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COMMERCE BANCORP INC /NJ/
Form 10-Q
August 09, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 For the quarterly period ended June 30, 2004

OR

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File #1-12069

[COMMERCE BANCORP LOGO OMITTED]
(Exact name of registrant as specified in its charter)

New Jersey

22-2433468

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification
Number)

Commerce Atrium, 1701 Route 70 East, Cherry Hill, New Jersey 08034-5400

(Address of Principal Executive Offices) (Zip Code)

(856) 751-9000

(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 report(s), and (2) has been subject to such filing
requirements for the past 90 days.

Yes X

No ___

Indicate by check mark whether the registrant is an accelerated filer (as
defined in Rule 12b-2 of the Exchange Act).

Yes X

No ___

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of
common stock, as of the latest practicable date.

Common Stock

78,585,388

(Title of Class)

(No. of Shares Outstanding
as of August 2, 2004)

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COMMERCE BANCORP, INC. AND SUBSIDIARIES
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COMMERCE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(unaudited)

| | | June 30, |
|--------|-------------------------|------------------------|
| | | 2004 |
| | | ----- |
| | | (dollars in thousands) |
| | | ----- |
| Assets | Cash and due from banks | \$ 1,081,459 |
| | Federal funds sold | 8,500 |
| | | ----- |

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| | | |
|----------------------|---|---------------|
| | Cash and cash equivalents | 1,089,959 |
| | Loans held for sale | 41,047 |
| | Trading securities | 182,105 |
| | Securities available for sale | 12,131,104 |
| | Securities held to maturity | 3,772,204 |
| | (market value 06/04-\$3,696,221; 12/03-\$2,467,192) | |
| | Loans | 8,330,456 |
| | Less allowance for loan losses | 124,688 |
| | | ----- |
| | | 8,205,768 |
| | Bank premises and equipment, net | 906,455 |
| | Other assets | 410,029 |
| | | ----- |
| | | \$ 26,738,671 |
| | | ===== |
| Liabilities | Deposits: | |
| | Demand: | |
| | Noninterest-bearing | \$ 5,622,574 |
| | Interest-bearing | 9,632,178 |
| | Savings | 5,597,767 |
| | Time | 3,209,229 |
| | | ----- |
| | Total deposits | 24,061,748 |
| | Other borrowed money | 944,040 |
| | Other liabilities | 204,768 |
| | Long-term debt | 200,000 |
| | | ----- |
| | | 25,410,556 |
| Stockholders' Equity | Common stock, 78,658,414 shares | |
| | issued (76,869,415 shares at December 31, 2003) | 78,658 |
| | Capital in excess of par value | 936,539 |
| | Retained earnings | 446,260 |
| | Accumulated other comprehensive loss | (122,003) |
| | | ----- |
| | | 1,339,454 |
| | Less treasury stock, at cost, 397,859 shares | |
| | issued (363,076 shares at December 31, 2003) | 11,339 |
| | | ----- |
| | Total stockholders' equity | 1,328,115 |
| | | ----- |
| | | \$ 26,738,671 |
| | | ===== |

See accompanying notes.

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| | | Three Months Ended June 30, | | |
|--|---|--------------------------------|-----------|------|
| (dollars in thousands, except per share amounts) | | 2004 | 2003 | 2002 |
| Interest income | Interest and fees on loans | \$113,947 | \$ 95,548 | \$ 2 |
| | Interest on investments | 177,929 | 123,098 | 3 |
| | Other interest | 154 | 98 | |
| | Total interest income | 292,030 | 218,744 | 5 |
| Interest expense | Interest on deposits: | | | |
| | Demand | 18,729 | 11,961 | |
| | Savings | 10,216 | 6,754 | |
| | Time | 14,264 | 17,387 | |
| | Total interest on deposits | 43,209 | 36,102 | |
| | Interest on other borrowed money | 1,052 | 318 | |
| | Interest on long-term debt | 3,020 | 3,020 | |
| Total interest expense | 47,281 | 39,440 | | |
| | Net interest income | 244,749 | 179,304 | 4 |
| | Provision for loan losses | 10,748 | 6,900 | |
| | Net interest income after provision for loan losses | 234,001 | 172,404 | 4 |
| Noninterest income | Deposit charges and service fees | 52,717 | 38,765 | |
| | Other operating income | 38,923 | 43,388 | |
| | Net investment securities gains | 635 | 1,217 | |
| | Total noninterest income | 92,275 | 83,370 | 1 |
| Noninterest expense | Salaries and benefits | 104,110 | 86,338 | 2 |
| | Occupancy | 27,949 | 22,695 | |
| | Furniture and equipment | 27,001 | 20,556 | |
| | Office | 10,920 | 9,233 | |
| | Marketing | 9,278 | 9,198 | |
| | Other | 46,997 | 39,658 | |
| | Total noninterest expenses | 226,255 | 187,678 | 4 |
| | Income before income taxes | 100,021 | 68,096 | 1 |
| | Provision for federal and state income taxes | 33,786 | 22,779 | |
| | Net income | \$ 66,235 | \$ 45,317 | \$ 1 |
| Net income per common and common equivalent share: | | | | |
| | Basic | \$ 0.85 | \$ 0.65 | \$ |
| | Diluted | \$ 0.79 | \$ 0.63 | \$ |
| Average common and common equivalent shares outstanding: | | | | |
| | Basic | 77,980 | 69,193 | |
| | Diluted | 86,260 | 72,128 | |
| | Cash dividends, common stock | \$ 0.19 | \$ 0.16 | \$ |

See accompanying notes.

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COMMERCE BANCORP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

| | | \$ |
|------------------------|--|---------|
| (dollars in thousands) | | 20 |
| Operating activities | Net income | \$ 128, |
| | Adjustments to reconcile net income to net cash provided by operating activities: | |
| | Provision for loan losses | 20, |
| | Provision for depreciation, amortization and accretion | 63, |
| | Gain on sales of securities available for sale | (1, |
| | Proceeds from sales of loans held for sale | 408, |
| | Originations of loans held for sale | (406, |
| | Net (increase) decrease in trading securities | (11, |
| | Increase in other assets, net | (35, |
| | Decrease in other liabilities | (14, |
| | Net cash provided by operating activities | 150, |
| Investing activities | Proceeds from the sales of securities available for sale | 1,656, |
| | Proceeds from the maturity of securities available for sale | 2,228, |
| | Proceeds from the maturity of securities held to maturity | 407, |
| | Purchase of securities available for sale | (5,569, |
| | Purchase of securities held to maturity | (1,690, |
| | Net increase in loans | (897, |
| | Capital expenditures | (136, |
| | Net cash used by investing activities | (4,001, |
| Financing activities | Net increase in demand and savings deposits | 3,481, |
| | Net (decrease) increase in time deposits | (120, |
| | Net increase in other borrowed money | 632, |
| | Dividends paid | (29, |
| | Proceeds from issuance of common stock under dividend reinvestment and other stock plans | 69, |
| | Other | (1, |
| | Net cash provided by financing activities | 4,030, |
| | Increase in cash and cash equivalents | 179, |
| | Cash and cash equivalents at beginning of year | 910, |
| | | |

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Cash and cash equivalents at end of period \$ 1,089,
 =====

Supplemental disclosures of cash flow information:

Cash paid during the period for:
 Interest \$ 89,
 Income taxes 63,

See accompanying notes.

