

COMMERCE BANCSHARES INC /MO/

Form 10-K

February 25, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549  
**FORM 10-K**

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

For the Fiscal Year Ended December 31, 2010 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)

**Securities registered pursuant to Section 12(b) of the Act:**

| <b>Title of class</b>      | <b>Name of exchange on which registered</b> |
|----------------------------|---|
| \$5 Par Value Common Stock | NASDAQ Global Select Market                 |

**Securities registered pursuant to Section 12(g) of the Act:**

NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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  Smaller reporting company   
(Do not check if a smaller reporting company)

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

Yes  No

As of June 30, 2010, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$2,604,000,000.

As of February 11, 2011, there were 86,958,563 shares of Registrant's \$5 Par Value Common Stock outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement for its 2011 annual meeting of shareholders, which will be filed within 120 days of December 31, 2010, are incorporated by reference into Part III of this Report.

---

**Commerce Bancshares, Inc.**

**Form 10-K**

**INDEX**

**Page**

**PART I**

|                 |                                  |    |
|-----------------|----------------------------------|----|
| <u>Item 1.</u>  | <u>Business</u>                  | 3  |
| <u>Item 1a.</u> | <u>Risk Factors</u>              | 9  |
| <u>Item 1b.</u> | <u>Unresolved Staff Comments</u> | 12 |
| <u>Item 2.</u>  | <u>Properties</u>                | 13 |
| <u>Item 3.</u>  | <u>Legal Proceedings</u>         | 13 |
| <u>Item 4.</u>  | <u>Removed and Reserved</u>      | 13 |

**PART II**

|                 |   |     |
|-----------------|---|-----|
| <u>Item 5.</u>  | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 15  |
| <u>Item 6.</u>  | <u>Selected Financial Data</u>  | 17  |
| <u>Item 7.</u>  | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 17  |
| <u>Item 7a.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | 64  |
| <u>Item 8.</u>  | <u>Financial Statements and Supplementary Data</u>  | 64  |
| <u>Item 9.</u>  | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 121 |
| <u>Item 9a.</u> | <u>Controls and Procedures</u>  | 121 |
| <u>Item 9b.</u> | <u>Other Information</u>  | 123 |

**PART III**

|                 |   |     |
|-----------------|---|-----|
| <u>Item 10.</u> | <u>Directors, Executive Officers and Corporate Governance</u> | 123 |
| <u>Item 11.</u> | <u>Executive Compensation</u>                                 | 123 |

|  |   |   |     |
|--|---|---|-----|
| <u>Item 12.</u>                              | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 123   |     |
| <u>Item 13.</u>                              | <u>Certain Relationships and Related Transactions, and Director Independence</u>                      | 123   |     |
| <u>Item 14.</u>                              | <u>Principal Accountant Fees and Services</u>   | 123   |     |
| <b><u>PART IV</u></b>                        | <u>Item 15.</u>   | <u>Exhibits and Financial Statement Schedules</u> | 124 |
| <u>Signatures</u>                            |   |   | 125 |
| <u>Index to Exhibits</u>                     |   |   | E-1 |
| <u>EX-10.E</u>                               |   |   |     |
| <u>EX-21</u>                                 |   |   |     |
| <u>EX-23</u>                                 |   |   |     |
| <u>EX-24</u>                                 |   |   |     |
| <u>EX-31.1</u>                               |   |   |     |
| <u>EX-31.2</u>                               |   |   |     |
| <u>EX-32</u>                                 |   |   |     |
| <u>EX-101 INSTANCE DOCUMENT</u>              |   |   |     |
| <u>EX-101 SCHEMA DOCUMENT</u>                |   |   |     |
| <u>EX-101 CALCULATION LINKBASE DOCUMENT</u>  |   |   |     |
| <u>EX-101 LABELS LINKBASE DOCUMENT</u>       |   |   |     |
| <u>EX-101 PRESENTATION LINKBASE DOCUMENT</u> |   |   |     |
| <u>EX-101 DEFINITION LINKBASE DOCUMENT</u>   |   |   |     |

**Table of Contents**

**PART I**

**Item 1. BUSINESS**

**General**

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

The Company is one of the nation's top 50 bank holding companies, based on asset size. At December 31, 2010, the Company had consolidated assets of \$18.5 billion, loans of \$9.5 billion, deposits of \$15.1 billion, and equity of \$2.0 billion. All of the Company's operations conducted by subsidiaries are consolidated for purposes of preparing the Company's consolidated financial statements. The Company does not utilize unconsolidated subsidiaries or special purpose entities to provide off-balance sheet borrowings or securitizations.

The Company's goal is to be the preferred provider of targeted financial services in its communities, based on strong customer relationships. It believes in building long-term relationships based on top quality service, high ethical standards and safe, sound assets. The Company operates under a super-community banking format with a local orientation, augmented by experienced, centralized support in select critical areas. The Company's local market orientation is reflected in its financial centers and regional advisory boards, which are comprised of local business persons, professionals and other community representatives, that assist the Company in responding to local banking needs. In addition to this local market, community-based focus, the Company offers sophisticated financial products available at much larger financial institutions.

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

The markets the Bank serves, being located in the lower Midwest, provide natural sites for production and distribution facilities and also serve as transportation hubs. The economy has been well-diversified in these markets with many major industries represented, including telecommunications, automobile, aircraft and general manufacturing, health care, numerous service industries, food production, and agricultural production and related industries. In addition, several of the Illinois markets are located in areas with some of the most productive farmland in the world. The real estate lending operations of the Bank are centered in its lower Midwestern markets. Historically, these markets have generally tended to be less volatile than in other parts of the country. While the decline in the national real estate market resulted in significantly higher real estate loan losses during 2008, 2009 and 2010 for the banking industry, management believes the diversity and nature of the Bank's markets has resulted in lower real estate loan losses in these markets and is a key factor in the Bank's relatively lower loan loss levels.

The Company regularly evaluates the potential acquisition of, and holds discussions with, various financial institutions eligible for bank holding company ownership or control. In addition, the Company regularly considers the potential disposition of certain of its assets and branches. The Company seeks merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. For additional information on acquisition and branch disposition activity, refer to page 75.

## **Table of Contents**

### **Operating Segments**

The Company is managed in three operating segments. The Consumer segment includes the retail branch network, consumer installment lending, personal mortgage banking, consumer debit and credit bank card activities, and student lending. It provides services through a network of 209 full-service branches, a widespread ATM network of 408 machines, and the use of alternative delivery channels such as extensive online banking and telephone banking services. In 2010, this retail segment contributed 35% of total segment pre-tax income. The Commercial segment provides a full array of corporate lending, merchant and commercial bank card products, leasing, and international services, as well as business and government deposit and cash management services. In 2010, it contributed 50% of total segment pre-tax income. The Wealth segment provides traditional trust and estate tax planning services, brokerage services, and advisory and discretionary investment portfolio management services to both personal and institutional corporate customers. This segment also manages the Company's family of proprietary mutual funds, which are available for sale to both trust and general retail customers. Fixed income investments are sold to individuals and institutional investors through the Capital Markets Group, which is also included in this segment. At December 31, 2010, the Wealth segment managed investments with a market value of \$14.3 billion and administered an additional \$10.7 billion in non-managed assets. Additional information relating to operating segments can be found on pages 53 and 99.

### **Supervision and Regulation**

#### *General*

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

The Company is required to file with the Federal Reserve Board various reports and such additional information as the Federal Reserve Board may require. The Federal Reserve Board also makes regular examinations of the Company and its subsidiaries. The Company's banking subsidiary is organized as a national banking association and is subject to regulation, supervision and examination by the Office of the Comptroller of the Currency (OCC). The Bank is also subject to regulation by the Federal Deposit Insurance Corporation (FDIC). In addition, there are numerous other federal and state laws and regulations which control the activities of the Company and the Bank, including requirements and limitations relating to capital and reserve requirements, permissible investments and lines of business, transactions with affiliates, loan limits, mergers and acquisitions, issuance of securities, dividend payments, and extensions of credit. If the Company fails to comply with these or other applicable laws and regulations, it may be subject to civil monetary penalties, imposition of cease and desist orders or other written directives, removal of management and, in certain circumstances, criminal penalties. This regulatory framework is intended primarily for the protection of depositors and the preservation of the federal deposit insurance funds, and not for the protection of security holders. Statutory and regulatory controls increase a bank holding company's cost of doing business and limit the options of its management to employ assets and maximize income.



In addition to its regulatory powers, the Federal Reserve Bank affects the conditions under which the Company operates by its influence over the national supply of bank credit. The Federal Reserve Board employs open market operations in U.S. government securities, changes in the discount rate on bank

## **Table of Contents**

borrowings, changes in the federal funds rate on overnight inter-bank borrowings, and changes in reserve requirements on bank deposits in implementing its monetary policy objectives. These instruments are used in varying combinations to influence the overall level of the interest rates charged on loans and paid for deposits, the price of the dollar in foreign exchange markets and the level of inflation. The monetary policies of the Federal Reserve have a significant effect on the operating results of financial institutions, most notably on the interest rate environment. In view of changing conditions in the national economy and in the money markets, as well as the effect of credit policies of monetary and fiscal authorities, no prediction can be made as to possible future changes in interest rates, deposit levels or loan demand, or their effect on the financial statements of the Company.

### *Subsidiary Bank*

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

Substantially all of the deposits of the Bank are insured up to the applicable limits by the Bank Insurance Fund of the FDIC, generally up to \$250,000 per depositor, for each account ownership category. Through December 31, 2012, all non-interest bearing transaction accounts are fully guaranteed by the FDIC for the entire amount of the account. The Bank pays deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC for Bank Insurance Fund member institutions. The FDIC has established a risk-based assessment system under which institutions are classified and pay premiums according to their perceived risk to the federal deposit insurance funds. The Bank's premiums had been relatively low prior to the 2008 economic crisis. These rose significantly in 2009 due to higher fees charged by the FDIC in order to replenish its insurance fund, which had been depleted by high levels of bank failures across the country. The Bank's FDIC expense totaled \$19.2 million in 2010 and \$27.4 million in 2009, compared to \$2.1 million in 2008. In late 2009, the FDIC Board ruled that insured institutions must prepay their quarterly risk-based assessments for the fourth quarter of 2009 and subsequent years 2010 through 2012, in order to cover the costs of future expected bank failures. The Bank's pre-payment on December 30, 2009 totaled \$68.7 million. In November 2010, under the provisions of the Dodd-Frank Act (mentioned below), the FDIC proposed changing its assessment base from total domestic deposits to average total assets minus average tangible equity. The proposal alters other adjustments in the current assessment system for heavy use of unsecured liabilities, secured liabilities and brokered deposits, and adds an adjustment for holdings of unsecured bank debt. The proposal is expected to increase assessments on banks with more than \$10 billion in assets, raising their share of overall FDIC assessments from the present 70% to 80%. The assessment increase would be in place by the second quarter of 2011. Also, for banks with more than \$10 billion in assets, the FDIC has proposed changing the assessment rate. The proposal would abandon the current method for determining premiums, which are based on bank supervisory ratings, debt issuer ratings and financial ratios. Instead, the proposed assessment would rely on a scorecard designed to measure financial performance and ability to withstand stress, in addition to measuring the FDIC's exposure should the bank fail. This proposal would be effective beginning in the second quarter of 2011. The Company expects that the effect of these proposals, if adopted, would be to reduce FDIC insurance expense in 2011 in the range of \$4 to \$5 million.

### *Payment of Dividends*

The principal source of the Company's cash revenues is dividends paid by the Bank. The Federal Reserve Board may prohibit the payment of dividends by bank holding companies if their actions constitute unsafe or unsound practices. The OCC limits the payment of dividends by the Bank in any calendar year to the net profit of the current year combined with the retained net profits of the preceding two years. Permission must



## **Table of Contents**

be obtained from the OCC for dividends exceeding these amounts. The payment of dividends by the Bank may also be affected by factors such as the maintenance of adequate capital.

### *Capital Adequacy*

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

In addition, the Federal Reserve also requires bank holding companies to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization's Tier I capital to its total consolidated quarterly average assets (as defined for regulatory purposes), net of the allowance for loan losses, goodwill and certain other intangible assets. The minimum leverage ratio for bank holding companies is 4%. At December 31, 2010, the Bank was well-capitalized under regulatory capital adequacy standards, as further discussed on page 102.

In December 2010, the Basel Committee on Banking Supervision presented to the public the Basel III rules text, which proposes new global regulatory standards on bank capital adequacy and liquidity. The Basel Committee seeks to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector. The framework sets out tougher capital requirements, higher risk-weighted assets, the introduction of a leverage ratio, and higher requirements for minimum capital ratios. Basel III also establishes two minimum standards for liquidity to promote short-term resilience, as well as resilience over a longer period of time through a stable maturity structure of assets and liabilities. Banks are required to begin phasing in Basel III requirements beginning in 2013. The Company continues to evaluate the impact of this framework on its operations and reporting.

### *Legislation*

The financial industry operates under laws and regulations that are under constant review by various agencies and legislatures, and are subject to sweeping change. The Gramm-Leach-Bliley Financial Modernization Act of 1999 (GLB Act) contained major changes in laws that previously kept the banking industry largely separate from the securities and insurance industries. The GLB Act authorized the creation of a new kind of financial institution, known as a financial holding company, and a new kind of bank subsidiary, called a financial subsidiary, which may engage in a broader range of investment banking, insurance agency, brokerage, and underwriting activities. The GLB Act also included privacy provisions that limit banks' abilities to disclose non-public information about customers to non-affiliated entities. Banking organizations are not required to become financial holding companies, but instead may continue to operate as bank holding companies, providing the same services they were authorized to provide prior to the enactment of the GLB Act. The Company currently operates as a bank holding company.

The Company must also comply with the requirements of the Bank Secrecy Act (BSA). The BSA is designed to help fight drug trafficking, money laundering, and other crimes. Compliance is monitored by the OCC. The BSA was enacted to prevent banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity. Since its passage, the BSA has been amended several times. These amendments include the Money Laundering Control Act of 1986 which made money laundering a

criminal act, as well as the Money Laundering Suppression Act of 1994 which required regulators to develop enhanced examination procedures and

## **Table of Contents**

increased examiner training to improve the identification of money laundering schemes in financial institutions.

In 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act) was signed into law. The USA PATRIOT Act substantially broadened the scope of U.S. anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The U.S. Treasury Department issued a number of regulations implementing the USA PATRIOT Act that apply certain of its requirements to financial institutions such as the Company's broker-dealer subsidiary. The regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing.

The Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (the Credit CARD Act) was signed into law in May 2009. It is comprehensive credit card legislation that aims to establish fair and transparent practices relating to open end consumer credit plans. The first phase of the legislation began in August 2009, under which the payment period (with no late fees) was extended from 14 days to 21 days, the advance warning period for significant changes to credit card accounts was extended from 15 days to 45 days, and opt-out provisions were made available to customers. A second phase began in February 2010, which included provisions governing when rate increases can be applied on late accounts, requirements for clearer disclosures of terms before opening an account, prohibitions on charging over-limit fees and double-cycle billing, and various other restrictions. Additional rules became effective in July 2010, which deal with interest rate reinstatements on former overdue accounts, and gift card expiration dates and inactivity fees.

In late 2009, the Federal Reserve issued new regulations, effective July 1, 2010, which prohibited financial institutions from assessing fees for paying ATM and one-time debit card transactions that overdraw consumer accounts unless the consumer affirmatively consents to the financial institution's overdraft practices. The Company 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 not all customers provided such consent, these new regulations resulted in lower deposit fee income in the second half of 2010. Overdraft fees decreased \$7.8 million in the second half of 2010 compared to the first half. The Company estimates that the effect of these regulations will reduce annualized pre-tax revenue by \$15 to \$16 million. As a means to mitigate some of the impact to revenue, the Company is also developing other products and has begun offering some deposit accounts with monthly fees.

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

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was signed into law. The Dodd-Frank Act is sweeping legislation intended to overhaul regulation of the financial services industry. Its goals are to establish a new council of systemic risk regulators, create a new consumer protection division within the Federal Reserve, empower the Federal Reserve to supervise the largest, most complex financial companies, allow the government to seize and liquidate failing financial companies, and give regulators new powers to oversee the derivatives market. The provisions of the Dodd-Frank Act are so extensive and overreaching that full implementation may require several years, and an assessment of its full effect on the Company is not possible at this time.

Under the provisions of the Dodd-Frank Act, the Federal Reserve proposed changes in December 2010 that would significantly limit the amount of debit card interchange fees charged by banks. The proposal outlines two alternatives

for computing a reasonable and proportional fee. Industry analysts have estimated that revenues from debit card interchange may be reduced by as much as 70% under either approach.

## **Table of Contents**

The proposal also seeks to limit network exclusivity, requiring issuers to ensure that a debit card transaction can be carried on several unaffiliated networks. The new rules would apply to bank issuers with more than \$10 billion in assets and would take effect in July 2011. The Federal Reserve's proposal did not include a specific adjustment for fraud prevention costs, which it intends to separately consider at a future date. The Company's fees from debit card interchange subject to the proposed rule were \$57 million in 2010.

## **Competition**

The Company's locations in regional markets throughout Missouri, Kansas, central Illinois, Tulsa, Oklahoma, and Denver, Colorado, face intense competition from hundreds of financial service providers. The Company competes with national and state banks for deposits, loans and trust accounts, and with savings and loan associations and credit unions for deposits and consumer lending products. In addition, the Company competes with other financial intermediaries such as securities brokers and dealers, personal loan companies, insurance companies, finance companies, and certain governmental agencies. The passage of the GLB Act, which removed barriers between banking and the securities and insurance industries, has resulted in greater competition among these industries. The Company generally competes on the basis of customer service and responsiveness to customer needs, interest rates on loans and deposits, lending limits and customer convenience, such as location of offices.

## **Employees**

The Company and its subsidiaries employed 4,389 persons on a full-time basis and 616 persons on a part-time basis at December 31, 2010. The Company provides a variety of benefit programs including a 401K plan as well as group life, health, accident, and other insurance. The Company also maintains training and educational programs designed to prepare employees for positions of increasing responsibility.

## **Available Information**

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

## **Statistical Disclosure**

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

|  | Page         |
|--|--------------|
| I. Distribution of Assets, Liabilities and Stockholders' Equity;<br>Interest Rates and Interest Differential | 23, 60-63    |
| II. Investment Portfolio   | 42-44, 80-85 |
| III. Loan Portfolio  |              |
| Types of Loans   | 29           |
| Maturities and Sensitivities of Loans to Changes in Interest Rates   | 30           |
| Risk Elements  | 36-42        |
| IV. Summary of Loan Loss Experience  | 33-36        |



|      |                             |           |
|------|-----------------------------|-----------|
| V.   | Deposits                    | 44-45, 87 |
| VI.  | Return on Equity and Assets | 18        |
| VII. | Short-Term Borrowings       | 88-89     |

**Table of Contents**

**Item 1a. RISK FACTORS**

Making or continuing an investment in securities issued by Commerce Bancshares, Inc., including its common stock, involves certain risks that you should carefully consider. The risks and uncertainties described below are not the only risks that may have a material adverse effect on the Company. Additional risks and uncertainties also could adversely affect its business and financial results. If any of the following risks actually occur, its business, financial condition or results of operations could be negatively affected, the market price for your securities could decline, and you could lose all or a part of your investment. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause the Company's actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of Commerce Bancshares, Inc.

**Difficult market conditions have adversely affected the Company's industry and may continue to do so.**

Given the concentration of the Company's banking business in the United States, it is particularly exposed to downturns in the U.S. economy. The economic trends which began in 2008, such as declines in the housing market, falling home prices, increasing foreclosures, unemployment and under-employment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial and investment banks. These write-downs, initially of mortgage-backed securities and other complex financial instruments, but spreading to various classes of real estate, commercial and consumer loans in turn, have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. The weak U.S. economy and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. The resulting economic pressure on consumers and lack of confidence in the financial markets has adversely affected the Company's business, financial condition and results of operations through higher levels of loan losses and lower loan demand. While there have been some recent indications of stabilization, management does not expect significant economic improvement in the near future. In particular, the Company may face the following risks in connection with these market conditions:

The Company may face increased regulation of the industry. Compliance with such regulation may divert resources from other areas of the business and limit the ability to pursue other opportunities. Recently adopted regulation over credit card and overdraft account practices will likely result in lower revenues from these products.

High unemployment levels, weak economic activity and other market developments may affect consumer confidence levels and may cause declines in consumer credit usage and adverse changes in payment patterns, causing increases in delinquencies and default rates. These could impact the Company's loan losses and provision for loan losses, as a significant part of the Company's business includes consumer and credit card lending.

Reduced levels of economic activity may also cause declines in financial service transactions and the fees earned by the Company on such transactions.

The Company's ability to assess the creditworthiness of its customers may be impaired if the models and approaches it uses to select, manage, and underwrite its customers become less predictive of future behaviors.

The process used to estimate losses inherent in the Company's credit exposure requires difficult, subjective, and complex judgments, including forecasts of economic conditions and how these economic predictions might impair the ability of its borrowers to repay their loans. If an instance occurs

## **Table of Contents**

that renders these predictions no longer capable of accurate estimation, this may in turn impact the reliability of the process.

Competition in the industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions.

With higher bank failures occurring in 2009 and 2010 and more expected in the future, the Company may be required to pay significantly higher FDIC premiums for extended periods of time because of the low funding levels within the FDIC insurance fund.

### **Significant changes in banking laws and regulations could materially affect the Company's business.**

Increased regulation of the banking industry is being demanded by the current political administration. Certain regulation has already been imposed during the past year, and much additional regulation has been proposed. Such regulation, along with possible changes in tax laws and accounting rules, may have a significant impact on the ways that financial institutions conduct business, implement strategic initiatives, engage in tax planning and make financial disclosures. Compliance with such regulation may increase costs and limit the ability to pursue business opportunities.

### **The performance of the Company is dependent on the economic conditions of the markets in which the Company operates.**

The Company's success is heavily influenced by the general economic conditions of the specific markets in which it operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides financial services primarily throughout the states of Missouri, Kansas, and central Illinois, and has recently begun to expand into Oklahoma, Colorado and other surrounding states. Since the Company does not have a significant presence in other parts of the country, a prolonged economic downturn in these markets could have a material adverse effect on the Company's financial condition and results of operations.

### **Significant changes in federal monetary policy could materially affect the Company's business.**

The Federal Reserve System regulates the supply of money and credit in the United States. Its policies determine in large part the cost of funds for lending and investing by influencing the interest rate earned on loans and paid on borrowings and interest bearing deposits. Credit conditions are influenced by its open market operations in U.S. government securities, changes in the member bank discount rate, and bank reserve requirements. Changes in Federal Reserve Board policies are beyond the Company's control and difficult to predict.

### **The soundness of other financial institutions could adversely affect the Company.**

The Company's ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institution counterparties. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual funds, and other institutional clients. Transactions with these institutions include overnight and term borrowings, interest rate swap agreements, securities purchased and sold, short-term investments, and other such transactions. As a result of this exposure, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by the Company or by other institutions. Many of these transactions expose the Company to credit risk in the event of default of its counterparty or client, while other transactions expose the Company to liquidity risks should funding sources quickly disappear. In addition, the

Company's credit risk may be exacerbated when the collateral held cannot be realized upon or is liquidated at

## **Table of Contents**

prices not sufficient to recover the full amount of the financial instrument exposure due to the Company. Any such losses could materially and adversely affect results of operations.

**The Company's asset valuation may include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to asset valuations that may materially adversely affect its results of operations or financial condition.**

The Company uses estimates, assumptions, and judgments when financial assets and liabilities are measured and reported at fair value. Assets and liabilities carried at fair value inherently result in a higher degree of financial statement volatility. Fair values and the information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices and/or other observable inputs provided by independent third-party sources, when available. When such third-party information is not available, fair value is estimated primarily by using cash flow and other financial modeling techniques utilizing assumptions such as credit quality, liquidity, interest rates and other relevant inputs. Changes in underlying factors, assumptions, or estimates in any of these areas could materially impact the Company's future financial condition and results of operations.

During periods of market disruption, including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain assets if trading becomes less frequent and/or market data becomes less observable. There may be certain asset classes that were in active markets with significant observable data that become illiquid due to the current financial environment. In such cases, certain asset valuations may require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation. Further, rapidly changing and unprecedented credit and equity market conditions could materially impact the valuation of assets as reported within the Company's consolidated financial statements, and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on results of operations or financial condition.

**The Company's investment portfolio values may be adversely impacted by changing interest rates and deterioration in the credit quality of underlying collateral within mortgage and other asset-backed investment securities.**

The Company generally invests in securities issued by government-backed agencies or privately issued securities that are highly rated by credit rating agencies at the time of purchase, but are subject to changes in market value due to changing interest rates and implied credit spreads. Recently, budget deficits and other financial problems in a number of states and political subdivisions have been reported in the media. While the Company maintains rigorous risk management practices over bonds issued by municipalities, further credit deterioration in these bonds could occur and result in losses. Certain mortgage and asset-backed securities represent beneficial interests which are collateralized by residential mortgages, credit cards, automobiles, mobile homes or other assets. While these investment securities are highly rated at the time of initial investment, the value of these securities may decline significantly due to actual or expected deterioration in the underlying collateral, especially residential mortgage collateral. Market conditions have resulted in a deterioration in fair values for non-guaranteed mortgage-backed and other asset-backed securities. Under accounting rules, when the impairment is due to declining expected cash flows, some portion of the impairment, depending on the Company's intent to sell and the likelihood of being required to sell before recovery, must be recognized in current earnings. This could result in significant non-cash losses.

**The Company is subject to interest rate risk.**

The Company's net interest income is the largest source of overall revenue to the Company, representing 61% of total revenue. Interest rates are beyond the Company's control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board.

Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits, and the rates received on loans and investment securities and paid on deposits. Management believes it has implemented effective

## **Table of Contents**

asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations. However, any substantial, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

### **Future loan losses could increase.**

The Company maintains an allowance for loan losses that represents management's best estimate of probable losses that have been incurred at the balance sheet date within the existing portfolio of loans. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. In recent years the Company has seen significant increases in losses in its loan portfolio, particularly in residential construction, consumer, and credit card loans, due to the deterioration in the housing industry and general economic conditions. Until the housing sector and overall economy begin to recover, it is likely that these losses will continue. While the Company's credit loss ratios remain below industry averages, continued economic deterioration and further loan losses may negatively affect its results of operations and could further increase levels of its allowance. In addition, the Company's allowance level is subject to review by regulatory agencies, and that review could result in adjustments to the allowance. See the section captioned "Allowance for Loan Losses" in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of this report for further discussion related to the Company's process for determining the appropriate level of the allowance for possible loan loss.

### **The Company operates in a highly competitive industry and market area.**

The Company operates in the financial services industry, a rapidly changing environment having numerous competitors including other banks and insurance companies, securities dealers, brokers, trust and investment companies and mortgage bankers. The pace of consolidation among financial service providers is accelerating, and there are many new changes in technology, product offerings and regulation. New entrants offering competitive products continually penetrate our markets. The Company must continue to make investments in its products and delivery systems to stay competitive with the industry as a whole, or its financial performance may suffer.

### **The Company's reputation and future growth prospects could be impaired if events occur which breach its customers' privacy.**

The Company relies heavily on communications and information systems to conduct its business, and as part of its business, the Company maintains significant amounts of data about its customers and the products they use. While the Company has policies and procedures designed to prevent or limit the effect of failure, interruption or security breach of its information systems, there can be no assurances that any such failures, interruptions or security breaches will not occur; or if they do occur, that they will be adequately addressed. Should any of these systems become compromised, the reputation of the Company could be damaged, relationships with existing customers may be impaired, the compromise could result in lost business and as a result, the Company could incur significant expenses trying to remedy the compromise.

### **The Company may not attract and retain skilled employees.**

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people can be intense, and the Company spends considerable time and resources attracting and hiring qualified people for its various business lines and support units. The unexpected loss of the services of one or more of the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, and years of industry experience, as well as the difficulty of promptly finding qualified



replacement personnel.

**Item 1b. UNRESOLVED STAFF COMMENTS**

None

**Table of Contents****Item 2. PROPERTIES**

The main offices of the Bank are located in the larger metropolitan areas of its markets in various multi-story office buildings. The Bank owns its main offices and leases unoccupied premises to the public. The larger offices include:

| Building                               | Net rentable square footage | % occupied in total | % occupied by bank |
|--|-----------------------------|---------------------|--------------------|
| 922 Walnut<br>Kansas City, MO          | 256,000                     | 95%                 | 93%                |
| 1000 Walnut<br>Kansas City, MO         | 403,000                     | 83                  | 36                 |
| 811 Main<br>Kansas City, MO            | 237,000                     | 100                 | 100                |
| 8000 Forsyth<br>Clayton, MO            | 178,000                     | 95                  | 92                 |
| 1551 N. Waterfront<br>PkwY Wichita, KS | 120,000                     | 99                  | 32                 |

The Bank leases offices in Omaha, Nebraska which house its credit card operations. Additionally, certain other installment loan, trust and safe deposit functions operate out of leased offices in downtown Kansas City. The Company has an additional 203 branch locations in Missouri, Illinois, Kansas, Oklahoma and Colorado which are owned or leased, and 158 off-site ATM locations.

**Item 3. LEGAL PROCEEDINGS**

The information required by this item is set forth in Item 8 under Note 19, Commitments, Contingencies and Guarantees on page 116.

**Item 4. REMOVED AND RESERVED****Executive Officers of the Registrant**

The following are the executive officers of the Company as of February 25, 2011, each of whom is designated annually. There are no arrangements or understandings between any of the persons so named and any other person pursuant to which such person was designated an executive officer.

| Name and Age            | Positions with Registrant   |
|-------------------------|---|
| Jeffery D. Aberdeen, 57 | Controller of the Company since December 1995. Prior thereto he was Assistant Controller of the Company. He is Controller of the Company's subsidiary bank, Commerce Bank, N.A. |

Kevin G. Barth, 50

Executive Vice President of the Company since April 2005 and Executive Vice President of Commerce Bank, N.A. since October 1998. Senior Vice President of the Company and Officer of Commerce Bank, N.A. prior thereto.

Daniel D. Callahan, 53

Executive Vice President of the Company since December 2010, Senior Vice President of the Company since April 2005 and Vice President of the Company prior thereto. Executive Vice President of Commerce Bank, N.A. since May 2003. Effective December 2010, he was appointed Chief Credit Officer of the Company.

Sara E. Foster, 50

Senior Vice President of the Company since February 1998 and Vice President of the Company prior thereto.

**Table of Contents**

| Name and Age           | Positions with Registrant   |
|------------------------|---|
| David W. Kemper, 60    | Chairman of the Board of Directors of the Company since November 1991, Chief Executive Officer of the Company since June 1986, and President of the Company since April 1982. He is Chairman of the Board, President and Chief Executive Officer of Commerce Bank, N.A. He is the son of James M. Kemper, Jr. (a former Director and former Chairman of the Board of the Company), the brother of Jonathan M. Kemper, Vice Chairman of the Company, and father of John W. Kemper.   |
| John W. Kemper, 32     | Senior Vice President of the Company since December 2010 and Senior Vice President of Commerce Bank, N.A. since January 2009. His employment began in August 2007 as Strategic Planning Consultant and was elected Strategic Planning Director in January 2009. Prior to his employment with the Commerce Bank, N.A. he was employed as an engagement manager with McKinsey & Company, a global management consulting firm, from 2005 until August 2007, managing strategy and operations projects primarily focused in the financial service industry. He is the son of David W. Kemper, Chairman, President, and Chief Executive Officer of the Company and nephew of Jonathan M. Kemper, Vice Chairman of the Company. |
| Jonathan M. Kemper, 57 | Vice Chairman of the Company since November 1991 and Vice Chairman of Commerce Bank, N.A. since December 1997. Prior thereto, he was Chairman of the Board, Chief Executive Officer, and President of Commerce Bank, N.A. He is the son of James M. Kemper, Jr. (a former Director and former Chairman of the Board of the Company), the brother of David W. Kemper, Chairman, President, and Chief Executive Officer of the Company, and uncle of John W. Kemper.  |
| Charles G. Kim, 50     | Chief Financial Officer of the Company since July 2009. Executive Vice President of the Company since April 1995 and Executive Vice President of Commerce Bank, N.A. since January 2004. Prior thereto, he was Senior Vice President of Commerce Bank, N.A. (Clayton, MO), a former subsidiary of the Company.  |
| Seth M. Leadbeater, 60 | Vice Chairman of the Company since January 2004. Prior thereto he was Executive Vice President of the Company. He has been Vice Chairman of Commerce Bank, N.A. since September 2004. Prior thereto he was Executive Vice President of Commerce Bank, N.A. and President of Commerce Bank, N.A. (Clayton, MO).  |
| Michael J. Petrie, 54  | Senior Vice President of the Company since April 1995. Prior thereto, he was Vice President of the Company.   |
| Robert J. Rauscher, 53 | Senior Vice President of the Company since October 1997. Senior Vice President of Commerce Bank, N.A. prior thereto.  |

V. Raymond Stranghoener, 59

Executive Vice President of the Company since July 2005 and Senior Vice President of the Company prior thereto.

14

---

Table of Contents**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Commerce Bancshares, Inc.  
Common Stock Data**

The following table sets forth the high and low prices of actual transactions for the Company's common stock and cash dividends paid for the periods indicated (restated for the 5% stock dividend distributed in December 2010).

|             | Quarter       | High            | Low             | Cash Dividends |
|-------------|---------------|-----------------|-----------------|----------------|
| <b>2010</b> | <b>First</b>  | <b>\$ 39.87</b> | <b>\$ 35.76</b> | <b>\$ .224</b> |
|             | <b>Second</b> | <b>41.16</b>    | <b>33.83</b>    | <b>.224</b>    |
|             | <b>Third</b>  | <b>38.42</b>    | <b>33.43</b>    | <b>.224</b>    |
|             | <b>Fourth</b> | <b>40.59</b>    | <b>34.35</b>    | <b>.224</b>    |
| 2009        | First         | \$ 40.28        | \$ 25.22        | \$ .218        |
|             | Second        | 35.60           | 26.97           | .218           |
|             | Third         | 36.26           | 28.06           | .218           |
|             | Fourth        | 38.46           | 32.56           | .218           |
| 2008        | First         | \$ 39.39        | \$ 32.83        | \$ .216        |
|             | Second        | 39.44           | 34.06           | .216           |
|             | Third         | 45.77           | 31.53           | .216           |
|             | Fourth        | 47.95           | 32.15           | .216           |

Commerce Bancshares, Inc. common shares are listed on the Nasdaq Global Select Market (NASDAQ) under the symbol CBSH. The Company had 4,284 shareholders of record as of December 31, 2010.

**Table of Contents****Performance Graph**

The following graph presents a comparison of Company (CBSH) performance to the indices named below. It assumes \$100 invested on December 31, 2005 with dividends invested on a Total Return basis.

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, during the fourth quarter of 2010.

| Period                | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased<br>as Part of Publicly<br>Announced<br>Program | Maximum Number<br>that<br>May Yet Be<br>Purchased<br>Under the Program |
|-----------------------|---|------------------------------------|--|--|
| October 1 - 31, 2010  | 506,154                                   | \$ 36.70                           | 506,154  | 2,329,156  |
| November 1 - 30, 2010 | 566,534                                   | \$ 37.43                           | 566,534  | 1,762,622  |
| December 1 - 31, 2010 | 4,044                                     | \$ 39.34                           | 4,044  | 1,758,578  |
| <b>Total</b>          | <b>1,076,732</b>                          | <b>\$ 37.09</b>                    | <b>1,076,732</b>   | <b>1,758,578</b>   |

The Company's stock purchases shown above were made under a 3,000,000 share authorization by the Board of Directors on February 1, 2008. Under this authorization, 1,758,578 shares remained available for purchase at December 31, 2010.

**Table of Contents**

**Item 6. SELECTED FINANCIAL DATA**

The required information is set forth below in Item 7.

**Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

Commerce Bancshares, Inc. (the Company) operates as a super-community bank offering an array of sophisticated financial products delivered with high-quality, personal customer service. It is the largest bank holding company headquartered in Missouri, with its principal offices in Kansas City and St. Louis, Missouri. Customers are served from approximately 370 locations in Missouri, Kansas, Illinois, Oklahoma and Colorado using delivery platforms which include an extensive network of branches and ATM machines, full-featured online banking, and a central contact center.

The core of the Company's competitive advantage is its focus on the local markets it services and its concentration on relationship banking, with high service levels and competitive products. In order to enhance shareholder value, the Company grows its core revenue by expanding new and existing customer relationships, utilizing improved technology, and enhancing customer satisfaction.

Various indicators are used by management in evaluating the Company's financial condition and operating performance. Among these indicators are the following:

**Net income and growth in earnings per share** Net income was \$221.7 million, an increase of 31.1% compared to the previous year. The return on average assets was 1.22%. Diluted earnings per share increased 27.9% in 2010 compared to 2009.

**Growth in total revenue** Total revenue is comprised of net interest income and non-interest income. Total revenue in 2010 grew 1.9% over 2009, which resulted from growth of \$10.4 million, or 1.6%, in net interest income coupled with growth of \$8.9 million, or 2.2%, in non-interest income. Total revenue has risen 4.7%, compounded annually, over the last five years.

**Expense control** Non-interest expense grew by 1.5% this year. Salaries and employee benefits, the largest expense component, grew by .2%, due to higher incentive payments and 401K plan expense, which were partly offset by lower pension and medical costs.

**Asset quality** Net loan charge-offs in 2010 decreased \$41.9 million from those recorded in 2009, and averaged 1.00% of loans compared to 1.31% in the previous year. Total non-performing assets, which include non-accrual loans and other real estate owned, amounted to \$97.3 million, a decrease of \$19.4 million from balances at the previous year end, and represented 1.03% of loans outstanding.

**Shareholder return** Total shareholder return, including the change in stock price and dividend reinvestment, was 10.3% over the past year and 6.4% over the past 10 years.



**Table of Contents**

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes. The historical trends reflected in the financial information presented below are not necessarily reflective of anticipated future results.

**Key Ratios**

| <i>(Based on average balances)</i>                          | <b>2010</b>  | 2009  | 2008  | 2007  | 2006  |
|---|--------------|-------|-------|-------|-------|
| Return on total assets                                      | <b>1.22%</b> | .96%  | 1.15% | 1.33% | 1.54% |
| Return on total equity                                      | <b>11.15</b> | 9.76  | 11.81 | 13.97 | 15.92 |
| Equity to total assets                                      | <b>10.91</b> | 9.83  | 9.71  | 9.55  | 9.70  |
| Loans to deposits <sup>(1)</sup>                            | <b>70.02</b> | 79.79 | 92.11 | 88.49 | 84.73 |
| Non-interest bearing deposits to total deposits             | <b>6.92</b>  | 6.66  | 5.47  | 5.45  | 5.78  |
| Net yield on interest earning assets (tax equivalent basis) | <b>3.89</b>  | 3.93  | 3.96  | 3.85  | 3.95  |
| <i>(Based on end of period data)</i>                        |              |       |       |       |       |
| Non-interest income to revenue <sup>(2)</sup>               | <b>38.54</b> | 38.41 | 38.80 | 40.85 | 40.72 |
| Efficiency ratio <sup>(3)</sup>                             | <b>59.71</b> | 59.88 | 63.08 | 62.65 | 60.20 |
| Tier I risk-based capital ratio                             | <b>14.38</b> | 13.04 | 10.92 | 10.31 | 11.25 |
| Total risk-based capital ratio                              | <b>15.75</b> | 14.39 | 12.31 | 11.49 | 12.56 |
| Tier I leverage ratio                                       | <b>10.17</b> | 9.58  | 9.06  | 8.76  | 9.05  |
| Tangible equity to assets ratio <sup>(4)</sup>              | <b>10.27</b> | 9.71  | 8.25  | 8.61  | 8.77  |
| Cash dividend payout ratio                                  | <b>35.52</b> | 44.15 | 38.54 | 33.76 | 30.19 |

(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).

**Selected Financial Data**

| <i>(In thousands, except per share data)</i> | <b>2010</b>       | 2009       | 2008       | 2007       | 2006       |
|--|-------------------|------------|------------|------------|------------|
| Net interest income                          | \$ <b>645,932</b> | \$ 635,502 | \$ 592,739 | \$ 538,072 | \$ 513,199 |
| Provision for loan losses                    | <b>100,000</b>    | 160,697    | 108,900    | 42,732     | 25,649     |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|   |                   |            |            |            |            |
|---|-------------------|------------|------------|------------|------------|
| Non-interest income                       | <b>405,111</b>    | 396,259    | 375,712    | 371,581    | 352,586    |
| Investment securities gains (losses), net | <b>(1,785)</b>    | (7,195)    | 30,294     | 8,234      | 9,035      |
| Non-interest expense                      | <b>631,134</b>    | 621,737    | 615,380    | 574,159    | 522,391    |
| Net income                                | <b>221,710</b>    | 169,075    | 188,655    | 206,660    | 219,842    |
| Net income per common share-basic*        | <b>2.54</b>       | 1.98       | 2.26       | 2.46       | 2.57       |
| Net income per common share-diluted*      | <b>2.52</b>       | 1.97       | 2.24       | 2.44       | 2.54       |
| Cash dividends                            | <b>78,231</b>     | 74,720     | 72,055     | 68,915     | 65,758     |
| Cash dividends per share*                 | <b>.895</b>       | .871       | .864       | .823       | .768       |
| Market price per share*                   | <b>39.73</b>      | 36.88      | 39.86      | 38.75      | 39.83      |
| Book value per share*                     | <b>23.36</b>      | 21.64      | 18.90      | 18.41      | 17.01      |
| Common shares outstanding*                | <b>86,624</b>     | 87,159     | 83,560     | 83,113     | 85,028     |
| Total assets                              | <b>18,502,339</b> | 18,120,189 | 17,532,447 | 16,204,831 | 15,230,349 |
| Loans, including held for sale            | <b>9,474,733</b>  | 10,490,327 | 11,644,544 | 10,841,264 | 9,960,118  |
| Investment securities                     | <b>7,409,534</b>  | 6,473,388  | 3,780,116  | 3,297,015  | 3,496,323  |
| Deposits                                  | <b>15,085,021</b> | 14,210,451 | 12,894,733 | 12,551,552 | 11,744,854 |
| Long-term debt                            | <b>512,273</b>    | 1,236,062  | 1,447,781  | 1,083,636  | 553,934    |
| Equity                                    | <b>2,023,464</b>  | 1,885,905  | 1,579,467  | 1,530,156  | 1,446,536  |
| Non-performing assets                     | <b>97,320</b>     | 116,670    | 79,077     | 33,417     | 18,223     |

\* Restated for the 5% stock dividend distributed in December 2010.

Table of Contents**Results of Operations**

| <i>(Dollars in thousands)</i>             | <b>2010</b>       | 2009       | 2008       | <b>\$ Change</b> |             | <b>% Change</b> |         |
|---|-------------------|------------|------------|------------------|-------------|-----------------|---------|
|   |                   |            |            | <b>10- 09</b>    | 09- 08      | <b>10- 09</b>   | 09- 08  |
| Net interest income                       | \$ <b>645,932</b> | \$ 635,502 | \$ 592,739 | \$ <b>10,430</b> | \$ 42,763   | <b>1.6%</b>     | 7.2%    |
| Provision for loan losses                 | <b>(100,000)</b>  | (160,697)  | (108,900)  | <b>(60,697)</b>  | 51,797      | <b>(37.8)</b>   | 47.6    |
| Non-interest income                       | <b>405,111</b>    | 396,259    | 375,712    | <b>8,852</b>     | 20,547      | <b>2.2</b>      | 5.5     |
| Investment securities gains (losses), net | <b>(1,785)</b>    | (7,195)    | 30,294     | <b>5,410</b>     | (37,489)    | <b>75.2</b>     | (123.8) |
| Non-interest expense                      | <b>(631,134)</b>  | (621,737)  | (615,380)  | <b>9,397</b>     | 6,357       | <b>1.5</b>      | 1.0     |
| Income taxes                              | <b>(96,249)</b>   | (73,757)   | (85,077)   | <b>22,492</b>    | (11,320)    | <b>30.5</b>     | (13.3)  |
| Non-controlling interest (expense) income | <b>(165)</b>      | 700        | (733)      | <b>(865)</b>     | 1,433       | <b>(123.6)</b>  | 195.5   |
| <b>Net income</b>                         | \$ <b>221,710</b> | \$ 169,075 | \$ 188,655 | \$ <b>52,635</b> | \$ (19,580) | <b>31.1%</b>    | (10.4)% |

Net income for 2010 was \$221.7 million, an increase of \$52.6 million, or 31.1%, compared to \$169.1 million in 2009. Diluted income per share was \$2.52 in 2010 compared to \$1.97 in 2009. The increase in net income resulted from a \$60.7 million decrease in the provision for loan losses coupled with growth of \$10.4 million in net interest income and \$8.9 million in non-interest income. The growth in income was partly offset by an increase of \$9.4 million in non-interest expense. Several significant items of non-interest income and non-interest expense affected results for 2010. During 2010, the Company paid off \$125.0 million in Federal Home Loan Bank (FHLB) borrowings with high interest coupons prior to maturity and incurred a pre-payment penalty of \$11.8 million. The Company also sold its held to maturity portfolio of student loans, totaling \$311.0 million, for a gain of \$6.9 million. During 2010, Visa, Inc. (Visa) indemnification obligation liabilities were reduced by \$4.4 million, decreasing expense. The combined effect of these items was a reduction in pre-tax net income of \$465 thousand. The return on average assets was 1.22% in 2010 compared to .96% in 2009, and the return on average equity was 11.15% compared to 9.76%. At December 31, 2010, the ratio of tangible equity to assets improved to 10.27% compared to 9.71% at year end 2009.

During 2010, net interest income increased \$10.4 million, or 1.6%, compared to 2009. This growth was mainly the result of lower rates paid on deposits and higher average balances in investment securities, but partly offset by lower yields on loans and investment securities and declining loan balances. The provision for loan losses totaled \$100.0 million in 2010, a decrease of \$60.7 million from the prior year. The Company incurred lower loan losses in nearly all categories, notably construction, consumer and business.

Non-interest income in 2010 increased \$8.9 million, or 2.2%, over amounts reported in the previous year, mainly due to growth in bank card and trust fees, which rose \$26.8 million and \$4.1 million, respectively. Bank card fees increased due to strong growth in corporate card revenues, resulting from both new customer transactions and increased volumes from existing customers as the Company continued to expand this product on a national basis.

Offsetting this growth was a decline in deposit account fees of \$13.7 million, or 12.9%, due largely to the effect of new regulations on overdraft fees, in addition to lower brokerage and bond trading revenue. Non-interest expense increased \$9.4 million, or 1.5%, over 2009. The growth in expense included a pre-payment penalty to the FHLB of \$11.8 million, partly offset by an \$8.2 million reduction in FDIC insurance expense. Reductions in a Visa indemnification obligation, discussed further in Note 19 to the consolidated financial statements, were recorded in both 2010 and 2009. Income tax expense amounted to \$96.2 million in 2010 and \$73.8 million in 2009. The effective tax rate was 30.3% in 2010 compared to 30.4% in the previous year.

