,731 | 3.49 |  |
| Short-term federal funds sold and securities |  |  |  |  |  |  |  |  |
| Long-term securities purchased under agreements to resell | 741,575 | 9,240 | 1.67 |  | 67,164 | 862 | 1.72 |  |
| Interest earning deposits with banks | 218,178 | 411 | . 25 |  | 200,363 | 372 | . 25 |  |
| Total interest earning assets | 17,969,171 | 542,010 | 4.03 |  | 17,085,590 | 566,922 | 4.44 |  |
| Allowance for loan losses | (192,998 | ) |  |  | (196,023 | ) |  |  |
| Unrealized gain on investment securities | 154,193 |  |  |  | 140,003 |  |  |  |
| Cash and due from banks | 342,759 |  |  |  | 369,641 |  |  |  |
| Land, buildings and equipment, net | 379,718 |  |  |  | 397,396 |  |  |  |
| Other assets | 377,493 |  |  |  | 419,566 |  |  |  |
| Total assets | \$ 19,030,336 |  |  |  | \$18,216,173 |  |  |  |
| LIABILITIES AND EQUITY: |  |  |  |  |  |  |  |  |
| Interest bearing deposits: |  |  |  |  |  |  |  |  |
| Savings | \$524,139 | 623 | . 16 |  | \$477,977 | 448 | . 13 |  |
| Interest checking and money market | 7,579,863 | 19,094 | . 34 |  | 6,709,259 | 21,620 | . 43 |  |
| Time open \& C.D.'s of less than \$100,000 | 1,326,496 | 9,121 | . 92 |  | 1,703,307 | 18,318 | 1.44 |  |
| Time open \& C.D.'s of \$100,000 and over | 1,423,984 | 7,237 | . 68 |  | 1,354,985 | 10,946 | 1.08 |  |


| Total interest bearing deposits | $10,854,482$ | 36,075 | .44 | $10,245,528$ | 51,332 | .67 |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Borrowings: <br> Federal funds purchased and |  |  |  |  |  |  |  |  |
| securities sold |  |  |  |  |  |  |  |  |
| $\quad$ under agreements to repurchase | 997,124 | 1,601 | .21 | $1,071,595$ | 2,230 | .28 |  |  |
| $\quad$ Other borrowings | 112,135 | 2,759 | 3.29 | 527,738 | 13,227 | 3.35 |  |  |
| Total borrowings | $1,109,259$ | 4,360 | .53 | $1,599,333$ | 15,457 | 1.29 |  |  |
| Total interest bearing liabilities | $11,963,741$ | 40,435 | .45 | $\%$ | $11,844,861$ | 66,789 | .75 | $\%$ |
| Non-interest bearing deposits | $4,596,763$ |  |  | $4,036,624$ |  |  |  |  |
| Other liabilities | 370,663 |  |  | 366,410 |  |  |  |  |
| Equity | $2,099,169$ |  |  | $1,968,278$ |  |  |  |  |
| Total liabilities and equity | $\$ 19,030,336$ | $\$ 501,575$ |  | $\$ 18,216,173$ |  | $\$ 500,133$ |  |  |
| Net interest margin (T/E) |  | $\$ 3.73$ | $\%$ |  |  | 3.91 | $\%$ |  |

(A) Stated on a tax equivalent basis using a federal income tax rate of $35 \%$.
(B) This portfolio was sold during October 2010.

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

Interest rate risk management focuses on maintaining consistent growth in net interest income within Board-approved policy limits. The Company primarily uses earnings simulation models to analyze net interest sensitivity to movement in interest rates. The Company performs monthly simulations which model interest rate movements and risk in accordance with changes to its balance sheet composition. For further discussion of the Company's market risk, see the Interest Rate Sensitivity section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2010 Annual Report on Form 10-K.

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


As shown above, under the above scenarios at September 30, 2011, a gradual increase in interest rates of 200 basis points is expected to decrease net interest income by $\$ 1.5$ million, or $.2 \%$, and a rise of 300 basis points is expected to decrease net interest income by $\$ 4.0$ million, or $.6 \%$. Under a 100 basis point rising rate scenario, net income would increase by $\$ 125$ thousand. Due to the already low interest rate environment, the Company did not model falling rate scenarios.

During the third quarter of 2011 compared to the previous quarter, average loans (including held for sale loans) declined by $\$ 177.6$ million. Average available for sale securities increased by $\$ 745.6$ million, of which $\$ 304.5$ million related to purchases which were not settled as of September 30, 2010. Also, average deposits increased $\$ 193.9$ million while total average borrowings grew by $\$ 64.4$ million.
Under the 200 and 300 rising rate scenarios, the overall balance sheet became liability sensitive and net interest income declined due to an increase during the quarter in investment securities balances, which are mostly at fixed rates, coupled with a decline in loan balances, which are more sensitive to changes in interest rates. Also, growth in average non-maturity deposits (which occurred mainly in non-interest bearing demand and money market accounts, partly offset by a decline in certificates of deposit) had the effect of reducing net interest income in these scenarios, as interest costs would increase more quickly.

The Company believes that its approach to interest rate risk has appropriately considered its susceptibility to both rising and falling rates and has adopted strategies which minimized impacts to overall interest rate risk.

## Item 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2011. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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## PART II: OTHER INFORMATION

## Item 1. LEGAL PROCEEDINGS

The information required by this item is set forth in Part I, Item 1 under Note 15, Legal Proceedings.

## 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.

Period
July 1-31, 2011
Aug 1 - 31, 2011
Sept 1 - 30, 2011
Total

| Total <br> Number | Average | Total Number of <br> Shares Purchased | Maximum Number that |
| :--- | :---: | :--- | :--- |
| of Shares | Price Paid | as part of Publicly | May Yet Be Purchased <br> Purchased |
| per Share | Announced Program | Under the Program |  |
| 180,000 | $\$ 41.17$ | 180,000 | $2,820,000$ |
| $1,682,961$ | $\$ 37.83$ | $1,682,961$ | $1,137,039$ |
| 312,924 | $\$ 37.36$ | 312,924 | 824,115 |
| $2,175,885$ | $\$ 38.04$ | $2,175,885$ | 824,115 |

In July 2011, the Board of Directors approved the purchase of up to $3,000,000$ shares of the Company's common stock. At September 30, 2011, 824,115 shares remained available to be purchased under the current authorization.

## Item 6. EXHIBITS

See Index to Exhibits

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## SIGNATURES

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

COMMERCE BANCSHARES, INC.

By /s/ JAMES L. SWARTS<br>James L. Swarts<br>Vice President \& Secretary

Date: November 4, 2011
By /s/ JEFFERY D. ABERDEEN
Jeffery D. Aberdeen
Controller
(Chief Accounting Officer)
Date: November 4, 2011

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## INDEX TO EXHIBITS

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

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

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