COMMERCE BANCORP, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 (unaudited)

Six months ended June 30, 2004
 (in thousands)

| | Common Stock | Capital in Excess of Par Value | Retained Earnings | Treas Sto |
|---|-----------------|---|----------------------|--------------|
| Balances at December 31, 2003 | \$76,869 | \$866,095 | \$347,365 | \$ (9 |
| Net income | | | 128,210 | |
| Other comprehensive income(loss), net of tax | | | | |
| Unrealized loss on securities (pre-tax \$217,801) | | | | |
| Reclassification adjustment (pre-tax \$32,786) | | | | |
| Other comprehensive income (loss) | | | | |
| Total comprehensive income | | | | |
| Cash dividends paid | | | (29,315) | |
| Shares issued under dividend reinvestment | | | | |
| and compensation and benefit plans (1,789 shares) | 1,789 | 67,644 | | |
| Other | | 2,800 | | (2 |
| Balances at June 30, 2004 | \$78,658 | \$936,539 | \$446,260 | \$ (11 |

See accompanying notes.

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COMMERCE BANCORP, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

A. Consolidated Financial Statements

The consolidated financial statements included herein have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements were prepared in accordance with the accounting policies set forth in note 1 (Significant Accounting Policies) of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. The accompanying consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to reflect a fair statement of the results for the interim periods presented. Such adjustments are of a normal recurring nature.

These consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the registrant's Annual Report on Form 10-K for the year ended December 31, 2003. The results for the three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2004.

The consolidated financial statements include the accounts of Commerce Bancorp, Inc. and its consolidated subsidiaries. All material intercompany transactions have been eliminated. Certain amounts from prior years have been reclassified to conform with 2004 presentation.

B. Legal Proceedings

On June 29, 2004 the U.S. Attorney General indicted two officers of the Company's Philadelphia bank subsidiary in connection with its investigation of certain Philadelphia city government officials. The Company confirms that neither it, nor any of its subsidiaries or other officers and employees are targets of the investigation. The Company has fully cooperated with this investigation and believes it will have no material negative financial impact on the Company.

During July 2004, class action complaints were filed in the United States District Court for the District of New Jersey and the Eastern District of Pennsylvania against the Company and certain Company (or subsidiary) current and former officers and directors. The complaints allege that the defendants violated the federal securities laws, specifically Sections 10 (b) and 20 (a) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The plaintiffs seek unspecified damages on behalf of a purported class of purchasers of the Company's securities during various periods. The Company believes that the complaints against it are without merit and intends to vigorously defend itself.

C. Long Term Debt

On April 1, 2004, the Company's \$200.0 million of 5.95% Convertible Trust Capital Securities, recorded on the consolidated balance sheet as long term debt, became convertible at the option of the holder. The holders of the Convertible Trust Capital Securities may convert each security into 0.9478 shares of Company common stock. The Company has calculated the effect of these securities on diluted net income per share by using the if-converted method. Under the if-converted method, the related interest charges on the Convertible

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Trust Capital Securities, adjusted for income taxes, have been added back to the numerator and the common shares to be issued upon conversion have been added to the denominator.

The Convertible Trust Capital Securities were issued on March 11, 2002 through Commerce Capital Trust II, a Delaware business trust. The Convertible Trust Capital Securities mature in 2032.

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D. Bank Premises and Equipment

In accordance with accounting principles generally accepted in the United States, when capitalizing costs for branch construction, the Company includes the costs of purchasing the land, developing the site, constructing the building (or leasehold improvements if the property is leased), and furniture, fixtures and equipment necessary to equip the branch. All other pre-opening and post-opening costs related to branches are expensed as incurred. As of June 30, 2004 and December 31, 2003, Bank premises and equipment in progress was \$87.6 million and \$87.2 million, respectively.

E. Commitments

In the normal course of business, there are various outstanding commitments to extend credit, such as letters of credit and unadvanced loan commitments. Management does not anticipate any material losses as a result of these transactions. In accordance with FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45), the Company defers the fees associated with standby letters of credit and records them in "Other liabilities" on the consolidated balance sheet. These fees are immaterial to the Company's consolidated financial statements at June 30, 2004.

F. Comprehensive Income (Loss)

Total comprehensive income (loss), which for the Company included net income and changes in unrealized gains and losses on the Company's available for sale securities, amounted to \$(133.8) million and \$41.6 million, respectively, for the three months ended June 30, 2004 and 2003. For the six months ended June 30, 2004 and 2003, total comprehensive income was \$9.9 million and \$64.1 million, respectively.

G. New Accounting Standards

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). In December 2003, the FASB deferred the implementation date of FIN 46 to periods ending after March 15, 2004 for all variable interest entities with the exception of special-purpose entities, which were subject to adoption in periods ending after December 15, 2003. This interpretation provides guidance on how to identify a variable interest entity (VIE) and determine when the assets, liabilities, noncontrolling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. The adoption of FIN 46 did not have a material impact on the Company's financial condition or operating results.

The Company makes investments directly in low-income housing tax credit (LIHTC) operating partnerships, private venture capital funds and Small Business

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Investment Companies (SBIC). The Company has determined these entities do not meet the consolidation criteria of FIN 46. At June 30, 2004 and December 31, 2003, the Company's investment in these entities totaled \$38.8 million and \$30.1 million, respectively.

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H. Stock-Based Compensation

The Company follows APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related Interpretations to account for its stock-based compensation plans. If the Company had accounted for stock options under the fair value provisions of FAS 123, "Accounting for Stock-Based Compensation", net income and net income per share would have been as follows (in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Mo Ju |
|---|--------------------------------|----------|--------------|
| | 2004 | 2003 | 2004 |
| Reported net income | \$66,235 | \$45,317 | \$128,210 |
| Less: Stock option compensation expense determined under fair value method, net of tax | (3,090) | (2,233) | (6,510) |
| Pro forma net income, basic | \$63,145 | \$43,084 | \$121,700 |
| Add: Interest expense on Convertible Trust Capital Securities, net of tax | 1,963 | | 3,926 |
| Pro forma net income, diluted | \$65,108 | | \$125,626 |
| Reported net income per share: | | | |
| Basic | \$ 0.85 | \$ 0.65 | \$ 1.65 |
| Diluted | \$ 0.79 | \$ 0.63 | \$ 1.54 |
| Pro forma net income per share: | | | |
| Basic | \$ 0.81 | \$ 0.62 | \$ 1.57 |
| Diluted | \$ 0.75 | \$ 0.60 | \$ 1.46 |

The fair value of options granted in 2004 and 2003 was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rates of 3.09% to 3.00%, dividend yields of 1.33% to 1.50%, volatility factors of the expected market price of the Company's common stock of .255 to .304 and weighted average expected lives of the options of 5.27 and 5.22 years.

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The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

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I. Segment Information

The Company operates one reportable segment of business, Community Banks, which includes all of the Company's banking subsidiaries. Through its Community Banks, the Company provides a broad range of retail and commercial banking services, and corporate trust services. Parent/Other includes the holding company, Commerce Insurance Services, Inc. and Commerce Capital Markets, Inc.

