

COMMERCE BANCSHARES INC /MO/  
Form 10-Q  
November 08, 2010

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**(Mark One)**

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

For the quarterly period ended September 30, 2010  
OR

**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)

**43-0889454**  
(IRS Employer Identification No.)

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

**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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark 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  Accelerated filer  Non-accelerated filer  (Do not check if a smaller reporting company)  
Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of October 28, 2010, the registrant had outstanding 82,983,244 shares of its \$5 par value common stock, registrant's only class of common stock.

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**Commerce Bancshares, Inc. and Subsidiaries**

**Form 10-Q**

**INDEX**

**Page**

**Part I**

**Financial Information**

Item 1. Financial Statements

Consolidated Balance Sheets as of September 30, 2010 (unaudited) and December 31, 2009 3

Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2010 and 2009 (unaudited) 4

Consolidated Statements of Changes in Equity for the Nine Months Ended September 30, 2010 and 2009 (unaudited) 5

Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2010 and 2009 (unaudited) 6

Notes to Consolidated Financial Statements 7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 35

Item 3. Quantitative and Qualitative Disclosures about Market Risk 62

Item 4. Controls and Procedures 62

**Part II**

**Other Information**

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 63

Item 6. Exhibits 63

Signatures 64

Index to Exhibits 65

**PART I: FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****Commerce Bancshares, Inc. and Subsidiaries****CONSOLIDATED BALANCE SHEETS**

|   | <b>September 30<br/>2010</b> | December 31<br>2009 |
|---|------------------------------|---------------------|
|   | <i>(Unaudited)</i>           |                     |
|   | <i>(In thousands)</i>        |                     |
| <b>ASSETS</b>   |                              |                     |
| Loans   | <b>\$ 9,706,265</b>          | \$ 10,145,324       |
| Allowance for loan losses   | <b>(197,538)</b>             | (194,480)           |
| <b>Net loans</b>  | <b>9,508,727</b>             | 9,950,844           |
| Loans held for sale   | <b>248,108</b>               | 345,003             |
| Investment securities:  |                              |                     |
| Available for sale (\$427,276,000 and \$537,079,000 pledged in 2010 and 2009, respectively, to secure structured repurchase agreements) | <b>7,164,273</b>             | 6,340,975           |
| Trading   | <b>20,828</b>                | 10,335              |
| Non-marketable  | <b>110,487</b>               | 122,078             |
| <b>Total investment securities</b>  | <b>7,295,588</b>             | 6,473,388           |
| Short-term federal funds sold and securities purchased under agreements to resell   | <b>4,550</b>                 | 22,590              |
| Long-term securities purchased under agreements to resell   | <b>350,000</b>               |                     |
| Interest earning deposits with banks  | <b>4,047</b>                 | 24,118              |
| Cash and due from banks   | <b>412,315</b>               | 417,126             |
| Land, buildings and equipment, net  | <b>387,792</b>               | 402,633             |
| Goodwill  | <b>125,585</b>               | 125,585             |
| Other intangible assets, net  | <b>11,285</b>                | 14,333              |
| Other assets  | <b>403,762</b>               | 344,569             |
| <b>Total assets</b>   | <b>\$ 18,751,759</b>         | \$ 18,120,189       |

**LIABILITIES AND EQUITY**

## Deposits:

|   |                     |              |
|---|---------------------|--------------|
| Non-interest bearing demand                 | <b>\$ 1,752,930</b> | \$ 1,793,816 |
| Savings, interest checking and money market | <b>9,712,088</b>    | 9,202,916    |
| Time open and C.D. s of less than \$100,000 | <b>1,607,664</b>    | 1,801,332    |
| Time open and C.D. s of \$100,000 and over  | <b>1,318,877</b>    | 1,412,387    |

|                       |                   |            |
|-----------------------|-------------------|------------|
| <b>Total deposits</b> | <b>14,391,559</b> | 14,210,451 |
|-----------------------|-------------------|------------|

|  |                  |           |
|--|------------------|-----------|
| Federal funds purchased and securities sold under agreements to repurchase | <b>1,530,555</b> | 1,103,191 |
| Other borrowings   | <b>337,863</b>   | 736,062   |
| Other liabilities  | <b>445,177</b>   | 184,580   |

|                          |                   |            |
|--------------------------|-------------------|------------|
| <b>Total liabilities</b> | <b>16,705,154</b> | 16,234,284 |
|--------------------------|-------------------|------------|

## Commerce Bancshares, Inc. stockholders' equity:

|   |                |         |
|---|----------------|---------|
| Preferred stock, \$1 par value  |                |         |
| Authorized and unissued 2,000,000 shares  |                |         |
| Common stock, \$5 par value   |                |         |
| Authorized 100,000,000 shares; issued 83,565,412 shares in 2010 and 83,127,401 shares in 2009 | <b>417,827</b> | 415,637 |
| Capital surplus   | <b>865,246</b> | 854,490 |
| Retained earnings   | <b>669,485</b> | 568,532 |
| Treasury stock of 60,428 shares in 2010 and 22,328 shares in 2009, at cost                    | <b>(2,323)</b> | (838)   |
| Accumulated other comprehensive income  | <b>95,204</b>  | 46,407  |

|  |                  |           |
|--|------------------|-----------|
| Total Commerce Bancshares, Inc. stockholders' equity | <b>2,045,439</b> | 1,884,228 |
| Non-controlling interest                             | <b>1,166</b>     | 1,677     |

|                     |                  |           |
|---------------------|------------------|-----------|
| <b>Total equity</b> | <b>2,046,605</b> | 1,885,905 |
|---------------------|------------------|-----------|

|                                     |                      |               |
|-------------------------------------|----------------------|---------------|
| <b>Total liabilities and equity</b> | <b>\$ 18,751,759</b> | \$ 18,120,189 |
|-------------------------------------|----------------------|---------------|

*See accompanying notes to consolidated financial statements.*

## Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF INCOME

|   | For the Three Months<br>Ended September 30 |            | For the Nine Months<br>Ended September 30 |            |
|---|--|------------|---|------------|
|   | 2010                                       | 2009       | 2010                                      | 2009       |
| <i>(In thousands, except per share data)</i>  |  |            |   |            |
|   |  |            | <i>(Unaudited)</i>                        |            |
| <b>INTEREST INCOME</b>  |  |            |   |            |
| Interest and fees on loans  | \$ 126,273                                 | \$ 138,614 | \$ 385,976                                | \$ 422,446 |
| Interest and fees on loans held for sale  | 1,368                                      | 1,445      | 5,533                                     | 6,840      |
| Interest on investment securities   | 50,295                                     | 61,416     | 159,259                                   | 164,403    |
| Interest on short-term federal funds sold and securities purchased under agreements to resell | 12   | 52         | 40  | 202        |
| Interest on long-term securities purchased under agreements to resell                         | 862  |            | 862                                       |            |
| Interest on deposits with banks   | 106  | 120        | 372                                       | 622        |
| <b>Total interest income</b>  | <b>178,916</b>                             | 201,647    | <b>552,042</b>                            | 594,513    |
| <b>INTEREST EXPENSE</b>   |  |            |   |            |
| Interest on deposits:   |  |            |   |            |
| Savings, interest checking and money market   | 7,261                                      | 7,695      | 22,068                                    | 23,726     |
| Time open and C.D. s of less than \$100,000   | 5,444                                      | 13,485     | 18,318                                    | 42,777     |
| Time open and C.D. s of \$100,000 and over  | 3,461                                      | 8,431      | 10,946                                    | 29,646     |
| Interest on federal funds purchased and securities sold under agreements to repurchase        | 584  | 816        | 2,230                                     | 2,895      |
| Interest on other borrowings  | 2,729                                      | 7,681      | 13,225                                    | 24,470     |
| <b>Total interest expense</b>   | <b>19,479</b>                              | 38,108     | <b>66,787</b>                             | 123,514    |
| <b>Net interest income</b>  | <b>159,437</b>                             | 163,539    | <b>485,255</b>                            | 470,999    |
| Provision for loan losses   | 21,844                                     | 35,361     | 78,353                                    | 119,695    |
| <b>Net interest income after provision for loan losses</b>                                    | <b>137,593</b>                             | 128,178    | <b>406,902</b>                            | 351,304    |
| <b>NON-INTEREST INCOME</b>  |  |            |   |            |
| Bank card transaction fees  | 37,723                                     | 31,279     | 107,872                                   | 88,552     |
| Deposit account charges and other fees  | 21,693                                     | 27,750     | 71,146                                    | 80,277     |
| Trust fees  | 20,170                                     | 19,258     | 59,846                                    | 57,486     |

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|   |                  |           |                   |            |
|---|------------------|-----------|-------------------|------------|
| Bond trading income   | 5,133            | 4,834     | 15,524            | 16,381     |
| Consumer brokerage services   | 2,390            | 3,045     | 6,879             | 9,566      |
| Loan fees and sales   | 5,830            | 6,851     | 11,141            | 13,545     |
| Other   | 6,604            | 9,118     | 22,034            | 27,321     |
| <b>Total non-interest income</b>  | <b>99,543</b>    | 102,135   | <b>294,442</b>    | 293,128    |
| <b>INVESTMENT SECURITIES GAINS (LOSSES), NET</b>                                |                  |           |                   |            |
| Impairment (losses) reversals on debt securities                                | 5,645            | (3,457)   | 11,355            | (35,422)   |
| Less noncredit-related losses (reversals) on securities not expected to be sold | (7,690)          | 1,993     | (15,533)          | 32,611     |
| Net impairment losses   | (2,045)          | (1,464)   | (4,178)           | (2,811)    |
| Realized gains (losses) on sales and fair value adjustments                     | 2,061            | 519       | 1,189             | (3,059)    |
| <b>Investment securities gains (losses), net</b>                                | <b>16</b>        | (945)     | <b>(2,989)</b>    | (5,870)    |
| <b>NON-INTEREST EXPENSE</b>   |                  |           |                   |            |
| Salaries and employee benefits  | 85,442           | 87,267    | 259,988           | 260,299    |
| Net occupancy   | 12,086           | 11,752    | 35,697            | 34,652     |
| Equipment   | 5,709            | 6,306     | 17,548            | 18,883     |
| Supplies and communication  | 6,724            | 8,061     | 20,891            | 24,994     |
| Data processing and software  | 16,833           | 15,500    | 50,936            | 44,854     |
| Marketing   | 5,064            | 4,846     | 14,784            | 14,099     |
| Deposit insurance   | 4,756            | 4,833     | 14,445            | 21,908     |
| Indemnification obligation  |                  | (2,496)   | (1,683)           | (2,496)    |
| Other   | 18,505           | 18,420    | 54,282            | 50,193     |
| <b>Total non-interest expense</b>   | <b>155,119</b>   | 154,489   | <b>466,888</b>    | 467,386    |
| Income before income taxes  | 82,033           | 74,879    | 231,467           | 171,176    |
| Less income taxes   | 26,012           | 23,415    | 71,817            | 52,264     |
| Net income before non-controlling interest                                      | 56,021           | 51,464    | 159,650           | 118,912    |
| Less non-controlling interest expense (income)                                  | 136              | (185)     | (139)             | (541)      |
| <b>Net income</b>   | <b>\$ 55,885</b> | \$ 51,649 | <b>\$ 159,789</b> | \$ 119,453 |
| Net income per common share basic   | \$ .67           | \$ .63    | \$ 1.92           | \$ 1.47    |

|                             |         |    |            |    |     |    |             |    |      |
|-----------------------------|---------|----|------------|----|-----|----|-------------|----|------|
| Net income per common share | diluted | \$ | <b>.67</b> | \$ | .63 | \$ | <b>1.91</b> | \$ | 1.47 |
|-----------------------------|---------|----|------------|----|-----|----|-------------|----|------|

*See accompanying notes to consolidated financial statements.*





|   |                   |                   |                   |                   |                  |                 |                     |
|---|-------------------|-------------------|-------------------|-------------------|------------------|-----------------|---------------------|
| <b>Balance September 30, 2010</b>   | <b>\$ 417,827</b> | <b>\$ 865,246</b> | <b>\$ 669,485</b> | <b>\$ (2,323)</b> | <b>\$ 95,204</b> | <b>\$ 1,166</b> | <b>\$ 2,046,605</b> |
| Balance January 1, 2009   | \$ 379,505        | \$ 621,458        | \$ 633,159        | \$ (761)          | \$ (56,729)      | \$ 2,835        | \$ 1,579,467        |
| Net income  |                   |                   | 119,453           |                   |                  | (541)           | 118,912             |
| Change in unrealized gain (loss) related to available for sale securities for which a portion of an other-than-temporary impairment has been recorded in earnings, net of tax |                   |                   |                   |                   | 7,309            |                 | 7,309               |
| Change in unrealized gain (loss) on all other available for sale securities, net of tax   |                   |                   |                   |                   | 95,048           |                 | 95,048              |
| Amortization of pension loss, net of tax  |                   |                   |                   |                   | 1,375            |                 | 1,375               |
| Total comprehensive income  |                   |                   |                   |                   |                  |                 | 222,644             |
| Distributions to non-controlling interest   |                   |                   |                   |                   |                  | (474)           | (474)               |
| Purchase of treasury stock  |                   |                   |                   | (462)             |                  |                 | (462)               |
| Issuance of stock under open market sale program  | 14,474            | 83,698            |                   |                   |                  |                 | 98,172              |
| Issuance of stock under purchase and equity compensation plans  | 439               | 1,570             |                   | (39)              |                  |                 | 1,970               |
| Net tax benefit related to equity compensation plans  |                   | 138               |                   |                   |                  |                 | 138                 |
| Stock-based compensation  |                   | 4,925             |                   |                   |                  |                 | 4,925               |
| Issuance of nonvested stock awards  | 764               | (1,201)           |                   | 437               |                  |                 |                     |
| Cash dividends paid (\$.686 per share)  |                   |                   | (55,736)          |                   |                  |                 | (55,736)            |
| Balance September 30, 2009  | \$ 395,182        | \$ 710,588        | \$ 696,876        | \$ (825)          | \$ 47,003        | \$ 1,820        | \$ 1,850,644        |

*See accompanying notes to consolidated financial statements.*



## Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| <i>(In thousands)</i>   | <b>For the Nine Months<br/>Ended September 30</b> |                    |
|---|---|--------------------|
|   | <b>2010</b>                                       | <b>2009</b>        |
|   | <i>(Unaudited)</i>                                |                    |
| <b>OPERATING ACTIVITIES:</b>  |   |                    |
| Net income  | \$ 159,789  | \$ 119,453         |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |                    |
| Provision for loan losses   | 78,353  | 119,695            |
| Provision for depreciation and amortization                                       | 36,891  | 38,334             |
| Net amortization (accretion) of investment security premiums/discounts            | 16,835  | (811)              |
| Investment securities losses, net(A)  | 2,989   | 5,870              |
| Gain on sale of branch  |   | (644)              |
| Net gains on sales of loans held for sale   | (6,656)   | (9,689)            |
| Originations of loans held for sale   | (316,641)   | (465,020)          |
| Proceeds from sales of loans held for sale  | 420,391   | 504,305            |
| Net increase in trading securities  | (15,901)  | (6,371)            |
| Stock-based compensation  | 4,669   | 4,925              |
| Decrease in interest receivable   | 1,654   | 1,318              |
| Decrease in interest payable  | (6,632)   | (11,587)           |
| Increase (decrease) in income taxes payable                                       | (3,514)   | 2,069              |
| Net tax benefit related to equity compensation plans                              | (1,174)   | (138)              |
| Other changes, net  | 34,815  | 33,001             |
| <b>Net cash provided by operating activities</b>                                  | <b>405,868</b>                                    | <b>334,710</b>     |
| <b>INVESTING ACTIVITIES:</b>  |   |                    |
| Cash paid in branch sale  |   | (3,494)            |
| Proceeds from sales of investment securities(A)                                   | 77,678  | 32,185             |
| Proceeds from maturities/pay downs of investment securities(A)                    | 1,650,002   | 1,012,734          |
| Purchases of investment securities(A)   | (2,270,478)                                       | (3,319,666)        |
| Net decrease in loans   | 363,764   | 898,708            |
| Long-term securities purchased under agreements to resell                         | (350,000)   |                    |
| Purchases of land, buildings and equipment  | (13,161)  | (21,017)           |
| Sales of land, buildings and equipment  | 394   | 135                |
| <b>Net cash used in investing activities</b>                                      | <b>(541,801)</b>                                  | <b>(1,400,415)</b> |

**FINANCING ACTIVITIES:**

|   |                   |            |
|---|-------------------|------------|
| Net increase in non-interest bearing demand, savings, interest checking and money market deposits     | <b>403,068</b>    | 1,277,145  |
| Net decrease in time open and C.D. s  | <b>(287,178)</b>  | (258,380)  |
| Long-term securities sold under agreements to repurchase  | <b>400,000</b>    |            |
| Repayment of long-term securities sold under agreements to repurchase                                 | <b>(500,000)</b>  |            |
| Net increase in short-term federal funds purchased and securities sold under agreements to repurchase | <b>527,364</b>    | 103,656    |
| Additional other long-term borrowings   |                   | 100,000    |
| Repayment of other long-term borrowings   | <b>(398,200)</b>  | (225,840)  |
| Net increase (decrease) in other short-term borrowings  | <b>1</b>          | (800,000)  |
| Purchases of treasury stock   | <b>(1,047)</b>    | (462)      |
| Issuance of stock under open market stock sale program, stock purchase and equity compensation plans  | <b>6,665</b>      | 100,142    |
| Net tax benefit related to equity compensation plans  | <b>1,174</b>      | 138        |
| Cash dividends paid on common stock   | <b>(58,836)</b>   | (55,736)   |
| <b>Net cash provided by financing activities</b>  | <b>93,011</b>     | 240,663    |
| Decrease in cash and cash equivalents   | <b>(42,922)</b>   | (825,042)  |
| Cash and cash equivalents at beginning of year  | <b>463,834</b>    | 1,299,356  |
| <b>Cash and cash equivalents at September 30</b>  | <b>\$ 420,912</b> | \$ 474,314 |

(A) Available for sale and non-marketable securities

|  |                  |            |
|--|------------------|------------|
| Income tax net payments                  | <b>\$ 75,138</b> | \$ 51,096  |
| Interest paid on deposits and borrowings | <b>\$ 73,419</b> | \$ 135,121 |

*See accompanying notes to consolidated financial statements.*

**Commerce Bancshares, Inc. and Subsidiaries****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

September 30, 2010 (Unaudited)

**1. Principles of Consolidation and Presentation**

The accompanying consolidated financial statements include the accounts of Commerce Bancshares, Inc. and all majority-owned subsidiaries (the Company). The consolidated financial statements in this report have not been audited. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to 2009 data to conform to current year presentation. In the opinion of management, all adjustments necessary to present fairly the financial position and the results of operations for the interim periods have been made. All such adjustments are of a normal recurring nature. The results of operations for the three and nine month periods ended September 30, 2010 are not necessarily indicative of results to be attained for the full year or any other interim periods.

The significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the 2009 Annual Report on Form 10-K. The Company recently purchased securities under agreements to resell which will mature in 2012 and 2013, which have been segregated from other short-term agreements in the accompanying September 30, 2010 consolidated balance sheet. The Company's former policy of including all securities purchased under agreements to resell in cash and cash equivalents was modified to exclude the new long-term agreements from cash and cash equivalents in the accompanying consolidated statements of cash flows.

**2. Loans and Allowance for Loan Losses**

Major classifications within the Company's held to maturity loan portfolio at September 30, 2010 and December 31, 2009 are as follows.

| <i>(In thousands)</i>               | <b>September 30<br/>2010</b> | <b>December 31<br/>2009</b> |
|-------------------------------------|------------------------------|-----------------------------|
| Business                            | <b>\$ 2,934,062</b>          | \$ 2,877,936                |
| Real estate - construction and land | <b>523,749</b>               | 665,110                     |
| Real estate - business              | <b>1,988,646</b>             | 2,104,030                   |
| Real estate - personal              | <b>1,445,535</b>             | 1,537,687                   |
| Consumer                            | <b>1,217,113</b>             | 1,333,763                   |
| Revolving home equity               | <b>486,687</b>               | 489,517                     |
| Student                             | <b>311,501</b>               | 331,698                     |
| Consumer credit card                | <b>791,316</b>               | 799,503                     |
| Overdrafts                          | <b>7,656</b>                 | 6,080                       |
| <b>Total loans</b>                  | <b>\$ 9,706,265</b>          | <b>\$ 10,145,324</b>        |

The Company's holdings of student loans in the table above were acquired in 2008 from a student loan agency in exchange for certain auction rate securities. In October 2010, the agency, as allowed under the original exchange contract, elected to repurchase the loans. This transaction was recorded in the fourth quarter and a gain of \$6.9 million was recognized at that time.

At September 30, 2010, loans of \$2.9 billion were pledged at the Federal Home Loan Bank as collateral for borrowings and letters of credit obtained to secure public deposits. Additional loans of \$1.3 billion were pledged at the Federal Reserve Bank as collateral for discount window borrowings.

In addition to its basic portfolio, the Company originates other loans which it intends to sell in secondary markets. Loans classified as held for sale have historically consisted primarily of loans originated to students while attending colleges and universities, which are sold to various student loan agencies. Most of this origination activity ceased on July 1, 2010, as the federal government became the sole originator of federally subsidized student loans on that date. The Company sold approximately \$350 million from this student loan portfolio during the first nine months of 2010, most of which were originated under the Department of

Education's program. The remaining loans originated under this program, totaling approximately \$178 million, are expected to be sold in the fourth quarter. Other loans included as held for sale consist of certain fixed rate residential mortgage loans which are sold in the secondary market, generally within three months of origination.

