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

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010
OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to
Commission File No. 0-2989

COMMERCE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Missouri (State of Incorporation)	**43-0889454** (IRS Employer Identification No.)
1000 Walnut, **Kansas City, MO** (Address of principal executive offices)	**64106** (Zip Code)

(816) 234-2000
(Registrant s telephone number, including area code)

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

Yes þ No o

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

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

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o (Do not check if a smaller reporting company)
Smaller reporting company o

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

Yes o No þ

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

Commerce Bancshares, Inc. and Subsidiaries

Form 10-Q

PART I: FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

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

LIABILITIES AND EQUITY		
Deposits:		
Non-interest bearing demand	**$ 1,752,930**	$ 1,793,816
Savings, interest checking and money market	**9,712,088**	9,202,916
Time open and C.D. s of less than $100,000	**1,607,664**	1,801,332
Time open and C.D. s of $100,000 and over	**1,318,877**	1,412,387
Total deposits	**14,391,559**	14,210,451
Federal funds purchased and securities sold under agreements to repurchase	**1,530,555**	1,103,191
Other borrowings	**337,863**	736,062
Other liabilities	**445,177**	184,580
Total liabilities	**16,705,154**	16,234,284
Commerce Bancshares, Inc. stockholders equity:		
Preferred stock, $1 par value		
Authorized and unissued 2,000,000 shares		
Common stock, $5 par value		
Authorized 100,000,000 shares; issued 83,565,412 shares in 2010 and 83,127,401 shares in 2009	**417,827**	415,637
Capital surplus	**865,246**	854,490
Retained earnings	**669,485**	568,532
Treasury stock of 60,428 shares in 2010 and 22,328 shares in 2009, at cost	**(2,323)**	(838)
Accumulated other comprehensive income	**95,204**	46,407
Total Commerce Bancshares, Inc. stockholders equity	**2,045,439**	1,884,228
Non-controlling interest	**1,166**	1,677
Total equity	**2,046,605**	1,885,905
Total liabilities and equity	**$ 18,751,759**	$ 18,120,189

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

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

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

Net income per common share diluted	**$ .67**	$ .63	**$ 1.91**	$ 1.47

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Commerce Bancshares, Inc. Shareholders						
(In thousands, except per share data)	**Common Stock**	**Capital Surplus**	**Retained Earnings**	**Treasury Stock**	**Accumulated Other Comprehensive Income (Loss)**	**Non-Controlling Interest**	**Total**
				(Unaudited)			
Balance January 1, 2010	**$ 415,637**	**$ 854,490**	**$ 568,532**	**$ (838)**	**$ 46,407**	**$ 1,677**	**$ 1,885,905**
Net income			**159,789**			**(139)**	**159,650**
Change in unrealized gain (loss) related to available for sale securities for which a portion of an other-than-temporary impairment has been recorded in earnings, net of tax					**12,469**		**12,469**
Change in unrealized gain (loss) on all other available for sale securities, net of tax					**35,274**		**35,274**
Amortization of pension loss, net of tax					**1,054**		**1,054**
Total comprehensive income							**208,447**
Distributions to non-controlling interest						**(372)**	**(372)**
Purchase of treasury stock				**(1,047)**			**(1,047)**
Issuance of stock under purchase and equity compensation plans	**1,425**	**5,439**		**(199)**			**6,665**
Net tax benefit related to equity compensation plans		**1,174**					**1,174**
Stock-based compensation		**4,669**					**4,669**
Issuance of nonvested stock awards	**765**	**(526)**		**(239)**			
Cash dividends paid ($.705 per share)			**(58,836)**				**(58,836)**

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

See accompanying notes to consolidated financial statements.

5

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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

(A) Available for sale and non-marketable securities

Income tax net payments	**$**	**75,138**	$	51,096
Interest paid on deposits and borrowings	**$**	**73,419**	$	135,121

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010 (Unaudited)

1. Principles of Consolidation and Presentation

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

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

2. Loans and Allowance for Loan Losses

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

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

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

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

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

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

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

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

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

The table below shows the Company s investment in impaired loans at September 30, 2010 and December 31, 2009. These loans consist of loans on non-accrual status and other restructured loans whose terms have been modified and classified as troubled debt restructurings under ASC 310-40. The restructured loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession. Restructured loans are largely comprised of certain business, construction and business real estate loans totaling $68.0 million and $85.7 million at September 30, 2010 and December 31, 2009, respectively, and classified as substandard, which when renewed at maturity were at interest rates equal to or greater than the previous rates in effect. The new rates, however, were not judged to be market rates for new debt with similar risk, and thus these loans were classified as troubled debt restructurings. These restructured loans are performing in accordance with their modified terms, and because the Company believes it probable that all amounts due under the modified terms of the agreements will be collected, interest on these loans is being recognized on an accrual basis. However, because of their substandard classification they are also regarded as potential problem loans, as disclosed at both December 31, 2009 and September 30, 2010 in the Risk Elements of Loan Portfolio section of the following discussion. Troubled debt restructurings also include certain credit card loans under various debt management and assistance programs, which totaled $14.3 million at September 30, 2010 and $16.0 million at December 31, 2009.