Selected segment information is as follows (in thousands):

| | Three Months Ended June 30, 2004 | | | Three Months Ended June 30, 2003 | |
|-------------------------------------|-------------------------------------|------------------|------------|-------------------------------------|------------------|
| | Community Banks | Parent/ Other | Total | Community Banks | Parent/ Other |
| Net interest income | \$ 246,385 | \$ (1,636) | \$ 244,749 | \$ 180,729 | \$ 1,000 |
| Provision for loan losses | 10,748 | - | 10,748 | 6,900 | - |
| Net interest income after provision | 235,637 | (1,636) | 234,001 | 173,829 | 1,000 |
| Noninterest income | 66,836 | 25,439 | 92,275 | 56,009 | - |
| Noninterest expense | 203,155 | 23,100 | 226,255 | 166,136 | - |
| Income before income taxes | 99,318 | 703 | 100,021 | 63,702 | - |
| Income tax expense | 33,917 | (131) | 33,786 | 21,317 | - |
| Net income | \$ 65,401 | \$ 834 | \$ 66,235 | \$ 42,385 | \$ - |
| Average assets (in millions) | \$ 23,778 | \$ 2,044 | \$ 25,822 | \$ 16,715 | \$ - |

| | Six Months Ended June 30, 2004 | | | Six Months Ended June 30, 2003 | |
|---------------------------|-----------------------------------|------------------|------------|-----------------------------------|------------------|
| | Community Banks | Parent/ Other | Total | Community Banks | Parent/ Other |
| Net interest income | \$ 478,221 | \$ (3,260) | \$ 474,961 | \$ 348,958 | \$ 1,000 |
| Provision for loan losses | 20,248 | - | 20,248 | 13,800 | - |

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| | | | | |
|-------------------------------------|------------|----------|------------|-----------|
| Net interest income after provision | 457,973 | (3,260) | 454,713 | 335,158 |
| Noninterest income | 124,969 | 53,538 | 178,507 | 106,004 |
| Noninterest expense | 392,508 | 45,997 | 438,505 | 315,586 |
| Income before income taxes | 190,434 | 4,281 | 194,715 | 125,576 |
| Income tax expense | 65,124 | 1,381 | 66,505 | 42,292 |
| Net income | \$ 125,310 | \$ 2,900 | \$ 128,210 | \$ 83,284 |
| Average assets (in millions) | \$ 22,596 | \$ 2,060 | \$ 24,656 | \$ 15,858 |

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J. Net Income Per Share

The calculation of net income per share follows (in thousands, except for per share amounts):

| | Three Months Ended June 30, | | |
|---|--------------------------------|----------|-----------|
| | 2004 | 2003 | 2002 |
| Basic: | | | |
| Net income available to common shareholders - basic | \$66,235 | \$45,317 | \$128,210 |
| Average common shares outstanding | 77,980 | 69,193 | 77,980 |
| Net income per common share - basic | \$ 0.85 | \$ 0.65 | \$ 1.64 |
| Diluted: | | | |
| Net income | \$66,235 | \$45,317 | \$128,210 |
| Add interest expense on Convertible Trust Capital Securities, net of tax | 1,963 | | 3,000 |
| Net income available to common shareholders - diluted | \$68,198 | \$45,317 | \$131,210 |
| Average common shares outstanding | 77,980 | 69,193 | 77,980 |
| Additional shares considered in diluted computation assuming: | | | |

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| | | | |
|--|---------|---------|----|
| Exercise of stock options | 4,489 | 2,935 | 4 |
| Conversion of Convertible Trust Capital Securities | 3,791 | | 3 |
| Average common shares outstanding - diluted | 86,260 | 72,128 | 85 |
| Net income per common share - diluted | \$ 0.79 | \$ 0.63 | \$ |

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

Executive Summary

During the first six months of 2004, the Company experienced strong deposit growth and positive operating leverage as year over year revenue growth of 29% exceeded non-interest expense growth of 22% during the same period. Total assets grew to \$26.7 billion, an increase of 35% over June 30, 2003, while total deposits grew 35%. Net income increased 46% to \$66.2 million and 45% to \$128.2 million during the second quarter and first six months of 2004, respectively, as compared to the same periods in 2003. Diluted net income per share increased by 25% to \$0.79 and \$1.54 during the second quarter and first six months of 2004, respectively, as compared the same periods in 2003. The net income per share calculations for 2004 include 5.0 million shares issued in connection with the Company's September 2003 secondary offering and an additional 3.8 million shares assuming the conversion of the Company's Convertible Trust Capital Securities, neither of which were included in the calculations for 2003.

The Company has identified two critical accounting policies: the policies related to the allowance for loan losses and capitalization of branch costs. The foregoing critical accounting policies are more fully described in the Company's annual report on Form 10-K for the year ended December 31, 2003. During the first six months of 2004, there were no material changes to the estimates or methods by which estimates are derived with regard to the critical accounting policies.

Capital Resources

At June 30, 2004, stockholders' equity totaled \$1.3 billion or 4.97% of total assets, compared to \$1.3 billion or 5.62% of total assets at December 31, 2003.

The Company and its subsidiaries are subject to risk-based capital standards issued by bank regulatory authorities. Under these standards, Tier 1 capital includes stockholders' equity, as adjusted for certain items. The Company makes two significant adjustments in calculating regulatory capital. The first adjustment is to exclude from capital the unrealized appreciation or depreciation in its available for sale securities portfolio. The second adjustment is to add to capital the Convertible Trust Capital Securities. Total capital is comprised of all the components of Tier 1 capital plus the allowance for loan losses.

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The table below presents Commerce Bancorp and Commerce N.A.'s risk-based and leverage ratios at June 30, 2004 and 2003:

| | Actual | | Per Regulatory Guid | | "W Am |
|----------------------------|-------------|--------|---------------------|-------|----------|
| | Amount | Ratio | Amount | Ratio | |
| June 30, 2004: | | | | | |
| Commerce Bancorp | | | | | |
| Risk based capital ratios: | | | | | |
| Tier 1 | \$1,640,555 | 12.37% | \$530,388 | 4.00% | \$ |
| Total capital | 1,765,243 | 13.31 | 1,060,776 | 8.00 | 1, |
| Leverage ratio | 1,640,555 | 6.33 | 1,036,022 | 4.00 | 1, |
| Commerce N.A. | | | | | |
| Risk based capital ratios: | | | | | |
| Tier 1 | \$1,088,255 | 11.16% | \$390,195 | 4.00% | \$ |
| Total capital | 1,184,593 | 12.14 | 780,389 | 8.00 | |
| Leverage ratio | 1,088,255 | 6.03 | 722,139 | 4.00 | |

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| | Actual | | Per Regulatory Guid | | "W A |
|----------------------------|-------------|--------|---------------------|-------|---------|
| | Amount | Ratio | Amount | Ratio | |
| June 30, 2003: | | | | | |
| Commerce Bancorp | | | | | |
| Risk based capital ratios: | | | | | |
| Tier 1 | \$1,110,820 | 11.13% | \$399,313 | 4.00% | \$ |
| Total capital | 1,210,138 | 12.12 | 798,627 | 8.00 | |
| Leverage ratio | 1,110,820 | 6.04 | 735,335 | 4.00 | |
| Commerce N.A. | | | | | |
| Risk based capital ratios: | | | | | |
| Tier 1 | \$756,909 | 10.29% | \$294,114 | 4.00% | \$ |
| Total capital | 832,704 | 11.32 | 588,228 | 8.00 | |
| Leverage ratio | 756,909 | 5.75 | 526,680 | 4.00 | |

At June 30, 2004, the Company's consolidated capital levels and each of the Company's bank subsidiaries met the regulatory definition of a "well capitalized" financial institution, i.e., a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6%, and a total risk-based capital ratio exceeding 10%. Management believes that as of June 30, 2004, the Company and its subsidiaries meet all capital adequacy requirements to which they are subject.

