

COMMERCE BANCSHARES INC /MO/
Form 10-Q
November 07, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark
One)

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

For the quarterly period ended September 30, 2012

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

For the transition period from to
Commission File No. 0-2989

COMMERCE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Missouri 43-0889454
(State of Incorporation) (IRS Employer Identification No.)

1000 Walnut, 64106
Kansas City, MO
(Address of principal executive offices) (Zip Code)

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

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

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Yes No

As of November 1, 2012, the registrant had outstanding 87,301,292 shares of its \$5 par value common stock, registrant's only class of common stock.

Commerce Bancshares, Inc. and Subsidiaries

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PART I: FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

| | September 30, 2012 (Unaudited) (In thousands) | December 31, 2011 |
|---|--|----------------------|
| ASSETS | | |
| Loans | \$9,638,645 | \$9,177,478 |
| Allowance for loan losses | (175,032) | (184,532) |
| Net loans | 9,463,613 | 8,992,946 |
| Loans held for sale | 8,741 | 31,076 |
| Investment securities: | | |
| Available for sale (\$742,060,000 and \$418,046,000 pledged in 2012 and 2011, respectively, to secure repurchase agreements) | 9,020,951 | 9,224,702 |
| Trading | 13,595 | 17,853 |
| Non-marketable | 117,540 | 115,832 |
| Total investment securities | 9,152,086 | 9,358,387 |
| Short-term federal funds sold and securities purchased under agreements to resell | 10,475 | 11,870 |
| Long-term securities purchased under agreements to resell | 850,000 | 850,000 |
| Interest earning deposits with banks | 132,144 | 39,853 |
| Cash and due from banks | 426,742 | 465,828 |
| Land, buildings and equipment, net | 350,040 | 360,146 |
| Goodwill | 125,585 | 125,585 |
| Other intangible assets, net | 5,804 | 7,714 |
| Other assets | 353,539 | 405,962 |
| Total assets | \$20,878,769 | \$20,649,367 |
| LIABILITIES AND EQUITY | | |
| Deposits: | | |
| Non-interest bearing | \$5,814,932 | \$5,377,549 |
| Savings, interest checking and money market | 9,025,688 | 8,933,941 |
| Time open and C.D.'s of less than \$100,000 | 1,094,215 | 1,166,104 |
| Time open and C.D.'s of \$100,000 and over | 914,795 | 1,322,289 |
| Total deposits | 16,849,630 | 16,799,883 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,257,949 | 1,256,081 |
| Other borrowings | 103,744 | 111,817 |
| Other liabilities | 360,374 | 311,225 |
| Total liabilities | 18,571,697 | 18,479,006 |
| 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 89,277,398 shares in 2012 and 2011 | 446,387 | 446,387 |
| Capital surplus | 1,033,515 | 1,042,065 |
| Retained earnings | 717,138 | 575,419 |

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| | | | |
|--|--------------|--------------|---|
| Treasury stock of 1,561,575 shares in 2012 and 217,755 shares in 2011, at cost | (60,644 |) (8,362 |) |
| Accumulated other comprehensive income | 166,040 | 110,538 | |
| Total Commerce Bancshares, Inc. stockholders' equity | 2,302,436 | 2,166,047 | |
| Non-controlling interest | 4,636 | 4,314 | |
| Total equity | 2,307,072 | 2,170,361 | |
| Total liabilities and equity | \$20,878,769 | \$20,649,367 | |

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

| (In thousands, except per share data) | For the Three Months | | For the Nine Months | |
|---|----------------------|------------|---------------------|------------|
| | Ended September 30 | | Ended September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| | (Unaudited) | | | |
| INTEREST INCOME | | | | |
| Interest and fees on loans | \$ 111,619 | \$ 114,731 | \$ 335,627 | \$ 349,877 |
| Interest and fees on loans held for sale | 85 | 270 | 278 | 877 |
| Interest on investment securities | 46,513 | 51,697 | 157,832 | 164,298 |
| Interest on short-term federal funds sold and securities purchased under agreements to resell | 24 | 13 | 70 | 45 |
| Interest on long-term securities purchased under agreements to resell | 4,913 | 3,913 | 13,770 | 9,240 |
| Interest on deposits with banks | 40 | 211 | 207 | 411 |
| Total interest income | 163,194 | 170,835 | 507,784 | 524,748 |
| INTEREST EXPENSE | | | | |
| Interest on deposits: | | | | |
| Savings, interest checking and money market | 4,623 | 6,445 | 14,338 | 19,717 |
| Time open and C.D.'s of less than \$100,000 | 1,945 | 2,413 | 6,055 | 9,121 |
| Time open and C.D.'s of \$100,000 and over | 1,743 | 2,130 | 5,482 | 7,237 |
| Interest on federal funds purchased and securities sold under agreements to repurchase | 221 | 292 | 623 | 1,601 |
| Interest on other borrowings | 851 | 925 | 2,633 | 2,759 |
| Total interest expense | 9,383 | 12,205 | 29,131 | 40,435 |
| Net interest income | 153,811 | 158,630 | 478,653 | 484,313 |
| Provision for loan losses | 5,581 | 11,395 | 18,961 | 39,372 |
| Net interest income after provision for loan losses | 148,230 | 147,235 | 459,692 | 444,941 |
| NON-INTEREST INCOME | | | | |
| Bank card transaction fees | 39,488 | 42,149 | 112,655 | 120,915 |
| Trust fees | 23,681 | 22,102 | 70,328 | 66,218 |
| Deposit account charges and other fees | 19,873 | 21,939 | 59,184 | 62,028 |
| Capital market fees | 5,110 | 5,556 | 16,991 | 15,255 |
| Consumer brokerage services | 2,441 | 2,333 | 7,543 | 7,876 |
| Loan fees and sales | 1,358 | 2,034 | 4,625 | 5,933 |
| Other | 8,971 | 5,519 | 24,995 | 20,657 |
| Total non-interest income | 100,922 | 101,632 | 296,321 | 298,882 |
| INVESTMENT SECURITIES GAINS (LOSSES), NET | | | | |
| Impairment (losses) reversals on debt securities | 5,989 | (1,200) | 11,579 | 2,986 |
| Noncredit-related losses (reversals) on securities not expected to be sold | (6,546) | 369 | (12,806) | (4,741) |
| Net impairment losses | (557) | (831) | (1,227) | (1,755) |
| Realized gains on sales and fair value adjustments | 3,737 | 3,418 | 9,783 | 7,625 |
| Investment securities gains, net | 3,180 | 2,587 | 8,556 | 5,870 |
| NON-INTEREST EXPENSE | | | | |
| Salaries and employee benefits | 89,292 | 85,700 | 266,346 | 257,315 |
| Net occupancy | 11,588 | 11,510 | 33,953 | 34,760 |
| Equipment | 4,976 | 5,390 | 15,164 | 16,669 |
| Supplies and communication | 5,400 | 5,674 | 16,680 | 16,898 |
| Data processing and software | 19,279 | 16,232 | 55,030 | 50,230 |