(In thousands)	**September 30 2010**	December 31 2009
Non-accrual loans	**$ 89,609**	$ 106,613
Restructured loans	**82,313**	101,765
Total impaired loans	**$ 171,922**	$ 208,378

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

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

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

3. Investment Securities

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

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

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

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

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

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

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

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

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

For securities classified as available for sale, the following table shows the unrealized gains and losses (pre-tax) in accumulated other comprehensive income, by security type.

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

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

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

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

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

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

	For the Nine Months Ended September 30	
(In thousands)	**2010**	2009
Balance, January 1	**$ 2,473**	$
Credit losses on debt securities for which impairment was not previously recognized	**281**	2,811
Credit losses on debt securities for which impairment was previously recognized	**3,897**	
Balance, September 30	**$ 6,651**	$ 2,811

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

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

September 30, 2010						
U.S. government and federal agency obligations	**$ 166,776**	**$ 153**	**$**	**$**	**$ 166,776**	**$ 153**
State and municipal obligations	**93,572**	**1,307**	**84,427**	**9,180**	**177,999**	**10,487**
Mortgage and asset-backed securities:						
Agency mortgage-backed securities	**118,856**	**128**	**2,095**	**40**	**120,951**	**168**
Non-agency mortgage-backed securities	**76,362**	**6,445**	**126,725**	**10,677**	**203,087**	**17,122**
Other asset-backed securities	**38,424**	**56**	**24,866**	**65**	**63,290**	**121**
Total mortgage and asset-backed securities	**233,642**	**6,629**	**153,686**	**10,782**	**387,328**	**17,411**
Total	**$ 493,990**	**$ 8,089**	**$ 238,113**	**$ 19,962**	**$ 732,103**	**$ 28,051**
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
Total mortgage and asset-backed securities	714,715	20,641	249,764	32,738	964,479	53,379
Total	$ 924,200	$ 21,215	$ 353,979	$ 35,645	$ 1,278,179	$ 56,860

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

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

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

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

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

	For the Nine Months Ended

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

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

4. Goodwill and Other Intangible Assets

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

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

Aggregate amortization expense on intangible assets was $864 thousand and $1.0 million, respectively, for the three month periods ended September 30, 2010 and 2009, and $2.7 million and $3.1 million for the nine month periods ended September 30, 2010 and 2009. The following table shows the estimated annual amortization expense for the next five fiscal years. This expense is based on existing asset balances and the interest rate environment as of September 30, 2010. The Company s actual amortization expense in any given period may be different from the estimated amounts depending upon the acquisition of intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions.

(In thousands)	
2010	$ 3,403
2011	2,838
2012	2,277
2013	1,738
2014	1,266

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

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

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

(In thousands)	
Consumer segment	$ 67,765
Commercial segment	57,074
Wealth segment	746
Total goodwill	$ 125,585

5. Guarantees

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

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

The Company periodically enters into risk participation agreements (RPAs) as a guarantor to other financial institutions, in order to mitigate those institutions credit risk associated with interest rate swaps with third parties. The RPA stipulates that, in the event of default by the third party on the interest rate swap, the Company will reimburse a portion of the loss borne by the financial institution. These interest rate swaps are normally collateralized (generally with real property, inventories and equipment) by the third party, which limits the credit risk associated with the Company s RPAs. The third parties usually have other borrowing relationships with the Company. The Company monitors overall borrower collateral, and at September 30, 2010, believes sufficient collateral is available to cover potential swap losses. The Company receives a fee from the institution at the inception of the contract, which is recorded as a liability representing the fair value of the RPA. Any future changes in fair value, including those due to a change in the third party s creditworthiness, are recorded in current earnings. The terms of the RPAs, which correspond to the terms of the underlying swaps, range from 2 to 8 years. At September 30, 2010, the liability recorded for guarantor RPAs was $303 thousand, and the notional amount of the underlying swaps was $41.7 million. The maximum potential future payment guaranteed by the Company cannot be readily estimated, but is dependent upon the fair value of the interest rate swaps at the time of default. If an event of default on all contracts had occurred at September 30, 2010, the Company would have been required to make payments of approximately $4.5 million.

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

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

6. Pension

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

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

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

7. Common Stock

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

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

Undistributed income	**$ 36,066**	$ 32,545	**$ 100,415**	$ 63,445
Weighted average common shares outstanding	**83,040**	82,169	**82,968**	80,646
Net effect of the assumed exercise of stock-based awards based on the treasury stock method using the average market price for the respective periods	**350**	322	**399**	305
Weighted average diluted common shares outstanding	**83,390**	82,491	**83,367**	80,951
Distributed income per share	**$ .23**	$ .23	**$ .70**	$ .69
Undistributed income per share	**.44**	.40	**1.21**	.78
Diluted income per common share	**$ .67**	$ .63	**$ 1.91**	$ 1.47

8. Other Comprehensive Income

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

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

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

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

Pension loss amortization	**351**	525	**1,054**	1,375
Other comprehensive income	**$ 19,407**	$ 54,931	**$ 48,797**	$ 103,732

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

9. Segments

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

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

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