Net income for 2009 was \$169.1 million, a decline of \$19.6 million, or 10.4%, compared to \$188.7 million in 2008. The decline in net income resulted from a \$51.8 million increase in the provision for loan losses and a \$37.5 million decrease in investment securities gains, but was partly offset by increases of \$42.8 million in net interest income and \$20.5 million in non-interest income. Diluted income per share was \$1.97 in 2009 compared to \$2.24 in 2008. Several significant items of non-interest income and non-interest expense affected results for 2009 and 2008. During 2009, FDIC insurance expense rose to \$27.4 million compared to \$2.1 million in 2008. Results for 2008 included a \$22.2 million gain on the redemption of Visa stock, a loss

## **Table of Contents**

of \$33.3 million relating to purchases of auction rate securities, and a \$6.9 million gain on a bank branch sale. Reductions in the Visa indemnification obligation were \$2.5 million in 2009 compared to \$9.6 million in 2008. The return on average assets was .96% in 2009 compared to 1.15% in 2008, and the return on average equity was 9.76% compared to 11.81%. At December 31, 2009, the ratio of tangible equity to assets improved to 9.71% compared to 8.25% at year end 2008.

During 2009, net interest income increased \$42.8 million, or 7.2%, compared to 2008. Similarly to the trend in 2010, growth in 2009 was largely due to lower rates paid on deposits and borrowings coupled with a higher average balance in investment securities, but partly offset by lower yields on loans and investment securities and lower loan balances. The provision for loan losses totaled \$160.7 million in 2009, an increase of \$51.8 million over the prior year and indicative of the general economic decline. The Company incurred higher net loan charge-offs in all loan categories, with the largest increases in construction, consumer, consumer credit card, and business loans.

Non-interest income in 2009 increased \$20.5 million, or 5.5%, over amounts reported in 2008, mainly due to growth in bank card and student lending fees, which rose \$8.3 million and \$20.8 million, respectively. Student lending (included in loan fees and sales) included higher gains on loan sales and the reversal of certain impairment charges which had been recorded in 2008. Non-interest expense increased \$6.4 million, or 1.0%, over 2008. This expense growth included increases of \$25.3 million in FDIC insurance expense and \$12.2 million in salaries and employee benefits expense, in addition to a \$7.1 million decline in reductions to the Visa indemnification obligation. These increases in expense were largely offset by the 2008 loss of \$33.3 million on the purchase of auction rate securities, discussed further in the Non-Interest Expense section. Income tax expense declined 13.3% in 2009 and resulted in an effective tax rate of 30.4%, which was slightly lower than the effective tax rate of 31.1% in the previous year. The decrease in income tax expense in 2009 compared to 2008 was mainly due to changes in the mix of taxable and non-taxable income on lower pre-tax income.

The Company continually evaluates the profitability of its network of bank branches throughout its markets. As a result of this evaluation process, the Company may periodically sell the assets and liabilities of certain branches, or may sell the premises of specific banking facilities. In February 2009, the Company sold its branch in Lakin, Kansas. In this transaction, the Company sold the bank facility and certain deposits totaling approximately \$4.7 million and recorded a gain of \$644 thousand. During the second quarter of 2008, the Company sold its banking branch, including the facility, in Independence, Kansas. In this transaction, approximately \$23.3 million in loans, \$85.0 million in deposits, and various other assets and liabilities were sold. A gain of \$6.9 million was recorded.

The Company distributed a 5% stock dividend for the seventeenth consecutive year on December 20, 2010. All per share and average share data in this report has been restated to reflect the 2010 stock dividend.

## **Critical Accounting Policies**

The Company's consolidated financial statements are prepared based on the application of certain accounting policies, the most significant of which are described in Note 1 to the consolidated financial statements. Certain of these policies 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 certain investment

securities, and accounting for income taxes.

**Table of Contents***Allowance for Loan Losses*

The Company performs periodic and systematic detailed reviews of its loan portfolio to assess overall collectability. The level of the allowance for loan losses reflects the Company's estimate of the losses inherent in the loan portfolio at any point in time. While these estimates are based on substantive methods for determining allowance requirements, actual outcomes may differ significantly from estimated results, especially when determining allowances for business, lease, construction and business real estate loans. These loans are normally larger and more complex, and their collection rates are harder to predict. Personal loans, including personal mortgage, credit card and consumer loans, are individually smaller and perform in a more homogenous manner, making loss estimates more predictable. Further discussion of the methodology used in establishing the allowance is provided in the Allowance for Loan Losses section of this discussion and in Note 1.

*Valuation of Investment Securities*

The Company carries its investment securities at fair value and employs valuation techniques which utilize observable inputs when those inputs are available. These observable inputs reflect assumptions market participants would use in pricing the security and are developed based on market data obtained from sources independent of the Company. When such information is not available, the Company employs valuation techniques which utilize unobservable inputs, or those which reflect the Company's own assumptions about market participants, based on the best information available in the circumstances. These valuation methods typically involve cash flow and other financial modeling techniques. Changes in underlying factors, assumptions, estimates, or other inputs to the valuation techniques could have a material impact on the Company's future financial condition and results of operations. Assets and liabilities carried at fair value inherently result in more financial statement volatility. Under the fair value measurement hierarchy, fair value measurements are classified as Level 1 (quoted prices), Level 2 (based on observable inputs) or Level 3 (based on unobservable, internally-derived inputs), as discussed in more detail in Note 16 on Fair Value Measurements. Most of the available for sale investment portfolio is priced utilizing industry-standard models that consider various assumptions observable in the marketplace, or can be derived from observable data. Such securities totaled approximately \$6.7 billion, or 91.5% of the available for sale portfolio at December 31, 2010, and were classified as Level 2 measurements. The Company also holds \$150.1 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 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 December 31, 2010, non-agency guaranteed mortgage-backed securities with a par value of \$184.3 million were identified as other-than-temporarily impaired. The credit-related impairment loss on



**Table of Contents**

these securities amounted to \$7.5 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 \$12.2 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 \$58.2 million at December 31, 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.

**Table of Contents****Net Interest Income**

Net interest income, the largest source of revenue, results from the Company's lending, investing, borrowing, and deposit gathering activities. It is affected by both changes in the level of interest rates and changes in the amounts and mix of interest earning assets and interest bearing liabilities. 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.

| <i>(In thousands)</i>   | 2010                               |                 |                 | 2009                               |                  |                 |
|---|------------------------------------|-----------------|-----------------|------------------------------------|------------------|-----------------|
|   | Change due to<br>Average<br>Volume | Average<br>Rate | Total           | Change due to<br>Average<br>Volume | Average<br>Rate  | Total           |
| <b>Interest income, fully taxable equivalent basis</b>                            |                                    |                 |                 |                                    |                  |                 |
| Loans   | \$ (40,397)                        | \$ (7,643)      | \$ (48,040)     | \$ (31,745)                        | \$ (66,327)      | \$ (98,072)     |
| Loans held for sale   | (809)                              | (1,319)         | (2,128)         | 2,161                              | (8,910)          | (6,749)         |
| Investment securities:  |                                    |                 |                 |                                    |                  |                 |
| U.S. government and federal agency obligations                                    | 10,767                             | (7,848)         | 2,919           | 6,568                              | (178)            | 6,390           |
| Government-sponsored enterprise obligations                                       | 2,009                              | (1,637)         | 372             | (1,531)                            | (1,325)          | (2,856)         |
| State and municipal obligations   | 4,676                              | (3,089)         | 1,587           | 9,669                              | (3,557)          | 6,112           |
| Mortgage and asset-backed securities  | 34,296                             | (49,602)        | (15,306)        | 63,862                             | (22,144)         | 41,718          |
| Other securities  | (726)                              | 805             | 79              | 4,524                              | (1,155)          | 3,369           |
| Short-term federal funds sold and securities purchased under agreements to resell | (206)                              | 32              | (174)           | (7,361)                            | (704)            | (8,065)         |
| Long-term securities purchased under agreements to resell                         | 2,549                              |                 | 2,549           |                                    |                  |                 |
| Interest earning deposits with banks  | (385)                              | 5               | (380)           | 1,183                              | (574)            | 609             |
| <b>Total interest income</b>  | <b>11,774</b>                      | <b>(70,296)</b> | <b>(58,522)</b> | <b>47,330</b>                      | <b>(104,874)</b> | <b>(57,544)</b> |
| <b>Interest expense</b>   |                                    |                 |                 |                                    |                  |                 |
| Interest bearing deposits:  |                                    |                 |                 |                                    |                  |                 |
| Savings   | 60                                 | (80)            | (20)            | 113                                | (657)            | (544)           |
| Interest checking and money market  | 5,562                              | (7,675)         | (2,113)         | 6,211                              | (35,369)         | (29,158)        |
|   | (8,420)                            | (20,691)        | (29,111)        | (3,466)                            | (21,874)         | (25,340)        |

|  |                  |                    |                  |                  |                   |                  |
|--|------------------|--------------------|------------------|------------------|-------------------|------------------|
| Time open and C.D. s of less than \$100,000                                |                  |                    |                  |                  |                   |                  |
| Time open and C.D. s of \$100,000 and over                                 | (7,117)          | (14,407)           | (21,524)         | 8,424            | (28,718)          | (20,294)         |
| Federal funds purchased and securities sold under agreements to repurchase | 295              | (1,410)            | (1,115)          | (8,439)          | (12,947)          | (21,386)         |
| Other borrowings   | (15,064)         | (1,515)            | (16,579)         | (4,611)          | (1,767)           | (6,378)          |
| <b>Total interest expense</b>  | <b>(24,684)</b>  | <b>(45,778)</b>    | <b>(70,462)</b>  | <b>(1,768)</b>   | <b>(101,332)</b>  | <b>(103,100)</b> |
| <b>Net interest income, fully taxable equivalent basis</b>                 | <b>\$ 36,458</b> | <b>\$ (24,518)</b> | <b>\$ 11,940</b> | <b>\$ 49,098</b> | <b>\$ (3,542)</b> | <b>\$ 45,556</b> |

Net interest income totaled \$645.9 million in 2010, representing an increase of \$10.4 million, or 1.6%, compared to \$635.5 million in 2009. On a tax equivalent basis, net interest income totaled \$666.1 million and increased \$11.9 million, or 1.8%, over the previous year. This increase was mainly the result of lower average deposit and borrowing balances and lower rates paid on these liabilities, which were partly offset by lower average loan balances and yields, coupled with lower rates earned on the investment securities portfolio. The net yield on earning assets (tax equivalent) was 3.89% in 2010 compared with 3.93% in the previous year.

During 2010, interest income on loans (tax equivalent) declined \$48.0 million from 2009 due to lower average balances on most loan categories, coupled with lower rates earned on personal real estate and other personal banking loan products. The average rate earned on the loan portfolio was 5.28% compared to 5.27% in the previous year. Rates on consumer credit cards were impacted by new regulations on interest and service charges, while lower rates on personal real estate loans reflected the overall lower rate environment in the industry this year. Rates increased on business and construction loans, reflecting some increase in risk based pricing obtained earlier in the year. Total average loan balances decreased \$931.2 million, or 8.8%, reflecting declines of \$346.8 million in business and business real estate loans, \$182.6 million in construction loans, \$109.2 million in personal real estate and \$214.1 million in consumer loans. The decrease in business,

**Table of Contents**

business real estate and personal real estate loans was the result of loan principal pay downs and lower line of credit utilization, which exceeded new loan originations due to lower loan demands. The decline in construction loans was mainly due to the weak housing economy and the Company's efforts to reduce this portfolio. The decrease in average consumer loans was reflective of lower customer demand for automobile financing, coupled with the fact that the Company ceased most marine and recreational vehicle lending in 2008, while pay downs on the existing balances continued. In October 2010, the Company sold its entire held to maturity student loan portfolio, which totaled approximately \$311.0 million, to another loan servicer. Total average loans held for sale, which are mainly federally guaranteed student loans, declined \$39.1 million. In the second half of 2010, the Company sold most of these loans, and new regulations prohibit the Company from originating new federally guaranteed student loans in the future. Tax equivalent interest earned on investment securities decreased by \$10.3 million, or 4.3%, due to lower rates earned, partly offset by higher average balances of securities. The average rate earned on the investment securities portfolio declined from 4.54% in 2009 to 3.40% in 2010, resulting in a decline in interest income of approximately \$61.4 million due to lower rates. Average balances of mortgage and other asset-backed securities increased \$1.1 billion, or 28.2%, while the average rate earned decreased 130 basis points to 3.17%. Average balances of U.S. government and federal agency securities increased \$269.9 million during the year, while average rates earned decreased 179 basis points to 2.20%. Average state and municipal obligations balances increased \$93.1 million, while average rates earned decreased 32 basis points to 4.70%. During the second half of 2010, in order to diversify its investment portfolio, the Company purchased long-term resell agreements. The average balance of these long-term resell agreements in 2010 was \$150.2 million, and earned interest at an average rate of 1.70%. Most of the purchases were made in the later half of the year, and the year end balance grew to \$450.0 million. Average rates (tax equivalent) earned on total interest earning assets in 2010 decreased to 4.38% compared to 4.85% in the previous year, or a decline of 47 basis points.

During 2010, interest expense on deposits decreased \$52.8 million, or 44.4%, compared to 2009. This was mainly the result of lower rates on all deposit products coupled with a \$930.1 million decline in average certificate of deposit balances, but partly offset by the effects of higher average balances of money market and interest checking accounts, which grew by \$1.4 billion. Average rates paid on deposit balances declined 43 basis points in 2010 to .49%. Interest expense on borrowings declined \$17.7 million, mainly the result of lower rates paid on total debt and lower average balances outstanding of FHLB borrowings. The average balance of FHLB borrowings decreased \$383.7 million, partly due to scheduled maturities of advances and partly due to the early pay off of \$125.0 million in advances prior to maturity. The average rate paid on total interest bearing liabilities decreased to .56% compared to 1.04% in 2009.

During 2009, interest income on loans (tax equivalent) declined \$98.1 million from 2008 due to lower rates earned on most lending products coupled with lower loan balances, especially in business, business real estate and consumer loans. The average rate earned on the loan portfolio decreased 75 basis points to 5.27% compared to 6.02% in the previous year. Average loan balances decreased \$306.0 million, or 2.8%, reflecting lower line of credit usage, lower demand and pay downs. Tax equivalent interest earned on investment securities increased by \$54.7 million, or 29.8%, due to higher average balances of securities, partially offset by a decrease in rates earned on these investments. Average balances of mortgage and asset-backed securities increased 51.4% to \$3.7 billion, and state and municipal obligations increased 25.6%. Additionally, average balances of U.S. government and federal agency securities increased 67.8% during the year to \$307.1 million, primarily a result of purchases of U.S. Treasury inflation-protected securities during the last six months of 2009. Interest earned on federal funds sold and resell agreement assets declined \$8.1 million, mainly due to a \$381.5 million decrease in average balances coupled with much lower overnight rates. Average rates (tax equivalent) earned on interest earning assets in 2009 decreased to 4.85% compared to 5.63% in the previous year, or a decline of 78 basis points.

Interest expense on deposits decreased \$75.3 million in 2009 compared to 2008. The decline resulted from much lower rates paid on all deposit products, but was partly offset by the effects of higher average balances of money market accounts and certificates of deposit of \$100,000 and over. Average rates paid on deposit balances declined

76 basis points from 1.68% in 2008 to .92% in 2009. Interest expense on borrowings declined \$27.8 million, or 44.1%, as a result of lower rates paid and lower average balances of federal funds

**Table of Contents**

purchased and repurchase agreement borrowings. The average rate paid on interest bearing liabilities decreased to 1.04% compared to 1.83% in 2008.

**Provision for Loan Losses**

The provision for loan losses totaled \$100.0 million in 2010, which represented a decrease of \$60.7 million from the 2009 provision of \$160.7 million. Net loan charge-offs for the year totaled \$96.9 million compared with \$138.8 million in 2009, or a decrease of \$41.9 million. The decrease in net loan charge-offs from the previous year was mainly the result of lower construction, consumer and business losses, which declined \$19.1 million, \$11.7 million, and \$8.3 million, respectively. The allowance for loan losses totaled \$197.5 million at December 31, 2010, an increase of \$3.1 million over the prior year, and represented 2.10% of outstanding loans. The provision for loan losses is recorded to bring the allowance for loan losses to a level deemed adequate by management based on the factors mentioned in the following Allowance for Loan Losses section of this discussion.

**Non-Interest Income**

| <i>(Dollars in thousands)</i>                   | <b>2010</b>       | 2009       | 2008       | <b>% Change</b> |        |
|---|-------------------|------------|------------|-----------------|--------|
|   |                   |            |            | <b>10- 09</b>   | 09- 08 |
| Bank card transaction fees                      | <b>\$ 148,888</b> | \$ 122,124 | \$ 113,862 | <b>21.9%</b>    | 7.3%   |
| Deposit account charges and other fees          | <b>92,637</b>     | 106,362    | 110,361    | <b>(12.9)</b>   | (3.6)  |
| Trust fees                                      | <b>80,963</b>     | 76,831     | 80,294     | <b>5.4</b>      | (4.3)  |
| Bond trading income                             | <b>21,098</b>     | 22,432     | 15,665     | <b>(5.9)</b>    | 43.2   |
| Consumer brokerage services                     | <b>9,190</b>      | 10,831     | 12,156     | <b>(15.2)</b>   | (10.9) |
| Loan fees and sales                             | <b>23,116</b>     | 21,273     | (2,413)    | <b>8.7</b>      | N.M.   |
| Other   | <b>29,219</b>     | 36,406     | 45,787     | <b>(19.7)</b>   | (20.5) |
| <b>Total non-interest income</b>                | <b>\$ 405,111</b> | \$ 396,259 | \$ 375,712 | <b>2.2%</b>     | 5.5%   |
| Non-interest income as a % of total revenue*    | <b>38.5%</b>      | 38.4%      | 38.8%      |                 |        |
| Total revenue per full-time equivalent employee | <b>\$ 211.1</b>   | \$ 201.3   | \$ 185.6   |                 |        |

\* Total revenue is calculated as net interest income plus non-interest income.

Non-interest income totaled \$405.1 million, an increase of \$8.9 million, or 2.2%, compared to \$396.3 million in 2009. Bank card fees increased \$26.8 million, or 21.9%, due to growth of 50.2%, 13.2%, and 15.6% in corporate card, debit card and merchant transactions, respectively. During 2010, debit card fees totaled \$57.0 million and comprised 38.3% of total bank card fees, while corporate card fees totaled \$48.3 million and comprised 32.4% of total fees. Trust fee income increased \$4.1 million, or 5.4%, as a result of growth in personal and institutional trust fees, partly offset by lower corporate fees. While most of the growth in trust fees came from private client business, fees from institutional

trust services also grew \$1.5 million, or 10.2%, in 2010. Because of the low interest rate environment this year, the Company waived trust fees on certain short-term client assets in money market investments. It is estimated that these waived fees amounted to approximately \$6 million. The market value of total customer trust assets (on which fees are charged) totaled \$25.1 billion at year end 2010, and grew 13.5% over year end 2009. Deposit account fees declined \$13.7 million, or 12.9%, from the prior year as a result of a \$13.6 million decline in overdraft fee revenue. Overdraft fees comprised 55.2% of total deposit account fee income in 2010, down from 60.9% in 2009. The lower overdraft fees resulted from the Company's implementation on July 1, 2010 of new overdraft regulations on debit card transactions. Also, corporate cash management fees, which comprised 35.7% of total deposit account fees in 2010, declined 1.9% this year on lower sales/activity. Bond trading income declined \$1.3 million, or 5.9%, due to lower sales of fixed income securities to correspondent banks and corporate customers, while consumer brokerage services revenue declined \$1.6 million, or 15.2%, mainly due to lower fees earned on mutual fund sales. Loan fees and sales increased by \$1.8 million over 2009. This increase included a \$6.9 million gain recorded on the sale of the Company's held to maturity portfolio of student loans in late 2010, partly offset by a \$5.3 million decline in gains on sales of loans held for sale and adjustments to related impairment reserves. Other non-interest income decreased by \$7.2 million partly due to impairment charges of \$2.0 million on certain bank premises, coupled

**Table of Contents**

with other fixed asset retirements. Also included were declines in cash sweep commissions and equipment rental income, partially offset by higher fees on letters of credit and foreign exchange transactions.

During 2009, non-interest income increased \$20.5 million, or 5.5%, over 2008 to \$396.3 million. Deposit account fees declined \$4.0 million, or 3.6%, as a result of lower overdraft fee revenue, which fell \$6.8 million, or 9.5%. Partly offsetting this decline was an increase in cash management fees, which grew \$3.2 million, or 10.6%, over the prior year. Bank card fee income rose \$8.3 million, or 7.3% overall, due to growth in transaction fees earned on corporate card, debit card and merchant transactions, which increased 24.1%, 4.6% and 3.4%, respectively, but was negatively impacted by lower retail sales affecting credit card fees. Trust fees decreased \$3.5 million, or 4.3%, mainly in institutional and corporate fees and reflected the impact that lower markets had on trust asset values during 2009, as well as the effects of low interest rates on money market assets held in trust accounts. The market value of total customer trust assets totaled \$22.1 billion at year end 2009 and grew 14.0% over year end 2008. Bond trading income rose \$6.8 million due to higher sales volume, while consumer brokerage services revenue declined \$1.3 million due to lower fees earned on sales of annuity and mutual fund products. Loan fees and sales increased by \$23.7 million, as gains on student loan sales increased \$20.8 million. The 2009 gains included the reversal of impairment reserves of \$8.6 million on certain held for sale student loans, through sales of the related loans and recoveries in the fair value of most of the remaining outstanding loans. The impairment had originally been established in 2008 due to liquidity concerns, which at year end 2009 were largely alleviated. In addition, mortgage banking revenue and loan commitment fees both increased over 2008. The decrease in other non-interest income of \$9.4 million from 2008 was mainly due to a gain of \$6.9 million recorded in the second quarter of 2008 on the sale of a banking branch in Independence, Kansas. Other declines were reported in cash sweep commissions, equipment rental income and fees on interest rate swap sales. Partly offsetting these declines was an impairment charge of \$1.1 million recorded in 2008 on a Kansas City office building.

**Investment Securities Gains (Losses), Net**

Net gains and losses on investment securities during 2010, 2009 and 2008 are shown in the table below. Included in these amounts are gains and losses arising from sales of bonds from the Company's available for sale portfolio, including credit-related losses on debt securities identified as other-than-temporarily impaired. Also included are gains and losses on sales of publicly traded common stock held by the holding company, Commerce Bancshares, Inc. (the Parent). Gains and losses relating to non-marketable private equity investments, which are primarily held by the Parent's majority-owned venture capital subsidiaries, are also shown below. These include fair value adjustments, in addition to gains and losses realized upon disposition. Portions of the fair value adjustments attributable to minority interests are reported as non-controlling interest in the consolidated income statement and resulted in income of \$108 thousand and \$1.1 million in 2010 and 2009, respectively, and expense of \$299 thousand in 2008.

Net securities losses of \$1.8 million were recorded in 2010. Included in these losses are credit-related impairment losses of \$5.1 million on certain non-agency guaranteed mortgage-backed securities which have been identified as other-than-temporarily impaired. These securities had a par value of \$184.3 million at December 31, 2010. The cumulative credit-related impairment loss on these securities, recorded in earnings, amounted to \$7.5 million, while the cumulative noncredit-related loss on these securities, which has been recorded in other comprehensive income (loss), was \$12.2 million. Offsetting these losses were net gains of \$3.5 million recorded on sales of investment securities (mainly mortgage-backed and municipals) from the bank portfolio.



**Table of Contents**

Net securities losses of \$7.2 million were recorded in 2009, compared to net gains of \$30.3 million in 2008. Most of the loss recorded in 2009 resulted from a \$5.0 million net decline in fair value of various private equity securities. In addition, credit-related other-than-temporary impairment (OTTI) losses of \$2.5 million were recorded on the non-agency mortgage-backed securities mentioned above. The net gain in 2008 included a \$22.2 million gain resulting from the redemption of Visa Class B stock in conjunction with an initial public offering by Visa. In addition, during 2008 certain auction rate securities were sold in exchange for student loans, resulting in a gain of \$7.9 million.

| <i>(Dollars in thousands)</i>                          | <b>2010</b>       | 2009       | 2008       |
|--|-------------------|------------|------------|
| <b>Available for sale:</b>                             |                   |            |            |
| Preferred equity securities                            | \$                | \$         | \$ (3,504) |
| Common stock   |                   |            | (294)      |
| Auction rate securities                                |                   |            | 7,861      |
| Other bonds:   |                   |            |            |
| Realized gains   | <b>3,488</b>      | 322        | 1,140      |
| OTTI losses  | <b>(5,069)</b>    | (2,473)    |            |
| <b>Non-marketable:</b>                                 |                   |            |            |
| Private equity investments                             | <b>(204)</b>      | (5,044)    | 2,895      |
| Visa Class B stock                                     |                   |            | 22,196     |
| <b>Total investment securities gains (losses), net</b> | <b>\$ (1,785)</b> | \$ (7,195) | \$ 30,294  |

**Non-Interest Expense**

| <i>(Dollars in thousands)</i>               | <b>2010</b>       | 2009       | 2008       | <b>% Change</b> |               |
|---|-------------------|------------|------------|-----------------|---------------|
|   |                   |            |            | <b>10- 09</b>   | <b>09- 08</b> |
| Salaries                                    | \$ <b>292,675</b> | \$ 290,289 | \$ 286,161 | <b>.8%</b>      | 1.4%          |
| Employee benefits                           | <b>53,875</b>     | 55,490     | 47,451     | <b>(2.9)</b>    | 16.9          |
| Net occupancy                               | <b>46,987</b>     | 45,925     | 46,317     | <b>2.3</b>      | (.8)          |
| Equipment                                   | <b>23,324</b>     | 25,472     | 24,569     | <b>(8.4)</b>    | 3.7           |
| Supplies and communication                  | <b>27,113</b>     | 32,156     | 35,335     | <b>(15.7)</b>   | (9.0)         |
| Data processing and software                | <b>67,935</b>     | 61,789     | 56,387     | <b>9.9</b>      | 9.6           |
| Marketing                                   | <b>18,161</b>     | 18,231     | 19,994     | <b>(.4)</b>     | (8.8)         |
| Deposit insurance                           | <b>19,246</b>     | 27,373     | 2,051      | <b>(29.7)</b>   | N.M.          |
| Debt extinguishment                         | <b>11,784</b>     |            |            | <b>N.M.</b>     | N.M.          |
| Loss on purchase of auction rate securities |                   |            | 33,266     | <b>N.M.</b>     | N.M.          |
| Indemnification obligation                  | <b>(4,405)</b>    | (2,496)    | (9,619)    | <b>N.M.</b>     | N.M.          |
| Other                                       | <b>74,439</b>     | 67,508     | 73,468     | <b>10.3</b>     | (8.1)         |

|  |                   |            |            |             |      |
|--|-------------------|------------|------------|-------------|------|
| <b>Total non-interest expense</b>                          | <b>\$ 631,134</b> | \$ 621,737 | \$ 615,380 | <b>1.5%</b> | 1.0% |
| Efficiency ratio   | <b>59.7%</b>      | 59.9%      | 63.1%      |             |      |
| Salaries and benefits as a % of total non-interest expense | <b>54.9%</b>      | 55.6%      | 54.2%      |             |      |
| Number of full-time equivalent employees                   | <b>4,979</b>      | 5,125      | 5,217      |             |      |

Non-interest expense was \$631.1 million in 2010, an increase of \$9.4 million, or 1.5%, over the previous year. Non-interest expense included a debt pre-payment penalty of \$11.8 million in 2010, in addition to reductions in a Visa indemnification obligation of \$4.4 million and \$2.5 million in 2010 and 2009, respectively. Excluding these items, non-interest expense would have amounted to \$623.8 million in 2010, a decrease of \$478 thousand from the prior year. Salaries and benefits grew by \$771 thousand, or .2%, mainly as a result of higher costs for incentives and 401K plan contributions, but lower costs for base salaries, pension and

**Table of Contents**

medical plans. Total salaries expense was up \$2.4 million, or .8%, and full-time equivalent employees totaled 4,979 and 5,125 at December 31, 2010 and 2009, respectively, a decline of 2.8%. Occupancy costs increased \$1.1 million, or 2.3%, primarily resulting from higher real estate taxes and utilities expense. Equipment costs decreased \$2.1 million mainly due to lower depreciation on data processing equipment. Supplies and communication expense declined \$5.0 million, or 15.7%, which reflected certain initiatives to reduce paper supplies, customer checks and courier costs. Data processing and software costs grew \$6.1 million, primarily due to higher bank card processing costs, which have increased in proportion to the growth in bank card revenues. Deposit insurance decreased \$8.1 million mainly due to a special assessment levied by the FDIC in 2009 which did not reoccur in 2010. Other non-interest expense increased \$6.9 million and included foreclosed property expense of \$6.3 million, which increased due to higher write-downs to fair value and additional holding costs, in conjunction with higher levels of such assets held by the Company. Also included were higher costs for professional services, partially offset by lower operating losses.

In 2009, non-interest expense was \$621.7 million, an increase of \$6.4 million, or 1.0%, over the previous year. FDIC insurance expense, including normal deposit premiums and special assessments, increased \$25.3 million compared to 2008, as the FDIC began a program to replenish its insurance fund. During 2009, salaries and benefits expense increased by \$12.2 million, or 3.6%, over 2008 due to merit increases and higher pension and medical costs. Occupancy expense decreased slightly, while equipment expense increased \$903 thousand, or 3.7%, mainly due to higher data processing equipment depreciation expense. Supplies and communication expense decreased \$3.2 million, or 9.0%, as a result of lower supplies and courier expense. Data processing and software costs grew by \$5.4 million, or 9.6%. Core data processing expense increased \$3.5 million due to several new software and servicing systems, in addition to higher bank card processing costs. Marketing expense decreased \$1.8 million, or 8.8%. Other non-interest expense decreased \$6.0 million, or 8.1%, partly due to declines in travel and entertainment expense and impairment charges on foreclosed property. Other decreases occurred in leased asset depreciation, professional fees and recruiting expense, which were partly offset by a decline in loan origination cost deferrals. Total non-interest expense in 2008 included a \$33.3 million non-cash loss related to the purchase of auction rate securities from customers, which represented the amount by which the purchase price (at par) exceeded estimated fair value on the purchase date.

**Income Taxes**

Income tax expense was \$96.2 million in 2010, compared to \$73.8 million in 2009 and \$85.1 million in 2008. Income tax expense in 2010 increased 30.5% over 2009, compared to a 31.4% increase in pre-tax income. The effective tax rate, including the effect of non-controlling interest, was 30.3%, 30.4% and 31.1% in 2010, 2009 and 2008, respectively. The Company's effective tax rates in those years were lower than the federal statutory rate of 35% mainly due to tax-exempt interest on state and local municipal obligations.

**Table of Contents****Financial Condition****Loan Portfolio Analysis**

Classifications of consolidated loans by major category at December 31 for each of the past five years are shown in the table below. This portfolio consists of loans which were acquired or originated with the intent of holding to their maturity. Loans held for sale are separately discussed in a following section. A schedule of average balances invested in each loan category below appears on page 60.

| <i>(In thousands)</i>             | <b>Balance at December 31</b> |               |               |               |              |
|-----------------------------------|-------------------------------|---------------|---------------|---------------|--------------|
|                                   | <b>2010</b>                   | 2009          | 2008          | 2007          | 2006         |
| <b>Commercial:</b>                |                               |               |               |               |              |
| Business                          | \$ <b>2,957,043</b>           | \$ 2,877,936  | \$ 3,404,371  | \$ 3,257,047  | \$ 2,860,692 |
| Real estate construction and land | <b>460,853</b>                | 665,110       | 837,369       | 668,701       | 658,148      |
| Real estate business              | <b>2,065,837</b>              | 2,104,030     | 2,137,822     | 2,239,846     | 2,148,195    |
| <b>Personal banking:</b>          |                               |               |               |               |              |
| Real estate personal              | <b>1,440,386</b>              | 1,537,687     | 1,638,553     | 1,540,289     | 1,478,669    |
| Consumer                          | <b>1,164,327</b>              | 1,333,763     | 1,615,455     | 1,648,072     | 1,435,038    |
| Revolving home equity             | <b>477,518</b>                | 489,517       | 504,069       | 460,200       | 441,851      |
| Student                           |                               | 331,698       | 358,049       |               |              |
| Consumer credit card              | <b>831,035</b>                | 799,503       | 779,709       | 780,227       | 648,326      |
| Overdrafts                        | <b>13,983</b>                 | 6,080         | 7,849         | 10,986        | 10,601       |
| <b>Total loans</b>                | <b>\$ 9,410,982</b>           | \$ 10,145,324 | \$ 11,283,246 | \$ 10,605,368 | \$ 9,681,520 |

In December 2008, the Company elected to reclassify certain segments of its real estate, business, and consumer portfolios. The reclassifications were made to better align the loan reporting with its related collateral and purpose. Amounts reclassified to real estate construction and land pertained mainly to commercial or residential land and lots which were held by borrowers for future development. Amounts reclassified to personal real estate related mainly to one to four family rental property secured by residential mortgages. The table below shows the effect of the reclassifications on the various lending categories as of the transfer date. Because the information was not readily available and it was impracticable to do so, periods prior to 2008 were not restated.

| <i>(In thousands)</i>             | Effect of reclassification |
|-----------------------------------|----------------------------|
| Business                          | \$ (55,991)                |
| Real estate construction and land | 158,268                    |

|             |          |           |
|-------------|----------|-----------|
| Real estate | business | (214,071) |
| Real estate | personal | 142,093   |
| Consumer    |          | (30,299)  |

**Net reclassification** \$

**Table of Contents**

The contractual maturities of loan categories at December 31, 2010, and a breakdown of those loans between fixed rate and floating rate loans are as follows:

| <i>(In thousands)</i>                       | Principal Payments Due    |   |                        | Total               |
|---|---------------------------|---|------------------------|---------------------|
|   | In<br>One Year<br>or Less | After One<br>Year Through<br>Five Years | After<br>Five<br>Years |                     |
| Business                                    | \$ 1,578,361              | \$ 1,216,165                            | \$ 162,517             | \$ 2,957,043        |
| Real estate construction and land           | 304,116                   | 154,252                                 | 2,485                  | 460,853             |
| Real estate business                        | 550,012                   | 1,303,888                               | 211,937                | 2,065,837           |
| Real estate personal                        | 155,182                   | 381,797                                 | 903,407                | 1,440,386           |
| <b>Total business and real estate loans</b> | <b>\$ 2,587,671</b>       | <b>\$ 3,056,102</b>                     | <b>\$ 1,280,346</b>    | <b>6,924,119</b>    |
| Consumer <sup>(1)</sup>                     |                           |   |                        | 1,164,327           |
| Revolving home equity <sup>(2)</sup>        |                           |   |                        | 477,518             |
| Consumer credit card <sup>(3)</sup>         |                           |   |                        | 831,035             |
| Overdrafts                                  |                           |   |                        | 13,983              |
| <b>Total loans</b>                          |                           |   |                        | <b>\$ 9,410,982</b> |
| Loans with fixed rates                      | \$ 540,563                | \$ 1,573,442                            | \$ 451,261             | \$ 2,565,266        |
| Loans with floating rates                   | 2,047,108                 | 1,482,660                               | 829,085                | 4,358,853           |
| <b>Total business and real estate loans</b> | <b>\$ 2,587,671</b>       | <b>\$ 3,056,102</b>                     | <b>\$ 1,280,346</b>    | <b>\$ 6,924,119</b> |

(1) Consumer loans with floating rates totaled \$113.8 million.

(2) Revolving home equity loans with floating rates totaled \$472.7 million.

(3) Consumer credit card loans with floating rates totaled \$465.9 million.

Total loans at December 31, 2010 were \$9.4 billion, a decrease of \$734.3 million, or 7.2%, from balances at December 31, 2009. The decline in loans during 2010 occurred principally in construction, consumer and student loans. Business loans increased \$79.1 million, or 2.7%, reflecting growth in commercial and tax free loans, while lease balances, which are also included in the business category, decreased \$37.9 million, or 13.5%, compared with the previous year end balance, as demand for equipment financing weakened. Business real estate loans were lower by \$38.2 million, or 1.8%, and construction loans decreased \$204.3 million, or 30.7%. The decline in construction loans

reflected continued uncertain economic conditions in the real estate markets and lower overall demand. Personal real estate loans and consumer loans declined \$97.3 million and \$169.4 million, respectively, as loan pay downs exceeded new loan originations. Consumer loans declined primarily because the Company ceased most marine and recreational vehicle lending from that portfolio several years ago. Revolving home equity loans decreased \$12.0 million due to fewer new account activations. Consumer credit card loans increased by \$31.5 million, or 3.9%. The student loan portfolio, which was originally acquired in 2008, was sold in October 2010 as discussed below.

Period end loans decreased \$1.1 billion, or 10.8%, in 2009 compared to 2008, resulting from decreases in business, construction, personal real estate and consumer loans.

The Company currently generates approximately 31% of its loan portfolio in the St. Louis market, 29% in the Kansas City market, and 40% in various other regional markets. The portfolio is diversified from a business and retail standpoint, with 58% in loans to businesses and 42% in loans to consumers. A balanced approach to loan portfolio management and an historical aversion toward credit concentrations, from an industry, geographic and product perspective, have contributed to low levels of problem loans and loan losses.

## **Commercial Loans**

### *Business*

Total business loans amounted to \$3.0 billion at December 31, 2010 and include loans used mainly to fund customer accounts receivable, inventories, and capital expenditures. This portfolio also includes direct financing and sales type leases totaling \$243.5 million, which are used by commercial customers to finance capital purchases ranging from computer equipment to office and transportation equipment. These leases comprise 2.6% of the Company's total loan portfolio. Also included in this portfolio are corporate card loans,

**Table of Contents**

which totaled \$175.9 million at December 31, 2010. These loans, which grew by 13.9% in 2010, are made in conjunction with the Company's corporate card business, which assists the increasing number of businesses that are shifting from paper checks to a credit card payment system in order to automate payment processes. These loans are generally short-term, with outstanding balances averaging between 7 to 13 days in duration, which helps to limit risk in these loans.

Business loans are made primarily to customers in the regional trade area of the Company, generally the central Midwest, encompassing the states of Missouri, Kansas, Illinois, and nearby Midwestern markets, including Iowa, Oklahoma, Colorado and Ohio. The portfolio is diversified from an industry standpoint and includes businesses engaged in manufacturing, wholesaling, retailing, agribusiness, insurance, financial services, public utilities, and other service businesses. Emphasis is upon middle-market and community businesses with known local management and financial stability. The Company participates in credits of large, publicly traded companies when business operations are maintained in the local communities or regional markets and opportunities to provide other banking services are present. Consistent with management's strategy and emphasis upon relationship banking, most borrowing customers also maintain deposit accounts and utilize other banking services. Net loan charge-offs in this category totaled \$4.6 million in 2010 and \$12.8 million in 2009. Non-accrual business loans were \$8.9 million (.3% of business loans) at December 31, 2010 compared to \$12.9 million at December 31, 2009. Included in these totals were non-accrual lease-related loans of \$887 thousand and \$3.3 million at December 31, 2010 and 2009, respectively. Growth opportunities in business loans will largely depend on the speed and sustainability of economic recovery. Such growth is dependent on market conditions which enable businesses to grow and invest in new capital, in addition to the Company's own solicitation efforts in attracting new, high quality loans.

*Real Estate-Construction and Land*

The portfolio of loans in this category amounted to \$460.9 million at December 31, 2010 and comprised 4.9% of the Company's total loan portfolio. These loans are predominantly made to businesses in the local markets of the Company's banking subsidiary. Commercial construction loans, comprising 33.0% of the portfolio at December 31, 2010, are made during the construction phase for small and medium-sized office and medical buildings, manufacturing and warehouse facilities, apartment complexes, shopping centers, hotels and motels, and other commercial properties. Exposure to larger, speculative commercial properties remains low. Commercial land and land development loans relate to land owned or developed for use in conjunction with business properties. Residential construction and land development loans at December 31, 2010 totaled \$193.5 million. The largest percentage of residential construction and land development loans are for projects located in the Kansas City and St. Louis metropolitan areas. Credit risk in this sector has risen over the last few years, especially in residential land development lending, as a result of the slowdown in the housing industry and worsening economic conditions. Over the last two years, net charge-offs on construction and land loans have remained at elevated levels. However, in 2010 net loan charge-offs decreased 56.0% to \$15.0 million, compared to net charge-offs of \$34.1 million in 2009. The net charge-offs in 2010 were mainly comprised of \$11.2 million in charge-offs on loans to three specific borrowers, and the largest portion of total 2010 charge-offs occurred in the first quarter. Construction and land development loans on non-accrual status declined to \$52.8 million at year end 2010 compared to \$62.5 million at year end 2009, with approximately 40% of the non-accrual balance at year end 2010 comprised of loans to three individual borrowers. The Company's watch list, which includes special mention and substandard categories, included \$37.0 million of residential land and construction loans which are being closely monitored.

*Real Estate-Business*

Total business real estate loans were \$2.1 billion at December 31, 2010 and comprised 22.0% of the Company's total loan portfolio. This category includes mortgage loans for small and medium-sized office and medical buildings, manufacturing and warehouse facilities, shopping centers, hotels and motels, and other commercial properties.



Emphasis is placed on owner-occupied and income producing commercial real estate properties, which present lower risk levels. The borrowers and/or the properties are generally located in local and regional markets. Additional information about loans by type is presented on page 39. At December 31, 2010, non-accrual balances amounted to \$16.2 million, or .8%, of the loans in this category, down from

**Table of Contents**

\$21.8 million at year end 2009. The Company experienced net charge-offs of \$4.1 million in 2010, compared to net charge-offs of \$5.2 million in 2009.

**Personal Banking Loans***Real Estate-Personal*

At December 31, 2010, there were \$1.4 billion in outstanding personal real estate loans, which comprised 15.3% of the Company's total loan portfolio. The mortgage loans in this category are mainly for owner-occupied residential properties. The Company originates both adjustable rate and fixed rate mortgage loans. The Company retains adjustable rate mortgage loans, and may from time to time retain certain fixed rate loans (typically 15 and 20-year fixed rate loans) as directed by its Asset/Liability Management Committee. Other fixed rate loans in the portfolio have resulted from previous bank acquisitions. The Company does not purchase these types of loans from outside parties or brokers, and has never maintained or promoted subprime or reduced document products. At December 31, 2010, 51% of the portfolio was comprised of adjustable rate loans while 49% was comprised of fixed rate loans. Levels of mortgage loan origination activity decreased slightly in 2010 compared to 2009, with originations of \$197 million in 2010 compared with \$199 million in 2009. Growth in mortgage loan originations continued to be constrained in 2010 as a result of the weakened economy, slower housing starts, demand for fixed rates, and lower re-sales within the Company's markets. The Company has experienced lower loan losses in this category than many others in the industry, and believes this is partly because of its conservative underwriting culture and the fact that it does not offer subprime lending products or purchase loans from brokers. Net loan charge-offs for 2010 amounted to \$2.1 million, compared to \$2.8 million in the previous year. The non-accrual balances of loans in this category decreased to \$7.3 million at December 31, 2010, compared to \$9.4 million at year end 2009.

*Consumer*

Consumer loans consist of auto, marine, tractor/trailer, recreational vehicle (RV), fixed rate home equity, and other consumer installment loans. These loans totaled \$1.2 billion at year end 2010. Approximately 66% of consumer loans outstanding were originated indirectly from auto and other dealers, while the remaining 34% were direct loans made to consumers. Approximately 28% of the consumer portfolio consists of automobile loans, 46% in marine and RV loans and 11% in fixed rate home equity lending. As mentioned above, total consumer loans declined \$169.4 million in 2010 as a result of a decrease of \$135.8 million in marine and RV loans, due to the Company's decision in 2008 to cease most marine and RV lending. In addition, auto lending declined \$40.8 million, or 11.0%. Net charge-offs on consumer loans were \$20.5 million in 2010 compared to \$32.2 million in 2009. Net charge-offs decreased to 1.6% of average consumer loans in 2010 compared to 2.2% in 2009. Consumer loan net charge-offs included marine and RV loan net charge-offs of \$14.8 million, which were 2.5% of average marine and RV loans in 2010, compared to 3.0% in 2009.

*Revolving Home Equity*

Revolving home equity loans, of which 99% are adjustable rate loans, totaled \$477.5 million at year end 2010. An additional \$657.8 million was available in unused lines of credit, which can be drawn at the discretion of the borrower. Home equity loans are secured mainly by second mortgages (and less frequently, first mortgages) on residential property of the borrower. The underwriting terms for the home equity line product permit borrowing availability, in the aggregate, generally up to 80% or 90% of the appraised value of the collateral property at the time of origination.

*Student*

In December 2008, the Company acquired a portfolio of federally guaranteed student loans from a student loan agency. The loans were acquired in exchange for certain auction rate securities issued by that agency, which were purchased earlier in the year by the Bank from its customers. The loans, which had an average estimated life of approximately seven years at purchase date, were recorded at fair value, which resulted in a discount from their face value of approximately 2.5%. At the time of the purchase, the Company intended to hold the loans until their maturity. However, in October 2010, the agency, as allowed under the

## **Table of Contents**

original exchange contract, elected to repurchase the loans. The carrying amount of the loans sold totaled approximately \$311.0 million, and the Company recorded a gain of \$6.9 million.

### *Consumer Credit Card*

Total consumer credit card loans amounted to \$831.0 million at December 31, 2010 and comprised 8.8% of the Company's total loan portfolio. The credit card portfolio is concentrated within regional markets served by the Company. The Company offers a variety of credit card products, including affinity cards, rewards cards, and standard and premium credit cards, and emphasizes its credit card relationship product, Special Connections. Approximately 63% of the households in Missouri that own a Commerce credit card product also maintain a deposit relationship with the subsidiary bank. At December 31, 2010, approximately 56% of the outstanding credit card loan balances had a floating interest rate, compared to 92% in the prior year. This decline is due to the provisions of the Card Act, which went into effect in 2009, under which certain credit card balances that previously had variable rates were changed to non-variable rates. Net charge-offs amounted to \$47.7 million in 2010, compared to \$49.3 million in 2009. The annual ratio of net credit card loan charge-offs to total average credit card loans totaled 6.3% in 2010 compared to 6.8% in 2009. These ratios, however, remain below national loss averages.

### **Loans Held for Sale**

Total loans held for sale at December 31, 2010 were \$63.8 million, a decrease of \$281.3 million, from \$345.0 million at year end 2009. Loans classified as held for sale consist of student loans and residential mortgage loans.

Most of the portfolio is comprised of originated loans to students attending colleges and universities. These loans are normally sold to the secondary market when the student graduates and the loan enters into repayment status. Nearly all of these loans are based on variable rates. The Company has historically sold these loans under agreements with the Department of Education and various student loan servicing agencies, including the Missouri Higher Education Loan Authority, the Student Loan Marketing Association and others. However, because of recent legislation which required the Company to terminate its guaranteed student loan origination business effectively July 1, 2010, student loan balances declined to \$53.3 million at year end 2010, compared to \$334.5 million at year end 2009.

The student loans outstanding at year end 2010 have associated purchase commitments from various student loan agencies. However, certain agencies have been unable to make purchases under contractual terms and uncertainties exist about their future ability. These loans are carried at fair value and totaled \$12.1 million at December 31, 2010, including an associated impairment allowance of \$569 thousand.

