COMMERCE BANCSHARES INC /MO/
Form 10-Q
May 07, 2014
Table of contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark
One)
p QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

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

## Missouri

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

$$
43-0889454
$$

(IRS Employer Identification No.)

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

As of April 30, 2014, the registrant had outstanding $95,185,720$ shares of its $\$ 5$ par value common stock, registrant's only class of common stock.

Commerce Bancshares, Inc. and Subsidiaries
Form 10-Q
Page
INDEX
Part I Financial Information
Item 1. Financial Statements
Consolidated Balance Sheets as of March 31, 2014 (unaudited) and December $\underline{3}_{3}$
31, 2013
Consolidated Statements of Income for the Three Months Ended March 31. 2014 and 2013 (unaudited) ..... 4
Consolidated Statements of Comprehensive Income for the Three Months ..... 5 Ended March 31, 2014 and 2013 (unaudited)
Consolidated Statements of Changes in Equity for the Three Months Ended March 31. 2014, and 2013 (unaudited) ..... 6
Consolidated Statements of Cash Flows for the Three Months Ended March ..... 7
31, 2014 and 2013 (unaudited)
Notes to Consolidated Financial Statements ..... 8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ..... $\underline{37}$
Item 3. Quantitative and Qualitative Disclosures about Market Risk ..... 55
Item 4. Controls and Procedures ..... 55
Part II Other Information
Item 1. Legal Proceedings ..... $\underline{56}$
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds ..... $\underline{56}$
Item 6. Exhibits ..... $\underline{56}$
Signatures ..... $\underline{57}$
Index to Exhibits ..... $\underline{58}$

## Table of contents

## PART I: FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED BALANCE SHEETS

## ASSETS

Loans
Allowance for loan losses
Net loans
Investment securities:
Available for sale (\$552,477,000 and \$687,680,000 pledged in 2014 and 2013, respectively, to secure swap and 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 96,244,762 shares in 2014 and 2013
Capital surplus
Retained earnings
Treasury stock of 391,599 shares in 2014 and 235,986 shares in 2013, at cost

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| Accumulated other comprehensive income | 40,499 | 9,731 |
| :--- | :--- | :--- |
| Total Commerce Bancshares, Inc. stockholders' equity | $2,270,379$ | $2,210,642$ |
| Non-controlling interest | 3,132 | 3,755 |
| Total equity | $2,273,511$ | $2,214,397$ |
| Total liabilities and equity | $\$ 22,837,120$ | $\$ 23,072,036$ |

See accompanying notes to consolidated financial statements.

3

## Table of contents

Commerce Bancshares, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME

| (In thousands, except per share data) | For the Three Months Ended March 31 |  |
| :---: | :---: | :---: |
|  | 20142013 |  |
|  | (Unaudited) |  |
| INTEREST INCOME |  |  |
| Interest and fees on loans | \$110,702 | \$107,786 |
| Interest and fees on loans held for sale | - | 85 |
| Interest on investment securities | 45,019 | 44,959 |
| Interest on short-term federal funds sold and securities purchased under |  |  |
| Interest on long-term securities purchased under agreements to resell | 4,151 | 5,829 |
| Interest on deposits with banks | 100 | 77 |
| Total interest income | 159,998 | 158,745 |
| INTEREST EXPENSE |  |  |
| Interest on deposits: |  |  |
| Savings, interest checking and money market | 3,306 | 3,924 |
| Time open and C.D.'s of less than \$100,000 | 1,120 | 1,749 |
| Time open and C.D.'s of \$100,000 and over | 1,452 | 1,699 |
| Interest on federal funds purchased and securities sold under |  |  |
| Interest on other borrowings | 851 | 812 |
| Total interest expense | 6,932 | 8,402 |
| Net interest income | 153,066 | 150,343 |
| Provision for loan losses | 9,660 | 3,285 |
| Net interest income after provision for loan losses | 143,406 | 147,058 |
| NON-INTEREST INCOME |  |  |
| Bank card transaction fees | 41,717 | 38,550 |
| Trust fees | 26,573 | 25,169 |
| Deposit account charges and other fees | 18,590 | 18,712 |
| Capital market fees | 3,870 | 4,391 |
| Consumer brokerage services | 2,747 | 2,686 |
| Loan fees and sales | 1,209 | 1,473 |
| Other | 7,921 | 8,896 |
| Total non-interest income | 102,627 | 99,877 |
| INVESTMENT SECURITIES GAINS (LOSSES), NET |  |  |
| Change in fair value of other-than-temporarily impaired securities | (63 | ) 1,389 |
| Portion recognized in other comprehensive income | (283 | ) $(1,831$ |
| Net impairment losses recognized in earnings | (346 | ) (442 |
| Realized gains (losses) on sales and fair value adjustments | 10,383 | (1,723 |
| Investment securities gains (losses), net | 10,037 | (2,165 |
| NON-INTEREST EXPENSE |  |  |
| Salaries and employee benefits | 94,263 | 90,881 |
| Net occupancy | 11,616 | 11,235 |
| Equipment | 4,504 | 4,683 |
| Supplies and communication | 5,699 | 5,589 |
| Data processing and software | 19,087 | 18,951 |


| Marketing | 3,681 | 3,359 |
| :--- | :--- | :--- |
| Deposit insurance | 2,894 | 2,767 |
| Other | 20,596 | 17,572 |
| Total non-interest expense | 162,340 | 155,037 |
| Income before income taxes | 93,730 | 89,733 |
| Less income taxes | 29,609 | 28,925 |
| Net income | 64,121 | 60,808 |
| Less non-controlling interest expense (income) | $(192$ | $)(209$ |
| Net income attributable to Commerce Bancshares, Inc. | $\$ 64,313$ | $\$ 61,017$ |
| Net income per common share - basic | $\$ .67$ | $\$ .64$ |
| Net income per common share - diluted | $\$ .67$ | $\$ .63$ |

See accompanying notes to consolidated financial statements.
4

## Table of contents

Commerce Bancshares, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
$\left.\begin{array}{lll} & \begin{array}{l}\text { For the Three Months } \\ \text { Ended March 31 }\end{array} \\ \text { (In thousands) } & \begin{array}{l}\text { 2014 } \\ \text { (Unaudited) }\end{array} \\ \begin{array}{lll}\text { Net income } \\ \text { Other comprehensive income (loss): } \\ \text { Net unrealized gains on securities for which a } \\ \text { portion of an other-than-temporary impairment } \\ \text { has been recorded in earnings }\end{array} & \begin{array}{lll}\$ 64,121 & \$ 60,808\end{array} \\ \begin{array}{lll}\text { Net unrealized gains (losses) on other } \\ \text { securities }\end{array} & 166 & 1,137 \\ \text { Pension loss amortization } & 30,379 & (8,193\end{array}\right)$

See accompanying notes to consolidated financial statements.

5

## Table of contents

Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Commerce Bancshares, Inc. Shareholders

| (In thousands, except per share data) | Common Stock | Capital <br> Surplus | Accumulated |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Retained Earnings | Treasury Stock | Other Comprehe Income (L | Non-Con iventerest s) | oll | ling |
|  | (Unaudited) |  |  |  |  |  |  |  |
| Balance January 1, 2014 | \$481,224 | \$ 1,279,948 | \$449,836 | \$(10,097 | ) \$ 9,731 | \$ 3,755 |  | \$2,214,397 |
| Net income |  |  | 64,313 |  |  | (192 |  | 64,121 |
| Other comprehensive income |  |  |  |  | 30,768 |  |  | 30,768 |
| Distributions to non-controlling interest |  |  |  |  |  | (431 | ) | (431 |
| Purchase of treasury stock |  |  |  | (20,900 | ) |  |  | (20,900 |
| Issuance of stock under purchase and equity compensation plans |  | (2,897 | ) | 6,982 |  |  |  | 4,085 |
| Net tax benefit related to equity compensation plans |  | 800 |  |  |  |  |  | 800 |
| Stock-based compensation |  | 2,261 |  |  |  |  |  | 2,261 |
| Issuance of nonvested stock awards |  | (6,822 | ) | 6,822 |  |  |  | - |
| Cash dividends ( $\$ .225$ per share) |  |  | (21,590 | ) |  |  |  | (21,590 |
| Balance March 31, 2014 | \$481,224 | \$ 1,273,290 | \$492,559 | \$(17,193 | )\$ 40,499 | \$ 3,132 |  | \$2,273,511 |
| Balance January 1, 2013 | \$458,646 | \$ 1,102,507 | \$477,210 | \$(7,580 | )\$ 136,344 | \$ 4,447 |  | \$2,171,574 |
| Net income |  |  | 61,017 |  |  | (209 | ) | 60,808 |
| Other comprehensive loss |  |  |  |  | (6,581 | ) |  | (6,581 |
| Distributions to non-controlling interest |  |  |  |  |  | (192 | ) | (192 |
| Purchase of treasury stock |  |  |  | (29,993 | ) |  |  | (29,993 |
| Issuance of stock under purchase and equity compensation plans |  | (1,146 | ) | 3,752 |  |  |  | 2,606 |
| Net tax benefit related to equity compensation plans |  | 181 |  |  |  |  |  | 181 |
| Stock-based compensation |  | 1,223 |  |  |  |  |  | 1,223 |
| Issuance of nonvested stock awards |  | (1,320 | ) | 1,320 |  |  |  | - |
| Cash dividends (\$.214 per share) |  |  | (20,435 |  |  |  |  | (20,435 |
| Balance March 31, 2013 | \$458,646 | \$ 1,101,445 | \$517,792 | \$(32,501 | )\$ 129,763 | \$ 4,046 |  | \$2,179,191 |

See accompanying notes to consolidated financial statements.

## Table of contents

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

| (In thousands) | For the Three Months Ended March 31 |  |
| :---: | :---: | :---: |
|  | 2014 | 2013 |
|  | (Unaudited) |  |
| OPERATING ACTIVITIES: |  |  |
| Net income | \$64,121 | \$60,808 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |
| Provision for loan losses | 9,660 | 3,285 |
| Provision for depreciation and amortization | 10,508 | 10,424 |
| Amortization of investment security premiums, net | 6,675 | 12,539 |
| Investment securities (gains) losses, net(A) | (10,037 | 2,165 |
| Net decrease in trading securities | 16,597 | 9,609 |
| Stock-based compensation | 2,261 | 1,223 |
| Increase in interest receivable | (1,421 | (5 |
| Increase in interest payable | 25 | 246 |
| Increase in income taxes payable | 30,410 | 26,894 |
| Net tax benefit related to equity compensation plans | (800 | (181 |
| Other changes, net | (6,524 | (28,936 |
| Net cash provided by operating activities | 121,475 | 98,071 |
| INVESTING ACTIVITIES: |  |  |
| Proceeds from sales of investment securities(A) | 31,666 | 52 |
| Proceeds from maturities/pay downs of investment securities(A) | 456,956 | 674,270 |
| Purchases of investment securities(A) | (628,237 ) | (934,142) |
| Net increase in loans | $(275,036)$ | (159,087) |
| Long-term securities purchased under agreements to resell | (100,000 ) | (50,000 |
| Repayments of long-term securities purchased under agreements to resell | 300,000 | 50,000 |
| Purchases of land, buildings and equipment | (3,954 | (5,867 |
| Sales of land, buildings and equipment | 5 | 404 |
| Net cash used in investing activities | (218,600 ) | (424,370) |
| FINANCING ACTIVITIES: |  |  |
| Net decrease in non-interest bearing, savings, interest checking and money market deposits | (132,858) | (138,419) |
| Net increase in time open and C.D.'s | 167,862 | 310,948 |
| Repayment of long-term securities sold under agreements to repurchase | (150,000 ) | - |
| Net increase (decrease) in short-term federal funds purchased and securities sold under |  |  |
| Repayment of other long-term borrowings | (196 | (927 |
| Net decrease in other short-term borrowings | (2,000 ) | - |
| Purchases of treasury stock | (20,900 ) | (29,993 |
| Issuance of stock under stock purchase and equity compensation plans | 4,085 | 2,606 |
| Net tax benefit related to equity compensation plans | 800 | 181 |
| Cash dividends paid on common stock | (21,590 ) | (20,435 |
| Net cash provided by (used in) financing activities | (424,203 ) | 167,269 |
| Decrease in cash and cash equivalents | (521,328) | (159,030) |
| Cash and cash equivalents at beginning of year | 1,269,514 | 779,825 |
| Cash and cash equivalents at March 31 | \$748,186 | \$620,795 |

(A) Available for sale and non-marketable securities

| Income tax net payments (refunds) | $\$(807$ | ) |
| :--- | :--- | :--- |
| Interest paid on deposits and borrowings | $\$ 2,031$ |  |
| Loans transferred to foreclosed real estate | $\$ 8369$ | $\$ 8,156$ |
| See accompanying notes to consolidated financial statements. | $\$ 3,925$ |  |

7

## Table of contents

Commerce Bancshares, Inc. and Subsidiaries

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014 (Unaudited)

## 1. Principles of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts of Commerce Bancshares, Inc. and all majority-owned subsidiaries (the Company). Most of the Company's operations are conducted by its subsidiary bank, Commerce Bank (the Bank). The consolidated financial statements in this report have not been audited. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to 2013 data to conform to current year presentation. In the opinion of management, all adjustments necessary to present fairly the financial position and the results of operations for the interim periods have been made. All such adjustments are of a normal recurring nature. The results of operations for the three month period ended March 31, 2014 are not necessarily indicative of results to be attained for the full year or any other interim period.

The significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the 2013 Annual Report on Form 10-K.

## 2. Acquisition and Disposition

On September 1, 2013, the Company acquired Summit Bancshares Inc. (Summit). Summit's results of operations are included in the Company's consolidated financial results beginning on that date. The transaction was accounted for using the acquisition method of accounting and, as such, assets acquired, liabilities assumed and consideration exchanged were recorded at their estimated fair value on the acquisition date. In this transaction, the Company acquired all of the outstanding stock of Summit in exchange for shares of Company stock valued at $\$ 43.2$ million. The valuation of Company stock was determined on the basis of the closing market price of the Company's common shares on August 30, 2013. The Company's acquisition of Summit added $\$ 261.6$ million in assets (including $\$ 207.4$ million in loans), $\$ 232.3$ million in deposits and two branch locations in Tulsa and Oklahoma City, Oklahoma. Intangible assets recognized as a result of the transaction consisted of approximately $\$ 13.3$ million in goodwill and $\$ 5.6$ million in core deposit premium. Most of the goodwill was assigned to the Company's Commercial segment. None of the goodwill recognized is deductible for income tax purposes.
The Company has contracted to sell banking branches in Farmington, Desloge and Bonne Terre, Missouri. The transaction is expected to close in July 2014, pending regulatory approval. The Company expects to sell approximately $\$ 16$ million in loans, $\$ 75$ million in deposits, and various bank premises.
3. Loans and Allowance for Loan Losses

Major classifications within the Company's held for investment loan portfolio at March 31, 2014 and December 31, 2013 are as follows:

| (In thousands) | March 31, 2014 | December 31, <br> 2013 |
| :--- | :--- | :--- |
| Commercial: |  | $\$ 3,941,394$ |
| Business | 423,667 | $\$ 3,715,319$ |
| Real estate - construction and land | $2,315,167$ | 406,197 |
| Real estate - business |  | $2,313,550$ |
| Personal Banking: | $1,782,831$ | $1,787,626$ |
| Real estate - personal | $1,561,973$ | $1,512,716$ |
| Consumer | 419,376 | 420,589 |

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| Consumer credit card | 775,044 | 796,228 |
| :--- | :--- | :--- |
| Overdrafts | 2,586 | 4,611 |
| Total loans | $\$ 11,222,038$ | $\$ 10,956,836$ |

At March 31, 2014, loans of $\$ 3.7$ billion were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit obtained to secure public deposits. Additional loans of $\$ 1.4$ billion were pledged at the Federal Reserve Bank as collateral for discount window borrowings.