Deposits

Total deposits at June 30, 2004 were \$24.1 billion, up \$6.3 billion, or 35% over total deposits of \$17.8 billion at June 30, 2003, and up by \$3.4 billion, or 16% from year-end 2003. Deposit growth during the first six months of 2004 included core deposit growth in all categories as well as growth from the public sector. Same-store core deposit growth is measured as the year over year percentage increase in core deposits for branches open two years or more at the balance sheet date. The Company experienced same-store core deposit growth of 25% at June 30, 2004.

Interest Rate Sensitivity and Liquidity

The Company's risk of loss arising from adverse changes in the fair market value of financial instruments, or market risk, is composed primarily of interest rate risk. The primary objective of the Company's asset/liability management activities is to maximize net interest income, while maintaining acceptable levels of interest rate risk. The Company's Asset/Liability Committee (ALCO) is responsible for establishing policies to limit exposure to interest rate risk, and to ensure procedures are established to monitor compliance with these policies. The guidelines established by ALCO are reviewed by the Company's Board of Directors.

Management considers the simulation of net interest income in different interest rate environments to be the best indicator of the Company's interest rate risk. Income simulation analysis captures not only the potential of all assets and liabilities to mature or reprice, but also the probability that they will do so. Income simulation also attends to the relative interest rate sensitivities of these items, and projects their behavior over an extended period of time. Finally, income simulation permits management to assess the probable effects on the balance sheet not only of changes in interest rates, but also of proposed strategies for responding to them.

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The Company's income simulation model analyzes interest rate sensitivity by projecting net income over the next 24 months in a flat rate scenario versus net income in alternative interest rate scenarios. Management continually reviews and refines its interest rate risk management process in response to the changing economic climate. Currently, the Company's model projects a proportionate plus 200 and minus 100 basis point change during the next year, with rates remaining constant in the second year. The Company's ALCO policy has established that interest income sensitivity will be considered acceptable if net income in the above interest rate scenario is within 10% of net income in the flat rate scenario in the first year and within 15% over the two year time frame. Net income in the flat rate scenario is projected to increase by approximately 25% per year. The following table illustrates the impact on projected net income at June 30, 2004 and 2003 of a plus 200 and minus 100 basis point change in interest rates.

| ----- | |
|--------------------|-----------|
| Basis Point Change | |
| ----- | |
| Plus 200 | Minus 100 |

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| | | |
|--------------------|--------|----------|
| June 30, 2004: | | |
| Twelve Months | 4.06% | 1.45% |
| Twenty Four Months | 11.38% | (0.31)% |
| June 30, 2003: | | |
| Twelve Months | 1.34% | (9.47)% |
| Twenty Four Months | 11.09% | (15.03)% |

All of these net income projections are within an acceptable level of interest rate risk pursuant to the policy established by ALCO.

In the event the Company's interest rate risk models indicate an unacceptable level of risk, the Company could undertake a number of actions that would reduce this risk, including the use of risk management strategies such as interest rate swaps and caps or the extension of the maturities of its short-term borrowings.

Management also monitors interest rate risk by utilizing a market value of equity model (MVE). The model assesses the impact of a change in interest rates on the market value of all the Company's assets and liabilities, as well as any off balance sheet items. The model calculates the market value of the Company's assets and liabilities in excess of book value in the current rate scenario, and then compares the excess of market value over book value given an immediate plus 200 and minus 100 basis point change in rates. The Company's ALCO policy indicates that the level of interest rate risk is unacceptable if the immediate plus 200 and minus 100 basis point change would result in the loss of 45% or more of the excess of market value over book value in the current rate scenario. At June 30, 2004, the market value of equity model indicates an acceptable level of interest rate risk.

The MVE reflects certain estimates and assumptions regarding the impact on the market value of the Company's assets and liabilities given an immediate plus 200 or minus 100 basis point change in interest rates. One of the key assumptions is the market value assigned to the Company's core deposits, or the core deposit premium. Utilizing an independent consultant, the Company has completed and updated comprehensive core deposit studies in order to assign its own core deposit premiums as permitted by the Company's regulatory authorities. The studies have consistently confirmed management's assertion that the Company's core deposits have stable balances over long periods of time, are generally insensitive to changes in interest rates and have significantly longer average lives and durations than the Company's loans and investment securities. At June 30, 2004, the average life of the Company's deposits was 13.3 years. Thus, these core deposit balances provide an internal hedge to market value fluctuations in the Company's fixed rate assets.

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The MVE analyzes both sides of the balance sheet and, as indicated below, demonstrates the inherent value of the Company's core deposits in a rising rate environment. As rates rise, the value of the Company's core deposits increases which offsets the decrease in value of the Company's fixed rate assets. The following table summarizes the market value of equity at June 30, 2004 (in millions, except for per share amounts):

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| | Market Value Of Equity | Per Share |
|------------------------|---------------------------|-----------|
| Plus 200 basis points | \$5,569 | \$70.81 |
| Current Rate | \$5,906 | \$75.09 |
| Minus 100 basis points | \$5,347 | \$67.97 |

Liquidity involves the Company's ability to raise funds to support asset growth or decrease assets to meet deposit withdrawals and other borrowing needs, to maintain reserve requirements and to otherwise operate the Company on an ongoing basis. The Company's liquidity needs are primarily met by growth in core deposits, its cash and federal funds sold position, cash flow from its amortizing investment and loan portfolios, as well as the use of short-term borrowings, as required. If necessary, the Company has the ability to raise liquidity through collateralized borrowings or Federal Home Loan Bank advances. As of June 30, 2004 the Company had in excess of \$11.8 billion in immediately available liquidity which includes securities that could be used for collateralized borrowings, cash on hand, and borrowing capacities under existing lines of credit. During the first six months of 2004, deposit growth and short-term borrowings were used to fund growth in the loan portfolio and purchase additional investment securities.

Short-Term Borrowings

Short-term borrowings, or other borrowed money, consist primarily of securities sold under agreements to repurchase and overnight lines of credit, and are used to meet short-term funding needs. At June 30, 2004, short-term borrowings aggregated \$944.0 million and had an average rate of 1.68%, as compared to \$311.5 million at an average rate of 0.77% at December 31, 2003. The increase in short-term borrowings primarily occurred towards the end of the second quarter, as the Company took advantage of an opportunity to purchase investments by pre-funding anticipated deposit growth. The Company anticipates the short-term borrowings will be paid down during the third quarter of 2004.

Interest Earning Assets

The Company's cash flow from deposit growth and repayments from its investment portfolio totaled approximately \$6.0 billion for the first six months of 2004. This significant cash flow provides the Company with ongoing reinvestment opportunities as interest rates change. For the six month period ended June 30, 2004, interest earning assets increased \$3.7 billion from \$20.8 billion to \$24.5 billion. This increase was primarily in investment securities and the loan portfolio as described below.