The remainder of the held for sale portfolio consists of fixed rate mortgage loans, which are sold in the secondary market, generally within three months of origination. The loans are sold primarily to other financial institutions and federal agencies under industry-standard contracts which require various representations by the Company as to ownership, tax status, document delivery, and compliance with selection criteria underwriting standards, and may obligate the Company to repurchase such loans if these representations cannot be satisfied. The Company did not receive any repurchase requests in 2010, and does not believe there are any significant risks or uncertainties associated with its sales. Mortgage loans held for sale totaled \$10.4 million and \$10.5 million at December 31, 2010 and 2009, respectively.

### **Allowance for Loan Losses**

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

needed for pools of loans.

Loans subject to individual evaluation generally consist of business, construction, commercial real estate and personal real estate loans on non-accrual status. These impaired loans are evaluated individually for the impairment of repayment potential and collateral adequacy, and in conjunction with current economic

**Table of Contents**

conditions and loss experience, allowances are estimated. Loans which are not individually evaluated are segregated by loan type and sub-type, and are collectively evaluated. These include certain troubled debt restructurings, which are collectively evaluated because they have similar risk characteristics. 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.

The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses rests upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in portfolio risk ratings, levels of non-performing assets, and prevailing regional and national economic conditions. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company's senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. The Company's subsidiary bank continues to be subject to examination by the Office of the Comptroller of the Currency (OCC) and examinations are conducted throughout the year, targeting various segments of the loan portfolio for review. In addition to the examination of the subsidiary bank by the OCC, the parent holding company and its non-bank subsidiaries are examined by the Federal Reserve Bank. Refer to Note 1 to the consolidated financial statements for additional discussion on the allowance and charge-off policies.

At December 31, 2010, the allowance for loan losses was \$197.5 million compared to a balance at year end 2009 of \$194.5 million. Total loans delinquent 90 days or more and still accruing were \$20.5 million at December 31, 2010, a decrease of \$22.2 million compared to year end 2009. Approximately \$13.8 million of this decrease was due to the sale of the held to maturity student loan portfolio in the fourth quarter of 2010. Non-accrual loans at December 31, 2010 were \$85.3 million, a decrease of \$21.3 million from the prior year, and were mainly comprised of construction and business real estate loans totaling \$52.8 million and \$16.2 million, respectively. The Company's analysis of the allowance considered the impact of the economic downturn experienced in 2009 on the current portfolio, which resulted in a slight increase in the allowance balance during the first quarter of 2010. The percentage of allowance to loans increased to 2.10% at December 31, 2010 compared to 1.92% at year end 2009 as a result of the slight increase in the allowance balance, coupled with a decrease in period end loan balances of 7.2%.

Net loan charge-offs totaled \$96.9 million in 2010, representing a \$41.9 million decrease compared to net charge-offs of \$138.8 million in 2009. Net charge-offs related to business loans were \$4.6 million in 2010 compared to \$12.8 million in 2009. Construction and land loans incurred net charge-offs of \$15.0 million in 2010 compared to \$34.1 million in 2009. Net charge-offs related to consumer loans decreased \$11.7 million to \$20.5 million at December 31, 2010, representing 21.1% of total net charge-offs during 2010. Additionally, net charge-offs related to consumer credit cards were \$47.7 million in 2010 compared to \$49.3 million in 2009. Approximately 49.2% of total net loan charge-offs during 2010 were related to consumer credit card loans compared to 35.5% during 2009. Net consumer credit card charge-offs decreased to 6.3% of average consumer credit card loans in 2010 compared to 6.8% in 2009.

The ratio of net charge-offs to total average loans outstanding in 2010 was 1.00% compared to 1.31% in 2009 and .64% in 2008. The provision for loan losses in 2010 was \$100.0 million, compared to a provision of \$160.7 million in 2009 and \$108.9 million in 2008.

The Company considers the allowance for loan losses of \$197.5 million adequate to cover losses inherent in the loan portfolio at December 31, 2010.

**Table of Contents**

The schedules which follow summarize the relationship between loan balances and activity in the allowance for loan losses:

| <i>(Dollars in thousands)</i>                              | <b>Years Ended December 31</b> |               |               |               |              |
|--|--------------------------------|---------------|---------------|---------------|--------------|
|  | <b>2010</b>                    | 2009          | 2008          | 2007          | 2006         |
| <b>Net loans outstanding at end of year<sup>(A)</sup></b>  | <b>\$ 9,410,982</b>            | \$ 10,145,324 | \$ 11,283,246 | \$ 10,605,368 | \$ 9,681,520 |
| <b>Average loans outstanding<sup>(A)</sup></b>             | <b>\$ 9,698,670</b>            | \$ 10,629,867 | \$ 10,935,858 | \$ 10,189,316 | \$ 9,105,432 |
| Allowance for loan losses:<br>Balance at beginning of year | <b>\$ 194,480</b>              | \$ 172,619    | \$ 133,586    | \$ 131,730    | \$ 128,447   |
| Additions to allowance through charges to expense          | <b>100,000</b>                 | 160,697       | 108,900       | 42,732        | 25,649       |
| Allowances of acquired companies                           |                                |               |               | 1,857         | 3,688        |
| Loans charged off:   |                                |               |               |               |              |
| Business   | <b>8,550</b>                   | 15,762        | 7,820         | 5,822         | 1,343        |
| Real estate construction and land                          | <b>15,199</b>                  | 34,812        | 6,215         | 2,049         | 62           |
| Real estate business                                       | <b>4,780</b>                   | 5,957         | 2,293         | 2,396         | 854          |
| Real estate personal                                       | <b>2,484</b>                   | 3,150         | 1,765         | 181           | 119          |
| Consumer   | <b>24,582</b>                  | 35,973        | 26,229        | 14,842        | 11,364       |
| Revolving home equity                                      | <b>2,014</b>                   | 1,197         | 447           | 451           | 158          |
| Student  | <b>5</b>                       | 6             |               |               |              |
| Consumer credit card                                       | <b>54,287</b>                  | 54,060        | 35,825        | 28,218        | 22,104       |
| Overdrafts   | <b>2,672</b>                   | 3,493         | 4,499         | 4,909         | 4,940        |
| <b>Total loans charged off</b>                             | <b>114,573</b>                 | 154,410       | 85,093        | 58,868        | 40,944       |
| Recovery of loans previously charged off:                  |                                |               |               |               |              |
| Business   | <b>3,964</b>                   | 2,925         | 3,406         | 1,429         | 2,166        |
| Real estate construction and land                          | <b>193</b>                     | 720           |               | 37            |              |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|                       |              |       |       |       |       |
|-----------------------|--------------|-------|-------|-------|-------|
| Real estate business  | <b>722</b>   | 709   | 117   | 1,321 | 890   |
| Real estate personal  | <b>428</b>   | 363   | 51    | 42    | 27    |
| Consumer              | <b>4,108</b> | 3,772 | 4,782 | 5,304 | 5,263 |
| Revolving home equity | <b>39</b>    | 7     | 18    | 5     | 23    |
| Consumer credit card  | <b>6,556</b> | 4,785 | 4,309 | 4,520 | 4,250 |
| Overdrafts            | <b>1,621</b> | 2,293 | 2,543 | 3,477 | 2,271 |

Total recoveries **17,631** 15,574 15,226 16,135 14,890

Net loans charged off **96,942** 138,836 69,867 42,733 26,054

**Balance at end of year** \$ **197,538** \$ 194,480 \$ 172,619 \$ 133,586 \$ 131,730

|   |              |       |       |       |       |
|---|--------------|-------|-------|-------|-------|
| Ratio of allowance to loans at end of year      | <b>2.10%</b> | 1.92% | 1.53% | 1.26% | 1.36% |
| Ratio of provision to average loans outstanding | <b>1.03%</b> | 1.51% | 1.00% | .42%  | .28%  |

(A) Net of unearned income, before deducting allowance for loan losses, excluding loans held for sale.

| (Dollars in thousands)   | Years Ended December 31 |       |       |       |       |
|--|-------------------------|-------|-------|-------|-------|
|  | 2010                    | 2009  | 2008  | 2007  | 2006  |
| Ratio of net charge-offs to average loans outstanding, by loan category: |                         |       |       |       |       |
| Business   | <b>.16%</b>             | .41%  | .13%  | .14%  | NA    |
| Real estate construction and land  | <b>2.69</b>             | 4.61  | .89   | .30   | .01   |
| Real estate business   | <b>.20</b>              | .24   | .10   | .05   | NA    |
| Real estate personal   | <b>.14</b>              | .18   | .11   | .01   | .01   |
| Consumer   | <b>1.64</b>             | 2.20  | 1.28  | .61   | .45   |
| Revolving home equity  | <b>.41</b>              | .24   | .09   | .10   | .03   |
| Consumer credit card   | <b>6.28</b>             | 6.77  | 4.06  | 3.56  | 3.00  |
| Overdrafts   | <b>14.42</b>            | 12.27 | 16.40 | 10.36 | 18.18 |
| Ratio of total net charge-offs to total average loans outstanding        | <b>1.00%</b>            | 1.31% | .64%  | .42%  | .29%  |

NA: Net recoveries were experienced in 2006.



**Table of Contents**

The following schedule provides a breakdown of the allowance for loan losses by loan category and the percentage of each loan category to total loans outstanding at year end:

| (in thousands)   | 2010                    |                                       | 2009                    |                                    | 2008                    |                                    | 2007                    |                                    | 2006                    |
|------------------|-------------------------|---------------------------------------|-------------------------|------------------------------------|-------------------------|------------------------------------|-------------------------|------------------------------------|-------------------------|
|                  | Loan Loss<br>Allocation | % of<br>Loans<br>to<br>Total<br>Loans | Loan Loss<br>Allocation | % of<br>Loans<br>to Total<br>Loans | Loan Loss<br>Allocation | % of<br>Loans<br>to Total<br>Loans | Loan Loss<br>Allocation | % of<br>Loans<br>to Total<br>Loans | Loan Loss<br>Allocation |
| Construction and | \$ 45,754               | 31.4%                                 | \$ 42,949               | 28.4%                              | \$ 37,912               | 30.2%                              | \$ 29,392               | 30.7%                              | \$ 28,529               |
| Business         | 20,864                  | 4.9                                   | 30,776                  | 6.6                                | 23,526                  | 7.4                                | 8,507                   | 6.3                                | 4,605                   |
| Commercial       | 48,189                  | 22.0                                  | 30,640                  | 20.7                               | 25,326                  | 19.0                               | 14,842                  | 21.1                               | 19,343                  |
| Personal         | 4,016                   | 15.3                                  | 5,231                   | 15.2                               | 4,680                   | 14.5                               | 2,389                   | 14.5                               | 2,243                   |
| Home equity      | 19,404                  | 12.4                                  | 29,994                  | 13.1                               | 28,638                  | 14.3                               | 24,611                  | 15.6                               | 18,655                  |
| Credit card      | 2,316                   | 5.1                                   | 1,590                   | 4.8                                | 1,332                   | 4.4                                | 5,839                   | 4.3                                | 5,035                   |
| Other            | 55,903                  | 8.8                                   | 229                     | 3.3                                | 49,492                  | 6.9                                | 44,307                  | 7.4                                | 39,965                  |
| Unallocated      | 1,092                   | .1                                    | 1,270                   | 7.9                                | 1,713                   | .1                                 | 2,351                   | .1                                 | 3,592                   |
|                  |                         |                                       |                         |                                    |                         |                                    | 1,348                   |                                    | 9,763                   |
|                  | \$ 197,538              | 100.0%                                | \$ 194,480              | 100.0%                             | \$ 172,619              | 100.0%                             | \$ 133,586              | 100.0%                             | \$ 131,730              |

**Risk Elements of Loan Portfolio**

Management reviews the loan portfolio continuously for evidence of problem loans. During the ordinary course of business, management becomes aware of borrowers that may not be able to meet the contractual requirements of loan agreements. Such loans are placed under close supervision with consideration given to placing the loan on non-accrual status, the need for an additional allowance for loan loss, and (if appropriate) partial or full loan charge-off. 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. Consumer installment loans and related accrued interest are normally charged down to the fair value of related collateral (or are charged off in full if no collateral) once the loans are more than 120 days delinquent. Credit card loans and the related accrued interest are charged off when the receivable is more than 180 days past due. After a loan is placed on non-accrual status, any interest previously accrued but not yet collected is reversed against current income. Interest is included in income only as received and only after all previous loan charge-offs have been recovered, so long as management is satisfied there is no impairment of collateral values. The loan is returned to accrual status only when the borrower has brought all past due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled.



**Table of Contents**

The following schedule shows non-performing assets and loans past due 90 days and still accruing interest.

| <i>(Dollars in thousands)</i>                             | <b>December 31</b> |            |           |           |           |
|---|--------------------|------------|-----------|-----------|-----------|
|   | <b>2010</b>        | 2009       | 2008      | 2007      | 2006      |
| Non-performing assets:                                    |                    |            |           |           |           |
| Non-accrual loans:  |                    |            |           |           |           |
| Business  | \$ 8,933           | \$ 12,874  | \$ 4,007  | \$ 4,700  | \$ 5,808  |
| Real estate construction and land                         | 52,752             | 62,509     | 48,871    | 7,769     | 120       |
| Real estate business                                      | 16,242             | 21,756     | 13,137    | 5,628     | 9,845     |
| Real estate personal                                      | 7,348              | 9,384      | 6,794     | 1,095     | 384       |
| Consumer  |                    | 90         | 87        | 547       | 551       |
| <b>Total non-accrual loans</b>                            | <b>85,275</b>      | 106,613    | 72,896    | 19,739    | 16,708    |
| <b>Real estate acquired in foreclosure</b>                | <b>12,045</b>      | 10,057     | 6,181     | 13,678    | 1,515     |
| <b>Total non-performing assets</b>                        | <b>\$ 97,320</b>   | \$ 116,670 | \$ 79,077 | \$ 33,417 | \$ 18,223 |
| Non-performing assets as a percentage of total loans      | <b>1.03%</b>       | 1.15%      | .70%      | .32%      | .19%      |
| Non-performing assets as a percentage of total assets     | <b>.53%</b>        | .64%       | .45%      | .21%      | .12%      |
| Past due 90 days and still accruing interest:             |                    |            |           |           |           |
| Business  | \$ 854             | \$ 3,672   | \$ 1,459  | \$ 1,427  | \$ 2,814  |
| Real estate construction and land                         | 217                | 1,184      | 466       | 768       | 593       |
| Real estate business                                      |                    | 402        | 1,472     | 281       | 1,336     |
| Real estate personal                                      | 3,554              | 3,102      | 4,717     | 5,131     | 3,994     |
| Consumer  | 2,867              | 3,042      | 4,346     | 2,676     | 1,961     |
| Revolving home equity                                     | 825                | 878        | 440       | 700       | 659       |
| Student   |                    | 14,346     | 14,018    | 1         | 1         |
| Consumer credit card                                      | 12,149             | 16,006     | 13,046    | 9,902     | 9,018     |
| <b>Total past due 90 days and still accruing interest</b> | <b>\$ 20,466</b>   | \$ 42,632  | \$ 39,964 | \$ 20,886 | \$ 20,376 |

The table below shows the effect on interest income in 2010 of loans on non-accrual status at year end.

*(In thousands)*

|   |              |
|---|--------------|
| Gross amount of interest that would have been recorded at original rate | \$ 7,583     |
| Interest that was reflected in income                                   | 1,174        |
| <br>  |              |
| Interest income not recognized  | <br>\$ 6,409 |

Total non-accrual loans at year end 2010 were \$85.3 million, a decrease of \$21.3 million from the balance at year end 2009. Most of the decrease occurred in non-accrual construction and land loans, which declined \$9.8 million to \$52.8 million. In addition, business and business real estate non-accrual loans decreased \$3.9 million and \$5.5 million, respectively. Foreclosed real estate increased to a total of \$12.0 million at year end 2010, of which \$4.5 million related to four individual borrowers. Total non-performing assets remain low compared to the overall banking industry in 2010, with the non-performing loans to total loans ratio at .91% at December 31, 2010. Loans past due 90 days and still accruing interest decreased \$22.2 million at year end 2010 compared to 2009, mainly due to \$13.8 million in federally guaranteed student loans which, as noted previously, were sold in October 2010.

In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. They are classified as substandard under the Company's internal rating system. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, they may never become non-performing. Such loans totaled \$233.5 million at December 31, 2010 compared with

**Table of Contents**

\$319.9 million at December 31, 2009, resulting in a decrease of \$86.4 million, or 27.0%. The decrease was largely due to a \$63.7 million decline in construction and land real estate loans.

| <i>(In thousands)</i>                | <b>December 31<br/>2010</b> | December 31<br>2009 |
|--------------------------------------|-----------------------------|---------------------|
| Potential problem loans:             |                             |                     |
| Business                             | \$ 79,640                   | \$ 93,256           |
| Real estate construction and land    | <b>51,589</b>               | 115,251             |
| Real estate business                 | <b>94,063</b>               | 98,951              |
| Real estate personal                 | <b>7,910</b>                | 12,013              |
| Consumer                             | <b>284</b>                  | 409                 |
| <b>Total potential problem loans</b> | <b>\$ 233,486</b>           | <b>\$ 319,880</b>   |

At December 31, 2010, the Company had identified approximately \$94.6 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, \$34.5 million have been placed on non-accrual status. Of the remaining \$60.1 million, approximately \$41.3 million were commercial loans (business, construction and business real estate) classified as substandard, which were renewed at interest rates that were not judged to be market rates for new debt with similar risk. These loans are performing under their modified terms and the Company believes it probable that all amounts due under the modified terms of the agreements will be collected. However, because of their substandard classification, they are included as potential problem loans in the table above. An additional \$18.8 million in troubled debt restructurings were composed of certain credit card loans under various debt management and assistance programs.

***Loans with Special Risk Characteristics***

Management relies primarily on an internal risk rating system, in addition to delinquency status, to assess risk in the loan portfolio, and these statistics are presented in Note 3 to the consolidated financial statements. However, certain types of loans are considered at high risk of loss due to their terms, location, or special conditions. Construction and land loans and business real estate loans are subject to higher risk as a result of the current weak economic climate and issues in the housing industry. Certain personal real estate products have contractual features that could increase credit exposure in a market of declining real estate prices, when interest rates are steadily increasing, or when a geographic area experiences an economic downturn. For these types of loans higher risk could exist when 1) loan terms require a minimum monthly payment that covers only interest, or 2) loan-to-collateral value (LTV) ratios are above 80%, with no private mortgage insurance. Information presented below is based on LTV ratios which were generally calculated with valuations at loan origination date.

**Table of Contents***Real Estate Construction and Land Loans*

The Company's portfolio of construction loans, as shown in the table below, amounted to 4.9% of total loans outstanding at December 31, 2010.

| <i>(In thousands)</i>                                | <b>December 31<br/>2010</b> | <b>% of<br/>Total</b> | <b>% of<br/>Total<br/>Loans</b> | <b>December 31<br/>2009</b> | <b>% of<br/>Total</b> | <b>% of<br/>Total<br/>Loans</b> |
|--|-----------------------------|-----------------------|---------------------------------|-----------------------------|-----------------------|---------------------------------|
| Residential land and land development                | \$ 112,963                  | 24.5%                 | 1.2%                            | \$ 181,257                  | 27.2%                 | 1.8%                            |
| Residential construction                             | 80,516                      | 17.5                  | .9                              | 110,165                     | 16.6                  | 1.1                             |
| Commercial land and land development                 | 115,106                     | 25.0                  | 1.2                             | 144,880                     | 21.8                  | 1.4                             |
| Commercial construction                              | 152,268                     | 33.0                  | 1.6                             | 228,808                     | 34.4                  | 2.3                             |
| <b>Total real estate construction and land loans</b> | <b>\$ 460,853</b>           | <b>100.0%</b>         | <b>4.9%</b>                     | <b>\$ 665,110</b>           | <b>100.0%</b>         | <b>6.6%</b>                     |

*Real Estate Business Loans*

Total business real estate loans were \$2.1 billion at December 31, 2010 and comprised 22.0% 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 48% of these loans were for owner-occupied real estate properties, which present lower risk profiles.

| <i>(In thousands)</i> | <b>December 31<br/>2010</b> | <b>% of<br/>Total</b> | <b>Total<br/>Loans</b> | <b>December 31<br/>2009</b> | <b>% of<br/>Total</b> | <b>Total<br/>Loans</b> |
|-----------------------|-----------------------------|-----------------------|------------------------|-----------------------------|-----------------------|------------------------|
| Owner-occupied        | \$ 990,892                  | 48.0%                 | 10.5%                  | \$ 1,101,870                | 52.4%                 | 10.9%                  |
| Office                | 254,882                     | 12.4                  | 2.7                    | 214,408                     | 10.2                  | 2.1                    |
| Retail                | 226,418                     | 11.0                  | 2.4                    | 210,619                     | 10.0                  | 2.1                    |
| Multi-family          | 143,051                     | 6.9                   | 1.5                    | 112,664                     | 5.3                   | 1.1                    |
| Farm                  | 120,388                     | 5.8                   | 1.3                    | 131,245                     | 6.2                   | 1.3                    |
| Industrial            | 118,159                     | 5.7                   | 1.3                    | 142,745                     | 6.8                   | 1.4                    |
| Hotels                | 108,127                     | 5.2                   | 1.2                    | 115,056                     | 5.5                   | 1.1                    |
| Other                 | 103,920                     | 5.0                   | 1.1                    | 75,423                      | 3.6                   | .7                     |
|                       | <b>\$ 2,065,837</b>         | <b>100.0%</b>         | <b>22.0%</b>           | <b>\$ 2,104,030</b>         | <b>100.0%</b>         | <b>20.7%</b>           |

**Total real estate business  
loans**

*Real Estate Personal Loans*

The Company's \$1.4 billion personal real estate portfolio is composed of loans collateralized with residential real estate. Included in this portfolio are personal real estate loans made to commercial customers, which totaled \$229.4 million at December 31, 2010. This group of loans has an original weighted average term of approximately 6 years, with 63% of the balance in fixed rate loans and 37% in floating rate loans. The remainder of the personal real estate portfolio, totaling \$1.2 billion at December 31, 2010, is comprised of loans made to the retail customer base. It includes adjustable rate mortgage loans and certain fixed rate loans, retained by the Company as directed by its Asset/Liability Management Committee.

Within the retail mortgage loan group, only 1.5% were made with interest only payments (see table below). These loans are typically made to high net-worth borrowers and generally have low LTV ratios or have additional collateral pledged to secure the loan and, therefore, they are not perceived to represent above normal credit risk. At December 31, 2010, these loans had a weighted average LTV and FICO score of 71.1% and 742 respectively, and there were no delinquencies noted in this group. The majority of these loans (95.9%) consist of loans written within the Company's five state branch network territories of Missouri, Kansas,

**Table of Contents**

Illinois, Oklahoma, and Colorado. Loans originated with interest only payments were not made to qualify the borrower for a lower payment amount.

The following table presents information about the retail based personal real estate loan portfolio for 2010 and 2009.

| <i>(Dollars in thousands)</i>                               | 2010                                 |                     | 2009                                 |                     |
|---|--------------------------------------|---------------------|--------------------------------------|---------------------|
|   | Principal Outstanding at December 31 | % of Loan Portfolio | Principal Outstanding at December 31 | % of Loan Portfolio |
| Loans with interest only payments                           | \$ 18,191                            | 1.5%                | \$ 25,201                            | 2.0%                |
| Loans with no insurance and LTV:                            |                                      |                     |                                      |                     |
| Between 80% and 90%   | 86,191                               | 7.1                 | 99,395                               | 7.8                 |
| Between 90% and 95%   | 25,851                               | 2.2                 | 31,331                               | 2.5                 |
| Over 95%  | 42,738                               | 3.5                 | 52,033                               | 4.1                 |
| Over 80% LTV with no insurance                              | 154,780                              | 12.8                | 182,759                              | 14.4                |
| Total loan portfolio from which above loans were identified | 1,210,939                            |                     | 1,267,156                            |                     |

*Revolving Home Equity Loans*

The Company also has revolving home equity loans that are generally collateralized by residential real estate. Most of these loans (95.2%) are written with terms requiring interest only monthly payments. These loans are offered in three main product lines: LTV up to 80%, 80% to 90%, and 90% to 100%. The following tables break out the year end outstanding balances by product for 2010 and 2009.

| <i>(Dollars in thousands)</i> | Principal Outstanding at December 31 |   | New Lines Originated During |   | Unused Portion of Available Lines at December 31 |   | Balances Over 30 Days Past Due |   |
|-------------------------------|--------------------------------------|---|-----------------------------|---|--|---|--------------------------------|---|
|                               | 2010                                 | * | 2010                        | * | 2010   | * | Due                            | * |



|   |            |       |           |      |            |        |          |     |
|---|------------|-------|-----------|------|------------|--------|----------|-----|
| Loans with interest only payments                           | \$ 454,693 | 95.2% | \$ 31,472 | 6.6% | \$ 647,928 | 135.7% | \$ 1,340 | .3% |
| Loans with LTV:   |            |       |           |      |            |        |          |     |
| Between 80% and 90%   | 57,553     | 12.0  | 7,019     | 1.5  | 39,949     | 8.4    | 364      | .1  |
| Over 90%  | 21,301     | 4.5   | 865       | .2   | 13,384     | 2.8    | 327      |     |
| Over 80% LTV  | 78,854     | 16.5  | 7,884     | 1.7  | 53,333     | 11.2   | 691      | .1  |
| Total loan portfolio from which above loans were identified | 477,518    |       | 121,428   |      | 665,701    |        |          |     |

\* Percentage of total principal outstanding of \$477.5 million at December 31, 2010.

|   | Principal Outstanding at December 31 |       | New Lines Originated During |      | Unused Portion of Available Lines at December 31 |        | Balances Over 30 Days Past Due |     |
|---|--------------------------------------|-------|-----------------------------|------|--|--------|--------------------------------|-----|
| <i>(Dollars in thousands)</i>                               | 2009                                 | *     | 2009                        | *    | 2009   | *      |                                | *   |
| Loans with interest only payments                           | \$ 469,460                           | 95.9% | \$ 30,832                   | 6.3% | \$ 647,669                                       | 132.3% | \$ 2,102                       | .4% |
| Loans with LTV:   |                                      |       |                             |      |  |        |                                |     |
| Between 80% and 90%   | 63,369                               | 12.9  | 3,181                       | .7   | 44,261   | 9.0    | 547                            | .1  |
| Over 90%  | 23,369                               | 4.8   | 104                         |      | 16,751   | 3.5    | 504                            | .1  |
| Over 80% LTV  | 86,738                               | 17.7  | 3,285                       | .7   | 61,012   | 12.5   | 1,051                          | .2  |
| Total loan portfolio from which above loans were identified | 489,517                              |       | 32,485                      |      | 658,845  |        |                                |     |

\* *Percentage of total principal outstanding of \$489.5 million at December 31, 2009.*

**Table of Contents***Fixed Rate Home Equity Loans*

In addition to the residential real estate mortgage loans and the revolving floating rate line product discussed above, the Company offers a third choice to those consumers desiring a fixed rate loan and a fixed maturity date. This fixed rate home equity loan, typically for home repair or remodeling, 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 totaled \$132.7 million at both December 31, 2010 and 2009. At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, less than 7% of the outstanding balance has interest only payments. The delinquency history on this product has been low, as balances over 30 days past due totaled only \$1.7 million, or 1.3%, of the portfolio, at both year end 2010 and 2009.

|   | 2010  |      |                            |      | 2009  |      |                            |      |
|---|---|------|----------------------------|------|---|------|----------------------------|------|
|   | Principal<br>Outstanding<br>at<br>December 31 | *    | New<br>Loans<br>Originated | *    | Principal<br>Outstanding<br>at<br>December 31 | *    | New<br>Loans<br>Originated | *    |
| <i>(Dollars in thousands)</i>                               |   |      |                            |      |   |      |                            |      |
| Loans with interest only payments                           | \$ 8,620                                      | 6.5% | \$ 9,954                   | 7.5% | \$ 4,731                                      | 3.6% | \$ 2,355                   | 1.8% |
| Loans with LTV:   |   |      |                            |      |   |      |                            |      |
| Between 80% and 90%   | 17,597  | 13.3 | 5,540                      | 4.2  | 19,526  | 14.7 | 7,682                      | 5.8  |
| Over 90%  | 21,653  | 16.3 | 4,677                      | 3.5  | 25,398  | 19.1 | 924                        | .7   |
| Over 80% LTV  | 39,250  | 29.6 | 10,217                     | 7.7  | 44,924  | 33.8 | 8,606                      | 6.5  |
| Total loan portfolio from which above loans were identified | 132,706                                       |      |                            |      | 132,747                                       |      |                            |      |

\* Percentage of total principal outstanding of \$132.7 million at both December 31, 2010 and 2009.

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 2010 of \$2.1 million, \$2.0 million and \$1.5 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 are 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. During 2010 \$187.1 million of new loans, mostly automobile loans, were originated, compared to \$159.9 million during 2009. The Company experienced rapid growth in marine and RV loans in 2006 through 2008, and the majority of these loans were outside the Company's basic five state branch network. However, due to continuing weak credit and economic conditions, this loan product was curtailed in mid 2008. The loss ratios experienced for marine and RV loans have been higher than for other consumer loan products in recent years, at 2.5% and 3.0% in 2010 and 2009, respectively, but balances over 30 days past due have decreased \$4.6 million from 2009. The table below provides the total outstanding principal and other data for this group of direct and indirect lending products at December 31, 2010 and 2009.

**Table of Contents**

| <i>(Dollars in thousands)</i> | 2010  |                            |   | 2009  |                         |   |
|-------------------------------|---|----------------------------|---|---|-------------------------|---|
|                               | Principal<br>Outstanding<br>at<br>December 31 | New<br>Loans<br>Originated | Balances<br>Over 30<br>Days<br>Past Due | Principal<br>Outstanding<br>at<br>December 31 | New Loans<br>Originated | Balances<br>Over 30<br>Days<br>Past Due |
| Passenger vehicles            | \$ 330,212                                    | \$ 162,212                 | \$ 3,050                                | \$ 371,009                                    | \$ 130,839              | \$ 5,281                                |
| Marine                        | 142,536                                       | 1,207                      | 4,170                                   | 182,866                                       | 1,537                   | 5,617                                   |
| RV                            | 376,115                                       | 60                         | 7,661                                   | 466,757                                       | 2,214                   | 10,793                                  |
| Other                         | 33,809  | 23,607                     | 235                                     | 42,726  | 25,345                  | 740                                     |
| <b>Total</b>                  | <b>\$ 882,672</b>                             | <b>\$ 187,086</b>          | <b>\$ 15,116</b>                        | <b>\$ 1,063,358</b>                           | <b>\$ 159,935</b>       | <b>\$ 22,431</b>                        |

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at December 31, 2010 of \$831.0 million in consumer credit card loans outstanding, approximately \$179.9 million, or 21.6%, carried a low introductory rate. Within the next six months, \$86.2 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.

**Investment Securities Analysis**

Investment securities are comprised of securities which are available for sale, non-marketable, and held for trading. During 2010, total investment securities increased \$910.3 million, or 14.3%, to \$7.3 billion (excluding unrealized gains/losses) compared to \$6.4 billion at the previous year end. During 2010, securities of \$3.2 billion were purchased, which included \$1.0 billion in agency mortgage-backed securities, \$1.6 billion in other asset-backed securities, and \$405.8 million in state and municipal obligations. Total sales, maturities and pay downs were \$2.4 billion during 2010. During 2011, maturities of approximately \$1.6 billion are expected to occur. The average tax equivalent yield earned on total investment securities was 3.40% in 2010 and 4.54% in 2009.

At December 31, 2010, the fair value of available for sale securities was \$7.3 billion, including a net unrealized gain in fair value of \$129.5 million, compared to \$103.6 million at December 31, 2009. The overall unrealized gain in fair value at December 31, 2010 included gains of \$54.1 million in agency mortgage-backed securities, \$20.7 million in U.S. government and federal agency obligations, and \$31.6 million in marketable equity securities held by the Parent.

**Table of Contents**

Available for sale investment securities at year end for the past two years are shown below:

| <i>(In thousands)</i>                                 | <b>December 31</b>  |                     |
|---|---------------------|---------------------|
|   | <b>2010</b>         | <b>2009</b>         |
| <b>Amortized Cost</b>                                 |                     |                     |
| U.S. government and federal agency obligations        | \$ 434,878          | \$ 436,607          |
| Government-sponsored enterprise obligations           | 200,061             | 162,191             |
| State and municipal obligations                       | 1,117,020           | 917,267             |
| Agency mortgage-backed securities                     | 2,437,123           | 2,205,177           |
| Non-agency mortgage-backed securities                 | 459,363             | 654,711             |
| Other asset-backed securities                         | 2,342,866           | 1,685,691           |
| Other debt securities                                 | 165,883             | 164,402             |
| Equity securities                                     | 7,569               | 11,285              |
| <b>Total available for sale investment securities</b> | <b>\$ 7,164,763</b> | <b>\$ 6,237,331</b> |
| <b>Fair Value</b>                                     |                     |                     |
| U.S. government and federal agency obligations        | \$ 455,537          | \$ 447,038          |
| Government-sponsored enterprise obligations           | 201,895             | 165,814             |
| State and municipal obligations                       | 1,119,485           | 939,338             |
| Agency mortgage-backed securities                     | 2,491,199           | 2,262,003           |
| Non-agency mortgage-backed securities                 | 455,790             | 609,016             |
| Other asset-backed securities                         | 2,354,260           | 1,701,569           |
| Other debt securities                                 | 176,964             | 176,331             |
| Equity securities                                     | 39,173              | 39,866              |
| <b>Total available for sale investment securities</b> | <b>\$ 7,294,303</b> | <b>\$ 6,340,975</b> |

The largest component of the available for sale portfolio consists of agency mortgage-backed securities, which are collateralized bonds issued by agencies, including FNMA, GNMA, FHLMC, FHLB, Federal Farm Credit Banks and FDIC. Non-agency mortgage-backed securities totaled \$459.4 million, on an amortized cost basis, at December 31, 2010, and included Alt-A type mortgage-backed securities of \$174.7 million and prime/jumbo loan type securities of \$284.7 million. Certain of the non-agency mortgage-backed securities are other-than-temporarily impaired, and the processes for determining impairment and the related losses are discussed in Note 4 to the consolidated financial statements. The portfolio does not have exposure to subprime originated mortgage-backed or collateralized debt obligation instruments.

At December 31, 2010, U.S. government obligations included \$445.7 million in U.S. Treasury inflation-protected securities, and state and municipal obligations included \$150.1 million in auction rate securities, at fair value. Other debt securities include corporate bonds, notes and commercial paper. Available for sale equity securities are mainly

comprised of publicly traded stock held by the Parent which totaled \$35.9 million at December 31, 2010.

The types of debt securities in the available for sale security portfolio are presented in the table below. Additional detail by maturity category is provided in Note 4 on Investment Securities in the consolidated financial statements.

|  | December 31, 2010                         |                              |                                   |
|--|---|------------------------------|-----------------------------------|
|  | Percent<br>of Total<br>Debt<br>Securities | Weighted<br>Average<br>Yield | Estimated<br>Average<br>Maturity* |
| <b>Available for sale debt securities:</b>     |   |                              |                                   |
| U.S. government and federal agency obligations | 6.3%                                      | 1.11%                        | 3.4years                          |
| Government-sponsored enterprise obligations    | 2.8                                       | 2.10                         | 1.4                               |
| State and municipal obligations                | 15.4                                      | 2.94                         | 8.5                               |
| Agency mortgage-backed securities              | 34.3                                      | 3.61                         | 3.3                               |
| Non-agency mortgage-backed securities          | 6.3                                       | 6.17                         | 3.6                               |
| Other asset-backed securities                  | 32.5                                      | 1.49                         | 1.9                               |
| Other debt securities                          | 2.4                                       | 4.36                         | 1.9                               |

\* Based on call provisions and estimated prepayment speeds.

**Table of Contents**

Non-marketable securities, which totaled \$103.5 million at December 31, 2010, included \$30.5 million in Federal Reserve Bank stock and \$14.7 million in Federal Home Loan Bank (Des Moines) stock held by the bank subsidiary in accordance with debt and regulatory requirements. These are restricted securities which, lacking a market, are carried at cost. Other non-marketable securities also include private equity securities which are carried at estimated fair value.

The Company engages in private equity activities through direct private equity investments and through three private equity/venture capital subsidiaries. These subsidiaries hold investments in various portfolio concerns, which are carried at fair value and totaled \$53.9 million at December 31, 2010. The Company expects to fund an additional \$21.9 million to these subsidiaries for investment purposes over the next several years. In addition to investments held by its private equity/venture capital subsidiaries, the Parent directly holds investments in several private equity concerns, which totaled \$3.7 million at year end 2010. Most of the private equity investments are not readily marketable. While the nature of these investments carries a higher degree of risk than the normal lending portfolio, this risk is mitigated by the overall size of the investments and oversight provided by management, and management believes the potential for long-term gains in these investments outweighs the potential risks.

Non-marketable securities at year end for the past two years are shown below:

| <i>(In thousands)</i>                             | <b>December 31</b> |                   |
|---|--------------------|-------------------|
|   | <b>2010</b>        | <b>2009</b>       |
| Debt securities                                   | \$ 24,327          | \$ 19,908         |
| Equity securities                                 | <b>79,194</b>      | 102,170           |
| <b>Total non-marketable investment securities</b> | <b>\$ 103,521</b>  | <b>\$ 122,078</b> |

**Deposits and Borrowings**

Deposits are the primary funding source for the Bank, and are acquired from a broad base of local markets, including both individual and corporate customers. Total deposits were \$15.1 billion at December 31, 2010, compared to \$14.2 billion last year, reflecting an increase of \$874.6 million, or 6.2%. Average deposits grew by \$541.8 million, or 3.9%, in 2010 compared to 2009 with most of this growth centered in money market deposits, which grew \$1.3 billion, or 16.0%, in 2010 compared to 2009. Certificates of deposit with balances under \$100,000 fell on average by \$395.5 million, or 19.2%, while certificates of deposit over \$100,000 also decreased by \$534.6 million, or 28.8%.

The following table shows year end deposits by type as a percentage of total deposits.

| <b>December 31</b> |             |
|--------------------|-------------|
| <b>2010</b>        | <b>2009</b> |



|   |               |        |
|---|---------------|--------|
| Non-interest bearing demand                 | <b>14.3%</b>  | 12.6%  |
| Savings, interest checking and money market | <b>67.5</b>   | 64.8   |
| Time open and C.D. s of less than \$100,000 | <b>9.7</b>    | 12.7   |
| Time open and C.D. s of \$100,000 and over  | <b>8.5</b>    | 9.9    |
| <b>Total deposits</b>                       | <b>100.0%</b> | 100.0% |

Core deposits, which include demand, interest checking, savings, and money market deposits, supported 67% of average earning assets in 2010 and 59% in 2009. Average balances by major deposit category for the last six years appear on page 60. A maturity schedule of time deposits outstanding at December 31, 2010 is included in Note 7 on Deposits in the consolidated financial statements.

The Company's primary sources of overnight borrowings are federal funds purchased and securities sold under agreements to repurchase (repurchase agreements). Balances in these accounts can fluctuate significantly on a day-to-day basis, and generally have one day maturities. During 2010, the Company entered into long-term structured repurchase agreements totaling \$400.0 million while previous long-term agreements of \$500.0 million matured. The new borrowings mature in 2013 and 2014. Total balances of federal funds

**Table of Contents**

purchased and repurchase agreements outstanding at year end 2010 were \$982.8 million, a \$120.4 million decrease from the \$1.1 billion balance outstanding at year end 2009. On an average basis, these borrowings increased \$116.5 million, or 12.0% during 2010, with increases of \$63.3 million in federal funds purchased and \$53.2 million in repurchase agreements. The average rate paid on total federal funds purchased and repurchase agreements was .24% during 2010 and .38% during 2009.

Most of the Company's long-term debt is comprised of fixed rate advances from the FHLB. These borrowings declined from \$724.4 million at December 31, 2009 to \$104.7 million outstanding at December 31, 2010, due to scheduled maturities of \$494.7 million and prepayments of \$125.0 million. The average rate paid on FHLB advances was 3.30% during 2010 and 3.68% during 2009. Most of the remaining balance outstanding at December 31, 2010 is due in 2017.

**Liquidity and Capital Resources**

**Liquidity Management**

Liquidity is managed within the Company in order to satisfy cash flow requirements of deposit and borrowing customers while at the same time meeting its own cash flow needs. The Company maintains its liquidity position through a variety of sources including:

- A portfolio of liquid assets including marketable investment securities and overnight investments,
- A large customer deposit base and limited exposure to large, volatile certificates of deposit,
- Lower long-term borrowings that might place demands on Company cash flow,
- Relatively low loan to deposit ratio promoting strong liquidity,
- Excellent debt ratings from both Standard & Poor's and Moody's national rating services, and
- Available borrowing capacity from outside sources.

During 2008, liquidity risk became a concern affecting the general banking industry, as some of the major banking institutions across the country experienced unprecedented erosion in capital. This erosion was fueled by declines in asset values, losses in market and investor confidence, and higher defaults, resulting in higher credit costs and less available credit. The Company, as discussed below, took numerous steps to address liquidity risk, and over the past few years has developed a variety of liquidity sources which it believes will provide the necessary funds to grow its business into the future. During 2009 and 2010, overall liquidity improved significantly throughout the banking industry and in the Company by a combination of growth in deposits, a decline in loans outstanding and growth in marketable securities. As a result, the Company's average loans to deposits ratio, one measure of liquidity, decreased from 79.8% in 2009 to 70.0% in 2010.

The Company's most liquid assets include available for sale marketable investment securities, federal funds sold, balances at the Federal Reserve Bank, and securities purchased under agreements to resell (resell agreements). At December 31, 2010 and 2009, such assets were as follows:

*(In thousands)* **2010**                      2009

|   |                     |                     |
|---|---------------------|---------------------|
| Available for sale investment securities                  | <b>\$ 7,294,303</b> | \$ 6,340,975        |
| Federal funds sold  | <b>10,135</b>       | 22,590              |
| Long-term securities purchased under agreements to resell | <b>450,000</b>      |                     |
| Balances at the Federal Reserve Bank                      | <b>122,076</b>      | 24,118              |
| <b>Total</b>  | <b>\$ 7,876,514</b> | <b>\$ 6,387,683</b> |

Federal funds sold are sold to the Company's correspondent bank customers and are used to satisfy the daily cash needs of the Company. Interest earning balances at the Federal Reserve Bank (FRB), which have overnight maturities and are also used for general liquidity purposes, earned an average rate of 25 basis points during 2010. In addition, as mentioned previously, the Company purchased \$450.0 million in long-term resell agreements during 2010. The Company holds marketable securities as collateral under these

**Table of Contents**

agreements, which totaled \$468.5 million in fair value at December 31, 2010. The Company's available for sale investment portfolio has maturities of approximately \$1.6 billion which are scheduled to occur during 2011 and offers substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits, repurchase agreements, trust funds, letters of credit issued by the FHLB, and borrowing capacity at the FRB. At December 31, 2010, total investment securities pledged for these purposes were as follows:

| <i>(In thousands)</i>                                      | 2010                |
|--|---------------------|
| Investment securities pledged for the purpose of securing: |                     |
| Federal Reserve Bank borrowings                            | \$ 652,453          |
| FHLB borrowings and letters of credit                      | 231,535             |
| Repurchase agreements                                      | 1,629,173           |
| Other deposits   | 1,123,399           |
| <br>   |                     |
| Total pledged securities                                   | 3,636,560           |
| Unpledged and available for pledging                       | 3,042,084           |
| Ineligible for pledging                                    | 615,659             |
| <br>   |                     |
| <b>Total available for sale securities, at fair value</b>  | <b>\$ 7,294,303</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 December 31, 2010, such deposits totaled \$12.3 billion and represented 81.8% of the Company's 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. During 2010, total core deposits increased \$1.3 billion, mainly in non-interest bearing demand and money market accounts. This increase was comprised of growth in consumer deposits of \$981.5 million and corporate and non-personal deposits of \$362.6 million. Some of the growth in corporate deposits was the result of a tendency by businesses to maintain higher levels of liquidity, in addition to low rate investment alternatives. While the Company considers core consumer deposits less volatile, corporate deposits could decline if interest rates increase significantly or if corporate customers move funds from the Company. In order to address funding needs should these corporate deposits decline, the Company maintains adequate levels of earning assets maturing in 2011. Time open and certificates of deposit of \$100,000 or greater totaled \$1.3 billion at December 31, 2010. These deposits are normally considered more volatile and higher costing, and comprised 8.5% of total deposits at December 31, 2010.

| <i>(In thousands)</i>       | 2010         | 2009         |
|-----------------------------|--------------|--------------|
| Core deposit base:          |              |              |
| Non-interest bearing demand | \$ 2,150,725 | \$ 1,793,816 |

|                          |                      |               |
|--------------------------|----------------------|---------------|
| Interest checking        | <b>818,359</b>       | 735,870       |
| Savings and money market | <b>9,371,775</b>     | 8,467,046     |
| <b>Total</b>             | <b>\$ 12,340,859</b> | \$ 10,996,732 |

Other important components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are mainly comprised of federal funds purchased, repurchase agreements, and advances from the FRB and the FHLB, as follows:

| <i>(In thousands)</i>   | <b>2010</b>         | 2009         |
|-------------------------|---------------------|--------------|
| Borrowings:             |                     |              |
| Federal funds purchased | <b>\$ 4,910</b>     | \$ 62,130    |
| Repurchase agreements   | <b>977,917</b>      | 1,041,061    |
| FHLB advances           | <b>104,675</b>      | 724,386      |
| Subordinated debentures |                     | 4,000        |
| Other long-term debt    | <b>7,598</b>        | 7,676        |
| <b>Total</b>            | <b>\$ 1,095,100</b> | \$ 1,839,253 |

**Table of Contents**

Federal funds purchased and repurchase agreements are generally borrowed overnight and amounted to \$982.8 million at December 31, 2010. Federal funds purchased are unsecured overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved lines of credit. Repurchase agreements are secured by a portion of the Company's investment portfolio and are comprised of both non-insured customer funds, totaling \$577.9 million at December 31, 2010, and structured repurchase agreements of \$400.0 million purchased from an upstream financial institution. Customer repurchase agreements are offered to customers wishing to earn interest in highly liquid balances and are used by the Company as a funding source considered to be stable, but short-term in nature. The Company also borrows on a secured basis through advances from the FHLB, which totaled \$104.7 million at December 31, 2010. All of these advances have fixed interest rates and mature in 2011 through 2017. The Company's other borrowings are mainly comprised of debt related to the Company's private equity business. The overall long-term debt position of the Company is small relative to the Company's overall liability position.