8

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## Table of contents

Allowance for loan losses
A summary of the activity in the allowance for loan losses during the three months ended March 31, 2014 and 2013, respectively, follows:

|  | For the Three Months Ended March 31, 2014 |  |  | For the Three Months Ended March 31, 2013 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (In thousands) | Commercial | Personal Banking | Total | Commercial | Personal Banking | Total |
| Balance at January 1 | \$94,189 | \$67,343 | \$161,532 | \$105,725 | \$66,807 | \$172,532 |
| Provision | 4,067 | 5,593 | 9,660 | (6,590 | ) 9,875 | 3,285 |
| Deductions: |  |  |  |  |  |  |
| Loans charged off | 1,130 | 12,751 | 13,881 | 705 | 11,801 | 12,506 |
| Less recoveries on loans | 755 | 3,466 | 4,221 | 1,391 | 3,330 | 4,721 |
| Net loan charge-offs (recoveries) | 375 | 9,285 | 9,660 | (686 | ) 8,471 | 7,785 |
| Balance at March 31 | \$97,881 | \$63,651 | \$161,532 | \$99,821 | \$68,211 | \$168,032 |

The following table shows the balance in the allowance for loan losses and the related loan balance at March 31, 2014 and December 31, 2013, disaggregated on the basis of impairment methodology. Impaired loans evaluated under ASC 310-10-35 include loans on non-accrual status, which are individually evaluated for impairment, and other impaired loans discussed below, which are deemed to have similar risk characteristics and are collectively evaluated. All other loans are collectively evaluated for impairment under ASC 450-20.

| Impaired Loans <br> Allowance forLoans <br> Loan Losses | All Other Loans <br> Oltanding | Allowance forLoans <br> Loan Losses |
| :--- | :--- | :--- | :--- |
| Outstanding |  |  |

Impaired loans
The table below shows the Company's investment in impaired loans at March 31, 2014 and December 31, 2013. These loans consist of all loans on non-accrual status and other restructured loans whose terms have been modified and classified as troubled debt restructurings under ASC 310-40. 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. They are discussed further in the "Troubled debt restructurings" section on page 13.
(In thousands)
Non-accrual loans
Restructured loans (accruing)
Total impaired loans

Mar. 31, 2014
\$47,573
60,826
\$108,399

Dec. 31, 2013
\$48,814
58,822
\$ 107,636

## Table of contents

The following table provides additional information about impaired loans held by the Company at March 31, 2014 and December 31, 2013, segregated between loans for which an allowance for credit losses has been provided and loans for which no allowance has been provided.

|  | Recorded <br> Investment | Unpaid <br> Principal <br> Balance | Related <br> Allowance |
| :--- | :--- | :--- | :--- |
| (In thousands) |  |  |  |
| March 31,2014 |  |  |  |
| With no related allowance recorded: | $\$ 7,969$ | $\$ 9,000$ | $\$-$ |
| Business | 8,228 | 15,965 | - |
| Real estate - construction and land | 3,742 | 6,432 | - |
| Real estate - business | 1,538 | 2,188 | - |
| Consumer | 2,191 | 2,741 | - |
| Revolving home equity | $\$ 23,668$ | $\$ 36,326$ | $\$-$ |
|  |  |  |  |
| With an allowance recorded: | $\$ 25,834$ | $\$ 29,189$ | $\$ 2,806$ |
| Business | 15,558 | 17,591 | 1,968 |
| Real estate - construction and land | 17,994 | 26,755 | 2,863 |
| Real estate - business | 9,496 | 12,517 | 1,127 |
| Real estate - personal | 3,948 | 3,948 | 75 |
| Consumer | 605 | 605 | 2 |
| Revolving home equity | 11,296 | 11,296 | 915 |
| Consumer credit card | $\$ 84,731$ | $\$ 101,901$ | $\$ 9,756$ |
|  | $\$ 108,399$ | $\$ 138,227$ | $\$ 9,756$ |
| Total |  |  |  |
| December 31, 2013 | $\$ 7,969$ | $\$ 9,000$ | $\$-$ |
| With no related allowance recorded: | 8,766 | 16,067 | - |
| Business | 4,089 | 6,417 | - |
| Real estate - construction and land | 2,191 | 2,741 | - |
| Real estate - business | $\$ 23,015$ | $\$ 34,225$ | $\$-$ |
| Revolving home equity |  |  |  |
| With an allowance recorded: | $\$ 19,266$ | $\$ 22,597$ | $\$ 3,037$ |
| Business | 17,632 | 19,708 | 2,174 |
| Real estate - construction and land | 20,794 | 29,287 | 3,265 |
| Real estate - business | 10,425 | 13,576 | 1,361 |
| Real estate - personal | 4,025 | 4,025 | 85 |
| Consumer | 666 | 666 | 2 |
| Revolving home equity | 11,813 | 11,813 | 976 |
| Consumer credit card | $\$ 84,621$ | $\$ 101,672$ | $\$ 10,900$ |
|  | $\$ 107,636$ | $\$ 135,897$ | $\$ 10,900$ |

Total average impaired loans for the three month periods ended March 31, 2014 and 2013, respectively, are shown in the table below.
(In thousands)
Average Impaired Loans:
For the three months ended March 31, 2014

Non-accrual loans
Restructured loans (accruing)
Total
For the three months ended March 31, 2013
Non-accrual loans
Restructured loans (accruing)
Total
\$40,302 $\$ 7,565 \quad \$ 47,867$
38,393 21,431 59,824
$\$ 78,695 \quad \$ 28,996 \quad \$ 107,691$
\$41,108 $\$ 6,059 \quad \$ 47,167$
$38,642 \quad 27,291 \quad 65,933$
$\$ 79,750 \quad \$ 33,350 \quad \$ 113,100$

## Table of contents

The table below shows interest income recognized during the three month periods ended March 31, 2014 and 2013 for impaired loans held at the end of each respective period. This interest all relates to accruing restructured loans, as discussed in the "Troubled debt restructurings" section on page 13.
(In thousands)
For the Three Months Ended March 31

Interest income recognized on impaired loans:
Business \$163 \$397
Real estate - construction and land 202
Real estate - business $\quad 30 \quad 61$
Real estate - personal 63
Consumer $\quad 75 \quad 93$
Revolving home equity $\quad 8$
Consumer credit card 240
Total \$702
\$1,075
Delinquent and non-accrual loans
The following table provides aging information on the Company's past due and accruing loans, in addition to the balances of loans on non-accrual status, at March 31, 2014 and December 31, 2013.
(In thousands)
March 31, 2014
Commercial:
Business
Real estate - construction and land
Real estate - business
Personal Banking:
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Overdrafts
Total
December 31, 2013
Commercial:
Business
Real estate - construction and land
Real estate - business
Personal Banking:
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Overdrafts
Total

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


| $\$ 3,922,118$ | $\$ 7,780$ | $\$ 485$ | $\$ 11,011$ | $\$ 3,941,394$ |
| :--- | :--- | :--- | :--- | :--- |
| 409,592 | 4,609 | 19 | 9,447 | 423,667 |
| $2,284,479$ | 11,592 | 42 | 19,054 | $2,315,167$ |
|  |  |  |  |  |
| $1,766,163$ | 11,569 | 767 | 4,332 | $1,782,831$ |
| $1,547,246$ | 10,980 | 2,209 | 1,538 | $1,561,973$ |
| 415,637 | 884 | 664 | 2,191 | 419,376 |
| 758,313 | 8,430 | 8,301 | - | 775,044 |
| 2,380 | 206 | - | - | 2,586 |
| $\$ 11,105,928$ | $\$ 56,050$ | $\$ 12,487$ | $\$ 47,573$ | $\$ 11,222,038$ |


| $\$ 3,697,589$ | $\$ 5,467$ | $\$ 671$ | $\$ 11,592$ | $\$ 3,715,319$ |
| :--- | :--- | :--- | :--- | :--- |
| 386,423 | 9,601 | - | 10,173 | 406,197 |
| $2,292,385$ | 1,340 | 47 | 19,778 | $2,313,550$ |
| $1,771,231$ | 9,755 | 1,560 | 5,080 | $1,787,626$ |
| $1,492,960$ | 17,482 | 2,274 | - | $1,512,716$ |
| 416,614 | 1,082 | 702 | 2,191 | 420,589 |
| 777,564 | 9,952 | 8,712 | - | 796,228 |
| 4,315 | 296 | - | - | 4,611 |
| $\$ 10,839,081$ | $\$ 54,975$ | $\$ 13,966$ | $\$ 48,814$ | $\$ 10,956,836$ |

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## Table of contents

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

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

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## Table of contents

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 "Delinquent and non-accrual loans" 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 borrower'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 certain Personal Banking loans for which FICO scores are not obtained because they generally pertain to commercial customer activities and are often underwritten with other collateral considerations. At March 31, 2014, these were comprised of $\$ 240.8$ million in personal real estate loans and $\$ 12.3$ million in consumer loans, or $5.6 \%$ of the Personal Banking portfolio. At December 31, 2013, these were comprised of $\$ 244.3$ million in personal real estate loans and $\$ 47.5$ million in consumer loans, or $6.5 \%$ of the Personal Banking portfolio. For the remainder of loans in the Personal Banking portfolio, the table below shows the percentage of balances outstanding at March 31, 2014 and December 31, 2013 by FICO score.

Personal Banking Loans
\% of Loan Category

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

March 31, 2014
FICO score:

| Under 600 | 1.7 | $\% 5.5$ | $\% 3.0$ | $\% 4.4$ | $\%$ |
| :--- | :--- | :---: | :---: | :---: | :---: |
| $600-659$ | 3.2 | 10.3 | 4.9 | 12.1 |  |
| $660-719$ | 10.4 | 23.0 | 14.6 | 34.0 |  |
| $720-779$ | 26.1 | 28.9 | 31.9 | 27.7 |  |
| 780 and Over | 58.6 | 32.3 | 45.6 | 21.8 |  |
| Total | 100.0 | $\% 100.0$ | $\% 100.0$ | $\% 100.0$ | $\%$ |
| December 31, 2013 |  |  |  |  |  |
| FICO score: |  |  |  |  |  |
| Under 600 | 1.7 | $\% 5.4$ | $\% 2.1$ | $\% 4.1$ | $\%$ |
| $600-659$ | 3.3 | 10.1 | 7.3 | 11.7 |  |
| $660-719$ | 10.3 | 23.4 | 15.0 | 32.9 |  |
| $720-779$ | 25.8 | 28.3 | 28.5 | 27.9 |  |
| 780 and Over | 58.9 | 32.8 | 47.1 | 23.4 |  |
| Total | 100.0 | $\% 100.0$ | $\% 100.0$ | $\% 100.0$ | $\%$ |

Troubled debt restructurings
As mentioned previously, the Company's impaired loans include loans which have been classified as troubled debt restructurings. Total restructured loans amounted to $\$ 86.0$ million at March 31, 2014. Restructured loans are those extended to borrowers who are experiencing financial difficulty and who have been granted a concession.
Restructured loans are placed on non-accrual status if the Company does not believe it probable that amounts due under the contractual terms will be collected, and those non-accrual loans totaled $\$ 25.2$ million at March 31, 2014. Other performing restructured loans totaled $\$ 60.8$ million at March 31, 2014. These are primarily 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 commercial loans totaled $\$ 41.0$ million at March 31, 2014. 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 $\$ 11.3$ million at March 31, 2014. Modifications to credit card loans generally involve removing the available line of credit, placing loans on amortizing status, and lowering the contractual interest
rate. The Company has classified additional loans as troubled debt restructurings because they were not reaffirmed by the borrower in bankruptcy proceedings. At March 31, 2014, these loans totaled $\$ 8.5$ million in personal real estate, revolving home equity, and consumer loans. Interest on these loans is being recognized on an accrual basis, as the borrowers are continuing to make payments under the terms of the loan agreements.

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

The following table shows the outstanding balances of loans classified as troubled debt restructurings at March 31, 2014, in addition to the outstanding balances of these restructured loans which the Company considers to have been in default at any time during the past twelve months. For purposes of this disclosure, the Company considers "default" to mean 90 days or more past due as to interest or principal.
$\left.\begin{array}{lll}\text { (In thousands) } & \text { March 31, 2014 } & \begin{array}{l}\text { Balance 90 days } \\ \text { past due at any } \\ \text { time during } \\ \text { previous 12 }\end{array} \\ \text { months }\end{array}\right]$

For those loans on non-accrual status also classified as restructured, the modification did not create any further financial effect on the Company as those loans were already recorded at net realizable value. For those performing commercial loans classified as restructured, there were no concessions involving forgiveness of principal or interest and, therefore, there was no financial impact to the Company as a result of modification to these loans. No financial impact resulted from those performing loans where the debt was not reaffirmed in bankruptcy, as no changes to loan terms occurred in that process. The effects of modifications to consumer credit card loans were estimated to decrease interest income by approximately $\$ 1.2$ million on an annual, pre-tax basis, compared to amounts contractually owed.

The allowance for loan losses related to 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 performing loans classified as troubled debt restructurings are accruing loans which management expects to collect under contractual terms. Performing commercial loans have had no other concessions granted other than being renewed at an interest rate judged not to be market. As such, they have similar risk characteristics as non-troubled debt commercial loans and are collectively evaluated based on internal risk rating, loan type, delinquency, historical experience and current economic factors. Performing personal banking loans classified as troubled debt restructurings resulted from the borrower not reaffirming the debt during bankruptcy and have had no other concession granted, other than the Bank's future limitations on collecting payment deficiencies or in pursuing foreclosure actions. As such, they have similar risk characteristics as non-troubled debt personal banking loans and are evaluated collectively based on loan type, delinquency, historical experience and current economic factors.

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

The Company had commitments of $\$ 10.5$ million at March 31, 2014 to lend additional funds to borrowers with restructured loans.

The Company's holdings of foreclosed real estate totaled $\$ 6.9$ million and $\$ 6.6$ million at March 31, 2014 and December 31, 2013, respectively. Personal property acquired in repossession, generally autos and marine and recreational vehicles, totaled $\$ 2.0$ million and $\$ 2.8$ million at March 31, 2014 and December 31, 2013, 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.

## Table of contents

## 4. Investment Securities

Investment securities, at fair value, consisted of the following at March 31, 2014 and December 31, 2013.

| (In thousands) | Mar. 31, 2014 | Dec. 31, |
| :--- | :--- | :--- |
| Available for sale |  |  |

Most of the Company's investment securities are classified as available for sale, and this portfolio is discussed in more detail below. Securities which are classified as non-marketable include Federal Home Loan Bank (FHLB) stock and Federal Reserve Bank stock held for debt and regulatory purposes, which totaled $\$ 46.5$ million at both March 31, 2014 and December 31, 2013. Investment in Federal Reserve Bank stock is based on the capital structure of the investing bank, and investment in FHLB stock is tied to the level of borrowings from the FHLB. Non-marketable securities also include private equity investments, which amounted to $\$ 79.5$ million at March 31, 2014 and $\$ 60.7$ million at December 31, 2013.

A summary of the available for sale investment securities by maturity groupings as of March 31, 2014 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 and does not hold trust preferred securities.
(In thousands)
U.S. government and federal agency obligations:

Within 1 year $\quad \$ 42,859$
Amortized Fair Value
Cost

After 1 but within 5 years
After 5 but within 10 years
After 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 256,506
139,206
52,996 47,703
491,567 507,638

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
35,317 35,599
492,447 492,574
143,543 135,524
141,998 133,076
813,305 796,773

Non-agency mortgage-backed securities

| Asset-backed securities | $2,813,445$ | $2,816,012$ |
| :--- | :--- | :--- |
| Total mortgage and asset-backed securities | $5,950,830$ | $6,007,144$ |
| Other debt securities: | 11,938 | 12,042 |
| Within 1 year | 42,390 | 42,904 |
| After 1 but within 5 years | 86,130 | 81,907 |
| After 5 but within 10 years | 140,458 | 136,853 |
| Total other debt securities | 10,517 | 44,060 |
| Equity securities | $\$ 9,024,710$ | $\$ 9,115,116$ |

15

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## Table of contents

Investments in U.S. government securities are comprised mainly of U.S. Treasury inflation-protected securities, which totaled $\$ 507.5$ million, at fair value, at March 31, 2014. 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 $\$ 127.0$ 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 $\$ 36.8$ million at March 31, 2014.

For securities classified as available for sale, the following table shows the unrealized gains and losses (pre-tax) in accumulated other comprehensive income, by security type.
(In thousands)
March 31, 2014
U.S. government and federal agency obligations

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage and asset-backed securities:
Agency mortgage-backed securities
Non-agency mortgage-backed securities
Asset-backed securities
Total mortgage and asset-backed securities
Other debt securities
Equity securities
Total
December 31, 2013
U.S. government and federal agency obligations

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

| Amortized Cost | Gross | Gross |  |
| :---: | :---: | :---: | :---: |
|  | Unrealized | Unrealized | Fair Value |
|  | Gains | Losses |  |
| \$491,567 | \$21,368 | \$(5,297 | ) $\$ 507,638$ |
| 813,305 | 2,264 | (18,796 | ) 796,773 |
| 1,618,033 | 29,651 | (25,036 | ) 1,622,648 |
| 2,850,043 | 62,175 | (19,719 | ) 2,892,499 |
| 287,342 | 12,428 | (1,137 | ) 298,633 |
| 2,813,445 | 9,290 | (6,723 | ) 2,816,012 |
| 5,950,830 | 83,893 | (27,579 | ) 6,007,144 |
| 140,458 | 752 | (4,357 | ) 136,853 |
| 10,517 | 33,543 | - | 44,060 |
| \$9,024,710 | \$171,471 | \$(81,065 | )\$9,115,116 |
| \$498,226 | \$20,614 | \$(13,144 | )\$505,696 |
| 766,802 | 2,245 | (27,281 | ) 741,766 |
| 1,624,195 | 28,321 | (33,345 | ) 1,619,171 |
| 2,743,803 | 54,659 | (26,124 | ) 2,772,338 |
| 236,595 | 12,008 | (1,620 | ) 246,983 |
| 2,847,368 | 6,872 | (10,169 | ) $2,844,071$ |
| 5,827,766 | 73,539 | (37,913 | ) 5,863,392 |
| 147,581 | 671 | (6,495 | ) 141,757 |
| 9,970 | 33,928 | - | 43,898 |
| \$8,874,540 | \$159,318 | \$(118,178) | ) $\$ 8,915,680$ |

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 (Moody's) or A(Standard \& Poor's), whose fair values have fallen more than $20 \%$ below purchase price for an extended period of time, or have been identified based on management's judgment. These securities are placed on a watch list, and for all such securities, detailed cash flow models are prepared which use inputs specific to each security. Inputs to these models include factors such as cash flow received, contractual payments required, and various other information related to the underlying collateral (including current delinquencies), collateral loss severity rates (including loan to values), expected delinquency rates, credit support from other tranches, and prepayment speeds. Stress tests are performed at varying levels of delinquency rates, prepayment speeds and loss severities in order to gauge probable ranges of credit loss. At March 31, 2014, the fair value of securities on this watch list was $\$ 180.2$ million compared to $\$ 188.8$ million at December 31, 2013.