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| | | | | |
|--|----------|----------|-----------|-----------|
| Marketing | 4,100 | 4,545 | 12,391 | 13,298 |
| Deposit insurance | 2,608 | 2,772 | 7,746 | 10,443 |
| Other | 16,148 | 21,923 | 52,882 | 61,606 |
| Total non-interest expense | 153,391 | 153,746 | 460,192 | 461,219 |
| Income before income taxes | 98,941 | 97,708 | 304,377 | 288,474 |
| Less income taxes | 32,155 | 31,699 | 99,541 | 91,898 |
| Net income | 66,786 | 66,009 | 204,836 | 196,576 |
| Less non-controlling interest expense | 780 | 657 | 2,298 | 1,737 |
| Net income attributable to Commerce Bancshares, Inc. | \$66,006 | \$65,352 | \$202,538 | \$194,839 |
| Net income per common share — basic | \$.75 | \$.72 | \$2.29 | \$2.14 |
| Net income per common share — diluted | \$.75 | \$.72 | \$2.29 | \$2.13 |

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (In thousands) | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|--|--|-----------|---|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| | (Unaudited) | | | |
| Net income | \$66,786 | \$66,009 | \$204,836 | \$196,576 |
| Other comprehensive income (loss): | | | | |
| Available for sale debt securities for which a portion of an other-than-temporary impairment (OTTI) has been recorded in earnings: | | | | |
| Unrealized holding gains (losses) subsequent to initial OTTI recognition | 5,959 | (1,091) | 12,245 | 4,572 |
| Income tax (expense) benefit | (2,264) | 415 | (4,653) | (1,737) |
| Net unrealized gains (losses) on OTTI securities | 3,695 | (676) | 7,592 | 2,835 |
| Other available for sale investment securities: | | | | |
| Unrealized holding gains | 40,582 | 53,143 | 75,427 | 78,278 |
| Reclassification adjustment for gains included in net income | — | — | (342) | (177) |
| Net unrealized gains on securities | 40,582 | 53,143 | 75,085 | 78,101 |
| Income tax expense | (15,422) | (20,195) | (28,533) | (29,679) |
| Net unrealized gains on other securities | 25,160 | 32,948 | 46,552 | 48,422 |
| Prepaid pension cost: | | | | |
| Amortization of accumulated pension loss | 730 | 821 | 2,190 | 1,901 |
| Income tax expense | (277) | (312) | (832) | (722) |
| Pension loss amortization | 453 | 509 | 1,358 | 1,179 |
| Other comprehensive income | 29,308 | 32,781 | 55,502 | 52,436 |
| Comprehensive income | 96,094 | 98,790 | 260,338 | 249,012 |
| Non-controlling interest expense | (780) | (657) | (2,298) | (1,737) |
| Comprehensive income attributable to Commerce Bancshares, Inc. | \$95,314 | \$98,133 | \$258,040 | \$247,275 |

See accompanying notes to consolidated financial statements.

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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, 2012 | \$446,387 | \$1,042,065 | \$575,419 | \$(8,362) | \$110,538 | \$ 4,314 | \$2,170,361 |
| Net income | | | 202,538 | | | 2,298 | 204,836 |
| Other comprehensive income | | | | | 55,502 | | 55,502 |
| Distributions to non-controlling interest | | | | | | (1,976) | (1,976) |
| Purchase of treasury stock | | | | (75,536) | | | (75,536) |
| Issuance of stock under purchase and equity compensation plans | | (4,987) | | 14,753 | | | 9,766 |
| Net tax benefit related to equity compensation plans | | 1,233 | | | | | 1,233 |
| Stock-based compensation | | 3,705 | | | | | 3,705 |
| Issuance of nonvested stock awards | | (8,501) | | 8,501 | | | — |
| Cash dividends (\$.690 per share) | | | (60,819) | | | | (60,819) |
| Balance September 30, 2012 | \$446,387 | \$1,033,515 | \$717,138 | \$(60,644) | \$166,040 | \$ 4,636 | \$2,307,072 |
| Balance January 1, 2011 | \$433,942 | \$971,293 | \$555,778 | \$(2,371) | \$63,345 | \$ 1,477 | \$2,023,464 |
| Net income | | | 194,839 | | | 1,737 | 196,576 |
| Other comprehensive income | | | | | 52,436 | | 52,436 |
| Distributions to non-controlling interest | | | | | | (463) | (463) |
| Purchase of treasury stock | | | | (101,111) | | | (101,111) |
| Issuance of stock under purchase and equity compensation plans | 1,563 | 5,261 | | 7,236 | | | 14,060 |
| Net tax benefit related to equity compensation plans | | 1,025 | | | | | 1,025 |
| Stock-based compensation | | 3,614 | | | | | 3,614 |
| Issuance of nonvested stock awards | 976 | (1,017) | | 41 | | | — |
| Cash dividends (\$.657 per share) | | | (59,636) | | | | (59,636) |
| Balance September 30, 2011 | \$436,481 | \$980,176 | \$690,981 | \$(96,205) | \$115,781 | \$ 2,751 | \$2,129,965 |