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 and permits 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 December 31, 2010.

|                                      | December 31, 2010   |                     |
|--------------------------------------|---------------------|---------------------|
| <i>(In thousands)</i>                | FHLB                | Federal Reserve     |
| Total collateral value pledged       | \$ 1,919,639        | \$ 1,489,448        |
| Advances outstanding                 | (104,675)           |                     |
| Letters of credit issued             | (502,214)           |                     |
| <b>Available for future advances</b> | <b>\$ 1,312,750</b> | <b>\$ 1,489,448</b> |

The Company's average loans to deposits ratio was 70.0% at December 31, 2010, which is considered in the banking industry to be a conservative measure of good liquidity. Also, the Company receives outside ratings from both Standard & Poor's and Moody's on both the consolidated company and its subsidiary bank, Commerce Bank, N.A. These ratings are as follows:

Standard & Poor's      Moody's

**Commerce Bancshares, Inc.**

Counterparty rating

A

|                                |        |        |
|--------------------------------|--------|--------|
| Commercial paper rating        | A-1    | P-1    |
| Rating outlook                 | Stable | Stable |
| <b>Commerce Bank, N. A.</b>    |        |        |
| Issuer rating                  | A+     | Aa2    |
| Bank deposits                  | A+     | Aa2    |
| Bank financial strength rating |        | B+     |

The Company considers these ratings to be indications of a sound capital base and good liquidity, and believes that these ratings would help ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been outstanding during the past ten years. The Company has no subordinated or hybrid debt instruments which would affect future borrowings capacity. Because of its lack of significant long-term debt, the Company believes that, through its Capital Markets Group or in other public debt markets, it could generate additional liquidity from sources such as jumbo certificates of deposit, privately-placed corporate notes or other forms of debt. Future financing could also include the issuance of common or preferred stock.

**Table of Contents**

The cash flows from the operating, investing and financing activities of the Company resulted in a net decrease in cash and cash equivalents of \$3.2 million in 2010, as reported in the consolidated statements of cash flows on page 67 of this report. Operating activities, consisting mainly of net income adjusted for certain non-cash items, provided cash flow of \$671.2 million and has historically been a stable source of funds. Investing activities used total cash of \$654.5 million in 2010, and consisted mainly of purchases and maturities of available for sale investment securities and changes in the level of the Company's loan portfolio. Growth in the investment securities portfolio used cash of \$830.6 million, and the purchase of long-term resell agreements used cash of \$450.0 million. The decline in the loan portfolio provided cash of \$644.3 million. Investing activities are somewhat unique to financial institutions in that, while large sums of cash flow are normally used to fund growth in investment securities, loans, or other bank assets, they are normally dependent on the financing activities described below.

Financing activities used total cash of \$19.9 million, resulting from an \$831.0 million increase in deposits, partly offset by net debt repayments of \$623.8 million and a net decrease in federal funds purchased and repurchase agreements of \$120.4 million. Cash dividend payments totaled \$78.2 million. Future short-term liquidity needs for daily operations are not expected to vary significantly and the Company maintains adequate liquidity to meet these cash flows. The Company's sound equity base, along with its low debt level, common and preferred stock availability, and excellent debt ratings, provide several alternatives for future financing. Future acquisitions may utilize partial funding through one or more of these options.

Cash flows resulting from the Company's transactions in its common stock were as follows:

| <i>(In millions)</i>   | <b>2010</b>       | 2009    | 2008      |
|--|-------------------|---------|-----------|
| Stock sale program   | \$                | \$ 98.2 | \$        |
| Exercise of stock-based awards and sales to affiliate non-employee directors | <b>11.3</b>       | 5.5     | 16.0      |
| Purchases of treasury stock  | <b>(41.0)</b>     | (.5)    | (9.5)     |
| Cash dividends paid  | <b>(78.2)</b>     | (74.7)  | (72.1)    |
| <b>Cash provided (used)</b>  | <b>\$ (107.9)</b> | \$ 28.5 | \$ (65.6) |

The Parent faces unique liquidity constraints due to legal limitations on its ability to borrow funds from its bank subsidiary. The Parent obtains funding to meet its obligations from two main sources: dividends received from bank and non-bank subsidiaries (within regulatory limitations) and from management fees charged to subsidiaries as reimbursement for services provided by the Parent, as presented below:

| <i>(In millions)</i>                 | <b>2010</b>     | 2009    | 2008    |
|--------------------------------------|-----------------|---------|---------|
| Dividends received from subsidiaries | <b>\$ 105.1</b> | \$ 45.1 | \$ 76.2 |
| Management fees                      | <b>22.6</b>     | 46.6    | 44.0    |



**Total** \$ 127.7    \$ 91.7    \$ 120.2

These sources of funds are used mainly to pay cash dividends on outstanding common stock, pay general operating expenses, and purchase treasury stock when appropriate. At December 31, 2010, the Parent's available for sale investment securities totaled \$101.5 million at fair value, consisting mainly of publicly traded common stock and non-agency backed collateralized mortgage obligations. To support its various funding commitments, the Parent maintains a \$20.0 million line of credit with its subsidiary bank. There were no borrowings outstanding under the line during 2010 or 2009.

Company senior management is responsible for measuring and monitoring the liquidity profile of the organization with oversight by the Company's Asset/Liability Committee. This is done through a series of controls, including a written Contingency Funding Policy and risk monitoring procedures, including daily, weekly and monthly reporting. In addition, the Company prepares forecasts which project changes in the balance sheet affecting liquidity, and which allow the Company to better plan for forecasted changes.

**Table of Contents****Capital Management**

The Company maintains strong regulatory capital ratios, including those of its banking subsidiary, in excess of the well-capitalized guidelines under federal banking regulations. The Company's capital ratios at the end of the last three years are as follows:

|                                   | 2010          | 2009   | 2008   | Well-Capitalized Regulatory Guidelines |
|-----------------------------------|---------------|--------|--------|--|
| <b>Risk-based capital ratios:</b> |               |        |        |  |
| Tier I capital                    | <b>14.38%</b> | 13.04% | 10.92% | 6.00%                                  |
| Total capital                     | <b>15.75</b>  | 14.39  | 12.31  | 10.00                                  |
| Leverage ratio                    | <b>10.17</b>  | 9.58   | 9.06   | 5.00                                   |
| Tangible equity to assets         | <b>10.27</b>  | 9.71   | 8.25   |  |
| Dividend payout ratio             | <b>35.52</b>  | 44.15  | 38.54  |  |

The components of the Company's regulatory risk-based capital and risk-weighted assets at the end of the last three years are as follows:

| <i>(In thousands)</i>                 | 2010                | 2009         | 2008         |
|---------------------------------------|---------------------|--------------|--------------|
| <b>Regulatory risk-based capital:</b> |                     |              |              |
| Tier I capital                        | <b>\$ 1,828,965</b> | \$ 1,708,901 | \$ 1,510,959 |
| Tier II capital                       | <b>173,681</b>      | 177,077      | 191,957      |
| Total capital                         | <b>2,002,646</b>    | 1,885,978    | 1,702,916    |
| Total risk-weighted assets            | <b>12,717,868</b>   | 13,105,948   | 13,834,161   |

In February 2008, the Board of Directors authorized the Company to purchase additional shares of common stock under its repurchase program, which brought the total purchase authorization to 3,000,000 shares. During 2010, approximately 1,103,000 shares were acquired under the current Board authorization at an average price of \$37.15 per share.

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. Per share cash dividends paid by the Company increased 2.8% in 2010 compared with 2009. The Company paid its seventeenth consecutive annual stock dividend in December 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.

**Table of Contents****Commitments, Contractual Obligations, and Off-Balance Sheet Arrangements**

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, totaling \$7.4 billion (including approximately \$3.4 billion in unused approved credit card lines), and the contractual amount of standby letters of credit, totaling \$338.7 million at December 31, 2010. Since many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. 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 table summarizing contractual cash obligations of the Company at December 31, 2010 and the expected timing of these payments follows:

## Payments Due by Period

| <i>(In thousands)</i>   | In One Year<br>or Less | After One<br>Year<br>Through<br>Three<br>Years | After Three<br>Years<br>Through<br>Five Years | After<br>Five<br>Years | Total               |
|---|------------------------|--|---|------------------------|---------------------|
| Long-term debt obligations,<br>including structured repurchase<br>agreements* | \$ 333                 | \$ 59,618                                      | \$ 351,298                                    | \$ 101,024             | \$ 512,273          |
| Operating lease obligations   | 5,831                  | 9,160  | 6,180   | 19,694                 | 40,865              |
| Purchase obligations  | 50,523                 | 80,099   | 11,450  | 4,750                  | 146,822             |
| Time open and C.D. s*   | 2,189,969              | 436,932  | 116,717                                       | 544                    | 2,744,162           |
| <b>Total</b>  | <b>\$ 2,246,656</b>    | <b>\$ 585,809</b>                              | <b>\$ 485,645</b>                             | <b>\$ 126,012</b>      | <b>\$ 3,444,122</b> |

\* Includes principal payments only.

As of December 31, 2010, the Company has unrecognized tax benefits that, if recognized, would impact the effective tax rate in future periods. Due to the uncertainty of the amounts to be ultimately paid as well as the timing of such payments, all uncertain tax liabilities that have not been paid have been excluded from the table above. Further detail on the impact of income taxes is located in Note 9 of the consolidated financial statements.

The Company funds a defined benefit pension plan for a portion of its employees. Under the funding policy for the plan, contributions are made as necessary to provide for current service and for any unfunded accrued actuarial liabilities over a reasonable period. During recent years, the Company has not been required to make cash contributions to the plan and does not expect to do so in 2011.

The Company has investments in several low-income housing partnerships within the area it serves. At December 31, 2010, these investments totaled \$5.5 million and were recorded as other assets in the Company's consolidated balance sheet. These partnerships supply funds for the construction and operation of apartment complexes that provide

affordable housing to that segment of the population with lower family income. If these developments successfully attract a specified percentage of residents falling in that lower income range, state and/or federal income tax credits are made available to the partners. The tax credits are normally recognized over ten years, and they play an important part in the anticipated yield from these investments. In order to continue receiving the tax credits each year over the life of the partnership, the low-income residency targets must be maintained. Under the terms of the partnership agreements, the Company has a commitment to fund a specified amount that will be due in installments over the life of the agreements, which ranges from 10 to 15 years. These unfunded commitments are recorded as liabilities on the Company's consolidated balance sheet and aggregated to \$4.6 million at December 31, 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 2010, purchases and sales of tax credits amounted to \$37.6 million and \$43.8 million, respectively. At December 31, 2010, the Company had outstanding purchase commitments totaling \$131.5 million.

**Table of Contents**

The Parent has investments in several private equity concerns which are classified as non-marketable securities in the Company's consolidated balance sheet. Under the terms of the agreements with two of these concerns, the Parent has unfunded commitments outstanding of \$1.3 million at December 31, 2010. The Parent also expects to fund \$21.9 million to venture capital subsidiaries over the next several years.

**Interest Rate Sensitivity**

The Company's Asset/Liability Management Committee (ALCO) measures and manages the Company's interest rate risk on a monthly basis to identify trends and establish strategies to maintain stability in net interest income throughout various rate environments. Analytical modeling techniques provide management insight into the Company's exposure to changing rates. These techniques include net interest income simulations and market value analyses. Management has set guidelines specifying acceptable limits within which net interest income and market value may change under various rate change scenarios. These measurement tools indicate that the Company is currently within acceptable risk guidelines as set by management.

The Company's main interest rate measurement tool, income simulations, projects net interest income under various rate change scenarios in order to quantify the magnitude and timing of potential rate-related changes. Income simulations are able to capture option risks within the balance sheet where expected cash flows may be altered under various rate environments. Modeled rate movements include "shocks, ramps and twists". Shocks are intended to capture interest rate risk under extreme conditions by immediately shifting rates up and down, while ramps measure the impact of gradual changes and twists measure yield curve risk. The size of the balance sheet is assumed to remain constant so that results are not influenced by growth predictions. The table below shows the expected effect that gradual basis point shifts in the LIBOR/swap curve over a twelve month period would have on the Company's net interest income, given a static balance sheet.

| <i>(Dollars in millions)</i> | <b>December 31, 2010</b>       |   | September 30, 2010             |   | December 31, 2009              |   |
|------------------------------|--------------------------------|---|--------------------------------|---|--------------------------------|---|
|                              | <b>Increase<br/>(Decrease)</b> | <b>% of Net<br/>Interest<br/>Income</b> | <b>Increase<br/>(Decrease)</b> | <b>% of Net<br/>Interest<br/>Income</b> | <b>Increase<br/>(Decrease)</b> | <b>% of Net<br/>Interest<br/>Income</b> |
| 300 basis points rising      | \$ 10.4                        | 1.70%                                   | \$ 13.1                        | 2.05%                                   | \$ 21.6                        | 3.22%                                   |
| 200 basis points rising      | 7.6                            | 1.25                                    | 11.5                           | 1.79                                    | 17.3                           | 2.57                                    |
| 100 basis points rising      | 2.8                            | .46                                     | 5.3                            | .83                                     | 10.6                           | 1.58                                    |

The Company also employs a sophisticated simulation technique known as a stochastic income simulation. This technique allows management to see a range of results from hundreds of income simulations. The stochastic simulation creates a vector of potential rate paths around the market's best guess (forward rates) concerning the future path of interest rates and allows rates to randomly follow paths throughout the vector. This allows for the modeling of non-biased rate forecasts around the market consensus. Results give management insight into a likely range of rate-related risk as well as worst and best-case rate scenarios.

The Company also uses market value analyses to help identify longer-term risks that may reside on the balance sheet. This is considered a secondary risk measurement tool by management. The Company measures the market value of equity as the net present value of all asset and liability cash flows discounted along the current LIBOR/swap curve

plus appropriate market risk spreads. It is the change in the market value of equity under different rate environments, or effective duration that gives insight into the magnitude of risk to future earnings due to rate changes. Market value analyses also help management understand the price sensitivity of non-marketable bank products under different rate environments.

The Company's modeling of interest rate risk as of December 31, 2010 shows that under various rising rate scenarios, net interest income would show growth. The Company has not modeled falling rate scenarios due the extremely low interest rate environment. At December 31, 2010, the Company calculated that a gradual increase in rates of 100 basis points would increase net interest income by \$2.8 million, or .5%, compared with an increase of \$10.6 million projected at December 31, 2009. A 200 basis point gradual rise in rates calculated at December 31, 2010 would increase net interest income by \$7.6 million, or 1.3%, down from

## **Table of Contents**

an increase of \$17.3 million last year. Also, a gradual increase of 300 basis points would increase net interest income by \$10.4 million, or 1.7%, compared to a growth of \$21.6 million at December 31, 2009.

Using rising rate models, the potential increase in net interest income is lower at December 31, 2010 when compared to the prior year due to several factors. These factors include a decline of \$970.3 million in average loan balances in 2010 compared to the previous year, which are mainly variable rate assets, and average growth of \$1.5 billion in available for sale securities, most of which have fixed rates. In addition to the change in earning assets, average interest bearing deposits grew during 2009 by \$468.2 million, mainly in money market deposit accounts. Deposits have lower rates and are modeled to re-price upwards more slowly, thus partially offsetting the effect of a larger fixed rate securities portfolio. Other borrowings (mainly FHLB advances) declined on average by \$467.7 million, resulting in lower interest expense.

Thus, under rising rate scenarios, the Company benefits from the repricing of its loan portfolio, the majority of which is variable rate. However, higher levels of fixed rate securities will partly offset the effect of the loan portfolio on interest income. Additionally, deposit balances 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.

Through review and oversight by the ALCO, the Company attempts to engage in strategies that neutralize interest rate risk as much as possible. The Company's balance sheet remains well-diversified with moderate interest rate risk and is well-positioned for future growth. The use of derivative products is limited and the deposit base is strong and stable. The loan to deposit ratio is still at relatively low levels, which should present the Company with opportunities to fund future loan growth at reasonable costs. 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 minimize impacts of interest rate risk.

## **Derivative Financial Instruments**

The Company maintains an overall interest rate risk management strategy that permits the use of derivative instruments to modify exposure to interest rate risk. The Company's interest rate risk management strategy includes the ability to modify the re-pricing 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. As of December 31, 2010, the Company had entered into three interest rate swaps with a notional amount of \$15.7 million which are designated as fair value hedges of certain fixed rate loans. The Company also sells swap contracts to customers who wish to modify their interest rate sensitivity. The Company offsets the interest rate risk of these swaps by purchasing matching contracts with offsetting pay/receive rates from other financial institutions. The notional amount of these types of swaps at December 31, 2010 was \$482.3 million.

Credit risk participation agreements arise when the Company contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps. These agreements provide for reimbursement of losses resulting from a third party default on the underlying swap.

The Company enters into foreign exchange derivative instruments as an accommodation to customers and offsets the related foreign exchange risk by entering into offsetting third-party forward contracts with approved, reputable counterparties. In addition, the Company takes proprietary positions in such contracts based on market expectations. Hedge accounting has not been applied to these foreign exchange activities. This trading activity is managed within a policy of specific controls and limits. Most of the foreign exchange contracts outstanding at December 31, 2010 mature within 90 days, and the longest period to maturity is 11 months.



Additionally, interest rate lock commitments issued on residential mortgage loans held for resale are considered derivative instruments. The interest rate exposure on these commitments is economically hedged primarily with forward sale contracts in the secondary market.

In all of these contracts, the Company is exposed to credit risk in the event of nonperformance by counterparties, who may be bank customers or other financial institutions. The Company controls the credit

**Table of Contents**

risk of its financial contracts through credit approvals, limits and monitoring procedures. Because the Company generally enters into transactions only with high quality counterparties, there have been no losses associated with counterparty nonperformance on derivative financial instruments.

The following table summarizes the notional amounts and estimated fair values of the Company's derivative instruments at December 31, 2010 and 2009. Notional amount, along with the other terms of the derivative, is used to determine the amounts to be exchanged between the counterparties. Because the notional amount does not represent amounts exchanged by the parties, it is not a measure of loss exposure related to the use of derivatives nor of exposure to liquidity risk.

| <i>(In thousands)</i>                   | <b>Notional<br/>Amount</b> | <b>2010<br/>Positive<br/>Fair<br/>Value</b> | <b>Negative<br/>Fair<br/>Value</b> | Notional<br>Amount | 2009<br>Positive<br>Fair<br>Value | Negative<br>Fair<br>Value |
|---|----------------------------|---|------------------------------------|--------------------|-----------------------------------|---------------------------|
| Interest rate swaps                     | \$ 498,071                 | \$ 17,712                                   | \$ (18,958)                        | \$ 503,530         | \$ 16,962                         | \$ (17,816)               |
| Interest rate caps                      | 31,736                     | 84  | (84)                               | 16,236             | 239                               | (239)                     |
| Credit risk participation<br>agreements | 40,661                     |   | (130)                              | 53,246             | 140                               | (239)                     |
| Foreign exchange contracts              | 25,867                     | 492   | (359)                              | 17,475             | 415                               | (295)                     |
| Mortgage loan commitments               | 12,125                     | 101   | (30)                               | 9,767              | 44                                | (16)                      |
| Mortgage loan forward sale<br>contracts | 24,112                     | 434   | (23)                               | 19,986             | 184                               | (5)                       |
| <b>Total at December 31</b>             | <b>\$ 632,572</b>          | <b>\$ 18,823</b>                            | <b>\$ (19,584)</b>                 | <b>\$ 620,240</b>  | <b>\$ 17,984</b>                  | <b>\$ (18,610)</b>        |

**Operating Segments**

The Company segregates financial information for use in assessing its performance and allocating resources among three operating segments. The results are determined based on the Company's management accounting process, which assigns balance sheet and income statement items to each responsible segment. These segments are defined by customer base and product type. The management process measures the performance of the operating segments based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. Each segment is managed by executives who, in conjunction with the Chief Executive Officer, make strategic business decisions regarding that segment. The three reportable operating segments are Consumer, Commercial and Wealth. Additional information is presented in Note 13 on Segments in the consolidated financial statements.

The Company uses a funds transfer pricing method to value funds used (e.g., loans, fixed assets, cash, etc.) and funds provided (deposits, borrowings, and equity) by the business segments and their components. This process assigns a specific value to each new source or use of funds with a maturity, based on current LIBOR interest rates, thus determining an interest spread at the time of the transaction. Non-maturity assets and liabilities are assigned to LIBOR based funding pools. This method helps to provide an accurate means of valuing fund sources and uses in a varying

interest rate environment. The Company also assigns loan charge-offs and recoveries (labeled in the table below as provision for loan losses ) directly to each operating segment instead of allocating an estimated loan loss provision. The operating segments also include a number of allocations of income and expense from various support and overhead centers within the Company.

**Table of Contents**

The table below is a summary of segment pre-tax income results for the past three years.

| <i>(Dollars in thousands)</i>                      | Consumer   | Commercial | Wealth    | Segment<br>Totals | Other/<br>Elimination | Consolidated<br>Totals |
|--|------------|------------|-----------|-------------------|-----------------------|------------------------|
| <b>Year ended</b>                                  |            |            |           |                   |                       |                        |
| <b>December 31, 2010</b>                           |            |            |           |                   |                       |                        |
| Net interest income                                | \$ 311,231 | \$ 259,296 | \$ 41,075 | \$ 611,602        | \$ 34,330             | \$ 645,932             |
| Provision for loan losses                          | (70,633)   | (24,825)   | (1,263)   | (96,721)          | (3,279)               | (100,000)              |
| Non-interest income                                | 157,903    | 131,954    | 116,095   | 405,952           | (841)                 | 405,111                |
| Investment securities losses, net                  |            |            |           |                   | (1,785)               | (1,785)                |
| Non-interest expense                               | (287,359)  | (205,069)  | (106,438) | (598,866)         | (32,268)              | (631,134)              |
| <br>   |            |            |           |                   |                       |                        |
| Income (loss) before income taxes                  | \$ 111,142 | \$ 161,356 | \$ 49,469 | \$ 321,967        | \$ (3,843)            | \$ 318,124             |
| <br>   |            |            |           |                   |                       |                        |
| <b>Year ended</b>                                  |            |            |           |                   |                       |                        |
| <b>December 31, 2009</b>                           |            |            |           |                   |                       |                        |
| Net interest income                                | \$ 331,607 | \$ 243,083 | \$ 40,691 | \$ 615,381        | \$ 20,121             | \$ 635,502             |
| Provision for loan losses                          | (84,019)   | (54,230)   | (520)     | (138,769)         | (21,928)              | (160,697)              |
| Non-interest income                                | 163,150    | 114,637    | 114,445   | 392,232           | 4,027                 | 396,259                |
| Investment securities losses, net                  |            |            |           |                   | (7,195)               | (7,195)                |
| Non-interest expense                               | (302,505)  | (191,628)  | (106,370) | (600,503)         | (21,234)              | (621,737)              |
| <br>   |            |            |           |                   |                       |                        |
| Income (loss) before income taxes                  | \$ 108,233 | \$ 111,862 | \$ 48,246 | \$ 268,341        | \$ (26,209)           | \$ 242,132             |
| <br>   |            |            |           |                   |                       |                        |
| <b>2010 vs. 2009</b>                               |            |            |           |                   |                       |                        |
| Increase (decrease) in income before income taxes: |            |            |           |                   |                       |                        |
| <br>   |            |            |           |                   |                       |                        |
| Amount   | \$ 2,909   | \$ 49,494  | \$ 1,223  | \$ 53,626         | \$ 22,366             | \$ 75,992              |
| <br>   |            |            |           |                   |                       |                        |
| Percent  | 2.7%       | 44.2%      | 2.5%      | 20.0%             | N.M.                  | 31.4%                  |

**Year ended  
December 31, 2008**

|                                  |            |            |           |            |           |            |
|----------------------------------|------------|------------|-----------|------------|-----------|------------|
| Net interest income              | \$ 323,568 | \$ 203,961 | \$ 37,174 | \$ 564,703 | \$ 28,036 | \$ 592,739 |
| Provision for loan losses        | (56,639)   | (13,526)   | (265)     | (70,430)   | (38,470)  | (108,900)  |
| Non-interest income              | 146,295    | 107,445    | 113,879   | 367,619    | 8,093     | 375,712    |
| Investment securities gains, net |            |            |           |            | 30,294    | 30,294     |
| Non-interest expense             | (285,796)  | (180,779)  | (131,710) | (598,285)  | (17,095)  | (615,380)  |

|                                   |            |            |           |            |           |            |
|-----------------------------------|------------|------------|-----------|------------|-----------|------------|
| Income (loss) before income taxes | \$ 127,428 | \$ 117,101 | \$ 19,078 | \$ 263,607 | \$ 10,858 | \$ 274,465 |
|-----------------------------------|------------|------------|-----------|------------|-----------|------------|

**2009 vs. 2008**

Increase (decrease) in income before income taxes:

|        |             |            |           |          |             |             |
|--------|-------------|------------|-----------|----------|-------------|-------------|
| Amount | \$ (19,195) | \$ (5,239) | \$ 29,168 | \$ 4,734 | \$ (37,067) | \$ (32,333) |
|--------|-------------|------------|-----------|----------|-------------|-------------|

|         |         |        |        |      |      |         |
|---------|---------|--------|--------|------|------|---------|
| Percent | (15.1)% | (4.5)% | 152.9% | 1.8% | N.M. | (11.8)% |
|---------|---------|--------|--------|------|------|---------|

*Consumer*

The Consumer segment includes consumer deposits, consumer finance, consumer debit and credit cards, and student lending. Pre-tax income for 2010 was \$111.1 million, an increase of \$2.9 million, or 2.7%, over 2009. This increase was mainly due to declines of \$15.1 million, or 5.0%, in non-interest expense and \$13.4 million in the provision for loan losses. The decline in non-interest expense was largely due to lower FDIC insurance expense, deposit account processing expense and teller services expense. The provision for loan losses totaled \$70.6 million in 2010 compared to \$84.0 million in the prior year and included lower losses on marine and RV loans, consumer credit card loans and other consumer loans. These lower expenses were partly offset by a decline of \$20.4 million in net interest income, due to a \$30.5 million decrease in net allocated funding credits assigned to the Consumer segment's loan and deposit portfolios and a \$30.4 million decrease in loan interest income, partly offset by a decline of \$40.6 million in deposit interest expense. Also, non-interest income decreased \$5.2 million, or 3.2%, from the prior year due to lower deposit account fees (mainly overdraft charges). This decline was partly offset by an increase in bank card fee income (primarily debit card fees) and higher gains on sales of student loans. Total average loans decreased 11.5% in 2010 compared to the prior year due to declines in consumer loans and the sale of the student loan portfolio mentioned below. Average deposits increased slightly over the prior period, resulting mainly from growth in

**Table of Contents**

interest checking and premium money market deposit accounts, partly offset by a decline in short-term certificates of deposit.

Pre-tax profitability for 2009 was \$108.2 million, a decrease of \$19.2 million, or 15.1%, from 2008. The decline in profitability was mainly due to an increase of \$27.4 million in the provision for loan losses and an increase of \$16.7 million in non-interest expense, which were partly offset by higher net interest income of \$8.0 million and \$16.9 million in non-interest income. The increase in net interest income resulted mainly from a \$53.0 million decrease in deposit interest expense, mainly in premium money market accounts and short-term certificates of deposit. This effect was partly offset by a decline of \$24.5 million in net allocated funding credits and a \$20.4 million decrease in loan interest income. The increase in the loan loss provision was mainly due to higher consumer credit card and marine and RV loan charge-offs. An increase of \$16.9 million, or 11.5%, in non-interest income resulted mainly from higher gains on sales of student loans, including the reversal of an impairment reserve discussed above in the Non-Interest Income section of this discussion. This increase in income was partly offset by a decline in overdraft charges. Non-interest expense grew \$16.7 million, or 5.8%, over the prior year due to higher FDIC insurance expense and data processing costs, partly offset by lower bank card servicing expense. Total average loans increased slightly in 2009 over the prior year due to the acquisition of a student loan portfolio late in 2008, partly offset by declines in other types of consumer loans. Average deposits increased 2.8% over the prior period, resulting mainly from growth in interest checking and premium money market deposit accounts, partly offset by a decline in certificates of deposit.

*Commercial*

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. Pre-tax income for 2010 increased \$49.5 million, or 44.2%, compared to the prior year. Net interest income increased \$16.2 million, or 6.7%, due to lower net allocated funding costs of \$31.5 million, which was partly offset by a \$17.7 million decline in loan interest income. The loan loss provision in this segment totaled \$24.8 million in 2010, a decrease of \$29.4 million from the prior year. During 2010, lower charge-offs occurred on construction and business loans. Non-interest income increased \$17.3 million, or 15.1%, over the previous year due to higher bank card fees (mainly corporate card). Non-interest expense increased \$13.4 million, or 7.0%, over the prior 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. Average segment loans decreased 8.9% compared to 2009 as a result of declines in business, construction and business real estate loans, while average deposits increased 16.6% due to growth in non-interest bearing demand and money market deposit accounts.

In 2009, pre-tax profitability for the Commercial segment decreased \$5.2 million, or 4.5%, compared to the prior year. The decline was mainly due to a higher loan loss provision of \$40.7 million and greater non-interest expense of \$10.8 million. Partly offsetting the increases in expense were a \$39.1 million, or 19.2%, increase in net interest income and a \$7.2 million increase in non-interest income. The increase in net interest income was mainly due to lower net allocated funding costs of \$113.8 million and a decrease of \$6.7 million in deposit interest expense, which were partly offset by a decline in loan interest income of \$81.3 million. The growth in the loan loss provision included a \$27.9 million increase in construction and land loan net charge-offs and smaller increases in other commercial loan categories. Non-interest income increased \$7.2 million, or 6.7%, over the prior year and included higher commercial cash management fees and bank card fees (mainly corporate card), partly offset by lower cash sweep commissions. Non-interest expense increased \$10.8 million, or 6.0%, over the previous year, mainly due to higher FDIC insurance expense and an increase in salaries and benefits expense. Average segment loans decreased 4.9% compared to 2008 largely due to declines in business and business real estate loans, while average deposits increased 38.0% due to growth in non-interest bearing demand and money market deposit accounts.



**Table of Contents***Wealth*

The Wealth segment provides traditional trust and estate planning, advisory and discretionary investment management services, brokerage services, and includes Private Banking accounts. At December 31, 2010, the Trust group managed investments with a market value of \$14.3 billion and administered an additional \$10.7 billion in non-managed assets. It also provides investment management services to The Commerce Funds, a series of mutual funds with \$1.5 billion in total assets at December 31, 2010. The segment includes the Capital Markets Group, which sells fixed-income securities to individuals, corporations, correspondent banks, public institutions, and municipalities, and also provides investment safekeeping and bond accounting services. Pre-tax profitability for the Wealth segment was \$49.5 million in 2010 compared to \$48.2 million in 2009, an increase of \$1.2 million, or 2.5%. Net interest income increased \$384 thousand and was impacted by a \$10.3 million decline in deposit interest expense, offset by an \$8.0 million decrease in assigned net funding credits and a \$2.0 million decrease in loan interest income. Non-interest income increased \$1.7 million, or 1.4%, due to higher trust fee income, partly offset by lower bond trading income and brokerage fees. Non-interest expense increased slightly due to higher corporate management fees, partly offset by lower FDIC insurance expense. Average assets increased \$4.2 million during 2010 mainly due to activity in the trading securities portfolio, partly offset by a decline in loans. Average deposits decreased \$98.8 million, or 5.0%, during 2010 due to a decline in certificates of deposit over \$100,000, partly offset by growth in premium money market accounts.

In 2009, pre-tax income for the Wealth segment was \$48.2 million compared to \$19.1 million in 2008, an increase of \$29.2 million. The profitability increase was the result of a \$25.3 million decline in non-interest expense, which was due to a \$33.3 million loss on the purchase of auction rate securities in 2008, as mentioned above in the Non-Interest Expense section of this discussion. Partly offsetting this decline in expense were increases in FDIC insurance costs, allocated processing costs, and salaries and benefits expense. Net interest income increased \$3.5 million, or 9.5%, largely due to a \$14.6 million decline in interest expense on short-term jumbo certificates of deposit, and a \$7.5 million decline in overnight borrowings expense. These effects were partly offset by a \$24.5 million decrease in assigned net funding credits. Non-interest income increased slightly over the prior year due to higher bond trading income, partly offset by lower trust fee income and cash sweep commissions. Average assets decreased \$13.7 million during 2009 mainly due to a decline in the trading securities portfolio. Average deposits increased \$400.3 million, or 25.3%, during 2009, due to growth in premium money market accounts and certificates of deposit over \$100,000.

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 certain administrative functions, the investment securities portfolio, and the effect of certain expense allocations to the segments. Also included in this category is the excess of the Company's provision for loan losses over net loan charge-offs, which are generally assigned directly to the segments. In 2010, the pre-tax loss in this category was \$3.8 million, compared to a loss of \$26.2 million in 2009. This increase was mainly due to a decline in the unallocated loan loss provision of \$18.6 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 \$14.2 million and unallocated investment securities losses decreased \$5.4 million. Non-interest expense in this category increased due to an unallocated debt prepayment penalty of \$11.8 million.

**Impact of Recently Issued Accounting Standards**

***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

## **Table of Contents**

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.

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

***Credit Quality of Financing Receivables and the Allowance for Credit Losses*** In July 2010, the FASB issued ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This guidance is 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 ASU requires disclosures about the activity in the allowance, non-accrual and impaired loan status, credit quality indicators, past due information, loan modifications, and significant loan purchases and sales. Much of the disclosure is required on a disaggregated level, by portfolio segment or class basis. The disclosures about the activity in the allowance and loan modifications during a reported period are effective for the March 31, 2011 financial statements. Disclosure about loans modified as troubled debt restructurings have been deferred until further guidance for determining what constitutes a troubled debt restructuring is issued, which is expected later in 2011. The required disclosures have been included in Notes 1 and 3 in the accompanying financial statements. Adoption of the remaining requirements is not expected to have a significant effect on the Company's financial statements.

## **Corporate Governance**

The Company has adopted a number of corporate governance measures. These include corporate governance guidelines, a code of ethics that applies to its senior financial officers and the charters for its audit committee, its committee on compensation and human resources, and its committee on governance/directors. This information is available on the Company's Web site [www.commercebank.com](http://www.commercebank.com) under Investor Relations.

## **Forward-Looking Statements**

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

**Table of Contents**

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 which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in, or implied by, such forward-looking statements. Readers should not rely solely on the forward-looking statements and should consider all uncertainties and risks discussed throughout this report. Forward-looking statements speak only as of the date they are made. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made or to reflect the occurrence of unanticipated events. Such possible events or factors include: changes in economic conditions in the Company s market area; changes in policies by regulatory agencies, governmental legislation and regulation; fluctuations in interest rates; changes in liquidity requirements; demand for loans in the Company s market area; changes in accounting and tax principles; estimates made on income taxes; and competition with other entities that offer financial services.

**Table of Contents****SUMMARY OF QUARTERLY STATEMENTS OF INCOME**

| Year Ended December 31, 2010<br><i>(In thousands, except per share data)</i> | 12/31/10   | For the Quarter Ended |            | 3/31/10    |
|--|------------|-----------------------|------------|------------|
|  |            | 9/30/10               | 6/30/10    |            |
| Interest income  | \$ 177,436 | \$ 178,916            | \$ 185,057 | \$ 188,069 |
| Interest expense   | (16,759)   | (19,479)              | (21,949)   | (25,359)   |
| Net interest income  | 160,677    | 159,437               | 163,108    | 162,710    |
| Non-interest income  | 110,454    | 100,010               | 101,458    | 93,189     |
| Investment securities gains (losses), net                                    | 1,204      | 16                    | 660        | (3,665)    |
| Salaries and employee benefits   | (86,562)   | (85,442)              | (87,108)   | (87,438)   |
| Other expense  | (77,469)   | (70,144)              | (68,685)   | (68,286)   |
| Provision for loan losses  | (21,647)   | (21,844)              | (22,187)   | (34,322)   |
| Income before income taxes   | 86,657     | 82,033                | 87,246     | 62,188     |
| Income taxes   | (24,432)   | (26,012)              | (27,428)   | (18,377)   |
| Non-controlling interest   | (304)      | (136)                 | (84)       | 359        |
| Net income   | \$ 61,921  | \$ 55,885             | \$ 59,734  | \$ 44,170  |
| Net income per common share basic*   | \$ .72     | \$ .63                | \$ .69     | \$ .50     |
| Net income per common share diluted*   | \$ .70     | \$ .64                | \$ .68     | \$ .50     |
| Weighted average shares basic*   | 86,564     | 87,192                | 87,139     | 87,017     |
| Weighted average shares diluted*   | 86,927     | 87,560                | 87,554     | 87,492     |
| <br>   |            |                       |            |            |
| Year Ended December 31, 2009<br><i>(In thousands, except per share data)</i> | 12/31/09   | For the Quarter Ended |            | 3/31/09    |
|  |            | 9/30/09               | 6/30/09    |            |
| Interest income  | \$ 194,999 | \$ 201,647            | \$ 198,992 | \$ 193,874 |
| Interest expense   | (30,496)   | (38,108)              | (41,547)   | (43,859)   |
| Net interest income  | 164,503    | 163,539               | 157,445    | 150,015    |
| Non-interest income  | 102,519    | 102,414               | 98,363     | 92,963     |
| Investment securities losses, net  | (1,325)    | (945)                 | (2,753)    | (2,172)    |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|                                      |           |           |           |           |
|--------------------------------------|-----------|-----------|-----------|-----------|
| Salaries and employee benefits       | (85,480)  | (87,267)  | (86,279)  | (86,753)  |
| Other expense                        | (68,259)  | (67,501)  | (73,533)  | (66,665)  |
| Provision for loan losses            | (41,002)  | (35,361)  | (41,166)  | (43,168)  |
| Income before income taxes           | 70,956    | 74,879    | 52,077    | 44,220    |
| Income taxes                         | (21,493)  | (23,415)  | (15,257)  | (13,592)  |
| Non-controlling interest             | 159       | 185       | 148       | 208       |
| Net income                           | \$ 49,622 | \$ 51,649 | \$ 36,968 | \$ 30,836 |
| Net income per common share basic*   | \$ .57    | \$ .61    | \$ .43    | \$ .37    |
| Net income per common share diluted* | \$ .57    | \$ .60    | \$ .43    | \$ .37    |
| Weighted average shares basic*       | 86,818    | 86,278    | 84,264    | 83,462    |
| Weighted average shares diluted*     | 87,192    | 86,616    | 84,551    | 83,797    |

| Year Ended December 31, 2008<br>(In thousands, except per share data) | For the Quarter Ended |            |            |            |
|---|-----------------------|------------|------------|------------|
|   | 12/31/08              | 9/30/08    | 6/30/08    | 3/31/08    |
| Interest income   | \$ 209,628            | \$ 209,464 | \$ 208,204 | \$ 222,553 |
| Interest expense  | (53,339)              | (57,900)   | (63,425)   | (82,446)   |
| Net interest income   | 156,289               | 151,564    | 144,779    | 140,107    |
| Non-interest income   | 85,226                | 95,593     | 102,733    | 92,160     |
| Investment securities gains, net                                      | 4,814                 | 1,149      | 1,008      | 23,323     |
| Salaries and employee benefits  | (83,589)              | (83,766)   | (83,247)   | (83,010)   |
| Other expense   | (60,099)              | (100,680)  | (63,818)   | (57,171)   |
| Provision for loan losses   | (41,333)              | (29,567)   | (18,000)   | (20,000)   |
| Income before income taxes  | 61,308                | 34,293     | 83,455     | 95,409     |
| Income taxes  | (17,757)              | (9,534)    | (27,118)   | (30,668)   |
| Non-controlling interest  | 285                   | (86)       | (358)      | (574)      |
| Net income  | \$ 43,836             | \$ 24,673  | \$ 55,979  | \$ 64,167  |
| Net income per common share basic*                                    | \$ .52                | \$ .30     | \$ .67     | \$ .77     |
| Net income per common share diluted*                                  | \$ .52                | \$ .29     | \$ .67     | \$ .76     |
| Weighted average shares basic*  | 83,370                | 83,190     | 83,075     | 82,978     |

|                         |          |        |        |        |        |
|-------------------------|----------|--------|--------|--------|--------|
| Weighted average shares | diluted* | 83,986 | 83,861 | 83,742 | 83,687 |
|-------------------------|----------|--------|--------|--------|--------|

\* Restated for the 5% stock dividend distributed in 2010.

**Table of Contents****AVERAGE BALANCE SHEETS    AVERAGE RATES AND YIELDS**

|                                | <b>Years Ended December 31</b> |   |   |                            |   |   |                            |   |
|--------------------------------|--------------------------------|---|---|----------------------------|---|---|----------------------------|---|
|                                | <b>2010</b>                    |   |   | <b>2009</b>                |   |   | <b>2008</b>                |   |
| <i>(Thousands)</i>             | <b>Average<br/>Balance</b>     | <b>Interest<br/>Income/<br/>Expense</b> | <b>Average<br/>Rates<br/>Earned/<br/>Paid</b> | <b>Average<br/>Balance</b> | <b>Interest<br/>Income/<br/>Expense</b> | <b>Average<br/>Rates<br/>Earned/<br/>Paid</b> | <b>Average<br/>Balance</b> | <b>Interest<br/>Income/<br/>Expense</b> |
|                                | <b>\$ 2,887,427</b>            | <b>\$ 110,792</b>                       | <b>3.84%</b>                                  | <b>\$ 3,119,778</b>        | <b>\$ 116,686</b>                       | <b>3.74%</b>                                  | <b>\$ 3,478,927</b>        | <b>\$ 170,620</b>                       |
| construction and               | <b>557,282</b>                 | <b>22,384</b>                           | <b>4.02</b>                                   | 739,896                    | 26,746                                  | 3.61  | 701,519                    | 34,445                                  |
| business                       | <b>2,029,214</b>               | <b>102,451</b>                          | <b>5.05</b>                                   | 2,143,675                  | 108,107                                 | 5.04  | 2,281,664                  | 136,955                                 |
| personal                       | <b>1,476,031</b>               | <b>76,531</b>                           | <b>5.18</b>                                   | 1,585,273                  | 87,085                                  | 5.49  | 1,522,172                  | 88,322                                  |
|                                | <b>1,250,076</b>               | <b>84,204</b>                           | <b>6.74</b>                                   | 1,464,170                  | 101,761                                 | 6.95  | 1,674,497                  | 119,837                                 |
| me equity                      | <b>484,878</b>                 | <b>20,916</b>                           | <b>4.31</b>                                   | 495,629                    | 21,456                                  | 4.33  | 474,635                    | 23,960                                  |
|                                | <b>246,395</b>                 | <b>5,783</b>                            | <b>2.35</b>                                   | 344,243                    | 9,440                                   | 2.74  | 13,708                     | 287                                     |
| credit card                    | <b>760,079</b>                 | <b>89,225</b>                           | <b>11.74</b>                                  | 727,422                    | 89,045                                  | 12.24   | 776,810                    | 83,972                                  |
|                                | <b>7,288</b>                   |   |   | 9,781                      |   |   | 11,926                     |   |
|                                | <b>9,698,670</b>               | <b>512,286</b>                          | <b>5.28</b>                                   | 10,629,867                 | 560,326                                 | 5.27  | 10,935,858                 | 658,398                                 |
| or sale                        | <b>358,492</b>                 | <b>6,091</b>                            | <b>1.70</b>                                   | 397,583                    | 8,219                                   | 2.07  | 347,441                    | 14,968                                  |
| curities:                      |                                |   |   |                            |   |   |                            |   |
| ment & federal                 | <b>439,073</b>                 | <b>9,673</b>                            | <b>2.20</b>                                   | 169,214                    | 6,754                                   | 3.99  | 7,065                      | 364                                     |
| sponsored                      | <b>203,593</b>                 | <b>4,591</b>                            | <b>2.25</b>                                   | 137,928                    | 4,219                                   | 3.06  | 176,018                    | 7,075                                   |
| icipal                         | <b>966,694</b>                 | <b>45,469</b>                           | <b>4.70</b>                                   | 873,607                    | 43,882                                  | 5.02  | 695,542                    | 37,770                                  |
| d asset-backed                 | <b>4,795,219</b>               | <b>151,781</b>                          | <b>3.17</b>                                   | 3,739,967                  | 167,087                                 | 4.47  | 2,469,467                  | 125,369                                 |
| able securities <sup>(B)</sup> | <b>183,328</b>                 | <b>8,889</b>                            | <b>4.85</b>                                   | 179,847                    | 9,793                                   | 5.45  | 98,650                     | 4,243                                   |
| urities <sup>(B)</sup>         | <b>21,899</b>                  | <b>671</b>                              | <b>3.06</b>                                   | 16,927                     | 506                                     | 2.99  | 28,840                     | 1,355                                   |
| ble securities <sup>(B)</sup>  | <b>113,326</b>                 | <b>7,216</b>                            | <b>6.37</b>                                   | 136,911                    | 6,398                                   | 4.67  | 133,996                    | 7,730                                   |
| <b>ment securities</b>         | <b>6,723,132</b>               | <b>228,290</b>                          | <b>3.40</b>                                   | 5,254,401                  | 238,639                                 | 4.54  | 3,609,578                  | 183,906                                 |
| ederal funds sold              | <b>6,542</b>                   | <b>48</b>                               | <b>.73</b>                                    | 43,811                     | 222                                     | .51   | 425,273                    | 8,287                                   |
| s purchased                    |                                |   |   |                            |   |   |                            |   |



|  |                      |                |             |               |         |       |               |         |
|--|----------------------|----------------|-------------|---------------|---------|-------|---------------|---------|
| securities to resell under agreements                        | 150,235              | 2,549          | 1.70        |               |         |       |               |         |
| time deposits with   | 171,883              | 427            | .25         | 325,744       | 807     | .25   | 46,670        | 198     |
| <b>total earning assets</b>                                  | <b>17,108,954</b>    | <b>749,691</b> | <b>4.38</b> | 16,651,406    | 808,213 | 4.85  | 15,364,820    | 865,757 |
| allowance for loan losses                                    | (195,870)            |                |             | (181,417)     |         |       | (145,176)     |         |
| gain (loss) on securities                                    | 149,106              |                |             | 24,105        |         |       | 27,068        |         |
| deposits from banks  | 368,340              |                |             | 364,579       |         |       | 451,105       |         |
| loans and net  | 395,108              |                |             | 411,366       |         |       | 412,852       |         |
|  | 410,361              |                |             | 349,164       |         |       | 343,664       |         |
|  | <b>\$ 18,235,999</b> |                |             | \$ 17,619,203 |         |       | \$ 16,454,333 |         |
| <b>ASSETS AND LIABILITIES</b>                                |                      |                |             |               |         |       |               |         |
| time deposits:   |                      |                |             |               |         |       |               |         |
| checking and money market                                    | \$ 478,592           | 622            | .13         | \$ 438,748    | 642     | .15   | \$ 400,948    | 1,186   |
| time deposits  | 9,906,210            | 28,676         | .29         | 8,547,801     | 30,789  | .36   | 7,400,125     | 59,947  |
| C.D. s of less than 1 year                                   | 1,660,462            | 22,871         | 1.38        | 2,055,952     | 51,982  | 2.53  | 2,149,119     | 77,322  |
| C.D. s of 1 year or more                                     | 1,323,952            | 13,847         | 1.05        | 1,858,543     | 35,371  | 1.90  | 1,629,500     | 55,665  |
| <b>total bearing interest</b>                                | <b>13,369,216</b>    | <b>66,016</b>  | <b>.49</b>  | 12,901,044    | 118,784 | .92   | 11,579,692    | 194,120 |
| securities purchased and held under agreements to repurchase | 1,085,121            | 2,584          | .24         | 968,643       | 3,699   | .38   | 1,373,625     | 25,085  |
| securities sold under agreements to repurchase (D)           | 452,810              | 14,948         | 3.30        | 920,467       | 31,527  | 3.43  | 1,092,746     | 37,905  |
| <b>total</b>   | <b>1,537,931</b>     | <b>17,532</b>  | <b>1.14</b> | 1,889,110     | 35,226  | 1.86  | 2,466,371     | 62,990  |
| <b>total</b>   | <b>14,907,147</b>    | <b>83,548</b>  | <b>.56%</b> | 14,790,154    | 154,010 | 1.04% | 14,046,063    | 257,110 |

**Interest bearing**

Interest bearing demand

**993,753** 920,118 670,118

Loans

**346,312** 176,676 140,333

**1,988,787** 1,732,255 1,597,819

**Assets and equity** \$ **18,235,999**

\$ 17,619,203

\$ 16,454,333

**Net interest margin (T/E)**

\$ **666,143**

\$ 654,203

\$ 608,647

**Net interest**

**income**

**3.89%**

3.93%

**Change**

**in net interest**

**(loss) compared to**

**2009**

**1.83%**

7.48%

(A) Loans on non-accrual status are included in the computation of average balances. Included in interest income above are loan fees and late charges, net of amortization of deferred loan origination fees and costs, which are immaterial. Credit card income from merchant discounts and net interchange fees are not included in loan income.