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As of March 31, 2014, 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 $\$ 66.1$ million. The cumulative credit-related portion of the impairment initially recorded on these securities totaled $\$ 13.2$ million and was recorded in earnings. The Company does not intend to sell these securities and believes it is not likely that it will be required to sell the securities before the recovery of their amortized cost.

## Table of contents

The credit-related 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 at
March 31, 2014 included the following:

| Significant Inputs | Range |  |
| :--- | :--- | :--- |
| Prepayment CPR | $0 \%$ | $-25 \%$ |
| Projected cumulative default | $18 \%$ | $-56 \%$ |
| Credit support | $0 \%$ | $-14 \%$ |
| Loss severity | $20 \%$ | $-81 \%$ |

The following table shows changes in the credit losses recorded in earnings during the three months ended March 31, 2014 and 2013, for which a portion of an OTTI was recognized in other comprehensive income.

For the Three Months Ended March 31
(In thousands)
Balance at January 1
20142013
Credit losses on debt securities for which impairment was previously recognized
\$12,499 \$11,306
Increase in expected cash flows that are recognized over remaining life of security
$346 \quad 442$
Balance at March 31
(25 ) (20 )
\$12,820 \$11,728
Securities with unrealized losses recorded in accumulated other comprehensive income are shown in the table below, along with the length of the impairment period.

Less than 12 months 12 months or longer Total

| (In thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized <br> Losses |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| March 31, 2014 |  |  |  |  |  |  |
| U.S. government and federal agency obligatio | 29,349 | \$ 27 | \$30,928 | \$5,270 | \$60,277 | \$5,297 |
| Government-sponsored enterprise obligations | 481,558 | 11,182 | 106,412 | 7,614 | 587,970 | 18,796 |
| State and municipal obligations | 387,791 | 8,018 | 189,058 | 17,018 | 576,849 | 25,036 |
| Mortgage and asset-backed securities: |  |  |  |  |  |  |
| Agency mortgage-backed securities | 759,734 | 19,716 | 107 | 3 | 759,841 | 19,719 |
| Non-agency mortgage-backed securities | 56,501 | 563 | 22,388 | 574 | 78,889 | 1,137 |
| Asset-backed securities | 583,899 | 5,535 | 118,267 | 1,188 | 702,166 | 6,723 |
| Total mortgage and asset-backed securities | 1,400,134 | 25,814 | 140,762 | 1,765 | 1,540,896 | 27,579 |
| Other debt securities | 85,844 | 3,321 | 15,294 | 1,036 | 101,138 | 4,357 |
| Total | \$2,384,676 | \$ 48,362 | \$482,454 | \$32,703 | \$2,867,130 | \$81,065 |
| December 31, 2013 |  |  |  |  |  |  |
| U.S. government and federal agency obligation | \$96,172 | \$ 243 | \$59,677 | \$ 12,901 | \$155,849 | \$ 13,144 |
| Government-sponsored enterprise obligations | 487,317 | 18,155 | 93,654 | 9,126 | 580,971 | 27,281 |
| State and municipal obligations | 478,818 | 15,520 | 178,150 | 17,825 | 656,968 | 33,345 |
| Mortgage and asset-backed securities: |  |  |  |  |  |  |
| Agency mortgage-backed securities | 717,778 | 26,124 | - | - | 717,778 | 26,124 |
| Non-agency mortgage-backed securities | 53,454 | 918 | 22,289 | 702 | 75,743 | 1,620 |
| Asset-backed securities | 1,088,556 | 9,072 | 58,398 | 1,097 | 1,146,954 | 10,169 |
| Total mortgage and asset-backed securities | 1,859,788 | 36,114 | 80,687 | 1,799 | 1,940,475 | 37,913 |
| Other debt securities | 90,028 | 5,604 | 9,034 | 891 | 99,062 | 6,495 |
| Total | \$3,012,123 | \$ 75,636 | \$421,202 | \$42,542 | \$3,433,325 | \$118,178 |

The total available for sale portfolio consisted of approximately 1,800 individual securities at March 31, 2014. The portfolio included 431 securities, having an aggregate fair value of $\$ 2.9$ billion, that were in an unrealized loss position at March 31, 2014, compared to 507 securities, with a fair value of $\$ 3.4$ billion, at December 31, 2013. The total amount of unrealized loss on these securities decreased $\$ 37.1$ million to $\$ 81.1$ million at March 31, 2014. At March 31, 2014, the fair value of securities in an unrealized loss position for 12 months or longer totaled $\$ 482.5$ million, or $5.3 \%$ of the total portfolio value, and did not include any securities identified as other-than-temporarily impaired.

17

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## Table of contents

The Company's holdings of state and municipal obligations included gross unrealized losses of $\$ 25.0$ million at March 31, 2014. Of these losses, $\$ 11.0$ million related to auction rate securities and $\$ 14.1$ million related to other state and municipal obligations. This portfolio, exclusive of auction rate securities, totaled $\$ 1.5$ billion at fair value, or $16.4 \%$ of total available for sale securities. The average credit quality of the portfolio, excluding auction rate securities, is Aa2 as rated by Moody's. The portfolio is diversified in order to reduce risk, and information about the top five largest holdings, by state and economic sector, is shown in the table below. The Company does not have exposure to obligations of municipalities which have filed for Chapter 9 bankruptcy. The Company has processes and procedures in place to monitor its holdings, identify signs of financial distress and, if necessary, exit its positions in a timely manner.

At March 31, 2014

| Texas | 10.5 | $\% 4.6$ | Aa 1 |
| :--- | ---: | ---: | ---: |
| Florida | 9.8 | 4.5 | Aa 3 |
| New York | 6.2 | 6.1 | Aa 2 |
| Ohio | 6.0 | 4.9 | Aa 2 |
| Washington | 5.2 | 4.8 | Aa 2 |
| General obligation | 31.0 | $\% 4.6$ | Aa 2 |
| Lease | 16.5 | 4.7 | Aa 3 |
| Housing | 15.5 | 4.3 | Aa 1 |
| Transportation | 13.6 | 4.3 | A 1 |
| Limited tax | 6.0 | 5.3 | Aa 1 |

The following table presents proceeds from sales of securities and the components of investment securities gains and losses which have been recognized in earnings.
(In thousands)
Proceeds from sales of available for sale securities
Proceeds from sales of non-marketable securities
Total proceeds

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

$\left.\begin{array}{lll} & \begin{array}{l}\text { For the Three Months } \\ \text { Ended March 31 }\end{array} \\ \text { (In thousands) } & 2014 & 2013 \\ \text { Proceeds from sales of available for sale securities } & \$ 30,998 & \$- \\ \text { Proceeds from sales of non-marketable securities } & 668 & 52 \\ \text { Total proceeds } & \$ 31,666 & \$ 52 \\ \text { Available for sale: } & \$(5,197 & \\ \text { Losses realized on sales } & (346 & (442\end{array}\right)$

At March 31, 2014, securities totaling $\$ 4.8$ billion in fair value were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowings at the Federal Reserve Bank and FHLB. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated $\$ 552.5$ 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 exceeded $10 \%$ of stockholders' equity.

## Table of contents

5. Goodwill and Other Intangible Assets

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


Aggregate amortization expense on intangible assets was $\$ 559$ thousand and $\$ 557$ thousand, respectively, for the three month periods ended March 31, 2014 and 2013. The following table shows the estimated annual amortization expense for the next five fiscal years. This expense is based on existing asset balances and the interest rate environment as of March 31, 2014. 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)
2014 \$1,997
2015 1,607
2016 1,244
2017 920
2018 687

Changes in the carrying amount of goodwill and net other intangible assets for the three month period ended March 31, 2014 is as follows.

| (In thousands) | Goodwill | Core Deposit <br> Premium | Mortgage <br> Servicing <br> Rights |
| :--- | :--- | :--- | :--- |
| Balance January 1, 2014 | $\$ 138,921$ | $\$ 8,489$ | $\$ 779$ |
| Originations | - | - | 88 |
| Amortization | - | $(521$ | $)(38$ |
| Impairment reversal | - | - | 14 |
| Balance March 31, 2014 | $\$ 138,921$ | $\$ 7,968$ | $\$ 843$ |


| Goodwill allocated to the Company's operating segments at March 31, 2014 and December 31, 2013 is shown below. |  |
| :--- | :--- |
| (In thousands) | $\$ 70,721$ |
| Consumer segment | 67,454 |
| Commercial segment | 746 |
| Wealth segment | $\$ 138,921$ |

## 6. Guarantees

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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 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.

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

Upon issuance of standby letters of credit, the Company recognizes a liability for the fair value of the obligation undertaken, which is estimated to be equivalent to the amount of fees received from the customer over the life of the agreement. At March 31, 2014 that net liability was $\$ 3.5$ 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 $\$ 333.3$ million at March 31, 2014.

The Company periodically enters into risk participation agreements (RPAs) as a guarantor to other financial institutions, in order to mitigate those institutions' credit risk associated with interest rate swaps with third parties. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. These interest rate swaps are normally collateralized (generally with real property, inventories and equipment) by the third party, which limits the credit risk associated with the Company's RPAs. The third parties usually have other borrowing relationships with the Company. The Company monitors overall borrower collateral, and at March 31, 2014, 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 3 to 10 years. At March 31, 2014, the fair value of the Company's guarantee liabilities for RPAs was $\$ 71$ thousand, and the notional amount of the underlying swaps was $\$ 65.4$ 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.

## 7. Pension

The amount of net pension cost is shown in the table below:

| (In thousands) | 2014 | 2013 |
| :--- | :--- | :--- |
| Service cost - benefits earned during the period | $\$ 133$ | $\$ 132$ |
| Interest cost on projected benefit obligation | 1,261 | 1,122 |
| Expected return on plan assets | $(1,561$ | $)(1,609$ |
| Amortization of unrecognized net loss | 360 | 767 |
| Net periodic pension cost | $\$ 193$ | $\$ 412$ |

Substantially all benefits accrued under the Company's defined benefit pension plan were frozen effective January 1 , 2005, and the remaining benefits were frozen effective January 1, 2011. During the first three months of 2014, 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 2014.

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## Table of contents

## 8. 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 13.

|  | For the Three Months Ended March 31 |  |
| :---: | :---: | :---: |
| (In thousands, except per share data) | 2014 | 2013 |
| Basic income per common share: |  |  |
| Net income attributable to Commerce Bancshares, Inc. | \$64,313 | \$61,017 |
| Less income allocated to nonvested restricted stock | 802 | 594 |
| Net income allocated to common stock | \$63,511 | \$60,423 |
| Weighted average common shares outstanding | 94,773 | 94,722 |
| Basic income per common share | \$. 67 | \$. 64 |
| Diluted income per common share: |  |  |
| Net income attributable to Commerce Bancshares, Inc. | \$64,313 | \$61,017 |
| Less income allocated to nonvested restricted stock | 799 | 593 |
| Net income allocated to common stock | \$63,514 | \$60,424 |
| Weighted average common shares outstanding | 94,773 | 94,722 |
| 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 | 421 | 244 |
| Weighted average diluted common shares outstanding | 95,194 | 94,966 |
| Diluted income per common share | \$. 67 | \$. 63 |

Unexercised stock options and stock appreciation rights of 90 thousand were excluded in the computation of diluted income per share for the three month period ended March 31, 2014 because their inclusion would have been anti-dilutive. All unexercised stock options and rights were included in the computation of diluted income per share for the three month period ended March 31, 2013.

In the Annual Meeting of the Shareholders, held on April 16, 2014, a proposal to increase the shares of Company common stock authorized for issuance under its articles of incorporation was approved. This approval increased the authorized shares from $100,000,000$ to $120,000,000$.

## 9. Accumulated Other Comprehensive Income

The table below shows the activity and accumulated balances for components of other comprehensive income. The largest component is the unrealized holding gains and losses on available for sale securities. Unrealized gains and losses on debt securities for which an other-than-temporary impairment (OTTI) has been recorded in current earnings are shown separately below. The other component is the amortization from other comprehensive income of losses associated with pension benefits, which occurs as the losses are included in current net periodic pension cost.


## 10. Segments

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

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

The following table presents selected financial information by segment and reconciliations of combined segment totals to consolidated totals. There were no material intersegment revenues among the three segments. Management periodically makes changes to methods of assigning costs and income to its business segments to better reflect operating results. If appropriate, these changes are reflected in prior year information presented below.

| (In thousands) | Consumer CommercialWealth |  |  | Segment <br> Totals | Other/ <br> Elimination |  | Consolidated Totals |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Three Months Ended March 31, 2014 |  |  |  |  |  |  |  |
| Net interest income | \$66,862 | \$ 73,401 | \$9,912 | \$150,175 | \$ 2,891 |  | \$ 153,066 |
| Provision for loan losses | (9,220 | ) (383 | ) (41 | ) (9,644 | ) (16 | ) | (9,660 |
| Non-interest income | 25,644 | 47,117 | 29,989 | 102,750 | (123 | ) | 102,627 |
| Investment securities gains, net | - | - | - | - | 10,037 |  | 10,037 |
| Non-interest expense | (66,287 | ) (60,826 | ) $(24,749$ | ) (151,862 | ) (10,478 | ) | (162,340 |
| Income before income taxes | \$16,999 | \$ 59,309 | \$15,111 | \$91,419 | \$ 2,311 |  | \$ 93,730 |
| Three Months Ended March 31, 2013 |  |  |  |  |  |  |  |
| Net interest income | \$67,213 | \$ 70,215 | \$ 10,174 | \$147,602 | \$ 2,741 |  | \$ 150,343 |
| Provision for loan losses | (8,211 | ) 489 | (48 | ) (7,770 | ) 4,485 |  | (3,285 |
| Non-interest income | 26,608 | 44,506 | 28,819 | 99,933 | (56 | ) | 99,877 |
| Investment securities losses, net | - | - | - | - | (2,165 |  | (2,165 |
| Non-interest expense | (67,904 | ) (58,912 | ) $(24,308$ | ) (151,124 | ) (3,913 | ) | (155,037 |
| Income before income taxes | \$17,706 | \$ 56,298 | \$ 14,637 | \$88,641 | \$ 1,092 |  | \$ 89,733 |

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 net loan charge-offs assigned directly to the segments and the recorded provision for loan loss expense. Included in this category's net interest income are earnings of the investment portfolio, which are not allocated to a segment.

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

## 11. Derivative Instruments

The notional amounts of the Company's derivative instruments are shown in the table below. These contractual amounts, along with other terms of the derivative, are used to determine amounts to be exchanged between counterparties and are not a measure of loss exposure. The largest group of notional amounts relate to interest rate swaps, which are discussed in more detail below. The Company also contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps through risk participation agreements. The Company's risks and responsibilities as guarantor are further discussed in Note 6 on Guarantees. Through its International Department, the Company enters into foreign exchange contracts, which are mainly
comprised of contracts to purchase or deliver foreign currencies for customers at specific future dates.

| (In thousands) | March 31, | December 31, |
| :--- | :--- | :--- |
| Interest rate swaps | 2014 | 2013 |
| Interest rate caps | $\$ 657,418$ | $\$ 596,933$ |
| Credit risk participation agreements | 9,236 | 9,736 |
| Foreign exchange contracts | 67,276 | 52,456 |
| Total notional amount | 63,544 | 81,207 |
|  | $\$ 797,474$ | $\$ 740,332$ |

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

The Company's interest rate risk management strategy includes the ability to modify the repricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. At March 31, 2014, the Company had entered into one interest rate swap with a notional amount of $\$ 6.3$ million, included in the table above, which is designated as a fair value hedge of a specific fixed rate loan.

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 commercial customers who wish to modify their interest rate sensitivity. These swaps are offset by matching contracts purchased by the Company from other financial dealer institutions. Contracts with dealers that require central clearing (generally, transactions occurring after June 10,2013 ) are novated to a clearing agency who becomes the Company's counterparty. 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 free-standing swaps at March 31, 2014 was $\$ 651.1$ million.

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

The banking customer counterparties are engaged in a variety of businesses, including real estate, building materials, education, financial services, communications, consumer products, and manufacturing. At March 31, 2014, the largest loss exposures were in the groups related to real estate, education, and manufacturing. If the counterparties in these groups failed to perform, and if the underlying collateral proved to be of no value, the Company estimates that it would incur losses of $\$ 2.7$ million (real estate and building materials), $\$ 2.6$ million (education) and $\$ 1.3$ million (manufacturing) at March 31, 2014.