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands) | For the Nine Months Ended September 30 | |
|---|---|-------------|
| | 2012 | 2011 |
| | (Unaudited) | |
| OPERATING ACTIVITIES: | | |
| Net income | \$204,836 | \$196,576 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 18,961 | 39,372 |
| Provision for depreciation and amortization | 32,565 | 35,281 |
| Amortization of investment security premiums, net | 29,989 | 9,406 |
| Investment securities gains, net(A) | (8,556) | (5,870) |
| Net gains on sales of loans held for sale | (376) | (1,554) |
| Originations of loans held for sale | — | (41,231) |
| Proceeds from sales of loans held for sale | 22,649 | 67,065 |
| Net (increase) decrease in trading securities | 5,454 | (2,941) |
| Stock-based compensation | 3,705 | 3,614 |
| (Increase) decrease in interest receivable | 4,728 | (1,077) |
| Decrease in interest payable | (1,067) | (4,393) |
| Increase (decrease) in income taxes payable | (5,571) | 14,863 |
| Net tax benefit related to equity compensation plans | (1,233) | (1,025) |
| Other changes, net | (10,718) | 3,011 |
| Net cash provided by operating activities | 295,366 | 311,097 |
| INVESTING ACTIVITIES: | | |
| Proceeds from sales of investment securities(A) | 14,931 | 11,699 |
| Proceeds from maturities/pay downs of investment securities(A) | 2,341,083 | 1,968,848 |
| Purchases of investment securities(A) | (2,036,260) | (2,926,445) |
| Net (increase) decrease in loans | (489,628) | 288,987 |
| Long-term securities purchased under agreements to resell | (125,000) | (500,000) |
| Repayments of long-term securities purchased under agreements to resell | 125,000 | 100,000 |
| Purchases of land, buildings and equipment | (19,243) | (16,135) |
| Sales of land, buildings and equipment | 2,338 | 2,288 |
| Net cash used in investing activities | (186,779) | (1,070,758) |
| FINANCING ACTIVITIES: | | |
| Net increase in non-interest bearing, savings, interest checking and money market deposits | 554,167 | 1,090,342 |
| Net decrease in time open and C.D.'s | (479,383) | (150,511) |
| Net increase in short-term federal funds purchased and securities sold under agreements to repurchase | 1,868 | 74,901 |
| Repayment of long-term borrowings | (8,073) | (404) |
| Purchases of treasury stock | (75,536) | (101,111) |
| Issuance of stock under stock purchase and equity compensation plans | 9,766 | 14,060 |
| Net tax benefit related to equity compensation plans | 1,233 | 1,025 |
| Cash dividends paid on common stock | (60,819) | (59,636) |
| Net cash provided by (used in) financing activities | (56,777) | 868,666 |
| Increase in cash and cash equivalents | 51,810 | 109,005 |
| Cash and cash equivalents at beginning of year | 517,551 | 460,675 |
| Cash and cash equivalents at September 30 | \$569,361 | \$569,680 |

(A) Available for sale and non-marketable securities

| | | |
|---|-----------|----------|
| Income tax payments, net | \$104,175 | \$76,795 |
| Interest paid on deposits and borrowings | \$30,198 | \$44,828 |
| Loans transferred to foreclosed real estate | \$7,178 | \$20,630 |

See accompanying notes to consolidated financial statements.

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Commerce Bancshares, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012 (Unaudited)

1. Principles of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts of Commerce Bancshares, Inc. and all majority-owned subsidiaries (the Company). Most of the Company's operations are conducted by its subsidiary bank, Commerce Bank (the Bank). The consolidated financial statements in this report have not been audited. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to 2011 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, 2012 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 2011 Annual Report on Form 10-K.

2. Loans and Allowance for Loan Losses

Major classifications within the Company's held to maturity loan portfolio at September 30, 2012 and December 31, 2011 are as follows:

| (In thousands) | September 30, 2012 | December 31, 2011 |
|-------------------------------------|-----------------------|----------------------|
| Commercial: | | |
| Business | \$3,098,908 | \$2,808,265 |
| Real estate – construction and land | 335,113 | 386,598 |
| Real estate – business | 2,193,206 | 2,180,100 |
| Personal Banking: | | |
| Real estate – personal | 1,556,754 | 1,428,777 |
| Consumer | 1,243,400 | 1,114,889 |
| Revolving home equity | 453,527 | 463,587 |
| Consumer credit card | 748,885 | 788,701 |
| Overdrafts | 8,852 | 6,561 |
| Total loans | \$9,638,645 | \$9,177,478 |

At September 30, 2012, loans of \$3.2 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 \$1.2 billion were pledged at the Federal Reserve Bank as collateral for discount window borrowings.

Allowance for loan losses

A summary of the activity in the allowance for loan losses during the three and nine months ended September 30, 2012 follows:

| (In thousands) | For the Three Months Ended September 30 | | | For the Nine Months Ended September 30 | | |
|----------------|--|---------------------|-------|---|---------------------|-------|
| | Commercial | Personal Banking | Total | Commercial | Personal Banking | Total |

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| | | | | | | |
|--------------------------------|-----------|----------|-----------|-----------|----------|-----------|
| Balance at beginning of period | \$114,671 | \$63,862 | \$178,533 | \$122,497 | \$62,035 | \$184,532 |
| Provision | (2,479 |)8,060 | 5,581 | (10,125 |)29,086 | 18,961 |
| Deductions: | | | | | | |
| Loans charged off | 1,795 | 12,480 | 14,275 | 7,502 | 39,710 | 47,212 |
| Less recoveries on loans | 1,720 | 3,473 | 5,193 | 7,247 | 11,504 | 18,751 |
| Net loans charged off | 75 | 9,007 | 9,082 | 255 | 28,206 | 28,461 |
| Balance September 30, 2012 | \$112,117 | \$62,915 | \$175,032 | \$112,117 | \$62,915 | \$175,032 |

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A summary of the activity in the allowance for loan losses during the three and nine months ended September 30, 2011 follows:

| (In thousands) | For the Three Months Ended September 30 | | | For the Nine Months Ended September 30 | | |
|--------------------------------|--|---------------------|------------|---|---------------------|------------|
| | Commercial | Personal Banking | Total | Commercial | Personal Banking | Total |
| Balance at beginning of period | \$ 127,263 | \$ 64,275 | \$ 191,538 | \$ 119,946 | \$ 77,592 | \$ 197,538 |
| Provision | 1,503 | 9,892 | 11,395 | 16,783 | 22,589 | 39,372 |
| Deductions: | | | | | | |
| Loans charged off | 4,047 | 14,831 | 18,878 | 14,357 | 47,512 | 61,869 |
| Less recoveries on loans | 514 | 3,469 | 3,983 | 2,861 | 10,136 | 12,997 |
| Net loans charged off | 3,533 | 11,362 | 14,895 | 11,496 | 37,376 | 48,872 |
| Balance September 30, 2011 | \$ 125,233 | \$ 62,805 | \$ 188,038 | \$ 125,233 | \$ 62,805 | \$ 188,038 |

The following table shows the balance in the allowance for loan losses and the related loan balance at September 30, 2012 and December 31, 2011, disaggregated on the basis of impairment methodology. Impaired loans evaluated under ASC 310-10-35 include loans on non-accrual status, which are individually evaluated for impairment, and other impaired loans discussed below, which are deemed to have similar risk characteristics and are collectively evaluated. All other loans are collectively evaluated for impairment under ASC 450-20.

| (In thousands) | Impaired Loans Allowance for Loans | | All Other Loans Allowance for Loans | |
|--------------------|---------------------------------------|-------------|--|--------------|
| | Loan Losses | Outstanding | Loan Losses | Outstanding |
| September 30, 2012 | | | | |
| Commercial | \$ 6,542 | \$ 88,678 | \$ 105,575 | \$ 5,538,549 |
| Personal Banking | 1,952 | 26,284 | 60,963 | 3,985,134 |
| Total | \$ 8,494 | \$ 114,962 | \$ 166,538 | \$ 9,523,683 |
| December 31, 2011 | | | | |
| Commercial | \$ 6,668 | \$ 108,167 | \$ 115,829 | \$ 5,266,796 |
| Personal Banking | 4,090 | 31,088 | 57,945 | 3,771,427 |
| Total | \$ 10,758 | \$ 139,255 | \$ 173,774 | \$ 9,038,223 |