Loans

During the first six months of 2004, loans increased \$889.9 million from \$7.4 billion to \$8.3 billion. All segments of the loan portfolio experienced growth in the first six months of 2004, including loans secured by commercial real

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estate properties, commercial loans, and consumer loans.

The following table summarizes the loan portfolio of the Company by type of loan as of the dates shown.

| | June 30, | December 31, |
|------------------------------------|----------------|--------------|
| | 2004 | 2003 |
| | (in thousands) | |
| Commercial: | | |
| Term | \$ 1,111,848 | \$ 1,027,526 |
| Line of credit | 1,046,104 | 959,158 |
| Demand | | 1,077 |
| | 2,157,952 | 1,987,761 |
| Owner-occupied | 1,805,336 | 1,619,079 |
| | 3,963,288 | 3,606,840 |
| Consumer: | | |
| Mortgages (1-4 family residential) | 1,111,049 | 918,686 |
| Installment | 134,710 | 138,437 |
| Home equity | 1,573,454 | 1,405,795 |
| Credit lines | 65,421 | 60,579 |
| | 2,884,634 | 2,523,497 |
| Commercial real estate: | | |
| Investor developer | 1,308,103 | 1,167,672 |
| Construction | 174,431 | 142,567 |
| | 1,482,534 | 1,310,239 |
| Total loans | \$ 8,330,456 | \$ 7,440,576 |

Investments

In total, for the first six months of 2004, securities increased \$2.8 billion from \$13.3 billion to \$16.1 billion. The available for sale portfolio increased \$1.4 billion to \$12.1 billion at June 30, 2004 from \$10.7 billion at December 31, 2003, and the securities held to maturity portfolio increased \$1.3 billion to \$3.8 billion at June 30, 2004 from \$2.5 billion at year-end 2003. The portfolio of trading securities increased \$11.6 million from year-end 2003 to \$182.1 million at June 30, 2004. At June 30, 2004, the average life of the investment portfolio was approximately 5.19 years, and the duration was approximately 4.20 years. The yield on the total portfolio decreased slightly from 4.86% at December 31, 2003 to 4.79% at June 30, 2004.

The following table summarizes the book value of securities available for sale and securities held to maturity by the Company as of the dates shown.

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| | At June 30, 2004 | | | Market Value | At De | |
|--|------------------|------------------------|-------------------------|--------------|----------------|----------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | | Amortized Cost | Gro Unreal Gai |
| U.S. Government agency and mortgage-backed obligations | \$12,172,873 | \$29,290 | \$ (227,915) | \$11,974,248 | \$10,528,396 | \$82 |
| Obligations of state and political subdivisions | 104,281 | 548 | (1,708) | 103,121 | 30,223 | |
| Other | 44,874 | 8,861 | | 53,735 | 97,943 | 10 |
| Securities available for sale | \$12,322,028 | \$38,699 | \$ (229,623) | \$12,131,104 | \$10,656,562 | \$93 |
| U.S. Government agency and mortgage-backed obligations | \$3,424,051 | \$ 9,310 | \$ (77,506) | \$3,355,855 | \$2,193,577 | \$15 |
| Obligations of state and political subdivisions | 258,985 | | (7,787) | 251,198 | 227,199 | |
| Other | 89,168 | | | 89,168 | 69,708 | |
| Securities held to maturity | \$3,772,204 | \$ 9,310 | \$ (85,293) | \$3,696,221 | \$2,490,484 | \$15 |

Gross gains and losses on securities sold during the second quarter of 2004 were \$635 thousand and \$0, respectively. For the first six months of 2004, gross gains and losses on securities sold amounted to \$12.8 million and \$11.8 million, respectively.

As of August 6, 2004, with the yield on the 10 year Treasury Note at 4.22%, the after-tax depreciation of the Company's available for sale portfolio was approximately \$6.6 million.

Detailed below is information regarding the composition and characteristics of the Company's investment portfolio, excluding trading securities, as of June 30, 2004.

| Product Description | Amount | Average Yield | Average Book Price | Average Duration |
|---------------------|--------|---------------|--------------------|------------------|
| (in millions) | | | | |

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Mortgage-backed Securities:

| | | | | |
|---|----------|-------|-----------|-------|
| Federal Agencies Pass Through Certificates (AAA Rated) | \$4,349 | 4.88% | \$ 101.17 | 4.39 |
| Collateralized Mortgage Obligations (AAA Rated) | 10,226 | 4.85 | 100.84 | 4.04 |
| U.S. Government agencies/Other | 1,328 | 4.01 | 100.24 | 4.79 |
| | ----- | ----- | ----- | ----- |
| Total | \$15,903 | 4.79% | \$ 100.88 | 4.20 |
| | ===== | ===== | ===== | ===== |

The Company's mortgage-backed securities (MBS) portfolio comprises 91% of the total investment portfolio. The MBS portfolio consists of Federal Agencies Pass-Through Certificates and Collateralized Mortgage Obligations (CMO's) which are issued by federal agencies and other private sponsors. The Company's investment policy does not permit investments in inverse floaters, IO's, PO's and other similar issues.

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Net Income

Net income for the second quarter of 2004 was \$66.2 million, an increase of \$20.9 million or 46% over the \$45.3 million recorded for the second quarter of 2003. Net income for the first six months of 2004 totaled \$128.2 million, an increase of \$40.0 million or 45% from \$88.2 million in the first six months of 2003. On a per share basis, diluted net income for the second quarter and first six months of 2004 was \$0.79 and \$1.54 per common share compared to \$0.63 and \$1.23 per common share for the same periods in 2003. Net income per share for the second quarter and first six months of 2004 reflects the addition of 5.0 million shares from the secondary offering in September 2003 and 3.8 million shares assuming conversion of the Convertible Trust Capital Securities.

Return on average assets (ROA) and return on average equity (ROE) for the second quarter of 2004 were 1.03% and 19.86%, respectively, compared to 0.98% and 17.91%, respectively, for the same 2003 period. ROA and ROE for the first six months of 2004 were 1.04% and 18.87%, respectively, compared to 1.00% and 17.92%, respectively, for the same 2003 period. The increases in both ROA and ROE are due to net income growth that has exceeded growth in average assets and average equity during the three month and six month periods ended June 30, 2004 as compared to the same periods in 2003. As noted above, net income has grown 46% and 45% during the second quarter and first six months of 2004, respectively, as compared to the same 2003 periods. Average assets and average equity have grown 40% and 32%, respectively, from June 30, 2003 to June 30, 2004.

Net Interest Income

Net interest income totaled \$244.7 million for the second quarter of 2004, an increase of \$65.4 million or 36% from \$179.3 million in the second quarter of

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2003. Net interest income for the first six months of 2004 was \$475.0 million, up \$128.4 million or 37% from \$346.6 million for the first six months of 2003. The increases in net interest income for the quarter and first six months of 2004 were due to the volume increases in interest earning assets resulting from the Company's strong, low-cost core deposit growth.

The increase in net interest income on a tax equivalent basis is shown below (in thousands).

| 2004 vs. 2003 | Net Interest Income | | |
|--------------------------|---------------------|----------------|-------------------|
| | Volume Increase | Rate Change | Total Increase |
| Quarter Ended June 30 | \$72,797 | (\$6,873) | \$65,924 |
| Six Months Ended June 30 | \$142,325 | (\$13,124) | \$129,201 |

The net interest margin for the second quarter of 2004 was 4.29% down 10 basis points from the 4.39% margin for the first quarter of 2004. The decrease in the margin was attributed primarily to a decrease in the yield on the investment portfolio of 10 basis points, which was caused by the spike in mortgage-backed security prepayments experienced in the second quarter.