(B) Interest income and yields are presented on a fully-taxable equivalent basis using the Federal statutory income tax rate. Loan interest income includes tax free loan income (categorized as business loan income) which includes tax equivalent adjustments of \$4,620,000 in 2010, \$3,922,000 in 2009, \$3,553,000 in 2008, \$2,895,000 in 2007, \$1,826,000 in 2006, and \$1,035,000 in 2005. Investment securities interest income include tax equivalent adjustments of \$15,593,000 in 2010, \$14,779,000 in 2009, \$12,355,000 in 2008, \$13,079,000 in 2007, \$9,476,000 in 2006 and \$3,626,000 in 2005. These adjustments relate to state and municipal obligations, other marketable securities, trading securities, and non-marketable securities.

**Table of Contents**

| Average<br>Balance | Years Ended December 31                |                                     |                    |  |                                     |                    |  |                                     |   |
|--------------------|--|-------------------------------------|--------------------|--|-------------------------------------|--------------------|--|-------------------------------------|---|
|                    | 2007<br>Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid | Average<br>Balance | 2006<br>Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid | Average<br>Balance | 2005<br>Interest<br>Income/<br>Expense | Average<br>Rates<br>Earned/<br>Paid | Average<br>Balance<br>Five Y<br>Compo<br>Grow<br>Rate |
| 3,110,386          | \$ 209,523                             | 6.74%                               | \$ 2,688,722       | \$ 177,543                             | 6.60%                               | \$ 2,336,681       | \$ 125,354                             | 5.36%                               | 4.3   |
| 671,986            | 49,436                                 | 7.36                                | 540,574            | 40,477                                 | 7.49                                | 480,864            | 28,422                                 | 5.91                                | 2.9   |
| 2,204,041          | 154,819                                | 7.02                                | 2,053,455          | 140,659                                | 6.85                                | 1,794,269          | 106,167                                | 5.92                                | 2.4   |
| 1,521,066          | 90,537                                 | 5.95                                | 1,415,321          | 79,816                                 | 5.64                                | 1,339,900          | 71,222                                 | 5.32                                | 1.9   |
| 1,558,302          | 115,184                                | 7.39                                | 1,352,047          | 95,074                                 | 7.03                                | 1,242,163          | 80,431                                 | 6.48                                | .1  |
| 443,748            | 33,526                                 | 7.56                                | 445,376            | 33,849                                 | 7.60                                | 429,911            | 26,463                                 | 6.16                                | 2.4   |
|                    |  |                                     |                    |  |                                     | 357,319            | 17,050                                 | 4.77                                | NM  |
| 665,964            | 84,856                                 | 12.74                               | 595,252            | 77,737                                 | 13.06                               | 554,471            | 66,552                                 | 12.00                               | 6.5   |
| 13,823             |  |                                     | 14,685             |  |                                     | 13,995             |  |                                     | (12.2   |
| 0,189,316          | 737,881                                | 7.24                                | 9,105,432          | 645,155                                | 7.09                                | 8,549,573          | 521,661                                | 6.10                                | 2.5   |
| 321,916            | 21,940                                 | 6.82                                | 315,950            | 21,788                                 | 6.90                                | 11,909             | 657                                    | 5.52                                | NM  |
| 9,063              | 506                                    | 5.58                                | 49,735             | 2,160                                  | 4.34                                | 132,894            | 6,570                                  | 4.94                                | 27.0  |
| 401,107            | 15,999                                 | 3.99                                | 590,504            | 20,657                                 | 3.50                                | 933,410            | 33,398                                 | 3.58                                | (26.2   |
| 594,154            | 33,416                                 | 5.62                                | 414,282            | 22,499                                 | 5.43                                | 137,007            | 6,591                                  | 4.81                                | 47.8  |
| 2,120,521          | 102,243                                | 4.82                                | 2,201,685          | 96,270                                 | 4.37                                | 2,812,757          | 114,978                                | 4.09                                | 11.2  |
| 129,622            | 7,355                                  | 5.67                                | 200,013            | 10,695                                 | 5.35                                | 216,984            | 8,808                                  | 4.06                                | (3.3  |
| 22,321             | 1,144                                  | 5.13                                | 17,444             | 884                                    | 5.07                                | 10,624             | 478                                    | 4.50                                | 15.5  |
| 92,251             | 5,710                                  | 6.19                                | 85,211             | 7,863                                  | 9.23                                | 78,709             | 4,984                                  | 6.33                                | 7.5   |
| 3,369,039          | 166,373                                | 4.94                                | 3,558,874          | 161,028                                | 4.52                                | 4,322,385          | 175,807                                | 4.07                                | 9.2   |
| 527,304            | 25,881                                 | 4.91                                | 299,554            | 15,637                                 | 5.22                                | 116,553            | 4,102                                  | 3.52                                | (43.7   |
|                    |  |                                     |                    |  |                                     |                    |  |                                     | NM  |
|                    |  |                                     |                    |  |                                     |                    |  |                                     | NM  |
| 4,407,575          | 952,075                                | 6.61                                | 13,279,810         | 843,608                                | 6.35                                | 13,000,420         | 702,227                                | 5.40                                | 5.6   |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|           |            |       |               |            |       |               |            |       |       |
|-----------|------------|-------|---------------|------------|-------|---------------|------------|-------|-------|
| (132,234) |            |       | (129,224)     |            |       | (129,272)     |            |       | 8.6   |
| 25,333    |            |       | (9,443)       |            |       | 22,607        |            |       | NM    |
| 463,970   |            |       | 470,826       |            |       | 508,389       |            |       | (6.2) |
| 400,161   |            |       | 376,375       |            |       | 369,471       |            |       | 1.3   |
| 315,522   |            |       | 250,260       |            |       | 201,829       |            |       | 15.2  |
| 5,480,327 |            |       | \$ 14,238,604 |            |       | \$ 13,973,444 |            |       | 5.4   |
| 392,942   | 2,067      | .53   | \$ 393,870    | 2,204      | .56   | \$ 403,158    | 1,259      | .31   | 3.4   |
| 6,996,943 | 114,027    | 1.63  | 6,717,280     | 94,238     | 1.40  | 6,745,714     | 52,112     | .77   | 7.9   |
| 2,359,386 | 110,957    | 4.70  | 2,077,257     | 85,424     | 4.11  | 1,736,804     | 50,597     | 2.91  | (.8)  |
| 1,480,856 | 73,739     | 4.98  | 1,288,845     | 58,381     | 4.53  | 983,703       | 30,779     | 3.13  | 6.1   |
| 1,230,127 | 300,790    | 2.68  | 10,477,252    | 240,247    | 2.29  | 9,869,379     | 134,747    | 1.37  | 6.2   |
| 1,696,613 | 83,464     | 4.92  | 1,455,544     | 70,154     | 4.82  | 1,609,868     | 48,776     | 3.03  | (7.5) |
| 292,446   | 13,775     | 4.71  | 182,940       | 8,744      | 4.78  | 366,072       | 12,464     | 3.40  | 4.3   |
| 1,989,059 | 97,239     | 4.89  | 1,638,484     | 78,898     | 4.82  | 1,975,940     | 61,240     | 3.10  | (4.8) |
| 3,219,186 | 398,029    | 3.01% | 12,115,736    | 319,145    | 2.63% | 11,845,319    | 195,987    | 1.65% | 4.7   |
| 647,888   |            |       | 642,545       |            |       | 655,729       |            |       | 8.6   |
| 134,278   |            |       | 99,396        |            |       | 90,752        |            |       | 30.7  |
| 1,478,975 |            |       | 1,380,927     |            |       | 1,381,644     |            |       | 7.5   |
| 5,480,327 |            |       | \$ 14,238,604 |            |       | \$ 13,973,444 |            |       | 5.4   |
|           | \$ 554,046 |       |               | \$ 524,463 |       |               | \$ 506,240 |       |       |
|           |            | 3.85% |               |            | 3.95% |               |            | 3.89% |       |
|           |            | 5.64% |               |            | 3.60% |               |            | 1.32% |       |

(C) The Company's portfolio of originated student loans was classified as held for sale in the first quarter of 2006 and, accordingly, is included in the held for sale balances for 2006 through 2010. In December 2008, the

*Company purchased \$358,451,000 of student loans with the intent to hold to maturity. In October 2010, the seller elected to repurchase the loans under the terms of the original agreement.*

*(D) Interest expense of \$2,000, \$38,000 and \$123,000 which was capitalized on construction projects in 2010, 2006 and 2005, respectively, is not deducted from the interest expense shown above.*

**Table of Contents****QUARTERLY AVERAGE BALANCE SHEETS AVERAGE RATES AND YIELDS**

| <i>(Dollars in millions)</i>                           | Year Ended December 31, 2010 |                               |                 |                               |                 |                               |                 |                               |
|--|------------------------------|-------------------------------|-----------------|-------------------------------|-----------------|-------------------------------|-----------------|-------------------------------|
|  | Fourth Quarter               |                               | Third Quarter   |                               | Second Quarter  |                               | First Quarter   |                               |
|  | Average Balance              | Average Rates Earned/<br>Paid | Average Balance | Average Rates Earned/<br>Paid | Average Balance | Average Rates Earned/<br>Paid | Average Balance | Average Rates Earned/<br>Paid |
| <b>ASSETS</b>  |                              |                               |                 |                               |                 |                               |                 |                               |
| Loans:   |                              |                               |                 |                               |                 |                               |                 |                               |
| Business <sup>(A)</sup>                                | \$ 2,920                     | 3.77%                         | \$ 2,918        | 3.82%                         | \$ 2,881        | 3.93%                         | \$ 2,830        | 3.83%                         |
| Real estate construction and land                      | 498                          | 4.17                          | 530             | 4.00                          | 568             | 3.90                          | 634             | 4.01                          |
| Real estate business                                   | 2,003                        | 5.01                          | 1,999           | 5.10                          | 2,029           | 5.08                          | 2,088           | 5.00                          |
| Real estate personal                                   | 1,444                        | 5.00                          | 1,451           | 5.13                          | 1,484           | 5.25                          | 1,526           | 5.35                          |
| Consumer   | 1,191                        | 6.61                          | 1,234           | 6.65                          | 1,270           | 6.72                          | 1,307           | 6.94                          |
| Revolving home equity                                  | 483                          | 4.31                          | 485             | 4.32                          | 483             | 4.32                          | 488             | 4.31                          |
| Student  | 22                           | 2.10                          | 315             | 2.40                          | 322             | 2.38                          | 329             | 2.28                          |
| Consumer credit card                                   | 776                          | 10.82                         | 763             | 11.29                         | 738             | 12.32                         | 763             | 12.58                         |
| Overdrafts   | 8                            |                               | 7               |                               | 7               |                               | 8               |                               |
| <b>Total loans</b>                                     | <b>9,345</b>                 | <b>5.22</b>                   | <b>9,702</b>    | <b>5.21</b>                   | <b>9,782</b>    | <b>5.33</b>                   | <b>9,973</b>    | <b>5.37</b>                   |
| Loans held for sale                                    | 93                           | 2.38                          | 305             | 1.78                          | 557             | 1.63                          | 484             | 1.60                          |
| Investment securities:                                 |                              |                               |                 |                               |                 |                               |                 |                               |
| U.S. government & federal agency                       | 436                          | 2.32                          | 437             | 1.07                          | 443             | 3.43                          | 439             | 1.99                          |
| Government-sponsored enterprise obligations            | 187                          | 2.25                          | 235             | 2.12                          | 225             | 2.16                          | 167             | 2.59                          |
| State & municipal obligations <sup>(A)</sup>           | 1,091                        | 4.45                          | 982             | 4.53                          | 893             | 4.87                          | 899             | 5.04                          |
| Mortgage and asset-backed securities                   | 5,221                        | 2.86                          | 5,101           | 2.77                          | 4,390           | 3.47                          | 4,457           | 3.69                          |
| Other marketable securities <sup>(A)</sup>             | 177                          | 5.01                          | 183             | 5.18                          | 193             | 4.55                          | 181             | 4.67                          |
| Trading securities <sup>(A)</sup>                      | 32                           | 3.35                          | 23              | 2.87                          | 19              | 2.93                          | 14              | 2.91                          |
| Non-marketable securities <sup>(A)</sup>               | 107                          | 5.98                          | 109             | 9.43                          | 114             | 4.26                          | 123             | 5.91                          |
| <b>Total investment securities</b>                     | <b>7,251</b>                 | <b>3.15</b>                   | <b>7,070</b>    | <b>3.05</b>                   | <b>6,277</b>    | <b>3.67</b>                   | <b>6,280</b>    | <b>3.81</b>                   |
| Short-term federal funds sold and securities purchased | 5                            | .61                           | 7               | .69                           | 7               | .76                           | 7               | .84                           |

|                                      |           |      |           |      |           |      |           |      |
|--------------------------------------|-----------|------|-----------|------|-----------|------|-----------|------|
| under agreements to resell           |           |      |           |      |           |      |           |      |
| Long-term securities                 |           |      |           |      |           |      |           |      |
| purchased under agreements           |           |      |           |      |           |      |           |      |
| to resell                            | 397       | 1.69 | 199       | 1.72 |           |      |           |      |
| Interest earning deposits with       |           |      |           |      |           |      |           |      |
| banks                                | 87        | .25  | 171       | .25  | 322       | .25  | 108       | .24  |
| <b>Total interest earning assets</b> | 17,178    | 4.22 | 17,454    | 4.19 | 16,945    | 4.49 | 16,852    | 4.64 |
| Less allowance for loan              |           |      |           |      |           |      |           |      |
| losses                               | (195)     |      | (195)     |      | (196)     |      | (197)     |      |
| Unrealized gain (loss) on            |           |      |           |      |           |      |           |      |
| investment securities                | 176       |      | 159       |      | 133       |      | 128       |      |
| Cash and due from banks              | 365       |      | 367       |      | 378       |      | 364       |      |
| Land, buildings and                  |           |      |           |      |           |      |           |      |
| equipment net                        | 388       |      | 392       |      | 397       |      | 402       |      |
| Other assets                         | 383       |      | 444       |      | 401       |      | 413       |      |
| <b>Total assets</b>                  | \$ 18,295 |      | \$ 18,621 |      | \$ 18,058 |      | \$ 17,962 |      |
| <b>LIABILITIES AND EQUITY</b>        |           |      |           |      |           |      |           |      |
| Interest bearing deposits:           |           |      |           |      |           |      |           |      |
| Savings                              | \$ 480    | .14  | \$ 482    | .16  | \$ 490    | .11  | \$ 461    | .10  |
| Interest checking and money          |           |      |           |      |           |      |           |      |
| market                               | 10,316    | .27  | 9,980     | .28  | 9,872     | .31  | 9,447     | .30  |
| Time open & C.D. s under             |           |      |           |      |           |      |           |      |
| \$100,000                            | 1,533     | 1.18 | 1,642     | 1.32 | 1,703     | 1.43 | 1,766     | 1.56 |
| Time open & C.D. s \$100,000         |           |      |           |      |           |      |           |      |
| & over                               | 1,232     | .93  | 1,417     | .97  | 1,323     | 1.08 | 1,324     | 1.20 |
| <b>Total interest bearing</b>        |           |      |           |      |           |      |           |      |
| <b>deposits</b>                      | 13,561    | .43  | 13,521    | .47  | 13,388    | .52  | 12,998    | .56  |
| Borrowings:                          |           |      |           |      |           |      |           |      |
| Federal funds purchased and          |           |      |           |      |           |      |           |      |
| securities sold under                |           |      |           |      |           |      |           |      |
| agreements to repurchase             | 1,125     | .12  | 1,024     | .23  | 1,027     | .32  | 1,166     | .29  |
| Other borrowings                     | 231       | 2.96 | 350       | 3.09 | 502       | 3.02 | 735       | 3.70 |
| <b>Total borrowings</b>              | 1,356     | .61  | 1,374     | .96  | 1,529     | 1.21 | 1,901     | 1.61 |
| <b>Total interest bearing</b>        |           |      |           |      |           |      |           |      |
| <b>liabilities</b>                   | 14,917    | .45% | 14,895    | .52% | 14,917    | .59% | 14,899    | .69% |

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Non-interest bearing demand deposits        | 1,041            | 1,006            | 980              | 947              |
| Other liabilities                           | 287              | 701              | 199              | 194              |
| Equity                                      | 2,050            | 2,019            | 1,962            | 1,922            |
| <b>Total liabilities and equity</b>         | <b>\$ 18,295</b> | <b>\$ 18,621</b> | <b>\$ 18,058</b> | <b>\$ 17,962</b> |
| <b>Net interest margin (T/E)</b>            | <b>\$ 166</b>    | <b>\$ 165</b>    | <b>\$ 168</b>    | <b>\$ 167</b>    |
| <b>Net yield on interest earning assets</b> | <b>3.83%</b>     | <b>3.75%</b>     | <b>3.97%</b>     | <b>4.03%</b>     |

*(A) Includes tax equivalent calculations.*



**Table of Contents**

| <i>(Dollars in millions)</i>                           | Year Ended December 31, 2009 |                               |                 |                               |                 |                               |                 |                               |
|--|------------------------------|-------------------------------|-----------------|-------------------------------|-----------------|-------------------------------|-----------------|-------------------------------|
|  | Fourth Quarter               |                               | Third Quarter   |                               | Second Quarter  |                               | First Quarter   |                               |
|  | Average Balance              | Average Rates Earned/<br>Paid | Average Balance | Average Rates Earned/<br>Paid | Average Balance | Average Rates Earned/<br>Paid | Average Balance | Average Rates Earned/<br>Paid |
| <b>ASSETS</b>  |                              |                               |                 |                               |                 |                               |                 |                               |
| Loans:   |                              |                               |                 |                               |                 |                               |                 |                               |
| Business <sup>(A)</sup>                                | \$ 2,866                     | 3.77%                         | \$ 3,019        | 3.77%                         | \$ 3,260        | 3.81%                         | \$ 3,341        | 3.61%                         |
| Real estate construction and land                      | 695                          | 3.93                          | 699             | 3.74                          | 751             | 3.50                          | 816             | 3.34                          |
| Real estate business                                   | 2,113                        | 4.98                          | 2,147           | 5.04                          | 2,174           | 5.05                          | 2,141           | 5.10                          |
| Real estate personal                                   | 1,547                        | 5.32                          | 1,578           | 5.38                          | 1,596           | 5.55                          | 1,621           | 5.72                          |
| Consumer   | 1,358                        | 7.03                          | 1,424           | 6.99                          | 1,498           | 6.87                          | 1,579           | 6.92                          |
| Revolving home equity                                  | 488                          | 4.33                          | 492             | 4.35                          | 498             | 4.33                          | 505             | 4.31                          |
| Student  | 335                          | 2.28                          | 341             | 2.37                          | 347             | 2.61                          | 354             | 3.69                          |
| Consumer credit card                                   | 749                          | 11.80                         | 729             | 12.60                         | 698             | 12.70                         | 734             | 11.90                         |
| Overdrafts   | 11                           |                               | 11              |                               | 9               |                               | 8               |                               |
| <b>Total loans</b>                                     | <b>10,162</b>                | <b>5.27</b>                   | <b>10,440</b>   | <b>5.31</b>                   | <b>10,831</b>   | <b>5.27</b>                   | <b>11,099</b>   | <b>5.24</b>                   |
| Loans held for sale                                    | 322                          | 1.70                          | 294             | 1.95                          | 514             | 1.53                          | 463             | 3.00                          |
| Investment securities:                                 |                              |                               |                 |                               |                 |                               |                 |                               |
| U.S. government & federal agency                       | 376                          | 3.08                          | 274             | 5.26                          | 11              | 3.73                          | 11              | 3.75                          |
| Government-sponsored enterprise obligations            | 142                          | 2.84                          | 139             | 2.90                          | 148             | 2.98                          | 123             | 3.60                          |
| State & municipal obligations <sup>(A)</sup>           | 931                          | 4.80                          | 908             | 4.97                          | 906             | 5.22                          | 747             | 5.13                          |
| Mortgage and asset-backed securities                   | 4,478                        | 3.86                          | 3,985           | 4.47                          | 3,649           | 4.66                          | 2,827           | 5.20                          |
| Other marketable securities <sup>(A)</sup>             | 188                          | 5.45                          | 195             | 5.20                          | 193             | 5.40                          | 142             | 5.84                          |
| Trading securities <sup>(A)</sup>                      | 14                           | 2.66                          | 18              | 3.08                          | 19              | 3.12                          | 17              | 3.01                          |
| Non-marketable securities <sup>(A)</sup>               | 134                          | 6.02                          | 134             | 4.98                          | 139             | 3.65                          | 141             | 4.09                          |
| <b>Total investment securities</b>                     | <b>6,263</b>                 | <b>4.02</b>                   | <b>5,653</b>    | <b>4.58</b>                   | <b>5,065</b>    | <b>4.70</b>                   | <b>4,008</b>    | <b>5.11</b>                   |
| Short-term federal funds sold and securities purchased | 10                           | .85                           | 31              | .66                           | 26              | .56                           | 110             | .42                           |

|  |           |      |           |       |           |       |           |       |
|--|-----------|------|-----------|-------|-----------|-------|-----------|-------|
| under agreements to resell   |           |      |           |       |           |       |           |       |
| Interest earning deposits with banks                                       | 290       | .25  | 204       | .23   | 213       | .10   | 601       | .30   |
| <b>Total interest earning assets</b>                                       | 17,047    | 4.66 | 16,622    | 4.93  | 16,649    | 4.91  | 16,281    | 4.93  |
| Less allowance for loan losses   | (188)     |      | (186)     |       | (178)     |       | (173)     |       |
| Unrealized gain (loss) on investment securities                            | 115       |      | 41        |       | (13)      |       | (49)      |       |
| Cash and due from banks  | 366       |      | 357       |       | 357       |       | 378       |       |
| Land, buildings and equipment net  | 408       |      | 411       |       | 412       |       | 415       |       |
| Other assets   | 345       |      | 363       |       | 348       |       | 340       |       |
| <b>Total assets</b>  | \$ 18,093 |      | \$ 17,608 |       | \$ 17,575 |       | \$ 17,192 |       |
| <b>LIABILITIES AND EQUITY</b>  |           |      |           |       |           |       |           |       |
| Interest bearing deposits:   |           |      |           |       |           |       |           |       |
| Savings  | \$ 442    | .14  | \$ 443    | .15   | \$ 452    | .15   | \$ 418    | .15   |
| Interest checking and money market   | 9,181     | .33  | 8,653     | .35   | 8,460     | .37   | 7,881     | .41   |
| Time open & C.D. s under \$100,000   | 1,895     | 1.93 | 2,108     | 2.54  | 2,130     | 2.74  | 2,092     | 2.86  |
| Time open & C.D. s \$100,000 & over  | 1,559     | 1.46 | 1,785     | 1.87  | 2,004     | 1.98  | 2,093     | 2.19  |
| <b>Total interest bearing deposits</b>                                     | 13,077    | .69  | 12,989    | .90   | 13,046    | 1.00  | 12,484    | 1.11  |
| Borrowings:  |           |      |           |       |           |       |           |       |
| Federal funds purchased and securities sold under agreements to repurchase | 980       | .33  | 938       | .35   | 963       | .35   | 995       | .50   |
| Other borrowings   | 773       | 3.62 | 833       | 3.66  | 873       | 3.79  | 1,208     | 2.86  |
| <b>Total borrowings</b>  | 1,753     | 1.78 | 1,771     | 1.90  | 1,836     | 1.99  | 2,203     | 1.80  |
| <b>Total interest bearing liabilities</b>                                  | 14,830    | .82% | 14,760    | 1.02% | 14,882    | 1.12% | 14,687    | 1.21% |
|  | 1,167     |      | 878       |       | 861       |       | 771       |       |

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Non-interest bearing demand deposits        |                  |                  |                  |                  |
| Other liabilities                           | 217              | 186              | 168              | 135              |
| Equity                                      | 1,879            | 1,784            | 1,664            | 1,599            |
| <b>Total liabilities and equity</b>         | <b>\$ 18,093</b> | <b>\$ 17,608</b> | <b>\$ 17,575</b> | <b>\$ 17,192</b> |
| <b>Net interest margin (T/E)</b>            | <b>\$ 170</b>    | <b>\$ 168</b>    | <b>\$ 162</b>    | <b>\$ 154</b>    |
| <b>Net yield on interest earning assets</b> | <b>3.95%</b>     | <b>4.02%</b>     | <b>3.91%</b>     | <b>3.83%</b>     |

(A) Includes tax equivalent calculations.

**Table of Contents**

**Item 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by this item is set forth on pages 51 through 53 of Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Commerce Bancshares, Inc.:

We have audited the accompanying consolidated balance sheets of Commerce Bancshares, Inc. and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Commerce Bancshares, Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Kansas City, Missouri  
February 25, 2011

**Table of Contents****Commerce Bancshares, Inc. and Subsidiaries  
CONSOLIDATED BALANCE SHEETS**

|   | <b>December 31</b>    |               |
|---|-----------------------|---------------|
|   | <b>2010</b>           | 2009          |
|   | <i>(In thousands)</i> |               |
| <b>ASSETS</b>   |                       |               |
| Loans   | \$ 9,410,982          | \$ 10,145,324 |
| Allowance for loan losses   | (197,538)             | (194,480)     |
| <b>Net loans</b>  | <b>9,213,444</b>      | 9,950,844     |
| Loans held for sale   | <b>63,751</b>         | 345,003       |
| Investment securities:  |                       |               |
| Available for sale (\$429,439,000 and \$537,079,000 pledged in 2010 and 2009, respectively, to secure structured repurchase agreements) | <b>7,294,303</b>      | 6,340,975     |
| Trading   | <b>11,710</b>         | 10,335        |
| Non-marketable  | <b>103,521</b>        | 122,078       |
| <b>Total investment securities</b>  | <b>7,409,534</b>      | 6,473,388     |
| Short-term federal funds sold and securities purchased under agreements to resell   | <b>10,135</b>         | 22,590        |
| Long-term securities purchased under agreements to resell   | <b>450,000</b>        |               |
| Interest earning deposits with banks  | <b>122,076</b>        | 24,118        |
| Cash and due from banks   | <b>328,464</b>        | 417,126       |
| Land, buildings and equipment net   | <b>383,397</b>        | 402,633       |
| Goodwill  | <b>125,585</b>        | 125,585       |
| Other intangible assets net   | <b>10,937</b>         | 14,333        |
| Other assets  | <b>385,016</b>        | 344,569       |
| <b>Total assets</b>   | <b>\$ 18,502,339</b>  | \$ 18,120,189 |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                       |               |
| Deposits:   |                       |               |
| Non-interest bearing demand   | \$ 2,150,725          | \$ 1,793,816  |
| Savings, interest checking and money market   | <b>10,190,134</b>     | 9,202,916     |
| Time open and C.D. s of less than \$100,000   | <b>1,465,050</b>      | 1,801,332     |
| Time open and C.D. s of \$100,000 and over  | <b>1,279,112</b>      | 1,412,387     |
| <b>Total deposits</b>   | <b>15,085,021</b>     | 14,210,451    |

|   |                      |               |
|---|----------------------|---------------|
| Federal funds purchased and securities sold under agreements to repurchase                            | <b>982,827</b>       | 1,103,191     |
| Other borrowings  | <b>112,273</b>       | 736,062       |
| Other liabilities   | <b>298,754</b>       | 184,580       |
| <b>Total liabilities</b>  | <b>16,478,875</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 86,788,322 and 83,127,401 shares in 2010 and 2009, respectively | <b>433,942</b>       | 415,637       |
| Capital surplus   | <b>971,293</b>       | 854,490       |
| Retained earnings   | <b>555,778</b>       | 568,532       |
| Treasury stock of 61,839 and 22,328 shares in 2010 and 2009, respectively, at cost                    | <b>(2,371)</b>       | (838)         |
| Accumulated other comprehensive income  | <b>63,345</b>        | 46,407        |
| Total Commerce Bancshares, Inc. stockholders' equity  | <b>2,021,987</b>     | 1,884,228     |
| Non-controlling interest  | <b>1,477</b>         | 1,677         |
| <b>Total equity</b>   | <b>2,023,464</b>     | 1,885,905     |
| <b>Total liabilities and equity</b>   | <b>\$ 18,502,339</b> | \$ 18,120,189 |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Commerce Bancshares, Inc. and Subsidiaries  
CONSOLIDATED STATEMENTS OF INCOME**

|   | <b>For the Years Ended December 31</b> |            |            |
|---|--|------------|------------|
| <i>(In thousands, except per share data)</i>  | <b>2010</b>                            | 2009       | 2008       |
| <b>INTEREST INCOME</b>  |  |            |            |
| Interest and fees on loans  | <b>\$ 507,666</b>                      | \$ 556,404 | \$ 654,845 |
| Interest on loans held for sale   | <b>6,091</b>                           | 8,219      | 14,968     |
| Interest on investment securities   | <b>212,697</b>                         | 223,860    | 171,551    |
| Interest on short-term federal funds sold and securities purchased under agreements to resell | <b>48</b>                              | 222        | 8,287      |
| Interest on long-term securities purchased under agreements to resell                         | <b>2,549</b>                           |            |            |
| Interest on deposits with banks   | <b>427</b>                             | 807        | 198        |
| <b>Total interest income</b>  | <b>729,478</b>                         | 789,512    | 849,849    |
| <b>INTEREST EXPENSE</b>   |  |            |            |
| Interest on deposits:   |  |            |            |
| Savings, interest checking and money market   | <b>29,298</b>                          | 31,431     | 61,133     |
| Time open and C.D. s of less than \$100,000   | <b>22,871</b>                          | 51,982     | 77,322     |
| Time open and C.D. s of \$100,000 and over  | <b>13,847</b>                          | 35,371     | 55,665     |
| Interest on federal funds purchased and securities sold under agreements to repurchase        | <b>2,584</b>                           | 3,699      | 25,085     |
| Interest on other borrowings  | <b>14,946</b>                          | 31,527     | 37,905     |
| <b>Total interest expense</b>   | <b>83,546</b>                          | 154,010    | 257,110    |
| <b>Net interest income</b>  | <b>645,932</b>                         | 635,502    | 592,739    |
| Provision for loan losses   | <b>100,000</b>                         | 160,697    | 108,900    |
| <b>Net interest income after provision for loan losses</b>                                    | <b>545,932</b>                         | 474,805    | 483,839    |
| <b>NON-INTEREST INCOME</b>  |  |            |            |
| Bank card transaction fees  | <b>148,888</b>                         | 122,124    | 113,862    |
| Deposit account charges and other fees  | <b>92,637</b>                          | 106,362    | 110,361    |
| Trust fees  | <b>80,963</b>                          | 76,831     | 80,294     |
| Bond trading income   | <b>21,098</b>                          | 22,432     | 15,665     |
| Consumer brokerage services   | <b>9,190</b>                           | 10,831     | 12,156     |
| Loan fees and sales   | <b>23,116</b>                          | 21,273     | (2,413)    |
| Other   | <b>29,219</b>                          | 36,406     | 45,787     |

|  |                   |            |            |
|--|-------------------|------------|------------|
| <b>Total non-interest income</b>   | <b>405,111</b>    | 396,259    | 375,712    |
| <b>INVESTMENT SECURITIES GAINS (LOSSES), NET</b>                           |                   |            |            |
| Impairment (losses) reversals on debt securities                           | <b>13,058</b>     | (32,783)   |            |
| Noncredit-related losses (reversals) on securities not expected to be sold | <b>(18,127)</b>   | 30,310     |            |
| Net impairment losses  | <b>(5,069)</b>    | (2,473)    |            |
| Realized gains (losses) on sales and fair value adjustments                | <b>3,284</b>      | (4,722)    | 30,294     |
| <b>Investment securities gains (losses), net</b>                           | <b>(1,785)</b>    | (7,195)    | 30,294     |
| <b>NON-INTEREST EXPENSE</b>  |                   |            |            |
| Salaries and employee benefits   | <b>346,550</b>    | 345,779    | 333,612    |
| Net occupancy  | <b>46,987</b>     | 45,925     | 46,317     |
| Equipment  | <b>23,324</b>     | 25,472     | 24,569     |
| Supplies and communication   | <b>27,113</b>     | 32,156     | 35,335     |
| Data processing and software   | <b>67,935</b>     | 61,789     | 56,387     |
| Marketing  | <b>18,161</b>     | 18,231     | 19,994     |
| Deposit insurance  | <b>19,246</b>     | 27,373     | 2,051      |
| Debt extinguishment  | <b>11,784</b>     |            |            |
| Loss on purchase of auction rate securities                                |                   |            | 33,266     |
| Indemnification obligation   | <b>(4,405)</b>    | (2,496)    | (9,619)    |
| Other  | <b>74,439</b>     | 67,508     | 73,468     |
| <b>Total non-interest expense</b>  | <b>631,134</b>    | 621,737    | 615,380    |
| Income before income taxes   | <b>318,124</b>    | 242,132    | 274,465    |
| Less income taxes  | <b>96,249</b>     | 73,757     | 85,077     |
| Net income before non-controlling interest                                 | <b>221,875</b>    | 168,375    | 189,388    |
| Less non-controlling interest expense (income)                             | <b>165</b>        | (700)      | 733        |
| <b>NET INCOME</b>  | <b>\$ 221,710</b> | \$ 169,075 | \$ 188,655 |
| Net income per share basic   | <b>\$ 2.54</b>    | \$ 1.98    | \$ 2.26    |
| Net income per share diluted   | <b>\$ 2.52</b>    | \$ 1.97    | \$ 2.24    |

*See accompanying notes to consolidated financial statements.*





**Table of Contents****Commerce Bancshares, Inc. and Subsidiaries  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

| <i>(In thousands)</i>   | <b>For the Years Ended December 31</b> |             |             |
|---|--|-------------|-------------|
|   | <b>2010</b>                            | <b>2009</b> | <b>2008</b> |
| <b>OPERATING ACTIVITIES</b>   |  |             |             |
| Net income  | \$ 221,710                             | \$ 169,075  | \$ 188,655  |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |             |             |
| Provision for loan losses   | <b>100,000</b>                         | 160,697     | 108,900     |
| Provision for depreciation and amortization                                       | <b>48,924</b>                          | 51,514      | 50,696      |
| Amortization of investment security premiums, net                                 | <b>21,635</b>                          | 2,348       | 3,946       |
| Deferred income tax expense (benefit)   | <b>(9,085)</b>                         | (7,310)     | 2,656       |
| Investment securities (gains) losses, net   | <b>1,785</b>                           | 7,195       | (30,294)    |
| Gain on sale of branch  |  | (644)       | (6,938)     |
| Gain on sale of held to maturity student loans                                    | <b>(6,914)</b>                         |             |             |
| Impairment losses (reversals) on loans held for sale                              | <b>191</b>                             | (3,796)     | 9,398       |
| Net gains on sales of loans held for sale   | <b>(10,402)</b>                        | (12,201)    | (3,168)     |
| Proceeds from sales of loans held for sale  | <b>635,743</b>                         | 577,726     | 235,305     |
| Originations of loans held for sale   | <b>(344,360)</b>                       | (545,380)   | (366,873)   |
| Net (increase) decrease in trading securities                                     | <b>(928)</b>                           | (14,014)    | 13,281      |
| Stock-based compensation  | <b>6,021</b>                           | 6,642       | 6,389       |
| Decrease in interest receivable   | <b>12,041</b>                          | 2,943       | 2,908       |
| Decrease in interest payable  | <b>(9,462)</b>                         | (18,574)    | (28,351)    |
| Increase (decrease) in income taxes payable                                       | <b>2,714</b>                           | (3,067)     | (1,204)     |
| Net tax benefit related to equity compensation plans                              | <b>(1,178)</b>                         | (557)       | (1,928)     |
| Loss on purchase of auction rate securities                                       |  |             | 33,266      |
| Prepayment of FDIC insurance premiums   |  | (63,739)    |             |
| Other changes, net  | <b>2,742</b>                           | (13,570)    | 650         |
| <b>Net cash provided by operating activities</b>                                  | <b>671,177</b>                         | 295,288     | 217,294     |
| <b>INVESTING ACTIVITIES</b>   |  |             |             |
| Net cash and cash equivalents paid in acquisitions/dispositions                   |  | (3,494)     | (54,490)    |
| Cash paid in exchange of investment securities for student loans                  |  |             | (17,164)    |
| Proceeds from sales of available for sale securities                              | <b>78,640</b>                          | 207,852     | 131,843     |
| Proceeds from maturities/pay downs of available for sale securities               | <b>2,308,323</b>                       | 1,332,347   | 1,311,605   |
| Purchases of available for sale securities  | <b>(3,217,600)</b>                     | (4,078,962) | (2,396,109) |
| Net (increase) decrease in loans  | <b>644,314</b>                         | 999,086     | (412,593)   |
| Long-term securities purchased under agreements to resell                         | <b>(450,000)</b>                       |             |             |
| Purchases of land, buildings and equipment  | <b>(18,528)</b>                        | (29,247)    | (42,563)    |
| Sales of land, buildings and equipment  | <b>397</b>                             | 151         | 495         |

|  |                   |             |              |
|--|-------------------|-------------|--------------|
| <b>Net cash used in investing activities</b>   | <b>(654,454)</b>  | (1,572,267) | (1,478,976)  |
| <b>FINANCING ACTIVITIES</b>  |                   |             |              |
| Net increase in non-interest bearing demand, savings, interest checking and money market deposits                | <b>1,300,555</b>  | 2,041,513   | 381,276      |
| Net decrease in time open and C.D. s   | <b>(469,557)</b>  | (693,941)   | (36,612)     |
| 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 (decrease) in short-term federal funds purchased and securities sold under agreements to repurchase | <b>(20,364)</b>   | 76,654      | (212,375)    |
| Additional other long-term borrowings  |                   | 100,000     | 375,000      |
| Repayment of other long-term borrowings  | <b>(623,789)</b>  | (311,719)   | (10,855)     |
| Net increase (decrease) in other short-term borrowings   |                   | (800,000)   | 799,997      |
| Purchases of treasury stock  | <b>(40,984)</b>   | (528)       | (9,490)      |
| Issuance of stock under open market stock sale program, stock purchase and equity compensation plans             | <b>11,310</b>     | 103,641     | 15,978       |
| Net tax benefit related to equity compensation plans   | <b>1,178</b>      | 557         | 1,928        |
| Cash dividends paid on common stock  | <b>(78,231)</b>   | (74,720)    | (72,055)     |
| <b>Net cash provided by (used in) financing activities</b>   | <b>(19,882)</b>   | 441,457     | 1,232,792    |
| Decrease in cash and cash equivalents  | <b>(3,159)</b>    | (835,522)   | (28,890)     |
| Cash and cash equivalents at beginning of year   | <b>463,834</b>    | 1,299,356   | 1,328,246    |
| <b>Cash and cash equivalents at end of year</b>  | <b>\$ 460,675</b> | \$ 463,834  | \$ 1,299,356 |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Commerce Bancshares, Inc. and Subsidiaries****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

|  | Commerce Bancshares, Inc. Shareholders |                    |                      |                   |   |                                 |              |
|--|--|--------------------|----------------------|-------------------|---|---------------------------------|--------------|
|  | Common<br>Stock                        | Capital<br>Surplus | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Non-<br>Controlling<br>Interest | Total        |
| <i>(In thousands, except per share data)</i>   |  |                    |                      |                   |   |                                 |              |
| <b>Balance, December 31, 2007</b>  | \$ 359,694                             | \$ 475,220         | \$ 669,142           | \$ (2,477)        | \$ 26,107   | \$ 2,470                        | \$ 1,530,156 |
| Net income   |  |                    | 188,655              |                   |   | 733                             | 189,388      |
| Change in unrealized gain (loss) on<br>available for sale securities, net of tax   |  |                    |                      |                   | (66,445)  |                                 | (66,445)     |
| Change related to pension plan, net of<br>tax  |  |                    |                      |                   | (16,391)  |                                 | (16,391)     |
| Total comprehensive income   |  |                    |                      |                   |   |                                 | 106,552      |
| Distributions to non-controlling<br>interest   |  |                    |                      |                   |   | (368)                           | (368)        |
| Purchase of treasury stock   |  |                    |                      | (9,490)           |   |                                 | (9,490)      |
| Cash dividends paid (\$.864 per share)   |  |                    | (72,055)             |                   |   |                                 | (72,055)     |
| Net tax benefit related to equity<br>compensation plans  |  | 1,928              |                      |                   |   |                                 | 1,928        |
| Stock-based compensation   |  | 6,389              |                      |                   |   |                                 | 6,389        |
| Issuance under stock purchase and<br>equity compensation plans, net  | 1,778                                  | 2,994              |                      | 11,206            |   |                                 | 15,978       |
| 10% stock dividend, net  | 18,033                                 | 134,927            | (153,118)            |                   |   |                                 | (158,153)    |
| Adoption of fair value guidance<br>allowing use of transaction price at<br>initial measurement   |  |                    | 903                  |                   |   |                                 | 903          |
| Adoption of guidance requiring<br>recognition of liabilities for benefits<br>payable under split-dollar life<br>insurance arrangements |  |                    | (716)                |                   |   |                                 | (716)        |
| Change in pension benefit obligation<br>resulting from change in measurement<br>rate   |  |                    | 348                  |                   |   |                                 | 348          |
| <b>Balance, December 31, 2008</b>  | 379,505                                | 621,458            | 633,159              | (761)             | (56,729)  | 2,835                           | 1,579,467    |

|   |                |                |                 |                 |               |              |                  |
|---|----------------|----------------|-----------------|-----------------|---------------|--------------|------------------|
| Net income  |                |                | 169,075         |                 |               | (700)        | 168,375          |
| 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 |                |                |                 |                 | 7,596         |              | 7,596            |
| Change in unrealized gain (loss) on all other available for sale securities, net of tax   |                |                |                 |                 | 93,075        |              | 93,075           |
| Change related to pension plan, net of tax  |                |                |                 |                 | 2,465         |              | 2,465            |
| Total comprehensive income  |                |                |                 |                 |               |              | 271,511          |
| Distributions to non-controlling interest   |                |                |                 |                 |               | (458)        | (458)            |
| Purchase of treasury stock  |                |                |                 | (528)           |               |              | (528)            |
| Cash dividends paid (\$.871 per share)  |                |                | (74,720)        |                 |               |              | (74,720)         |
| Net tax benefit related to equity compensation plans  |                | 557            |                 |                 |               |              | 557              |
| Stock-based compensation  |                | 6,642          |                 |                 |               |              | 6,642            |
| Issuance under stock purchase and equity compensation plans, net  | 1,910          | 3,127          |                 | 451             |               |              | 5,488            |
| Issuance of stock under open market sale program  | 14,474         | 83,679         |                 |                 |               |              | 98,153           |
| 10% stock dividend, net   | 19,748         | 139,027        | (158,982)       |                 |               |              | (207,211)        |
| <b>Balance, December 31, 2009</b>   | <b>415,637</b> | <b>854,490</b> | <b>568,532</b>  | <b>(838)</b>    | <b>46,407</b> | <b>1,677</b> | <b>1,885,905</b> |
| Net income  |                |                | <b>221,710</b>  |                 |               | <b>165</b>   | <b>221,875</b>   |
| 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 |                |                |                 |                 | <b>14,243</b> |              | <b>14,243</b>    |
| Change in unrealized gain (loss) on all other available for sale securities, net of tax   |                |                |                 |                 | <b>1,813</b>  |              | <b>1,813</b>     |
| Change related to pension plan, net of tax  |                |                |                 |                 | <b>882</b>    |              | <b>882</b>       |
| Total comprehensive income  |                |                |                 |                 |               |              | <b>238,813</b>   |
| Distributions to non-controlling interest   |                |                |                 |                 |               | <b>(365)</b> | <b>(365)</b>     |
| Purchase of treasury stock  |                |                |                 | <b>(40,984)</b> |               |              | <b>(40,984)</b>  |
| Cash dividends paid (\$.895 per share)  |                |                | <b>(78,231)</b> |                 |               |              | <b>(78,231)</b>  |
| Net tax benefit related to equity compensation plans  |                | <b>1,178</b>   |                 |                 |               |              | <b>1,178</b>     |

|  |                   |                   |                   |                   |                  |                 |                     |
|--|-------------------|-------------------|-------------------|-------------------|------------------|-----------------|---------------------|
| stock-based compensation   |                   | <b>6,021</b>      |                   |                   |                  |                 | <b>6,021</b>        |
| issuance under stock purchase and equity compensation plans, net | <b>2,196</b>      | <b>3,102</b>      |                   | <b>6,012</b>      |                  |                 | <b>11,310</b>       |
| % stock dividend, net  | <b>16,109</b>     | <b>106,502</b>    | <b>(156,233)</b>  | <b>33,439</b>     |                  |                 | <b>(183,223)</b>    |
| <b>Balance, December 31, 2010</b>                                | <b>\$ 433,942</b> | <b>\$ 971,293</b> | <b>\$ 555,778</b> | <b>\$ (2,371)</b> | <b>\$ 63,345</b> | <b>\$ 1,477</b> | <b>\$ 2,023,464</b> |

*See accompanying notes to consolidated financial statements.*

**Table of Contents**

**Commerce Bancshares, Inc. and Subsidiaries**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

*Nature of Operations*

Commerce Bancshares, Inc. (the Company) conducts its principal activities through its banking and non-banking subsidiaries from approximately 370 locations throughout Missouri, Illinois, Kansas, Oklahoma and Colorado. Principal activities include retail and commercial banking, investment management, securities brokerage, mortgage banking, credit related insurance, and private equity investment activities.

*Basis of Presentation*

The Company follows accounting principles generally accepted in the United States of America (GAAP) and reporting practices applicable to the banking industry. The preparation of financial statements under GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes. These estimates are based on information available to management at the time the estimates are made. While the consolidated financial statements reflect management's best estimates and judgment, actual results could differ from those estimates. The consolidated financial statements include the accounts of the Company and its majority-owned subsidiaries (after elimination of all material intercompany balances and transactions). Certain amounts for prior years have been reclassified to conform to the current year presentation. Such reclassifications had no effect on net income or total assets.

*Cash and Cash Equivalents*

In the accompanying consolidated statements of cash flows, cash and cash equivalents include 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 consolidated balance sheets.