Impaired loans

The table below shows the Company's investment in impaired loans at September 30, 2012 and December 31, 2011. 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. They are largely comprised of certain business, construction and business real estate loans classified as substandard. Upon maturity, the loans renewed at interest rates that were judged not to be market rates for new debt with similar risk, and as a result were classified as troubled debt restructurings. These loans totaled \$44.4 million at September 30, 2012 and \$41.3 million at December 31, 2011. 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. Restructured loans also include certain credit card loans under various debt management and assistance programs, which totaled \$15.4 million at September 30, 2012 and \$22.4 million at December 31, 2011.

| (In thousands) | Sept. 30, 2012 | Dec. 31, 2011 |
|-------------------------------|----------------|---------------|
| Non-accrual loans | \$ 55,201 | \$ 75,482 |
| Restructured loans (accruing) | 59,761 | 63,773 |

| | | |
|----------------------|-----------|-----------|
| Total impaired loans | \$114,962 | \$139,255 |
|----------------------|-----------|-----------|

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The following table provides additional information about impaired loans held by the Company at September 30, 2012 and December 31, 2011, segregated between loans for which an allowance for credit losses has been provided and loans for which no allowance has been provided.

| (In thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
|-------------------------------------|------------------------|--------------------------------|----------------------|
| September 30, 2012 | | | |
| With no related allowance recorded: | | | |
| Business | \$10,674 | \$12,291 | \$— |
| Real estate – construction and land | 7,173 | 13,558 | — |
| Real estate – business | 7,289 | 8,524 | — |
| Real estate – personal | 1,262 | 1,390 | — |
| Revolving home equity | 510 | 843 | — |
| | \$26,908 | \$36,606 | \$— |
| With an allowance recorded: | | | |
| Business | \$19,644 | \$23,758 | \$1,873 |
| Real estate – construction and land | 27,101 | 40,728 | 2,328 |
| Real estate – business | 16,797 | 22,336 | 2,341 |
| Real estate – personal | 7,601 | 10,746 | 764 |
| Consumer | 1,435 | 1,475 | 21 |
| Revolving home equity | 73 | 73 | 1 |
| Consumer credit card | 15,403 | 15,403 | 1,166 |
| | \$88,054 | \$114,519 | \$8,494 |
| Total | \$114,962 | \$151,125 | \$8,494 |
| December 31, 2011 | | | |
| With no related allowance recorded: | | | |
| Business | \$19,759 | \$22,497 | \$— |
| Real estate – construction and land | 8,391 | 22,746 | — |
| Real estate – business | 6,853 | 9,312 | — |
| Real estate – personal | 793 | 793 | — |
| | \$35,796 | \$55,348 | \$— |
| With an allowance recorded: | | | |
| Business | \$15,604 | \$19,286 | \$1,500 |
| Real estate – construction and land | 37,387 | 47,516 | 2,580 |
| Real estate – business | 20,173 | 24,799 | 2,588 |
| Real estate – personal | 7,867 | 10,671 | 795 |
| Consumer credit card | 22,428 | 22,428 | 3,295 |
| | \$103,459 | \$124,700 | \$10,758 |
| Total | \$139,255 | \$180,048 | \$10,758 |

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Total average impaired loans for the three and nine month periods ending September 30, 2012 and 2011, respectively, are shown in the table below.

| (In thousands) | Commercial | Personal Banking | Total |
|---|------------|---------------------|-----------|
| Average Impaired Loans: | | | |
| For the three months ended September 30, 2012 | | | |
| Non-accrual loans | \$51,337 | \$7,621 | \$58,958 |
| Restructured loans (accruing) | 41,885 | 19,750 | 61,635 |
| Total | \$93,222 | \$27,371 | \$120,593 |
| For the nine months ended September 30, 2012 | | | |
| Non-accrual loans | \$59,159 | \$7,399 | \$66,558 |
| Restructured loans (accruing) | 44,063 | 21,204 | 65,267 |
| Total | \$103,222 | \$28,603 | \$131,825 |
| For the three months ended September 30, 2011 | | | |
| Non-accrual loans | \$68,554 | \$7,733 | \$76,287 |
| Restructured loans (accruing) | 41,993 | 22,522 | 64,515 |
| Total | \$110,547 | \$30,255 | \$140,802 |
| For the nine months ended September 30, 2011 | | | |
| Non-accrual loans | \$70,962 | \$7,277 | \$78,239 |
| Restructured loans (accruing) | 43,652 | 21,584 | 65,236 |
| Total | \$114,614 | \$28,861 | \$143,475 |

The table below shows interest income recognized during the three and nine month periods ending September 30, 2012 and 2011 for impaired loans held at the end of each respective period. This interest relates to accruing restructured loans, as discussed above.

| (In thousands) | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|---|--|-------|---|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Interest income recognized on impaired loans: | | | | |
| Business | \$248 | \$72 | \$745 | \$217 |
| Real estate – construction and land | 210 | 192 | 630 | 575 |
| Real estate – business | 72 | 174 | 216 | 522 |
| Real estate – personal | 22 | 8 | 65 | 24 |
| Consumer | 16 | — | 47 | — |
| Revolving home equity | 1 | — | 2 | — |
| Consumer credit card | 328 | 484 | 983 | 1,451 |
| Total | \$897 | \$930 | \$2,688 | \$2,789 |

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Delinquent and non-accrual loans

The following table provides aging information on the Company's past due and accruing loans, in addition to the balances of loans on non-accrual status, at September 30, 2012 and December 31, 2011.