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 14 on Fair Value Measurements.

|  | Asset Derivatives |  | Liability Derivatives |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Balance | Mar. 31, Dec. 31, | Balance | Mar. 31 | Dec. 31, |
|  | Sheet | 20142013 | Sheet | 2014 | 2013 |
| (In thousands) | Location | Fair Value | Location | Fair V |  |

Derivatives designated as hedging instruments:
Interest rate swaps
Total derivatives designated as hedging
instruments
Derivatives not designated as hedging
instruments:
$\left.\begin{array}{rllll}\text { Other assets } \$- & \$- & \begin{array}{l}\text { Other } \\ \text { liabilities }\end{array} & \$(229 & ) \$(300\end{array}\right)$

| Interest rate swaps | Other assets $\$ 10,971$ | $\$ 11,428$ | Other <br> liabilities | $\$(10,971) \$(11,429)$ |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Interest rate caps | Other assets 1 | 1 | Other <br> liabilities | $(1$ | $)(1)$ | $(1)$ |
| Credit risk participation agreements | Other assets 4 | 4 | Other <br> liabilities | $(71$ | $)(69 \quad)$ |  |


| Foreign exchange contracts | Other assets 988 | 1,547 | Other <br> liabilities | $(1,140 \quad)(1,530 \quad)$ |
| :--- | ---: | :--- | :--- | :--- | :--- |
| Total derivatives not designated as hedging <br> instruments | $\$ 11,964$ | $\$ 12,980$ |  | $\$(12,183) \$(13,029)$ |
| Total derivatives | $\$ 11,964$ | $\$ 12,980$ | $\$(12,412) \$(13,329)$ |  |

24

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

The effects of derivative instruments on the consolidated statements of income are shown in the table below.
$\left.\left.\begin{array}{lll} & \begin{array}{l}\text { Location of Gain or } \\ \text { (Loss) Recognized in } \\ \text { Income on Derivatives }\end{array} & \begin{array}{l}\text { Amount of Gain or } \\ \text { (Loss) Recognized } \\ \text { in Income on } \\ \text { Derivatives }\end{array} \\ \text { For the Three } \\ \text { Months Ended }\end{array}\right] \begin{array}{lll}\text { March 31 } \\ 2014\end{array}\right] 2013$

## 12. Balance Sheet Offsetting

The following tables show the extent to which assets and liabilities relating to derivative instruments, securities purchased under agreements to resell (resell agreements), and securities sold under agreements to repurchase (repurchase agreements) have been offset in the consolidated balance sheets. They also provide information about these instruments which are subject to an enforceable master netting arrangement, irrespective of whether they are offset, and the extent to which the instruments could potentially be offset. Also shown is collateral received or pledged in the form of other financial instruments, which are generally marketable securities. The collateral amounts in these tables are limited to the outstanding balances of the related asset or liability (after netting is applied); thus amounts of excess collateral are not shown. Most of the assets and liabilities in the following tables were transacted under master netting arrangements that contain a conditional right of offset, such as close-out netting, upon default.

The Company is party to master netting arrangements with most of its swap derivative counterparties; however, the Company does not offset derivative assets and liabilities under these arrangements on its consolidated balance sheet. Collateral, usually in the form of marketable securities, is exchanged between the Company and dealer bank counterparties, and is generally subject to thresholds and transfer minimums. By contract, it may be sold or re-pledged by the secured party until recalled at a subsequent valuation date by the pledging party. For those swap transactions requiring central clearing, the Company posts cash and securities to its clearing agency. At March 31, 2014, the Company had a net liability position with dealer bank and clearing agency counterparties totaling $\$ 9.5$ million, and had posted securities with a fair value of $\$ 9.8$ million and cash totaling $\$ 2.3$ million. Collateral positions are valued daily, and adjustments to amounts received and pledged by the Company are made as appropriate to maintain proper collateralization for these transactions. Swap derivative transactions with customers are generally secured by rights to non-financial collateral, such as real and personal property, which is not shown in the table below.

Resell and repurchase agreements are agreements to purchase/sell securities subject to an obligation to resell/repurchase the same or similar securities. They are accounted for as collateralized financing transactions, not as sales and purchases of the securities portfolio. The securities collateral accepted or pledged in resell and repurchase
agreements with other financial institutions also may be sold or re-pledged by the secured party, but is usually delivered to and held by third party trustees. The Company generally retains custody of securities pledged for repurchase agreements with customers.

The Company is party to several agreements commonly known as collateral swaps. These agreements involve the exchange of collateral under simultaneous repurchase and resell agreements with the same financial institution counterparty. These repurchase and resell agreements have the same principal amounts, inception dates, and maturity dates and have been offset against each other in the balance sheet, as permitted under the netting provisions of ASC 210-20-45. The collateral swaps totaled $\$ 300.0$ million at both March 31, 2014 and December 31, 2013. At March 31, 2014, the Company had posted collateral consisting of $\$ 310.2$ million in agency mortgage-backed securities and accepted $\$ 330.6$ million in investment grade asset-backed, commercial mortgage-backed, and corporate bonds.

## Table of contents

(In thousands)

March 31, 2014
Assets:
Derivatives subject to master netting agreements Derivatives not subject to master netting agreements
Total derivatives
Total resell agreements, subject to master netting arrangements Liabilities:
Derivatives subject to master netting agreements
Derivatives not subject to master netting agreements
Total derivatives
Total repurchase agreements, subject to master netting arrangements
December 31, 2013
Assets:
Derivatives subject to master netting agreements
Derivatives not subject to master netting agreements
Total derivatives 12,212

200 - 200
12,412 $\quad$ - $\quad 12,412$
1,218,212 (300,000 ) 918,212 - $\quad$ (918,212 ) -

Total resell agreements, subject
to master netting arrangements
Liabilities:
Derivatives subject to master
netting agreements
Derivatives not subject to
master netting agreements
Total derivatives
Total repurchase agreements, subject to master netting arrangements

## 13. Stock-Based Compensation

The Company has historically issued stock-based compensation in the form of nonvested restricted stock, stock options and stock appreciation rights (SARs). During the first three months of 2014, stock-based compensation was

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issued in the form of nonvested restricted stock and SARs. The stock-based compensation expense that has been charged against income was $\$ 2.3$ million and $\$ 1.2$ million in the three month periods ended March 31, 2014 and 2013, respectively. The Company normally issues most of its annual stock-based compensation awards during the first quarter, which is reflected in the current quarter expense. However, in 2013, due to plan administration considerations, this process was postponed until April.

26

## Table of contents

Nonvested stock awards generally vest in 4 to 7 years and contain restrictions as to transferability, sale, pledging, or assigning, among others, prior to the end of the vesting period. Dividend and voting rights are conferred upon grant. A summary of the status of the Company's nonvested share awards as of March 31, 2014, and changes during the three month period then ended, is presented below.

|  |  | Weighted <br> Average <br> Grant Date |
| :--- | :--- | :--- |
| Nonvested at January 1, 2014 | Shares |  |
| Fair Value |  |  |

SARs and stock options are granted with exercise prices equal to the market price of the Company's stock at the date of grant. SARs vest ratably over 4 years of continuous service and have 10 -year contractual terms. All SARs must be settled in stock under provisions of the plan. Stock options, which have not been granted since 2005, vested ratably over 3 years of continuous service and also have 10 -year contractual terms. In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of SARs and options on date of grant. The current year per share average fair value and the model assumptions are shown in the table below.

Weighted per share average fair value at grant date
$\$ 9.26$
Assumptions:
Dividend yield $\quad 2.0$ \%
Volatility 22.1 \%
Risk-free interest rate 2.3 \%
Expected term $\quad 7.1$ years

A summary of SAR activity during the first three months of 2014 is presented below.

| (Dollars in thousands, except per share data) | Rights | Weighted <br> Average <br> Exercise <br> Price | Weighted <br> Average <br> Remaining <br> Contractual <br> Term | Aggregate <br> Intrinsic <br> Value |
| :---: | :---: | :---: | :---: | :---: |
| Outstanding at January 1, 2014 | 1,758,254 | \$34.68 |  |  |
| Granted | 172,968 | 44.52 |  |  |
| Forfeited | - | - |  |  |
| Expired | - | - |  |  |
| Exercised | (34,894 | ) 33.35 |  |  |
| Outstanding at March 31, 2014 | 1,896,328 | \$35.60 | 4.3 years | \$20,521 |

A summary of option activity during the first three months of 2014 is presented below.

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

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Granted

-     - 

Forfeited
Expired
Exercised
Outstanding at March 31, 2014
(198,067 ) 30.60
$254,256 \quad \$ 30.51 \quad 0.9$ years $\quad \$ 4,044$

27

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

## 14. 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.

## Table of contents

Instruments Measured at Fair Value on a Recurring Basis
The table below presents the March 31, 2014 and December 31, 2013 carrying values of assets and liabilities measured at fair value on a recurring basis. There were no transfers among levels during the first three months of 2014 or the year ended December 31, 2013.

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

March 31, 2014
Assets:
Available for sale securities:
U.S. government and federal agency obligations
Government-sponsored enterprise obligations

| $\$ 507,638$ | $\$ 507,638$ | $\$-$ | $\$-$ |
| :--- | :--- | :--- | :--- |
| 796,773 | - | 796,773 | - |
| $1,622,648$ | - | $1,495,669$ | 126,979 |
| $2,892,499$ | - | $2,892,499$ | - |
| 298,633 | - | 298,633 | - |
| $2,816,012$ | - | $2,816,012$ | - |
| 136,853 | - | 136,853 | - |
| 44,060 | 25,007 | 19,053 | - |
| 15,740 | - | 15,740 | - |
| 76,446 | - | - | 76,446 |
| 11,964 | - | 11,960 | 4 |
| 8,285 | 8,285 | - | - |
| $\$ 9,227,551$ | $\$ 540,930$ | $\$ 8,483,192$ | $\$ 203,429$ |
| $\$ 12,412$ | $\$-$ | $\$ 12,341$ | $\$ 71$ |
| $\$ 12,412$ | $\$-$ | $\$ 12,341$ | $\$ 71$ |

December 31, 2013
Assets:
Available for sale securities:

| U.S. government and federal agency obligations | $\$ 505,696$ | $\$ 505,696$ | $\$-$ | $\$-$ |
| :--- | :--- | :--- | :--- | :--- |
| Government-sponsored enterprise obligations | 741,766 | - | 741,766 | - |
| State and municipal obligations | $1,619,171$ | - | $1,491,447$ | 127,724 |
| Agency mortgage-backed securities | $2,772,338$ | - | $2,772,338$ | - |
| Non-agency mortgage-backed securities | 246,983 | - | 246,983 | - |
| Asset-backed securities | $2,844,071$ | - | $2,844,071$ | - |
| Other debt securities | 141,757 | - | 141,757 | - |
| Equity securities | 43,898 | 24,646 | 19,252 | - |
| Trading securities | 19,993 | - | 19,993 | - |
| Private equity investments | 56,612 | - | - | 56,612 |
| Derivatives * | 12,980 | - | 12,976 | 4 |
| Assets held in trust | 7,511 | 7,511 | - | - |
| Total assets | $\$ 9,012,776$ | $\$ 537,853$ | $\$ 8,290,583$ | $\$ 184,340$ |
| Liabilities: | $\$ 13,329$ | $\$-$ | $\$ 13,260$ | $\$ 69$ |

Total liabilities

* The fair value of each class of derivative is shown in Note 11.


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## Table of contents

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 4 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.

The fair values of Level 1 and 2 securities (excluding equity securities) in the available for sale portfolio are prices provided by a third-party pricing service. The prices provided by the third-party pricing service are based on observable market inputs, as described in the sections below. On a quarterly basis, the Company compares a sample of these prices to other independent sources for the same and similar securities. Variances are analyzed, and, if appropriate, additional research is conducted with the third-party pricing service. Based on this research, the pricing service may affirm or revise its quoted price. No significant adjustments have been made to the prices provided by the pricing service. The pricing service also provides documentation on an ongoing basis that includes reference data, inputs and methodology by asset class, which is reviewed to ensure that security placement within the fair value hierarchy is appropriate.
Valuation methods and inputs, by class of security:

## U.S. government and federal agency obligations

U.S. treasury bills, bonds and notes, including inflation-protected securities, are valued using live data from active market makers and inter-dealer brokers. Valuations for stripped coupon and principal issues are derived from yield curves generated from various dealer contacts and live data sources.

## Government-sponsored enterprise obligations

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

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

Mortgage and asset-backed securities

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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

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## Table of contents

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.

The available for sale portfolio includes certain auction rate securities. The auction process by which auction rate securities are normally priced has not functioned in recent years, 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 auction rate securities are estimated using a discounted cash flows analysis which is discussed more fully in the Level 3 Inputs section of this note. Because several of the inputs significant to the measurement are not observable, these measurements are classified as Level 3 measurements.

## Trading securities

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

Private equity investments
These securities are held by the Company's private equity subsidiaries and are included in non-marketable investment securities in the consolidated balance sheets. Due to the absence of quoted market prices, valuation of these nonpublic investments requires significant management judgment. These fair value measurements, which are discussed in the Level 3 Inputs section of this note, are classified as Level 3.

## Derivatives

The Company's derivative instruments include interest rate swaps, foreign exchange forward contracts 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 a proprietary model whose significant inputs are readily observable market parameters, primarily yield curves used to calculate current exposure. Counterparty credit risk is incorporated into the model and calculated by applying a net credit spread over LIBOR to the swap's total expected exposure over time. The net credit spread is comprised of spreads for both the Company and its counterparty, derived from probability of default and other loss estimate information obtained from a third party credit data provider or from the Company's Credit Department when not otherwise available. The credit risk component is not significant compared to the overall fair value of the swaps. The results of the model 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 Company's contracts related to credit risk guarantees are valued under a proprietary model which uses unobservable inputs and assumptions about the creditworthiness of the counterparty (generally a Bank customer). Customer credit spreads, which are based on probability of default and other loss estimates, are calculated internally by the Company's Credit Department, as mentioned above, and are based on the Company's internal risk rating for each customer. Because these inputs are significant to the measurements, they 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

## Table of contents

representing the total investment amount. The Company has also recorded a corresponding nonfinancial liability, representing the Company's liability to the plan participants.

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
(In thousands)
For the three months ended March 31, 2014
Balance January 1, 2014
ObligationInvestments

Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income *
Discount accretion
Purchases of private equity investments
Sale/pay down of private equity investments
Capitalized interest/dividends
\$127,724 \$ 56,612 \$ (65 ) \$184, 271

Sale of risk participation agreement
Balance March 31, 2014
Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets $\$-\quad \$ 16,794 \quad \$ 105 \quad \$ 16,899$ still held at March 31, 2014
For the three months ended March 31, 2013
Balance January 1, 2013
Total gains or losses (realized/unrealized):
Included in earnings
Included in other comprehensive income *
Investment securities called
Discount accretion
Purchases of private equity investments
Capitalized interest/dividends
Balance March 31, 2013
\$126,414 \$ 68,167 \$(187 ) \$194,394

Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets $\$-\quad \$(1,775) \$ 56 \quad \$(1,719)$ still held at March 31, 2013

* Included in "net unrealized gains (losses) on other securities" in the consolidated statements of comprehensive income.

Gains and losses included in earnings for the Level 3 assets and liabilities in the previous table are reported in the following line items in the consolidated statements of income:

| (In thousands) | Investment <br> Securities |
| :--- | :--- | :--- |
| Other Total |  |
| Non-Interest Gains (Losses), |  |
| Income |  |


| Change in unrealized gains or losses relating to assets still held at March 31, <br> 2014 | $\$ 105$ | $\$ 16,794$ | $\$ 16,899$ |
| :--- | :--- | :--- | :--- | :--- |
| For the three months ended March 31, 2013 |  |  |  |
| Total gains or losses included in earnings <br> Change in unrealized gains or losses relating to assets still held at March 31, <br> 2013 | $\$ 56$ | $\$(1,775$ | $\$(1,719 \quad)$ |

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## Table of contents

Level 3 Inputs
As shown above, the Company's significant Level 3 measurements which employ unobservable inputs that are readily quantifiable pertain to auction rate securities (ARS) held by the Bank and investments in portfolio concerns held by the Company's private equity subsidiaries. ARS are included in state and municipal securities and totaled $\$ 127.0$ million at March 31, 2014, while private equity investments, included in non-marketable securities, totaled $\$ 76.4$ million.
Information about these inputs is presented in the table and discussions below.
Quantitative Information about Level 3 Fair Value Measurements

| Auction rate securities | Valuation Technique | Unobservable Input | Range |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Discounted cash flow | Estimated market recovery period | 4 | - 5 years |
|  |  | Estimated market rate | 1.8\% | - $4.0 \%$ |
| Private equity investments | Market comparable | EBITDA multiple | 4.0 | - 5.5 |

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

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

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## Table of contents

Instruments Measured at Fair Value on a Nonrecurring Basis
For assets measured at fair value on a nonrecurring basis during the first three months of 2014 and 2013, and still held as of March 31, 2014 and 2013, the following table provides the adjustments to fair value recognized during the respective periods, the level of valuation inputs used to determine each adjustment, and the carrying value of the related individual assets or portfolios at March 31, 2014 and 2013.

| (In thousands) | Fair Value | Fair Value Measurements Using |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Quoted <br> Prices in <br> Active <br> Markets for <br> Identical <br> Assets <br> (Level 1) | Significant Other Observable Inputs (Level 2) | Significant <br> Unobservable <br> Inputs <br> (Level 3) | Total Gains (Losses) <br> Recognized During the Three Months Ended March 31 |
| March 31, 2014 |  |  |  |  |  |
| Collateral dependent impaired loans | \$7,916 | \$- | \$- | \$ 7,916 | \$ 1,875 |
| Private equity investments | 919 | - | - | 919 | (1,081 |
| Mortgage servicing rights | 843 | - | - | 843 | 14 |
| Foreclosed assets | 1,220 | - | - | 1,220 | (181 |
| Long-lived assets | 7,246 | - | - | 7,246 | (1,408 |
| March 31, 2013 |  |  |  |  |  |
| Collateral dependent impaired loans | \$1,900 | \$- | \$- | \$ 1,900 | \$(659 ) |
| Mortgage servicing rights | 503 | - | - | 503 | 57 |

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 and internal appraisals of property values depending on the size and complexity of the real estate collateral. The Company maintains a staff of qualified appraisers who also review third party appraisal reports for reasonableness. 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. Values of all loan collateral are regularly reviewed by credit administration. Unobservable inputs to these measurements, which include estimates and judgments often used in conjunction with appraisals, are not readily quantifiable. These measurements are classified as Level 3. Changes in fair value recognized for partial charge-offs of loans and loan impairment reserves on loans held by the Company at March 31, 2014 and 2013 are shown in the table above.