*Loans and Related Earnings*

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances, net of undisbursed loan proceeds, the allowance for loan losses, and any deferred fees and costs on originated loans. Origination fee income received on loans and amounts representing the estimated direct costs of origination are deferred and amortized to interest income over the life of the loan using the interest method. Prepayment premium or yield maintenance agreements are generally required on all term commercial loans with fixed rate intervals of three years or more.

Interest on loans is accrued based upon the principal amount outstanding. Interest income is recognized primarily on the level yield method. Loan and commitment fees, net of costs, are deferred and recognized in income over the term of the loan or commitment as an adjustment of yield. Annual fees charged on credit card loans are capitalized to principal and amortized over 12 months to loan fees and sales in the accompanying consolidated income statements. Other credit card fees, such as cash advance fees and late payment fees, are recognized in income as an adjustment of yield when charged to the cardholder's account.

*Non-Accrual Loans*

Loans are placed on non-accrual status when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment. Business, construction real estate, business real estate, and personal real estate loans that are contractually 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. Consumer, revolving home equity and credit card loans are exempt under regulatory rules from being classified as non-accrual. When a loan is placed on non-accrual status, any interest previously accrued but not collected is reversed against current income, and the loan is charged-off to the extent uncollectible. Principal and interest payments received on non-accrual loans are generally applied to principal. Interest is



**Table of Contents**

included in income only after all previous loan charge-offs have been recovered, and is recorded only as received. The loan is returned to accrual status only when the borrower has brought all past due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled. A six month history of sustained payment performance is generally required before reinstatement of accrual status.

*Restructured Loans*

A loan is accounted for as a troubled debt restructuring if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. A troubled debt restructuring typically involves a modification of terms such as a reduction of the stated interest rate or face amount of the loan, a reduction of accrued interest, or an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk. The Company measures the impairment loss of a troubled debt restructuring based on the difference between the original loan's carrying amount and the present value of expected future cash flows discounted at the original, contractual rate of the loan. Business, business real estate, construction real estate and personal real estate loans whose terms have been modified in a troubled debt restructuring with impairment charges are generally placed on non-accrual status. Other loans identified as troubled debt restructurings were so designated because they were renewed at interest rates that were not deemed to represent current market rates for debt of similar risk. These loans are performing under their modified terms, and interest continues to be accrued and recognized in income. Troubled debt restructurings also include certain credit card loans which have been modified under various debt management and assistance programs.

*Impaired Loans*

Loans are evaluated regularly by management for impairment. Included in impaired loans are all non-accrual loans, as well as loans whose terms have been modified in a troubled debt restructuring, as discussed above. Once a loan has been identified as impaired, impairment is measured based on either the present value of the expected future cash flows at the loan's initial effective interest rate or the fair value of the collateral if collateral dependent. Factors considered in determining impairment include delinquency status, cash flow analysis, credit analysis, and collateral value and availability.

*Loans Held for Sale*

Loans held for sale include student loans and fixed rate residential mortgage loans. These loans are typically classified as held for sale upon origination based upon management's intent to sell all the production of these loans. They are carried at the lower of aggregate cost or fair value. Fair value is determined based on prevailing market prices for loans with similar characteristics, sale contract prices, or, for those portfolios for which management has concerns about contractual performance, discounted cash flow analyses. Declines in fair value below cost (and subsequent recoveries) are recognized in loan fees and sales. Deferred fees and costs related to these loans are not amortized but are recognized as part of the cost basis of the loan at the time it is sold. Gains or losses on sales are recognized upon delivery and included in loan fees and sales.

*Allowance/Provision for Loan Losses*

The allowance for loan losses is maintained at a level believed to be appropriate by management to provide for probable loan losses inherent in the portfolio as of the balance sheet date, including losses on known or anticipated problem loans as well as for loans which are not currently known to require specific allowances. Management has established a process to determine the amount of the allowance for loan losses which assesses the risks and losses

inherent in its portfolio. Business, construction real estate and business real estate loans are normally larger and more complex, and their collection rates are harder to predict. These loans are more likely to be collateral dependent and are allocated a larger reserve, due to their potential volatility. Personal real estate, credit card, consumer and revolving home equity loans, are individually smaller and perform in a more homogenous manner, making loss estimates more predictable. Management s

## **Table of Contents**

process provides an allowance consisting of a specific allowance component based on certain individually evaluated loans and a general component based on estimates of reserves needed for pools of loans.

Loans subject to individual evaluation generally consist of business, construction real estate, business real estate and personal real estate loans on non-accrual status. These impaired loans are evaluated individually for the impairment of repayment potential and collateral adequacy, and in conjunction with current economic conditions and loss experience, allowances are estimated. Certain other impaired loans identified as troubled debt restructurings are collectively evaluated because they have similar risk characteristics. Loans which have not been identified as impaired are segregated by loan type and sub-type and are collectively evaluated. Reserves calculated for these loan pools are estimated using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic factors, loan risk ratings and industry concentrations.

The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses is based on various judgments and assumptions made by management. The amount of the allowance for loan losses is highly dependent on management's estimates affecting valuation, appraisal of collateral, evaluation of performance and status, and the amount and timing of future cash flows expected to be received on impaired loans. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in portfolio risk ratings, levels of non-performing assets, prevailing regional and national economic conditions, and the Company's ongoing loan review process.

The estimates, appraisals, evaluations, and cash flows utilized by management may be subject to frequent adjustments due to changing economic prospects of borrowers or properties. These estimates are reviewed periodically and adjustments, if necessary, are recorded in the provision for loan losses in the periods in which they become known.

Loans, or portions of loans, are charged off to the extent deemed uncollectible. Loan charge-offs reduce the allowance for loan losses, and recoveries of loans previously charged off are added back to the allowance. Business, business real estate, construction real estate and personal real estate loans are generally charged down to estimated collectible balances when they are placed on non-accrual status. Consumer loans and related accrued interest are normally charged down to the fair value of related collateral (or are charged off in full if no collateral) once the loans are more than 120 days delinquent. Credit card loans are charged off against the allowance for loan losses when the receivable is more than 180 days past due. The interest and fee income previously capitalized but not collected on credit card charge-offs is reversed against interest income.

### *Operating, Direct Financing and Sales Type Leases*

The net investment in direct financing and sales type leases is included in loans on the Company's consolidated balance sheets, and consists of the present values of the sum of the future minimum lease payments and estimated residual value of the leased asset. Revenue consists of interest earned on the net investment, and is recognized over the lease term as a constant percentage return thereon. The net investment in operating leases is included in other assets on the Company's consolidated balance sheets. It is carried at cost, less the amount depreciated to date. Depreciation is recognized, on the straight-line basis, over the lease term to the estimated residual value. Operating lease revenue consists of the contractual lease payments and is recognized over the lease term in other non-interest income. Estimated residual values are established at lease inception utilizing contract terms, past customer experience, and general market data and are reviewed, and adjusted if necessary, on an annual basis.

### *Investments in Debt and Equity Securities*

The Company has classified the majority of its investment portfolio as available for sale. From time to time, the Company sells securities and utilizes the proceeds to reduce borrowings, fund loan growth, or modify its interest rate profile. Securities classified as available for sale are carried at fair value. Changes in fair value, excluding certain losses associated with other-than-temporary impairment (OTTI), are reported in other comprehensive income (loss), a component of stockholders' equity. Securities are periodically evaluated for OTTI in accordance with guidance provided in ASC 320-10-35. For securities with OTTI,

**Table of Contents**

the entire loss in fair value is required to be recognized in current earnings if the Company intends to sell the securities or believes it likely that it will be required to sell the security before the anticipated recovery. If neither condition is met, but the Company does not expect to recover the amortized cost basis, the Company determines whether a credit loss has occurred, which is then recognized in current earnings. The noncredit-related portion of the overall loss is reported in other comprehensive income (loss). Mortgage and asset-backed securities whose credit ratings are below AA at their purchase date are evaluated for OTTI under ASC 325-40-35, which requires evaluations for OTTI at purchase date and in subsequent periods. Gains and losses realized upon sales of securities are calculated using the specific identification method and are included in Investment securities gains (losses), net in the consolidated statements of income. Premiums and discounts are amortized to interest income over the estimated lives of the securities. Prepayment experience is continually evaluated and a determination made regarding the appropriate estimate of the future rate of prepayment. When a change in a bond's estimated remaining life is necessary, a corresponding adjustment is made in the related amortization of premium or discount accretion.

Non-marketable securities include certain private equity investments, consisting of both debt and equity instruments. These securities are carried at fair value in accordance with ASC 946-10-15, with changes in fair value reported in current earnings. In the absence of readily ascertainable market values, fair value is estimated using internally developed models. Changes in fair value and gains and losses from sales are included in Investment securities gains (losses), net. Other non-marketable securities acquired for debt and regulatory purposes are accounted for at cost.

Trading account securities, which are bought and held principally for the purpose of resale in the near term, are carried at fair value. Gains and losses, both realized and unrealized, are recorded in non-interest income.

Purchases and sales of securities are recognized on a trade date basis. A receivable or payable is recognized for pending transaction settlements.

*Securities Purchased under Agreements to Resell and Securities Sold under Agreements to Repurchase*

The Company enters into short-term purchases of securities under agreements to resell which are accounted for as collateralized financing transactions. Securities delivered under these transactions are delivered to either the dealer custody account at the Federal Reserve Bank or to the applicable counterparty. Collateral is valued daily and the Company may require counterparties to deposit additional collateral or the Company may return collateral pledged when appropriate to maintain full collateralization for these transactions. At December 31, 2010, the Company had entered into \$450.0 million of long-term agreements to resell and had accepted securities valued at \$468.5 million as collateral.

Securities sold under agreements to repurchase are offered to cash management customers as an automated, collateralized investment account. Securities sold are also used by the Bank to obtain favorable borrowing rates on its purchased funds, and at December 31, 2010, included \$400.0 million of long-term structured repurchase agreements. As of December 31, 2010, the Company had pledged \$1.6 billion of available for sale securities as collateral for repurchase agreements.

*Land, Buildings and Equipment*

Land is stated at cost, and buildings and equipment are stated at cost, including capitalized interest when appropriate, less accumulated depreciation. Depreciation is computed using straight-line and accelerated methods. The Company generally assigns depreciable lives of 30 years for buildings, 10 years for building improvements, and 3 to 8 years for equipment. Leasehold improvements are amortized over the shorter of their estimated useful lives or remaining lease terms. Maintenance and repairs are charged to non-interest expense as incurred.

*Foreclosed Assets*

Foreclosed assets consist of property that has been repossessed and is comprised of commercial and residential real estate and other non-real estate property, including auto and recreational and marine

## **Table of Contents**

vehicles. The assets are initially recorded at the lower of the related loan balance or fair value of the collateral less estimated selling costs, with any valuation adjustments charged to the allowance for loan losses. Fair values are estimated primarily based on appraisals when available or quoted market prices of liquid assets. After their initial recognition, foreclosed assets are valued at the lower of the amount recorded at acquisition date or the current fair value less estimated costs to sell. Any resulting valuation adjustments, in addition to gains and losses realized on sales and net operating expenses, are recorded in other non-interest expense. The Company held \$12.0 million in foreclosed real estate and \$10.4 million in other repossessed personal property at December 31, 2010.

### *Intangible Assets*

Goodwill and intangible assets that have indefinite useful lives are not amortized, but are tested annually for impairment. Intangible assets that have finite useful lives, such as core deposit intangibles and mortgage servicing rights, are amortized over their estimated useful lives. Core deposit intangibles are amortized over periods of 8 to 14 years, representing their estimated lives, using accelerated methods. Mortgage servicing rights are amortized in proportion to and over the period of estimated net servicing income, considering appropriate prepayment assumptions.

When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the asset carrying value, using estimates of undiscounted future cash flows over the remaining asset life. Any impairment loss is measured by the excess of carrying value over fair value. Goodwill impairment tests are performed on an annual basis or when events or circumstances dictate. In these tests, the fair value of each reporting unit, or segment, is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated. If so, the implied fair value of the reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value. There has been no impairment resulting from goodwill impairment tests. However, adverse changes in the economic environment, operations of the reporting unit, or other factors could result in a decline in the implied fair value.

### *Income Taxes*

Amounts provided for income tax expense are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable under tax laws. Deferred income taxes are provided for temporary differences between the financial reporting bases and income tax bases of the Company's assets and liabilities, net operating losses, and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates that are expected to apply to taxable income when such assets and liabilities are anticipated to be settled or realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as tax expense or benefit in the period that includes the enactment date of the change. In determining the amount of deferred tax assets to recognize in the financial statements, the Company evaluates the likelihood of realizing such benefits in future periods. A valuation allowance is established if it is more likely than not that all or some portion of the deferred tax asset will not be realized. The Company recognizes interest and penalties related to income taxes within income tax expense in the consolidated statements of income.

The Company and its eligible subsidiaries file a consolidated federal income tax return. State and local income tax returns are filed on a combined, consolidated or separate return basis based upon each jurisdiction's laws and regulations.

### *Derivatives*

The Company is exposed to market risk, including changes in interest rates and currency exchange rates. To manage the volatility relating to these exposures, the Company's risk management policies permit its use of derivative

products. The Company manages potential credit exposure through established credit approvals, risk control limits and other monitoring procedures. The Company uses derivatives on a limited basis mainly to stabilize interest rate margins and hedge against interest rate movements. The Company



## **Table of Contents**

more often manages normal asset and liability positions by altering the products it offers and by selling portions of specific loan or investment portfolios as necessary.

Derivative accounting guidance requires that all derivative financial instruments be recorded on the balance sheet at fair value, with the adjustment to fair value recorded in current earnings. Derivatives that are part of a qualifying hedging relationship under ASC 815-20-25 can be designated, based on the exposure being hedged, as fair value or cash flow hedges. Under the fair value hedging model, gains or losses attributable to the change in fair value of the derivative, as well as gains and losses attributable to the change in fair value of the hedged item, are recognized in current earnings. Under the cash flow hedging model, the effective portion of the gain or loss related to the derivative is recognized as a component of other comprehensive income. The ineffective portion is recognized in current earnings.

The Company formally documents all hedging relationships between hedging instruments and the hedged item, as well as its risk management objective. At December 31, 2010, the Company had three interest rate swaps designated as fair value hedges. The Company performs quarterly assessments, using the regression method, to determine whether the hedging relationship has been highly effective in offsetting changes in fair values.

Derivative contracts are also offered to customers to assist in hedging their risks of adverse changes in interest rates and foreign exchange rates. The Company serves as an intermediary between its customers and the markets. Each contract between the Company and its customers is offset by a contract between the Company and various counterparties. These contracts do not qualify for hedge accounting. They are carried at fair value, with changes in fair value recorded in other non-interest income. Since each customer contract is paired with an offsetting contract, the impact to net income is minimized.

The Company enters into interest rate lock commitments on mortgage loans, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding. The Company also has corresponding forward sales contracts related to these interest rate lock commitments. Both the mortgage loan commitments and the related sales contracts are accounted for as derivatives and carried at fair value, with changes in fair value recorded in loan fees and sales. Fair values are based upon quoted prices, and fair value measurements of mortgage loan commitments include the value of loan servicing rights.

### *Pension Plan*

The Company's pension plan is described in Note 10, Employee Benefit Plans. The measurement of the projected benefit obligation and pension expense involve actuarial valuation methods and the use of various actuarial and economic assumptions. The Company monitors the assumptions and updates them periodically. Due to the long-term nature of the pension plan obligation, actual results may differ significantly from estimations. Such differences are adjusted over time as the assumptions are replaced by facts and values are recalculated.

### *Stock-Based Compensation*

The Company's stock-based employee compensation plan is described in Note 11, Stock-Based Compensation and Directors Stock Purchase Plan. In accordance with the requirements of ASC 718-10-30-3 and 35-2, the Company measures the cost of stock-based compensation based on the grant-date fair value of the award, recognizing the cost over the requisite service period. The fair value of an award is estimated using the Black-Scholes option-pricing model. The expense recognized is based on an estimation of the number of awards for which the requisite service is expected to be rendered, and is included in salaries and employee benefits in the accompanying consolidated statements of income.

*Treasury Stock*

Purchases of the Company's common stock are recorded at cost. Upon re-issuance for acquisitions, exercises of stock-based awards or other corporate purposes, treasury stock is reduced based upon the average cost basis of shares held.

**Table of Contents***Income per Share*

Basic income per share is computed using the weighted average number of common shares outstanding during each year. Diluted income per share includes the effect of all dilutive potential common shares (primarily stock options and stock appreciation rights) outstanding during each year. The Company applies the two-class method of computing income per share. The two-class method is an earnings allocation formula that determines income per share for common stock and for participating securities, according to dividends declared and participation rights in undistributed earnings. The Company's restricted share awards are considered to be a class of participating security. All per share data has been restated to reflect the 5% stock dividend distributed in December 2010.

**2. Acquisitions and Dispositions**

In February 2009, the Company sold its branch in Lakin, Kansas. In this transaction, the Company sold the bank facility and certain deposits totaling approximately \$4.7 million and recorded a gain of \$644 thousand.

During the second quarter of 2008, the Company sold its banking branch in Independence, Kansas. In this transaction, approximately \$23.3 million in loans, \$85.0 million in deposits, and various other assets and liabilities were sold, and the Company recorded a gain of \$6.9 million.

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

Major classifications within the Company's loan portfolio at December 31, 2010 and 2009 are as follows:

| <i>(In thousands)</i>               | <b>2010</b>         | 2009                 |
|-------------------------------------|---------------------|----------------------|
| <b>Commercial:</b>                  |                     |                      |
| Business                            | \$ 2,957,043        | \$ 2,877,936         |
| Real estate - construction and land | 460,853             | 665,110              |
| Real estate - business              | 2,065,837           | 2,104,030            |
| <b>Personal Banking:</b>            |                     |                      |
| Real estate - personal              | 1,440,386           | 1,537,687            |
| Consumer                            | 1,164,327           | 1,333,763            |
| Revolving home equity               | 477,518             | 489,517              |
| Student                             |                     | 331,698              |
| Consumer credit card                | 831,035             | 799,503              |
| Overdrafts                          | 13,983              | 6,080                |
| <b>Total loans</b>                  | <b>\$ 9,410,982</b> | <b>\$ 10,145,324</b> |

Loans to directors and executive officers of the Parent and its significant subsidiaries, and to their associates, are summarized as follows:

*(In thousands)*

|                              |           |
|------------------------------|-----------|
| Balance at January 1, 2010   | \$ 94,907 |
| Additions                    | 109,631   |
| Amounts collected            | (138,820) |
| Amounts written off          |           |
| <br>                         |           |
| Balance at December 31, 2010 | \$ 65,718 |

Management believes all loans to directors and executive officers have been made in the ordinary course of business with normal credit terms, including interest rate and collateral considerations, and do not represent more than a normal risk of collection. There were no outstanding loans at December 31, 2010 to principal holders (over 10% ownership) of the Company's common stock.

The Company's lending activity is generally centered in Missouri, Illinois, Kansas and other nearby states including Iowa, Oklahoma, Colorado, Ohio, and others. The Company maintains a diversified portfolio

**Table of Contents**

with limited industry concentrations of credit risk. Loans and loan commitments are extended under the Company's normal credit standards, controls, and monitoring features. Most loan commitments are short or intermediate term in nature. Loan maturities, with the exception of residential mortgages, generally do not exceed five years. Collateral is commonly required and would include such assets as marketable securities and cash equivalent assets, accounts receivable and inventory, equipment, other forms of personal property, and real estate. At December 31, 2010, unfunded loan commitments totaled \$7.4 billion (which included \$3.4 billion in unused approved lines of credit related to credit card loan agreements) which could be drawn by customers subject to certain review and terms of agreement. At December 31, 2010, loans of \$2.9 billion were pledged at the FHLB 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.

The Company has a net investment in direct financing and sales type leases of \$243.5 million and \$281.4 million at December 31, 2010 and 2009, respectively, which is included in business loans on the Company's consolidated balance sheets. This investment includes deferred income of \$25.4 million and \$32.3 million at December 31, 2010 and 2009, respectively. The net investment in operating leases amounted to \$10.8 million and \$7.2 million at December 31, 2010 and 2009, respectively, and is included in other assets on the Company's consolidated balance sheets.

In October 2010, the Company sold its student loan portfolio, formerly acquired from a student loan agency with the intent to hold until maturity. The loans had been acquired in 2008 in exchange for certain auction rate securities issued by the same agency. The agency, as allowed under the original exchange contract, elected to repurchase the loans, which totaled approximately \$311 million. The Company recorded a \$6.9 million gain in connection with the sale, which is included in loan fees and sales in the accompanying income statement. On December 30, 2010, the Company purchased business real estate loans totaling \$40.1 million from another financial institution. These loans are to borrowers within the Company's existing markets, and were without evidence of deterioration in credit quality at the acquisition date.

*Allowance for loan losses*

A summary of the activity in the allowance for losses follows:

| <i>(In thousands)</i>     | <b>Years Ended December 31</b> |            |            |
|---------------------------|--------------------------------|------------|------------|
|                           | <b>2010</b>                    | 2009       | 2008       |
| <b>Balance, January 1</b> | <b>\$ 194,480</b>              | \$ 172,619 | \$ 133,586 |
| Additions:                |                                |            |            |
| Provision for loan losses | <b>100,000</b>                 | 160,697    | 108,900    |
| <b>Total additions</b>    | <b>100,000</b>                 | 160,697    | 108,900    |
| Deductions:               |                                |            |            |

|                             |                   |            |            |
|-----------------------------|-------------------|------------|------------|
| Loan losses                 | <b>114,573</b>    | 154,410    | 85,093     |
| Less recoveries             | <b>17,631</b>     | 15,574     | 15,226     |
| <b>Net loan losses</b>      | <b>96,942</b>     | 138,836    | 69,867     |
| <b>Balance, December 31</b> | <b>\$ 197,538</b> | \$ 194,480 | \$ 172,619 |

**Table of Contents**

The following table shows the balance in the allowance for loan losses at December 31, 2010, and the related loan balance, disaggregated on the basis of impairment methodology. Loans evaluated under ASC 310-10-35 include loans on non-accrual status with balances exceeding \$500 thousand, which are individually evaluated for impairment, and other impaired loans deemed to have similar risk characteristics, which are collectively evaluated. All other loans are collectively evaluated for impairment under ASC 450-20.

| <i>(In thousands)</i>  | Commercial | Personal<br>Banking | Total     |
|--|------------|---------------------|-----------|
| <b>At December 31, 2010</b>                                  |            |                     |           |
| <b>Allowance for loan losses:</b>                            |            |                     |           |
| Ending balance: evaluated for impairment under ASC 310-10-35 | \$ 6,127   | \$ 3,243            | \$ 9,370  |
| Ending balance: evaluated for impairment under ASC 450-20    | 108,680    | 79,488              | 188,168   |
| <b>Loans outstanding, net of allowance:</b>                  |            |                     |           |
| Ending balance: evaluated for impairment under ASC 310-10-35 | 118,532    | 26,828              | 145,360   |
| Ending balance: evaluated for impairment under ASC 450-20    | 5,365,201  | 3,900,421           | 9,265,622 |

*Impaired loans*

Impaired loans totaled \$145.4 million and \$208.4 million at December 31, 2010 and 2009, respectively, and are comprised of loans on non-accrual status and loans which have been restructured. The restructured loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession. They are largely comprised of certain business, construction and business real estate loans classified as substandard. Upon maturity, the loans renewed at interest rates judged not to be market rates for new debt with similar risk, and as a result were classified as troubled debt restructurings. These loans totaled \$41.3 million and \$85.7 million at December 31, 2010 and 2009, respectively. These restructured loans are performing in accordance with their modified terms, and because the Company believes it probable that all amounts due under the modified terms of the agreements will be collected, interest on these loans is being recognized on an accrual basis. Troubled debt restructurings also include certain credit card loans under various debt management and assistance programs, which totaled \$18.8 million at December 31, 2010 and \$16.0 million at December 31, 2009.

The categories of impaired loans at December 31 for the last two years are presented in the following table:

| <i>(In thousands)</i> | <b>2010</b> | <b>2009</b> |
|-----------------------|-------------|-------------|
|-----------------------|-------------|-------------|

|                             |                   |                   |
|-----------------------------|-------------------|-------------------|
| Non-accrual loans           | \$ 85,275         | \$ 106,613        |
| Restructured loans          | 60,085            | 101,765           |
| <b>Total impaired loans</b> | <b>\$ 145,360</b> | <b>\$ 208,378</b> |



**Table of Contents**

The following table provides additional information about impaired loans held by the Company at December 31, 2010, segregated between loans for which an allowance for credit losses has been provided and loans for which no allowance has been provided.

| <i>(In thousands)</i>                      | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Interest<br>Income<br>Recognized * |
|--|------------------------|--------------------------------|----------------------|------------------------------------|
| <b>With no related allowance recorded:</b> |                        |                                |                      |                                    |
| Business                                   | \$ 3,544               | \$ 5,095                       | \$                   | \$                                 |
| Real estate construction and land          | 30,979                 | 55,790                         |                      |                                    |
| Real estate business                       | 4,245                  | 5,295                          |                      |                                    |
| Real estate personal                       | 755                    | 755                            |                      |                                    |
|  | \$ 39,523              | \$ 66,935                      | \$                   | \$                                 |
| <b>With an allowance recorded:</b>         |                        |                                |                      |                                    |
| Business                                   | \$ 18,464              | \$ 21,106                      | \$ 1,665             | \$ 395                             |
| Real estate construction and land          | 39,719                 | 52,587                         | 2,538                | 756                                |
| Real estate business                       | 21,581                 | 25,713                         | 1,924                | 387                                |
| Real estate personal                       | 7,294                  | 9,489                          | 936                  | 25                                 |
| Consumer credit card                       | 18,779                 | 18,779                         | 2,307                | 1,304                              |
|  | \$ 105,837             | \$ 127,674                     | \$ 9,370             | \$ 2,867                           |
| <b>Total at December 31, 2010</b>          | <b>\$ 145,360</b>      | <b>\$ 194,609</b>              | <b>\$ 9,370</b>      | <b>\$ 2,867</b>                    |

\* Represents interest income recognized since date of impairment. Interest shown is interest recognized in 2010 on accruing restructured loans as noted above.

Average impaired loans were \$173.0 million during 2010, consisting of \$91.3 million in non-accrual loans and \$81.7 million in restructured loans, compared to \$160.6 million during 2009.

*Delinquent and non-accrual loans*

The following table provides aging information on the Company's past due and accruing loans, in addition to the balances of loans on non-accrual status, at December 31, 2010. Non-accrual loans totaled \$85.3 million and \$106.6 million at December 31, 2010 and 2009, respectively. Loans 90 days delinquent and still accruing interest amounted to \$20.5 million and \$42.6 million at December 31, 2010 and 2009, respectively.

| <i>(In thousands)</i>             | Current or<br>Less<br>Than 30<br>Days Past<br>Due | 30-89 Days<br>Past Due | 90 Days<br>Past Due<br>and Still<br>Accruing | Non-accrual      | Total               |
|-----------------------------------|---|------------------------|--|------------------|---------------------|
| <b>Commercial:</b>                |   |                        |  |                  |                     |
| Business                          | \$ 2,927,403                                      | \$ 19,853              | \$ 854                                       | \$ 8,933         | \$ 2,957,043        |
| Real estate construction and land | 400,420   | 7,464                  | 217  | 52,752           | 460,853             |
| Real estate business              | 2,040,794   | 8,801                  |  | 16,242           | 2,065,837           |
| <b>Personal Banking:</b>          |   |                        |  |                  |                     |
| Real estate personal              | 1,413,905   | 15,579                 | 3,554  | 7,348            | 1,440,386           |
| Consumer                          | 1,145,561   | 15,899                 | 2,867  |                  | 1,164,327           |
| Revolving home equity             | 475,764   | 929                    | 825  |                  | 477,518             |
| Consumer credit card              | 806,373   | 12,513                 | 12,149                                       |                  | 831,035             |
| Overdrafts                        | 13,555  | 428                    |  |                  | 13,983              |
| <b>Total at December 31, 2010</b> | <b>\$ 9,223,775</b>                               | <b>\$ 81,466</b>       | <b>\$ 20,466</b>                             | <b>\$ 85,275</b> | <b>\$ 9,410,982</b> |

**Table of Contents***Credit quality*

The following table provides information about the credit quality of the Commercial loan portfolio, using the Company's internal rating system as an indicator. The information below was updated as of December 31, 2010 for this indicator. The credit quality of Personal Banking loans is monitored on the basis of aging/delinquency, and this information is provided in the table above.

The internal rating system is a series of grades reflecting management's risk assessment, based on its analysis of the borrower's financial condition. The "pass" category consists of a range of loan grades that reflect increasing, though still acceptable, risk. Movement of risk through the various grade levels in the "pass" category is monitored for early identification of credit deterioration. The "special mention" rating is attached to loans where the borrower exhibits material negative financial trends due to borrower specific or systemic conditions that, if left uncorrected, threaten its capacity to meet its debt obligations. The borrower is believed to have sufficient financial flexibility to react to and resolve its negative financial situation. It is a transitional grade that is closely monitored for improvement or deterioration. The "substandard" rating is applied to loans where the borrower exhibits well-defined weaknesses that jeopardize its continued performance and are of a severity that the distinct possibility of default exists. Loans are placed on "non-accrual" when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment, as discussed in Note 1.

| <i>(In thousands)</i>             | Commercial Loans    |                              |                          |
|-----------------------------------|---------------------|------------------------------|--------------------------|
|                                   | Business            | Real Estate-<br>Construction | Real Estate-<br>Business |
| Pass                              | \$ 2,801,328        | \$ 327,167                   | \$ 1,878,005             |
| Special mention                   | 67,142              | 29,345                       | 77,527                   |
| Substandard                       | 79,640              | 51,589                       | 94,063                   |
| Non-accrual                       | 8,933               | 52,752                       | 16,242                   |
| <b>Total at December 31, 2010</b> | <b>\$ 2,957,043</b> | <b>\$ 460,853</b>            | <b>\$ 2,065,837</b>      |

*Loans held for sale*

In addition to the portfolio of loans which are intended to be held to maturity, the Company historically originates loans which it intends to sell in secondary markets. Loans classified as held for sale primarily consist of loans originated to students while attending colleges and universities. Most of this portfolio was sold under contracts with the Federal Department of Education and various student loan agencies. Significant future student loan originations are not anticipated, because under statutory requirements effective July 1, 2010, the Company is prohibited from making federally guaranteed student loans. Also included as held for sale are certain fixed rate residential mortgage loans which are sold in the secondary market, generally within three months of origination. The following table presents information about loans held for sale, including an impairment valuation allowance resulting from declines in fair value below cost, which is further discussed in Note 16 on Fair Value Measurements.

| <i>(In thousands)</i>  | <b>2010</b>      | 2009       |
|--|------------------|------------|
| Balance outstanding at end of year:                              |                  |            |
| Student loans, at cost   | <b>\$ 53,901</b> | \$ 335,358 |
| Residential mortgage loans, at cost                              | <b>10,419</b>    | 10,473     |
| Valuation allowance on student loans                             | <b>(569)</b>     | (828)      |
| <b>Total loans held for sale, at lower of cost or fair value</b> | <b>\$ 63,751</b> | \$ 345,003 |
| Net gains on sales:  |                  |            |
| Student loans  | <b>\$ 8,398</b>  | \$ 9,738   |
| Residential mortgage loans                                       | <b>2,004</b>     | 2,463      |
| <b>Total gains on sales of loans held for sale, net</b>          | <b>\$ 10,402</b> | \$ 12,201  |

**Table of Contents****4. Investment Securities**

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

| <i>(In thousands)</i>                          | <b>2010</b>         | <b>2009</b>         |
|--|---------------------|---------------------|
| Available for sale:                            |                     |                     |
| U.S. government and federal agency obligations | \$ 455,537          | \$ 447,038          |
| Government-sponsored enterprise obligations    | 201,895             | 165,814             |
| State and municipal obligations                | 1,119,485           | 939,338             |
| Agency mortgage-backed securities              | 2,491,199           | 2,262,003           |
| Non-agency mortgage-backed securities          | 455,790             | 609,016             |
| Other asset-backed securities                  | 2,354,260           | 1,701,569           |
| Other debt securities                          | 176,964             | 176,331             |
| Equity securities                              | 39,173              | 39,866              |
| <br>   |                     |                     |
| Total available for sale                       | <b>7,294,303</b>    | 6,340,975           |
| <br>   |                     |                     |
| Trading  | 11,710              | 10,335              |
| Non-marketable                                 | 103,521             | 122,078             |
| <br>   |                     |                     |
| <b>Total investment securities</b>             | <b>\$ 7,409,534</b> | <b>\$ 6,473,388</b> |

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 borrowing and regulatory purposes, which totaled \$45.2 million and \$72.6 million at December 31, 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 mainly tied to the level of borrowings from the FHLB. These holdings are carried at cost. Non-marketable securities also include private equity investments, which amounted to \$58.2 million and \$49.5 million at December 31, 2010 and December 31, 2009, respectively. In the absence of readily ascertainable market values, these securities are carried at estimated fair value.

A summary of the available for sale investment securities by maturity groupings as of December 31, 2010 is shown below. The weighted average yield for each range of maturities was calculated using the yield on each security within that range weighted by the amortized cost of each security at December 31, 2010. Yields on tax exempt securities have not been adjusted for tax exempt status. The investment portfolio includes agency mortgage-backed securities, which are guaranteed by agencies such as FHLMC, FNMA, GNMA and FDIC, in addition to non-agency mortgage-backed securities which have no guarantee, but are collateralized by residential mortgages. Also included are certain other asset-backed securities, primarily collateralized by credit cards, automobiles and commercial loans. These securities differ from traditional debt securities primarily in that they have uncertain maturity dates and are

priced based on estimated prepayment rates on

**Table of Contents**

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 Value       | Weighted<br>Average<br>Yield |
|---|-------------------|------------------|------------------------------|
| U.S. government and federal agency obligations:             |                   |                  |                              |
| Within 1 year   | \$ 168,836        | \$ 169,163       | .02%                         |
| After 1 but within 5 years                                  | 104,069           | 111,101          | 1.83                         |
| After 5 but within 10 years                                 | 161,973           | 175,273          | 1.79                         |
| <b>Total U.S. government and federal agency obligations</b> | <b>434,878</b>    | <b>455,537</b>   | <b>1.11</b>                  |
| Government-sponsored enterprise obligations:                |                   |                  |                              |
| Within 1 year   | 82,263            | 82,889           | 2.37                         |
| After 1 but within 5 years                                  | 106,418           | 108,156          | 1.87                         |
| After 5 but within 10 years                                 | 11,380            | 10,850           | 2.25                         |
| <b>Total government-sponsored enterprise obligations</b>    | <b>200,061</b>    | <b>201,895</b>   | <b>2.10</b>                  |
| State and municipal obligations:                            |                   |                  |                              |
| Within 1 year   | 141,499           | 143,745          | 3.69                         |
| After 1 but within 5 years                                  | 428,899           | 437,716          | 2.93                         |
| After 5 but within 10 years                                 | 285,211           | 282,224          | 2.95                         |
| After 10 years  | 261,411           | 255,800          | 2.54                         |
| <b>Total state and municipal obligations</b>                | <b>1,117,020</b>  | <b>1,119,485</b> | <b>2.94</b>                  |
| Mortgage and asset-backed securities:                       |                   |                  |                              |
| Agency mortgage-backed securities                           | 2,437,123         | 2,491,199        | 3.61                         |
| Non-agency mortgage-backed securities                       | 459,363           | 455,790          | 6.17                         |
| Other asset-backed securities                               | 2,342,866         | 2,354,260        | 1.49                         |
| <b>Total mortgage and asset-backed securities</b>           | <b>5,239,352</b>  | <b>5,301,249</b> | <b>2.89</b>                  |
| Other debt securities:                                      |                   |                  |                              |

|   |              |              |
|---|--------------|--------------|
| Within 1 year   | 20,036       | 20,227       |
| After 1 but within 5 years                            | 145,847      | 156,737      |
| <b>Total other debt securities</b>                    | 165,883      | 176,964      |
| <b>Equity securities</b>                              | 7,569        | 39,173       |
| <b>Total available for sale investment securities</b> | \$ 7,164,763 | \$ 7,294,303 |

Included in U.S. government securities are U.S. Treasury inflation-protected securities, which totaled \$445.7 million, at fair value, at December 31, 2010. Interest paid on these securities increases with inflation and decreases with deflation, as measured by the Consumer Price Index. At maturity, the principal paid is the greater of an inflation-adjusted principal or the original principal. Included in state and municipal obligations are \$150.1 million, at fair value, of auction rate securities, which were purchased from bank customers in 2008. Equity securities are primarily comprised of investments in common stock held by the Parent, which totaled \$35.9 million, at fair value, at December 31, 2010.



**Table of Contents**

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 Value              |
|--|-------------------------|------------------------------|-------------------------------|-------------------------|
| <b>December 31, 2010</b>                       |                         |                              |                               |                         |
| U.S. government and federal agency obligations | \$ 434,878              | \$ 20,659                    | \$                            | \$ 455,537              |
| Government-sponsored enterprise obligations    | 200,061                 | 2,364                        | (530)                         | 201,895                 |
| State and municipal obligations                | 1,117,020               | 19,108                       | (16,643)                      | 1,119,485               |
| Mortgage and asset-backed securities:          |                         |                              |                               |                         |
| Agency mortgage-backed securities              | 2,437,123               | 57,516                       | (3,440)                       | 2,491,199               |
| Non-agency mortgage-backed securities          | 459,363                 | 10,940                       | (14,513)                      | 455,790                 |
| Other asset-backed securities                  | 2,342,866               | 12,445                       | (1,051)                       | 2,354,260               |
| <br>Total mortgage and asset-backed securities | <br>5,239,352           | <br>80,901                   | <br>(19,004)                  | <br>5,301,249           |
| <br>Other debt securities                      | <br>165,883             | <br>11,081                   |                               | <br>176,964             |
| Equity securities                              | 7,569                   | 31,604                       |                               | 39,173                  |
| <br><b>Total</b>                               | <br><b>\$ 7,164,763</b> | <br><b>\$ 165,717</b>        | <br><b>\$ (36,177)</b>        | <br><b>\$ 7,294,303</b> |
| <br><b>December 31, 2009</b>                   |                         |                              |                               |                         |
| 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 December 31, 2010, the fair value of securities on this watch list was \$241.7 million.

As of December 31, 2010, the Company had recorded OTTI on certain non-agency mortgage-backed securities, part of the watch list mentioned above, which had an aggregate fair value of \$163.6 million. The credit portion of the impairment totaled \$7.5 million and was recorded in earnings. The noncredit-related portion of the impairment totaled \$12.2 million on a pre-tax basis, and has been recognized in accumulated other comprehensive income. The Company does not intend to sell these securities and believes it is not more likely than not that it will be required to sell the securities before the recovery of their amortized cost.

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

**Table of Contents**

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               | 2% - 25%  |
| Projected cumulative default | 11% - 51% |
| Credit support               | 0% - 11%  |
| Loss severity                | 33% - 57% |

The following table shows changes in the credit losses recorded in current earnings, for which a portion of an OTTI was recognized in other comprehensive income.

| <i>(In thousands)</i>   | 2010            | 2009            |
|---|-----------------|-----------------|
| Balance, January 1  | \$ 2,473        | \$              |
| Credit losses on debt securities for which impairment was not previously recognized | 353             | 3,619           |
| Credit losses on debt securities for which impairment was previously recognized     | 4,716           |                 |
| Credit losses reversed on securities sold   |                 | (1,146)         |
| <b>Balance, December 31</b>   | <b>\$ 7,542</b> | <b>\$ 2,473</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 Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| <b>At December 31, 2010</b>                 |                     |                   |                     |                   |            |                   |
| Government-sponsored enterprise obligations | \$ 10,850           | \$ 530            | \$                  | \$                | \$ 10,850  | \$ 530            |
| State and municipal obligations             | 345,775             | 7,470             | 82,269              | 9,173             | 428,044    | 16,643            |

|  |                     |                  |                   |                  |                     |                  |
|--|---------------------|------------------|-------------------|------------------|---------------------|------------------|
| Mortgage and asset-backed securities:      |                     |                  |                   |                  |                     |                  |
| Agency mortgage-backed securities          | 660,326             | 3,440            |                   |                  | 660,326             | 3,440            |
| Non-agency mortgage-backed securities      | 15,893              | 36               | 170,545           | 14,477           | 186,438             | 14,513           |
| Other asset-backed securities              | 487,822             | 1,029            | 24,928            | 22               | 512,750             | 1,051            |
| <br>                                       |                     |                  |                   |                  |                     |                  |
| Total mortgage and asset-backed securities | 1,164,041           | 4,505            | 195,473           | 14,499           | 1,359,514           | 19,004           |
| <br>                                       |                     |                  |                   |                  |                     |                  |
| <b>Total</b>                               | <b>\$ 1,520,666</b> | <b>\$ 12,505</b> | <b>\$ 277,742</b> | <b>\$ 23,672</b> | <b>\$ 1,798,408</b> | <b>\$ 36,177</b> |

**At 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> |

**Table of Contents**

The total available for sale portfolio consisted of approximately 1,300 individual securities at December 31, 2010, with 259 securities in a loss position. Securities with temporary impairment totaled 243, of which 17 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 \$16.6 million at December 31, 2010. Of these losses, \$9.9 million related to auction rate securities, which are discussed above, and \$6.7 million related to other state and municipal obligations. This portfolio, excluding auction rate securities, totaled \$969.4 million at fair value, or 13.3% of total available for sale securities. The average credit quality of the portfolio, excluding auction rate securities, is Aa2 as rated by Moody's. The portfolio is diversified in order to reduce risk, and information about the 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 December 31, 2010</b> |                   |                               |                                |
| Texas                       | 11.1%             | 4.9                           | Aa1                            |
| Washington                  | 6.6               | 1.9                           | Aa2                            |
| Illinois                    | 6.0               | 3.9                           | Aa2                            |
| Missouri                    | 5.1               | 1.9                           | Aa1                            |
| Indiana                     | 4.6               | 2.3                           | Aa2                            |
| General obligation          | 26.2%             | 3.9                           | Aa2                            |
| Housing                     | 19.5              | 5.9                           | Aa1                            |
| Transportation              | 16.5              | 3.2                           | Aa3                            |
| Lease                       | 10.8              | 3.3                           | Aa2                            |
| Refunded                    | 6.9               | 2.6                           | Aaa                            |

The credit ratings (Moody's rating or equivalent) at December 31, 2010 in the state and municipal bond portfolio (excluding auction rate securities) are shown in the following table.

|           | % of<br>Portfolio |
|-----------|-------------------|
| Aaa       | 16.8%             |
| Aa        | 64.0              |
| A         | 14.1              |
| Baa       | 3.1               |
| Not rated | 2.0               |

100.0%

The remaining unrealized losses on the Company's investments, as shown in the preceding tables, are largely contained in the portfolio of non-agency mortgage-backed securities. These securities are not guaranteed by an outside agency and are dependent on payments received from the underlying mortgage collateral. While virtually all of these securities, at purchase date, were comprised of senior tranches and were highly rated by various rating agencies, the adverse housing market, 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 mainly of these securities, and has recorded OTTI losses on certain securities. The Company continues to closely monitor the performance of these securities. Additional OTTI losses may arise in future periods, due to further deterioration in expected cash flows, loss severities and delinquency levels of the securities' underlying collateral, which would negatively affect the Company's financial results.

**Table of Contents**

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

| <i>(In thousands)</i>   | <b>2010</b>       | 2009       | 2008       |
|---|-------------------|------------|------------|
| Proceeds from sales of available for sale securities          | <b>\$ 78,448</b>  | \$ 202,544 | \$ 109,543 |
| Proceeds from sales/redemption of non-marketable securities   | <b>192</b>        | 5,308      | 22,300     |
| <b>Total proceeds</b>   | <b>\$ 78,640</b>  | \$ 207,852 | \$ 131,843 |
| <b>Available for sale:</b>                                    |                   |            |            |
| Gains realized on sales                                       | <b>\$ 3,639</b>   | \$ 10,311  | \$ 9,946   |
| Losses realized on sales                                      | <b>(151)</b>      | (9,989)    | (4,743)    |
| Other-than-temporary impairment recognized on debt securities | <b>(5,069)</b>    | (2,473)    |            |
| <b>Non-marketable:</b>  |                   |            |            |
| Gains realized on sales/redemption                            | <b>52</b>         | 1,087      | 22,300     |
| Losses realized on sales                                      |                   | (170)      |            |
| Fair value adjustments, net                                   | <b>(256)</b>      | (5,961)    | 2,791      |
| <b>Investment securities gains (losses), net</b>              | <b>\$ (1,785)</b> | \$ (7,195) | \$ 30,294  |

Investment securities with a fair value of \$3.6 billion and \$4.1 billion were pledged at December 31, 2010 and 2009, respectively, to secure public deposits, securities sold under repurchase agreements, trust funds, and borrowings 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 \$429.4 million, while the remaining securities were pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral. Except for obligations of various government-sponsored enterprises such as FNMA, FHLB and FHLMC, no investment in a single issuer exceeds 10% of stockholders' equity.

**5. Land, Buildings and Equipment**

Land, buildings and equipment consist of the following at December 31, 2010 and 2009:

| <i>(In thousands)</i>      | <b>2010</b>       | 2009       |
|----------------------------|-------------------|------------|
| Land                       | <b>\$ 107,906</b> | \$ 107,002 |
| Buildings and improvements | <b>512,826</b>    | 504,916    |

|  |                   |            |
|--|-------------------|------------|
| Equipment                                      | <b>222,606</b>    | 225,621    |
| Total  | <b>843,338</b>    | 837,539    |
| Less accumulated depreciation and amortization | <b>459,941</b>    | 434,906    |
| <b>Net land, buildings and equipment</b>       | <b>\$ 383,397</b> | \$ 402,633 |

Depreciation expense of \$35.1 million, \$37.0 million and \$35.3 million for 2010, 2009 and 2008, respectively, was included in occupancy expense and equipment expense in the consolidated income statements. Repairs and maintenance expense of \$18.5 million, \$18.6 million and \$20.1 million for 2010, 2009 and 2008, respectively, was included in occupancy expense and equipment expense. Interest expense capitalized on construction projects in the past three years has not been significant.