| (In thousands) | Current or Less Than 30 Days Past Due | 30 – 89 Days Past Due | 90 Days Past Due and Still Accruing | Non-accrual | Total |
|-------------------------------------|--|-----------------------------|--|-------------|-------------|
| September 30, 2012 | | | | | |
| Commercial: | | | | | |
| Business | \$3,081,649 | \$2,598 | \$595 | \$ 14,066 | \$3,098,908 |
| Real estate – construction and land | 318,841 | 549 | 300 | 15,423 | 335,113 |
| Real estate – business | 2,158,019 | 16,668 | 90 | 18,429 | 2,193,206 |
| Personal Banking: | | | | | |
| Real estate – personal | 1,535,326 | 12,988 | 1,798 | 6,642 | 1,556,754 |
| Consumer | 1,226,713 | 15,350 | 1,206 | 131 | 1,243,400 |
| Revolving home equity | 450,540 | 1,494 | 983 | 510 | 453,527 |
| Consumer credit card | 732,749 | 8,876 | 7,260 | — | 748,885 |
| Overdrafts | 8,516 | 336 | — | — | 8,852 |
| Total | \$9,512,353 | \$58,859 | \$12,232 | \$ 55,201 | \$9,638,645 |
| December 31, 2011 | | | | | |
| Commercial: | | | | | |
| Business | \$2,777,578 | \$4,368 | \$595 | \$ 25,724 | \$2,808,265 |
| Real estate – construction and land | 362,592 | 1,113 | 121 | 22,772 | 386,598 |
| Real estate – business | 2,151,822 | 8,875 | 29 | 19,374 | 2,180,100 |
| Personal Banking: | | | | | |
| Real estate – personal | 1,406,449 | 11,671 | 3,045 | 7,612 | 1,428,777 |
| Consumer | 1,096,742 | 15,917 | 2,230 | — | 1,114,889 |
| Revolving home equity | 461,941 | 1,003 | 643 | — | 463,587 |
| Consumer credit card | 769,922 | 10,484 | 8,295 | — | 788,701 |
| Overdrafts | 6,173 | 388 | — | — | 6,561 |
| Total | \$9,033,219 | \$53,819 | \$14,958 | \$ 75,482 | \$9,177,478 |

Credit quality

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

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Commercial Loans

| (In thousands) | Business | Real Estate-Construction | Real Estate- Business | Total |
|--------------------|-------------|-----------------------------|-----------------------------|-------------|
| September 30, 2012 | | | | |
| Pass | \$2,978,076 | \$ 276,077 | \$2,057,584 | \$5,311,737 |
| Special mention | 56,130 | 7,388 | 44,936 | 108,454 |
| Substandard | 50,636 | 36,225 | 72,257 | 159,118 |
| Non-accrual | 14,066 | 15,423 | 18,429 | 47,918 |
| Total | \$3,098,908 | \$ 335,113 | \$2,193,206 | \$5,627,227 |
| December 31, 2011 | | | | |
| Pass | \$2,669,868 | \$ 304,408 | \$1,994,391 | \$4,968,667 |
| Special mention | 37,460 | 4,722 | 52,683 | 94,865 |
| Substandard | 75,213 | 54,696 | 113,652 | 243,561 |
| Non-accrual | 25,724 | 22,772 | 19,374 | 67,870 |
| Total | \$2,808,265 | \$ 386,598 | \$2,180,100 | \$5,374,963 |

The credit quality of Personal Banking loans is monitored primarily on the basis of aging/delinquency, and this information is provided in the table in the above Delinquency section. In addition, FICO scores are obtained and updated on a quarterly basis for most of the loans in the Personal Banking portfolio. This is a published credit score designed to measure the risk of default by taking into account various factors from a borrower's financial history. The Bank normally obtains a FICO score at the loan's origination and renewal dates, and updates are obtained on a quarterly basis. Excluded from the table below are certain loans for which FICO scores are not obtained because the loans are related to commercial activity. At September 30, 2012, these were comprised of \$225.6 million in personal real estate loans and \$127.1 million in consumer loans, or 8.8% of the Personal Banking portfolio. At December 31, 2011, these were comprised of \$222.8 million in personal real estate loans and \$148.7 million in consumer loans, or 9.8% of the Personal Banking portfolio. For the remainder of loans in the Personal Banking portfolio, the table below shows the percentage of balances outstanding at September 30, 2012 and December 31, 2011 by FICO score.

Personal Banking Loans

| | % of Loan Category | | | | |
|--------------------|---------------------------|----------|--------------------------|-------------------------|---|
| | Real Estate - Personal | Consumer | Revolving Home Equity | Consumer Credit Card | |
| September 30, 2012 | | | | | |
| FICO score: | | | | | |
| Under 600 | 2.4 | %6.5 | %2.4 | %4.4 | % |
| 600 - 659 | 3.6 | 10.4 | 5.6 | 11.6 | |
| 660 - 719 | 10.0 | 24.3 | 16.3 | 32.7 | |
| 720 - 779 | 26.7 | 26.7 | 29.0 | 28.4 | |
| 780 and Over | 57.3 | 32.1 | 46.7 | 22.9 | |
| Total | 100.0 | %100.0 | %100.0 | %100.0 | % |
| December 31, 2011 | | | | | |
| FICO score: | | | | | |
| Under 600 | 3.4 | %8.4 | %2.6 | %4.9 | % |
| 600 - 659 | 4.1 | 11.0 | 4.9 | 11.2 | |
| 660 - 719 | 12.2 | 23.2 | 15.1 | 31.0 | |
| 720 - 779 | 29.2 | 26.0 | 26.3 | 29.0 | |
| 780 and Over | 51.1 | 31.4 | 51.1 | 23.9 | |
| Total | 100.0 | %100.0 | %100.0 | %100.0 | % |

Troubled debt restructurings

As mentioned above, the Company's impaired loans include loans which have been classified as troubled debt restructurings, as shown in the table below. Total restructured loans include both loans on non-accrual status, which totaled \$27.5 million, and other restructured loans. Restructured loans are placed on non-accrual status if the Company does not believe it probable that amounts due under the contractual terms will be collected. Other restructured loans consist mainly of performing commercial loans and consumer credit card loans under debt management programs. The performing commercial loans are classified as troubled debt restructurings when, at renewal, the contractual interest rate of the renewed loan, which may be greater or less than the rate on the previous loan, was not judged to be a market rate for debt with similar risk. Consumer credit card loans classified as troubled

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debt restructurings are loans with borrowers under debt management plans. Modifications generally involve removing the available line of credit, placing loans on amortizing status and lowering the contractual interest rate.

The following table shows the outstanding balances at September 30, 2012 of loans classified as troubled debt restructurings, in addition to the outstanding balances of these restructured loans which the Company considers to have been in default at any time during the past twelve months. For purposes of this disclosure, the Company considers "default" to mean 90 days or more past due as to interest or principal.

| (In thousands) | September 30, 2012 | Balance 90 days past due at any time during previous 12 months |
|-------------------------------------|--------------------|--|
| Commercial: | | |
| Business | \$25,951 | \$974 |
| Real estate - construction and land | 32,180 | 8,189 |
| Real estate - business | 8,003 | 357 |
| Personal Banking: | | |
| Real estate - personal | 4,350 | 553 |
| Consumer | 1,304 | — |
| Revolving home equity | 73 | 49 |
| Consumer credit card | 15,403 | 887 |
| Total restructured loans | \$87,264 | \$11,009 |

For those loans on non-accrual status also classified as restructured, the modification did not create any further financial effect on the Company as those loans were already written down to net realizable value. For those performing commercial loans classified as restructured, there were no concessions involving forgiveness of principal or interest and, therefore, there was no financial impact to the Company as a result of modification to these loans. The effect of modifications to consumer credit card loans was estimated to decrease interest income by approximately \$2.6 million on an annual, pre-tax basis, compared to amounts contractually owed. The effect of modifications to the remaining performing loans in the personal banking portfolio was not significant.