The following table presents information about loans held for sale, including impairment losses on student loans resulting from declines in fair value, which are further discussed in Note 13 on Fair Value Measurements. Previously recognized impairment losses amounting to \$442 thousand were reversed during the first nine months of 2010, as certain impaired loans were sold.

| <i>(In thousands)</i>  | <b>September 30<br/>2010</b> | December 31<br>2009 |
|--|------------------------------|---------------------|
| Balance outstanding:   |                              |                     |
| Student loans, at cost   | \$ 237,594                   | \$ 335,358          |
| Residential mortgage loans, at cost                              | 10,900                       | 10,473              |
| Valuation allowance on student loans                             | (386)                        | (828)               |
| <b>Total loans held for sale, at lower of cost or fair value</b> | <b>\$ 248,108</b>            | <b>\$ 345,003</b>   |

| <i>(In thousands)</i>                                   | <b>For the Nine Months<br/>Ended September 30</b> |                 |
|---|---|-----------------|
|   | <b>2010</b>                                       | 2009            |
| Net gains on sales:                                     |   |                 |
| Student loans   | \$ 5,347  | \$ 7,636        |
| Residential mortgage loans                              | 1,309   | 2,053           |
| <b>Total gains on sales of loans held for sale, net</b> | <b>\$ 6,656</b>                                   | <b>\$ 9,689</b> |

The table below shows the Company's investment in impaired loans at September 30, 2010 and December 31, 2009. These loans consist of loans on non-accrual status and other restructured loans whose terms have been modified and classified as troubled debt restructurings under ASC 310-40. The restructured loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession. Restructured loans are largely comprised of certain business, construction and business real estate loans totaling \$68.0 million and \$85.7 million at September 30, 2010 and December 31, 2009, respectively, and classified as substandard, which when renewed at maturity were at interest rates equal to or greater than the previous rates in effect. The new rates, however, were not



judged to be market rates for new debt with similar risk, and thus these loans were classified as troubled debt restructurings. These restructured loans are performing in accordance with their modified terms, and because the Company believes it probable that all amounts due under the modified terms of the agreements will be collected, interest on these loans is being recognized on an accrual basis. However, because of their substandard classification they are also regarded as potential problem loans, as disclosed at both December 31, 2009 and September 30, 2010 in the Risk Elements of Loan Portfolio section of the following discussion. Troubled debt restructurings also include certain credit card loans under various debt management and assistance programs, which totaled \$14.3 million at September 30, 2010 and \$16.0 million at December 31, 2009.

| <i>(In thousands)</i>       | <b>September 30<br/>2010</b> | December 31<br>2009 |
|-----------------------------|------------------------------|---------------------|
| Non-accrual loans           | <b>\$ 89,609</b>             | \$ 106,613          |
| Restructured loans          | <b>82,313</b>                | 101,765             |
| <b>Total impaired loans</b> | <b>\$ 171,922</b>            | \$ 208,378          |

The Company's holdings of foreclosed real estate totaled \$12.5 million and \$10.1 million at September 30, 2010 and December 31, 2009, respectively. Personal property acquired in repossession, generally autos and marine and recreational vehicles, totaled \$10.0 million and \$14.5 million at September 30, 2010 and December 31, 2009, respectively. These assets are carried at the lower of the amount recorded at acquisition date or the current fair value less estimated costs to sell.

The following is a summary of the allowance for loan losses.

| <i>(In thousands)</i>               | <b>For the Three Months Ended<br/>September 30</b> |            | <b>For the Nine Months Ended<br/>September 30</b> |            |
|-------------------------------------|--|------------|---|------------|
|                                     | <b>2010</b>  | 2009       | <b>2010</b>                                       | 2009       |
| <b>Balance, beginning of period</b> | <b>\$ 197,538</b>                                  | \$ 186,001 | <b>\$ 194,480</b>                                 | \$ 172,619 |
| Additions:                          |  |            |   |            |
| Provision for loan losses           | <b>21,844</b>                                      | 35,361     | <b>78,353</b>                                     | 119,695    |
| <b>Total additions</b>              | <b>21,844</b>                                      | 35,361     | <b>78,353</b>                                     | 119,695    |
| Deductions:                         |  |            |   |            |
| Loan losses                         | <b>26,079</b>                                      | 34,853     | <b>88,417</b>                                     | 112,762    |
| Less recoveries on loans            | <b>4,235</b>                                       | 3,957      | <b>13,122</b>                                     | 10,914     |
| <b>Net loan losses</b>              | <b>21,844</b>                                      | 30,896     | <b>75,295</b>                                     | 101,848    |
| <b>Balance, September 30</b>        | <b>\$ 197,538</b>                                  | \$ 190,466 | <b>\$ 197,538</b>                                 | \$ 190,466 |

### 3. Investment Securities

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

| <i>(In thousands)</i>                          | <b>September 30<br/>2010</b> | December 31<br>2009 |
|--|------------------------------|---------------------|
| Available for sale:                            |                              |                     |
| U.S. government and federal agency obligations | <b>\$ 459,245</b>            | \$ 447,038          |
| Government-sponsored enterprise obligations    | <b>185,222</b>               | 165,814             |
| State and municipal obligations                | <b>1,105,686</b>             | 939,338             |
| Agency mortgage-backed securities              | <b>2,436,297</b>             | 2,262,003           |
| Non-agency mortgage-backed securities          | <b>558,615</b>               | 609,016             |
| Other asset-backed securities                  | <b>2,194,090</b>             | 1,701,569           |

|                                    |                     |              |
|------------------------------------|---------------------|--------------|
| Other debt securities              | <b>180,459</b>      | 176,331      |
| Equity securities                  | <b>44,659</b>       | 39,866       |
| <br>                               |                     |              |
| Total available for sale           | <b>7,164,273</b>    | 6,340,975    |
| <br>                               |                     |              |
| Trading                            | <b>20,828</b>       | 10,335       |
| Non-marketable                     | <b>110,487</b>      | 122,078      |
| <br>                               |                     |              |
| <b>Total investment securities</b> | <b>\$ 7,295,588</b> | \$ 6,473,388 |

Most of the Company's investment securities are classified as available for sale, and this portfolio is discussed in more detail below. Securities which are classified as non-marketable include Federal Home Loan Bank (FHLB) stock and Federal Reserve Bank (FRB) stock held for debt and regulatory purposes, which totaled \$55.2 million and \$72.6 million at September 30, 2010 and December 31, 2009, respectively. Investment in FRB stock is based on the capital structure of the investing bank, and investment in FHLB stock is tied to the level of borrowings from the FHLB. Non-marketable securities also include private equity investments, which amounted to \$55.2 million and \$49.5 million at September 30, 2010 and December 31, 2009, respectively.

A summary of the available for sale investment securities by maturity groupings as of September 30, 2010 is shown below. The investment portfolio includes agency mortgage-backed securities, which are guaranteed by government-sponsored agencies such as the FHLMC, FNMA and GNMA, and non-agency mortgage-backed securities, which have no guarantee but are collateralized by residential mortgages. Also included are certain other asset-backed securities, which are primarily collateralized by credit cards, automobiles, and commercial loans. These securities differ from traditional debt securities primarily in that they may have uncertain maturity dates and are priced based on estimated prepayment rates on the underlying collateral. The Company does not have exposure to subprime originated mortgage-backed or collateralized debt obligation instruments.

| <i>(Dollars in thousands)</i>                               | Amortized<br>Cost | Fair<br>Value    |
|---|-------------------|------------------|
| U.S. government and federal agency obligations:             |                   |                  |
| Within 1 year   | \$ 171,590        | \$ 171,457       |
| After 1 but within 5 years                                  | 103,710           | 111,083          |
| After 5 but within 10 years                                 | 161,564           | 176,705          |
| <b>Total U.S. government and federal agency obligations</b> | <b>436,864</b>    | <b>459,245</b>   |
| Government-sponsored enterprise obligations:                |                   |                  |
| Within 1 year   | 68,778            | 69,558           |
| After 1 but within 5 years                                  | 113,169           | 115,664          |
| <b>Total government-sponsored enterprise obligations</b>    | <b>181,947</b>    | <b>185,222</b>   |
| State and municipal obligations:                            |                   |                  |
| Within 1 year   | 128,501           | 130,414          |
| After 1 but within 5 years                                  | 430,483           | 445,998          |
| After 5 but within 10 years                                 | 266,256           | 272,230          |
| After 10 years  | 261,348           | 257,044          |
| <b>Total state and municipal obligations</b>                | <b>1,086,588</b>  | <b>1,105,686</b> |
| Mortgage and asset-backed securities:                       |                   |                  |
| Agency mortgage-backed securities                           | 2,357,963         | 2,436,297        |
| Non-agency mortgage-backed securities                       | 561,971           | 558,615          |
| Other asset-backed securities                               | 2,178,115         | 2,194,090        |

|   |              |              |
|---|--------------|--------------|
| <b>Total mortgage and asset-backed securities</b>     | 5,098,049    | 5,189,002    |
| Other debt securities:                                |              |              |
| Within 1 year   | 5,000        | 5,034        |
| After 1 but within 5 years                            | 162,108      | 175,425      |
| <b>Total other debt securities</b>                    | 167,108      | 180,459      |
| <b>Equity securities</b>                              | 13,071       | 44,659       |
| <b>Total available for sale investment securities</b> | \$ 6,983,627 | \$ 7,164,273 |

Included in U.S. government securities are \$447.1 million, at fair value, of U.S. Treasury inflation-protected securities (TIPS). Interest paid on these securities increases with inflation and decreases with deflation, as measured by the Consumer Price Index. Included in state and municipal obligations are \$154.1 million, at fair value, of auction rate securities (ARS), which were purchased from bank customers in the third quarter of 2008. These bonds are historically traded in a competitive bidding process at weekly/monthly auctions. These auctions have not functioned since early 2008, and this market has not recovered. Interest is currently being paid at the maximum failed auction rates. Included in equity securities is common stock held by the holding company, Commerce Bancshares, Inc. (the Parent), with a fair value of \$35.8 million at September 30, 2010.

Included in agency mortgage-backed securities are \$550 million, at par value, in securities which were purchased during the third quarter in the TBA (to be announced) market on a forward delivery basis. At September 30, 2010, undelivered securities totaled \$180 million. The transaction is discussed further in the Net Interest Income section of the following discussion.

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.

| <i>(In thousands)</i>                          | Amortized<br>Cost       | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value           |
|--|-------------------------|------------------------------|-------------------------------|-------------------------|
| <b>September 30, 2010</b>                      |                         |                              |                               |                         |
| U.S. government and federal agency obligations | \$ 436,864              | \$ 22,534                    | \$ (153)                      | \$ 459,245              |
| Government-sponsored enterprise obligations    | 181,947                 | 3,275                        |                               | 185,222                 |
| State and municipal obligations                | 1,086,588               | 29,585                       | (10,487)                      | 1,105,686               |
| Mortgage and asset-backed securities:          |                         |                              |                               |                         |
| Agency mortgage-backed securities              | 2,357,963               | 78,502                       | (168)                         | 2,436,297               |
| Non-agency mortgage-backed securities          | 561,971                 | 13,766                       | (17,122)                      | 558,615                 |
| Other asset-backed securities                  | 2,178,115               | 16,096                       | (121)                         | 2,194,090               |
| <br>Total mortgage and asset-backed securities | <br>5,098,049           | <br>108,364                  | <br>(17,411)                  | <br>5,189,002           |
| <br>Other debt securities                      | <br>167,108             | <br>13,351                   |                               | <br>180,459             |
| Equity securities                              | 13,071                  | 31,588                       |                               | 44,659                  |
| <br><b>Total</b>                               | <br><b>\$ 6,983,627</b> | <br><b>\$ 208,697</b>        | <br><b>\$ (28,051)</b>        | <br><b>\$ 7,164,273</b> |
| <br>December 31, 2009                          |                         |                              |                               |                         |
| U.S. government and federal agency obligations | \$ 436,607              | \$ 10,764                    | \$ (333)                      | \$ 447,038              |
| Government-sponsored enterprise obligations    | 162,191                 | 3,743                        | (120)                         | 165,814                 |
| State and municipal obligations                | 917,267                 | 25,099                       | (3,028)                       | 939,338                 |
| Mortgage and asset-backed securities:          |                         |                              |                               |                         |
| Agency mortgage-backed securities              | 2,205,177               | 58,740                       | (1,914)                       | 2,262,003               |
| Non-agency mortgage-backed securities          | 654,711                 | 4,505                        | (50,200)                      | 609,016                 |
| Other asset-backed securities                  | 1,685,691               | 17,143                       | (1,265)                       | 1,701,569               |
| <br>Total mortgage and asset-backed securities | <br>4,545,579           | <br>80,388                   | <br>(53,379)                  | <br>4,572,588           |
| <br>Other debt securities                      | <br>164,402             | <br>11,929                   |                               | <br>176,331             |
| Equity securities                              | 11,285                  | 28,581                       |                               | 39,866                  |
| <br><b>Total</b>                               | <br><b>\$ 6,237,331</b> | <br><b>\$ 160,504</b>        | <br><b>\$ (56,860)</b>        | <br><b>\$ 6,340,975</b> |

The Company's impairment policy requires a review of all securities for which fair value is less than amortized cost. Special emphasis and analysis is placed on securities whose credit rating has fallen below A3/A-, whose fair values have fallen more than 20% below purchase price for an extended period of time, or have been identified based on management's judgment. These securities are placed on a watch list, and for all such securities, detailed cash flow models are prepared which use inputs specific to each security. Inputs to these models include factors such as cash flow received, contractual payments required, and various other information related to the underlying collateral (including current delinquencies), collateral loss severity rates (including loan to values), expected delinquency rates, credit support from other tranches, and prepayment speeds. Stress tests are performed at varying levels of delinquency rates, prepayment speeds and loss severities in order to gauge probable ranges of credit loss. At September 30, 2010, the fair value of securities on this watch list was \$255.5 million.

As of September 30, 2010, the Company had recorded other-than-temporary impairment (OTTI) on certain non-agency mortgage-backed securities having an aggregate fair value of \$174.6 million, which included an unrealized loss of \$21.6 million. The credit-related portion of the impairment totaled \$6.7 million and was recorded in earnings. The noncredit-related portion of the impairment totaled \$14.9 million on a pre-tax basis, and has been recognized in other comprehensive income. The Company does not intend to sell these securities and believes it is not more likely than not that it will be required to sell the securities before the recovery of their amortized cost bases.

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

| Significant Inputs           | Range         |
|------------------------------|---------------|
| Prepayment CPR               | 1.8% - 25.0%  |
| Projected cumulative default | 10.7% - 50.8% |
| Credit support               | .1% - 11.2%   |
| Loss severity                | 32.8% - 57.1% |

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

| <i>(In thousands)</i>   | <b>For the<br/>Nine Months<br/>Ended September 30</b> |                 |
|---|---|-----------------|
|   | <b>2010</b>   | <b>2009</b>     |
| <b>Balance, January 1</b>   | <b>\$ 2,473</b>                                       | <b>\$</b>       |
| Credit losses on debt securities for which impairment was not previously recognized | <b>281</b>  | 2,811           |
| Credit losses on debt securities for which impairment was previously recognized     | <b>3,897</b>  |                 |
| <b>Balance, September 30</b>  | <b>\$ 6,651</b>                                       | <b>\$ 2,811</b> |

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

| <i>(In thousands)</i> | Less than 12 months |                      | 12 months or longer |                      | Total      |                      |
|-----------------------|---------------------|----------------------|---------------------|----------------------|------------|----------------------|
|                       | Fair Value          | Unrealized<br>Losses | Fair Value          | Unrealized<br>Losses | Fair Value | Unrealized<br>Losses |



**September 30, 2010**

|  |                   |                 |                   |                  |                   |                  |
|--|-------------------|-----------------|-------------------|------------------|-------------------|------------------|
| U.S. government and federal agency obligations | \$ 166,776        | \$ 153          | \$                | \$               | \$ 166,776        | \$ 153           |
| State and municipal obligations                | 93,572            | 1,307           | 84,427            | 9,180            | 177,999           | 10,487           |
| Mortgage and asset-backed securities:          |                   |                 |                   |                  |                   |                  |
| Agency mortgage-backed securities              | 118,856           | 128             | 2,095             | 40               | 120,951           | 168              |
| Non-agency mortgage-backed securities          | 76,362            | 6,445           | 126,725           | 10,677           | 203,087           | 17,122           |
| Other asset-backed securities                  | 38,424            | 56              | 24,866            | 65               | 63,290            | 121              |
| <br>   |                   |                 |                   |                  |                   |                  |
| Total mortgage and asset-backed securities     | 233,642           | 6,629           | 153,686           | 10,782           | 387,328           | 17,411           |
| <br>   |                   |                 |                   |                  |                   |                  |
| <b>Total</b>                                   | <b>\$ 493,990</b> | <b>\$ 8,089</b> | <b>\$ 238,113</b> | <b>\$ 19,962</b> | <b>\$ 732,103</b> | <b>\$ 28,051</b> |

## December 31, 2009

|  |                   |                  |                   |                  |                     |                  |
|--|-------------------|------------------|-------------------|------------------|---------------------|------------------|
| U.S. government and federal agency obligations | \$ 168,172        | \$ 333           | \$                | \$               | \$ 168,172          | \$ 333           |
| Government-sponsored enterprise obligations    | 24,842            | 120              |                   |                  | 24,842              | 120              |
| State and municipal obligations                | 16,471            | 121              | 104,215           | 2,907            | 120,686             | 3,028            |
| Mortgage and asset-backed securities:          |                   |                  |                   |                  |                     |                  |
| Agency mortgage-backed securities              | 214,571           | 1,911            | 150               | 3                | 214,721             | 1,914            |
| Non-agency mortgage-backed securities          | 209,961           | 18,512           | 215,158           | 31,688           | 425,119             | 50,200           |
| Other asset-backed securities                  | 290,183           | 218              | 34,456            | 1,047            | 324,639             | 1,265            |
| <br>   |                   |                  |                   |                  |                     |                  |
| Total mortgage and asset-backed securities     | 714,715           | 20,641           | 249,764           | 32,738           | 964,479             | 53,379           |
| <br>   |                   |                  |                   |                  |                     |                  |
| <b>Total</b>                                   | <b>\$ 924,200</b> | <b>\$ 21,215</b> | <b>\$ 353,979</b> | <b>\$ 35,645</b> | <b>\$ 1,278,179</b> | <b>\$ 56,860</b> |

The total available for sale portfolio consisted of approximately 1,300 individual securities at September 30, 2010, with 102 securities in a loss position. Securities with temporary impairment totaled 84, of which 15 securities, or 2% of the portfolio value, had been in a loss position for 12 months or longer.

The Company's holdings of state and municipal obligations included gross unrealized losses of \$10.5 million at September 30, 2010. Of these losses, \$10.1 million related to ARS, which are discussed above, and \$393 thousand related to other state and municipal obligations. This portfolio, exclusive of ARS, totaled \$951.6 million at fair value, or 13.3% of total available for sale securities. The average credit quality of the portfolio, excluding ARS, is Aa2 as rated by Moody's. The portfolio is diversified in order to reduce risk, and information about the largest holdings, by state and economic sector, is shown in the table below.

|                              | % of<br>Portfolio | Average<br>Life<br>(in years) | Average<br>Rating<br>(Moody's) |
|------------------------------|-------------------|-------------------------------|--------------------------------|
| <b>At September 30, 2010</b> |                   |                               |                                |
| Texas                        | 11.7%             | 4.6                           | Aa1                            |
| Illinois                     | 6.6               | 3.6                           | Aa2                            |
| Washington                   | 6.2               | 1.7                           | Aa3                            |
| Missouri                     | 5.3               | 1.7                           | Aa1                            |
| Arizona                      | 4.5               | 4.0                           | Aa3                            |
| General obligation           | 26.2%             | 3.9                           | Aa2                            |
| Housing                      | 19.4              | 5.1                           | Aa1                            |
| Transportation               | 17.6              | 3.4                           | Aa3                            |
| Lease                        | 8.8               | 3.0                           | Aa2                            |
| Refunded                     | 7.3               | 2.3                           | Aaa                            |

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

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

**For the Nine  
Months Ended**

| <i>(In thousands)</i>   | <b>September 30</b> |                   |
|---|---------------------|-------------------|
|   | <b>2010</b>         | <b>2009</b>       |
| Proceeds from sales of available for sale securities          | \$ 77,493           | \$ 26,877         |
| Proceeds from sales of non-marketable securities              | 185                 | 5,308             |
| <b>Total proceeds</b>   | <b>\$ 77,678</b>    | <b>\$ 32,185</b>  |
| <b>Available for sale:</b>                                    |                     |                   |
| Gains realized on sales                                       | \$ 2,684            | \$ 82             |
| Losses realized on sales                                      | (151)               | (41)              |
| Other-than-temporary impairment recognized on debt securities | (4,178)             | (2,811)           |
| <b>Non-marketable:</b>  |                     |                   |
| Gains realized on sales                                       | 45                  | 1,087             |
| Losses realized on sales                                      |                     | (170)             |
| Fair value adjustments, net                                   | (1,389)             | (4,017)           |
| <b>Investment securities losses, net</b>                      | <b>\$ (2,989)</b>   | <b>\$ (5,870)</b> |

At September 30, 2010, securities carried at \$3.3 billion were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowing capacity at the Federal Reserve Bank. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated \$427.3 million, while the remaining securities were pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral.

#### 4. Goodwill and Other Intangible Assets

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

|                                | September 30, 2010    |                          |                     |                  | December 31, 2009     |                          |                     |                  |
|--------------------------------|-----------------------|--------------------------|---------------------|------------------|-----------------------|--------------------------|---------------------|------------------|
|                                | Gross Carrying Amount | Accumulated Amortization | Valuation Allowance | Net Amount       | Gross Carrying Amount | Accumulated Amortization | Valuation Allowance | Net Amount       |
| <i>(In thousands)</i>          |                       |                          |                     |                  |                       |                          |                     |                  |
| Amortizable intangible assets: |                       |                          |                     |                  |                       |                          |                     |                  |
| Core deposit premium           | \$ 25,720             | \$ (15,397)              | \$                  | \$ 10,323        | \$ 25,720             | \$ (12,966)              | \$                  | \$ 12,754        |
| Mortgage servicing rights      | 2,964                 | (1,455)                  | (547)               | 962              | 2,898                 | (1,206)                  | (113)               | 1,579            |
| <b>Total</b>                   | <b>\$ 28,684</b>      | <b>\$ (16,852)</b>       | <b>\$ (547)</b>     | <b>\$ 11,285</b> | <b>\$ 28,618</b>      | <b>\$ (14,172)</b>       | <b>\$ (113)</b>     | <b>\$ 14,333</b> |

Aggregate amortization expense on intangible assets was \$864 thousand and \$1.0 million, respectively, for the three month periods ended September 30, 2010 and 2009, and \$2.7 million and \$3.1 million for the nine month periods ended September 30, 2010 and 2009. The following table shows the estimated annual amortization expense for the next five fiscal years. This expense is based on existing asset balances and the interest rate environment as of September 30, 2010. 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)*

|      |          |
|------|----------|
| 2010 | \$ 3,403 |
| 2011 | 2,838    |
| 2012 | 2,277    |
| 2013 | 1,738    |
| 2014 | 1,266    |

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

| <i>(In thousands)</i>                | Goodwill   | Core Deposit<br>Premium | Mortgage<br>Servicing<br>Rights |
|--------------------------------------|------------|-------------------------|---------------------------------|
| <b>Balance at January 1, 2010</b>    | \$ 125,585 | \$ 12,754               | \$ 1,579                        |
| Originations                         |            |                         | 66                              |
| Amortization                         |            | (2,431)                 | (249)                           |
| Impairment                           |            |                         | (434)                           |
| <b>Balance at September 30, 2010</b> | \$ 125,585 | \$ 10,323               | \$ 962                          |

Goodwill allocated to the Company's operating segments at September 30, 2010 and December 31, 2009 is shown below.