Private equity investments and restricted stock

These assets are included in non-marketable investment securities in the consolidated balance sheets. They include certain 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 and 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.

34

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## Table of contents

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.

## 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 and often involves obtaining third party appraisals from certified real estate appraisers. The carrying amounts of these real estate holdings are regularly monitored by real estate professionals employed by the Company. These fair value measurements are classified as Level 3. Unobservable inputs to these measurements, which include estimates and judgments often used in conjunction with appraisals, are not readily quantifiable. The measurements in 2014 pertained to a downtown Kansas City office building and several properties previously designated for future branch sites, which are held for sale.

## 15. Fair Value of Financial Instruments

The carrying amounts and estimated fair values of financial instruments held by the Company are set forth below. 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.

The methods and inputs used in the estimation of fair value for the financial instruments in the table below are discussed in the preceding Fair Value Measurements note and in the Fair Value of Financial Instruments note in the Company's 2013 Annual Report on Form 10-K. There have been no significant changes in these methods and inputs since December 31, 2013.

## Table of contents

The estimated fair values of the Company's financial instruments and the classification of their fair value measurement within the valuation hierarchy are as follows:
(In thousands)
Fair Value March 31, 2014
$\begin{array}{llll}\text { Hierarchy Carrying } & \text { Estimated } & \text { Carrying } & \text { Estimated } \\ \text { Level Amount } & \text { Fair Value } & \text { Amount } & \text { Fair Value }\end{array}$
Financial Assets
Loans:
Business
Real estate - construction and land
Real estate - business
Real estate - personal
Consumer
Revolving home equity
Consumer credit card
Overdrafts
Investment securities:
Available for sale
Available for sale
Available for sale
Trading
Non-marketable
Federal funds sold
Securities purchased under agreements to resell
Interest earning deposits with banks
Cash and due from banks
Derivative instruments
Derivative instruments
Financial Liabilities
Non-interest bearing deposits
Savings, interest checking and money market deposits
Time open and certificates of deposit
Federal funds purchased
Securities sold under agreements to repurchase
Other borrowings
Derivative instruments
Derivative instruments
Level Amount Fair Value
December 31, 2013

Level Amount Fair Value Amount Fair Value

| Level 3 | $\$ 3,941,394$ | $\$ 3,952,048$ | $\$ 3,715,319$ | $\$ 3,723,263$ |
| :--- | :--- | :--- | :--- | :--- |
| Level 3 | 423,667 | 427,885 | 406,197 | 410,022 |
| Level 3 | $2,315,167$ | $2,348,642$ | $2,313,550$ | $2,345,124$ |
| Level 3 | $1,782,831$ | $1,808,252$ | $1,787,626$ | $1,802,364$ |
| Level 3 | $1,561,973$ | $1,571,226$ | $1,512,716$ | $1,519,830$ |
| Level 3 | 419,376 | 423,239 | 420,589 | 424,811 |
| Level 3 | 775,044 | 789,515 | 796,228 | 811,550 |
| Level 3 | 2,586 | 2,586 | 4,611 | 4,611 |
|  |  |  |  |  |
| Level 1 | 532,645 | 532,645 | 530,342 | 530,342 |
| Level 2 | $8,455,492$ | $8,455,492$ | $8,257,614$ | $8,257,614$ |
| Level 3 | 126,979 | 126,979 | 127,724 | 127,724 |
| Level 2 | 15,740 | 15,740 | 19,993 | 19,993 |
| Level 3 | 126,119 | 126,119 | 107,324 | 107,324 |
| Level 1 | 19,525 | 19,525 | 43,845 | 43,845 |
| Level 3 | 950,000 | 947,959 | $1,150,000$ | $1,149,625$ |
| Level 1 | 198,417 | 198,417 | 707,249 | 707,249 |
| Level 1 | 530,244 | 530,244 | 518,420 | 518,420 |
| Level 2 | 11,960 | 11,960 | 12,976 | 12,976 |
| Level 3 | 4 | 4 | 4 | 4 |

## 16. Legal Proceedings

In December 2013, the settlement of a multi-district interchange suit against Visa, MasterCard and credit-card issuing major banks was approved in federal court. The settlement, as proposed in 2012, included a provision to reduce credit card interchange income by 10 basis points over an eight month period. In 2012, the Company established a liability for the estimated cost of this reduction in interchange, which totaled $\$ 5.2$ million. The Company's payments to Visa related to the reduction began in September 2013 and have totaled $\$ 4.0$ million through March 31, 2014. The Company's adjusted remaining liability for the final remaining payment totaled \$664 thousand at March 31, 2014.

As mentioned in the 2013 Annual Report on Form 10-K, the Company was named in a petition by Patrick J. Malloy III, Bankruptcy Trustee for the Bankruptcy Estate of George David Gordon Jr. At March 31, 2014, the Company had established a liability of $\$ 2.5$ million related to this suit.

The Company has various other lawsuits pending at March 31, 2014, 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 determined to be probable and estimable.

## Table of contents

## 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 2013 Annual Report on Form 10-K. Results of operations for the three month period ended March 31, 2014 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, changes in accounting and tax principles, estimates made on income taxes, failure of litigation settlement agreements to become final in accordance with their terms, and competition with other entities that offer financial services. For more discussion about each of these factors, see Part I Item 1A - "Risk Factors" in the Company's 2013 Annual Report on Form 10-K.

## Critical Accounting Policies

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. A discussion of these policies can be found in the sections captioned "Critical Accounting Policies" and "Allowance for Loan Losses" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2013 Annual Report on Form 10-K. There have been no changes in the Company's application of critical accounting policies since December 31, 2013.

## Table of contents

| Selected Financial Data |  |  |  |
| :---: | :---: | :---: | :---: |
|  | Three Months Ended March 31 |  |  |
|  | 2014 | 2013 |  |
| Per Share Data |  |  |  |
| Net income per common share - basic | \$. 67 | \$. 64 | * |
| Net income per common share - diluted | . 67 | . 63 | * |
| Cash dividends | . 225 | . 214 | * |
| Book value | 23.75 | 22.87 | * |
| Market price | 46.42 | 38.89 | * |
| Selected Ratios |  |  |  |
| (Based on average balance sheets) |  |  |  |
| Loans to deposits ${ }^{(1)}$ | 59.35 | \% 54.65 | \% |
| Non-interest bearing deposits to total deposits | 33.40 | 32.79 |  |
| Equity to loans ${ }^{(1)}$ | 20.36 | 22.00 |  |
| Equity to deposits | 12.09 | 12.02 |  |
| Equity to total assets | 10.06 | 9.92 |  |
| Return on total assets | 1.16 | 1.13 |  |
| Return on total equity | 11.56 | 11.38 |  |
| (Based on end-of-period data) |  |  |  |
| Non-interest income to revenue ${ }^{(2)}$ | 40.14 | 39.92 |  |
| Efficiency ratio ${ }^{(3)}$ | 63.28 | 61.76 |  |
| Tier I risk-based capital ratio | 13.98 | 13.63 |  |
| Total risk-based capital ratio | 15.16 | 14.94 |  |
| Tangible common equity to assets ratio ${ }^{(4)}$ | 9.36 | 9.26 |  |
| Tier I leverage ratio | 9.41 | 8.92 |  |

* Restated for the 5\% stock dividend distributed in December 2013.
(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 to assets ratio is a measurement which management believes is a useful indicator of capital adequacy and utilization. It provides a meaningful basis for period to period and company to company comparisons, and also assists regulators, investors and analysts in analyzing the financial position of the Company. Tangible common equity is a non-GAAP measure and represents common equity less goodwill, core deposit premium and non-controlling interest in subsidiaries. Tangible assets, also a non-GAAP measure, represents total assets less goodwill and core deposit premium. Other companies may define or calculate these measures differently. Non-GAAP measures should not be viewed as a substitute for, or superior to, data prepared in accordance with GAAP.

The following table is a reconciliation of the GAAP financial measures of total equity and total assets to the non-GAAP measures of total tangible common equity and total tangible assets.
(Dollars in thousands)
Total equity
Less non-controlling interest
Less goodwill
Less core deposit premium
Total tangible common equity (a)

March 31
$2014 \quad 2013$
\$2,273,511
\$2,179,191
3,132 4,046
138,921 125,585
7,968 4,367
\$2,123,490
\$2,045,193

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| Total assets | $\$ 22,837,120$ | $\$ 22,227,208$ |
| :--- | :--- | :--- |
| Less goodwill | 138,921 | 125,585 |
| Less core deposit premium | 7,968 | 4,367 |
| Total tangible assets (b) | $\$ 22,690,231$ | $\$ 22,097,256$ |
| Tangible common equity to assets ratio (a)/(b) | 9.36 | $\% 9.26$ |

## Table of contents

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

| $\left.\begin{array}{llll}\text { Three Months Ended } \\ \text { March 31 } & & & \\ \text { Increase (Decrease) } & \\ 2014 & 2013 & & \text { Amount }\end{array}\right) \%$ change |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
| $\$ 153,066$ | $\$ 150,343$ | $\$ 2,723$ | 1.8 | $\%$ |
| $(9,660$ | $)(3,285$ | $)$ | 6,375 | N.M. |

For the quarter ended March 31, 2014, net income attributable to Commerce Bancshares, Inc. (net income) amounted to $\$ 64.3$ million, an increase of $\$ 3.3$ million, or $5.4 \%$, compared to the first quarter of the previous year, and a decrease of $\$ 1.6$ million, or $2.4 \%$, compared to the previous quarter. For the current quarter, the annualized return on average assets was $1.16 \%$, the annualized return on average equity was $11.56 \%$, and the efficiency ratio was $63.28 \%$. Diluted earnings per share was $\$ .67$, an increase of $6.3 \%$ compared to $\$ .63$ per share in the first quarter of 2013 and a decrease of $2.9 \%$ compared to $\$ .69$ per share in the previous quarter.

Compared to the first quarter of last year, net interest income increased $\$ 2.7$ million, or $1.8 \%$, mostly due to a $\$ 2.9$ million increase in interest income on loans, along with a $\$ 1.5$ million decrease in deposit interest expense. The increase in net interest income was partially offset by a $\$ 1.7$ million decrease in interest on long-term securities purchased under agreements to resell. The provision for loan losses totaled $\$ 9.7$ million for the current quarter, representing an increase of $\$ 6.4$ million over the first quarter of 2013 . Non-interest income increased $\$ 2.8$ million, or $2.8 \%$, due to continued growth in bank card and trust fee income. Non-interest expense for the first quarter increased $\$ 7.3$ million, or $4.7 \%$, compared to the same quarter last year, largely due to an increase of $\$ 3.4$ million, or $3.7 \%$, in salaries and benefits expense. Additionally, a litigation provision increased non-interest expense by $\$ 1.5$ million in the first quarter of 2014. Net investment securities gains increased $\$ 12.2$ million in the current quarter compared to the first quarter of last year, mainly due to increases in fair value adjustments of the private equity securities portfolio.

In September 2013, the Company acquired Summit Bancshares, Inc., an Oklahoma-based franchise with \$261.6 million in assets and branch locations in Tulsa and Oklahoma City. The acquisition is further discussed in Note 2 to the consolidated financial statements.

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## Table of contents

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
Three Months Ended March
31, 2014 vs. 2013
Change due to
Average Average
Volume Rate Total
\$11,399 \$(8,037) \$3,362
Loans held for sale
Investment securities:
U.S. government and federal agency securities
(85 ) - (85 )

Government-sponsored enterprise obligations
State and municipal obligations
Mortgage-backed securities
Asset-backed securities
Other securities
Total interest on investment securities
Short-term federal funds sold and securities purchased under agreements to resell
Long-term securities purchased under agreements to resell
Interest earning deposits with banks
Total interest income
(144 ) 2,818 2,674
1,404 (380 ) 1,024
25 (382 ) (357 )
(3,163 ) 1,524 (1,639 )
(809 ) (256 ) (1,065 )
(501 ) (192 ) (693 )
(3,188 ) 3,132 (56 )

Interest expense:
Deposits:
$\left.\begin{array}{llll}\text { Savings } & 14 & - & 14 \\ \text { Interest checking and money market } & 65 & (697 & )(632\end{array}\right)$

Net interest income for the first quarter of 2014 was $\$ 153.1$ million, a $\$ 2.7$ million increase over the first quarter of 2013. On a tax equivalent (T/E) basis, net interest income totaled $\$ 159.8$ million in the first quarter of 2014, down $\$ 2.4$ million from the previous quarter and up $\$ 3.1$ million over the first quarter of 2013. The decline in net interest income compared to the previous quarter was partly due to fewer days in the current quarter, coupled with lower rates earned on loans and a decrease in interest and dividends received on the Company's private equity investments. The Consumer price index published this quarter increased somewhat, which increased inflation interest on the Company's holdings of U.S. Treasury inflation-protected securities by $\$ 844$ thousand compared to the previous quarter. Additionally, premium amortization expense was reduced by $\$ 539$ thousand this quarter due to an adjustment

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reflecting slowing prepayment speeds on mortgage-backed securities. The increase over the same period last year was mainly the result of lower rates paid on deposits and higher loan balances, partly offset by lower loan yields. The Company's net interest rate margin was $3.03 \%$ in the first quarter of 2014 , compared to $3.06 \%$ in the previous quarter and $3.07 \%$ in the first quarter of 2013.
Total interest income (T/E) increased $\$ 1.6$ million over the first quarter of 2013. Interest income on loans increased $\$ 3.3$ million due to a $12.2 \%$ increase in average loan balances, partly offset by a 37 basis point decrease in average rates earned. The higher balances contributed $\$ 11.3$ million to interest income and occurred mainly in business, consumer and personal real estate loans.

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## Table of contents

The overall average rate earned on total loans declined to $4.12 \%$ during the current quarter compared to $4.49 \%$ in the first quarter of 2013, which resulted in an $\$ 8.0$ million decrease in interest income. Most of the rate impact occurred in business, consumer, business real estate and personal real estate loans. The average rate earned on business real estate loans decreased 27 basis points, while average balances grew $\$ 92.8$ million. The average yield on personal real estate loans declined 22 basis points, while the average balance increased $\$ 178.4$ million, or $11.2 \%$. Average business loans increased $\$ 686.8$ million, or $21.8 \%$, which was offset by a decline of 27 basis points in rates earned. Average consumer loans increased $\$ 190.3$ million, or $14.2 \%$, while the average yield fell 62 basis points. Most of the increase in consumer loan balances resulted from growth of $\$ 166.8$ million in auto loans and $\$ 65.1$ million in fixed-rate home equity loans. This growth was was partly offset by a decrease of $\$ 73.1$ million in marine and RV loans, as that portfolio continues to pay down. Average consumer credit card loans increased $\$ 2.3$ million compared to the first quarter of 2013 and the average rate earned on these balances increased to $11.43 \%$ from $11.38 \%$.
Interest income on investment securities (T/E) was $\$ 49.8$ million during the first quarter of 2014, which was a slight decrease in total from the first quarter of last year. A $\$ 498.3$ million decline in total average balances (excluding fair value adjustments) reduced interest income by $\$ 3.2$ million, while a 12 basis point rise in the overall average rate earned contributed $\$ 3.1$ million. The overall average rate earned was $2.24 \%$ in the current quarter compared to $2.12 \%$ during the first quarter of 2013. This rate increase included a $\$ 2.5$ million increase in inflation interest on inflation-protected securities. Also, higher average rates were earned on mortgage-backed securities, which rose 21 basis points. This increase was partly due to a $\$ 539$ thousand reduction in premium amortization expense in the current quarter, as mentioned above. The decline in total average balances occurred mainly in mortgage-backed and asset-backed securities, which declined $\$ 495.2$ million and $\$ 352.7$ million, respectively, and was partly offset by growth of $\$ 306.1$ million in government-sponsored enterprise obligations.
Interest income on long-term securities purchased under agreements to resell decreased $\$ 1.7$ million from the first quarter of 2013, mainly due to a decline of 48 basis points in average rates earned.
The average tax equivalent yield on total interest earning assets was $3.16 \%$ in the first quarter of 2014 compared to $3.23 \%$ in the first quarter of 2013.
Total interest expense decreased $\$ 1.5$ million, or $17.5 \%$, compared to the first quarter of 2013, mainly due to lower interest expense on interest bearing deposits. The decrease in interest expense on deposits resulted primarily from declines of 4 basis points in average rates paid on money market accounts and 13 basis points on certificates of deposit. Total average interest bearing deposits increased $\$ 287.0$ million, or $2.4 \%$, over the first quarter of 2013 , as money market account balances increased $\$ 294.4$ million, while certificate of deposit balances decreased $\$ 90.2$ million (mainly in certificates of deposit under $\$ 100,000$ ). The overall average rate incurred on all interest bearing liabilities decreased to $.20 \%$ in the first quarter of 2014 compared to $.25 \%$ in the first quarter of 2013 .
Summaries of average assets and liabilities and the corresponding average rates earned/paid appear on the last page of this discussion.
Non-Interest Income
(Dollars in thousands)
Bank card transaction fees
Trust fees
Deposit account charges and other fees
Capital market fees
Consumer brokerage services
Loan fees and sales
Other
Total non-interest income
Non-interest income as a \% of total revenue*