The following table sets forth balance sheet items on a daily average basis for the three months ended June 30, 2004, March 31, 2004 and June 30, 2003 and presents the daily average interest earned on assets and paid on liabilities for such periods.

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Average Balances and Net Interest Income

| (dollars in thousands) | June 2004 | | | March 2004 | | |
|------------------------------|--------------------|------------|-----------------|--------------------|------------|-----------------|
| | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| Earning Assets | | | | | | |
| Investment securities | | | | | | |
| Taxable | \$14,747,643 | \$ 173,678 | 4.74% | \$13,295,903 | \$ 159,648 | 4.8 |
| Tax-exempt | 290,200 | 4,465 | 6.19 | 256,628 | 3,860 | 6.0 |
| Trading | 174,578 | 2,075 | 4.78 | 161,701 | 2,065 | 5.1 |
| Total investment securities | 15,212,421 | 180,218 | 4.76 | 13,714,232 | 165,573 | 4.8 |

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| | | | | | | |
|----------------------|--------------|-----------|-------|--------------|------------|-----|
| Federal funds sold | 62,357 | 154 | 0.99 | 144,297 | 340 | 0.9 |
| Loans | | | | | | |
| Commercial mortgages | 3,021,768 | 45,333 | 6.03 | 2,793,159 | 42,782 | 6.1 |
| Commercial | 1,961,351 | 25,477 | 5.22 | 1,878,353 | 24,535 | 5.2 |
| Consumer | 2,767,826 | 39,079 | 5.68 | 2,603,037 | 36,936 | 5.7 |
| Tax-exempt | 335,505 | 6,243 | 7.48 | 337,313 | 6,092 | 7.2 |
| Total loans | 8,086,450 | 116,132 | 5.78 | 7,611,862 | 110,345 | 5.8 |
| Total earning assets | \$23,361,228 | \$296,504 | 5.10% | \$21,470,391 | \$ 276,258 | 5.1 |

Sources of Funds

| | | | | | | |
|---|--------------|-----------|-------|--------------|------------|-----|
| Interest-bearing liabilities | | | | | | |
| Regular savings | \$5,276,657 | \$ 10,216 | 0.78% | \$4,492,847 | \$ 7,786 | 0.7 |
| Interest bearing demand | 9,643,771 | 18,729 | 0.78 | 8,986,070 | 15,943 | 0.7 |
| Time deposits | 2,507,526 | 11,378 | 1.82 | 2,430,589 | 11,323 | 1.8 |
| Public funds | 856,683 | 2,886 | 1.35 | 968,513 | 3,320 | 1.3 |
| Total deposits | 18,284,637 | 43,209 | 0.95 | 16,878,019 | 38,372 | 0.9 |
| Other borrowed money | 523,931 | 1,052 | 0.81 | 174,746 | 448 | 1.0 |
| Long-term debt | 200,000 | 3,020 | 6.07 | 200,000 | 3,020 | 6.0 |
| Total deposits and interest-bearing liabilities | 19,008,568 | 47,281 | 1.00 | 17,252,765 | 41,840 | 0.9 |
| Noninterest-bearing funds (net) | 4,352,660 | | | 4,217,626 | | |
| Total sources to fund earning assets | \$23,361,228 | 47,281 | 0.81 | \$21,470,391 | 41,840 | 0.7 |
| Net interest income and margin tax-equivalent basis | | \$249,223 | 4.29% | | \$ 234,418 | 4.3 |

Other Balances

| | | | | | | |
|---------------------------------------|-------------|--|--|-------------|--|--|
| Cash and due from banks | \$1,163,942 | | | \$1,007,182 | | |
| Other assets | 1,419,098 | | | 1,129,880 | | |
| Total assets | 25,822,157 | | | 23,491,544 | | |
| Total deposits | 23,541,453 | | | 21,478,730 | | |
| Demand deposits (noninterest-bearing) | 5,256,816 | | | 4,600,711 | | |
| Other liabilities | 222,779 | | | 253,890 | | |
| Stockholders' equity | 1,333,994 | | | 1,384,178 | | |

Notes - Weighted average yields on tax-exempt obligations have been computed on a tax-equivalent basis assuming a federal tax rate of 35%.
- Non-accrual loans have been included in the average loan balance.
- Investment securities includes investments available for sale.
- Consumer loans include mortgage loans held for sale.

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Noninterest Income

Noninterest income totaled \$92.3 million for the second quarter of 2004, an increase of \$8.9 million or 11% from \$83.4 million in the second quarter of 2003. Noninterest income for the first six months of 2004 increased to \$178.5 million from \$159.4 million in the first six months of 2003, a 12% increase. During the second quarter and first six months of 2004, the increases of 11% and 12%, respectively, were primarily due to increased deposit charges and services fees, which rose \$13.9 million, or 36%, and \$24.6 million, or 33%, over the second quarter and first six months of 2003, respectively.

The increases in deposit charges and services fees are attributable to the Company's 35% deposit growth rate during this same period. These increases were offset by decreases in both Commerce Capital Markets, Inc. (CCMI) revenues and loan brokerage fees, which decreased in total by \$6.9 million, or 40%, and \$12.0 million, or 34%, during the second quarter and first six months of 2004, respectively, compared to the same periods in 2003. The decrease in CCMI revenues was related primarily to volatility in interest rates during the second quarter of 2004 and the resulting impact on the trading and sales function. The decrease in loan brokerage fees resulted from declines in mortgage refinancing activity during 2004.

| | Three Months Ended | | | Six Months Ended | |
|---------------------------------|------------------------|----------|------------|------------------------|-----------|
| | 6/30/04 | 6/30/03 | % Increase | 6/30/04 | 6/30/03 |
| | (Dollars in thousands) | | | (Dollars in thousands) | |
| Deposit charges & service fees | \$52,717 | \$38,765 | 36% | \$98,198 | \$67,430 |
| Other operating income: | | | | | |
| Insurance | 18,570 | 17,190 | 8 | 36,906 | 34,190 |
| Capital Markets | 6,622 | 9,695 | (32) | 16,349 | 24,887 |
| Loan Brokerage Fees | 3,725 | 7,545 | (51) | 6,778 | 13,340 |
| Other | 10,006 | 8,958 | 12 | 19,217 | 17,000 |
| Total other | 38,923 | 43,388 | (10) | 79,250 | 89,417 |
| Net investment securities gains | 635 | 1,217 | (48) | 1,059 | 1,980 |
| Total non-interest income | \$92,275 | \$83,370 | 11% | \$178,507 | \$159,364 |

Noninterest Expense

For the second quarter of 2004, noninterest expense totaled \$226.3 million, an increase of \$38.6 million or 21% over the same period in 2003. For the first six months of 2004, noninterest expense totaled \$438.5 million, an increase of \$78.7 million or 22% over \$359.8 million for the first six months of 2003. Contributing to this increase was new branch activity over the past twelve months, with the number of branches increasing from 243 at June 30, 2003 to 289 at June 30, 2004. With the addition of these new offices, staff, facilities, and related expenses rose accordingly. Other noninterest expenses rose \$7.3 million during the second quarter of 2004 over the same period in 2003 and \$16.5 million

during the first six months of 2004 over the same period in 2003. These increases resulted primarily from higher bank card-related service charges, increased business development expenses, and increased provisions for non-credit-related losses.