*(In thousands)*

|                       |                   |
|-----------------------|-------------------|
| Consumer segment      | \$ 67,765         |
| Commercial segment    | 57,074            |
| Wealth segment        | 746               |
| <b>Total goodwill</b> | <b>\$ 125,585</b> |

## 5. Guarantees

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

Upon issuance of standby letters of credit, the Company recognizes a liability for the fair value of the obligation undertaken, which is estimated to be equivalent to the amount of fees received from the customer over the life of the agreement. At September 30, 2010 that net liability was \$3.1 million, which will be accreted into income over the remaining life of the respective commitments. The contractual amount of these letters of credit, which represents the maximum potential future payments guaranteed by the Company, was \$346.4 million at September 30, 2010.

The Company periodically enters into risk participation agreements (RPAs) as a guarantor to other financial institutions, in order to mitigate those institutions' credit risk associated with interest rate swaps with third parties. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. These interest rate swaps are normally collateralized (generally with real property, inventories and equipment) by the third party, which limits the credit risk associated with the Company's RPAs. The third parties usually have other borrowing relationships with the Company. The Company monitors overall borrower collateral, and at September 30, 2010, believes sufficient collateral is available to cover potential swap losses. The Company receives a fee from the institution at the inception of the contract, which is recorded as a liability representing the fair value of the RPA. Any future changes in fair value, including those due to a change in the third party's creditworthiness, are recorded in current earnings. The terms of the RPAs, which correspond to the terms of the underlying swaps, range from 2 to 8 years. At September 30, 2010, the liability recorded for guarantor RPAs was \$303 thousand, and the notional amount of the underlying swaps was \$41.7 million. The maximum potential future payment guaranteed by the Company cannot be readily estimated, but is dependent

upon the fair value of the interest rate swaps at the time of default. If an event of default on all contracts had occurred at September 30, 2010, the Company would have been required to make payments of approximately \$4.5 million.

At September 30, 2010, the Company had recorded a liability of \$7.2 million representing its obligation to share certain estimated litigation costs of Visa, Inc. (Visa). An escrow account has been established by Visa, and is being used to fund actual litigation settlements as they occur. The escrow account was funded initially with proceeds from an initial public offering, and subsequently with contributions by Visa. The Company's indemnification obligation is periodically adjusted to reflect changes in estimates of litigation costs, and is reduced as funding occurs in the escrow account. Additional funding occurred in October 2010, when Visa contributed \$800 million to the escrow account. As a result, the Company reduced its obligation by

\$2.7 million at that time, bringing the liability balance to \$4.4 million. The Company currently anticipates that its proportional share of eventual escrow funding will more than offset its liability related to the Visa litigation.

## 6. Pension

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

| <i>(In thousands)</i>                            | <b>For the<br/>Three Months<br/>Ended September 30</b> |               | <b>For the<br/>Nine Months<br/>Ended September 30</b> |                 |
|--|--|---------------|---|-----------------|
|  | <b>2010</b>  | <b>2009</b>   | <b>2010</b>   | <b>2009</b>     |
| Service cost – benefits earned during the period | \$ 184   | \$ 12         | \$ 550  | \$ 548          |
| Interest cost on projected benefit obligation    | 1,420  | 1,378         | 4,154   | 4,104           |
| Expected return on plan assets                   | (1,640)  | (1,395)       | (4,920)   | (4,592)         |
| Amortization of unrecognized net loss            | 566  | 832           | 1,700   | 2,182           |
| <b>Net periodic pension cost</b>                 | <b>\$ 530</b>  | <b>\$ 827</b> | <b>\$ 1,484</b>                                       | <b>\$ 2,242</b> |

Substantially all benefits under the Company's defined benefit pension plan were frozen effective January 1, 2005. During the first nine months of 2010, the Company made no funding contributions to its defined benefit pension plan, and made minimal funding contributions to a supplemental executive retirement plan (the CERP), which carries no segregated assets. The Company has no plans to make any further contributions, other than those related to the CERP, during the remainder of 2010.



## 7. Common Stock

Presented below is a summary of the components used to calculate basic and diluted income per share. The Company applies the two-class method of computing income per share, as unvested share-based awards that contain nonforfeitable rights to dividends are considered securities which participate in undistributed earnings with common stock. The two-class method requires the calculation of separate income per share amounts for the unvested share-based awards and for common stock. Income per share attributable to common stock is shown in the table below. Unvested share-based awards are further discussed in Note 12.

|   | For the<br>Three Months<br>Ended September 30 |           | For the<br>Nine Months<br>Ended September 30 |            |
|---|---|-----------|--|------------|
|   | 2010  | 2009      | 2010   | 2009       |
| <i>(In thousands, except per share data)</i>              |   |           |  |            |
| <b>Basic income per common share:</b>                     |   |           |  |            |
| Net income attributable to Commerce Bancshares, Inc.      | \$ 55,885                                     | \$ 51,649 | \$ 159,789                                   | \$ 119,453 |
| Less income allocated to unvested restricted stockholders | 306   | 224       | 871  | 526        |
| Net income available to common stockholders               | \$ 55,579                                     | \$ 51,425 | \$ 158,918                                   | \$ 118,927 |
| Distributed income  | \$ 19,514                                     | \$ 18,880 | \$ 58,506                                    | \$ 55,483  |
| Undistributed income                                      | \$ 36,065                                     | \$ 32,545 | \$ 100,412                                   | \$ 63,444  |
| Weighted average common shares outstanding                | 83,040  | 82,169    | 82,968                                       | 80,646     |
| Distributed income per share                              | \$ .24  | \$ .23    | \$ .71                                       | \$ .69     |
| Undistributed income per share                            | .43   | .40       | 1.21   | .78        |
| Basic income per common share                             | \$ .67  | \$ .63    | \$ 1.92                                      | \$ 1.47    |
| <b>Diluted income per common share:</b>                   |   |           |  |            |
| Net income attributable to Commerce Bancshares, Inc.      | \$ 55,885                                     | \$ 51,649 | \$ 159,789                                   | \$ 119,453 |
| Less income allocated to unvested restricted stockholders | 305   | 224       | 868  | 525        |
| Net income available to common stockholders               | \$ 55,580                                     | \$ 51,425 | \$ 158,921                                   | \$ 118,928 |
| Distributed income  | \$ 19,514                                     | \$ 18,880 | \$ 58,506                                    | \$ 55,483  |

|   |                  |           |                   |           |
|---|------------------|-----------|-------------------|-----------|
| Undistributed income  | \$ <b>36,066</b> | \$ 32,545 | \$ <b>100,415</b> | \$ 63,445 |
| Weighted average common shares outstanding  | <b>83,040</b>    | 82,169    | <b>82,968</b>     | 80,646    |
| 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 | <b>350</b>       | 322       | <b>399</b>        | 305       |
| Weighted average diluted common shares outstanding  | <b>83,390</b>    | 82,491    | <b>83,367</b>     | 80,951    |
| Distributed income per share  | \$ <b>.23</b>    | \$ .23    | \$ <b>.70</b>     | \$ .69    |
| Undistributed income per share  | <b>.44</b>       | .40       | <b>1.21</b>       | .78       |
| Diluted income per common share   | \$ <b>.67</b>    | \$ .63    | \$ <b>1.91</b>    | \$ 1.47   |

## 8. Other Comprehensive Income

Activity in other comprehensive income for the three and nine months ended September 30, 2010 and 2009 is shown in the table below. The first component of other comprehensive income is the unrealized holding gains and losses on available for sale securities. These gains and losses have been separated into two groups in the table below, as required by current accounting guidance for other-than-temporary impairment (OTTI) on debt securities. Under this guidance, credit-related losses on debt securities with OTTI are recorded in current earnings, while the noncredit-related portion of the overall gain or loss in fair value is recorded in other comprehensive income (loss). Changes in the noncredit-related gain or loss in fair value of these securities, after OTTI was initially recognized, are shown separately in the table below. The remaining unrealized holding gains and losses shown in the table apply to available for sale investment securities for

which OTTI has not been recorded (and include holding gains and losses on certain securities prior to the recognition of OTTI).

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

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

| <i>(In thousands)</i>  | <b>For the<br/>Three Months<br/>Ended September 30</b> |             | <b>For the<br/>Nine Months<br/>Ended September 30</b> |             |
|--|--|-------------|---|-------------|
|  | <b>2010</b>  | <b>2009</b> | <b>2010</b>   | <b>2009</b> |
| <b>Available for sale debt securities for which a portion of OTTI has been recorded in earnings:</b> |  |             |   |             |
| Unrealized holding gains subsequent to initial OTTI recognition                                      | \$ 8,145   | \$ 9,407    | \$ 20,112   | \$ 11,788   |
| Income tax expense   | <b>(3,096)</b>   | (3,574)     | <b>(7,643)</b>  | (4,479)     |
| <b>Net unrealized gains</b>  | <b>5,049</b>   | 5,833       | <b>12,469</b>   | 7,309       |
| <b>Other available for sale investment securities:</b>   |  |             |   |             |
| Unrealized holding gains   | <b>23,353</b>  | 78,321      | <b>59,426</b>   | 153,345     |
| Reclassification adjustment for (gains) losses included in net income                                | <b>(764)</b>   | 23          | <b>(2,534)</b>  | (41)        |
| Net unrealized gains on securities   | <b>22,589</b>  | 78,344      | <b>56,892</b>   | 153,304     |
| Income tax expense   | <b>(8,582)</b>   | (29,771)    | <b>(21,618)</b>                                       | (58,256)    |
| <b>Net unrealized gains</b>  | <b>14,007</b>  | 48,573      | <b>35,274</b>   | 95,048      |
| <b>Prepaid pension cost:</b>   |  |             |   |             |
| Amortization of accumulated pension loss   | <b>566</b>   | 832         | <b>1,700</b>  | 2,182       |
| Income tax expense   | <b>(215)</b>   | (307)       | <b>(646)</b>  | (807)       |

|                                   |                  |           |                  |            |
|-----------------------------------|------------------|-----------|------------------|------------|
| <b>Pension loss amortization</b>  | <b>351</b>       | 525       | <b>1,054</b>     | 1,375      |
| <b>Other comprehensive income</b> | <b>\$ 19,407</b> | \$ 54,931 | <b>\$ 48,797</b> | \$ 103,732 |

At September 30, 2010, accumulated other comprehensive income was \$95.2 million, net of tax. It was comprised of \$9.2 million in unrealized holding losses on available for sale debt securities for which a portion of OTTI has been recorded in earnings, \$121.2 million in unrealized holding gains on other available for sale securities, and \$16.8 million in accumulated pension loss.

## 9. Segments

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

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

| <i>(In thousands)</i>                | Consumer  | Commercial | Wealth    | Segment<br>Totals | Other/<br>Elimination | Consolidated<br>Totals |
|--------------------------------------|-----------|------------|-----------|-------------------|-----------------------|------------------------|
| <b>Three Months Ended</b>            |           |            |           |                   |                       |                        |
| <b>September 30, 2010:</b>           |           |            |           |                   |                       |                        |
| Net interest income                  | \$ 76,963 | \$ 64,338  | \$ 8,812  | \$ 150,113        | \$ 9,324              | \$ 159,437             |
| Provision for loan losses            | (17,552)  | (3,450)    | (817)     | (21,819)          | (25)                  | (21,844)               |
| Non-interest income                  | 38,303    | 32,411     | 28,960    | 99,674            | (131)                 | 99,543                 |
| Investment securities gains,<br>net  |           |            |           |                   | 16                    | 16                     |
| Non-interest expense                 | (71,744)  | (51,555)   | (25,432)  | (148,731)         | (6,388)               | (155,119)              |
| Income before income taxes           | \$ 25,970 | \$ 41,744  | \$ 11,523 | \$ 79,237         | \$ 2,796              | \$ 82,033              |
| <b>Three Months Ended</b>            |           |            |           |                   |                       |                        |
| <b>September 30, 2009:</b>           |           |            |           |                   |                       |                        |
| Net interest income                  | \$ 83,831 | \$ 62,115  | \$ 10,407 | \$ 156,353        | \$ 7,186              | \$ 163,539             |
| Provision for loan losses            | (19,835)  | (11,086)   | 76        | (30,845)          | (4,516)               | (35,361)               |
| Non-interest income                  | 42,738    | 30,333     | 27,920    | 100,991           | 1,144                 | 102,135                |
| Investment securities losses,<br>net |           |            |           |                   | (945)                 | (945)                  |
| Non-interest expense                 | (74,794)  | (47,174)   | (26,226)  | (148,194)         | (6,295)               | (154,489)              |
| Income before income taxes           | \$ 31,940 | \$ 34,188  | \$ 12,177 | \$ 78,305         | \$ (3,426)            | \$ 74,879              |

### **Nine Months Ended September 30, 2010:**

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|                                      |            |            |           |            |           |            |
|--------------------------------------|------------|------------|-----------|------------|-----------|------------|
| Net interest income                  | \$ 238,396 | \$ 190,400 | \$ 29,901 | \$ 458,697 | \$ 26,558 | \$ 485,255 |
| Provision for loan losses            | (54,543)   | (19,571)   | (1,038)   | (75,152)   | (3,201)   | (78,353)   |
| Non-interest income                  | 112,332    | 96,065     | 85,653    | 294,050    | 392       | 294,442    |
| Investment securities losses,<br>net |            |            |           |            | (2,989)   | (2,989)    |
| Non-interest expense                 | (218,617)  | (152,860)  | (79,884)  | (451,361)  | (15,527)  | (466,888)  |
| Income before income taxes           | \$ 77,568  | \$ 114,034 | \$ 34,632 | \$ 226,234 | \$ 5,233  | \$ 231,467 |

Nine Months Ended  
September 30, 2009:

|                                      |            |            |           |            |             |            |
|--------------------------------------|------------|------------|-----------|------------|-------------|------------|
| Net interest income                  | \$ 250,770 | \$ 175,888 | \$ 30,494 | \$ 457,152 | \$ 13,847   | \$ 470,999 |
| Provision for loan losses            | (62,255)   | (39,348)   | (199)     | (101,802)  | (17,893)    | (119,695)  |
| Non-interest income                  | 118,905    | 84,047     | 86,812    | 289,764    | 3,364       | 293,128    |
| Investment securities losses,<br>net |            |            |           |            | (5,870)     | (5,870)    |
| Non-interest expense                 | (227,812)  | (143,718)  | (80,107)  | (451,637)  | (15,749)    | (467,386)  |
| Income before income taxes           | \$ 79,608  | \$ 76,869  | \$ 37,000 | \$ 193,477 | \$ (22,301) | \$ 171,176 |

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

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

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

## 10. Derivative Instruments

The notional amounts of the Company's derivative instruments are shown in the table below. These contractual amounts, along with other terms of the derivative, are used to determine amounts to be exchanged between counterparties, and are not a measure of loss exposure. The largest group of notional amounts relate to interest rate swaps, which are discussed in more detail below. Through its International Department, the Company enters into foreign exchange contracts consisting mainly of contracts to purchase or deliver foreign currencies for customers at specific future dates. Also, mortgage loan commitments and forward sales contracts result from the Company's mortgage banking operation, in which fixed rate personal real estate loans are originated and sold to other institutions. The Company also contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps. The Company's risks and responsibilities as guarantor are further discussed in Note 5 on Guarantees.

| <i>(In thousands)</i>                | <b>September 30<br/>2010</b> | December 31<br>2009 |
|--------------------------------------|------------------------------|---------------------|
| Interest rate swaps                  | \$ 522,966                   | \$ 503,530          |
| Interest rate caps                   | 32,236                       | 16,236              |
| Credit risk participation agreements | 52,390                       | 53,246              |
| Foreign exchange contracts:          |                              |                     |
| Forward contracts                    | 22,127                       | 17,475              |
| Option contracts                     | 2,920                        |                     |
| Mortgage loan commitments            | 23,164                       | 9,767               |
| Mortgage loan forward sale contracts | 35,683                       | 19,986              |

|                              |                   |                   |
|------------------------------|-------------------|-------------------|
| <b>Total notional amount</b> | <b>\$ 691,486</b> | <b>\$ 620,240</b> |
|------------------------------|-------------------|-------------------|

The Company's interest rate risk management strategy includes the ability to modify the repricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. At September 30, 2010, the Company had entered into three interest rate swaps with a notional amount of \$16.0 million, which are designated as fair value hedges of certain fixed rate loans. Gains and losses on these derivative instruments, as well as the offsetting loss or gain on the hedged loans attributable to the hedged



risk, are recognized in current earnings. These gains and losses are reported in interest and fees on loans in the accompanying statements of income. The table below shows gains and losses related to fair value hedges.

| <i>(In thousands)</i>                  | <b>For the Three<br/>Months Ended<br/>September 30</b> |               | <b>For the Nine<br/>Months Ended<br/>September 30</b> |               |
|--|--|---------------|---|---------------|
|  | <b>2010</b>  | <b>2009</b>   | <b>2010</b>   | <b>2009</b>   |
| Gain (loss) on interest rate swaps     | \$ (208)   | \$ (191)      | \$ (598)  | \$ 442        |
| Gain (loss) on loans                   | 205  | 182           | 577   | (443)         |
| <b>Amount of hedge ineffectiveness</b> | <b>\$ (3)</b>  | <b>\$ (9)</b> | <b>\$ (21)</b>  | <b>\$ (1)</b> |

The Company's other derivative instruments are accounted for as free-standing derivatives, and changes in their fair value are recorded in current earnings. These instruments include interest rate swap contracts sold to customers who wish to modify their interest rate sensitivity. These swaps are offset by matching contracts purchased by the Company from other financial institutions. Because of the matching terms of the offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings. The notional amount of these types of swaps at September 30, 2010 was \$506.9 million. The Company is party to master netting arrangements with its institutional counterparties; however, the effect of offsetting assets and liabilities under these arrangements is not significant. Collateral exchanges typically involve marketable securities.

The Company's interest rate swap arrangements with other financial institutions contain contingent features relating to debt ratings or capitalization levels. Under these provisions, if the Company's debt rating falls below investment grade or if the Company ceases to be well-capitalized under risk-based capital guidelines, certain counterparties can require immediate and ongoing collateralization on interest rate swaps in net liability positions, or can require instant settlement of the contracts. The aggregate fair value of interest rate swap contracts with credit risk-related contingent features that were in a liability position on September 30, 2010 was \$23.7 million, for which the Company had posted collateral of \$22.8 million. Most of these features require contract settlement, which if triggered on September 30, 2010 would have required a cash disbursement of \$900 thousand, in addition to collateral posted.

The banking customer counterparties are engaged in a variety of businesses, including real estate, building materials, communications, consumer products, and manufacturing. The manufacturing group is the largest, with a combined notional amount of 31.5% of the total customer swap portfolio. If this group of manufacturing counterparties failed to perform, and if the underlying collateral proved to be of no value, the Company would incur a loss of \$5.8 million, based on amounts at September 30, 2010.

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

| <i>(In thousands)</i>  | Asset Derivatives |            |           | Liability Derivatives |             |             |
|--|-------------------|------------|-----------|-----------------------|-------------|-------------|
|  | Balance           | Sept. 30   | Dec. 31   | Balance               | Sept. 30    | Dec. 31     |
|  | Sheet             | 2010       | 2009      | Sheet                 | 2010        | 2009        |
|  | Location          | Fair Value |           | Location              | Fair Value  |             |
| Derivatives designated as hedging instruments:                 |                   |            |           |                       |             |             |
| Interest rate swaps  | Other assets      | \$         | \$ 64     | Other liabilities     | \$ (1,452)  | \$ (918)    |
| <b>Total derivatives designated as hedging instruments</b>     |                   | \$         | \$ 64     |                       | \$ (1,452)  | \$ (918)    |
| Derivatives not designated as hedging instruments:             |                   |            |           |                       |             |             |
| Interest rate swaps  | Other assets      | \$ 24,237  | \$ 16,898 | Other liabilities     | \$ (24,340) | \$ (16,898) |
| Interest rate caps   | Other assets      | 48         | 239       | Other liabilities     | (48)        | (239)       |
| Credit risk participation agreements                           | Other assets      | 78         | 140       | Other liabilities     | (303)       | (239)       |
| Foreign exchange contracts:                                    |                   |            |           |                       |             |             |
| Forward contracts  | Other assets      | 808        | 415       | Other liabilities     | (567)       | (295)       |
| Option contracts   | Other assets      | 6          |           | Other liabilities     | (6)         |             |
| Mortgage loan commitments                                      | Other assets      | 312        | 44        | Other liabilities     | (1)         | (16)        |
| Mortgage loan forward sale contracts                           | Other assets      | 39         | 184       | Other liabilities     | (69)        | (5)         |
| <b>Total derivatives not designated as hedging instruments</b> |                   | \$ 25,528  | \$ 17,920 |                       | \$ (25,334) | \$ (17,692) |
| <b>Total derivatives</b>                                       |                   | \$ 25,528  | \$ 17,984 |                       | \$ (26,786) | \$ (18,610) |

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

|  | Location of Gain or (Loss)<br>Recognized in Income on<br>Derivative | Amount of Gain or (Loss)<br>Recognized in Income on<br>Derivative |  |   |   |
|--|---|---|--|---|---|
|  |   | For the Three<br>Months<br>Ended<br>September 30<br>2010          | For the Three<br>Months<br>Ended<br>September 30<br>2009 | For the Nine<br>Months<br>Ended<br>September 30<br>2010 | For the Nine<br>Months<br>Ended<br>September 30<br>2009 |
| <i>(In thousands)</i>                              |   |   |  |   |   |
| Derivatives in fair value hedging relationships:   |   |   |  |   |   |
| Interest rate swaps                                | Interest and fees on loans  | \$ (208)  | \$ (191)   | \$ (598)  | \$ 442  |
| <b>Total</b>                                       |   | <b>\$ (208)</b>   | <b>\$ (191)</b>  | <b>\$ (598)</b>   | <b>\$ 442</b>   |
| Derivatives not designated as hedging instruments: |   |   |  |   |   |
| Interest rate swaps                                | Other non-interest income   | \$ 137  | \$ 226   | \$ 596  | \$ 350  |
| Interest rate caps                                 | Other non-interest income   |   | 1  | 32  | 6   |
| Credit risk participation agreements               | Other non-interest income   | (7)   | 4  | 6   | 13  |
| Foreign exchange contracts:                        |   |   |  |   |   |
| Forward contracts                                  | Other non-interest income   | (293)   | (127)  | 121   | (139)   |
| Option contracts                                   | Other non-interest income   |   |  |   |   |
| Mortgage loan commitments                          | Loan fees and sales   | 43  | 84   | 283   | 7   |
| Mortgage loan forward sale contracts               | Loan fees and sales   | 151   | (412)  | (210)   | (56)  |
| <b>Total</b>                                       |   | <b>\$ 31</b>  | <b>\$ (224)</b>  | <b>\$ 828</b>   | <b>\$ 181</b>   |

## 11. Income Taxes

For the third quarter of 2010, income tax expense amounted to \$26.0 million compared to \$23.4 million in the third quarter of 2009. The effective income tax rate for the Company, including the effect of non-controlling interest, was 31.8% in the current quarter compared to 31.2% in the same quarter last year. For the nine months ended September 30, 2010 and 2009, income tax expense amounted to \$71.8 million and \$52.3 million, resulting in effective income tax rates of 31.0% and 30.4%, respectively. Effective tax rates were higher in 2010 compared to 2009 mainly due to changes in the mix of taxable and non-taxable income on higher pre-tax income.