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

| Three Months Ended     <br> March 31     <br> Increase (Decrease)     <br> 2014 2013  Amount $\%$ change  <br> $\$ 41,717$ $\$ 38,550$  $\$ 3,167$ 8.2 | $\%$ |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 26,573 | 25,169 | 1,404 | 5.6 |  |  |
| 18,590 | 18,712 | $(122$ | $)(.7$ | $)$ |  |
| 3,870 | 4,391 | $(521$ | $)(11.9$ | $)$ |  |
| 2,747 | 2,686 | 61 | 2.3 |  |  |
| 1,209 | 1,473 | $(264$ | $)(17.9$ | $)$ |  |
| 7,921 | 8,896 | $(975$ | $)(11.0$ | $)$ |  |
| $\$ 102,627$ | $\$ 99,877$ | $\$ 2,750$ | 2.8 | $\%$ |  |
| 40.1 | $\% 39.9$ | $\%$ |  |  |  |

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## Table of contents

For the first quarter of 2014, total non-interest income amounted to $\$ 102.6$ million compared with $\$ 99.9$ million in the same quarter last year, which was an increase of $\$ 2.8$ million, or $2.8 \%$. Bank card fees for the current quarter increased $\$ 3.2$ million, or $8.2 \%$, over the first quarter of last year, as a result of a $12.8 \%$ increase in corporate card fees, which totaled $\$ 21.1$ million this quarter. Debit card fees also grew by $5.8 \%$ and totaled $\$ 8.7$ million this quarter. Trust fees for the quarter increased $\$ 1.4$ million, or $5.6 \%$, over the same quarter last year, resulting mainly from growth in personal (up $6.3 \%$ ) and institutional (up $5.7 \%$ ) trust fees. Deposit account fees decreased slightly compared to last year as overdraft fees declined by $\$ 718$ thousand, or $9.7 \%$, but were offset by combined growth in corporate cash management and other deposit fees of $\$ 596$ thousand. Capital market fees decreased $\$ 521$ thousand (totaling $\$ 3.9$ million in the current quarter) as customer demand for fixed income securities was down from the previous year. Loan fees and sales revenue declined $\$ 264$ thousand mainly due to lower loan commitment fees. Other income decreased $\$ 975$ thousand from the same quarter last year due to a reduction in fair value of $\$ 688$ thousand on certain bank-owned properties held for sale, in addition to net gains of $\$ 809$ thousand related to branch facilities that were recorded in the first quarter of 2013. Growth of swap fee income and higher revenue from sales of tax credits partially offset the reductions to other non-interest income.

Investment Securities Gains (Losses), Net
(In thousands)
Available for sale:
U.S. government bonds
OTTI losses on non-agency mortgage-backed bonds
Non-marketable:
Private equity investments
Total investment securities gains (losses), net

| Three Months Ended March 31 <br> 2014 |  |  |
| :--- | :--- | :--- |
|  |  |  |
| $\$(5,197$ | $) \$-$ |  |
| $(346$ | $)(442$ |  |
|  |  |  |
| 15,580 | $(1,723$ | $)$ |
| $\$ 10,037$ | $\$(2,165$ | $)$ |

Net gains and losses on investment securities which were recognized in earnings during the three months ended March 31,2014 and 2013 are shown in the table above. Net securities gains amounted to $\$ 10.0$ million in the first quarter of 2014, while net securities losses of $\$ 2.2$ million were recorded in the first quarter of 2013. Included in these net 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 fair value of $\$ 66.1$ million at March 31, 2014. During the current quarter, additional credit-related impairment losses of $\$ 346$ thousand were recorded. The cumulative credit-related impairment loss initially recorded on these securities amounted to $\$ 13.2$ million at March 31, 2014. Also shown above are net gains and losses relating to non-marketable private equity investments, which are primarily held by the Parent's majority-owned private equity subsidiaries. Most of the net gains in 2014 resulted from fair value adjustments to the investments in this portfolio and included a large gain of $\$ 18.4$ million on one investment the Company has held for many years. The portion of the private equity activity attributable to minority interests is reported as non-controlling interest in the consolidated statements of income and resulted in income of $\$ 333$ thousand and $\$ 350$ thousand during the first three months of 2014 and 2013, respectively. During 2014, the Company also sold $\$ 36.2$ million of U.S. Treasury inflation-protected bonds, realizing a loss of $\$ 5.2$ million.

Non-Interest Expense

|  | Three Months Ended |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
|  | Increase (Decrease) |  |  |  |
| March 31 |  | Amount | $\%$ change |  |
| (Dollars in thousands) | 2014 | 2013 |  | An |
| Salaries and employee benefits | $\$ 94,263$ | $\$ 90,881$ | $\$ 3,382$ | 3.7 |
| Net occupancy | 11,616 | 11,235 | 381 | 3.4 |
| Equipment | 4,504 | 4,683 | $(179$ | $)(3.8$ |

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| Supplies and communication | 5,699 | 5,589 | 110 | 2.0 |  |
| :--- | :--- | :--- | :--- | :--- | :--- |
| Data processing and software | 19,087 | 18,951 | 136 | .7 |  |
| Marketing | 3,681 | 3,359 | 322 | 9.6 |  |
| Deposit insurance | 2,894 | 2,767 | 127 | 4.6 |  |
| Other | 20,596 | 17,572 | 3,024 | 17.2 |  |
| Total non-interest expense | $\$ 162,340$ | $\$ 155,037$ | $\$ 7,303$ | 4.7 | $\%$ |

Non-interest expense for the first quarter of 2014 amounted to $\$ 162.3$ million, an increase of $\$ 7.3$ million, or $4.7 \%$, compared with $\$ 155.0$ million in the first quarter of last year. Salaries and benefits expense increased $\$ 3.4$ million, or $3.7 \%$, mainly due to

42

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## Table of contents

an increase in full-time salary costs of $\$ 2.3$ million, or $3.8 \%$, and an increase in medical costs of $\$ 546$ thousand, partly offset by lower retirement plan expenses. Growth in salaries and benefits expense resulted from added staffing mainly in the areas of commercial banking, wealth and commercial card, coupled with higher staffing costs of $\$ 863$ thousand related to the Summit acquisition that were not present in the first quarter of 2013. Full-time equivalent employees totaled 4,745 at March 31, 2014 compared to 4,725 at March 31, 2013. Compared to the first quarter of last year, occupancy expense grew $\$ 381$ thousand, or $3.4 \%$, on higher utilities and snow removal costs, while marketing costs grew $\$ 322$ thousand, or $9.6 \%$, due to lower spending levels last year. Data processing and software costs grew by $\$ 136$ thousand, or $.7 \%$, mainly due to lower software expense, partly offset by higher bank card transaction processing costs. Other non-interest expense increased $\$ 3.0$ million compared to the first quarter of last year, and included a litigation provision of $\$ 1.5$ million and write downs of $\$ 720$ thousand on certain surplus branch properties. The current quarter included operating expenses related to Summit totaling $\$ 432$ thousand (excluding salaries and benefits) which were not present in the same quarter last year. In the first quarter of 2013, the Company recorded a provision of $\$ 1.0$ million on a letter of credit exposure.

Provision and Allowance for Loan Losses
(In thousands)
Provision for loan losses
Three Months Ended

| Mar. 31, | Dec. 31, | Mar. 31, |
| :--- | :--- | :--- |
| 2014 | 2013 | 2013 |
| $\$ 9,660$ | $\$ 5,543$ | $\$ 3,285$ |

Net loan charge-offs (recoveries):
Commercial:

| Business | (106 | ) (76 | ) (50 | ) |
| :---: | :---: | :---: | :---: | :---: |
| Real estate-construction and land | 55 | (1,781 | ) (532 | ) |
| Real estate-business | 426 | (255 | ) (104 | ) |
| Personal Banking: |  |  |  |  |
| Real estate-personal | 6 | 358 | 373 |  |
| Consumer | 2,505 | 2,311 | 1,709 |  |
| Revolving home equity | 113 | 596 | 139 |  |
| Consumer credit card | 6,447 | 6,110 | 6,048 |  |
| Overdrafts | 214 | 280 | 202 |  |
| Total net loan charge-offs | \$9,660 | \$7,543 | \$7,785 |  |
|  | Three Mont | ths Ended |  |  |
|  | $\begin{aligned} & \text { Mar. 31, } \\ & 2014 \end{aligned}$ | $\begin{aligned} & \text { Dec. 31, } \\ & 2013 \end{aligned}$ | $\begin{aligned} & \text { Mar. 31, } \\ & 2013 \end{aligned}$ |  |
| Annualized net loan charge-offs (recoveries)*: |  |  |  |  |
| Commercial: |  |  |  |  |
| Business | (.01 ) | )\%(.01 | )\% (. 01 | )\% |
| Real estate-construction and land | . 05 | (1.81 | ) $(.61$ | ) |
| Real estate-business | . 07 | (.04 | ) $(.02$ | ) |
| Personal Banking: |  |  |  |  |
| Real estate-personal | - | . 08 | . 09 |  |
| Consumer | . 66 | . 61 | . 52 |  |
| Revolving home equity | . 11 | . 56 | . 13 |  |
| Consumer credit card | 3.45 | 3.19 | 3.25 |  |
| Overdrafts | 15.99 | 16.56 | 15.15 |  |
| Total annualized net loan charge-offs | . 35 \% | \% . 28 | \%. 32 | \% |

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


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

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## Table of contents

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 of collateral (including exit costs) are normally obtained annually but discounted based on date last received and market conditions. From these evaluations of expected cash flows and collateral values, specific allowances are determined.

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. Collectively-evaluated loans include certain troubled debt restructurings with similar risk characteristics. Allowances determined for personal banking loans, which are generally smaller balance homogeneous type loans, use consistent methodologies which consider historical and current loss trends, delinquencies and current economic conditions. Allowances for commercial type loans, which are generally larger and more complex in structure with more unpredictable loss characteristics, use methods which consider historical and current loss trends, current loan grades, delinquencies, industry concentrations, economic conditions throughout the Company's markets as monitored by Company credit officers, and general economic conditions.

The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses is based upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in delinquencies, portfolio risk ratings, levels of non-performing assets, and prevailing regional and national economic conditions. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company's senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The Company's subsidiary bank continues to be subject to examination by several regulatory agencies, and examinations are conducted throughout the year, targeting various segments of the loan portfolio for review. Note 1 in the 2013 Annual Report on Form 10-K contains additional discussion on the allowance and charge-off policies.

Net loan charge-offs in the first quarter of 2014 amounted to $\$ 9.7$ million, compared with $\$ 7.5$ million in the prior quarter and $\$ 7.8$ million in the first quarter of last year. The increase in net loan charge-offs compared to the previous quarter is mainly due to a decline of $\$ 2.6$ million in commercial loan recoveries received, resulting in a $\$ 2.5$ million increase in net charge-offs of commercial loans. Additionally, consumer credit card loan net charge-offs increased $\$ 337$ thousand. These increases were partially offset by lower net charge-offs in revolving home equity and personal real estate loans, which decreased $\$ 483$ thousand and $\$ 352$ thousand, respectively. For the three months ended March 31,2014 , the ratio of annualized total net loan charge-offs to total average loans was $.35 \%$, compared to $.28 \%$ in the previous quarter and $.32 \%$ in the same quarter last year.

For the first quarter of 2014, annualized net charge-offs on average consumer credit card loans amounted to $3.45 \%$, compared with $3.19 \%$ in the previous quarter and $3.25 \%$ in the same period last year. Consumer loan net charge-offs for the quarter amounted to $.66 \%$ of average consumer loans, compared to $.61 \%$ in the previous quarter and $.52 \%$ in the same quarter last year.

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The provision for loan losses for the current quarter totaled $\$ 9.7$ million, an increase of $\$ 4.1$ million over the previous quarter and $\$ 6.4$ million over the same period last year. The current quarter provision for loan losses matched net loan charge-offs, while in the previous quarter the provision was $\$ 2.0$ million less than net loan charge-offs. At March 31, 2014, the allowance for loan losses amounted to $\$ 161.5$ million and was $1.44 \%$ of total loans and $340 \%$ of total non-accrual loans.

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## Table of contents

## Risk Elements of Loan Portfolio

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

| March 31, | December 31, |  |
| :--- | :--- | :--- |
| 2014 | 2013 |  |
| $\$ 47,573$ | $\$ 48,814$ |  |
| 6,871 | 6,625 |  |
| $\$ 54,444$ | $\$ 55,439$ |  |
| .49 | $\% .51$ | $\%$ |
| .24 | $\% .24$ | $\%$ |
| $\$ 12,487$ | $\$ 13,966$ |  |

Non-accrual loans, which are also classified as impaired, totaled $\$ 47.6$ million at March 31, 2014, and decreased $\$ 1.2$ million from December 31, 2013. The decline from December 31, 2013 occurred mainly in personal real estate, construction and land, and business real estate non-accrual loans, which decreased $\$ 748$ thousand, $\$ 726$ thousand, and $\$ 724$ thousand, respectively. Business non-accrual loans also decreased $\$ 581$ thousand. These declines in non-accrual loans were partially offset by an increase of $\$ 1.5$ million in consumer non-accrual loans during the first quarter of 2014. At March 31, 2014, non-accrual loans were comprised mainly of business real estate ( $40.1 \%$ ), business ( $23.1 \%$ ), and construction and land (19.9\%) loans. Foreclosed real estate totaled $\$ 6.9$ million at March 31, 2014, an increase of $\$ 246$ thousand when compared to December 31, 2013. Total loans past due 90 days or more and still accruing interest were $\$ 12.5$ million as of March 31, 2014, a decrease of $\$ 1.5$ million when compared to December 31, 2013. Balances by class for non-accrual loans and loans past due 90 days and still accruing interest are shown in the "Delinquent and non-accrual loans" section in Note 3 to the consolidated financial statements.

In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. They are classified as substandard under the Company's internal rating system. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, they may never become non-performing. Such loans totaled $\$ 109.4$ million at March 31, 2014 compared with $\$ 98.3$ million at December 31, 2013, resulting in an increase of $\$ 11.1$ million, or $11.2 \%$. The change in potential problem loans was largely comprised of increases of $\$ 7.0$ million in business loans and $\$ 3.1$ million in business real estate loans.

| (In thousands) | March 31, <br> December 31, <br> 2013 |  |
| :--- | :--- | :--- |
| Potential problem loans: |  |  |
| Business | $\$ 30,675$ | $\$ 23,691$ |
| Real estate - construction and land | 21,223 | 21,812 |
| Real estate - business | 53,427 | 50,349 |
| Real estate - personal | 4,072 | 2,486 |
| Total potential problem loans | $\$ 109,397$ | $\$ 98,338$ |

At March 31, 2014, the Company had $\$ 86.0$ 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

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and who have been granted a concession, as defined by accounting guidance, and are further discussed in the "Troubled debt restructurings" section in Note 3 to the consolidated financial statements. This balance includes certain commercial loans totaling $\$ 41.0$ million which are classified as substandard and included in the table above because of this classification.

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 3 to the consolidated financial statements. However, certain types of loans are considered at high risk of loss due to their terms, location, or special conditions. Additional information about the major types of loans in these categories and their risk features are provided below. Information based on loan-to-value (LTV) ratios was generally

45

## Table of contents

calculated with valuations at loan origination date. The Company does not attempt to obtain updated appraisals or valuations unless the loans become significantly delinquent or are in the process of being foreclosed upon.