The allowance for loan losses related to troubled debt restructurings on non-accrual status is determined by individual evaluation, including collateral adequacy, using the same process as loans on non-accrual status which are not classified as troubled debt restructurings. Those performing commercial loans classified as troubled debt restructurings are accruing loans which management expects to collect under contractual terms and are generally risk-rated as substandard. These loans had no other concessions granted other than being renewed at an interest rate judged not to be market. The allowance for loan losses related to accruing restructured loans is determined by collective evaluation because the loans have similar risk characteristics. Collective evaluation, which is the same process used for other substandard loans, considers historical experience and current economic factors.

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

The Company had commitments of \$12.9 million at September 30, 2012 to lend additional funds to borrowers with restructured loans.

The Company's holdings of foreclosed real estate totaled \$18.2 million and \$18.3 million at September 30, 2012 and December 31, 2011, respectively. Personal property acquired in repossession, generally autos and marine and recreational vehicles, totaled \$2.0 million and \$4.2 million at September 30, 2012 and December 31, 2011, 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.

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3. Investment Securities

Investment securities, at fair value, consisted of the following at September 30, 2012 and December 31, 2011.

| (In thousands) | Sept. 30, 2012 | Dec. 31, 2011 |
|-----------------------------|----------------|------------------|
| Available for sale | \$9,020,951 | \$9,224,702 |
| Trading | 13,595 | 17,853 |
| Non-marketable | 117,540 | 115,832 |
| Total investment securities | \$9,152,086 | \$9,358,387 |

Most of the Company's investment securities are classified as available for sale, and this portfolio is discussed in more detail below. Securities which are classified as non-marketable include Federal Home Loan Bank (FHLB) stock and Federal Reserve Bank stock held for debt and regulatory purposes, which totaled \$45.4 million at September 30, 2012 and \$45.3 million at December 31, 2011. Investment in Federal Reserve Bank stock is based on the capital structure of the investing bank, and investment in FHLB stock is tied to the level of borrowings from the FHLB. Non-marketable securities also include private equity investments, which amounted to \$72.1 million and \$70.5 million at September 30, 2012 and December 31, 2011, respectively.

A summary of the available for sale investment securities by maturity groupings as of September 30, 2012 is shown below. The investment portfolio includes agency mortgage-backed securities, which are guaranteed by agencies such as the FHLMC, FNMA, GNMA and FDIC, in addition to non-agency mortgage-backed securities, which have no guarantee. Also included are certain other asset-backed securities, which are primarily collateralized by credit cards, automobiles, student loans, and commercial loans. These securities differ from traditional debt securities primarily in that they may have uncertain maturity dates and are priced based on estimated prepayment rates on the underlying collateral. The Company does not have exposure to subprime originated mortgage-backed or collateralized debt obligation instruments.

| (In thousands) | Amortized Cost | Fair Value |
|--|-------------------|------------|
| U.S. government and federal agency obligations: | | |
| Within 1 year | \$ 500 | \$ 500 |
| After 1 but within 5 years | 217,296 | 241,881 |
| After 5 but within 10 years | 106,679 | 125,116 |
| Total U.S. government and federal agency obligations | 324,475 | 367,497 |
| Government-sponsored enterprise obligations: | | |
| After 1 but within 5 years | 108,506 | 112,286 |
| After 5 but within 10 years | 74,682 | 75,436 |
| After 10 years | 191,337 | 192,468 |
| Total government-sponsored enterprise obligations | 374,525 | 380,190 |
| State and municipal obligations: | | |
| Within 1 year | 92,856 | 93,592 |
| After 1 but within 5 years | 629,641 | 655,509 |
| After 5 but within 10 years | 510,060 | 528,245 |
| After 10 years | 193,502 | 183,905 |
| Total state and municipal obligations | 1,426,059 | 1,461,251 |
| Mortgage and asset-backed securities: | | |
| Agency mortgage-backed securities | 3,311,100 | 3,471,262 |
| Non-agency mortgage-backed securities | 241,657 | 255,172 |
| Asset-backed securities | 2,917,206 | 2,930,810 |

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| | | |
|--|-------------|-------------|
| Total mortgage and asset-backed securities | 6,469,963 | 6,657,244 |
| Other debt securities: | | |
| Within 1 year | 45,809 | 46,574 |
| After 1 but within 5 years | 60,744 | 63,898 |
| After 5 but within 10 years | 3,969 | 4,047 |
| After 10 years | 6,988 | 7,104 |
| Total other debt securities | 117,510 | 121,623 |
| Equity securities | 8,483 | 33,146 |
| Total available for sale investment securities | \$8,721,015 | \$9,020,951 |

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Included in U.S. government securities are \$366.9 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 \$127.7 million, at fair value, of auction rate securities, which were purchased from bank customers in 2008. Included in equity securities is common stock held by the holding company, Commerce Bancshares, Inc. (the Parent), with a fair value of \$28.0 million at September 30, 2012.

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, 2012 | | | | |
| U.S. government and federal agency obligations | \$324,475 | \$43,022 | \$— | \$367,497 |
| Government-sponsored enterprise obligations | 374,525 | 5,678 | (13 |) 380,190 |
| State and municipal obligations | 1,426,059 | 48,313 | (13,121 |) 1,461,251 |
| Mortgage and asset-backed securities: | | | | |
| Agency mortgage-backed securities | 3,311,100 | 160,215 | (53 |) 3,471,262 |
| Non-agency mortgage-backed securities | 241,657 | 13,698 | (183 |) 255,172 |
| Asset-backed securities | 2,917,206 | 14,840 | (1,236 |) 2,930,810 |
| Total mortgage and asset-backed securities | 6,469,963 | 188,753 | (1,472 |) 6,657,244 |
| Other debt securities | 117,510 | 4,113 | — | 121,623 |
| Equity securities | 8,483 | 24,663 | — | 33,146 |
| Total | \$8,721,015 | \$314,542 | \$(14,606 |) \$9,020,951 |
| December 31, 2011 | | | | |
| U.S. government and federal agency obligations | \$328,530 | \$36,135 | \$— | \$364,665 |
| Government-sponsored enterprise obligations | 311,529 | 4,169 | — | 315,698 |
| State and municipal obligations | 1,220,840 | 35,663 | (11,219 |) 1,245,284 |
| Mortgage and asset-backed securities: | | | | |
| Agency mortgage-backed securities | 3,989,464 | 117,088 | (493 |) 4,106,059 |
| Non-agency mortgage-backed securities | 315,752 | 8,962 | (7,812 |) 316,902 |
| Asset-backed securities | 2,692,436 | 7,083 | (6,376 |) 2,693,143 |
| Total mortgage and asset-backed securities | 6,997,652 | 133,133 | (14,681 |) 7,116,104 |
| Other debt securities | 135,190 | 6,070 | — | 141,260 |
| Equity securities | 18,354 | 23,337 | — | 41,691 |
| Total | \$9,012,095 | \$238,507 | \$(25,900 |) \$9,224,702 |

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, 2012, the fair value of securities on this watch list was \$207.1 million.