## 12. Stock-Based Compensation

Stock-based compensation expense that has been charged against income was \$1.3 million and \$1.7 million in the three months ended September 30, 2010 and 2009, respectively, and \$4.7 million and \$4.9 million in the nine months ended September 30, 2010 and 2009, respectively. The Company has historically issued stock-based compensation in the form of options, stock appreciation rights (SARs) and nonvested stock. During 2009 and the first nine months of 2010, stock-based compensation has been issued mainly in the form of nonvested stock awards.

The 2010 stock awards generally vest in 5 to 7 years and contain restrictions as to transferability, sale, pledging, or assigning, among others, prior to the end of the vesting period. Dividend and voting rights are conferred upon grant. A summary of the status of the Company's nonvested share awards as of September 30, 2010 and changes during the nine month period then ended is presented below.

|  | Shares   | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--|----------|---|
| <b>Nonvested at January 1, 2010</b>    | 361,399  | \$ 37.23  |
| Granted                                | 152,907  | 39.43   |
| Vested                                 | (50,547) | 38.88   |
| Forfeited                              | (6,554)  | 34.77   |
| <b>Nonvested at September 30, 2010</b> | 457,205  | \$ 37.81  |

SARs and stock options are granted with an exercise price equal to the market price of the Company's stock at the date of grant and have 10-year contractual terms. SARs, which the Company granted in 2006 and subsequent years, vest on a graded basis over 4 years of continuous service. All SARs must be settled in stock under provisions of the plan. Stock options, which were granted in 2005 and previous years, vest on a graded basis over 3 years of continuous service. In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of SARs and options on date of grant. No SARs or options were granted during the first nine months of 2010.

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

| <i>(Dollars in thousands, except per share data)</i> | Shares        | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|--|---------------|--|---|---------------------------------|
| <b>Outstanding at January 1, 2010</b>                | 2,287,787     | \$ 31.30                                 |   |                                 |
| Granted  |               |  |   |                                 |
| Forfeited  |               |  |   |                                 |
| Expired  | (3,188)       | 37.30                                    |   |                                 |
| Exercised  | (284,506)     | 24.06                                    |   |                                 |
| <br><b>Outstanding at September 30, 2010</b>         | <br>2,000,093 | <br>\$ 32.32                             | <br>2.8 years   | <br>\$ 10,545                   |

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

| <i>(Dollars in thousands, except per share data)</i> | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|--|-----------|--|---|---------------------------------|
| <b>Outstanding at January 1, 2010</b>                | 1,669,753 | \$ 41.71                                 |   |                                 |
| Granted  |           |  |   |                                 |
| Forfeited  | (10,026)  | 40.47                                    |   |                                 |
| Expired  | (12,733)  | 41.90                                    |   |                                 |
| Exercised  | (1,436)   | 39.07                                    |   |                                 |
| <b>Outstanding at September 30, 2010</b>             | 1,645,558 | \$ 41.68                                 | 6.4 years   | \$ 16                           |

### 13. Fair Value Measurements

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

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value. For accounting disclosure purposes, a three-level valuation hierarchy of fair value measurements has been established. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and inputs that are observable for the assets or liabilities, either directly or indirectly (such as interest rates, yield curves, and prepayment speeds).

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value. These may be internally developed, using the Company's best information and assumptions that a market participant would consider.

When determining the fair value measurements for assets and liabilities required or permitted to be recorded or disclosed at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to observable market data for similar assets and liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets and the Company must use alternative valuation techniques to derive an estimated fair value measurement.

## **Valuation methods for instruments measured at fair value on a recurring basis**

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

### *Available for sale investment securities*

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

Valuation methods and inputs, by class of security:

#### *U.S. government and federal agency obligations*

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

#### *Government-sponsored enterprise obligations*

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

#### *State and municipal obligations, excluding auction rate securities*

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

#### *Mortgage and asset-backed securities*

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



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

*Other debt securities*

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

*Equity securities*

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

At September 30, 2010, the Company held certain auction rate securities (ARS) in its available for sale portfolio, totaling \$154.1 million. Nearly all of these securities were purchased from customers during the third quarter of 2008. The auction process by which the ARS are normally priced has not functioned since the first quarter of 2008, and the fair value of these securities cannot be based on observable market prices due to the illiquidity in the market. The fair values of the ARS are estimated using a discounted cash flows analysis. Estimated cash flows are based on mandatory interest rates paid under failing auctions and projected over an estimated market recovery period. The cash flows are discounted at an estimated market rate reflecting adjustments for liquidity premium and nonperformance risk. Because many of the inputs significant to the measurement are not observable, these measurements are classified as Level 3 measurements.

*Trading securities*

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

*Private equity investments*

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

*Derivatives*

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

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

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

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

trends. Based on the unobservable nature of this adjustment, these measurements are classified as Level 3.

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

*Assets held in trust*

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

The table below presents the carrying values of assets and liabilities measured at fair value on a recurring basis at September 30, 2010 and December 31, 2009. There were no transfers among levels during the first nine months of 2010.

| <i>(In thousands)</i>                          | Total Fair Value | Fair Value Measurements Using                                  |   |   |
|--|------------------|--|---|---|
|  |                  | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>As of September 30, 2010</b>                |                  |  |   |   |
| <b>Assets:</b>                                 |                  |  |   |   |
| Available for sale securities:                 |                  |  |   |   |
| U.S. government and federal agency obligations | \$ 459,245       | \$ 451,790   | \$ 7,455                                      | \$  |
| Government-sponsored enterprise obligations    | 185,222          |  | 185,222                                       |   |
| State and municipal obligations                | 1,105,686        |  | 951,587                                       | 154,099                                   |
| Agency mortgage-backed securities              | 2,436,297        |  | 2,436,297                                     |   |
| Non-agency mortgage-backed securities          | 558,615          |  | 558,615                                       |   |
| Other asset-backed securities                  | 2,194,090        |  | 2,194,090                                     |   |
| Other debt securities                          | 180,459          |  | 180,459                                       |   |
| Equity securities                              | 44,659           | 28,386   | 16,273  |   |
| Trading securities                             | 20,828           |  | 20,828  |   |
| Private equity investments                     | 50,797           |  |   | 50,797                                    |
| Derivatives*                                   | 25,528           |  | 25,099  | 429                                       |
| Assets held in trust                           | 3,919            | 3,919  |   |   |
| <b>Total assets</b>                            | <b>7,265,345</b> | <b>484,095</b>   | <b>6,575,925</b>                              | <b>205,325</b>                            |
| <b>Liabilities:</b>                            |                  |  |   |   |
| Derivatives*                                   | 26,786           |  | 26,413  | 373                                       |
| <b>Total liabilities</b>                       | <b>\$ 26,786</b> | <b>\$</b>  | <b>\$ 26,413</b>                              | <b>\$ 373</b>                             |

As of December 31, 2009

**Assets:**

Available for sale securities:

|  |            |            |    |    |
|--|------------|------------|----|----|
| U.S. government and federal agency obligations | \$ 447,038 | \$ 447,038 | \$ | \$ |
|--|------------|------------|----|----|

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|   |                  |                |                  |                |
|---|------------------|----------------|------------------|----------------|
| Government-sponsored enterprise obligations | 165,814          |                | 165,814          |                |
| State and municipal obligations             | 939,338          |                | 771,502          | 167,836        |
| Agency mortgage-backed securities           | 2,262,003        |                | 2,262,003        |                |
| Non-agency mortgage-backed securities       | 609,016          |                | 609,016          |                |
| Other asset-backed securities               | 1,701,569        |                | 1,701,569        |                |
| Other debt securities                       | 176,331          |                | 176,331          |                |
| Equity securities                           | 39,866           | 25,378         | 14,488           |                |
| Trading securities                          | 10,335           |                | 10,335           |                |
| Private equity investments                  | 44,827           |                |                  | 44,827         |
| Derivatives*                                | 17,984           |                | 17,616           | 368            |
| Assets held in trust                        | 3,419            | 3,419          |                  |                |
| <b>Total assets</b>                         | <b>6,417,540</b> | <b>475,835</b> | <b>5,728,674</b> | <b>213,031</b> |
| <b>Liabilities:</b>                         |                  |                |                  |                |
| Derivatives*                                | 18,610           |                | 18,350           | 260            |
| <b>Total liabilities</b>                    | <b>\$ 18,610</b> | <b>\$</b>      | <b>\$ 18,350</b> | <b>\$ 260</b>  |

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

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

| <i>(In thousands)</i>  | Fair Value Measurements Using<br>Significant Unobservable Inputs<br>(Level 3) |                                  |             |            |
|--|---|----------------------------------|-------------|------------|
|  | State and<br>Municipal<br>Obligations   | Private<br>Equity<br>Investments | Derivatives | Total      |
| <b>For the three months ended September 30, 2010:</b>  |   |                                  |             |            |
| Balance at June 30, 2010   | \$ 152,143  | \$ 46,257                        | \$ (110)    | \$ 198,290 |
| Total gains or losses (realized/unrealized):   |   |                                  |             |            |
| Included in earnings   |   | 1,352                            | 187         | 1,539      |
| Included in other comprehensive income   | 3,269   |                                  |             | 3,269      |
| Purchases, issuances, and settlements, net   | (1,313)   | 3,188                            | (21)        | 1,854      |
| <br>   |   |                                  |             |            |
| Balance at September 30, 2010  | \$ 154,099  | \$ 50,797                        | \$ 56       | \$ 204,952 |
| <br>   |   |                                  |             |            |
| Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2010 | \$  | \$ 1,352                         | \$ 292      | \$ 1,644   |
| <br>   |   |                                  |             |            |
| <b>For the nine months ended September 30, 2010:</b>   |   |                                  |             |            |
| Balance at January 1, 2010   | \$ 167,836  | \$ 44,827                        | \$ 108      | \$ 212,771 |
| Total gains or losses (realized/unrealized):   |   |                                  |             |            |
| Included in earnings   |   | (1,289)                          | 79          | (1,210)    |
| Included in other comprehensive income   | (10,138)  |                                  |             | (10,138)   |
| Purchases, issuances, and settlements, net   | (3,599)   | 7,259                            | (131)       | 3,529      |
| <br>   |   |                                  |             |            |
| Balance at September 30, 2010  | \$ 154,099  | \$ 50,797                        | \$ 56       | \$ 204,952 |
| <br>   |   |                                  |             |            |
| Total gains or losses for the nine months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2010  | \$  | \$ (1,089)                       | \$ 309      | \$ (780)   |

**For the three months ended September 30, 2009:**

|  |            |           |        |            |
|--|------------|-----------|--------|------------|
| Balance at June 30, 2009                     | \$ 170,263 | \$ 43,020 | \$ 247 | \$ 213,530 |
| Total gains or losses (realized/unrealized): |            |           |        |            |
| Included in earnings                         |            | (339)     | (324)  | (663)      |
| Included in other comprehensive income       | 1,198      |           |        | 1,198      |
| Purchases, issuances, and settlements, net   | (1,397)    | 119       | 50     | (1,228)    |

|                               |            |           |         |            |
|-------------------------------|------------|-----------|---------|------------|
| Balance at September 30, 2009 | \$ 170,064 | \$ 42,800 | \$ (27) | \$ 212,837 |
|-------------------------------|------------|-----------|---------|------------|

|  |    |          |       |          |
|--|----|----------|-------|----------|
| Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2009 | \$ | \$ (339) | \$ 79 | \$ (260) |
|--|----|----------|-------|----------|

**For the nine months ended September 30, 2009:**

|  |            |           |       |            |
|--|------------|-----------|-------|------------|
| Balance at January 1, 2009                   | \$ 167,996 | \$ 49,494 | \$ 64 | \$ 217,554 |
| Total gains or losses (realized/unrealized): |            |           |       |            |
| Included in earnings                         |            | (3,216)   | (36)  | (3,252)    |
| Included in other comprehensive income       | 3,751      |           |       | 3,751      |
| Purchases, issuances, and settlements, net   | (1,683)    | (3,478)   | (55)  | (5,216)    |

|                               |            |           |         |            |
|-------------------------------|------------|-----------|---------|------------|
| Balance at September 30, 2009 | \$ 170,064 | \$ 42,800 | \$ (27) | \$ 212,837 |
|-------------------------------|------------|-----------|---------|------------|

|   |    |            |       |            |
|---|----|------------|-------|------------|
| Total gains or losses for the nine months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2009 | \$ | \$ (3,216) | \$ 88 | \$ (3,128) |
|---|----|------------|-------|------------|



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

| <i>(In thousands)</i>  | Loan Fees<br>and Sales | Other<br>Non-<br>Interest<br>Income | Investment<br>Securities<br>Gains<br>(Losses),<br>Net | Total      |
|--|------------------------|-------------------------------------|---|------------|
| <b>For the three months ended September 30, 2010:</b>                                    |                        |                                     |   |            |
| Total gains or losses included in earnings   | \$ 194                 | \$ (7)                              | \$ 1,352  | \$ 1,539   |
| Change in unrealized gains or losses relating to assets still held at September 30, 2010 | \$ 281                 | \$ 11                               | \$ 1,352  | \$ 1,644   |
| <b>For the nine months ended September 30, 2010:</b>                                     |                        |                                     |   |            |
| Total gains or losses included in earnings   | \$ 73                  | \$ 6                                | \$ (1,289)  | \$ (1,210) |
| Change in unrealized gains or losses relating to assets still held at September 30, 2010 | \$ 281                 | \$ 28                               | \$ (1,089)  | \$ (780)   |
| <b>For the three months ended September 30, 2009:</b>                                    |                        |                                     |   |            |
| Total gains or losses included in earnings   | \$ (328)               | \$ 4                                | \$ (339)  | \$ (663)   |
| Change in unrealized gains or losses relating to assets still held at September 30, 2009 | \$ 75                  | \$ 4                                | \$ (339)  | \$ (260)   |
| <b>For the nine months ended September 30, 2009:</b>                                     |                        |                                     |   |            |
| Total gains or losses included in earnings   | \$ (49)                | \$ 13                               | \$ (3,216)  | \$ (3,252) |

|  |    |    |    |    |    |         |    |         |
|--|----|----|----|----|----|---------|----|---------|
| Change in unrealized gains or losses relating to assets still held at September 30, 2009 | \$ | 75 | \$ | 13 | \$ | (3,216) | \$ | (3,128) |
|--|----|----|----|----|----|---------|----|---------|

### Valuation methods for instruments measured at fair value on a nonrecurring basis

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

#### *Collateral dependent impaired loans*

While the overall loan portfolio is not carried at fair value, the Company periodically records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral dependent loans when establishing the allowance for loan losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. In determining the value of real estate collateral, the Company relies on external appraisals and assessment of property values by its internal staff. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgments based on the experience and expertise of internal specialists. Because many of these inputs are not observable, the measurements are classified as Level 3. Changes in fair value recognized for partial charge-offs of loans and loan impairment reserves on loans held by the Company at September 30, 2010 and 2009 are shown in the table below.

#### *Loans held for sale*

Loans held for sale are carried at the lower of cost or fair value. The portfolio consists primarily of student loans, and to a lesser extent, residential real estate loans. The Company's student loans are contracted for sale with the Federal Department of Education (DOE) and various investors in the secondary market. Beginning in 2008, the secondary market for student loans was disrupted by liquidity concerns. Consequently, several investors have been unable to consistently purchase loans under existing contractual terms. Loans under contract to these investors have been evaluated using a fair value measurement method based on a discounted cash flows analysis, which was classified as Level 3 and resulted in an impairment reserve of \$828 thousand at December 31, 2009. During the first nine months of

2010, \$442 thousand of this reserve was reversed as certain of the related loans were sold. The remainder of the identified portfolio, for which performance concern remains, was carried at \$12.4 million at September 30, 2010. The measurement of fair value for the remaining student loans is based on the specific prices mandated in the underlying sale contracts, the estimated exit price, and is classified as Level 2. Fair value measurements on mortgage loans held for sale are based on quoted market prices for similar loans in the secondary market and are classified as Level 2.

*Private equity investments and restricted stock*

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

*Mortgage servicing rights*

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

*Goodwill and core deposit premium*

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

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

carrying value, impairment is considered to have occurred. This measurement is classified as Level 3.

*Foreclosed assets*

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

*Long-lived assets held for sale*

The Company owns an office building in downtown Kansas City, which formerly housed its check processing operations, which is classified as held for sale. In accordance with the provisions of ASC 360-10-35, it was written down to its estimated fair value, less cost to sell, in June 2010. Fair value was estimated in a process which considered current local commercial real estate market conditions and the judgment of the sales agent on pricing and sales strategy. These fair value measurements are classified as Level 3.

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

|                                 | Fair Value | Fair Value Measurements Using   |   |  | Total Gains<br>(Losses)<br>Recognized<br>During the<br>Nine<br>Months Ended<br>September 30 |
|---------------------------------|------------|---|---|--|---|
|                                 |            | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |   |
| <i>(In thousands)</i>           |            |   |   |  |   |
| <b>As of September 30, 2010</b> |            |   |   |  |   |
| Loans                           | \$ 48,858  | \$  | \$  | \$ 48,858  | \$ (12,681)   |
| Private equity investments      | 980        |   |   | 980  | (100)   |
| Mortgage servicing rights       | 962        |   |   | 962  | (434)   |
| Foreclosed assets               | 8,423      |   |   | 8,423  | (3,016)   |
| Long-lived assets held for sale | 4,300      |   |   | 4,300  | (969)   |

As of September 30, 2009

|                            |    |        |    |  |    |        |    |          |
|----------------------------|----|--------|----|--|----|--------|----|----------|
| Loans                      | \$ | 58,817 | \$ |  | \$ | 58,817 | \$ | (37,637) |
| Private equity investments |    | 2,250  |    |  |    | 2,250  |    | (800)    |
| Mortgage servicing rights  |    | 1,470  |    |  |    | 1,470  |    | (58)     |
| Foreclosed assets          |    | 2,296  |    |  |    | 2,296  |    | (457)    |

**14. Fair Value of Financial Instruments**

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

*Loans*

The fair value of loans are estimated by discounting the expected future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same

remaining maturities. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC 820 Fair Value Measurements and Disclosures .

#### *Investment Securities*

A detailed description of the fair value measurement of the debt and equity instruments in the available for sale and trading sections of the investment security portfolio is provided in Note 13 on Fair Value Measurements. A schedule of available for sale securities by category and maturity is provided in Note 3 on Investment Securities.

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

The carrying amounts of short-term federal funds sold and securities purchased under agreements to resell, interest earning deposits with banks, and cash and due from banks approximate fair value. Federal funds sold and securities purchased under agreements to resell classified as short-term generally mature in 90 days or less. The fair value of long-term securities purchased under agreements to resell is estimated by discounting contractual maturities using an estimate of the current market rate for similar instruments.

#### *Accrued Interest Receivable/Payable*

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

#### *Derivative Instruments*

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

#### *Deposits*

The fair value of deposits with no stated maturity is equal to the amount payable on demand. Such deposits include savings and interest and non-interest bearing demand deposits. These fair value estimates do not recognize any benefit the Company receives as a result of being able to administer, or control, the pricing of these accounts. The fair value of certificates of deposit is based on the discounted value of cash flows, taking early withdrawal optionality into account. Discount rates are based on the Company's approximate cost of obtaining similar maturity funding in the market.

#### *Borrowings*

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

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

| <i>(In thousands)</i>   | <b>September 30, 2010</b>  |                                 |
|---|----------------------------|---------------------------------|
|   | <b>Carrying<br/>Amount</b> | <b>Estimated<br/>Fair Value</b> |
| <b>Financial Assets</b>   |                            |                                 |
| Loans, including held for sale  | \$ 9,954,373               | \$ 10,034,336                   |
| Available for sale investment securities  | 7,164,273                  | 7,164,273                       |
| Trading securities  | 20,828                     | 20,828                          |
| Non-marketable securities   | 110,487                    | 110,487                         |
| Short-term federal funds sold and securities purchased under agreements to resell | 4,550                      | 4,550                           |
| Long-term securities purchased under agreements to resell                         | 350,000                    | 358,573                         |
| Accrued interest receivable   | 72,899                     | 72,899                          |
| Derivative instruments  | 25,528                     | 25,528                          |
| Cash and due from banks   | 412,315                    | 412,315                         |
| Interest earning deposits with banks  | 4,047                      | 4,047                           |
| <b>Financial Liabilities</b>  |                            |                                 |
| Non-interest bearing demand deposits  | \$ 1,752,930               | \$ 1,752,930                    |
| Savings, interest checking and money market deposits                              | 9,712,088                  | 9,712,088                       |
| Time open and C.D. s  | 2,926,541                  | 2,953,800                       |
| Federal funds purchased and securities sold under agreements to repurchase        | 1,530,555                  | 1,530,953                       |
| Other borrowings  | 337,863                    | 363,475                         |
| Accrued interest payable  | 14,938                     | 14,938                          |
| Derivative instruments  | 26,786                     | 26,786                          |

#### *Off-Balance Sheet Financial Instruments*

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

#### *Limitations*

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

## **15. Pending Litigation**



On April 6, 2010 a suit was filed against Commerce Bank, N.A. (the Bank) in the U.S. District Court for the Western District of Missouri by a customer alleging that overdraft fees relating to debit card transactions have been unfairly assessed by the Bank. The suit seeks class-action status for Bank customers who may have been similarly affected. A second suit alleging the same facts and also seeking class-action status was filed on June 4, 2010 in Missouri state court. Since these cases are in a very early stage, a probable outcome is presently not determinable. The Company believes the claims to be without merit and intends to defend these actions vigorously.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company's 2009 Annual Report on Form 10-K. Results of operations for the three and nine month periods ended September 30, 2010 are not necessarily indicative of results to be attained for any other period.