**Table of Contents****6. Goodwill and Other Intangible Assets**

Goodwill and other intangible assets are summarized in the following table.

| <i>(In thousands)</i>                      | <b>December 31, 2010</b>     |                                 |                            |                   | <b>December 31, 2009</b>     |                                 |                            |                   |
|--|------------------------------|---------------------------------|----------------------------|-------------------|------------------------------|---------------------------------|----------------------------|-------------------|
|  | <b>Gross Carrying Amount</b> | <b>Accumulated Amortization</b> | <b>Valuation Allowance</b> | <b>Net Amount</b> | <b>Gross Carrying Amount</b> | <b>Accumulated Amortization</b> | <b>Valuation Allowance</b> | <b>Net Amount</b> |
| Amortizable intangible assets:             |                              |                                 |                            |                   |                              |                                 |                            |                   |
| Core deposit premium                       | \$ 25,720                    | \$ (16,108)                     | \$                         | \$ 9,612          | \$ 25,720                    | \$ (12,966)                     | \$                         | \$ 12,754         |
| Mortgage servicing rights                  | 3,082                        | (1,572)                         | (185)                      | 1,325             | 2,898                        | (1,206)                         | (113)                      | 1,579             |
| <b>Total amortizable intangible assets</b> | <b>28,802</b>                | <b>(17,680)</b>                 | <b>(185)</b>               | <b>10,937</b>     | <b>28,618</b>                | <b>(14,172)</b>                 | <b>(113)</b>               | <b>14,333</b>     |
| Goodwill                                   | <b>125,585</b>               |                                 |                            | <b>125,585</b>    | <b>125,585</b>               |                                 |                            | <b>125,585</b>    |
| <b>Total intangible assets</b>             | <b>\$ 154,387</b>            | <b>\$ (17,680)</b>              | <b>\$ (185)</b>            | <b>\$ 136,522</b> | <b>\$ 154,203</b>            | <b>\$ (14,172)</b>              | <b>\$ (113)</b>            | <b>\$ 139,918</b> |

As a result of ongoing assessments, no impairment of goodwill was recorded in 2010, 2009 or 2008. Further, the regular annual review on January 1, 2011 revealed no impairment as of that date. There were no changes in the carrying amount of goodwill or its allocation among operating segments, as shown in the following table, during the past three years.

| <i>(In thousands)</i>               | <b>Consumer Segment</b> | <b>Commercial Segment</b> | <b>Wealth Segment</b> | <b>Total Goodwill</b> |
|-------------------------------------|-------------------------|---------------------------|-----------------------|-----------------------|
| <b>Balance at December 31, 2010</b> | \$ 67,765               | \$ 57,074                 | \$ 746                | \$ 125,585            |

Changes in the net carrying amount of other intangible assets for the years ended December 31, 2009 and 2010 are shown in the following table.

| <i>(In thousands)</i>               | Core<br>Deposit<br>Premium | Mortgage<br>Servicing<br>Rights |
|-------------------------------------|----------------------------|---------------------------------|
| Balance at December 31, 2008        | \$ 16,396                  | \$ 795                          |
| Originations                        |                            | 1,082                           |
| Amortization                        | (3,642)                    | (335)                           |
| Impairment recovery                 |                            | 37                              |
| Balance at December 31, 2009        | 12,754                     | 1,579                           |
| Originations                        |                            | 184                             |
| Amortization                        | (3,142)                    | (366)                           |
| Impairment                          |                            | (72)                            |
| <b>Balance at December 31, 2010</b> | <b>\$ 9,612</b>            | <b>\$ 1,325</b>                 |

Mortgage servicing rights (MSRs) are initially recorded at fair value and subsequently amortized over the period of estimated servicing income. They are periodically reviewed for impairment and if impairment is indicated, recorded at fair value. At December 31, 2010, temporary impairment of \$185 thousand had been recognized. Temporary impairment, including impairment recovery, is effected through a change in a valuation allowance. The fair value of the MSRs is based on the present value of expected future cash flows, as further discussed in Note 16 on Fair Value Measurements.

Aggregate amortization expense on intangible assets for the years ended December 31, 2010, 2009 and 2008 was \$3.5 million, \$4.0 million and \$4.3 million, respectively. The following table shows the estimated future amortization expense based on existing asset balances and the interest rate environment as of December 31, 2010. The Company's actual amortization expense in any given period may be different from

**Table of Contents**

the estimated amounts depending upon the acquisition of intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions.

*(In thousands)*

|      |          |
|------|----------|
| 2011 | \$ 2,868 |
| 2012 | 2,335    |
| 2013 | 1,801    |
| 2014 | 1,326    |
| 2015 | 980      |

**7. Deposits**

At December 31, 2010, the scheduled maturities of total time open and certificates of deposit were as follows:

*(In thousands)*

|              |                     |
|--------------|---------------------|
| Due in 2011  | \$ 2,189,969        |
| Due in 2012  | 205,917             |
| Due in 2013  | 231,015             |
| Due in 2014  | 43,771              |
| Due in 2015  | 72,946              |
| Thereafter   | 544                 |
| <b>Total</b> | <b>\$ 2,744,162</b> |

The following table shows a detailed breakdown of the maturities of time open and certificates of deposit, by size category, at December 31, 2010.

| <i>(In thousands)</i> | Certificates of            | Other Time                  | Certificates of           | Other Time                 | Total |
|-----------------------|----------------------------|-----------------------------|---------------------------|----------------------------|-------|
|                       | Deposit under<br>\$100,000 | Deposits<br>under \$100,000 | Deposit over<br>\$100,000 | Deposits<br>over \$100,000 |       |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|                                    |           |                  |           |                |           |                  |           |               |           |                  |
|------------------------------------|-----------|------------------|-----------|----------------|-----------|------------------|-----------|---------------|-----------|------------------|
| Due in 3 months or less            | \$        | 259,544          | \$        | 43,347         | \$        | 387,770          | \$        | 10,217        | \$        | 700,878          |
| Due in over 3 through<br>6 months  |           | 348,099          |           | 55,164         |           | 368,148          |           | 12,483        |           | 783,894          |
| Due in over 6 through<br>12 months |           | 376,233          |           | 51,098         |           | 232,388          |           | 45,478        |           | 705,197          |
| Due in over 12 months              |           | 227,927          |           | 103,638        |           | 204,273          |           | 18,355        |           | 554,193          |
| <b>Total</b>                       | <b>\$</b> | <b>1,211,803</b> | <b>\$</b> | <b>253,247</b> | <b>\$</b> | <b>1,192,579</b> | <b>\$</b> | <b>86,533</b> | <b>\$</b> | <b>2,744,162</b> |

Regulations of the Federal Reserve System require cash balances to be maintained at the Federal Reserve Bank, based on certain deposit levels. The minimum reserve requirement for the Bank at December 31, 2010 totaled \$49.9 million.

**Table of Contents****8. Borrowings**

The following table sets forth selected information for short-term borrowings (borrowings with an original maturity of less than one year).

| <i>(Dollars in thousands)</i>                     | Year<br>End<br>Weighted<br>Rate | Average<br>Weighted<br>Rate | Average<br>Balance<br>Outstanding | Maximum<br>Outstanding<br>at any<br>Month End | Balance at<br>December 31 |
|---|---------------------------------|-----------------------------|-----------------------------------|---|---------------------------|
| <b>2010</b>                                       |                                 |                             |                                   |   |                           |
| Federal funds purchased and repurchase agreements | .1%                             | .1%                         | \$ 624,847                        | \$ 1,130,555                                  | \$ 582,827                |
| <b>2009</b>                                       |                                 |                             |                                   |   |                           |
| Federal funds purchased and repurchase agreements | .1                              | .1                          | 468,643                           | 674,121                                       | 603,191                   |
| <b>2008</b>                                       |                                 |                             |                                   |   |                           |
| Federal funds purchased and repurchase agreements | .1                              | 1.8                         | 873,625                           | 1,253,655                                     | 526,537                   |
| FHLB advances                                     | 2.7                             | 2.7                         | 29,508                            | 100,000                                       | 100,000                   |
| Term auction facility borrowings                  | .4                              | 1.4                         | 155,738                           | 700,000                                       | 700,000                   |

Short-term borrowings consist primarily of federal funds purchased and securities sold under agreements to repurchase (repurchase agreements), which generally mature within 90 days. Short-term repurchase agreements at December 31, 2010 were comprised of non-insured customer funds totaling \$577.9 million, which were secured by a portion of the Company's investment portfolio.

Long-term borrowings of the Company consisted of the following at December 31, 2010:

| <i>(Dollars in thousands)</i>    | Borrower        | Maturity<br>Date | Year<br>End<br>Weighted<br>Rate | Year End<br>Balance |
|----------------------------------|-----------------|------------------|---------------------------------|---------------------|
| FHLB advances                    | Subsidiary bank | 2011             | 4.3%                            | \$ 250              |
|                                  |                 | 2012             | 4.6                             | 460                 |
|                                  |                 | 2013-16          | 4.9                             | 3,965               |
|                                  |                 | 2017             | 3.5                             | 100,000             |
| Structured repurchase agreements | Subsidiary bank | 2013-14          | .0                              | 400,000             |

|                                    |                            |      |     |                   |
|------------------------------------|----------------------------|------|-----|-------------------|
| Structured note payable            | Venture capital subsidiary | 2012 | .0  | 7,515             |
| Non-recourse lease financing notes | Bank leasing subsidiary    | 2011 | 6.3 | 83                |
| <b>Total</b>                       |                            |      |     | <b>\$ 512,273</b> |

The Bank is a member of the Des Moines FHLB and has access to term financing from the FHLB. These borrowings are secured under a blanket collateral agreement including primarily residential mortgages as well as all unencumbered assets and stock of the borrowing bank. In November 2010, the Company elected to repay FHLB advances totaling \$125.0 million in advance of their maturity dates. These advances had a weighted average rate of 4.2%, and a prepayment penalty of \$11.8 million was paid. Total outstanding advances at December 31, 2010 were \$104.7 million. Nearly all of the outstanding advances have fixed interest rates and contain prepayment penalties. The FHLB has also issued letters of credit, totaling \$502.2 million at December 31, 2010, to secure the Company's obligations to certain depositors of public funds.

Structured repurchase agreements totaled \$400.0 million at December 31, 2010. The repurchase agreements were issued upon the maturity of \$500.0 million of other structured repurchase agreements in August 2010. The new borrowings have floating interest rates based upon various published constant maturity swap (CMS) rates and will mature in 2013 through 2014. As of year end they did not bear interest because of low CMS rates.

**Table of Contents**

Other long-term debt includes \$7.5 million borrowed from third-party insurance companies by a venture capital subsidiary, a Missouri Certified Capital Company, to support its investment activities. Because the insurance companies receive tax credits, the borrowings do not bear interest. This debt is secured by assets of the subsidiary and guaranteed by the Parent, evidenced by letters of credit from the Bank.

Cash payments for interest on deposits and borrowings during 2010, 2009 and 2008 on a consolidated basis amounted to \$93.0 million, \$172.6 million and \$285.5 million, respectively.

**9. Income Taxes**

The components of income tax expense (benefit) from operations for the years ended December 31, 2010, 2009 and 2008 were as follows:

| <i>(In thousands)</i>         | Current           | Deferred          | Total            |
|-------------------------------|-------------------|-------------------|------------------|
| Year ended December 31, 2010: |                   |                   |                  |
| U.S. federal                  | \$ 98,592         | \$ (6,612)        | \$ 91,980        |
| State and local               | 6,742             | (2,473)           | 4,269            |
|                               | <b>\$ 105,334</b> | <b>\$ (9,085)</b> | <b>\$ 96,249</b> |
| Year ended December 31, 2009: |                   |                   |                  |
| U.S. federal                  | \$ 77,753         | \$ (6,719)        | \$ 71,034        |
| State and local               | 3,314             | (591)             | 2,723            |
|                               | <b>\$ 81,067</b>  | <b>\$ (7,310)</b> | <b>\$ 73,757</b> |
| Year ended December 31, 2008: |                   |                   |                  |
| U.S. federal                  | \$ 81,536         | \$ 3,193          | \$ 84,729        |
| State and local               | 885               | (537)             | 348              |
|                               | <b>\$ 82,421</b>  | <b>\$ 2,656</b>   | <b>\$ 85,077</b> |

The components of income tax expense (benefit) recorded directly to stockholders' equity for the years ended December 31, 2010, 2009 and 2008 were as follows:

| <i>(In thousands)</i>  | <b>2010</b>     | 2009      | 2008        |
|--|-----------------|-----------|-------------|
| Unrealized gain (loss) on securities available for sale  | <b>\$ 9,841</b> | \$ 61,701 | \$ (40,724) |
| Compensation expense for tax purposes in excess of amounts recognized for financial reporting purposes | <b>(1,201)</b>  | (557)     | (1,941)     |
| Accumulated pension (benefit) loss   | <b>327</b>      | 1,476     | (9,833)     |
| Other  |                 |           | 549         |
| <b>Income tax expense (benefit) allocated to stockholders equity</b>                                   | <b>\$ 8,967</b> | \$ 62,620 | \$ (51,949) |



**Table of Contents**

Significant components of the Company's deferred tax assets and liabilities at December 31, 2010 and 2009 were as follows:

| <i>(In thousands)</i>                               | <b>2010</b>       | 2009       |
|---|-------------------|------------|
| Deferred tax assets:                                |                   |            |
| Loans, principally due to allowance for loan losses | \$ <b>90,875</b>  | \$ 90,774  |
| Equity-based compensation                           | <b>13,707</b>     | 13,987     |
| Accrued expenses                                    | <b>8,886</b>      | 7,102      |
| Deferred compensation                               | <b>5,374</b>      | 5,264      |
| Other   | <b>9,135</b>      | 7,758      |
| <b>Total deferred tax assets</b>                    | <b>127,977</b>    | 124,885    |
| Deferred tax liabilities:                           |                   |            |
| Unrealized gain on securities available for sale    | <b>49,225</b>     | 39,384     |
| Equipment lease financing                           | <b>47,976</b>     | 45,551     |
| Land, buildings and equipment                       | <b>20,579</b>     | 25,571     |
| Intangibles   | <b>4,700</b>      | 4,919      |
| Accretion on investment securities                  | <b>3,922</b>      | 6,055      |
| Prepaid expenses                                    | <b>2,775</b>      | 3,137      |
| Other   | <b>2,541</b>      | 2,926      |
| <b>Total deferred tax liabilities</b>               | <b>131,718</b>    | 127,543    |
| <b>Net deferred tax asset (liability)</b>           | <b>\$ (3,741)</b> | \$ (2,658) |

The Company acquired a federal net operating loss (NOL) carryforward of approximately \$4.3 million in connection with a 2003 acquisition. The NOL carryforward will begin to expire in 2021 if it cannot be utilized. At December 31, 2010, the tax benefit related to the remaining NOL carryforward was \$416 thousand. Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the total deferred tax assets.

A reconciliation between the expected federal income tax expense using the federal statutory tax rate of 35 percent and the Company's actual income tax expense for 2010, 2009 and 2008 is as follows:

| <i>(In thousands)</i> | <b>2010</b> | 2009 | 2008 |
|-----------------------|-------------|------|------|
|-----------------------|-------------|------|------|

|   |                  |                  |                  |
|---|------------------|------------------|------------------|
| Computed expected tax expense   | \$ 111,286       | \$ 84,991        | \$ 95,806        |
| Increase (decrease) in income taxes resulting from:                     |                  |                  |                  |
| Tax-exempt interest, net of cost to carry                               | (12,745)         | (11,813)         | (9,902)          |
| Tax deductible dividends on allocated shares held by the Company's ESOP | (1,096)          | (1,087)          | (1,084)          |
| State and local income taxes, net of federal tax benefit                | 2,775            | 1,770            | 226              |
| Other   | (3,971)          | (104)            | 31               |
| <b>Total income tax expense</b>   | <b>\$ 96,249</b> | <b>\$ 73,757</b> | <b>\$ 85,077</b> |

Cash payments of income taxes, net of refunds, amounted to \$100.6 million, \$82.9 million and \$84.4 million on a consolidated basis during 2010, 2009 and 2008, respectively. The Parent had net receipts of \$2.0 million, \$4.9 million and \$2.7 million during 2010, 2009 and 2008, respectively, from tax benefits.

It is the Company's policy to recognize interest and penalties related to income tax matters in income tax expense. The Company recorded tax benefits related to interest and penalties of \$68 thousand, \$156 thousand and \$73 thousand in 2010, 2009 and 2008, respectively. At December 31, 2010 and 2009, liabilities for interest and penalties were \$268 thousand and \$335 thousand, respectively.

As of December 31, 2010 and 2009, the gross amount of unrecognized tax benefits was \$1.6 million and \$2.7 million, respectively, and the total amount of unrecognized tax benefits that would impact the effective tax rate, if recognized, was \$1.1 million and \$2.1 million, respectively. While it is expected that the amount of

**Table of Contents**

unrecognized tax benefits will change in the next twelve months, the Company does not expect this change to have a material impact on the results of operations or the financial position of the Company.

The Company and its subsidiaries are subject to income tax by federal, state and local government taxing authorities. During 2010, the Internal Revenue Service concluded an examination of the Company's tax returns for the years ended December 31, 2006 through 2008. The examination resulted in an immaterial adjustment to income taxes recorded in the financial statements. Tax years 2009 and 2010 remain open to examination for U.S. federal income tax. The years open to examination by state and local government authorities vary by jurisdiction.

The activity in the accrued liability for unrecognized tax benefits for the years ended December 31, 2010 and 2009 was as follows:

| <i>(In thousands)</i>                           | <b>2010</b>     | 2009            |
|---|-----------------|-----------------|
| Unrecognized tax benefits at beginning of year  | \$ 2,714        | \$ 3,350        |
| Gross increases tax positions in prior period   | 166             | 9               |
| Gross decreases tax positions in prior period   | (1,044)         | (667)           |
| Gross increases current-period tax positions    | 328             | 349             |
| Settlements                                     | (251)           | (14)            |
| Lapse of statute of limitations                 | (300)           | (313)           |
| <b>Unrecognized tax benefits at end of year</b> | <b>\$ 1,613</b> | <b>\$ 2,714</b> |

**10. Employee Benefit Plans**

Employee benefits charged to operating expenses are summarized in the table below. Substantially all of the Company's employees are covered by a defined contribution (401K) plan, under which the Company makes matching contributions.

| <i>(In thousands)</i>          | <b>2010</b>      | 2009             | 2008             |
|--------------------------------|------------------|------------------|------------------|
| Payroll taxes                  | \$ 20,226        | \$ 20,587        | \$ 20,290        |
| Medical plans                  | 18,248           | 20,164           | 17,340           |
| 401K plan                      | 11,448           | 9,771            | 9,537            |
| Pension plans                  | 1,815            | 3,023            | (1,797)          |
| Other                          | 2,138            | 1,945            | 2,081            |
| <b>Total employee benefits</b> | <b>\$ 53,875</b> | <b>\$ 55,490</b> | <b>\$ 47,451</b> |

A large portion of the Company's current employees are covered by a noncontributory defined benefit pension plan, however, participation in the pension plan is not available to employees hired after June 30, 2003. All participants are fully vested in their benefit payable upon normal retirement date, which is based on years of participation and compensation. Certain key executives also participate in a supplemental executive retirement plan (the CERP) that the Company funds only as retirement benefits are disbursed. The CERP carries no segregated assets.

Effective January 1, 2005 substantially all benefits accrued under the pension plan were frozen. With this change, certain annual salary credits to pension accounts were discontinued, however, the accounts continue to accrue interest at a stated annual rate. Enhancements were then made to the 401K plan, which have increased employer contributions to the 401K plan. Enhancements were also made to the CERP, providing credits based on hypothetical contributions in excess of those permitted under the 401K plan. Effective January 1, 2011, all remaining benefits accrued under the pension plan were frozen.

An employer must recognize the funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and must recognize changes in that funded status in the year in which the changes occur through other comprehensive income. Effective in 2008, plan assets and benefit obligations must be measured as of fiscal year end. Accordingly, during 2008 the Company changed its measurement

**Table of Contents**

date from September 30 to December 31. The change resulted in an increase of \$561 thousand, on a pre-tax basis, to retained earnings, which was recorded on December 31, 2008.

Under the Company's funding policy for the defined benefit pension plan, contributions are made to a trust as necessary to satisfy the statutory minimum required contribution as defined by the Pension Protection Act, which is intended to provide for current service accruals and for any unfunded accrued actuarial liabilities over a reasonable period. To the extent that these requirements are fully covered by assets in the trust, a contribution might not be made in a particular year. The Company made no contributions to the defined benefit pension plan in 2010 and the minimum required contribution for 2011 is expected to be zero. The Company does not expect to make any further contributions other than the necessary funding contributions to the CERP. Contributions to the CERP were \$10 thousand, \$10 thousand and \$12 thousand during fiscal 2010, 2009 and 2008, respectively.

Benefit obligations of the CERP at the December 31, 2010 and 2009 valuation dates are shown in the table immediately below. In all other tables presented, the pension plan and the CERP are presented on a combined basis.

| <i>(In thousands)</i>          | <b>2010</b>     | 2009     |
|--------------------------------|-----------------|----------|
| Projected benefit obligation   | <b>\$ 2,829</b> | \$ 2,557 |
| Accumulated benefit obligation | <b>\$ 2,829</b> | \$ 2,557 |

The following items are components of the net pension cost for the years ended December 31, 2010, 2009 and 2008.

| <i>(In thousands)</i>                         | <b>2010</b>     | 2009     | 2008       |
|---|-----------------|----------|------------|
| Service cost-benefits earned during the year  | <b>\$ 716</b>   | \$ 683   | \$ 1,025   |
| Interest cost on projected benefit obligation | <b>5,505</b>    | 5,473    | 5,236      |
| Expected return on plan assets                | <b>(6,614)</b>  | (6,123)  | (8,165)    |
| Amortization of unrecognized net loss         | <b>2,208</b>    | 2,990    | 107        |
| <b>Net periodic pension cost (income)</b>     | <b>\$ 1,815</b> | \$ 3,023 | \$ (1,797) |

The following table sets forth the pension plans' funded status, using valuation dates of December 31, 2010 and 2009.

| <i>(In thousands)</i> | <b>2010</b> | 2009 |
|-----------------------|-------------|------|
|-----------------------|-------------|------|

**Change in projected benefit obligation**

|  |                |           |
|--|----------------|-----------|
| Projected benefit obligation at prior valuation date | \$ 98,148      | \$ 91,430 |
| Service cost   | 716            | 683       |
| Interest cost  | 5,505          | 5,473     |
| Benefits paid  | (4,768)        | (4,639)   |
| Actuarial (gain) loss                                | 4,256          | 5,201     |
| <br>   |                |           |
| Projected benefit obligation at valuation date       | <b>103,857</b> | 98,148    |

**Change in plan assets**

|   |               |         |
|---|---------------|---------|
| Fair value of plan assets at prior valuation date | 93,498        | 85,852  |
| Actual return (loss) on plan assets               | 10,084        | 12,275  |
| Employer contributions                            | 10            | 10      |
| Benefits paid                                     | (4,768)       | (4,639) |
| <br>  |               |         |
| Fair value of plan assets at valuation date       | <b>98,824</b> | 93,498  |

|  |                   |                   |
|--|-------------------|-------------------|
| <b>Funded status and net amount recognized at valuation date</b> | <b>\$ (5,033)</b> | <b>\$ (4,650)</b> |
|--|-------------------|-------------------|

**Table of Contents**

The accumulated benefit obligation, which represents the liability of a plan using only benefits as of the measurement date, was \$103.9 million and \$98.1 million for the combined plans on December 31, 2010 and 2009, respectively.

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income (loss) at December 31, 2010 and 2009 are shown below, including amounts recognized in other comprehensive income during the periods. All amounts are shown on a pre-tax basis.

| <i>(In thousands)</i>  | <b>2010</b>       | 2009       |
|--|-------------------|------------|
| Prior service credit (cost)  | \$                | \$         |
| Accumulated loss   | <b>(27,406)</b>   | (28,828)   |
| <b>Accumulated other comprehensive loss</b>  | <b>(27,406)</b>   | (28,828)   |
| Cumulative employer contributions in excess of net periodic benefit cost                             | <b>22,373</b>     | 24,178     |
| <b>Net amount recognized as an accrued benefit liability on the December 31 balance sheet</b>        | <b>\$ (5,033)</b> | \$ (4,650) |
| Net gain (loss) arising during period  | \$ <b>(786)</b>   | \$ 951     |
| Amortization of net loss   | <b>2,208</b>      | 2,990      |
| <b>Total recognized in other comprehensive income</b>  | <b>\$ 1,422</b>   | \$ 3,941   |
| <b>Total income (expense) recognized in net periodic pension cost and other comprehensive income</b> | <b>\$ (393)</b>   | \$ 918     |

The estimated net loss to be amortized from accumulated other comprehensive income into net periodic pension cost in 2011 is \$2.1 million.

The following assumptions, on a weighted average basis, were used in accounting for the plans.

|  | <b>2010</b>  | 2009  | 2008  |
|--|--------------|-------|-------|
| Determination of benefit obligation at year end: |              |       |       |
| Discount rate                                    | <b>5.40%</b> | 5.75% | 6.00% |

|  |              |       |       |
|--|--------------|-------|-------|
| Assumed credit on cash balance accounts                    | <b>5.00%</b> | 5.00% | 5.00% |
| Determination of net periodic benefit cost for year ended: |              |       |       |
| Discount rate  | <b>5.75%</b> | 6.00% | 6.25% |
| Long-term rate of return on assets                         | <b>7.25%</b> | 7.25% | 8.00% |
| Assumed credit on cash balance accounts                    | <b>5.00%</b> | 5.00% | 5.00% |



**Table of Contents**

The following table shows the fair values of the Company's pension plan assets by asset category at December 31, 2010 and 2009. Information about the valuation techniques and inputs used to measure fair value are provided in Note 16 on Fair Value Measurements.

|  | Total            | Fair Value Measurements   |   |  |
|--|------------------|---|---|--|
|  |                  | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <i>(In thousands)</i>                                      |                  |   |   |  |
| <b>December 31, 2010</b>                                   |                  |   |   |  |
| <b>Assets:</b>   |                  |   |   |  |
| Cash   | \$ 22            | \$ 22   | \$  | \$   |
| U.S. government obligations                                | 3,964            | 3,964   |   |  |
| Government-sponsored enterprise obligations <sup>(a)</sup> | 9,771            |   | 9,771   |  |
| State and municipal obligations                            | 3,644            |   | 3,644   |  |
| Agency mortgage-backed securities <sup>(b)</sup>           | 5,848            |   | 5,848   |  |
| Non-agency mortgage-backed securities                      | 7,802            |   | 7,802   |  |
| Other asset-backed securities                              | 6,060            |   | 6,060   |  |
| Corporate bonds <sup>(c)</sup>                             | 19,676           |   | 19,676  |  |
| International bonds  | 2,274            |   | 2,274   |  |
| Equity securities and mutual funds: <sup>(d)</sup>         |                  |   |   |  |
| U.S. large-cap   | 17,806           | 17,806  |   |  |
| U.S. mid-cap   | 8,849            | 8,849   |   |  |
| U.S. small-cap   | 3,344            | 3,344   |   |  |
| International developed markets                            | 1,951            | 1,951   |   |  |
| Emerging markets   | 2,771            | 2,771   |   |  |
| Money market funds   | 5,042            | 5,042   |   |  |
| <b>Total</b>   | <b>\$ 98,824</b> | <b>\$ 43,749</b>  | <b>\$ 55,075</b>  | <b>\$</b>  |
| <b>December 31, 2009</b>                                   |                  |   |   |  |
| <b>Assets:</b>   |                  |   |   |  |
| Government-sponsored enterprise obligations <sup>(a)</sup> | \$ 8,096         | \$  | \$ 8,096  | \$   |
| State and municipal obligations                            | 2,053            |   | 2,053   |  |
| Agency mortgage-backed securities <sup>(b)</sup>           | 4,946            |   | 4,946   |  |
| Non-agency mortgage-backed securities                      | 3,919            |   | 3,919   |  |
| Other asset-backed securities                              | 1,349            |   | 1,349   |  |
| Corporate bonds <sup>(c)</sup>                             | 23,104           |   | 23,104  |  |

|  |           |           |           |    |
|--|-----------|-----------|-----------|----|
| International bonds                                | 500       |           | 500       |    |
| Equity securities and mutual funds: <sup>(d)</sup> |           |           |           |    |
| U.S. large-cap                                     | 22,819    | 22,819    |           |    |
| U.S. mid-cap                                       | 10,595    | 10,595    |           |    |
| Emerging markets                                   | 781       | 781       |           |    |
| Money market funds                                 | 15,336    | 15,336    |           |    |
| <b>Total</b>                                       | \$ 93,498 | \$ 49,531 | \$ 43,967 | \$ |

(a) *This category represents bonds (excluding mortgage-backed securities) issued by agencies such as the Federal Home Loan Bank, the Federal Home Loan Mortgage Corp. and the Federal National Mortgage Association.*

(b) *This category represents mortgage-backed securities issued by the agencies mentioned in (a).*

(c) *This category represents investment grade bonds of U.S. issuers from diverse industries.*

(d) *This category represents investments in individual common stocks and equity funds. The majority of these investments are in equity mutual funds, which have diversified investment holdings across the financial services, healthcare, energy, consumer goods, and industrial materials sectors.*

**Table of Contents**

The investment policy of the pension plan is designed for growth in value within limits designed to safeguard against significant losses within the portfolio. The policy sets guidelines regarding the types of investments held that may change from time to time, currently including items such as holding bonds rated investment grade or better, and prohibiting investment in Company stock. The plan does not utilize derivatives. Management believes there are no significant concentrations of risk within the plan asset portfolio at December 31, 2010. Under the current policy, the long-term investment target mix for the plan is 35% equity securities and 65% fixed income securities. The Company regularly reviews its policies on investment mix and may make changes depending on economic conditions and perceived investment risk.

The selection of a discount rate has historically been based on a review of various published bond indices, and a discount rate based on this method was used in determining the December 31, 2009 and prior year benefit obligations. At December 31, 2010, the Company changed this selection, and the discount rate used in determining the year end benefit obligation was based on matching the Company's estimated plan cash flows to a yield curve derived from a portfolio of corporate bonds rated AA by Moody's. The Company intends to use the new basis for determining discount rates in the future.

The assumed overall expected long-term rate of return on pension plan assets used in calculating 2010 pension plan expense was 7.25%. Determination of the plan's expected rate of return is based upon historical and anticipated returns of the asset classes invested in by the pension plan and the allocation strategy currently in place among those classes. The rate used in plan calculations may be adjusted by management for current trends in the economic environment. The average 10-year annualized return for the Company's pension plan was 4.8%. During 2010, the plan's rate of return was 11.0%, compared to 13.8% in 2009. With a portion of the plan's investments in equities, the actual return for any one plan year may fluctuate with changes in the stock market. Due to the plan freeze, growth in asset values in 2010 and lower anticipated amortization of investment losses in 2011, partly offset by the effect of a lower discount rate in 2011, the Company expects to incur pension expense of \$1.3 million in 2011, compared to \$1.8 million in 2010.

The following future benefit payments are expected to be paid:

*(In thousands)*

|           |    |        |
|-----------|----|--------|
| 2011      | \$ | 5,868  |
| 2012      |    | 6,078  |
| 2013      |    | 6,326  |
| 2014      |    | 6,552  |
| 2015      |    | 6,789  |
| 2016-2020 |    | 36,067 |

**11. Stock-Based Compensation and Directors Stock Purchase Plan\***

The Company's stock-based compensation is provided under a stockholder-approved plan which allows for issuance of various types of awards, including stock options, stock appreciation rights, restricted stock and restricted stock units, performance awards and stock-based awards. At December 31, 2010, 3,146,432 shares remained available for

issuance under the plan. The stock-based compensation expense that was charged against income was \$6.0 million, \$6.6 million and \$6.4 million for the years ended December 31, 2010, 2009 and 2008, respectively. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$2.2 million, \$2.5 million and \$2.4 million for the years ended December 31, 2010, 2009 and 2008, respectively.

During 2010, stock-based compensation was issued in the form of nonvested stock awards. Nonvested stock is awarded to key employees, by action of the Board of Directors. These awards generally vest after 5 to 7 years of continued employment, but vesting terms may vary according to the specifics of the individual grant agreement. There are 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

**Table of Contents**

status of the Company's nonvested share awards as of December 31, 2010 and changes during the year then ended is presented below.

|                                       | Shares         | Weighted<br>Average<br>Grant Date<br>Fair Value |
|---------------------------------------|----------------|---|
| Nonvested at January 1, 2010          | 379,374        | \$ 35.46  |
| Granted                               | 161,723        | 37.52   |
| Vested                                | (55,857)       | 37.20   |
| Forfeited                             | (14,834)       | 34.53   |
| <b>Nonvested at December 31, 2010</b> | <b>470,406</b> | <b>\$ 36.00</b>                                 |

The total fair value (at vest date) of shares vested during 2010, 2009 and 2008 was \$2.1 million, \$1.7 million and \$1.8 million, respectively.

In previous years, stock appreciation rights (SARs) and stock options have also been granted, and were granted with exercise prices equal to the market price of the Company's stock at the date of grant. SARs, which the Company granted in 2006 and subsequent years, vest on a graded basis over 4 years of continuous service and have 10-year contractual terms. All SARs must be settled in stock under provisions of the plan. Stock options, which were granted in 2005 and previous years, vested on a graded basis over 3 years of continuous service, and also have 10-year contractual terms.

In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of options and SARs on date of grant. The Black-Scholes model is a closed-end model that uses various assumptions as shown in the following table. Expected volatility is based on historical volatility of the Company's stock. The Company uses historical exercise behavior and other factors to estimate the expected term of the options and SARs, which represents the period of time that the options and SARs granted are expected to be outstanding. The risk-free rate for the expected term is based on the U.S. Treasury zero coupon spot rates in effect at the time of grant. Below are weighted average fair values of SARs granted during 2009 and 2008. No SARs were granted during 2010.

|   | 2009    | 2008    |
|---|---------|---------|
| Weighted per share average fair value at grant date | \$ 6.78 | \$ 7.50 |
| Assumptions:  |         |         |

|                         |           |           |
|-------------------------|-----------|-----------|
| Dividend yield          | 2.7%      | 2.3%      |
| Volatility              | 20.8%     | 18.4%     |
| Risk-free interest rate | 3.2%      | 3.5%      |
| Expected term           | 7.3 years | 7.2 years |

A summary of option activity during 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 |
|---|-----------|--|---|---------------------------------|
| Outstanding at January 1, 2010                          | 2,401,891 | \$ 29.81                                 |   |                                 |
| Granted   |           |  |   |                                 |
| Forfeited   |           |  |   |                                 |
| Expired   | (14,679)  | 31.22                                    |   |                                 |
| Exercised   | (581,102) | 26.20                                    |   |                                 |
| <b>Outstanding at December 31, 2010</b>                 | 1,806,110 | \$ 30.96                                 | 2.6 years   | \$ 15,842                       |
| <b>Exercisable at December 31, 2010</b>                 | 1,806,110 | \$ 30.96                                 | 2.6 years   | \$ 15,842                       |
| <b>Vested and expected to vest at December 31, 2010</b> | 1,806,110 | \$ 30.96                                 | 2.6 years   | \$ 15,842                       |

**Table of Contents**

A summary of SAR activity during 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 |
|---|-----------|--|---|---------------------------------|
| Outstanding at January 1, 2010                          | 1,752,956 | \$ 39.73                                 |   |                                 |
| Granted   |           |  |   |                                 |
| Forfeited   | (16,527)  | 38.27                                    |   |                                 |
| Expired   | (24,149)  | 39.63                                    |   |                                 |
| Exercised   | (2,172)   | 37.21                                    |   |                                 |
| <b>Outstanding at December 31, 2010</b>                 | 1,710,108 | \$ 39.71                                 | 6.2 years   | \$ 1,019                        |
| <b>Exercisable at December 31, 2010</b>                 | 1,706,227 | \$ 39.71                                 | 6.2 years   | \$ 1,012                        |
| <b>Vested and expected to vest at December 31, 2010</b> | 1,275,514 | \$ 39.97                                 | 5.9 years   | \$ 544                          |

Additional information about stock options and SARs exercises is presented below.

| <i>(In thousands)</i>                                | <b>2010</b>      | 2009     | 2008      |
|--|------------------|----------|-----------|
| Intrinsic value of options and SARs exercised        | <b>\$ 7,005</b>  | \$ 3,249 | \$ 10,006 |
| Cash received from options and SARs exercised        | <b>\$ 10,563</b> | \$ 4,729 | \$ 15,186 |
| Tax benefit realized from options and SARs exercised | <b>\$ 1,042</b>  | \$ 636   | \$ 1,745  |

As of December 31, 2010, there was \$10.6 million of unrecognized compensation cost (net of estimated forfeitures) related to unvested options, SARs and stock awards. That cost is expected to be recognized over a weighted average period of 3.3 years.

The Company has a directors stock purchase plan whereby outside directors of the Company and its subsidiaries may elect to use their directors' fees to purchase Company stock at market value each month end. Remaining shares available for issuance under this plan were 64,277 at December 31, 2010. In 2010, 20,175 shares were purchased at an average price of \$37.03 and in 2009, 23,352 shares were purchased at an average price of \$32.45.

\* All share and per share amounts in this note have been restated for the 5% stock dividend distributed in 2010.

## 12. Comprehensive Income

Comprehensive income is the total of net income and all other non-owner changes in equity. Items recognized under accounting standards as components of comprehensive income are displayed in the consolidated statements of changes in equity, and additional information is presented below about the Company's components of other comprehensive income.

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 on other-than-temporary impairment on debt securities. Under this guidance, credit-related losses on debt securities with other-than-temporary impairment 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 other-than-temporary impairment (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



**Table of Contents**

included as part of other comprehensive income in that period or earlier periods. The reclassification amounts and the related income tax expense or benefit are shown 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>2010</b>      | 2009       | 2008        |
|--|------------------|------------|-------------|
| <b>Available for sale debt securities for which OTTI has been recognized:</b>      |                  |            |             |
| Unrealized holding gains subsequent to initial OTTI recognition                    | \$ 22,973        | \$ 12,251  | \$          |
| Income tax expense   | <b>(8,730)</b>   | (4,655)    |             |
| <b>Net unrealized gains</b>  | <b>14,243</b>    | 7,596      |             |
| <b>Other available for sale investment securities:</b>                             |                  |            |             |
| Unrealized holding gains (losses)  | <b>6,412</b>     | 150,443    | (101,968)   |
| Income tax (expense) benefit on unrealized gains/losses                            | <b>(2,470)</b>   | (57,152)   | 38,684      |
| Reclassification adjustment for (gains) losses realized and included in net income | <b>(3,488)</b>   | (322)      | (5,201)     |
| Reclassification adjustment for tax expense (benefit) on realized gains/losses     | <b>1,359</b>     | 106        | 2,040       |
| <b>Net unrealized gains (losses)</b>   | <b>1,813</b>     | 93,075     | (66,445)    |
| <b>Prepaid pension cost:</b>   |                  |            |             |
| Amortization of accumulated pension loss   | <b>2,208</b>     | 2,990      | 107         |
| Net gain (loss) arising during period  | <b>(786)</b>     | 951        | (26,544)    |
| Income tax (expense) benefit on change in pension loss                             | <b>(540)</b>     | (1,476)    | 10,046      |
| <b>Change in pension loss</b>  | <b>882</b>       | 2,465      | (16,391)    |
| <b>Other comprehensive income (loss)</b>   | <b>\$ 16,938</b> | \$ 103,136 | \$ (82,836) |

The end of period components of accumulated other comprehensive income (loss) are shown in the table below. At December 31, 2010, accumulated other comprehensive income was \$63.3 million, net of tax. It was comprised of

\$7.5 million in unrealized holding losses on available for sale debt securities for which OTTI has been recorded, \$87.8 million in unrealized holding gains on other available for sale securities, and \$17.0 million in accumulated pension loss.

| <i>(In thousands)</i>                     | Unrealized<br>Gains (Losses)<br>on Securities | Pension<br>Loss    | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) |
|---|---|--------------------|--|
| Balance at December 31, 2008              | \$ (36,412)                                   | \$ (20,317)        | \$ (56,729)  |
| Current period other comprehensive income | 100,671                                       | 2,465              | 103,136  |
| Balance at December 31, 2009              | 64,259  | (17,852)           | 46,407   |
| Current period other comprehensive income | 16,056  | 882                | 16,938   |
| <b>Balance at December 31, 2010</b>       | <b>\$ 80,315</b>                              | <b>\$ (16,970)</b> | <b>\$ 63,345</b>                                       |

**Table of Contents**

**13. Segments**

The Company segregates financial information for use in assessing its performance and allocating resources among three operating segments. The Consumer segment includes consumer deposits, consumer finance, consumer debit and credit cards, and student loans. The Commercial segment, which includes Small Business accounts, provides corporate lending, leasing, merchant and commercial bank card products, and international services, as well as business, government deposit and cash management services. The Wealth segment provides traditional trust and estate tax planning services, brokerage services, and advisory and discretionary investment management services, and includes Private Banking accounts. The Wealth segment also includes the Capital Markets Group, which sells fixed-income securities and provides investment safekeeping and bond accounting services.

The Company's business line reporting system derives segment information 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. Income and expense that directly relate to segment operations are recorded in the segment when incurred. Expenses that indirectly support the segments are allocated based on the most appropriate method available.

The Company uses a funds transfer pricing method to value funds used (e.g., loans, fixed assets, and cash) and funds provided (e.g., deposits, borrowings, and equity) by the business segments and their components. This process assigns a specific value to each new source or use of funds with a maturity, based on current LIBOR interest rates, thus determining an interest spread at the time of the transaction. Non-maturity assets and liabilities are assigned to LIBOR based funding pools. This provides an accurate means of valuing fund sources and uses in a varying interest rate environment. In early 2010, the Company determined that the internal interest rate ascribed to business units for providing non-contractual deposit funds should be adjusted to make it more reactive to market changes and reflect recent economic conditions. The resulting change to segment net interest income lowered total segment contribution and redistributed income among segments. The information for 2009 in the table below has been revised to reflect the lower rate environment during that year.

**Table of Contents**

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

**Segment Income Statement Data**

| <i>(In thousands)</i>                    | Consumer   | Commercial | Wealth    | Segment<br>Totals | Other/<br>Elimination | Consolidated<br>Totals |
|--|------------|------------|-----------|-------------------|-----------------------|------------------------|
| <b>Year ended December 31,<br/>2010:</b> |            |            |           |                   |                       |                        |
| Net interest income                      | \$ 311,231 | \$ 259,296 | \$ 41,075 | \$ 611,602        | \$ 34,330             | \$ 645,932             |
| Provision for loan losses                | (70,633)   | (24,825)   | (1,263)   | (96,721)          | (3,279)               | (100,000)              |
| Non-interest income                      | 157,903    | 131,954    | 116,095   | 405,952           | (841)                 | 405,111                |
| Investment securities<br>losses, net     |            |            |           |                   | (1,785)               | (1,785)                |
| Non-interest expense                     | (287,359)  | (205,069)  | (106,438) | (598,866)         | (32,268)              | (631,134)              |
| Income (loss) before<br>income taxes     | \$ 111,142 | \$ 161,356 | \$ 49,469 | \$ 321,967        | \$ (3,843)            | \$ 318,124             |
| <b>Year ended December 31,<br/>2009:</b> |            |            |           |                   |                       |                        |
| Net interest income                      | \$ 331,607 | \$ 243,083 | \$ 40,691 | \$ 615,381        | \$ 20,121             | \$ 635,502             |
| Provision for loan losses                | (84,019)   | (54,230)   | (520)     | (138,769)         | (21,928)              | (160,697)              |
| Non-interest income                      | 163,150    | 114,637    | 114,445   | 392,232           | 4,027                 | 396,259                |
| Investment securities<br>losses, net     |            |            |           |                   | (7,195)               | (7,195)                |
| Non-interest expense                     | (302,505)  | (191,628)  | (106,370) | (600,503)         | (21,234)              | (621,737)              |
| Income (loss) before<br>income taxes     | \$ 108,233 | \$ 111,862 | \$ 48,246 | \$ 268,341        | \$ (26,209)           | \$ 242,132             |
| <b>Year ended December 31,<br/>2008:</b> |            |            |           |                   |                       |                        |
| Net interest income                      | \$ 323,568 | \$ 203,961 | \$ 37,174 | \$ 564,703        | \$ 28,036             | \$ 592,739             |
| Provision for loan losses                | (56,639)   | (13,526)   | (265)     | (70,430)          | (38,470)              | (108,900)              |
| Non-interest income                      | 146,295    | 107,445    | 113,879   | 367,619           | 8,093                 | 375,712                |
| Investment securities gains,<br>net      |            |            |           |                   | 30,294                | 30,294                 |
| Non-interest expense                     | (285,796)  | (180,779)  | (131,710) | (598,285)         | (17,095)              | (615,380)              |

|                                   |            |            |           |            |           |            |
|-----------------------------------|------------|------------|-----------|------------|-----------|------------|
| Income (loss) before income taxes | \$ 127,428 | \$ 117,101 | \$ 19,078 | \$ 263,607 | \$ 10,858 | \$ 274,465 |
|-----------------------------------|------------|------------|-----------|------------|-----------|------------|

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.

### Segment Balance Sheet Data

| <i>(In thousands)</i>                | Consumer     | Commercial   | Wealth     | Segment Totals | Other/<br>Elimination | Consolidated Totals |
|--------------------------------------|--------------|--------------|------------|----------------|-----------------------|---------------------|
| <b>Average balances for 2010:</b>    |              |              |            |                |                       |                     |
| Assets                               | \$ 3,445,052 | \$ 5,703,714 | \$ 720,226 | \$ 9,868,992   | \$ 8,367,007          | \$ 18,235,999       |
| Loans, including held for sale       | 3,338,327    | 5,558,648    | 671,163    | 9,568,138      | 489,024               | 10,057,162          |
| Goodwill and other intangible assets | 77,515       | 59,816       | 746        | 138,077        |                       | 138,077             |
| Deposits                             | 8,290,834    | 4,102,458    | 1,881,692  | 14,274,984     | 87,985                | 14,362,969          |
| <b>Average balances for 2009:</b>    |              |              |            |                |                       |                     |
| Assets                               | \$ 3,891,311 | \$ 6,232,582 | \$ 716,002 | \$ 10,839,895  | \$ 6,779,308          | \$ 17,619,203       |
| Loans, including held for sale       | 3,772,374    | 6,099,415    | 683,763    | 10,555,552     | 471,898               | 11,027,450          |
| Goodwill and other intangible assets | 80,071       | 60,599       | 746        | 141,416        |                       | 141,416             |
| Deposits                             | 8,287,307    | 3,518,042    | 1,980,511  | 13,785,860     | 35,302                | 13,821,162          |

The above segment balances include only those items directly associated with the segment. The Other/Elimination column includes unallocated bank balances not associated with a segment (such as investment securities and federal funds sold), balances relating to certain other administrative and corporate functions, and eliminations between segment and non-segment balances. This column also includes the resulting effect of allocating such items as float, deposit reserve and capital for the purpose of computing the cost or credit for funds used/provided.

**Table of Contents**

The Company's reportable segments are strategic lines of business that offer different products and services. They are managed separately because each line services a specific customer need, requiring different performance measurement analyses and marketing strategies. The performance measurement of the 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.

**14. Common Stock**

On December 20, 2010, the Company distributed a 5% stock dividend on its \$5 par common stock for the seventeenth consecutive year. All per share data in this report has been restated to reflect the stock dividend.

Basic income per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted income per share gives effect to all dilutive potential common shares that were outstanding during the year. Presented below is a summary of the components used to calculate basic and diluted income per share, which have been restated for all stock dividends.