Real Estate - Construction and Land Loans

The Company's portfolio of construction and land loans, as shown in the table below, amounted to $3.8 \%$ of total loans outstanding at March 31, 2014.

| (Dollars in thousands) | $\begin{aligned} & \text { March 31, } \\ & 2014 \end{aligned}$ | \% of | \% of <br> Total <br> Loans | $\begin{aligned} & \text { December } \\ & 2013 \end{aligned}$ | \% of | \% of Tota al Loa |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Residential land and land development | \$83,090 | 19.6 | \%. 7 | \% \$ 79,273 | 19.5 | \%. 7 | \% |
| Residential construction | 102,500 | 24.2 | 1.0 | 86,043 | 21.2 | . 8 |  |
| Commercial land and land development | 79,057 | 18.7 | . 7 | 77,444 | 19.1 | . 7 |  |
| Commercial construction | 159,020 | 37.5 | 1.4 | 163,437 | 40.2 | 1.5 |  |
| Total real estate - construction and land loans | \$423,667 | 100.0 | \%3.8 | \% \$ 406,197 | 100.0 | \%3.7 | \% |

## Real Estate - Business Loans

Total business real estate loans were $\$ 2.3$ billion at March 31, 2014 and comprised 20.6\% 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. At March 31, 2014, 46.3\% of business real estate loans were for owner-occupied real estate properties, which present lower risk profiles.

| (Dollars in thousands) | $\begin{aligned} & \text { March 31, } \\ & 2014 \end{aligned}$ | \% of Total | \% of Total Loans | $\begin{aligned} & \text { December } 31 \\ & 2013 \end{aligned}$ |  | \% of Total tal Loans |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Owner-occupied | \$ 1,072,997 | 46.3 | \%9.6 | \% \$ 1,074,074 | 46.4 | \%9.8 | \% |
| Retail | 269,637 | 11.6 | 2.4 | 271,228 | 11.7 | 2.5 |  |
| Office | 261,943 | 11.3 | 2.2 | 265,352 | 11.5 | 2.4 |  |
| Multi-family | 191,064 | 8.3 | 1.7 | 178,524 | 7.7 | 1.6 |  |
| Hotels | 152,602 | 6.6 | 1.4 | 151,483 | 6.5 | 1.4 |  |
| Farm | 138,422 | 6.0 | 1.2 | 138,842 | 6.0 | 1.3 |  |
| Industrial | 87,454 | 3.8 | . 8 | 89,045 | 3.9 | . 8 |  |
| Other | 141,048 | 6.1 | 1.3 | 145,002 | 6.3 | 1.3 |  |
| Total real estate - business loans | \$2,315,167 | 100.0 | \% 20.6 | \% \$ 2,313,550 | 100.0 | \%21.1 | \% |

## Real Estate - Personal Loans

The Company's $\$ 1.8$ billion personal real estate loan portfolio is composed mainly of residential first mortgage real estate loans. As shown on page 43, recent loss rates have remained low, and at March 31, 2014, past due loans increased $\$ 1.0$ million and non-accrual loans declined $\$ 748$ thousand compared to December 31, 2013. Also, as shown in Note 3, only $4.9 \%$ of this portfolio has FICO scores of less than 660, and delinquency levels have been low. Approximately $\$ 15.1$ million of personal real estate loans were structured with interest only payments. These loans are typically made to high net-worth borrowers and generally have low LTV ratios at origination or have additional collateral pledged to secure the loan. Therefore, they are not perceived to represent above normal credit risk. Loans originated with interest only payments were not made to "qualify" the borrower for a lower payment amount. At March 31, 2014, loans with no mortgage insurance and an original LTV higher than $80 \%$ totaled $\$ 145.8$ million
compared to $\$ 146.1$ million at December 31, 2013.

## Revolving Home Equity Loans

The Company has $\$ 419.4$ million in revolving home equity loans at March 31, 2014 that are generally collateralized by residential real estate. Most of these loans ( $94.2 \%$ ) are written with terms requiring interest only monthly payments. These loans are offered in three main product lines: LTV up to $80 \%, 80 \%$ to $90 \%$, and $90 \%$ to $100 \%$. As of March 31, 2014, the outstanding principal of loans with an original LTV higher than $80 \%$ was $\$ 52.7$ million, or $12.6 \%$ of the portfolio, compared to $\$ 54.4$ million as of December 31, 2013. Total revolving home equity loan balances over 30 days past due or on non-accrual status were $\$ 3.7$

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## Table of contents

million at March 31, 2014 compared to $\$ 4.0$ million at December 31, 2013. The weighted average FICO score for the total current portfolio balance is 751 . At maturity, the accounts are re-underwritten, and if they qualify under the Company's credit, collateral and capacity policies, the borrower is given the option to renew the line of credit or convert the outstanding balance to an amortizing loan. If criteria are not met, amortization is required, or the borrower may pay off the loan. During the remainder of 2014 through 2016, approximately $43 \%$ of the Company's current outstanding balances are expected to mature. Of these balances, approximately $83 \%$ have a FICO score of 700 or higher. The Company does not expect a significant increase in losses as these loans mature, due to their high FICO scores, low LTVs, and low historical loss levels.

## 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 and a determined amortization schedule. The fixed rate home equity loan is typically used to finance a specific home repair or remodeling project. This portfolio of loans approximated $\$ 286.1$ million and $\$ 284.9$ million at March 31, 2014 and December 31, 2013, respectively. At the end of the first quarter of 2014, $\$ 73.4$ million of this portfolio had an LTV higher than $80 \%$, up slightly from a balance of $\$ 72.9$ million at the end of 2013.

At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, such loans totaled less than $2 \%$ of the outstanding balance of fixed rate home equity loans at March 31, 2014. The Company has limited the offering of fixed rate home equity loans with LTV ratios over $90 \%$ during the past several years, and only $\$ 416$ thousand in new fixed rate home equity loans were written with these LTV ratios during the first three months of 2014.

Management does not believe these loans collateralized by real estate (personal real estate, revolving home equity, and fixed rate home equity) represent any unusual concentrations of risk, as evidenced by net charge-offs on these loans in the first three months of 2014 of $\$ 6$ thousand, $\$ 113$ thousand, and $\$ 542$ 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, which are characterized as new loans to customers with FICO scores below 660. 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, marine and RVs. Outstanding balances for these loans were $\$ 1.0$ billion at March 31, 2014 and December 31, 2013. The balances over 30 days past due amounted to $\$ 10.6$ million at March 31, 2014 compared to $\$ 14.4$ million at the end of 2013. For the three months ended March 31, 2014, $\$ 142.9$ million of new automobile loans were originated, compared to $\$ 507.7$ million during the full year of 2013. The Company has curtailed new marine and RV loans since 2008, and at March 31, 2014, outstanding balances totaled $\$ 237.4$ million. The loss ratios experienced for marine and RV loans have been higher than other consumer loan products in recent years, and the annualized ratios were $1.4 \%$ and $1.3 \%$ in the first three months of 2014 and 2013, respectively.

Additionally, the Company offers low promotional rates on selected consumer credit card products. Out of a portfolio at March 31, 2014 of $\$ 775.0$ million in consumer credit card loans outstanding, approximately $\$ 161.3$ million, or $20.8 \%$, carried a low promotional rate. Within the next six months, $\$ 45.8$ 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.
Shared National Credits
The Company participates in credits of large, publicly traded companies which are defined by regulation as shared national credits, or SNCs. Regulations define SNCs as loans exceeding $\$ 20$ million that are shared by three or more financial institutions. The Company typically participates in these loans when business operations are maintained in the local communities or regional markets and opportunities to provide other banking services are present. The balance of SNC loans totaled $\$ 477.5$ million at March 31, 2014, compared to $\$ 406.3$ million at December 31, 2013. Additional unfunded commitments at March 31, 2014 totaled $\$ 1.1$ billion.

47

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## Table of contents

Income Taxes
Income tax expense was $\$ 29.6$ million in the first quarter of 2014, compared to $\$ 30.4$ million in the fourth quarter of 2013 and $\$ 28.9$ million in the first quarter of 2013. The Company's effective tax rate, including the effect of non-controlling interest, was $31.5 \%$ in both the first quarter of 2014 and fourth quarter of 2013 , compared to $32.2 \%$ in the first quarter of 2013. The decrease in the effective tax rate for the first three months of 2014 compared to the same period in 2013 was primarily due to lower state and local income taxes.

## Financial Condition

## Balance Sheet

Total assets of the Company were $\$ 22.8$ billion at March 31, 2014 and $\$ 23.1$ billion at December 31, 2013. Earning assets (excluding fair value adjustments on investment securities) amounted to $\$ 21.6$ billion at March 31, 2014, compared to $\$ 21.9$ billion at December 31, 2013, and consisted of $52 \%$ in loans and $43 \%$ in investment securities.

During the first quarter of 2014, average loans increased $\$ 287.7$ million compared to the previous quarter and increased $\$ 1.2$ billion, or $12.2 \%$, compared to the same period last year. Compared to the previous quarter, the increase in average loans resulted primarily from growth in business loans, which increased $\$ 208.2$ million. The increase in average loans during the quarter was supplemented by growth in consumer loans, which increased $\$ 33.1$ million, construction loans, which increased $\$ 28.3$ million, and business real estate loans, which increased $\$ 23.5$ million. Growth in business loans mainly resulted from continued growth in commercial and industrial and tax-advantaged lending activities. Consumer loan growth was mainly driven by increased demand for consumer automobile loans, which increased by $\$ 49.8$ million in the first quarter. However, average marine and RV loans, also included in the consumer loan portfolio, continued to run off this quarter by $\$ 14.5$ million.

Total available for sale investment securities, at fair value, averaged $\$ 9.0$ billion this quarter, an increase of $\$ 244.9$ million when compared to the previous quarter. This growth resulted partly from purchases occurring late in 2013 and also from purchases of new securities, totaling $\$ 649.6$ million in the first quarter of 2014. These purchases were offset by sales, maturities and pay downs of $\$ 493.6$ million. At March 31, 2014, the duration of the investment portfolio was 2.8 years, and maturities and pay downs of approximately $\$ 1.5$ billion are expected to occur during the next 12 months.

Total average deposits increased $\$ 292.7$ million during the first quarter of 2014 compared to the previous quarter. The increase in average deposits resulted mainly from $\$ 270.2$ million growth in money market accounts, growth of $\$ 30.4$ million in certificates of deposit, and $\$ 21.5$ million of growth in savings accounts. These increases were partly offset by a decline in non-interest bearing demand deposits, which declined $\$ 33.5$ million. Compared to the previous quarter, total average consumer, private banking and commercial deposits increased $\$ 194.9$ million, $\$ 42.4$ million and $\$ 40.9$ million, respectively. The average loans to deposits ratio in the current quarter was $59.4 \%$, compared to $58.7 \%$ in the previous quarter.

During the first quarter of 2014, the Company's average borrowings increased $\$ 22.8$ million compared to the previous quarter, mainly due to an increase in the average balance of customer repurchase agreements.

## Liquidity and Capital Resources

Liquidity Management

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

| (In thousands) | March 31, <br> 2014 | March 31, <br> 2013 | December 31, <br> 2013 |
| :--- | :--- | :--- | :--- |
| Liquid assets: |  |  |  |
| Available for sale investment securities | $\$ 9,115,116$ | $\$ 9,572,751$ | $\$ 8,915,680$ |
| Federal funds sold | 19,525 | 7,820 | 43,845 |
| Long-term securities purchased under agreements to resell | 950,000 | $1,200,000$ | $1,150,000$ |
| Balances at the Federal Reserve Bank | 198,417 | 199,956 | 707,249 |
| Total | $\$ 10,283,058$ | $\$ 10,980,527$ | $\$ 10,816,774$ |

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## Table of contents

Federal funds sold, which are funds lent to the Company's correspondent bank customers with overnight maturities, totaled $\$ 19.5$ million as of March 31, 2014. Long-term resell agreements, maturing in 2014 through 2016, totaled $\$ 950.0$ million at March 31, 2014. Under these agreements, the Company lends funds to upstream financial institutions and holds marketable securities, safekept by a third-party custodian, as collateral. This collateral totaled $\$ 997.1$ million in fair value at March 31, 2014. Interest earning balances at the Federal Reserve Bank, which have overnight maturities and are used for general liquidity purposes, totaled $\$ 198.4$ million at March 31, 2014. The fair value of the available for sale investment portfolio was $\$ 9.1$ billion at March 31, 2014 and included an unrealized net gain in fair value of $\$ 90.4$ million. The total net unrealized gain included net gains of $\$ 56.3$ million on mortgage and asset-backed securities and $\$ 33.5$ million on common stock held by the Parent. Net gains of $\$ 16.1$ million on U.S. government securities were offset by net losses of $\$ 16.5$ million on government-sponsored enterprise obligations.

Approximately $\$ 1.5$ billion of the available for sale investment portfolio is expected to mature or pay down during the next 12 months, and these funds offer substantial resources to meet new loan demand or help offset 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. Total investment securities pledged for these purposes were as follows:
(In thousands)
Investment securities pledged for the purpose of securing: Federal Reserve Bank borrowings
FHLB borrowings and letters of credit
Securities sold under agreements to repurchase
Other deposits and swaps
Total pledged securities
Unpledged and available for pledging
Ineligible for pledging
Total available for sale securities, at fair value

March 31, 2014 March 31, 2013
December 31, 2013

| $\$ 495,526$ | $\$ 580,800$ | $\$ 505,690$ |
| :--- | :--- | :--- |
| 54,668 | 34,085 | 58,445 |
| $2,251,659$ | $2,209,955$ | $2,814,597$ |
| $1,987,944$ | $1,933,572$ | $1,646,562$ |
| $4,789,797$ | $4,758,412$ | $5,025,294$ |
| $2,752,224$ | $3,165,302$ | $2,339,549$ |
| $1,573,095$ | $1,649,037$ | $1,550,837$ |
| $\$ 9,115,116$ | $\$ 9,572,751$ | $\$ 8,915,680$ |

Liquidity is also available from the Company's large base of core customer deposits, defined as non-interest bearing, interest checking, savings, and money market deposit accounts. At March 31, 2014, such deposits totaled $\$ 16.9$ billion and represented $87.8 \%$ of total deposits. These core deposits are normally less volatile, as they are often with customer relationships tied to other products offered by the Company, promoting long lasting relationships and stable funding sources. Time open and certificates of deposit of $\$ 100,000$ and over totaled $\$ 1.4$ billion at March 31, 2014. These accounts are normally considered more volatile and higher costing and comprised $7.2 \%$ of total deposits at March 31, 2014.
(In thousands)
Core deposit base:

| Non-interest bearing | $\$ 6,552,085$ | $\$ 6,170,274$ | $\$ 6,750,674$ |
| :--- | :--- | :--- | :--- |
| Interest checking | 874,125 | 805,960 | $1,113,110$ |
| Savings and money market | $9,454,787$ | $8,996,878$ | $8,995,126$ |
| Total | $\$ 16,880,997$ | $\$ 15,973,112$ | $\$ 16,858,910$ |

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) | March 31, 2014 | March 31, 2013 | December 31, <br> 2013 |
| :--- | :--- | :--- | :--- |
| Borrowings: |  |  |  |
| Federal funds purchased | $\$ 8,940$ | $\$ 36,750$ | $\$ 24,795$ |
| Securities sold under agreements to repurchase | 918,212 | $1,090,108$ | $1,321,763$ |
| FHLB advances | 105,114 | 102,783 | 105,310 |
| Total | $\$ 1,032,266$ | $\$ 1,229,641$ | $\$ 1,451,868$ |

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

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## Table of contents

Company's investment portfolio and are comprised of both non-insured customer funds totaling $\$ 718.2$ million, which generally mature overnight, and structured repurchase agreements of $\$ 200.0$ million. The structured repurchase agreements have variable rates and mature later in 2014. The Company also borrows on a secured basis through advances from the FHLB, which totaled $\$ 105.1$ million at March 31, 2014. These advances have fixed interest rates and most mature in 2017.

The Company pledges certain assets, including loans and investment securities, to both the Federal Reserve Bank and the FHLB as security to establish lines of credit and borrow from these entities. Based on the amount and type of collateral pledged, the FHLB establishes a collateral value from which the Company may draw advances against the collateral. Also, this collateral is used to enable the FHLB to issue letters of credit in favor of public fund depositors of the Company. The Federal Reserve Bank also establishes a collateral value of assets pledged to support borrowings from the discount window. The following table reflects the collateral value of assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company at March 31, 2014:

March 31, 2014
(In thousands)
Collateral value pledged
Advances outstanding
Letters of credit issued Available for future advances

|  | Federal Reserve |  |  |
| :--- | :--- | :--- | :--- |
| FHLB | Total |  |  |
| $\$ 2,453,748$ | $\$ 1,529,703$ | $\$ 3,983,451$ |  |
| $(105,114$ | $)-$ | $(105,114$ | $)$ |
| $(147,705$ | $)$ | $(147,705$ | $)$ |
| $\$ 2,200,929$ | $\$ 1,529,703$ | $\$ 3,730,632$ |  |

In addition to those mentioned above, several other sources of liquidity are available. The Bank has strong issuer ratings from Standard \& Poor's and Moody's of A and Aa3, respectively. Additionally, the Parent's sound commercial paper rating of P-1 from Moody's would help ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been issued or outstanding during the past ten years. The Company has no subordinated debt or hybrid instruments which could affect future borrowing capacity. Because of its lack of significant long-term debt, the Company believes that it could generate additional liquidity through its Capital Markets Group from sources such as jumbo certificates of deposit or privately placed corporate debt. Financing may also include the issuance of common or preferred stock.

The cash flows from the operating, investing and financing activities of the Company resulted in a net decrease in cash and cash equivalents of $\$ 521.3$ million during the first three months of 2014, as reported in the consolidated statements of cash flows in this report. Operating activities, consisting mainly of net income adjusted for certain non-cash items, provided cash flow of $\$ 121.5$ million and has historically been a stable source of funds. Investing activities, which occur mainly in the loan and investment securities portfolios, used cash of $\$ 218.6$ million. These activities included $\$ 628.2$ million in purchases of investment securities, offset by $\$ 488.6$ million in sales, maturities and pay downs, and a net increase in loans of $\$ 275.0$ million. Repayments of long-term securities purchased under agreements to resell, net of purchases, provided cash of $\$ 200.0$ million. Financing activities used cash of $\$ 424.2$ million, resulting from a net decrease of $\$ 419.4$ million in in borrowings of federal funds purchased and securities sold under agreements to repurchase. Additionally, purchases of treasury stock of $\$ 20.9$ million, and cash dividends paid of $\$ 21.6$ million contributed to financing activity net outflows during the period. These outflows were partially offset by a net increase of $\$ 35.0$ million in deposits. Future short-term liquidity needs arising from daily operations are not expected to vary significantly, and the Company believes it will be able to meet these cash flow needs.