As of September 30, 2012, the Company had recorded other-than-temporary impairment (OTTI) on certain non-agency mortgage-backed securities, part of the watch list mentioned above, which had an aggregate fair value of \$108.1 million. The credit-related portion of the impairment totaled \$11.3 million and was recorded in earnings. The Company does not intend to sell these securities and believes it is not likely that it will be required to sell the securities before the recovery of their amortized cost bases.

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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 | 0% - 25% |
| Projected cumulative default | 13% - 58% |
| Credit support | 0% - 16% |
| Loss severity | 33% - 70% |

The following table shows changes in the credit losses recorded in the nine months ended September 30, 2012 and 2011, for which a portion of an OTTI was recognized in other comprehensive income.

| (In thousands) | For the Nine Months Ended September 30 | |
|---|---|---------|
| | 2012 | 2011 |
| Balance at January 1 | \$9,931 | \$7,542 |
| Credit losses on debt securities for which impairment was not previously recognized | — | 53 |
| Credit losses on debt securities for which impairment was previously recognized | 1,227 | 1,702 |
| Increase in expected cash flows that are recognized over remaining life of security | (93) | (105) |
| Balance at September 30 | \$11,065 | \$9,192 |

Securities with unrealized losses recorded in accumulated other comprehensive income are shown in the table below, along with the length of the impairment period.

| (In thousands) | Less than 12 months | | 12 months or longer | | Total | |
|---|---------------------|-------------------|---------------------|-------------------|-------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2012 | | | | | | |
| Government-sponsored enterprise obligations | \$9,979 | \$ 13 | \$— | \$— | \$9,979 | \$ 13 |
| State and municipal obligations | 16,548 | 34 | 98,242 | 13,087 | 114,790 | 13,121 |
| Mortgage and asset-backed securities: | | | | | | |
| Agency mortgage-backed securities | 6,072 | 5 | 19,145 | 48 | 25,217 | 53 |
| Non-agency mortgage-backed securities | — | — | 19,445 | 183 | 19,445 | 183 |
| Asset-backed securities | 122,645 | 770 | 90,503 | 466 | 213,148 | 1,236 |
| Total mortgage and asset-backed securities | 128,717 | 775 | 129,093 | 697 | 257,810 | 1,472 |
| Total | \$155,244 | \$ 822 | \$227,335 | \$13,784 | \$382,579 | \$14,606 |
| December 31, 2011 | | | | | | |
| State and municipal obligations | \$65,962 | \$ 712 | \$110,807 | \$10,507 | \$176,769 | \$11,219 |
| Mortgage and asset-backed securities: | | | | | | |
| Agency mortgage-backed securities | 72,019 | 493 | — | — | 72,019 | 493 |
| Non-agency mortgage-backed securities | 23,672 | 784 | 118,972 | 7,028 | 142,644 | 7,812 |
| Asset-backed securities | 1,236,526 | 4,982 | 87,224 | 1,394 | 1,323,750 | 6,376 |
| Total mortgage and asset-backed securities | 1,332,217 | 6,259 | 206,196 | 8,422 | 1,538,413 | 14,681 |
| Total | \$1,398,179 | \$ 6,971 | \$317,003 | \$18,929 | \$1,715,182 | \$25,900 |

The total available for sale portfolio consisted of approximately 1,600 individual securities at September 30, 2012. The portfolio included 58 securities, having an aggregate fair value of \$382.6 million, that were in a loss position at September 30, 2012. Securities in a loss position for 12 months or longer included those with temporary impairment totaling \$215.1 million, or 2.4% of the total portfolio value and other securities identified as other-than-temporarily

impaired totaling \$12.2 million.

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The Company's holdings of state and municipal obligations included gross unrealized losses of \$13.1 million at September 30, 2012. Nearly all of these losses related to auction rate securities (ARS). This portfolio, exclusive of ARS, totaled \$1.3 billion at fair value, or 14.8% 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 top five 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, 2012 | | | |
| Texas | 9.9 | %5.2 | Aa1 |
| Florida | 9.5 | 4.7 | Aa2 |
| Washington | 6.4 | 4.2 | Aa2 |
| Ohio | 5.5 | 5.3 | Aa2 |
| Arizona | 4.7 | 3.4 | Aa3 |
| General Obligation | 31.8 | %4.8 | Aa2 |
| Housing | 20.0 | 6.9 | Aa1 |
| Transportation | 12.8 | 3.7 | Aa3 |
| Lease | 11.8 | 3.4 | Aa3 |
| Limited Tax | 7.5 | 5.6 | Aa1 |

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

| (In thousands) | For the Nine Months Ended September 30 | |
|---|---|----------|
| | 2012 | 2011 |
| Proceeds from sales of available for sale securities | \$4,951 | \$11,202 |
| Proceeds from sales of non-marketable securities | 9,980 | 497 |
| Total proceeds | \$14,931 | \$11,699 |
| Available for sale: | | |
| Gains realized on sales | \$342 | \$177 |
| Other-than-temporary impairment recognized on debt securities | (1,227) | (1,755) |
| Non-marketable: | | |
| Gains realized on sales | 1,267 | 497 |
| Losses realized on sales | (200) | — |
| Fair value adjustments, net | 8,374 | 6,951 |
| Investment securities gains, net | \$8,556 | \$5,870 |

At September 30, 2012, securities carried at \$4.0 billion were pledged to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowings at the Federal Reserve Bank and FHLB. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated \$742.1 million, while the remaining securities were pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral. Except for obligations of various government-sponsored enterprises such as FNMA, FHLB and FHLMC, no investment in a single issuer exceeded 10% of stockholders' equity.