The Company applies the two-class method of computing income per share. Under current guidance, 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 11 on Stock-Based Compensation.

| <i>(In thousands, except per share data)</i>              | <b>2010</b>       | 2009       | 2008       |
|---|-------------------|------------|------------|
| <b>Basic income per common share:</b>                     |                   |            |            |
| Net income attributable to Commerce Bancshares, Inc.      | \$ <b>221,710</b> | \$ 169,075 | \$ 188,655 |
| Less income allocated to unvested restricted stockholders | <b>1,208</b>      | 741        | 592        |
| Net income available to common stockholders               | \$ <b>220,502</b> | \$ 168,334 | \$ 188,063 |
| Distributed income  | \$ <b>77,796</b>  | \$ 74,384  | \$ 71,829  |
| Undistributed income                                      | \$ <b>142,706</b> | \$ 93,950  | \$ 116,234 |
| Weighted average common shares outstanding                | <b>86,977</b>     | 85,217     | 83,154     |
| Distributed income per share                              | \$ <b>.90</b>     | \$ .88     | \$ .86     |
| Undistributed income per share                            | <b>1.64</b>       | 1.10       | 1.40       |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|   |            |            |            |
|---|------------|------------|------------|
| Basic income per common share   | \$ 2.54    | \$ 1.98    | \$ 2.26    |
| <b>Diluted income per common share:</b>   |            |            |            |
| Net income attributable to Commerce Bancshares, Inc.  | \$ 221,710 | \$ 169,075 | \$ 188,655 |
| Less income allocated to unvested restricted stockholders   | 1,204      | 740        | 589        |
| Net income available to common stockholders   | \$ 220,506 | \$ 168,335 | \$ 188,066 |
| Distributed income  | \$ 77,796  | \$ 74,384  | \$ 71,829  |
| Undistributed income  | \$ 142,710 | \$ 93,951  | \$ 116,237 |
| Weighted average common shares outstanding  | 86,977     | 85,217     | 83,154     |
| 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 | 405        | 334        | 665        |
| Weighted average diluted common shares outstanding  | 87,382     | 85,551     | 83,819     |
| Distributed income per share  | \$ .89     | \$ .87     | \$ .86     |
| Undistributed income per share  | 1.63       | 1.10       | 1.38       |
| Diluted income per common share   | \$ 2.52    | \$ 1.97    | \$ 2.24    |

**Table of Contents**

The diluted income per common share computation for the years ended December 31, 2010, 2009 and 2008 excludes 1.7 million, 2.8 million and 1.7 million, respectively, in unexercised stock options and SARs because their inclusion would have been anti-dilutive to income per share.

The table below shows activity in the outstanding shares of the Company's common stock during the past three years. Shares in the table below are presented on an historical basis and have not been restated for the annual 5% stock dividends.

| <i>(In thousands)</i>                              | <b>Years Ended December 31</b> |        |        |
|--|--------------------------------|--------|--------|
|  | <b>2010</b>                    | 2009   | 2008   |
| Shares outstanding at January 1                    | <b>83,008</b>                  | 75,791 | 71,796 |
| Issuance of stock:                                 |                                |        |        |
| Awards and sales under employee and director plans | <b>603</b>                     | 394    | 620    |
| Stock offering                                     |                                | 2,895  |        |
| 5% stock dividend                                  | <b>4,122</b>                   | 3,949  | 3,607  |
| Purchases of treasury stock                        | <b>(1,103)</b>                 | (16)   | (231)  |
| Other  | <b>(6)</b>                     | (5)    | (1)    |
| <b>Shares outstanding at December 31</b>           | <b>86,624</b>                  | 83,008 | 75,791 |

The Company maintains a treasury stock buyback program authorized by its Board of Directors. At December 31, 2010, 1,758,578 shares were available for purchase under the current Board authorization.

**15. Regulatory Capital Requirements**

The Company is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and additional discretionary actions by regulators that could have a direct material effect on the Company's financial statements. The regulations require the Company to meet specific capital adequacy guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios of Tier I capital to total average assets (leverage ratio), and minimum ratios of Tier I and Total capital to risk-weighted assets (as defined). To meet minimum, adequately capitalized regulatory requirements, an institution must maintain a Tier I capital ratio of 4.00%, a Total capital ratio of 8.00% and a leverage ratio of 4.00%. The minimum required ratios for well-capitalized banks (under prompt corrective action provisions) are 6.00% for Tier I capital, 10.00% for Total capital and 5.00% for the leverage ratio.





**Table of Contents**

The following tables show the capital amounts and ratios for the Company (on a consolidated basis) and the Bank, together with the minimum and well-capitalized capital requirements, at the last two year ends.

| <i>(Dollars in thousands)</i>  | Actual       |        | Minimum<br>Capital Requirement |       | Well-Capitalized<br>Capital Requirement |        |
|--|--------------|--------|--------------------------------|-------|---|--------|
|  | Amount       | Ratio  | Amount                         | Ratio | Amount                                  | Ratio  |
| <b>December 31, 2010:</b>  |              |        |                                |       |   |        |
| <b>Total Capital (to risk-weighted assets):</b>                                |              |        |                                |       |   |        |
| Commerce Bancshares, Inc. (consolidated)                                       | \$ 2,002,646 | 15.75% | \$ 1,017,429                   | 8.00% | N.A.                                    | N.A.   |
| Commerce Bank, N.A.  | 1,762,382    | 14.03  | 1,004,781                      | 8.00  | \$ 1,255,977                            | 10.00% |
| <b>Tier I Capital (to risk-weighted assets):</b>                               |              |        |                                |       |   |        |
| Commerce Bancshares, Inc. (consolidated)                                       | \$ 1,828,965 | 14.38% | \$ 508,715                     | 4.00% | N.A.                                    | N.A.   |
| Commerce Bank, N.A.  | 1,604,873    | 12.78  | 502,391                        | 4.00  | \$ 753,586                              | 6.00%  |
| <b>Tier I Capital (to adjusted quarterly average assets): (Leverage Ratio)</b> |              |        |                                |       |   |        |
| Commerce Bancshares, Inc. (consolidated)                                       | \$ 1,828,965 | 10.17% | \$ 719,411                     | 4.00% | N.A.                                    | N.A.   |
| Commerce Bank, N.A.  | 1,604,873    | 9.00   | 713,230                        | 4.00  | \$ 891,538                              | 5.00%  |
| <b>December 31, 2009:</b>  |              |        |                                |       |   |        |
| <b>Total Capital (to risk-weighted assets):</b>                                |              |        |                                |       |   |        |
| Commerce Bancshares, Inc. (consolidated)                                       | \$ 1,885,978 | 14.39% | \$ 1,048,476                   | 8.00% | N.A.                                    | N.A.   |
| Commerce Bank, N.A.  | 1,658,312    | 12.83  | 1,034,224                      | 8.00  | \$ 1,292,780                            | 10.00% |
| <b>Tier I Capital (to risk-weighted assets):</b>                               |              |        |                                |       |   |        |
| Commerce Bancshares, Inc. (consolidated)                                       | \$ 1,708,901 | 13.04% | \$ 524,238                     | 4.00% | N.A.                                    | N.A.   |
| Commerce Bank, N.A.  | 1,496,295    | 11.57  | 517,112                        | 4.00  | \$ 775,668                              | 6.00%  |
| <b>Tier I Capital (to adjusted quarterly average assets):</b>                  |              |        |                                |       |   |        |

**(Leverage Ratio)**

|   |              |       |            |       |            |       |
|---|--------------|-------|------------|-------|------------|-------|
| Commerce Bancshares, Inc.<br>(consolidated) | \$ 1,708,901 | 9.58% | \$ 713,619 | 4.00% | N.A.       | N.A.  |
| Commerce Bank, N.A.                         | 1,496,295    | 8.43  | 710,119    | 4.00  | \$ 887,649 | 5.00% |

At December 31, 2010, the Company met all capital requirements to which it is subject, and the Bank's capital position exceeded the regulatory definition of well-capitalized.

**16. 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).

## **Table of Contents**

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

Valuation methods and inputs, by class of security:

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

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

#### *Government-sponsored enterprise obligations*

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

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

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

## **Table of Contents**

### *Mortgage and asset-backed securities*

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

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

### *Other debt securities*

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

### *Equity securities*

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

At December 31, 2010, the Company held certain auction rate securities in its available for sale portfolio, totaling \$150.1 million at fair value. The auction process by which the auction rate securities are normally priced has not functioned since 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 auction rate securities 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.

**Table of Contents**

*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 a proprietary model whose significant inputs are readily observable market parameters, primarily yield curves. The results of the model are constantly validated through comparison to active trading in the marketplace. These fair value measurements are classified as Level 2.

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

The fair values of mortgage loan commitments and forward sales contracts on the associated loans are based on quoted prices for similar loans in the secondary market. However, these prices are adjusted by a factor which considers the likelihood that a commitment will ultimately result in a closed loan. This estimate is based on the Company's historical data and its judgment about future economic trends. Based on the unobservable nature of this adjustment, these measurements are classified as Level 3.

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

*Assets held in trust*

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



**Table of Contents**

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

|  | 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) |
| <i>(In thousands)</i>                          |                  |  |   |   |
| <b>As of December 31, 2010</b>                 |                  |  |   |   |
| <b>Assets:</b>                                 |                  |  |   |   |
| Available for sale securities:                 |                  |  |   |   |
| U.S. government and federal agency obligations | \$ 455,537       | \$ 448,087   | \$ 7,450                                      | \$  |
| Government-sponsored enterprise obligations    | 201,895          |  | 201,895                                       |   |
| State and municipal obligations                | 1,119,485        |  | 969,396                                       | 150,089                                   |
| Agency mortgage-backed securities              | 2,491,199        |  | 2,491,199                                     |   |
| Non-agency mortgage-backed securities          | 455,790          |  | 455,790                                       |   |
| Other asset-backed securities                  | 2,354,260        |  | 2,354,260                                     |   |
| Other debt securities                          | 176,964          |  | 176,964                                       |   |
| Equity securities                              | 39,173           | 22,900   | 16,273  |   |
| Trading securities                             | 11,710           |  | 11,710  |   |
| Private equity investments                     | 53,860           |  |   | 53,860                                    |
| Derivatives*                                   | 18,823           |  | 18,288  | 535                                       |
| Assets held in trust                           | 4,213            | 4,213  |   |   |
| <b>Total assets</b>                            | <b>7,382,909</b> | <b>475,200</b>   | <b>6,703,225</b>                              | <b>204,484</b>                            |
| <b>Liabilities:</b>                            |                  |  |   |   |
| Derivatives*                                   | 19,584           |  | 19,401  | 183                                       |
| <b>Total liabilities</b>                       | <b>\$ 19,584</b> | <b>\$</b>  | <b>\$ 19,401</b>                              | <b>\$ 183</b>                             |
| <b>As of December 31, 2009</b>                 |                  |  |   |   |
| <b>Assets:</b>                                 |                  |  |   |   |
| Available for sale securities:                 |                  |  |   |   |
| U.S. government and federal agency obligations | \$ 447,038       | \$ 447,038   | \$  | \$  |
| Government-sponsored enterprise obligations    | 165,814          |  | 165,814                                       |   |

Edgar Filing: COMMERCE BANCSHARES INC /MO/ - Form 10-K

|                                       |                  |                |                  |                |
|---------------------------------------|------------------|----------------|------------------|----------------|
| 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 18.

**Table of Contents**

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 year ended December 31, 2010:</b>   |   |                                  |             |            |
| Balance at January 1, 2010   | \$ 167,836  | \$ 44,827                        | \$ 108      | \$ 212,771 |
| Total gains or losses (realized/unrealized):   |   |                                  |             |            |
| Included in earnings   |   | (156)                            | 375         | 219        |
| Included in other comprehensive income   | (9,460)   |                                  |             | (9,460)    |
| Purchases, issuances, and settlements, net   | (8,287)   | 9,189                            | (131)       | 771        |
| Balance at December 31, 2010   | \$ 150,089  | \$ 53,860                        | \$ 352      | \$ 204,301 |
| Total gains or losses for the annual period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2010 | \$  | \$ (44)                          | \$ 702      | \$ 658     |
| <b>For the year ended December 31, 2009:</b>   |   |                                  |             |            |
| Balance at January 1, 2009   | \$ 167,996  | \$ 49,494                        | \$ 64       | \$ 217,554 |
| Total gains or losses (realized/unrealized):   |   |                                  |             |            |
| Included in earnings   |   | (4,791)                          | 99          | (4,692)    |
| Included in other comprehensive income   | 4,496   |                                  |             | 4,496      |
| Purchases, issuances, and settlements, net   | (4,656)   | 124                              | (55)        | (4,587)    |
| Balance at December 31, 2009   | \$ 167,836  | \$ 44,827                        | \$ 108      | \$ 212,771 |
| Total gains or losses for the annual period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2009 | \$  | \$ (4,791)                       | \$ 223      | \$ (4,568) |

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-Interest<br>Income | Investment<br>Securities Gains<br>(Losses),<br>Net | Total      |
|---|------------------------|---------------------------------|--|------------|
| <b>For the year ended December 31, 2010:</b>  |                        |                                 |  |            |
| Total gains or losses included in earnings  | \$ 274                 | \$ 101                          | \$ (156)   | \$ 219     |
| Change in unrealized gains or losses relating to assets still held at December 31, 2010 | \$ 482                 | \$ 220                          | \$ (44)  | \$ 658     |
| <b>For the year ended December 31, 2009:</b>  |                        |                                 |  |            |
| Total gains or losses included in earnings  | \$ 83                  | \$ 16                           | \$ (4,791)   | \$ (4,692) |
| Change in unrealized gains or losses relating to assets still held at December 31, 2009 | \$ 207                 | \$ 16                           | \$ (4,791)   | \$ (4,568) |

**Table of Contents****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 December 31, 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 has historically consisted primarily of student loans, and to a lesser extent, residential real estate loans. As mentioned in Note 3 on Loans and Allowance for Loan Losses, during 2010 most of the Company's student loan portfolio was sold under contract to the Federal Department of Education and various student loan agencies. Since 2008, when the secondary market for student loans was disrupted by liquidity concerns, several agencies have been unable to consistently purchase loans under existing contractual terms. Loans under contract to these agencies 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 2010, \$191 thousand of additional impairment was recorded on certain loans based on market indications, while \$450 thousand of the reserve was reversed as the related loans were sold. The fair value of the student loan portfolio for which performance concern exists was \$12.1 million at December 31, 2010. The measurement of fair value for other 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

**Table of Contents**

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*

During 2010, the Company recorded an impairment loss on an office building, which formerly housed its check processing operations, in addition to losses on several branch facilities. In accordance with ASC 360-10-35, they were written down to estimated fair value, or estimated fair value less cost to sell if the property is held for sale. 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.

**Table of Contents**

For assets measured at fair value on a nonrecurring basis during 2010 and 2009, and still held as of December 31, 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 December 31, 2010 and 2009.

|                                | Fair Value | Fair Value Measurements Using  |   |  | Total Gains<br>(Losses) |
|--------------------------------|------------|--|---|--|-------------------------|
|                                |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 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 December 31, 2010</b> |            |  |   |  |                         |
| Loans                          | \$ 51,157  | \$   | \$  | \$ 51,157  | \$ (17,134)             |
| Loans held for sale            | 5,125      |  |   | 5,125  | (191)                   |
| Private equity investments     | 960        |  |   | 960  | (100)                   |
| Mortgage servicing rights      | 1,325      |  |   | 1,325  | (72)                    |
| Foreclosed assets              | 8,484      |  |   | 8,484  | (4,004)                 |
| Long-lived assets              | 6,372      |  |   | 6,372  | (2,018)                 |
| <b>As of December 31, 2009</b> |            |  |   |  |                         |
| Loans                          | \$ 66,773  | \$   | \$  | \$ 66,773  | \$ (41,468)             |
| Private equity investments     | 1,880      |  |   | 1,880  | (1,170)                 |
| Mortgage servicing rights      | 1,579      |  |   | 1,579  | 37                      |
| Foreclosed assets              | 2,770      |  |   | 2,770  | (612)                   |

**17. 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 values 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 16 on Fair Value Measurements. A schedule of available for sale investment securities by category and maturity is provided in Note 4 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.

**Table of Contents***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 the preceding note 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>   | 2010            |                      | 2009            |                      |
|---|-----------------|----------------------|-----------------|----------------------|
|   | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| <b>Financial Assets</b>   |                 |                      |                 |                      |
| Loans, including held for sale  | \$ 9,474,733    | \$ 9,482,631         | \$ 10,490,327   | \$ 10,513,232        |
| Available for sale investment securities  | 7,294,303       | 7,294,303            | 6,340,975       | 6,340,975            |
| Trading securities  | 11,710          | 11,710               | 10,335          | 10,335               |
| Non-marketable securities   | 103,521         | 103,521              | 122,078         | 122,078              |
| Short-term federal funds sold and securities purchased under agreements to resell | 10,135          | 10,135               | 22,590          | 22,590               |
| Long-term securities purchased under agreements to resell                         | 450,000         | 454,783              |                 |                      |
| Interest earning deposits with banks  | 122,076         | 122,076              | 24,118          | 24,118               |
| Cash and due from banks   | 328,464         | 328,464              | 417,126         | 417,126              |
| Accrued interest receivable   | 62,512          | 62,512               | 74,553          | 74,553               |
| Derivative instruments  | 18,823          | 18,823               | 17,984          | 17,984               |

**Financial Liabilities**

|  |              |              |              |              |
|--|--------------|--------------|--------------|--------------|
| Non-interest bearing demand deposits                                       | \$ 2,150,725 | \$ 2,150,725 | \$ 1,793,816 | \$ 1,793,816 |
| Savings, interest checking and money market deposits                       | 10,190,134   | 10,190,134   | 9,202,916    | 9,202,916    |
| Time open and C.D. s   | 2,744,162    | 2,761,796    | 3,213,719    | 3,243,627    |
| Federal funds purchased and securities sold under agreements to repurchase | 982,827      | 987,472      | 1,103,191    | 1,102,995    |
| Other borrowings   | 112,273      | 122,514      | 736,062      | 757,365      |
| Accrued interest payable   | 12,108       | 12,108       | 21,570       | 21,570       |
| Derivative instruments   | 19,584       | 19,584       | 18,610       | 18,610       |

**Table of Contents***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. These instruments are also referenced in Note 19 on Commitments, Contingencies and Guarantees.

*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.

**18. 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.

| <i>(In thousands)</i>                | <b>December 31</b> |                   |
|--------------------------------------|--------------------|-------------------|
|                                      | <b>2010</b>        | <b>2009</b>       |
| Interest rate swaps                  | \$ 498,071         | \$ 503,530        |
| Interest rate caps                   | 31,736             | 16,236            |
| Credit risk participation agreements | 40,661             | 53,246            |
| Foreign exchange contracts           | 25,867             | 17,475            |
| Mortgage loan commitments            | 12,125             | 9,767             |
| Mortgage loan forward sale contracts | 24,112             | 19,986            |
| <b>Total notional amount</b>         | <b>\$ 632,572</b>  | <b>\$ 620,240</b> |

The Company's mortgage banking operation makes commitments to extend fixed rate loans secured by 1-4 family residential properties, which are considered to be derivative instruments. These commitments are recognized on the balance sheet at fair value from their inception through their expiration or funding, and have an average term of 60 to 90 days. The Company's general practice is to sell such loans in the secondary market. The Company obtains forward sale contracts with investors in the secondary market in order to manage these risk positions. Most of the contracts are matched to a specific loan on a best efforts basis, in which the Company is obligated to deliver the loan only if the loan closes. The sale contracts are also accounted for as derivatives. Hedge accounting has not been applied to these activities.

The Company's foreign exchange activity involves the purchase and sale of forward foreign exchange contracts, which are commitments to purchase or deliver a specified amount of foreign currency at a specific future date. This activity enables customers involved in international business to hedge their exposure to foreign currency exchange rate fluctuations. The Company minimizes its related exposure arising from these customer transactions with offsetting contracts for the same currency and time frame. In addition, the Company uses foreign exchange contracts, to a limited extent, for trading purposes, including taking proprietary positions. Risk arises from changes in the currency exchange rate and from the potential for counterparty nonperformance. These risks are controlled by adherence to a foreign exchange trading policy which contains control limits on currency amounts, open positions, maturities and losses, and procedures for approvals, record-keeping, monitoring and reporting. Hedge accounting has not been applied to these foreign exchange activities.

Credit risk participation agreements arise when the Company contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps. The

**Table of Contents**

Company's risks and responsibilities as guarantor are further discussed in Note 19 on Commitments, Contingencies and Guarantees.

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 December 31, 2010, the Company had entered into three interest rate swaps with a notional amount of \$15.7 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 Years<br/>Ended December 31</b> |        |            |
|--|--|--------|------------|
|  | <b>2010</b>                                | 2009   | 2008       |
| Gain (loss) on interest rate swaps     | \$ (305)                                   | \$ 573 | \$ (1,035) |
| Gain (loss) on loans                   | <b>291</b>                                 | (571)  | 1,029      |
| <b>Amount of hedge ineffectiveness</b> | <b>\$ (14)</b>                             | \$ 2   | \$ (6)     |

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 December 31, 2010 was \$482.3 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, usually in the form of marketable securities, is posted by the counterparty with liability positions, in accordance with contract thresholds.

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 December 31, 2010 was \$15.9 million, for which the Company had posted collateral of \$15.1 million. Most of these features require contract settlement, which if triggered on December 31, 2010 would have required a cash disbursement of \$1.1 million, in addition to collateral posted.

The banking customer counterparties are engaged in a variety of businesses, including real estate, building materials, communications, consumer products, and manufacturing. The manufacturing group is the largest, with a combined

notional amount of 20.7% 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 \$2.9 million, based on amounts at December 31, 2010.

**Table of Contents**

The fair values of the Company's derivative instruments are shown in the table below. Information about the valuation methods used to measure fair value is provided in Note 16 on Fair Value Measurements.

|  | Asset Derivatives      |                  | Liability Derivatives  |                    |
|--|------------------------|------------------|------------------------|--------------------|
|  | December 31            |                  | December 31            |                    |
|  | 2010                   | 2009             | 2010                   | 2009               |
| (In thousands)   | Balance Sheet Location | Fair Value       | Balance Sheet Location | Fair Value         |
| Derivatives designated as hedging instruments:                 |                        |                  |                        |                    |
| Interest rate swaps  | Other assets           | \$ 64            | Other liabilities      | \$ (918)           |
| <b>Total derivatives designated as hedging instruments</b>     |                        | <b>\$ 64</b>     |                        | <b>\$ (918)</b>    |
| Derivatives not designated as hedging instruments:             |                        |                  |                        |                    |
| Interest rate swaps  | Other assets           | \$ 17,712        | Other liabilities      | \$ (17,799)        |
| Interest rate caps   | Other assets           | 84               | Other liabilities      | (239)              |
| Credit risk participation agreements                           | Other assets           | 140              | Other liabilities      | (239)              |
| Foreign exchange contracts                                     | Other assets           | 492              | Other liabilities      | (359)              |
| Mortgage loan commitments                                      | Other assets           | 101              | Other liabilities      | (30)               |
| Mortgage loan forward sale contracts                           | Other assets           | 434              | Other liabilities      | (23)               |
| <b>Total derivatives not designated as hedging instruments</b> |                        | <b>\$ 18,823</b> |                        | <b>\$ (18,425)</b> |
| <b>Total derivatives</b>                                       |                        | <b>\$ 18,823</b> |                        | <b>\$ (19,584)</b> |



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

|  | Location of Gain or<br>(Loss) Recognized in<br>Income on Derivative | Amount of Gain or (Loss) Recognized<br>in<br>Income on Derivative |               |                   |
|--|---|---|---------------|-------------------|
|  |   | <b>For the Years Ended December 31</b>                            |               |                   |
| <i>(In thousands)</i>                              |   | <b>2010</b>   | 2009          | 2008              |
| Derivatives in fair value hedging relationships:   |   |   |               |                   |
| Interest rate swaps                                | Interest and fees on loans  | \$ (305)  | \$ 573        | \$ (1,035)        |
| <b>Total</b>                                       |   | <b>\$ (305)</b>   | <b>\$ 573</b> | <b>\$ (1,035)</b> |
| Derivatives not designated as hedging instruments: |   |   |               |                   |
| Interest rate swaps                                | Other non-interest income   | \$ 1,202  | \$ 360        | \$ 1,519          |
| Interest rate caps                                 | Other non-interest income   | 32  | 11            |                   |
| Credit risk participation agreements               | Other non-interest income   | 101   | 16            | 19                |
| Foreign exchange contracts                         | Other non-interest income   | 12  | 130           | 35                |
| Mortgage loan commitments                          | Loan fees and sales   | 43  | (164)         | 184               |
| Mortgage loan forward sale contracts               | Loan fees and sales   | 231   | 247           | (58)              |
| <b>Total</b>                                       |   | <b>\$ 1,621</b>   | <b>\$ 600</b> | <b>\$ 1,699</b>   |

**Table of Contents****19. Commitments, Contingencies and Guarantees**

The Company leases certain premises and equipment, all of which were classified as operating leases. The rent expense under such arrangements amounted to \$6.2 million, \$6.3 million and \$6.1 million in 2010, 2009 and 2008, respectively. A summary of minimum lease commitments follows:

| <i>(In thousands)</i>               | Type of Property |           |                  |
|-------------------------------------|------------------|-----------|------------------|
|                                     | Real<br>Property | Equipment | Total            |
| Year Ended December 31              |                  |           |                  |
| 2011                                | \$ 5,455         | \$ 376    | \$ 5,831         |
| 2012                                | 4,602            | 195       | 4,797            |
| 2013                                | 4,294            | 69        | 4,363            |
| 2014                                | 3,550            |           | 3,550            |
| 2015                                | 2,630            |           | 2,630            |
| After                               | 19,694           |           | 19,694           |
| <b>Total minimum lease payments</b> |                  |           | <b>\$ 40,865</b> |

All leases expire prior to 2055. It is expected that in the normal course of business, leases that expire will be renewed or replaced by leases on other properties; thus, the future minimum lease commitments are not expected to be less than the amounts shown for 2011.

The Company engages in various transactions and commitments with off-balance sheet risk in the normal course of business to meet customer financing needs. The Company uses the same credit policies in making the commitments and conditional obligations described below as it does for on-balance sheet instruments. The following table summarizes these commitments at December 31:

| <i>(In thousands)</i>                            | 2010         | 2009         |
|--|--------------|--------------|
| Commitments to extend credit:                    |              |              |
| Credit card                                      | \$ 3,395,261 | \$ 3,285,041 |
| Other  | 3,977,542    | 3,753,526    |
| Standby letters of credit, net of participations | 338,724      | 404,144      |
| Commercial letters of credit                     | 14,258       | 21,329       |

Commitments to extend credit are legally binding agreements to lend to a borrower providing there are no violations of any conditions established in the contract. As many of the commitments are expected to expire without being drawn upon, the total commitment does not necessarily represent future cash requirements. Refer to Note 3 on Loans and Allowance for Loan Losses for further discussion.

Commercial letters of credit act as a means of ensuring payment to a seller upon shipment of goods to a buyer. The majority of commercial letters of credit issued are used to settle payments in international trade. Typically, letters of credit require presentation of documents which describe the commercial transaction, evidence shipment, and transfer title.

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 customer, the Company has rights to the underlying collateral, which could include commercial real estate, physical plant and property, inventory, receivables, cash and marketable securities.

At December 31, 2010, the Company had recorded a liability in the amount of \$3.4 million, representing the carrying value of the guarantee obligations associated with the standby letters of credit. This amount will

**Table of Contents**

be amortized into income over the life of the commitment. Commitments outstanding under these letters of credit, which represent the maximum potential future payments guaranteed by the Company, were \$338.7 million at December 31, 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 2010, purchases and sales of tax credits amounted to \$37.6 million and \$43.8 million, respectively. At December 31, 2010, the Company had outstanding purchase commitments totaling \$131.5 million. The commitments are expected to be funded in 2011 through 2014.

The Company periodically enters into risk participation agreements (RPAs) as a guarantor to other financial institutions, in order to mitigate those institutions' credit risk associated with interest rate swaps with third parties. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. These interest rate swaps are normally collateralized (generally with real property, inventories and equipment) by the third party, which limits the credit risk associated with the Company's RPAs. The third parties usually have other borrowing relationships with the Company. The Company monitors overall borrower collateral, and at December 31, 2010, believes sufficient collateral is available to cover potential swap losses. The RPAs are carried at fair value throughout their term, with all changes in fair value, including those due to a change in the third party's creditworthiness, recorded in current earnings. The terms of the RPAs, which correspond to the terms of the underlying swaps, range from 5 to 10 years. At December 31, 2010, the liability recorded for guarantor RPAs was \$130 thousand, and the notional amount of the underlying swaps was \$40.7 million.

At December 31, 2010, the Company carried a liability of \$4.4 million representing its obligation to share certain estimated litigation costs of Visa, Inc. (Visa). An escrow account 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 in 2008 and subsequently with contributions by Visa. The Company's indemnification obligation is periodically adjusted to reflect changes in estimates of litigation costs and is reduced as funding occurs in the escrow account. The Company currently anticipates that its proportional share of eventual escrow funding will more than offset its liability related to the Visa litigation.

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. As these cases are in a very early stage, a probable outcome is presently not determinable. The Company has other lawsuits pending at December 31, 2010, arising in the normal course of business. In the opinion of management, after consultation with legal counsel, none of these suits will have a significant effect on the financial condition or results of operations of the Company.

**20. Related Parties**

The Company's Chief Executive Officer and its Vice Chairman are directors of Tower Properties Company (Tower) and, together with members of their immediate families, beneficially own approximately 75% of the outstanding stock of Tower. At December 31, 2010, Tower owned 192,345 shares of Company stock. Tower is primarily engaged in the business of owning, developing, leasing and managing real property.



**Table of Contents**

Payments from the Company and its affiliates to Tower are summarized below. The Company leases several surface parking lots owned by Tower for employee use. Other payments, with the exception of dividend payments, relate to property management services, including construction oversight, on four Company-owned office buildings and related parking garages in downtown Kansas City.

| <i>(In thousands)</i>                         | <b>2010</b>     | 2009            | 2008            |
|---|-----------------|-----------------|-----------------|
| Rent on leased parking lots                   | \$ 353          | \$ 353          | \$ 501          |
| Leasing agent fees                            | 3               | 14              | 19              |
| Operation of parking garages                  | 107             | 115             | 114             |
| Building management fees                      | 1,769           | 1,704           | 1,525           |
| Property construction management fees         | 24              | 61              | 118             |
| Dividends paid on Company stock held by Tower | 172             | 167             | 166             |
| <b>Total</b>                                  | <b>\$ 2,428</b> | <b>\$ 2,414</b> | <b>\$ 2,443</b> |

Tower has a \$13.5 million line of credit with the Bank which is subject to normal credit terms and has a variable interest rate. No loans were outstanding during the past three years under this line of credit. Letters of credit may be collateralized under this line of credit, and fees received for these letters of credit totaled \$218 thousand in 2008. From time to time, the Bank extends additional credit to Tower for construction and development projects. No construction loans were outstanding during 2010, 2009 and 2008.

Beginning in 2009, Tower leased office space in the Kansas City bank headquarters building, owned by the Company. Rent paid to the Company totaled \$69 thousand in 2010 and \$45 thousand in 2009, at \$15.50 and \$15.25 per square foot, respectively.

Directors of the Company and their beneficial interests have deposit accounts with the Bank and may be provided with cash management and other banking services, including loans, in the ordinary course of business. Such loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other unrelated persons, and did not involve more than the normal risk of collectability.

In December 2008 and at various times during 2009, the Company purchased, through market transactions, corporate bonds issued by Enterprise Rent-A-Car Company, whose Chairman and CEO is a director of the Company. The bonds, totaling \$12.9 million at book value, were sold in the public market during December 2009.

**Table of Contents****21. Parent Company Condensed Financial Statements**

Following are the condensed financial statements of Commerce Bancshares, Inc. (Parent only) for the periods indicated:

**Condensed Balance Sheets**

| <i>(In thousands)</i>                            | <b>December 31</b>  |              |
|--|---------------------|--------------|
|  | <b>2010</b>         | <b>2009</b>  |
| <b>Assets</b>                                    |                     |              |
| Investment in consolidated subsidiaries:         |                     |              |
| Banks  | <b>\$ 1,797,853</b> | \$ 1,670,328 |
| Non-banks  | <b>45,143</b>       | 43,173       |
| Cash   | <b>55</b>           | 52           |
| Securities purchased under agreements to resell  | <b>77,700</b>       | 47,525       |
| Investment securities:                           |                     |              |
| Available for sale                               | <b>101,534</b>      | 115,157      |
| Non-marketable                                   | <b>3,664</b>        | 3,911        |
| Advances to subsidiaries, net of borrowings      | <b>11,298</b>       | 13,797       |
| Income tax benefits                              |                     | 1,201        |
| Other assets                                     | <b>11,966</b>       | 14,138       |
| <b>Total assets</b>                              | <b>\$ 2,049,213</b> | \$ 1,909,282 |
| <b>Liabilities and stockholders equity</b>       |                     |              |
| Indemnification obligation                       | <b>\$ 4,432</b>     | \$ 8,837     |
| Pension obligation                               | <b>5,033</b>        | 4,650        |
| Income taxes payable                             | <b>2,456</b>        |              |
| Other liabilities                                | <b>15,305</b>       | 11,567       |
| <b>Total liabilities</b>                         | <b>27,226</b>       | 25,054       |
| Stockholders equity                              | <b>2,021,987</b>    | 1,884,228    |
| <b>Total liabilities and stockholders equity</b> | <b>\$ 2,049,213</b> | \$ 1,909,282 |

**Condensed Statements of Income**

| <i>(In thousands)</i>                                   | <b>For the Years Ended December 31</b> |            |            |
|---|--|------------|------------|
|   | <b>2010</b>                            | 2009       | 2008       |
| <b>Income</b>   |  |            |            |
| Dividends received from consolidated subsidiaries:      |  |            |            |
| Banks   | \$ 105,000                             | \$ 45,001  | \$ 75,900  |
| Non-banks   | 105                                    | 129        | 270        |
| Earnings of consolidated subsidiaries, net of dividends | 110,809                                | 128,536    | 103,618    |
| Interest and dividends on investment securities         | 12,842                                 | 1,406      | 2,326      |
| Management fees charged subsidiaries                    | 22,621                                 | 46,613     | 44,035     |
| Investment securities gains (losses)                    | (56)                                   | 1,804      | 20,857     |
| Other   | 2,092                                  | 2,538      | 642        |
| <b>Total income</b>                                     | <b>253,413</b>                         | 226,027    | 247,648    |
| <b>Expense</b>  |  |            |            |
| Salaries and employee benefits                          | 21,293                                 | 39,528     | 36,586     |
| Professional fees                                       | 2,322                                  | 3,080      | 2,698      |
| Data processing fees paid to affiliates                 | 3,180                                  | 11,337     | 11,677     |
| Indemnification obligation                              | (4,405)                                | (2,495)    | (9,619)    |
| Other   | 7,451                                  | 10,941     | 11,280     |
| <b>Total expense</b>                                    | <b>29,841</b>                          | 62,391     | 52,622     |
| Income tax expense (benefit)                            | 1,862                                  | (5,439)    | 6,371      |
| <b>Net income</b>                                       | <b>\$ 221,710</b>                      | \$ 169,075 | \$ 188,655 |



**Table of Contents****Condensed Statements of Cash Flows**

| <i>(In thousands)</i>   | <b>For the Years Ended December 31</b> |            |            |
|---|--|------------|------------|
|   | <b>2010</b>                            | 2009       | 2008       |
| <b>Operating Activities</b>   |  |            |            |
| Net income  | \$ 221,710                             | \$ 169,075 | \$ 188,655 |
| Adjustments to reconcile net income to net cash provided by operating activities:           |  |            |            |
| Earnings of consolidated subsidiaries, net of dividends                                     | (110,809)                              | (128,536)  | (103,618)  |
| Other adjustments, net  | (4,787)                                | (1,093)    | (21,257)   |
| <b>Net cash provided by operating activities</b>  | <b>106,114</b>                         | 39,446     | 63,780     |
| <b>Investing Activities</b>   |  |            |            |
| (Increase) decrease in securities purchased under agreements to resell                      | (30,175)                               | 18,900     | (66,425)   |
| Decrease in investment in subsidiaries, net   | 101                                    | 353        | 99         |
| Proceeds from sales of investment securities  | 185                                    | 11,812     | 26,653     |
| Proceeds from maturities/pay downs of investment securities                                 | 26,487                                 | 105,944    | 73,291     |
| Purchases of investment securities  | (110)                                  | (195,935)  | (13,232)   |
| (Increase) decrease in advances to subsidiaries, net  | 2,499                                  | (9,080)    | (20,425)   |
| Net (purchases) sales of equipment  | 1,629                                  | (409)      | (127)      |
| <b>Net cash provided by (used in) investing activities</b>                                  | <b>616</b>                             | (68,415)   | (166)      |
| <b>Financing Activities</b>   |  |            |            |
| Purchases of treasury stock   | (40,984)                               | (528)      | (9,490)    |
| Issuance under open market stock sale program, stock purchase and equity compensation plans | 11,310                                 | 103,641    | 15,978     |
| Net tax benefit related to equity compensation plans  | 1,178                                  | 557        | 1,928      |
| Cash dividends paid on common stock   | (78,231)                               | (74,720)   | (72,055)   |
| <b>Net cash provided by (used in) financing activities</b>                                  | <b>(106,727)</b>                       | 28,950     | (63,639)   |
| Increase (decrease) in cash   | 3                                      | (19)       | (25)       |
| Cash at beginning of year   | 52                                     | 71         | 96         |
| <b>Cash at end of year</b>  | <b>\$ 55</b>                           | \$ 52      | \$ 71      |

Dividends paid by the Parent to its shareholders were substantially provided from Bank dividends. The Bank may distribute dividends without prior regulatory approval that do not exceed the sum of net income for the current year and retained net income for the preceding two years, subject to maintenance of minimum capital requirements. The Parent charges fees to its subsidiaries for management services provided, which are allocated to the subsidiaries based primarily on total average assets. The Parent makes advances to non-banking subsidiaries and its subsidiary bank holding company. Advances are made to the Parent by its subsidiary bank holding company for investment in temporary liquid securities. Interest on such advances is based on market rates.

For the past several years, the Parent has maintained a \$20.0 million line of credit for general corporate purposes with the Bank. The line of credit is secured by marketable investment securities. The Parent did not borrow under this line during 2010 or 2009, while average borrowings were \$245 thousand during 2008.

In January 2010, several administrative functions formerly reported by the Parent were transferred to the Bank in order to present a more accurate organizational structure within the Company. Certain employee payrolls and fixed assets were transferred, and various expense allocations relating to these functions, formerly reported by the Parent, declined during the remainder of 2010.

The Parent carries the Visa indemnification obligation, discussed in Note 19, which was \$4.4 million at December 31, 2010 compared to \$8.8 million at December 31, 2009. The liability is adjusted as covered suits are settled or additional funding is made to Visa's litigation escrow account, which resulted in declines in the

## **Table of Contents**

liability of \$4.4 million in 2010 and \$2.5 million during 2009. In 2008, the Parent recorded a gain of \$22.2 million on the redemption of Visa Class B stock, which occurred in conjunction with Visa's initial public offering in March 2008.

At December 31, 2010, the fair value of available for sale investment securities held by the Parent consisted of investments of \$35.9 million in marketable common stock and \$65.7 million in non-agency mortgage-backed securities. The Parent's unrealized net gain in fair value on its investments was \$34.2 million at December 31, 2010. The corresponding net of tax unrealized gain included in stockholders' equity was \$21.2 million. Also included in stockholders' equity was an unrealized net of tax gain in fair value of investment securities held by subsidiaries, which amounted to \$59.1 million at December 31, 2010.

The Parent plans to fund an additional \$23.2 million relating to private equity investments over the next several years. The investments are made directly by the Parent and through non-bank subsidiaries.

### **Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

There were no changes in or disagreements with accountants on accounting and financial disclosure.

### **Item 9a. CONTROLS AND PROCEDURES**

#### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

#### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

The Company's internal control over financial reporting as of December 31, 2010 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which follows.

#### **Changes in Internal Control Over Financial Reporting**

No change in the Company's internal control over financial reporting occurred that has materially affected, or is reasonably likely to materially affect, such controls during the last quarter of the period covered by this report.

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders  
Commerce Bancshares, Inc.:

We have audited Commerce Bancshares, Inc. and subsidiaries (the Company) internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Commerce Bancshares, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in equity, and cash flows for each of the years in the three-year period ended December 31, 2010, and our report dated February 25, 2011 expressed an unqualified opinion on those consolidated financial statements.

Kansas City, Missouri  
February 25, 2011



**Table of Contents**

**Item 9b. OTHER INFORMATION**

None

**PART III**

**Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by Items 401, 405 and 407(c)(3), (d)(4) and (d)(5) of Regulation S-K regarding executive officers is included at the end of Part I under the caption Executive Officers of the Registrant and under the captions Election of the 2014 Class of Directors, Section 16(a) Beneficial Ownership Reporting Compliance, Audit Committee Report, and Committee on Governance/Directors in the definitive proxy statement, which is incorporated herein by reference.

The Company's financial officer code of ethics for the chief executive officer and senior financial officers of the Company is available at [www.commercebank.com](http://www.commercebank.com). Amendments to, and waivers of, the code of ethics are posted on this Web site.

**Item 11. EXECUTIVE COMPENSATION**

The information required by Items 402 and 407(e)(4) and (e)(5) of Regulation S-K regarding executive compensation is included under the captions Executive Compensation, Compensation and Human Resources Committee Report, and Compensation and Human Resources Committee Interlocks and Insider Participation in the definitive proxy statement, which is incorporated herein by reference.

**Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by Items 201(d) and 403 of Regulation S-K is covered under the captions Equity Compensation Plan Information and Security Ownership of Certain Beneficial Owners and Management in the definitive proxy statement, which is incorporated herein by reference.

**Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by Items 404 and 407(a) of Regulation S-K is covered under the captions Election of the 2014 Class of Directors and Corporate Governance in the definitive proxy statement, which is incorporated herein by reference.

**Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by Item 9(c) of Schedule 14A is included under the captions Pre-approval of Services by the External Auditor and Fees Paid to KPMG LLP in the definitive proxy statement, which is incorporated herein by reference.

**PART IV**

**Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) The following documents are filed as a part of this report:

|   | <b>Page</b> |
|---|-------------|
| (1) Financial Statements:   |             |
| <u>Consolidated Balance Sheets</u>  | 65          |
| <u>Consolidated Statements of Income</u>  | 66          |
| <u>Consolidated Statements of Cash Flows</u>  | 67          |
| <u>Consolidated Statements of Changes in Equity</u>   | 68          |
| <u>Notes to Consolidated Financial Statements</u>   | 69          |
| <u>Summary of Quarterly Statements of Income</u>  | 59          |
| (2) Financial Statement Schedules:  |             |
| All schedules are omitted as such information is inapplicable or is included in the financial statements. |             |

(b) The exhibits filed as part of this report and exhibits incorporated herein by reference to other documents are listed in the Index to Exhibits (pages E-1 through E-2).

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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 this 25th day of February 2011.

Commerce Bancshares, Inc.

By: /s/ James L. Swarts  
James L. Swarts  
*Vice President and Secretary*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 25th day of February 2011.

By: /s/ Charles G. Kim  
Charles G. Kim  
*Chief Financial Officer*

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

David W. Kemper  
(Chief Executive Officer)  
John R. Capps  
Earl H. Devanny, III  
W. Thomas Grant, II  
James B. Hebenstreit  
Jonathan M. Kemper  
Terry O. Meek  
Benjamin F. Rassieur, III  
Todd R. Schnuck  
Dan C. Simons  
Andrew C. Taylor  
Kimberly G. Walker

A majority of the Board of Directors\*

\* David W. Kemper, Director and Chief Executive Officer, and the other Directors of Registrant listed, executed a power of attorney authorizing James L. Swarts, their attorney-in-fact, to sign this report on their behalf.

By: /s/ James L. Swarts  
James L. Swarts  
*Attorney-in-Fact*





**Table of Contents**

**INDEX TO EXHIBITS**

3 Articles of Incorporation and By-Laws:

(a) Restated Articles of Incorporation, as amended, were filed in quarterly report on Form 10-Q dated August 10, 1999, and the same are hereby incorporated by reference.

(b) Restated By-Laws, as amended, were filed in current report on Form 8-K dated February 3, 2011, and the same are hereby incorporated by reference.

4 Instruments defining the rights of security holders, including indentures:

(a) Pursuant to paragraph (b)(4)(iii) of Item 601 Regulation S-K, Registrant will furnish to the Commission upon request copies of long-term debt instruments.

10 Material Contracts (Each of the following is a management contract or compensatory plan arrangement):

(a) Commerce Bancshares, Inc. Executive Incentive Compensation Plan amended and restated as of January 1, 2009 was filed in quarterly report on Form 10-Q dated August 7, 2009, and the same is hereby incorporated by reference.

(b) Commerce Bancshares, Inc. 1987 Non-Qualified Stock Option Plan amended and restated as of July 24, 2009 was filed in quarterly report on Form 10-Q dated August 7, 2009, and the same is hereby incorporated by reference.

(c) Commerce Bancshares, Inc. Stock Purchase Plan for Non-Employee Directors amended and restated as of October 4, 1996 was filed in quarterly report on Form 10-Q dated November 8, 1996, and the same is hereby incorporated by reference.

(d) Commerce Bancshares, Inc. 1996 Incentive Stock Option Plan amended and restated as of April 2001 was filed in quarterly report on Form 10-Q dated May 8, 2001, and the same is hereby incorporated by reference.

(e) Commerce Executive Retirement Plan amended and restated as of January 28, 2011.

(f) Commerce Bancshares, Inc. Restricted Stock Plan amended and restated as of July 24, 2009 was filed in quarterly report on Form 10-Q dated August 7, 2009, and the same is hereby incorporated by reference.

(g) Form of Severance Agreement between Commerce Bancshares, Inc. and certain of its executive officers entered into as of October 4, 1996 was filed in quarterly report on Form 10-Q dated November 8, 1996, and the same is hereby incorporated by reference.

(h) Trust Agreement for the Commerce Bancshares, Inc. Executive Incentive Compensation Plan amended and restated as of January 1, 2001 was filed in quarterly report on Form 10-Q dated May 8, 2001, and the same is hereby incorporated by reference.

(i) Commerce Bancshares, Inc. 2011 Compensatory Arrangement with CEO and Named Executive Officers was filed in current report on Form 8-K dated February 3, 2011, and the same is hereby incorporated by reference.

(j) Commerce Bancshares, Inc. 2005 Equity Incentive Plan amended and restated as of July 24, 2009 was filed in quarterly report on Form 10-Q dated August 7, 2009, and the same is hereby incorporated by reference.

(k) Commerce Bancshares, Inc. Notice of Grant of Stock Options and Option Agreement was filed in quarterly report on Form 10-Q dated August 5, 2005, and the same is hereby incorporated by reference.

(l) Commerce Bancshares, Inc. Restricted Stock Award Agreement, pursuant to the Restricted Stock Plan, was filed in quarterly report on Form 10-Q dated August 5, 2005, and the same is hereby incorporated by reference.

E-1

---

**Table of Contents**

(m) Commerce Bancshares, Inc. Stock Appreciation Rights Agreement and Commerce Bancshares, Inc. Restricted Stock Award Agreement, pursuant to the 2005 Equity Incentive Plan, were filed in current report on Form 8-K dated February 23, 2006, and the same are hereby incorporated by reference.

21 Subsidiaries of the Registrant

23 Consent of Independent Registered Public Accounting Firm

24 Power of Attorney

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.