## Capital Management

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

| (Dollars in thousands) | March 31, 2014 | December 31, <br> 2013 | Minimum Ratios <br> for <br> Well-Capitalized |
| :--- | :--- | :--- | :--- |
| Risk-adjusted assets | $\$ 14,963,936$ | $\$ 14,660,536$ | Banks |

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## Table of contents

The Company maintains a treasury stock buyback program, and at a July 2013 meeting, the Board of Directors approved the purchase of additional shares, bringing the total shares authorized for future purchase to $4,000,000$ shares. During the quarter ended March 31, 2014, the Company purchased 474,854 shares of stock at an average cost of $\$ 44.01$ per share. At March 31, 2014, 3,017,411 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 $\$ .225$ per share cash dividend in the first quarter of 2014, which was a $5 \%$ increase compared to its 2013 fourth quarter dividend.

Commitments, Off-Balance Sheet Arrangements and Contingencies
In the normal course of business, various commitments and contingent liabilities arise which are not required to be recorded on the balance sheet. The most significant of these are loan commitments, which at March 31, 2014 totaled $\$ 8.3$ billion (including approximately $\$ 3.8$ billion in unused approved credit card lines). In addition, the Company enters into standby and commercial letters of credit. These contracts totaled $\$ 333.3$ million and $\$ 8.3$ million, respectively, at March 31, 2014. 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 $\$ 3.5$ million at March 31, 2014.

The Company regularly purchases various state tax credits arising from third-party property redevelopment. These credits are either resold to third parties or retained for use by the Company. During the first three months of 2014, purchases and sales of tax credits amounted to $\$ 17.9$ million and $\$ 19.0$ million, respectively. At March 31, 2014, outstanding purchase commitments totaled $\$ 177.7$ million.

Other contingencies related to lawsuits are discussed in Note 16 to the consolidated financial statements.

## Segment Results

The table below is a summary of segment pre-tax income results for the first three months of 2014 and 2013.
$\left.\begin{array}{lllllllll}\begin{array}{lllllll}\text { (Dollars in thousands) } \\ \text { Three Months Ended March 31, }\end{array} & \text { Consumer } & \text { Commercial } & \text { Wealth } & \begin{array}{l}\text { Segment } \\ \text { Totals }\end{array} & \begin{array}{l}\text { Other/ } \\ \text { Elimination }\end{array} & \begin{array}{l}\text { Consolidated } \\ \text { Totals }\end{array} \\ \text { 2014 } & & & & & & & & \\ \text { Net interest income } & \$ 66,862 & \$ 73,401 & \$ 9,912 & \$ 150,175 & \$ 2,891 & \$ 153,066 \\ \text { Provision for loan losses } & (9,220 & ) & (383 & ) & (41 & ) & (9,644 & ) \\ \text { Non-interest income } & 25,644 & 47,117 & 29,989 & 102,750 & (123 & ) & (9,660 & 102,627\end{array}\right)$

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Increase (decrease) in income
before income taxes:

| Amount | $\$(707$ | $)$ | $\$ 3,011$ | $\$ 474$ | $\$ 2,778$ | $\$ 1,219$ | $\$ 3,997$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Percent | $(4.0$ | $) \% 5.3$ | $\% 3.2$ | $\% 3.1$ | $\% 111.6$ | $\% 4.5$ | $\%$ |

51

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

## Consumer

For the three months ended March 31, 2014, income before income taxes for the Consumer segment decreased $\$ 707$ thousand, or $4.0 \%$, compared to the first three months of 2013. This decrease was mainly due to a decline of $\$ 351$ thousand in net interest income, an increase of $\$ 1.0$ million in the provision for loan losses and a decrease of $\$ 964$ thousand, or $3.6 \%$, in non-interest income. These income reductions were partly offset by a decrease of $\$ 1.6$ million, or $2.4 \%$, in non-interest expense. Net interest income declined due to a $\$ 458$ thousand decrease in loan interest income and a $\$ 1.0$ million decrease in net allocated funding credits assigned to the Consumer segment's loan and deposit portfolios, partly offset by a decline of $\$ 1.1$ million in deposit interest expense. Non-interest income decreased mainly due to a decline in mortgage banking revenue, partly offset by growth bank card fees (mainly debit card). Non-interest expense decreased from the same period in the previous year due to lower processing costs (mainly deposit account processing), corporate management fees and salaries and benefits expense (mainly incentives). The provision for loan losses totaled $\$ 9.2$ million, a $\$ 1.0$ million increase over the first three months of 2013, which was mainly due to higher losses on credit card, fixed rate home equity and other consumer loans.

## Commercial

For the three months ended March 31, 2014, income before income taxes for the Commercial segment increased $\$ 3.0$ million, or $5.3 \%$, compared to the same period in the previous year. This increase was mainly due to higher net interest income and higher non-interest income, partly offset by higher non-interest expense. Net interest income increased $\$ 3.2$ million, or $4.5 \%$, due to growth of $\$ 2.9$ million in loan interest income. The provision for loan losses increased $\$ 872$ thousand over the same period last year, as business real estate and construction and land loan net charge-offs were higher by $\$ 531$ thousand and $\$ 586$ thousand, respectively. Non-interest income increased by $\$ 2.6$ million, or $5.9 \%$, over the previous year due to growth in bank card fees (mainly corporate card), swap fees and tax credit sales fees, partly offset by lower capital market fees and loan commitment fees. Non-interest expense increased $\$ 1.9$ million, or $3.2 \%$, over the previous year, mainly due to higher full-time salary costs, foreclosed property expense, and corporate management and marketing expense. These increases were partly offset by lower processing costs (mainly in deposit account cash management costs) and the non-recurrence of a letter of credit loss provision recorded in 2013.

Wealth
Wealth segment pre-tax profitability for the three months ended March 31, 2014 increased $\$ 474$ thousand, or $3.2 \%$, over the same period in the previous year. Net interest income decreased $\$ 262$ thousand, or $2.6 \%$, mainly due to an $\$ 861$ thousand decline in net allocated funding credits, party offset by a $\$ 391$ thousand decline in deposit interest expense and a $\$ 207$ thousand increase in loan interest income. Non-interest income increased $\$ 1.2$ million, or $4.1 \%$, over the prior year due to higher personal and institutional trust fees. Non-interest expense increased $\$ 441$ thousand, or $1.8 \%$, mainly due to higher full-time salary costs.

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/recoveries 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 same period last year by $\$ 1.2$ million. This increase was mainly due to higher unallocated securities gains of $\$ 12.2$ million, partly offset by higher unallocated non-interest expense of $\$ 6.6$ million. In addition, the unallocated loan loss provision increased $\$ 4.5$ million, due to last year's excess of total net charge-offs over total provision.

Regulatory Changes Affecting the Banking Industry

In 2011, the Federal Reserve, under the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), approved a final debit card interchange rule that significantly limited the amount of debit card interchange fees charged by banks. The rule capped an issuer's base fee at 21 cents per transaction and allowed additional fees to help cover fraud losses. The pricing was a reduction of approximately $45 \%$ when compared to previous market rates. The rule also limited network exclusivity, requiring issuers to ensure that a debit card transaction can be carried on two unaffiliated networks: one signature-based and one PIN-based. The rules applied to bank issuers with more than $\$ 10$ billion in assets and took effect in phases, with the base fee cap effective in October 2011 and the network exclusivity rule effective in April 2012. On July 31, 2013, a Federal District Court judge ruled that the Federal Reserve inflated debit interchange fees when implementing the Dodd-Frank provision in 2011. The judge ruled that the Federal Reserve erred in using criteria outside of the scope Congress intended to determine the fee cap. The judge also ruled that the network options for both signature and PIN transactions were not set appropriately in accordance with the Dodd-Frank Act. The Federal Reserve appealed this decision on August 21 and ultimately won their appeal in March 2014. As a result of winning the appeal, the interchange fee cap will remain at 21 cents. Additionally, the appeal allows

## Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-Q

## Table of contents

for continuance of the current statute, which requires that each debit card have one PIN debit network choice and one signature network choice, rather than two unaffiliated PIN choices and two unaffiliated signature choices.

In October 2012, the Federal Reserve, as required by the Dodd-Frank Act, approved new stress testing regulations applicable to certain financial companies with total consolidated assets of more than $\$ 10$ billion but less than $\$ 50$ billion. The rule requires that these financial companies, including the Company, conduct stress tests on an annual basis. The initial stress test had an as-of date of September 30, 2013 using scenarios provided by the Federal Reserve in November 2013 (projected nine months out). The Company submitted its first regulatory report on its stress test results to the Federal Reserve in March 2014. This process will be repeated annually. In June 2015, the Company will be required to make public disclosures of the results of the 2015 stress tests performed under the severely adverse scenario.

In July 2013 the FDIC, the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System approved a final rule to implement in the United States the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). A key goal of the Basel III agreement is to strengthen the capital resources of banking organizations during normal and challenging business environments. The Basel III final rule increases minimum requirements for both the quantity and quality of capital held by banking organizations. The rule includes a new minimum ratio of common equity Tier I capital to risk-weighted assets of $4.5 \%$ and a common equity Tier I capital conservation buffer of $2.5 \%$ of risk-weighted assets. The final rule also adjusted the methodology for calculating risk-weighted assets to enhance risk sensitivity. Beginning January 1, 2015, the Company must be compliant with revised minimum regulatory capital ratios and will begin the transitional period for definitions of regulatory capital and regulatory capital adjustments and deductions established under the final rule. Compliance with the risk-weighted asset calculations is also required on January 1, 2015. Management believes that as of March 31, 2014, the Company's capital levels would remain "well-capitalized" under the new rules.

In December 2013, the Volcker Rule of the Dodd-Frank Act was approved by all five of the necessary financial regulatory agencies, and became effective on April 1, 2014. The rule places trading restrictions on financial institutions, and separates investment banking, private equity and proprietary trading (hedge fund) sections of financial institutions from their consumer lending arms. Key provisions restrict banks from simultaneously entering into advisory and creditor roles with their clients, such as with private equity firms. The Volcker Rule also restricts financial institutions from investing in and sponsoring certain types of investments, which must be divested by July 21, 2015. The Company does not believe it will be significantly affected by the Volcker Rule provisions.

## Impact of Recently Issued Accounting Standards

Investment Companies In June 2013, the FASB issued ASU 2013-08, "Amendments to the Scope, Measurement, and Disclosure Requirements" for investment companies. The amendments changed the assessment of whether an entity is an investment company by requiring an entity to possess certain fundamental characteristics, while allowing judgment in assessing other typical characteristics. The ASU was effective January 1, 2014, and the Company did not change the status of any subsidiary or the accounting applied to a subsidiary under the new guidelines.

Investments - Equity Method and Joint Ventures The FASB issued ASU 2014-01, "Accounting for Investments in Qualified Affordable Housing Projects", in January 2014. These amendments allow investors in low income housing tax credit entities to account for the investments using a proportional amortization method, provided that certain conditions are met, and recognize amortization of the investment as a component of income tax expense. In addition, disclosures are required that will enable users to understand the nature of the investments, and the effect of the measurement of the investments and the related tax credits on the investor's financial statements. This ASU is effective for interim and annual periods beginning January 1, 2015 and should be applied retrospectively to all periods

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presented. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

Troubled Debt Restructurings by Creditors The FASB issued ASU 2014-04, "Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure", in January 2014. These amendments require companies to disclose the amount of foreclosed residential real estate property held and the recorded investment in consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction. The ASU also defines when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan and thus when a loan is transferred to foreclosed property. The amendments are effective for interim and annual periods beginning January 1, 2015. The adoption is not expected to have a significant effect on the Company's consolidated financial statements.

## Table of contents

AVERAGE BALANCE SHEETS - AVERAGE RATES AND YIELDS
Three Months Ended March 31, 2014 and 2013
First Quarter 2014
First Quarter 2013
(Dollars in thousands)

ASSETS:
Loans:


| Time open \& C.D.'s of \$100,000 and over | 1,339,808 | 1,452 | . 44 |  | 1,336,952 | 1,699 | . 52 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total interest bearing deposits | 12,438,420 | 5,878 | . 19 |  | 12,151,391 | 7,372 | . 25 |  |
| Borrowings: |  |  |  |  |  |  |  |  |
| Federal funds purchased and securities sold |  |  |  |  |  |  |  |  |
| under agreements to repurchase | 1,209,180 | 203 | . 07 |  | 1,200,818 | 218 | . 07 |  |
| Other borrowings | 105,187 | 851 | 3.28 |  | 103,329 | 812 | 3.19 |  |
| Total borrowings | 1,314,367 | 1,054 | . 33 |  | 1,304,147 | 1,030 | . 32 |  |
| Total interest bearing liabilities | 13,752,787 | 6,932 | . 20 | \% | 13,455,538 | 8,402 | . 25 | \% |
| Non-interest bearing deposits | 6,237,479 |  |  |  | 5,929,229 |  |  |  |
| Other liabilities | 198,383 |  |  |  | 366,562 |  |  |  |
| Equity | 2,257,085 |  |  |  | 2,174,165 |  |  |  |
| Total liabilities and equity | \$22,445,734 |  |  |  | \$21,925,494 |  |  |  |
| Net interest margin (T/E) |  | \$ 159,761 |  |  |  | \$ 156 |  |  |
| Net yield on interest earning assets |  |  | 3.03 | \% |  |  | 3.07 | \% |

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

## Table of contents

## 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 2013 Annual Report on Form 10-K.

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

| (Dollars in millions) | March 31, 2014 |  | December 31, 2013 |  | March 31, 2013 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | \$ Change |  | \$ Change |  | \$ Change |  |
|  | in | \% Change in | in | \% Change in | in | \% Change in |
|  | Net | Net Interest | Net | Net Interest | Net | Net Interest |
|  | Interest | Income | Interest | Income | Interest | Income |
|  | Income |  | Income |  | Income |  |
| 300 basis points rising | \$.3 | . 05 \% | (\$5.0 | ) (.81 )\% | (\$6.1 | )(1.03 )\% |
| 200 basis points rising | 4.1 | . 68 | 1.0 | . 17 | . 3 | . 05 |
| 100 basis points rising | 5.7 | . 93 | 3.4 | . 56 | 3.2 | . 54 |

Under the above scenarios at March 31, 2014, a gradual increase in interest rates of 100 basis points is expected to increase net interest income from the base calculation by $\$ 5.7$ million, or $.93 \%$, and a rise of 200 basis points is expected to increase net interest income by $\$ 4.1$ million, or $.68 \%$. Under a 300 basis points rising rate scenario, net interest income would increase by $\$ 300$ thousand, or $.05 \%$. Due to the already low interest rate environment, the Company did not model falling rate scenarios. The change in net interest income from the base calculation at March 31, 2014 for the three scenarios shown was higher than projections made at December 31, 2013, largely due to a change in the mix of interest bearing liabilities. Short-term borrowings of federal funds purchased and repurchase agreements, which are generally more rate-sensitive, declined from the previous quarter's simulation results and were replaced by higher balances of interest checking and savings deposits, which are less rate-sensitive. In addition, non-maturity deposit rate assumptions were updated and this resulted in money market deposit rates increasing slower. These changes resulted in a more asset-sensitive risk pattern and improving income projections. As shown in the above scenarios, as rates rise from 100 to 300 basis points, the effect on projected net interest income generally becomes more negative. This occurs because, in the higher rate scenarios, the non-contractual deposits are modeled to become more rate sensitive, resulting in margin compression. Also, these scenarios project deposit run-off which is replaced by higher costing short-term borrowings.
The Company believes that its approach to interest rate risk has appropriately considered its susceptibility to both rising and falling rates and has adopted strategies which minimized impacts to overall interest rate risk.
Item 4. CONTROLS AND PROCEDURES
An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of March 31, 2014. 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.

## Table of contents

## PART II: OTHER INFORMATION

## Item 1. LEGAL PROCEEDINGS

There are no material legal proceedings currently pending or threatened against the Company.

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

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

Period
January 1 - 31, 2014
February 1 - 28, 2014
March 1 - 31, 2014
Total

Total Number Average of Shares Price Paid Purchased per Share

90,013 $\$ 44.94$
271,886
112,955
474,854

Maximum Number that May Yet Be Purchased Under the Program 3,402,252
\$43.31 271,886 3,130,366
\$44.98 112,955
\$44.01 474,854

3,017,411
3,017,411

The Company's stock purchases shown above were made under authorizations by the Board of Directors. Under the most recent authorization in July 2013 of 4,000,000 shares, $3,017,411$ shares remained available for purchase at March 31, 2014.

Item 6. EXHIBITS

See Index to Exhibits

## Table of contents

## 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/ THOMAS J. NOACK<br>Thomas J. Noack<br>Vice President \& Secretary

Date: May 7, 2014

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

Date: May 7, 2014

57

## Table of contents

INDEX TO EXHIBITS

3(a) - Restated Articles of Incorporation of Commerce Bancshares, Inc.
10(o) - Form of Notice of Grant of Award and Award Agreement for Restricted Stock for Executive Officers, pursuant to the Commerce Bancshares, Inc. 2005 Equity Incentive Plan

10(p) - Form of Notice of Grant of Award and Award Agreement for Restricted Stock for Employees other than Executive Officers, pursuant to the Commerce Bancshares, Inc. 2005 Equity Incentive Plan

10(q) - Form of Notice of Grant of Award and Award Agreement for Stock Appreciation Rights, pursuant to the Commerce Bancshares, Inc. 2005 Equity Incentive Plan
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 Comprehensive Income, (iv) the Consolidated Statements of Changes in Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text and in detail