### **Forward Looking Information**

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

### **Critical Accounting Policies**

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

#### *Allowance for Loan Losses*

The Company performs periodic and systematic detailed reviews of its loan portfolio to assess overall collectability. The level of the allowance for loan losses reflects the Company's estimate of the losses inherent in the loan portfolio at any point in time. While these estimates are based on substantive methods for determining allowance requirements, actual outcomes may differ significantly from estimated results, especially when determining allowances for business, lease, construction and business real estate loans. These loans are normally larger and more complex, and their

collection rates are harder to predict. Personal loans, including personal mortgage, credit card and consumer loans, are individually smaller and perform in a more homogenous manner, making loss estimates more predictable. Further discussion of the

methodologies used in establishing the allowance is provided in the Provision and Allowance for Loan Losses section of this discussion.

#### *Valuation of Investment Securities*

The Company carries its investment securities at fair value, and employs valuation techniques which utilize observable inputs when those inputs are available. These observable inputs reflect assumptions market participants would use in pricing the security, developed based on market data obtained from sources independent of the Company. When such information is not available, the Company employs valuation techniques which utilize unobservable inputs, or those which reflect the Company's own assumptions about market participants, based on the best information available in the circumstances. These valuation methods typically involve cash flow and other financial modeling techniques. Changes in underlying factors, assumptions, estimates, or other inputs to the valuation techniques could have a material impact on the Company's future financial condition and results of operations. Assets and liabilities carried at fair value inherently result in more financial statement volatility. Under the fair value measurement hierarchy, fair value measurements are classified as Level 1 (quoted prices), Level 2 (based on observable inputs) or Level 3 (based on unobservable, internally-derived inputs), as discussed in more detail in Note 13 to the consolidated financial statements. Most of the available for sale investment portfolio is priced utilizing industry-standard models that consider various assumptions which are observable in the marketplace, or can be derived from observable data. Such securities totaled approximately \$6.5 billion, or 91.1% of the available for sale portfolio at September 30, 2010, and were classified as Level 2 measurements. The Company also holds \$154.1 million in auction rate securities. These were classified as Level 3 measurements, as no market currently exists for these securities, and fair values were derived from internally generated cash flow valuation models which used unobservable inputs which were significant to the overall measurement.

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

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

At September 30, 2010, non-agency guaranteed mortgage-backed securities with a par value of \$197.5 million were identified as other than temporarily impaired. The credit-related impairment loss on these securities amounted to \$6.7 million, which was recorded in the consolidated income statement in investment securities gains (losses), net. The noncredit-related loss on these securities, which was recorded in other comprehensive income, was \$14.9 million on a pre-tax basis.

The Company, through its direct holdings and its Small Business Investment subsidiaries, has numerous private equity investments, categorized as non-marketable securities in the accompanying consolidated balance sheets. These

investments are reported at fair value, and totaled \$55.2 million at September 30, 2010. Changes in fair value are reflected in current earnings, and reported in investment securities gains (losses), net in the consolidated income statements. Because there is no observable market data for these securities, their fair values are internally developed using available information and

management's judgment, and are classified as Level 3 measurements. Although management believes its estimates of fair value reasonably reflect the fair value of these securities, key assumptions regarding the projected financial performance of these companies, the evaluation of the investee company's management team, and other economic and market factors may affect the amounts that will ultimately be realized from these investments.

#### *Accounting for Income Taxes*

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

#### **Selected Financial Data**

|   | <b>Three Months<br/>Ended<br/>September 30</b> |        | <b>Nine Months<br/>Ended<br/>September 30</b> |         |
|---|--|--------|---|---------|
|   | <b>2010</b>                                    | 2009   | <b>2010</b>                                   | 2009    |
| <b>Per Share Data</b>                           |  |        |   |         |
| Net income per common share - basic             | \$ <b>.67</b>                                  | \$ .63 | \$ <b>1.92</b>                                | \$ 1.47 |
| Net income per common share - diluted           | <b>.67</b>                                     | .63    | <b>1.91</b>                                   | 1.47    |
| Cash dividends                                  | <b>.235</b>                                    | .229   | <b>.705</b>                                   | .686    |
| Book value                                      |  |        | <b>24.54</b>                                  | 22.33   |
| Market price                                    |  |        | <b>37.59</b>                                  | 35.47   |
| <b>Selected Ratios</b>                          |  |        |   |         |
| (Based on average balance sheets)               |  |        |   |         |
| Loans to deposits <sup>(1)</sup>                | <b>68.88%</b>                                  | 77.40% | <b>71.88%</b>                                 | 81.96%  |
| Non-interest bearing deposits to total deposits | <b>6.93</b>                                    | 6.33   | <b>6.85</b>                                   | 6.12    |
| Equity to loans <sup>(1)</sup>                  | <b>20.18</b>                                   | 16.62  | <b>19.17</b>                                  | 15.01   |
| Equity to deposits                              | <b>13.90</b>                                   | 12.86  | <b>13.78</b>                                  | 12.30   |
| Equity to total assets                          | <b>10.84</b>                                   | 10.13  | <b>10.81</b>                                  | 9.64    |
| Return on total assets                          | <b>1.19</b>                                    | 1.16   | <b>1.17</b>                                   | .91     |
| Return on total equity                          | <b>10.98</b>                                   | 11.49  | <b>10.85</b>                                  | 9.49    |
| (Based on end-of-period data)                   |  |        |   |         |
| Non-interest income to revenue <sup>(2)</sup>   | <b>38.44</b>                                   | 38.44  | <b>37.76</b>                                  | 38.36   |
| Efficiency ratio <sup>(3)</sup>                 | <b>59.51</b>                                   | 57.75  | <b>59.48</b>                                  | 60.76   |
| Tier I risk-based capital ratio                 |  |        | <b>14.27</b>                                  | 12.77   |
| Total risk-based capital ratio                  |  |        | <b>15.64</b>                                  | 14.14   |
| Tangible equity to assets ratio <sup>(4)</sup>  |  |        | <b>10.26</b>                                  | 9.60    |
| Tier I leverage ratio                           |  |        | <b>9.93</b>                                   | 9.65    |

- (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 equity ratio is calculated as stockholders' equity reduced by goodwill and other intangible assets (excluding mortgage servicing rights) divided by total assets reduced by goodwill and other intangible assets (excluding mortgage servicing rights).*

**Results of Operations****Summary**

| <i>(Dollars in thousands)</i>                | <b>Three Months Ended</b> |             |                 | <b>Nine Months Ended</b> |             |                 |
|--|---------------------------|-------------|-----------------|--------------------------|-------------|-----------------|
|  | <b>2010</b>               | <b>2009</b> | <b>% Change</b> | <b>2010</b>              | <b>2009</b> | <b>% Change</b> |
| Net interest income                          | \$ <b>159,437</b>         | \$ 163,539  | (2.5)%          | \$ <b>485,255</b>        | \$ 470,999  | 3.0%            |
| Provision for loan losses                    | <b>(21,844)</b>           | (35,361)    | (38.2)          | <b>(78,353)</b>          | (119,695)   | (34.5)          |
| Non-interest income                          | <b>99,543</b>             | 102,135     | (2.5)           | <b>294,442</b>           | 293,128     | .4              |
| Investment securities gains<br>(losses), net | <b>16</b>                 | (945)       | N.M.            | <b>(2,989)</b>           | (5,870)     | (49.1)          |
| Non-interest expense                         | <b>(155,119)</b>          | (154,489)   | .4              | <b>(466,888)</b>         | (467,386)   | (.1)            |
| Income taxes                                 | <b>(26,012)</b>           | (23,415)    | 11.1            | <b>(71,817)</b>          | (52,264)    | 37.4            |
| Non-controlling interest<br>(expense) income | <b>(136)</b>              | 185         | N.M.            | <b>139</b>               | 541         | (74.3)          |
| <b>Net income</b>                            | \$ <b>55,885</b>          | \$ 51,649   | 8.2%            | \$ <b>159,789</b>        | \$ 119,453  | 33.8%           |

For the quarter ended September 30, 2010, net income amounted to \$55.9 million, an increase of \$4.2 million, or 8.2%, compared to the third quarter of the previous year. For the current quarter, the annualized return on average assets was 1.19%, the annualized return on average equity was 10.98%, and the efficiency ratio was 59.41%. Diluted earnings per share was \$.67, an increase of 6.3% compared to \$.63 per share in the third quarter of 2009. Compared to the third quarter of last year, net interest income decreased \$4.1 million, or 2.5%, mainly due to lower rates earned on investment securities and lower loan balances, partly offset by higher investment security balances and lower rates paid on deposits. In addition, non-interest income decreased \$2.6 million, largely due to a \$6.1 million decrease in deposit account fees. This reduction occurred as the Company implemented new regulations on July 1, 2010 which limited overdraft fees on debit card transactions. The effect was partly offset by increases in bank card and trust fees. Compared to the same period last year, non-interest expense increased \$630 thousand, or .4%, due mainly to a \$1.3 million increase in data processing and software expense and the reversal in the previous period of \$2.5 million of Visa litigation expense, partly offset by declines of \$1.8 million in salaries and benefits expense and \$1.3 million in supplies and communication costs. The provision for loan losses totaled \$21.8 million for the current quarter, representing a decrease of \$13.5 million from the third quarter of 2009.

Net income for the first nine months of 2010 was \$159.8 million, an increase of \$40.3 million, or 33.8%, over the same period in the previous year. For the first nine months of 2010, the annualized return on average assets was 1.17%, the annualized return on average equity was 10.85%, and the efficiency ratio was 59.48%. Diluted earnings per share was \$1.91, an increase of 29.9% over \$1.47 per share in the same period last year. Compared to the first nine months of 2009, net interest income grew \$14.3 million, or 3.0%. Non-interest income grew \$1.3 million, or .4%, largely due to an increase of \$19.3 million in bank card transaction fees and \$2.4 million in trust fees, which were partially offset by declines in deposit account fees, bond trading income, consumer brokerage services, and loan fees



and sales. Non-interest expense remained well-controlled, declining \$498 thousand compared to the same period last year. The provision for loan losses totaled \$78.4 million, down \$41.3 million, or 34.5%, compared to the same period last year.

**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**

| <i>(In thousands)</i>   | <b>Three Months Ended<br/>September 30, 2010 vs. 2009</b> |                         |                 | <b>Nine Months Ended<br/>September 30, 2010 vs. 2009</b> |                         |                 |
|---|---|-------------------------|-----------------|--|-------------------------|-----------------|
|   | <b>Change due to<br/>Average<br/>Volume</b>               | <b>Average<br/>Rate</b> | <b>Total</b>    | <b>Change due to<br/>Average<br/>Volume</b>              | <b>Average<br/>Rate</b> | <b>Total</b>    |
| <b>Interest income, fully taxable equivalent basis:</b>                           |   |                         |                 |  |                         |                 |
| Loans   | \$ (8,545)  | \$ (3,587)              | \$ (12,132)     | \$ (31,890)  | \$ (4,084)              | \$ (35,974)     |
| Loans held for sale   | 56  | (133)                   | (77)            | 403  | (1,710)                 | (1,307)         |
| Investment securities:  |   |                         |                 |  |                         |                 |
| U.S. government and federal agency securities                                     | 2,927   | (5,138)                 | (2,211)         | 12,299   | (8,677)                 | 3,622           |
| State and municipal obligations   | 935   | (1,106)                 | (171)           | 2,696  | (2,088)                 | 608             |
| Mortgage and asset-backed securities  | 9,535   | (18,779)                | (9,244)         | 31,879   | (41,219)                | (9,340)         |
| Other securities  | (438)   | 1,201                   | 763             | (352)  | 1,028                   | 676             |
| <b>Total interest on investment securities</b>                                    | <b>12,959</b>   | <b>(23,822)</b>         | <b>(10,863)</b> | <b>46,522</b>  | <b>(50,956)</b>         | <b>(4,434)</b>  |
| Short-term federal funds sold and securities purchased under agreements to resell | (43)  | 3                       | (40)            | (217)  | 55                      | (162)           |
| Long-term securities purchased under agreements to resell                         | 862   |                         | 862             | 862  |                         | 862             |
| Interest earning deposits with banks  | (19)  | 5                       | (14)            | (257)  | 7                       | (250)           |
| <b>Total interest income</b>  | <b>5,270</b>  | <b>(27,534)</b>         | <b>(22,264)</b> | <b>15,423</b>  | <b>(56,688)</b>         | <b>(41,265)</b> |
| <b>Interest expense:</b>  |   |                         |                 |  |                         |                 |
| Deposits:   |   |                         |                 |  |                         |                 |
| Savings   | 15  | 14                      | 29              | 45   | (88)                    | (43)            |
| Interest checking and money market  | 9,280   | (9,743)                 | (463)           | 4,494  | (6,109)                 | (1,615)         |
|   | (2,415)   | (5,626)                 | (8,041)         | (7,016)  | (17,443)                | (24,459)        |

|  |                 |                   |                   |                  |                    |                  |
|--|-----------------|-------------------|-------------------|------------------|--------------------|------------------|
| Time open & C.D. s of less than \$100,000                                  |                 |                   |                   |                  |                    |                  |
| Time open & C.D. s of \$100,000 and over                                   | (1,000)         | (3,970)           | (4,970)           | (6,394)          | (12,306)           | (18,700)         |
| <b>Total interest on deposits</b>  | <b>5,880</b>    | <b>(19,325)</b>   | <b>(13,445)</b>   | <b>(8,871)</b>   | <b>(35,946)</b>    | <b>(44,817)</b>  |
| Federal funds purchased and securities sold under agreements to repurchase | 44              | (276)             | (232)             | 283              | (948)              | (665)            |
| Other borrowings   | (4,450)         | (502)             | (4,952)           | (10,047)         | (1,196)            | (11,243)         |
| <b>Total interest expense</b>  | <b>1,474</b>    | <b>(20,103)</b>   | <b>(18,629)</b>   | <b>(18,635)</b>  | <b>(38,090)</b>    | <b>(56,725)</b>  |
| <b>Net interest income, fully taxable equivalent basis</b>                 | <b>\$ 3,796</b> | <b>\$ (7,431)</b> | <b>\$ (3,635)</b> | <b>\$ 34,058</b> | <b>\$ (18,598)</b> | <b>\$ 15,460</b> |

Net interest income for the third quarter of 2010 was \$159.4 million, a \$4.1 million, or 2.5%, decrease from the third quarter of 2009. The decrease in net interest income was primarily the result of lower average rates earned on loans and investment securities, in addition to lower average loan balances, which were partly offset by higher average balances of investment securities and lower interest expense on deposits and borrowings. The Company's tax equivalent net interest rate margin was 3.75% for the third quarter of 2010 compared to 4.02% in the third quarter of 2009.

Total interest income, on a tax equivalent basis (T/E), decreased \$22.3 million, or 10.8%, from the third quarter of 2009. Interest income on loans (T/E) declined \$12.1 million, due to a decrease of \$738.0 million, or 7.1%, in average loan balances coupled with a 10 basis point decrease in average rates earned. The decrease in average loans compared to the third quarter of 2009 occurred in all categories except consumer credit cards, as loan demand remained weak. Interest income from consumer loans, which consist mainly of automobile and marine and recreational vehicle (RV) loans, decreased from the third quarter of 2009 due to a decline of 13.3%, or \$189.8 million, in average consumer loans coupled with a 34 basis point decrease in

average rates earned. Included in the decrease in average consumer loan balances was a decline in marine and RV loans of \$141.8 million, as loan pay-downs exceeded new loan originations. Average business loans decreased \$101.2 million and average business real estate loans decreased \$148.6 million compared to the third quarter of 2009. Additionally, average construction loan balances decreased \$168.4 million and average personal real estate loan balances decreased \$127.0 million compared to third quarter 2009. Average credit card balances increased 4.7%, or \$34.4 million compared to the same quarter of 2009, and is reflective of increased card usage and continued marketing efforts to attract new balances. Interest income on investment securities (T/E) decreased \$10.9 million, or 16.6%, from the third quarter of 2009. This decrease resulted mainly from a 153 basis point decline in average rates earned, partly offset by a \$1.4 billion, or 25.1%, increase in average balances. The average yield on the investment portfolio declined to 3.05% in the current quarter compared to 4.58% in the third quarter of 2009, reducing tax equivalent interest income by \$23.8 million. Most of the offsetting growth in average balances occurred in mortgage and asset-backed securities and U.S. government and federal agency securities, which increased by \$1.1 billion and \$259.8 million, respectively. During the current quarter, the Company acquired \$550 million (par value) of agency mortgage-backed securities on a forward delivery basis in the TBA market. This was done as part of asset/liability strategies to lock in higher rates; however, interest was not earned on these securities for part of the quarter. The effect of this transaction was to reduce interest income approximately \$1.9 million this quarter, but it allows the Company to earn higher rates in future quarters. The Company also holds U.S. Treasury inflation-protected securities, which had a book value of \$425.4 million at September 30, 2010. During the current quarter, there was virtually no inflation-adjusted income earned on these bonds, compared to \$2.6 million earned in the second quarter of 2010. The estimated effect of the lower inflation income coupled with the purchase of the TBA securities was to lower the average yield on total earning assets in the current quarter by 10 basis points. The resulting average tax equivalent yield on total interest earning assets was 4.19% in the third quarter of 2010 compared to 4.93% in the third quarter of 2009.

Total interest expense decreased \$18.6 million, or 48.9%, compared to the third quarter of 2009, primarily due to a \$13.0 million decline in interest expense on certificates of deposit, coupled with a \$5.0 million decrease in interest expense on other borrowings. The decline in interest expense on certificates of deposit resulted from a 122 basis point decrease in average rates paid on certificates of deposit less than \$100,000 and a 90 basis point decrease in average rates paid on certificates of deposit greater than \$100,000, coupled with a decrease of \$833.8 thousand, or 21.4%, in total average certificate of deposit balances. Interest checking and money market average balances increased \$1.3 billion, or 15.3%. The impact of this growth was offset by a 7 basis point decrease in average rates paid on these deposits. Interest expense on other borrowings declined mainly due to lower FHLB advances, which declined \$469.1 million, or 57.8%. The overall average rate incurred on all interest bearing liabilities decreased to .52% in the third quarter of 2010 compared to 1.02% in the third quarter of 2009.

Net interest income for the first nine months of 2010 was \$485.3 million compared to \$471.0 million for the same period in 2009. For the first nine months of 2010, the net yield on total interest earning assets on a tax equivalent basis was 3.91% compared to 3.92% in the first nine months of 2009. The increase in net interest income in the first nine months in 2010 compared to the same period in 2009 was primarily the result of lower interest expense on interest bearing deposits and other borrowings due to lower average rates and balances, which were partially offset by lower earnings on the loan and investment securities portfolios. Interest expense decreased \$56.7 million, or 45.9%, which was partially offset by a decrease in interest income (T/E) of \$41.3 million, or 6.8%.

Total interest income (T/E) for the first nine months of 2010 decreased from the same period last year primarily due to lower interest earned on the loan and investment securities portfolios. Loan interest income (T/E) declined \$36.0 million, largely due to a \$969.8 million, or 9.0%, decline in total average loan balances. As noted in the quarterly comparison above, declines occurred in all loan categories except consumer credit card loans. Investment securities interest income (T/E) decreased \$4.4 million and resulted from a 128 basis point decrease in average rates earned, partially offset by an increase in investment securities average balances of \$1.6 billion, or 33.2%.



The decrease of \$56.7 million in interest expense for the nine months of 2010 compared to the same period in the prior year was primarily due to a decrease of 48 basis points in the average rate incurred on total interest bearing deposits coupled with a decrease in average interest bearing liabilities. Average certificates of deposit balances decreased \$1.0 billion. Additionally, average balances of other borrowings, which is mostly comprised of FHLB borrowings, decreased \$442.4 million, or 45.6%, contributing to the lower interest expense. For the first nine months of 2010, the overall cost of interest bearing liabilities decreased 52 basis points to .60%, compared to 1.12% in the same period in the prior year.

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

### Non-Interest Income

| <i>(Dollars in thousands)</i>                | Three Months Ended September 30 |                   |               | Nine Months Ended September 30 |                   |             |
|--|---------------------------------|-------------------|---------------|--------------------------------|-------------------|-------------|
|  | 2010                            | 2009              | %<br>Change   | 2010                           | 2009              | %<br>Change |
| Bank card transaction fees                   | \$ 37,723                       | \$ 31,279         | 20.6%         | \$ 107,872                     | \$ 88,552         | 21.8%       |
| Deposit account charges and other fees       | 21,693                          | 27,750            | (21.8)        | 71,146                         | 80,277            | (11.4)      |
| Trust fees                                   | 20,170                          | 19,258            | 4.7           | 59,846                         | 57,486            | 4.1         |
| Bond trading income                          | 5,133                           | 5,187             | (1.0)         | 15,524                         | 17,529            | (11.4)      |
| Consumer brokerage services                  | 2,390                           | 2,692             | (11.2)        | 6,879                          | 8,418             | (18.3)      |
| Loan fees and sales                          | 5,830                           | 6,851             | (14.9)        | 11,141                         | 13,545            | (17.7)      |
| Other  | 6,604                           | 9,118             | (27.6)        | 22,034                         | 27,321            | (19.4)      |
| <b>Total non-interest income</b>             | <b>\$ 99,543</b>                | <b>\$ 102,135</b> | <b>(2.5)%</b> | <b>\$ 294,442</b>              | <b>\$ 293,128</b> | <b>.4%</b>  |
| Non-interest income as a % of total revenue* | <b>38.4%</b>                    | 38.4%             |               | <b>37.8%</b>                   | 38.4%             |             |

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

For the third quarter of 2010, total non-interest income amounted to \$99.5 million compared with \$102.1 million in the same quarter last year, which was a decrease of \$2.6 million, or 2.5%. Bank card fees for the quarter increased \$6.4 million, or 20.6%, over the third quarter of last year, primarily due to continued growth in transaction fees earned on corporate card, debit card and merchant activity, which grew by 44.8%, 13.6% and 13.7%, respectively. The growth in corporate card fees continued to result from both new customer transactions and increased volumes from existing customers. Debit card fees in the current quarter comprised 38.6% of total bank card fees, while corporate card fees comprised 33.0% of total fees. Trust fees for the quarter increased \$912 thousand, or 4.7%, over the same

quarter last year and resulted from growth in both personal and institutional trust business, but continued to be negatively affected by low interest rates on money market investments held in trust accounts. Deposit account fees declined \$6.1 million, or 21.8%, from the same period last year as a result of a \$6.0 million decline in overdraft fee income. The lower overdraft fees resulted from the Company's implementation on July 1, 2010 of new overdraft regulations on debit card transactions. Corporate cash management fees, which comprised 37.8% of total deposit account fees in the current quarter, declined 5.0% compared to the same period in the previous year. Bond trading income for the current quarter totaled \$5.1 million, a decrease of 1.0% from the same period last year. Consumer brokerage services revenue decreased \$302 thousand, or 11.2%, mainly due to a 39.1% decline in money market mutual fund fees. Loan fees and sales revenue totaled \$5.8 million this quarter, down \$1.0 million compared to the same quarter last year. The current quarter included gains of \$3.7 million on sales of \$246 million of student loans, compared to gains of \$4.4 million in the same quarter last year, coupled with lower loan commitment fees. Other non-interest income for the current quarter decreased \$2.5 million, or 27.6%, from the same quarter last year, partly due to retirement losses on fixed assets no longer in use, in addition to declines in tax credit sales income and equipment rental income.