The Company continued to experience positive operating leverage in the second quarter, as revenue growth of 28% exceeded non-interest expense growth of 21%. One important factor influencing the growth in non-interest expenses is that the Company absorbed significant start-up expenses related to the New York City and Long Island markets in prior years. As a result, the impact of the growth in non-interest expenses in these markets is declining in 2004.

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The Company's operating efficiency ratio (noninterest expenses, less other real estate expense, divided by net interest income plus noninterest income excluding non-recurring gains) was 67.5% for the first six months of 2004 as compared to 71.3% for the same 2003 period. This improvement in the operating efficiency ratio is due to the positive operating leverage ratio discussed above. The Company's efficiency ratio remains above its peer group primarily due to its aggressive growth expansion activities.

Loan and Asset Quality

Total non-performing assets (non-performing loans and other real estate, excluding loans past due 90 days or more and still accruing interest) at June 30, 2004 were \$30.4 million, or 0.11% of total assets compared to \$23.6 million or 0.10% of total assets at December 31, 2003 and \$24.1 million or 0.12% of total assets at June 30, 2003.

Total non-performing loans (non-accrual loans and restructured loans, excluding loans past due 90 days or more and still accruing interest) at June 30, 2004 were \$29.7 million or 0.36% of total loans compared to \$21.7 million or 0.29% of total loans at December 31, 2003 and \$22.5 million or 0.35% of total loans at June 30, 2003. At June 30, 2004, loans past due 90 days or more and still accruing interest amounted to \$318 thousand compared to \$538 thousand at December 31, 2003 and \$434 thousand at June 30, 2003. Additional loans considered as potential problem loans by the Company's internal loan review department (\$38.1 million at June 30, 2004) have been evaluated as to risk exposure in determining the adequacy of the allowance for loan losses.

The increase in commercial non-accrual loans during 2004 is the result of four credits that experienced difficulties in the first quarter of 2004 and were in the process of collection and/or liquidation at the end of the second quarter. This increase in commercial non-accrual loans has led to the overall increase in non-performing assets noted during the first six months of 2004. Total non-performing assets and loans past due 90 days or more decreased slightly from March 31, 2004 to June 30, 2004 primarily as a result of collections on existing commercial non-accrual loans.

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The following summary presents information regarding non-performing loans and assets as of June 30, 2004 and the preceding four quarters (dollar amounts in thousands).

| | June 30, 2004 | March 31, 2004 | December 31, 2003 | Septem 2003 |
|---|------------------|-------------------|----------------------|----------------|
| Non-accrual loans: | | | | |
| Commercial | \$17,382 | \$19,701 | \$ 6,867 | \$ 7,867 |
| Consumer | 11,675 | 9,984 | 9,242 | 8,242 |
| Commercial real estate: | | | | |
| Construction | | | 138 | 138 |
| Mortgage | 675 | 810 | 5,494 | 7,494 |
| Total non-accrual loans | 29,732 | 30,495 | 21,741 | 23,732 |
| Restructured loans: | | | | |
| Commercial | 1 | 1 | 1 | 1 |
| Consumer | | | | |
| Commercial real estate: | | | | |
| Construction | | | | |
| Mortgage | | | | |
| Total restructured loans | 1 | 1 | 1 | 1 |
| Total non-performing loans | 29,733 | 30,496 | 21,742 | 23,733 |
| Other real estate | 653 | 1,890 | 1,831 | 1,831 |
| Total non-performing assets | 30,386 | 32,386 | 23,573 | 24,564 |
| Loans past due 90 days or more and still accruing | 318 | 696 | 538 | 538 |
| Total non-performing assets and loans past due 90 days or more | \$30,704 | \$33,082 | \$24,111 | \$25,102 |
| Total non-performing loans as a percentage of total period-end loans | 0.36% | 0.39% | 0.29% | 0.29% |
| Total non-performing assets as a percentage of total period-end assets | 0.11% | 0.13% | 0.10% | 0.10% |
| Total non-performing assets and loans past due 90 days or more as a percentage of total period-end assets | 0.11% | 0.13% | 0.11% | 0.11% |
| Allowance for loan losses as a percentage of total non-performing loans | 419% | 385% | 515% | 515% |
| Allowance for loan losses as a percentage of total period-end loans | 1.50% | 1.51% | 1.51% | 1.51% |
| Total non-performing assets and loans | | | | |

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past due 90 days or more as a percentage of stockholders' equity and allowance for loan losses

2%

2%

2%

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The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data (dollar amounts in thousands).

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|----------|------------------|----------|
| | 06/30/04 | 06/30/03 | 06/30/04 | 06/30/03 |
| Balance at beginning of period | \$117,329 | \$94,731 | \$112,057 | \$90,731 |
| Provisions charged to operating expenses | 10,748 | 6,900 | 20,248 | 13,800 |
| | 128,077 | 101,631 | 132,305 | 104,531 |
| Recoveries on loans charged-off: | | | | |
| Commercial | 104 | 141 | 260 | 300 |
| Consumer | 101 | 146 | 371 | 270 |
| Commercial real estate | 1 | - | 48 | - |
| Total recoveries | 206 | 287 | 679 | 570 |
| Loans charged-off: | | | | |
| Commercial | (2,587) | (1,197) | (4,880) | (3,000) |
| Consumer | (1,004) | (1,390) | (1,776) | (2,700) |
| Commercial real estate | (4) | (13) | (1,640) | (1,640) |
| Total charge-offs | (3,595) | (2,600) | (8,296) | (7,340) |
| Net charge-offs | (3,389) | (2,313) | (7,617) | (6,770) |
| Balance at end of period | \$124,688 | \$99,318 | \$124,688 | \$99,318 |
| Net charge-offs as a percentage of average loans outstanding | 0.17% | 0.15% | 0.19% | 0.15% |
| Net reserve additions | \$ 7,359 | \$ 4,587 | \$12,631 | \$8,500 |

During the first six months of 2004, there was an increase in commercial and commercial real estate loan charge-offs. These increases are related to a large credit that experienced difficulties during the first quarter of 2004 and another credit with both a real estate as well as a commercial component. The real estate component of this credit was sold and resulted in a \$1.5 million charge-off. Consumer loan charge-offs continued to decrease during the first six months of 2004, Consumer loan charge-offs during 2003 reflect charge-offs which arose as a result of attempts to defraud the Company and several other financial institutions and mortgage companies. The net reserve additions for the first six

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months and second quarter of 2004 are reflective of the increases in the non-performing assets since December 31, 2003 and increases in the overall loan portfolio.

The Company considers the allowance for loan losses of \$124.7 million adequate to cover probable losses inherent in the loan portfolio at June 30, 2004. The Company's determination of the level of the allowance for loan losses rests upon various judgments and assumptions surrounding the risk characteristics included in the loan portfolio. Such risk characteristics include changes in levels and trends of charge-offs, delinquencies, and nonaccrual loans, trends in volume and terms of loans, changes in underwriting standards and practices, portfolio mix, tenure of loan officers and management, entrance into new geographic markets, changes in credit concentrations, and national and local economic trends and conditions, and other relevant factors, all of which may be susceptible to significant change.