Non-interest income for the nine months ended September 30, 2010 was \$294.4 million compared to \$293.1 million in the first nine months of 2009, resulting in an increase of \$1.3 million, or .4%. Bank card fees

increased \$19.3 million, or 21.8%, due to growth of 52.4%, 13.3%, and 12.6% in corporate card, debit card, and merchant fees, respectively. Deposit account fees decreased \$9.1 million, or 11.4%, due to an 18.0% decline in overdraft fee revenue. Trust fee income increased \$2.4 million as a result of growth in personal and institutional trust fees, offset by lower corporate fees. Consumer brokerage revenue declined \$1.5 million, or 18.3%, mainly due to lower mutual fund fees. Bond trading income declined \$2.0 million, or 11.4%, due to lower sales volume, while loan fees and sales decreased by \$2.4 million, largely due to a \$2.3 million decline in gains on student loan sales. Other non-interest income decreased \$5.3 million partly due to an impairment charge of \$969 thousand on an office building held for sale, coupled with other fixed asset retirement losses. Also included were declines in cash sweep commissions and equipment rental income, partially offset by higher letters of credit fees.

### Investment Securities Gains (Losses), Net

Net gains and losses on investment securities which were recognized in earnings during the three and nine months ended September 30, 2010 and 2009 are shown in the table below. Net securities gains of \$16 thousand were recorded in the third quarter of 2010, while net securities losses of \$3.0 million were recorded in the first nine months of 2010. Included in these gains and losses are credit-related impairment losses on certain non-agency guaranteed mortgage-backed securities which have been identified as other than temporarily impaired. These identified securities had a total par value of \$197.5 million at September 30, 2010. During the current quarter, additional credit-related impairment losses of \$2.0 million were recorded, bringing the total credit-related impairment losses during the first nine months of 2010 to \$4.2 million. The cumulative credit-related impairment loss on these securities, recorded in earnings, amounted to \$6.7 million, while the cumulative noncredit-related loss on these securities, which has been recorded in other comprehensive income (loss), was \$14.9 million. Also shown below are net gains and losses relating to non-marketable private equity investments, which are primarily held by the Parent's majority-owned venture capital subsidiaries. These include fair value adjustments, in addition to gains and losses realized upon disposition. The portion of this activity attributable to minority interests is reported as non-controlling interest in the consolidated income statements, resulting in income of \$302 thousand for the first nine months of 2010 and \$865 thousand for the same period last year.

| <i>(In thousands)</i>                                  | <b>Three Months</b>       |                 | <b>Nine Months</b>        |                   |
|--|---------------------------|-----------------|---------------------------|-------------------|
|  | <b>Ended September 30</b> |                 | <b>Ended September 30</b> |                   |
|  | <b>2010</b>               | <b>2009</b>     | <b>2010</b>               | <b>2009</b>       |
| <b>Available for sale:</b>                             |                           |                 |                           |                   |
| Municipal bonds  | \$ 280                    | \$ (23)         | \$ 1,168                  | \$ (23)           |
| Corporate bonds  |                           |                 | 498                       | (11)              |
| Agency mortgage-backed bonds                           | 484                       |                 | 484                       |                   |
| Non-agency mortgage-backed bonds                       |                           |                 | 383                       |                   |
| Other asset-backed bonds                               |                           |                 |                           | 75                |
| OTTI losses on non-agency mortgage-backed bonds        | (2,045)                   | (1,464)         | (4,178)                   | (2,811)           |
| <b>Non-marketable:</b>                                 |                           |                 |                           |                   |
| Private equity investments                             | 1,297                     | 542             | (1,344)                   | (3,100)           |
| <b>Total investment securities gains (losses), net</b> | <b>\$ 16</b>              | <b>\$ (945)</b> | <b>\$ (2,989)</b>         | <b>\$ (5,870)</b> |





**Non-Interest Expense**

| <i>(Dollars in thousands)</i>     | <b>Three Months Ended<br/>September 30</b> |            |                    | <b>Nine Months Ended September 30</b> |            |                    |
|-----------------------------------|--|------------|--------------------|---------------------------------------|------------|--------------------|
|                                   | <b>2010</b>                                | 2009       | <i>%</i><br>Change | <b>2010</b>                           | 2009       | <i>%</i><br>Change |
| Salaries and employee benefits    | \$ <b>85,442</b>                           | \$ 87,267  | (2.1)%             | \$ <b>259,988</b>                     | \$ 260,299 | (.1)%              |
| Net occupancy                     | <b>12,086</b>                              | 11,752     | 2.8                | <b>35,697</b>                         | 34,652     | 3.0                |
| Equipment                         | <b>5,709</b>                               | 6,306      | (9.5)              | <b>17,548</b>                         | 18,883     | (7.1)              |
| Supplies and communication        | <b>6,724</b>                               | 8,061      | (16.6)             | <b>20,891</b>                         | 24,994     | (16.4)             |
| Data processing and software      | <b>16,833</b>                              | 15,500     | 8.6                | <b>50,936</b>                         | 44,854     | 13.6               |
| Marketing                         | <b>5,064</b>                               | 4,846      | 4.5                | <b>14,784</b>                         | 14,099     | 4.9                |
| Deposit insurance                 | <b>4,756</b>                               | 4,833      | (1.6)              | <b>14,445</b>                         | 21,908     | (34.1)             |
| Indemnification obligation        |  | (2,496)    | N.M.               | <b>(1,683)</b>                        | (2,496)    | (32.6)             |
| Other                             | <b>18,505</b>                              | 18,420     | .5                 | <b>54,282</b>                         | 50,193     | 8.1                |
| <b>Total non-interest expense</b> | <b>\$ 155,119</b>                          | \$ 154,489 | .4%                | <b>\$ 466,888</b>                     | \$ 467,386 | (.1)%              |

Non-interest expense for the third quarter of 2010 amounted to \$155.1 million, an increase of \$630 thousand, or .4%, compared with \$154.5 million recorded in the third quarter of last year. Salaries and benefits expense was well controlled in the current quarter, decreasing \$1.8 million, or 2.1%, from the same quarter last year, mainly due to lower salaries, pension and 401K plan expense, and medical claims costs. Full-time equivalent employees totaled 5,011 at September 30, 2010 compared to 5,148 at September 30, 2009. Occupancy costs increased \$334 thousand, or 2.8%, over the same quarter last year, primarily due to higher utilities expense. Equipment expense decreased \$597 thousand, or 9.5%, from the same quarter last year due to lower depreciation expense on data processing equipment. Supplies and communication expense declined \$1.3 million, or 16.6%, due to lower supplies, postage and courier costs, while marketing costs increased 4.5% over the same period last year. Data processing and software costs increased \$1.3 million, or 8.6%, mainly as a result of higher bank card processing costs (related to higher bank card revenues). FDIC insurance expense totaled \$4.8 million, a decrease of \$77 thousand from the same period last year. The indemnification obligation related to Visa litigation is reduced whenever Visa makes a contribution to its escrow account, which occurred in the third quarter of 2009 and resulted in a reversal of \$2.5 million. A contribution was also made in the second quarter of 2010, resulting in a \$1.7 million reversal. Other non-interest expense increased slightly over the same quarter last year due to higher write-downs and holding costs on foreclosed real estate and personal property, partly offset by a decline in operating losses.

For the first nine months of 2010, non-interest expense amounted to \$466.9 million, a decrease of \$498 thousand, or .1%, compared with \$467.4 million in the same period last year. Salaries and benefits expense declined by \$311 thousand overall, largely due to lower health care costs and pension plan expense. These declines were partly offset by higher 401K plan expense and a .4% increase in total salaries expense, mainly due to higher incentive compensation. Occupancy costs increased \$1.0 million, or 3.0%, primarily resulting from higher real estate taxes and utilities expense. Equipment costs decreased \$1.3 million mainly due to lower depreciation on data processing equipment. Supplies and communication expense declined \$4.1 million, or 16.4%, due to lower courier and supplies costs. Data

processing and software costs grew \$6.1 million, primarily due to higher bank card processing costs and higher student loan servicing costs. Deposit insurance decreased \$7.5 million mainly due to a special assessment levied by the FDIC in 2009 which did not reoccur in 2010. Other non-interest expense increased \$4.1 million and included higher write-downs and other expenses on foreclosed property, legal and professional fees, and bank card related expenses. These increases to expense were partially offset by lower operating losses.

**Provision and Allowance for Loan Losses**

| <i>(In thousands)</i>              | <b>Three Months Ended</b> |                 |                  | <b>Nine Months Ended</b>     |            |
|------------------------------------|---------------------------|-----------------|------------------|------------------------------|------------|
|                                    | <b>Sept. 30<br/>2010</b>  | June 30<br>2010 | Sept. 30<br>2009 | <b>September 30<br/>2010</b> | 2009       |
| <b>Provision for loan losses</b>   | <b>\$ 21,844</b>          | \$ 22,187       | \$ 35,361        | <b>\$ 78,353</b>             | \$ 119,695 |
| Net loan charge-offs (recoveries): |                           |                 |                  |                              |            |
| Business                           | <b>582</b>                | 2,223           | 4,626            | <b>3,072</b>                 | 10,846     |
| Real estate-construction and land  | <b>1,971</b>              | 480             | 4,463            | <b>13,417</b>                | 24,062     |
| Real estate-business               | <b>776</b>                | 1,022           | 1,253            | <b>2,229</b>                 | 3,062      |
| Consumer credit card               | <b>12,592</b>             | 12,338          | 12,577           | <b>37,995</b>                | 36,554     |
| Consumer                           | <b>4,912</b>              | 4,743           | 6,522            | <b>15,179</b>                | 24,331     |
| Revolving home equity              | <b>276</b>                | 650             | 233              | <b>1,506</b>                 | 629        |
| Student                            | <b>2</b>                  |                 | 2                | <b>5</b>                     | 4          |
| Real estate-personal               | <b>379</b>                | 515             | 797              | <b>1,095</b>                 | 1,557      |
| Overdrafts                         | <b>354</b>                | 216             | 423              | <b>797</b>                   | 803        |
| <b>Total net loan charge-offs</b>  | <b>\$ 21,844</b>          | \$ 22,187       | \$ 30,896        | <b>\$ 75,295</b>             | \$ 101,848 |

|  | <b>Three Months Ended</b> |                 |                  | <b>Nine Months Ended</b>     |       |
|--|---------------------------|-----------------|------------------|------------------------------|-------|
|  | <b>Sept. 30<br/>2010</b>  | June 30<br>2010 | Sept. 30<br>2009 | <b>September 30<br/>2010</b> | 2009  |
| Annualized net loan charge-offs*:            |                           |                 |                  |                              |       |
| Business                                     | <b>.08%</b>               | .31%            | .61%             | <b>.14%</b>                  | .45%  |
| Real estate-construction and land            | <b>1.47</b>               | .34             | 2.53             | <b>3.11</b>                  | 4.26  |
| Real estate-business                         | <b>.15</b>                | .20             | .23              | <b>.15</b>                   | .19   |
| Consumer credit card                         | <b>6.55</b>               | 6.71            | 6.85             | <b>6.73</b>                  | 6.79  |
| Consumer                                     | <b>1.58</b>               | 1.50            | 1.82             | <b>1.60</b>                  | 2.17  |
| Revolving home equity                        | <b>.23</b>                | .54             | .19              | <b>.41</b>                   | .17   |
| Real estate-personal                         | <b>.10</b>                | .14             | .20              | <b>.10</b>                   | .13   |
| Overdrafts                                   | <b>21.07</b>              | 12.71           | 14.87            | <b>15.17</b>                 | 11.38 |
| <b>Total annualized net loan charge-offs</b> | <b>.89%</b>               | .91%            | 1.17%            | <b>1.03%</b>                 | 1.26% |

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

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

Loans subject to individual evaluation are all classified as impaired, and generally consist of business, construction, commercial real estate and personal real estate loans on non-accrual status. These loans are evaluated individually for impairment, and in conjunction with current economic conditions and loss experience, allowances are estimated. Loans not individually evaluated are aggregated and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic factors, loan risk ratings and industry concentrations. Restructured loans whose terms have been modified and classified as troubled debt restructurings, and which are performing under those modified terms, are classified as impaired and also aggregated for impairment evaluation.

In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The process of

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

Net loan charge-offs for the third quarter of 2010 amounted to \$21.8 million, compared with \$22.2 million in the prior quarter and \$30.9 million in the third quarter of last year. The \$343 thousand decrease in net loan charge-offs in the third quarter of 2010 compared to the previous quarter was mainly the result of lower business, business real estate and revolving home equity loan losses, but offset by an increase in construction loan losses of \$1.5 million. The \$9.1 million decrease in net loan charge-offs in the third quarter of 2010 compared to the same quarter in 2009 was mainly the result of lower loan losses on business loans of \$4.0 million, construction loans of \$2.5 million, and consumer loans of \$1.6 million. The ratio of annualized total net loan charge-offs to total average loans was .89% in the current quarter, compared to .91% in the previous quarter and 1.17% in the same quarter last year.

For the third quarter of 2010, annualized net charge-offs on average consumer credit card loans amounted to 6.55%, compared with 6.71% in the previous quarter and 6.85% in the same period last year. Consumer loan net charge-offs for the quarter amounted to 1.58% of average consumer loans, compared to 1.50% in the previous quarter and 1.82% in the same quarter last year.

The provision for loan losses for the current quarter totaled \$21.8 million, matching net loan charge-offs for the quarter. The current quarter provision was \$343 thousand lower than the previous quarter and \$13.5 million lower than the same quarter last year. The amount of the provision in each quarter was determined by management's review and analysis of the adequacy of the allowance for loan losses, involving all the activities and factors described above regarding that process. The provision in the current quarter was influenced by improved asset quality and lower overall loan balances.

Net charge-offs during the first nine months of 2010 were \$75.3 million compared to \$101.8 million in the same period of 2009. The \$26.6 million decrease was due to declines in net charge-offs of business loans of \$7.8 million, construction loans of \$10.6 million and consumer loans of \$9.2 million. The decreases were slightly offset by an increase in net charge-offs of consumer credit card loans of \$1.4 million and revolving home equity loans of \$877 thousand. The provision for loan losses was \$78.4 million in the first nine months of 2010 compared to \$119.7 million in the same period in 2009.

The allowance for loan losses at September 30, 2010 totaled \$197.5 million, and was unchanged from the previous quarter. At September 30, 2010, the allowance was 2.04% of total loans, excluding loans held for sale, and 220% of total non-accrual loans. The Company considers the allowance for loan losses adequate to cover losses inherent in the loan portfolio at September 30, 2010.

**Risk Elements of Loan Portfolio**

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

| <i>(Dollars in thousands)</i>                                   | <b>September 30<br/>2010</b> | December 31<br>2009 |
|---|------------------------------|---------------------|
| Non-accrual loans:  |                              |                     |
| Business  | \$ 11,242                    | \$ 12,874           |
| Real estate construction and land                               | 53,106                       | 62,509              |
| Real estate business  | 17,886                       | 21,756              |
| Real estate personal  | 7,375                        | 9,384               |
| Consumer  |                              | 90                  |
| <b>Total non-accrual loans</b>                                  | <b>89,609</b>                | 106,613             |
| <b>Foreclosed real estate</b>                                   | <b>12,539</b>                | 10,057              |
| <b>Total non-performing assets</b>                              | <b>\$ 102,148</b>            | \$ 116,670          |
| Non-performing assets as a percentage of total loans            | <b>1.05%</b>                 | 1.15%               |
| Non-performing assets as a percentage of total assets           | <b>.54%</b>                  | .64%                |
| Loans past due 90 days and still accruing interest:             |                              |                     |
| Business  | \$ 2,598                     | \$ 3,672            |
| Real estate construction and land                               | 712                          | 1,184               |
| Real estate business  | 206                          | 402                 |
| Real estate personal  | 4,261                        | 3,102               |
| Consumer  | 1,956                        | 2,045               |
| Revolving home equity   | 804                          | 878                 |
| Student   | 19,949                       | 14,346              |
| Consumer credit card  | 12,237                       | 17,003              |
| <b>Total loans past due 90 days and still accruing interest</b> | <b>\$ 42,723</b>             | \$ 42,632           |

Non-accrual loans, which are also considered to be impaired, totaled \$89.6 million at September 30, 2010, and decreased \$17.0 million from amounts recorded at December 31, 2009. The decline from December 31, 2009 occurred mainly in construction and land real estate and business real estate non-accrual loans, which decreased \$9.4 million and \$3.9 million, respectively. At September 30, 2010, non-accrual loans were comprised mainly of construction and land real estate loans (59.3%), business real estate loans (20.0%) and business loans (12.5%). Foreclosed real estate increased \$2.5 million to a balance of \$12.5 million at September 30, 2010.

Total loans past due 90 days or more and still accruing interest amounted to \$42.7 million as of September 30, 2010, which included \$19.9 million in federally guaranteed student loans. The balance of loans 90 days past due or more increased slightly when compared to December 31, 2009, resulting mainly from increases of \$5.6 million in student and \$1.2 million in personal real estate loan delinquencies, offset by decreases of \$4.8 million and \$1.1 million in consumer credit card and business loan delinquencies, respectively.



In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. They are primarily classified as substandard under the Company's internal rating system. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, they may never become non-performing. Such loans totaled \$264.7 million at September 30, 2010 compared with \$319.9 million at December 31, 2009, resulting in a decrease of \$55.2 million, or 17.3%. The decrease was largely due to a \$49.0 million decline in construction and land real estate loans.

| <i>(In thousands)</i>                | <b>September 30<br/>2010</b> | December 31<br>2009 |
|--------------------------------------|------------------------------|---------------------|
| Potential problem loans:             |                              |                     |
| Business                             | \$ 92,521                    | \$ 93,256           |
| Real estate - construction and land  | <b>66,260</b>                | 115,251             |
| Real estate - business               | <b>97,535</b>                | 98,951              |
| Real estate - personal               | <b>8,188</b>                 | 12,013              |
| Consumer                             | <b>175</b>                   | 409                 |
| <b>Total potential problem loans</b> | <b>\$ 264,679</b>            | <b>\$ 319,880</b>   |

At September 30, 2010, the Company had identified approximately \$114.3 million of loans whose terms have been modified or restructured under a troubled debt restructuring. These loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession, as defined by accounting guidance. Of this balance, \$32.0 million have been placed on non-accrual status. Of the remaining \$82.3 million, approximately \$68.0 million were commercial loans (business, construction and business real estate) classified as substandard, which were renewed at interest rates equal to or higher than the previous rates in effect. The new rates, however, were not judged to be market rates for new debt with similar risk. These loans are performing under their modified terms and the Company believes it probable that all amounts due under the modified terms of the agreements will be collected. However, because of their substandard classification, they are included as potential problem loans in the table above. An additional \$14.3 million in troubled debt restructurings were composed of certain credit card loans under various debt management and assistance programs.

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

*Real Estate Construction and Land Loans*

The Company's portfolio of construction loans, as shown in the table below, amounted to 5.4% of total loans outstanding at September 30, 2010. Balances in this portfolio decreased \$141.4 million, or 21.3%, since December 31, 2009, which was mainly a reflection of the slower economy. Also contributing to the decline in balances were \$13.4 million in net loan charge offs during the first nine months of 2010, most of which occurred in the first quarter.

| <i>(In thousands)</i>                                | <b>September 30<br/>2010</b> | <b>% of<br/>Total</b> | <b>% of<br/>Total<br/>Loans</b> | December 31<br>2009 | <b>% of<br/>Total</b> | <b>% of<br/>Total<br/>Loans</b> |
|--|------------------------------|-----------------------|---------------------------------|---------------------|-----------------------|---------------------------------|
| Residential land and land development                | \$ 126,976                   | 24.2%                 | 1.3%                            | \$ 181,257          | 27.2%                 | 1.8%                            |
| Residential construction                             | 90,319                       | 17.2                  | 1.0                             | 110,165             | 16.6                  | 1.1                             |
| Commercial land and land development                 | 118,670                      | 22.7                  | 1.2                             | 144,880             | 21.8                  | 1.4                             |
| Commercial construction                              | 187,784                      | 35.9                  | 1.9                             | 228,808             | 34.4                  | 2.3                             |
| <b>Total real estate construction and land loans</b> | <b>\$ 523,749</b>            | <b>100.0%</b>         | <b>5.4%</b>                     | <b>\$ 665,110</b>   | <b>100.0%</b>         | <b>6.6%</b>                     |

*Real Estate Business Loans*

Total business real estate loans were \$2.0 billion at September 30, 2010 and comprised 20.5% of the Company's total loan portfolio. These loans include properties such as manufacturing and warehouse buildings, small office and medical buildings, churches, hotels and motels, shopping centers, and other commercial properties. Approximately 50% of these loans were for owner-occupied real estate properties, which present lower risk profiles.

| <i>(In thousands)</i> | <b>September 30<br/>2010</b> | <b>% of<br/>Total</b> | <b>% of<br/>Total<br/>Loans</b> | December 31<br>2009 | <b>% of<br/>Total</b> | <b>% of<br/>Total<br/>Loans</b> |
|-----------------------|------------------------------|-----------------------|---------------------------------|---------------------|-----------------------|---------------------------------|
| Owner-occupied        | \$ 989,922                   | 49.8%                 | 10.2%                           | \$ 1,101,870        | 52.4%                 | 10.9%                           |
| Office                | 255,614                      | 12.9                  | 2.6                             | 214,408             | 10.2                  | 2.1                             |
| Retail                | 197,168                      | 9.9                   | 2.0                             | 210,619             | 10.0                  | 2.1                             |
| Multi-family          | 137,601                      | 6.9                   | 1.4                             | 112,664             | 5.3                   | 1.1                             |
| Farm                  | 121,401                      | 6.1                   | 1.3                             | 131,245             | 6.2                   | 1.3                             |
| Hotels                | 103,316                      | 5.2                   | 1.1                             | 115,056             | 5.5                   | 1.1                             |

|                          |                     |               |              |                     |               |              |
|--------------------------|---------------------|---------------|--------------|---------------------|---------------|--------------|
| Industrial               | <b>95,405</b>       | <b>4.8</b>    | <b>1.0</b>   | 142,745             | 6.8           | 1.4          |
| Other                    | <b>88,219</b>       | <b>4.4</b>    | <b>.9</b>    | 75,423              | 3.6           | .7           |
| <b>Total real estate</b> |                     |               |              |                     |               |              |
| <b>business</b>          |                     |               |              |                     |               |              |
| <b>loans</b>             | <b>\$ 1,988,646</b> | <b>100.0%</b> | <b>20.5%</b> | <b>\$ 2,104,030</b> | <b>100.0%</b> | <b>20.7%</b> |

*Real Estate Personal Loans*

The Company's \$1.4 billion personal real estate loan portfolio is composed of loans collateralized with residential real estate. Approximately \$20.2 million of these loans were structured with interest only payments. These loans were mainly made to high net-worth borrowers and generally have low LTV ratios or have additional collateral pledged to secure the loan and, therefore, they are not perceived to represent above normal credit risk. At September 30, 2010, the Company had loans totaling \$162.0 million with no mortgage insurance that also have an LTV greater than 80%, compared to \$182.8 million at December 31, 2009. The decrease was mainly due to increased customer refinancings.

### *Revolving Home Equity Loans*

The Company also has \$486.7 million in revolving home equity loans at September 30, 2010, that are generally collateralized by residential real estate. Most of these loans (95.5%) are written with terms requiring interest only monthly payments. These loans are offered in three main product lines: LTV up to 80%, 80% to 90%, and 90% to 100%. As of September 30, 2010, the outstanding principal of loans with an LTV higher than 80% was \$81.1 million compared to \$86.7 million as of December 31, 2009. Loan balances over 30 days past due with interest only payments within the revolving home equity loan portfolio amounted to \$1.5 million, or .3%, at September 30, 2010 compared to \$2.1 million, or .4% at December 31, 2009.

### *Fixed Rate Home Equity Loans*

The Company also offers a fixed rate home equity loan product, typically for home repair or remodeling. This product is an alternative for individuals who want to finance a specific project or purchase, and decide to lock in a specific monthly payment over a defined period. This portfolio of loans approximated \$134.9 million and \$132.7 million at September 30, 2010 and December 31, 2009, respectively. At the end of the third quarter of 2010, \$41.0 million of this portfolio had an LTV over 80%, down slightly from \$44.9 million at the end of 2009.

At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, such loans totaled 6.1% of the outstanding balance of fixed rate home equity loans at September 30, 2010. Since 2008, the Company has limited the offering of fixed rate home equity loans with LTV ratios over 90%. As a result, \$4.7 million in new fixed rate home equity loans were written with LTV ratios over 90% during the first nine months of 2010, mainly to high net worth individuals.

Management does not believe these loans collateralized by real estate (personal real estate, revolving home equity, and fixed rate home equity) represent any unusual concentrations of risk, as evidenced by net charge-offs in the first nine months of 2010 of \$1.1 million, \$1.5 million and \$1.3 million, respectively. The amount of any increased potential loss on high LTV agreements relates mainly to amounts advanced that are in excess of the 80% collateral calculation, not the entire approved line. The Company currently offers no subprime loan products, which is defined as those offerings made to customers with a FICO score below 650, and has purchased no brokered loans.

### *Other Consumer Loans*

Within the consumer loan portfolio are several direct and indirect product lines, comprised of automobile and marine and RV. Outstanding balances for these loans were \$933.8 million and \$1.1 billion at September 30, 2010 and December 31, 2009, respectively. The balances over 30 days past due amounted to \$14.0 million at September 30, 2010 compared to \$22.4 million at the end of 2009. For the nine months ended September 30, 2010, \$136.8 million of new loans, mostly automobile loans, were originated, compared to \$159.9 million during the full year of 2009. The Company experienced rapid growth in marine and RV loans outstanding during 2006 through 2008. However, due to continuing weak credit and economic conditions, this loan product offering was curtailed in mid 2008.

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at September 30, 2010 of \$791.3 million in consumer credit card loans outstanding, approximately \$176.0 million, or 22.2%, carried a low introductory rate. Within the next nine months, \$94.9 million of these loans are scheduled to convert to the ongoing higher contractual rate. To mitigate some of the risk involved with this credit card product, the Company performs credit checks and detailed analysis of the customer borrowing profile before approving the loan application. Management believes that the risks in the consumer loan portfolio are reasonable and the anticipated loss ratios are within acceptable parameters.

**Income Taxes**

Income tax expense was \$26.0 million in the third quarter of 2010, compared to \$27.4 million in the second quarter of 2010 and \$23.4 million in the third quarter of 2009. The Company's effective income tax rate, including the effect of non-controlling interest, was 31.8% in the third quarter of 2010, compared with 31.5% in the second quarter of 2010 and 31.2% in the third quarter of 2009. Additionally, income tax expense

was \$71.8 million in the first nine months of 2010 compared to \$52.3 million in the first nine months of 2009, resulting in effective income tax rates, including the effect of non-controlling interest, of 31.0% and 30.4%, respectively. Effective tax rates were higher in 2010 compared to 2009 mainly due to changes in the mix of taxable and non-taxable income on higher pre-tax income.

## **Financial Condition**

### **Balance Sheet**

Total assets of the Company were \$18.8 billion at September 30, 2010 compared to \$18.1 billion at December 31, 2009. Earning assets (excluding fair value adjustments on available for sale investment securities) amounted to \$17.4 billion at September 30, 2010 consisting of 57.1% in loans and 40.8% in investment securities, compared to \$16.9 billion at December 31, 2009.

At September 30, 2010, total loans, excluding loans held for sale, decreased \$439.1 million, or 4.3%, compared with balances at December 31, 2009. Construction loans and business real estate loans declined \$256.7 million. Personal real estate loans decreased \$92.2 million and consumer loans, mainly comprised of automobile and marine and RV loans, declined \$116.7 million. The decrease in loan balances was the result of principal loan pay-downs exceeding new loan originations for these products as borrowers continue to react to the difficult economy by reducing line of credit usage and overall debt levels, resulting in lower origination demand. Also, the Company has ceased most marine and RV lending. As noted earlier, effective October 8, 2010, the Company sold all of its held to maturity student loans, totaling approximately \$311.5 million, and will recognize a gain of \$6.9 million in the fourth quarter of 2010.

Loans held for sale, comprised mostly of student loans, decreased \$96.9 million compared to December 31, 2009 primarily due to planned sales of student loans from the recent school year. The Company sold approximately \$246 million of student loans in the third quarter of 2010, most of which were originated under the DOE's program, and expects to sell the remaining loans under the program, totaling \$178 million, in the fourth quarter. Regulatory changes effective July 2010 preclude the Company from continuing to make federally guaranteed student loans.

Available for sale investment securities, excluding fair value adjustments, increased \$746.3 million, or 12.0%, at September 30, 2010 compared to December 31, 2009. State and municipal obligations increased \$169.3 million, or 18.5%, other asset-backed securities increased \$492.4 million, or 29.2%, and mortgage-backed securities increased \$60.0 million, or 2.1%. At September 30, 2010, the duration of the available for sale investment portfolio was 2.0 years and maturities of approximately \$1.7 billion are expected to occur during the next twelve months.

In the third quarter of 2010, the Company purchased \$350.0 million of securities under agreements to resell with terms ranging from two to three years, in order to diversify investments while loan demand is low. Agreements of \$100.0 million have rates which are fixed throughout their terms. The remaining \$250.0 million have rates which are fixed within a rate collar but may vary, based on the movement of a published constant maturity swap (CMS) rate, outside of that collar.

Deposits at September 30, 2010 totaled \$14.4 billion, a \$181.1 million, or 1.3%, increase compared to \$14.2 billion at December 31, 2009. This increase was primarily due to growth of \$509.2 million, or 5.5%, in interest bearing demand deposits, which occurred mainly in money market accounts. Certificates of deposit less than \$100,000 decreased \$193.7 million, or 10.8%, from balances at the previous year end, and certificates of deposit greater than \$100,000 decreased \$93.5 million, or 6.6%.

The Company's borrowings of federal funds purchased and securities sold under agreements to repurchase were \$1.5 billion at September 30, 2010, a 38.7% increase compared to \$1.1 billion at the previous year end. At September 30, 2010, the Company's other borrowings, consisting mainly of advances from the FHLB, had decreased \$398.2 million, or 54.1%, from December 31, 2009 mainly due to maturities of these advances.

**Liquidity and Capital Resources****Liquidity Management**

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

| <i>(In thousands)</i>                                     | <b>September 30<br/>2010</b> | June 30<br>2010 | December 31<br>2009 |
|---|------------------------------|-----------------|---------------------|
| Liquid assets:  |                              |                 |                     |
| Federal funds sold  | \$ 4,550                     | \$ 9,300        | \$ 22,590           |
| Long-term securities purchased under agreements to resell | <b>350,000</b>               |                 |                     |
| Available for sale investment securities                  | <b>7,164,273</b>             | 6,649,890       | 6,340,975           |
| Balances at the Federal Reserve Bank                      | <b>4,047</b>                 | 302,354         | 24,118              |
| <b>Total</b>  | <b>\$ 7,522,870</b>          | \$ 6,961,544    | \$ 6,387,683        |

Federal funds sold, which are sold to the Company's correspondent bank customers and have overnight maturities, totaled \$4.6 million at September 30, 2010. Also, as mentioned above, the Company recently purchased \$350.0 million in long-term resell agreements. The Company holds marketable securities as collateral under these agreements, which totaled \$363.5 million in fair value at September 30, 2010. Interest earning balances at the Federal Reserve Bank, which also have overnight maturities and are used for general liquidity purposes, totaled \$4.0 million at September 30, 2010. The fair value of the available for sale investment portfolio was \$7.2 billion at September 30, 2010 and included an unrealized net gain of \$180.6 million. The total net unrealized gain included gains of \$91.0 million on mortgage and asset-backed securities, \$22.4 million on U.S. government securities, \$19.1 million on state and municipal obligations, and \$13.4 million on corporate debt. An additional \$31.6 million unrealized gain was included in the fair value of common stock held by the Parent.

The portfolio includes maturities of approximately \$1.7 billion over the next 12 months, which offer substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits, securities sold under agreements to repurchase, trust funds, letters of credit issued by the FHLB, and borrowing capacity at the Federal Reserve Bank. At September 30, 2010, total investment securities pledged for these purposes were as follows:

| <i>(In thousands)</i>                                      | September 30<br>2010 |
|--|----------------------|
| Investment securities pledged for the purpose of securing: |                      |
| Federal Reserve Bank borrowings                            | \$ 781,778           |



|   |                     |
|---|---------------------|
| FHLB borrowings and letters of credit                     | 275,579             |
| Securities sold under agreements to repurchase            | 1,177,893           |
| Other deposits  | 1,032,376           |
| <br>  |                     |
| Total pledged securities                                  | 3,267,626           |
| Unpledged and available for pledging                      | 3,088,932           |
| Ineligible for pledging                                   | 807,715             |
| <br>  |                     |
| <b>Total available for sale securities, at fair value</b> | <b>\$ 7,164,273</b> |

Liquidity is also available from the Company's large base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At September 30, 2010, such deposits totaled \$11.5 billion and represented 79.7% of total deposits. These core deposits are normally less volatile, often with customer relationships tied to other products offered by the Company, promoting long lasting relationships and stable funding sources. Time open and certificates of deposit of \$100,000 and over totaled \$1.3 billion at September 30, 2010. These accounts are normally considered more volatile and higher costing, and comprised 9.2% of total deposits at September 30, 2010.

| <i>(In thousands)</i>       | <b>September 30<br/>2010</b> | June 30<br>2010      | December 31<br>2009  |
|-----------------------------|------------------------------|----------------------|----------------------|
| Core deposit base:          |                              |                      |                      |
| Non-interest bearing demand | \$ 1,752,930                 | \$ 1,666,649         | \$ 1,793,816         |
| Interest checking           | 610,145                      | 626,667              | 735,870              |
| Savings and money market    | 9,101,943                    | 9,004,761            | 8,467,046            |
| <b>Total</b>                | <b>\$ 11,465,018</b>         | <b>\$ 11,298,077</b> | <b>\$ 10,996,732</b> |

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:

| <i>(In thousands)</i>                          | <b>September 30<br/>2010</b> | June 30<br>2010     | December 31<br>2009 |
|--|------------------------------|---------------------|---------------------|
| Borrowings:                                    |                              |                     |                     |
| Federal funds purchased                        | \$ 646,940                   | \$ 23,685           | \$ 62,130           |
| Securities sold under agreements to repurchase | 883,615                      | 982,671             | 1,041,061           |
| FHLB advances                                  | 330,244                      | 356,359             | 724,386             |
| Subordinated debentures                        |                              |                     | 4,000               |
| Other long-term debt                           | 7,619                        | 7,638               | 7,676               |
| <b>Total</b>                                   | <b>\$ 1,868,418</b>          | <b>\$ 1,370,353</b> | <b>\$ 1,839,253</b> |

Federal funds purchased and securities sold under agreements to repurchase are generally borrowed overnight, and amounted to \$1.5 billion at September 30, 2010. Federal funds purchased are unsecured overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved lines of credit.

Securities sold under agreements to repurchase are secured by a portion of the Company's investment portfolio and at September 30, 2010 were comprised of both non-insured customer funds, totaling \$483.6 million, and structured repurchase agreements of \$400.0 million. The structured repurchased agreements were obtained in August 2010 from other financial institutions, at the same time other structured repurchase agreements of \$500.0 million matured. The new borrowings mature in 2013 and 2014 and have floating interest rates based upon a CMS rate. The Company also borrows on a secured basis through advances from the FHLB, which totaled \$330.2 million at September 30, 2010. Most of these advances have fixed interest rates and mature in 2010 through 2017. Other outstanding long-term borrowings relate mainly to the Company's leasing activities and private equity investments.

The Company pledges certain assets, including loans and investment securities, to both the Federal Reserve Bank and the FHLB as security to establish lines of credit and borrow from these entities. Based on the amount and type of collateral pledged, the FHLB establishes a collateral value from which the Company may draw advances against the collateral. Also, this collateral is used to enable the FHLB to issue letters of credit in favor of public fund depositors of the Company. The Federal Reserve Bank also establishes a collateral value of assets pledged to support borrowings from the discount window. The following table reflects the collateral value of assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company at September 30, 2010:

| <i>(In thousands)</i>                | September 30, 2010  |                     |
|--------------------------------------|---------------------|---------------------|
|                                      | FHLB                | Federal Reserve     |
| Collateral value pledged             | \$ 1,968,542        | \$ 1,638,582        |
| Advances outstanding                 | (330,244)           |                     |
| Letters of credit issued             | (517,200)           |                     |
| <b>Available for future advances</b> | <b>\$ 1,121,098</b> | <b>\$ 1,638,582</b> |

In addition to those mentioned above, several other sources of liquidity are available. The subsidiary bank has strong long-term deposit ratings from Standard & Poor's and Moody's of A+ and Aa2, respectively. Additionally, the Company's sound commercial paper rating of A-1 from Standard & Poor's and P-1 from Moody's would help ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been issued or outstanding during the past ten years. The Company has no subordinated debt or hybrid instruments which could affect future borrowing capacity. Because of its lack of significant long-term debt, the Company believes that it could generate additional liquidity through its Capital Markets Group from sources such as jumbo certificates of deposit or privately placed debt offerings. Financing may also include the issuance of common or preferred stock. As mentioned below, the Company concluded a stock sale program in the third quarter of 2009 which generated \$100.0 million in gross sales proceeds.

Cash and cash equivalents (defined as Cash and due from banks, Short-term federal funds sold and securities purchased under agreements to resell, and Interest earning deposits with banks as segregated in the accompanying balance sheets) was \$420.9 million at September 30, 2010 compared to \$463.8 million at December 31, 2009. The \$42.9 million decrease included changes in the various cash flows resulting from the operating, investing and financing activities of the Company, as shown in the accompanying statement of cash flows for September 30, 2010. Operating activities include net income adjusted for certain non-cash items, in addition to changes in the levels of loans held for sale and securities held for trading purposes. During the first nine months of 2010, operating activities provided cash of \$405.9 million. Investing activities, which occur mainly in the loan and investment securities portfolios, used cash of \$541.8 million. Most of the cash outflow was due to \$2.3 billion in purchases of investment securities, which was partly offset by \$1.7 billion in proceeds from sales, maturities and pay downs. In addition, investments in securities purchased under resell agreements increased \$350.0 million. These cash outflows were partly offset by a \$363.8 million decline in the loan portfolio. Financing activities provided cash of \$93.0 million, resulting mainly from increases of \$427.4 million in securities sold under repurchase agreements and \$115.9 million in deposit

accounts. These cash inflows were partly offset by repayments of \$398.2 million of long-term borrowings, mainly FHLB advances. 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:

| <i>(Dollars in thousands)</i>   | <b>September 30<br/>2010</b> | December 31<br>2009 | Minimum<br>Ratios<br>for<br>Well-Capitalized<br>Banks |
|---------------------------------|------------------------------|---------------------|---|
| Risk-adjusted assets            | \$ 12,751,595                | \$ 13,105,948       |   |
| Tier I risk-based capital       | 1,819,871                    | 1,708,901           |   |
| Total risk-based capital        | 1,993,962                    | 1,885,978           |   |
| Tier I risk-based capital ratio | 14.27%                       | 13.04%              | 6.00%   |
| Total risk-based capital ratio  | 15.64%                       | 14.39%              | 10.00%  |
| Tier I leverage ratio           | 9.93%                        | 9.58%               | 5.00%   |

The Company maintains a treasury stock buyback program, and in February 2008 was authorized by the Board of Directors to repurchase up to 3,000,000 shares of its common stock. During the quarter ended September 30, 2010, the Company purchased 2,808 shares of treasury stock, in connection with its equity compensation plan, at an average cost of \$37.14 per share. At September 30, 2010, 2,835,310 shares remained available for purchase under the current Board authorization.

The Company's common stock dividend policy reflects its earnings outlook, desired payout ratios, the need to maintain adequate capital levels, and alternative investment options. The Company paid a per share cash dividend of \$.235 in the first quarter of 2010, which was a 2.6% increase compared to the fourth quarter of 2009, and maintained the same payout in the second and third quarters of 2010.

## Common Equity Offering

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

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

### **Commitments, Off-Balance Sheet Arrangements and Contingencies**

Various commitments and contingent liabilities arise in the normal course of business, which are not required to be recorded on the balance sheet. The most significant of these are loan commitments, which at September 30, 2010 totaled \$7.0 billion (including approximately \$3.3 billion in unused approved credit card lines). In addition, the Company enters into standby and commercial letters of credit. These contracts amounted to \$346.4 million and \$16.6 million, respectively, at September 30, 2010. Since many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. The carrying value of the guarantee obligations associated with the standby letters of credit, which has been recorded as a liability on the balance sheet, amounted to \$3.1 million at September 30, 2010.

The Company regularly purchases various state tax credits arising from third-party property redevelopment. While most of the tax credits are resold to third parties, some are periodically retained

for use by the Company. During the first nine months of 2010, purchases and sales of tax credits amounted to \$27.6 million and \$33.5 million, respectively, and at September 30, 2010, outstanding purchase commitments totaled \$132.5 million.

The Parent has additional funding commitments arising from investments in private equity concerns, classified as non-marketable securities in the accompanying balance sheets, which total \$1.3 million at September 30, 2010. In addition, the Parent expects to fund \$24.3 million to venture capital subsidiaries over the next several years. Management does not anticipate any material losses arising from commitments and contingent liabilities and believes there are no material commitments to extend credit that represent risks of an unusual nature.

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



**Segment Results**

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

| <i>(In thousands)</i>   | Consumer   | Commercial | Wealth     | Segment<br>Totals | Other/<br>Elimination | Consolidated<br>Totals |
|---|------------|------------|------------|-------------------|-----------------------|------------------------|
| <b>Nine Months Ended<br/>September 30, 2010:</b>                  |            |            |            |                   |                       |                        |
| Net interest income   | \$ 238,396 | \$ 190,400 | \$ 29,901  | \$ 458,697        | \$ 26,558             | \$ 485,255             |
| Provision for loan<br>losses                                      | (54,543)   | (19,571)   | (1,038)    | (75,152)          | (3,201)               | (78,353)               |
| Non-interest income   | 112,332    | 96,065     | 85,653     | 294,050           | 392                   | 294,442                |
| Investment securities<br>losses, net                              |            |            |            |                   | (2,989)               | (2,989)                |
| Non-interest expense  | (218,617)  | (152,860)  | (79,884)   | (451,361)         | (15,527)              | (466,888)              |
| Income before income<br>taxes                                     | \$ 77,568  | \$ 114,034 | \$ 34,632  | \$ 226,234        | \$ 5,233              | \$ 231,467             |
| <b>Nine Months Ended<br/>September 30, 2009:</b>                  |            |            |            |                   |                       |                        |
| Net interest income   | \$ 250,770 | \$ 175,888 | \$ 30,494  | \$ 457,152        | \$ 13,847             | \$ 470,999             |
| Provision for loan<br>losses                                      | (62,255)   | (39,348)   | (199)      | (101,802)         | (17,893)              | (119,695)              |
| Non-interest income   | 118,905    | 84,047     | 86,812     | 289,764           | 3,364                 | 293,128                |
| Investment securities<br>losses, net                              |            |            |            |                   | (5,870)               | (5,870)                |
| Non-interest expense  | (227,812)  | (143,718)  | (80,107)   | (451,637)         | (15,749)              | (467,386)              |
| Income before income<br>taxes                                     | \$ 79,608  | \$ 76,869  | \$ 37,000  | \$ 193,477        | \$ (22,301)           | \$ 171,176             |
| <b>Increase (decrease) in<br/>income before income<br/>taxes:</b> |            |            |            |                   |                       |                        |
| Amount  | \$ (2,040) | \$ 37,165  | \$ (2,368) | \$ 32,757         | \$ 27,534             | \$ 60,291              |

|         |        |       |        |       |      |       |
|---------|--------|-------|--------|-------|------|-------|
| Percent | (2.6)% | 48.3% | (6.4)% | 16.9% | N.M. | 35.2% |
|---------|--------|-------|--------|-------|------|-------|

*Consumer*

For the nine months ended September 30, 2010, income before income taxes for the Consumer segment decreased \$2.0 million, or 2.6%, from the first nine months of 2009. This decrease was mainly due to a decline of \$12.4 million in net interest income due to a \$25.5 million decrease in net allocated funding credits assigned to the Consumer segment's loan and deposit portfolios and a \$20.9 million decrease in loan interest income, partly offset by a decline of \$34.0 million in deposit interest expense. Also, non-interest income decreased \$6.6 million, or 5.5%, from the first nine months of 2009 mainly due to a decline in deposit account fees (mainly overdraft charges) and lower gains on the sales of student loans. These declines were partly offset by an increase in bank card fee income (primarily debit card fees). Partially offsetting the decreases in income was a decline of \$9.2 million, or 4.0%, in non-interest expense, coupled with a decline of \$7.7 million in net loan charge-offs. The decline in non-interest expense was largely due to lower FDIC insurance expense, deposit account processing expense and teller services expense. Net loan charge-offs totaled \$54.5 million, a \$7.7 million decrease from the first nine months of 2010, which was due mainly to lower losses on marine and RV and other consumer loans, partly offset by higher consumer credit card loan losses.