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Forward-Looking Statements

The Company may from time to time make written or oral "forward-looking statements", including statements contained in the Company's filings with the Securities and Exchange Commission (including this Form 10-Q), in its reports to stockholders and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties and are subject to change based on various factors (some of which are beyond the Company's control). The words "may", "could", "should", "would", "believe", "anticipate", "estimate", "expect", "intend", "plan" and similar expressions are intended to identify forward-looking statements. The following factors, among others, could cause the Company's financial performance to differ materially from that expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary and fiscal policies, including interest rate policies of the Board of Governors of the Federal Reserve System (the "FRB"); inflation; interest rates, market and monetary fluctuations; the timely development of competitive new products and services by the Company and the acceptance of such products and services by customers; the willingness of customers to substitute competitors' products and services for the Company's products and services and vice versa; the impact of changes in financial services' laws and regulations (including laws concerning taxes, banking, securities and insurance); technological changes; future acquisitions; the expense savings and revenue enhancements from acquisitions being less than expected; the growth and profitability of the Company's noninterest or fee income being less than expected; unanticipated regulatory or judicial proceedings; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The Company cautions that the foregoing list of important factors is not exclusive. The Company does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on

behalf of the Company.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operation, Interest Rate Sensitivity and Liquidity.

Item 4. Controls and Procedures

Quarterly evaluation of the Company's Disclosure Controls and Internal Controls. As of the end of the period covered by this quarterly report, the Company has evaluated the effectiveness of the design and operation of its "disclosure controls and procedures" ("Disclosure Controls"). This evaluation ("Controls Evaluation") was done under the supervision and with the participation of management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO").

Limitations on the Effectiveness of Controls. The Company's management, including the CEO and CFO, does not expect that its Disclosure Controls or its "internal controls and procedures for financial reporting" ("Internal Controls") will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become

inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company conducts periodic evaluations of its internal controls to enhance, where necessary, its procedures and controls.

Conclusions. Based upon the Controls Evaluation, the CEO and CFO have concluded that, subject to the limitations noted above, the Disclosure Controls are effective in reaching a reasonable level of assurance that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms.

During the quarter ended June 30, 2004, there has not occurred any significant change in Internal Controls that has materially affected or is reasonably likely

to materially affect Internal Controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On June 29, 2004 the U.S. Attorney General indicted two officers of the Company's Philadelphia bank subsidiary in connection with its investigation of certain Philadelphia city government officials. The Company confirms that neither it, nor any of its subsidiaries or other officers and employees are targets of the investigation. The Company has fully cooperated with this investigation and believes it will have no material negative financial impact on the Company.

During July 2004, class action complaints were filed in the United States District Court for the District of New Jersey and the Eastern District of Pennsylvania against the Company and certain Company (or subsidiary) current and former officers and directors. The complaints allege that the defendants violated the federal securities laws, specifically Sections 10 (b) and 20 (a) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The plaintiffs seek unspecified damages on behalf of a purported class of purchasers of the Company's securities during various periods. The Company believes that the complaints against it are without merit and intends to vigorously defend itself.

Item 2. Changes in Securities, Use of Proceeds and Purchases of Certain Equity

Securities by the Issuer and Others

There were no purchases of equity securities by the Company during the second quarter of 2004.

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of the Registrant's Shareholders was held on June 11, 2004. Proxies representing 70,951,587 shares were received (total shares outstanding as of the record date were 77,907,957). The items of business acted upon at the Annual Meeting were (i) the election of 13 directors for one year terms; (ii) approval of the Commerce Bancorp, Inc.'s 2004 Employee Stock Option Plan; (iii) approval of the amendment to Bancorp's Restated Certificate of Incorporation to increase the number of shares of Common Stock that Bancorp is authorized to issue by 350,000,000 shares; and (iv) approval of the appointment of Ernst & Young LLP as Bancorp's independent auditors for the fiscal year ending December 31, 2004. The number of votes cast for, against, or withheld, as well as the number of abstentions and broker non-votes was as follows:

(i) Election of directors:

| | | |
|---------|-----|----------------------|
| Name of | | (Withhold Authority) |
| Nominee | For | Against |

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| ----- | --- | ----- |
|--------------------------|------------|-----------|
| Vernon W. Hill, II | 69,187,219 | 1,764,368 |
| Robert C. Beck | 64,560,038 | 6,391,549 |
| Jack R Bershad | 65,585,542 | 5,366,045 |
| Joseph E. Buckelew | 69,073,581 | 1,878,006 |
| Donald T. DiFrancesco | 64,468,447 | 6,483,140 |
| John P. Ferguson | 70,034,043 | 917,544 |
| Morton N. Kerr | 66,435,444 | 4,516,143 |
| Steven M. Lewis | 69,277,641 | 1,673,946 |
| George E. Norcross, III | 68,958,279 | 1,993,308 |
| Joseph J. Plumeri, II | 70,024,804 | 926,783 |
| Daniel J. Ragone | 67,905,369 | 3,046,218 |
| William A. Schwartz, Jr. | 70,034,493 | 917,094 |
| Joseph T. Tarquini, Jr. | 68,144,986 | 2,806,601 |

(ii) Approval of Commerce Bancorp, Inc.'s 2004 Employee Stock Option:

| For --- | Against ----- | Abstain ----- | Broker Non-Vote ----- |
|------------|------------------|------------------|-----------------------------|
| 28,378,564 | 21,971,757 | 284,459 | 27,273,177 |

(iii) Approval of the amendment to Bancorp's Restated Certificate of Incorporation to increase the number of shares of Common Stock that Bancorp is authorized to issue by 350,000,000 shares:

| For --- | Against ----- | Abstain ----- | Broker Non-Vote ----- |
|------------|------------------|------------------|-----------------------------|
| 52,451,292 | 18,288,419 | 211,876 | 6,956,370 |

(iv) Approval of the appointment of Ernst & Young LLP as Bancorp's independent auditors for the fiscal year ending December 31, 2004:

| For --- | Against ----- | Abstain ----- | Broker Non-Vote ----- |
|------------|------------------|------------------|-----------------------------|
| 70,146,667 | 631,760 | 173,161 | 6,956,369 |

Item 6. Exhibits and Reports on Form 8-K

Exhibits

| | |
|---------------|--|
| Exhibit 3.2 | By-laws of the Company, as amended. |
| Exhibit 10.37 | The Company's 2004 Employee Stock Option Plan. |
| Exhibit 31.1 | Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

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- Exhibit 31.2 Certification of the Company's Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- Exhibit 32 Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Reports on Form 8-K

On April 13, 2004, we filed a Current Report on Form 8-K which included as exhibits a press release, issued by us on April 13, 2004, announcing our results for the first quarter of 2004 and certain supplemental information.

On June 2, 2004, we filed a Current Report on Form 8-K, which included certain questions and answers regarding corporate information.

On June 29, 2004, we filed a Current Report on Form 8-K, which announced the indictment of two officers of the Company in connection with the U.S. Attorney General's investigation of certain Philadelphia government officials.

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SIGNATURES

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

COMMERCE BANCORP, INC.

(Registrant)

AUGUST 9, 2004

(Date)

/s/ DOUGLAS J. PAULS

DOUGLAS J. PAULS
SENIOR VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER
(PRINCIPAL FINANCIAL AND ACCOUNTING OFFICER)

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