*Commercial*

For the nine months ended September 30, 2010, income before income taxes for the Commercial segment increased \$37.2 million, or 48.3%, compared to the same period in the previous year. Net interest income

increased \$14.5 million, or 8.3%, due to higher net allocated funding credits of \$27.1 million, which was partly offset by a \$14.7 million decline in loan interest income. Net loan charge-offs in this segment totaled \$19.6 million in the first nine months of 2010, a decrease of \$19.8 million from the first nine months of 2009. During 2010, lower charge-offs occurred on construction and business loans. Non-interest income increased by \$12.0 million, or 14.3%, over the previous year due to higher bank card fees (mainly corporate card). Non-interest expense increased \$9.1 million, or 6.4%, over the previous year, mainly due to an increase in bank card fee expense and higher write-downs and holding costs on foreclosed real estate and personal property. These increases were partly offset by lower costs for FDIC insurance and deposit account processing.

### *Wealth*

Wealth segment pre-tax profitability for the nine months ended September 30, 2010 decreased \$2.4 million, or 6.4%, from the same period in the previous year. Net interest income decreased \$593 thousand, or 1.9%, and was impacted by a \$7.6 million decrease in assigned net funding credits and a \$1.7 million decrease in loan interest income, offset by an \$8.7 million decline in deposit interest expense. Non-interest income declined \$1.2 million, or 1.3%, from the prior year due to lower bond trading income, brokerage fees and cash sweep commissions, partly offset by higher trust fee income. Non-interest expense decreased \$233 thousand, mainly due to lower FDIC insurance expense, partly offset by higher corporate management fees.

The Other/Elimination category in the preceding table includes the activity of various support and overhead operating units of the Company, in addition to the investment securities portfolio and other items not allocated to the segments. In accordance with the Company's transfer pricing policies, the excess of the total loan loss provision over net loan charge-offs is not allocated to a business segment, and is included in this category. The pre-tax profitability of this category was higher than in the previous period by \$27.5 million. This increase was mainly due to a decline in the unallocated loan loss provision of \$14.7 million. In addition, net interest income in this category, related to earnings of the investment portfolio and interest expense on borrowings not allocated to a segment, increased \$12.7 million and unallocated amounts related to investment securities losses decreased \$2.9 million.

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

### **Regulatory Changes Affecting Student Lending**

In the past, the Company has originated federally guaranteed student loans from various colleges and universities in its markets which it holds for sale in its loan portfolio. In March 2010, the federal government passed legislation that made the federal government the sole originator of federally subsidized student loans beginning July 1, 2010. These new rules effectively required the Company to cease all new origination activities for federal Stafford and Plus student loans as of July 1, 2010. The existing student loans held for sale continue to be sold as in the past under existing sales contracts, and the Company expects to sell approximately \$178 million of loans originated under the DOE's program in the fourth quarter of 2010.

### **Regulatory Changes Affecting Overdraft Fees**

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

deposit fee income in the second half of 2010 and in 2011. The Company has implemented new procedures to solicit and capture required customer consents and effective July 1, 2010, prohibited such ATM and one-time debit card transactions causing overdrafts, unless an opt-in consent has been received. As a result of this regulatory change, overdraft fees decreased \$4.2 million compared to the previous quarter and were \$6.0 million lower than the same quarter last year. The Company

is also developing other products and has begun offering some deposit accounts with monthly fees as a means to mitigate some of the effects of these new rules. The Company estimates that the annualized impact of these regulations will reduce revenue by \$16 million to \$18 million on a pre-tax basis.

### **Regulatory Changes Affecting the Banking Industry**

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

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

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

### **Impact of Recently Issued Accounting Standards**

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

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

***Accounting for Transfers of Financial Assets*** The FASB issued additional guidance in June 2009 with the objective of providing greater transparency about transfers of financial assets and a transferor's continuing involvement. The

new guidance limits the circumstances in which a financial asset should be derecognized when the transferor has not transferred the entire original financial asset, or when the transferor has continuing involvement with the transferred asset. It establishes conditions for reporting a transfer of a portion of a financial asset as a sale. Also, it eliminates the exception for qualifying special

purpose entities from consolidation guidance, and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred assets. The new accounting requirements must be applied to transactions occurring on or after January 1, 2010. Their adoption did not have a significant effect on the Company's consolidated financial statements.

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

**Credit Quality of Financing Receivables and the Allowance for Credit Losses** In July 2010, the FASB issued new guidance which is expected to facilitate the evaluation of the nature of credit risk inherent in an entity's loan portfolio, how that risk influences the allowance for credit losses, and the changes and reasons for those changes in the allowance. The guidance requires disclosures about the activity in the allowance, non-accrual and impaired loan status, credit quality indicators, past due information, loan modifications, and significant loan purchases and sales. Much of the disclosure is required on a disaggregated level, by portfolio segment or class basis. These disclosures, except for those about activity during a reported period, are effective for the Company's December 31, 2010 financial statements. The disclosures about activity are effective for the March 31, 2011 financial statements. Adoption is not expected to have a significant effect on the Company's financial statements.

**AVERAGE BALANCE SHEETS    AVERAGE RATES AND YIELDS****Three Months Ended September 30, 2010 and 2009**

| <i>(Dollars in thousands)</i>   | Third Quarter 2010 |                                |                                  | Third Quarter 2009 |                                |                                  |
|---|--------------------|--------------------------------|----------------------------------|--------------------|--------------------------------|----------------------------------|
|   | Average<br>Balance | Interest<br>Income/<br>Expense | Avg.<br>Rates<br>Earned/<br>Paid | Average<br>Balance | Interest<br>Income/<br>Expense | Avg.<br>Rates<br>Earned/<br>Paid |
| <b>ASSETS:</b>  |                    |                                |                                  |                    |                                |                                  |
| Loans:  |                    |                                |                                  |                    |                                |                                  |
| Business <sup>(A)</sup>   | \$ 2,917,798       | \$ 28,070                      | 3.82%                            | \$ 3,019,018       | \$ 28,718                      | 3.77%                            |
| Real estate construction and land   | 530,472            | 5,346                          | 4.00                             | 698,876            | 6,589                          | 3.74                             |
| Real estate business  | 1,998,500          | 25,710                         | 5.10                             | 2,147,094          | 27,280                         | 5.04                             |
| Real estate personal  | 1,450,898          | 18,763                         | 5.13                             | 1,577,908          | 21,392                         | 5.38                             |
| Consumer  | 1,234,138          | 20,695                         | 6.65                             | 1,423,911          | 25,083                         | 6.99                             |
| Revolving home equity   | 485,034            | 5,284                          | 4.32                             | 491,525            | 5,389                          | 4.35                             |
| Student   | 315,150            | 1,910                          | 2.40                             | 341,516            | 2,039                          | 2.37                             |
| Consumer credit card  | 762,987            | 21,709                         | 11.29                            | 728,547            | 23,129                         | 12.60                            |
| Overdrafts  | 6,667              |                                |                                  | 11,288             |                                |                                  |
| <b>Total loans</b>  | <b>9,701,644</b>   | <b>127,487</b>                 | <b>5.21</b>                      | <b>10,439,683</b>  | <b>139,619</b>                 | <b>5.31</b>                      |
| Loans held for sale   | 305,013            | 1,368                          | 1.78                             | 293,636            | 1,445                          | 1.95                             |
| Investment securities:  |                    |                                |                                  |                    |                                |                                  |
| U.S. government and federal agency  | 672,447            | 2,434                          | 1.44                             | 412,667            | 4,645                          | 4.47                             |
| State and municipal obligations <sup>(A)</sup>                                    | 982,137            | 11,206                         | 4.53                             | 907,536            | 11,377                         | 4.97                             |
| Mortgage and asset-backed securities  | 5,100,958          | 35,632                         | 2.77                             | 3,985,402          | 44,876                         | 4.47                             |
| Other marketable securities <sup>(A)</sup>  | 182,966            | 2,387                          | 5.18                             | 194,802            | 2,554                          | 5.20                             |
| Trading securities <sup>(A)</sup>   | 22,525             | 163                            | 2.87                             | 18,143             | 141                            | 3.08                             |
| Non-marketable securities <sup>(A)</sup>  | 109,215            | 2,595                          | 9.43                             | 134,422            | 1,687                          | 4.98                             |
| <b>Total investment securities</b>  | <b>7,070,248</b>   | <b>54,417</b>                  | <b>3.05</b>                      | <b>5,652,972</b>   | <b>65,280</b>                  | <b>4.58</b>                      |
| Short-term federal funds sold and securities purchased under agreements to resell | 6,903              | 12                             | .69                              | 31,360             | 52                             | .66                              |



|  |                      |                |             |                      |                |              |
|--|----------------------|----------------|-------------|----------------------|----------------|--------------|
| Long-term securities purchased under agreements to resell                  | 199,302              | 862            | 1.72        |                      |                |              |
| Interest earning deposits with banks                                       | 170,504              | 106            | .25         | 203,954              | 120            | .23          |
| <b>Total interest earning assets</b>                                       | <b>17,453,614</b>    | <b>184,252</b> | <b>4.19</b> | <b>16,621,605</b>    | <b>206,516</b> | <b>4.93</b>  |
| Less allowance for loan losses   | (195,452)            |                |             | (185,910)            |                |              |
| Unrealized gain on investment securities                                   | 158,656              |                |             | 40,594               |                |              |
| Cash and due from banks  | 367,310              |                |             | 357,562              |                |              |
| Land, buildings and equipment, net   | 392,590              |                |             | 411,110              |                |              |
| Other assets   | 444,588              |                |             | 362,786              |                |              |
| <b>Total assets</b>  | <b>\$ 18,621,306</b> |                |             | <b>\$ 17,607,747</b> |                |              |
| <b>LIABILITIES AND EQUITY:</b>   |                      |                |             |                      |                |              |
| Interest bearing deposits:   |                      |                |             |                      |                |              |
| Savings  | \$ 481,997           | 197            | .16         | \$ 443,263           | 168            | .15          |
| Interest checking and money market   | 9,979,287            | 7,064          | .28         | 8,653,109            | 7,527          | .35          |
| Time open & C.D. s of less than \$100,000                                  | 1,642,200            | 5,444          | 1.32        | 2,107,778            | 13,485         | 2.54         |
| Time open & C.D. s of \$100,000 and over                                   | 1,417,162            | 3,461          | .97         | 1,785,414            | 8,431          | 1.87         |
| <b>Total interest bearing deposits</b>                                     | <b>13,520,646</b>    | <b>16,166</b>  | <b>.47</b>  | <b>12,989,564</b>    | <b>29,611</b>  | <b>.90</b>   |
| Borrowings:  |                      |                |             |                      |                |              |
| Federal funds purchased and securities sold under agreements to repurchase | 1,023,961            | 584            | .23         | 937,728              | 816            | .35          |
| Other borrowings <sup>(B)</sup>  | 350,328              | 2,729          | 3.09        | 833,189              | 7,681          | 3.66         |
| <b>Total borrowings</b>  | <b>1,374,289</b>     | <b>3,313</b>   | <b>.96</b>  | <b>1,770,917</b>     | <b>8,497</b>   | <b>1.90</b>  |
| <b>Total interest bearing liabilities</b>                                  | <b>14,894,935</b>    | <b>19,479</b>  | <b>.52%</b> | <b>14,760,481</b>    | <b>38,108</b>  | <b>1.02%</b> |

|   |                      |               |
|---|----------------------|---------------|
| Non-interest bearing demand deposits        | <b>1,006,578</b>     | 877,500       |
| Other liabilities                           | <b>700,754</b>       | 185,916       |
| Equity                                      | <b>2,019,039</b>     | 1,783,850     |
| <b>Total liabilities and equity</b>         | <b>\$ 18,621,306</b> | \$ 17,607,747 |
| <b>Net interest margin (T/E)</b>            | <b>\$ 164,773</b>    | \$ 168,408    |
| <b>Net yield on interest earning assets</b> | <b>3.75%</b>         | 4.02%         |

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

(B) Interest expense capitalized on construction projects is not deducted from the interest expense shown above.

**AVERAGE BALANCE SHEETS    AVERAGE RATES AND YIELDS****Nine Months Ended September 30, 2010 and 2009**

| <i>(Dollars in thousands)</i>                             | Nine Months 2010   |                                |                                  | Nine Months 2009   |                                |                                  |
|---|--------------------|--------------------------------|----------------------------------|--------------------|--------------------------------|----------------------------------|
|   | Average<br>Balance | Interest<br>Income/<br>Expense | Avg.<br>Rates<br>Earned/<br>Paid | Average<br>Balance | Interest<br>Income/<br>Expense | Avg.<br>Rates<br>Earned/<br>Paid |
| <b>ASSETS:</b>  |                    |                                |                                  |                    |                                |                                  |
| Loans:  |                    |                                |                                  |                    |                                |                                  |
| Business <sup>(A)</sup>                                   | \$ 2,876,601       | \$ 83,017                      | 3.86%                            | \$ 3,205,237       | \$ 89,448                      | 3.73%                            |
| Real estate construction and<br>land                      | 577,160            | 17,145                         | 3.97                             | 755,000            | 19,863                         | 3.52                             |
| Real estate business                                      | 2,038,142          | 77,171                         | 5.06                             | 2,154,082          | 81,578                         | 5.06                             |
| Real estate personal                                      | 1,486,826          | 58,318                         | 5.24                             | 1,598,231          | 66,351                         | 5.55                             |
| Consumer  | 1,270,031          | 64,357                         | 6.78                             | 1,499,821          | 77,705                         | 6.93                             |
| Revolving home equity                                     | 485,445            | 15,669                         | 4.32                             | 498,094            | 16,124                         | 4.33                             |
| Student   | 321,912            | 5,665                          | 2.35                             | 347,424            | 7,520                          | 2.89                             |
| Consumer credit card                                      | 754,570            | 68,042                         | 12.06                            | 720,178            | 66,769                         | 12.40                            |
| Overdrafts  | 7,025              |                                |                                  | 9,437              |                                |                                  |
| <b>Total loans</b>  | <b>9,817,712</b>   | <b>389,384</b>                 | <b>5.30</b>                      | <b>10,787,504</b>  | <b>425,358</b>                 | <b>5.27</b>                      |
| Loans held for sale                                       | 447,948            | 5,533                          | 1.65                             | 423,012            | 6,840                          | 2.16                             |
| Investment securities:                                    |                    |                                |                                  |                    |                                |                                  |
| U.S. government and federal<br>agency                     | 649,259            | 10,658                         | 2.19                             | 236,100            | 7,036                          | 3.98                             |
| State and municipal<br>obligations <sup>(A)</sup>         | 924,925            | 33,228                         | 4.80                             | 854,306            | 32,620                         | 5.10                             |
| Mortgage and asset-backed<br>securities                   | 4,651,629          | 114,180                        | 3.28                             | 3,491,197          | 123,520                        | 4.73                             |
| Other marketable securities <sup>(A)</sup>                | 185,586            | 6,660                          | 4.80                             | 176,942            | 7,204                          | 5.44                             |
| Trading securities <sup>(A)</sup>                         | 18,651             | 405                            | 2.90                             | 17,999             | 414                            | 3.08                             |
| Non-marketable securities <sup>(A)</sup>                  | 115,365            | 5,600                          | 6.49                             | 137,999            | 4,371                          | 4.23                             |
| <b>Total investment securities</b>                        | <b>6,545,415</b>   | <b>170,731</b>                 | <b>3.49</b>                      | <b>4,914,543</b>   | <b>175,165</b>                 | <b>4.77</b>                      |
| Short-term federal funds sold<br>and securities purchased | 6,988              | 40                             | .77                              | 55,413             | 202                            | .49                              |

|   |                      |                |             |               |         |       |
|---|----------------------|----------------|-------------|---------------|---------|-------|
| under agreements to resell<br>Long-term securities<br>purchased under agreements<br>to resell | 67,164               | 862            | 1.72        |               |         |       |
| Interest earning deposits with<br>banks   | 200,363              | 372            | .25         | 337,711       | 622     | .25   |
| <b>Total interest earning assets</b>  | <b>17,085,590</b>    | <b>566,922</b> | <b>4.44</b> | 16,518,183    | 608,187 | 4.92  |
| Less allowance for loan losses  | (196,023)            |                |             | (179,060)     |         |       |
| Unrealized gain (loss) on<br>investment securities  | 140,003              |                |             | (6,651)       |         |       |
| Cash and due from banks   | 369,641              |                |             | 364,176       |         |       |
| Land, buildings and<br>equipment, net   | 397,396              |                |             | 412,599       |         |       |
| Other assets  | 419,566              |                |             | 350,416       |         |       |
| <b>Total assets</b>   | <b>\$ 18,216,173</b> |                |             | \$ 17,459,663 |         |       |
| <b>LIABILITIES AND EQUITY:</b>  |                      |                |             |               |         |       |
| Interest bearing deposits:  |                      |                |             |               |         |       |
| Savings   | \$ 477,977           | 448            | .13         | \$ 437,640    | 491     | .15   |
| Interest checking and money<br>market   | 9,768,064            | 21,620         | .30         | 8,334,482     | 23,235  | .37   |
| Time open & C.D. s of less<br>than \$100,000  | 1,703,307            | 18,318         | 1.44        | 2,110,011     | 42,777  | 2.71  |
| Time open & C.D. s of<br>\$100,000 and over   | 1,354,985            | 10,946         | 1.08        | 1,959,601     | 29,646  | 2.02  |
| <b>Total interest bearing<br/>deposits</b>  | <b>13,304,333</b>    | <b>51,332</b>  | <b>.52</b>  | 12,841,734    | 96,149  | 1.00  |
| Borrowings:   |                      |                |             |               |         |       |
| Federal funds purchased and<br>securities sold under<br>agreements to repurchase              | 1,071,595            | 2,230          | .28         | 964,904       | 2,895   | .40   |
| Other borrowings <sup>(B)</sup>   | 527,738              | 13,227         | 3.35        | 970,119       | 24,470  | 3.37  |
| <b>Total borrowings</b>   | <b>1,599,333</b>     | <b>15,457</b>  | <b>1.29</b> | 1,935,023     | 27,365  | 1.89  |
|   | <b>14,903,666</b>    | <b>66,789</b>  | <b>.60%</b> | 14,776,757    | 123,514 | 1.12% |



**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 2009 Annual Report on Form 10-K.

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

|                              | September 30, 2010            |                        | June 30, 2010                 |                        | December 31, 2009             |                        |
|------------------------------|-------------------------------|------------------------|-------------------------------|------------------------|-------------------------------|------------------------|
|                              | \$                            | % Change               | \$                            | % Change               | \$                            | % Change               |
|                              | Change in Net Interest Income | in Net Interest Income | Change in Net Interest Income | in Net Interest Income | Change in Net Interest Income | in Net Interest Income |
| <i>(Dollars in millions)</i> |                               |                        |                               |                        |                               |                        |
| 300 basis points rising      | \$ 13.1                       | 2.05%                  | \$ 24.1                       | 3.85%                  | \$ 21.6                       | 3.22%                  |
| 200 basis points rising      | 11.5                          | 1.79                   | 19.8                          | 3.16                   | 17.3                          | 2.57                   |
| 100 basis points rising      | 5.3                           | .83                    | 11.3                          | 1.80                   | 10.6                          | 1.58                   |

As shown above, under the rising rate scenarios presented, net interest income would increase in a range of \$5.3 million (100 basis point rising scenario) to \$13.1 million (300 basis point rising scenario). The Company did not model a 100 basis point falling scenario due to the already low interest rate environment. Under rising rate models, the potential increase in net interest income is lower in the current quarter compared to the previous quarter. During the third quarter of 2010, period end loans, where most variable rate assets reside, declined \$270.5 million from the prior quarter, lowering somewhat the beneficial effect of rising rates, while available for sale securities, which earn fixed rates, increased \$514.4 million. Under rising rate scenarios, the Company's lower loan levels will lessen the beneficial effect of rising rates; however, this effect on interest income is somewhat mitigated by the growth in investment securities. Total deposits decreased \$94.6 million from the previous quarter end, with much of the decline in C.D.'s over \$100,000 that usually have shorter maturities and reprice faster. Deposit balances overall have a smaller impact on net interest income when rates are rising, due to lower overall rates and fewer accounts that carry variable rates moving in sequence with market rates.

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

**Item 4. CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of September 30, 2010. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. There were not any significant changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II: OTHER INFORMATION****Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

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

| <b>Period</b>          | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>per Share</b> | <b>Total Number of<br/>Shares Purchased<br/>as part of Publicly<br/>Announced<br/>Program</b> | <b>Maximum Number that<br/>May Yet Be Purchased<br/>Under the Program</b> |
|------------------------|---|---|---|---|
| July 1 - 31, 2010      | 2,339   | \$ 37.18                                    | 2,339   | 2,835,779   |
| August 1 - 31, 2010    | 263   | 36.56                                       | 263   | 2,835,516   |
| September 1 - 30, 2010 | 206   | 37.46                                       | 206   | 2,835,310   |
| <b>Total</b>           | <b>2,808</b>  | <b>\$ 37.14</b>                             | <b>2,808</b>  | <b>2,835,310</b>  |

In February 2008, the Board of Directors approved the purchase of up to 3,000,000 shares of the Company's common stock. At September 30, 2010, 2,835,310 shares remain available to be purchased under the current authorization.

**Item 6. EXHIBITS**

See Index to Exhibits



**SIGNATURES**

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

Commerce Bancshares, Inc.

By /s/ James L. Swarts  
James L. Swarts  
*Vice President & Secretary*

Date: November 8, 2010

By /s/ Jeffery D. Aberdeen  
Jeffery D. Aberdeen  
*Controller*  
*(Chief Accounting Officer)*

Date: November 8, 2010

**INDEX TO EXHIBITS**

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

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

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

101 Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Changes in Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text \*

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