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4. Goodwill and Other Intangible Assets

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

| (In thousands) | September 30, 2012 | | | | December 31, 2011 | | | |
|--------------------------------|-----------------------|--------------------------|---------------------|------------|-----------------------|--------------------------|---------------------|------------|
| | 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 | \$(20,431) | \$— | \$5,289 | \$25,720 | \$(18,750) | \$— | \$6,970 |
| Mortgage servicing rights | 3,097 | (2,192) | (390) | 515 | 3,097 | (1,926) | (427) | 744 |
| Total | \$28,817 | \$(22,623) | \$(390) | \$5,804 | \$28,817 | \$(20,676) | \$(427) | \$7,714 |

Aggregate amortization expense on intangible assets was \$594 thousand and \$766 thousand, respectively, for the three month periods ended September 30, 2012 and 2011 and \$1.9 million and \$2.3 million, respectively, for the nine month periods ended September 30, 2012 and 2011. 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, 2012. 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)

| | |
|------|---------|
| 2012 | \$2,271 |
| 2013 | 1,730 |
| 2014 | 1,260 |
| 2015 | 921 |
| 2016 | 613 |

Changes in the carrying amount of goodwill and net other intangible assets for the nine month period ended September 30, 2012 is as follows.

| (In thousands) | Goodwill | Core Deposit Premium | Mortgage Servicing Rights |
|----------------------------|-----------|----------------------|---------------------------|
| Balance January 1, 2012 | \$125,585 | \$6,970 | \$744 |
| Amortization | — | (1,681) | (266) |
| Impairment reversal | — | — | 37 |
| Balance September 30, 2012 | \$125,585 | \$5,289 | \$515 |

Goodwill allocated to the Company's operating segments at September 30, 2012 and December 31, 2011 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 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.

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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, 2012 that net liability was \$4.5 million, which will be accreted into income over the remaining life of the respective commitments. The contractual amount of these letters of credit, which represents the maximum potential future payments guaranteed by the Company, was \$371.9 million at September 30, 2012.

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, 2012, believes sufficient collateral is available to cover potential swap losses. The RPAs are carried at fair value throughout their term, with all changes in fair value, including those due to a change in the third party's creditworthiness, recorded in current earnings. The terms of the RPAs, which correspond to the terms of the underlying swaps, range from 4 to 10 years. At September 30, 2012, the liability recorded for guarantor RPAs was \$176 thousand, and the notional amount of the underlying swaps was \$37.1 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.

6. Pension

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

| (In thousands) | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|--|---|---------|---|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Service cost - benefits earned during the period | \$ 103 | \$ 126 | \$ 310 | \$ 302 |
| Interest cost on projected benefit obligation | 1,287 | 2,605 | 3,860 | 5,329 |
| Expected return on plan assets | (1,645) | (3,378) | (4,935) | (6,728) |
| Amortization of unrecognized net loss | 730 | 821 | 2,190 | 1,901 |
| Net periodic pension cost | \$475 | \$174 | \$1,425 | \$804 |

Substantially all benefits accrued under the Company's defined benefit pension plan were frozen effective January 1, 2005, and the remaining benefits were frozen effective January 1, 2011. During the first nine months of 2012, the Company made a discretionary contribution of \$1.5 million to its defined benefit pension plan in order to reduce pension guarantee costs. The Company also 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 2012.

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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 nonvested share-based awards that contain nonforfeitable rights to dividends are considered securities which participate in undistributed earnings with common stock. The two-class method requires the calculation of separate income per share amounts for the nonvested share-based awards and for common stock. Income per share attributable to common stock is shown in the table below. Nonvested share-based awards are further discussed in Note 11.

| (In thousands, except per share data) | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|---|---|----------|---|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Basic income per common share: | | | | |
| Net income attributable to Commerce Bancshares, Inc. | \$66,006 | \$65,352 | \$202,538 | \$194,839 |
| Less income allocated to nonvested restricted stockholders | 626 | 486 | 1,854 | 1,391 |
| Net income available to common stockholders | \$65,380 | \$64,866 | \$200,684 | \$193,448 |
| Weighted average common shares outstanding | 86,894 | 89,477 | 87,504 | 90,373 |
| Basic income per common share | \$.75 | \$.72 | \$2.29 | \$2.14 |
| Diluted income per common share: | | | | |
| Net income attributable to Commerce Bancshares, Inc. | \$66,006 | \$65,352 | \$202,538 | \$194,839 |
| Less income allocated to nonvested restricted stockholders | 623 | 486 | 1,849 | 1,388 |
| Net income available to common stockholders | \$65,383 | \$64,866 | \$200,689 | \$193,451 |
| Weighted average common shares outstanding | 86,894 | 89,477 | 87,504 | 90,373 |
| 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 | 298 | 260 | 300 | 351 |
| Weighted average diluted common shares outstanding | 87,192 | 89,737 | 87,804 | 90,724 |
| Diluted income per common share | \$.75 | \$.72 | \$2.29 | \$2.13 |

All unexercised stock options and stock appreciation rights were included in the computation of diluted income per share for the nine month period ended September 30, 2012. Unexercised options and rights of 854 thousand were excluded from the computation for the nine month period ended September 30, 2011 because their inclusion would have been anti-dilutive.

8. Accumulated Other Comprehensive Income

The table below shows the accumulated balances for components of other comprehensive income, net of tax. The largest component is the unrealized holding gains and losses on available for sale securities. Unrealized gains and losses on debt securities for which an other-than-temporary impairment (OTTI) has been recorded in current earnings are shown separately below. The other component is pension gains and losses that arise during the period but are not recognized as components on net periodic benefit cost, and corresponding adjustments when these gains and losses are subsequently amortized to net periodic benefit cost.

| (In thousands) | Unrealized Gains (Losses) on Securities | | Total Accumulated Other Comprehensive Income | |
|-------------------------|--|------------|--|------------|
| | OTTI | Other | Pension Loss | Other |
| Balance January 1, 2012 | \$(4,321) |)\$136,137 | \$(21,278) |)\$110,538 |

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| | | | | |
|---|-----------|------------|------------|------------|
| Current period other comprehensive income | 7,592 | 46,552 | 1,358 | 55,502 |
| Balance September 30, 2012 | \$3,271 | \$182,689 | \$(19,920) |)\$166,040 |
| Balance January 1, 2011 | \$(7,469) |)\$87,784 | \$(16,970) |)\$63,345 |
| Current period other comprehensive income | 2,835 | 48,422 | 1,179 | 52,436 |
| Balance September 30, 2011 | \$(4,634) |)\$136,206 | \$(15,791) |)\$115,781 |

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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, and consumer debit and credit bank cards. The Commercial segment provides corporate lending (including the Small Business Banking product line within the branch network), leasing, international services, and business, government deposit, and related commercial cash management services, as well as merchant and commercial bank card products. The Commercial segment includes the Capital Markets Group, which sells fixed income securities and provides investment safekeeping and bond accounting services. The Wealth segment provides traditional trust and estate tax planning, advisory and discretionary investment management, and brokerage services, and includes the Private Banking product portfolio.

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

| (In thousands) | Consumer | Commercial | Wealth | Segment Totals | Other/ Elimination | Consolidated Totals |
|---------------------------------------|-----------|------------|----------|-------------------|-----------------------|------------------------|
| Three Months Ended September 30, 2012 | | | | | | |
| Net interest income | \$68,694 | \$72,867 | \$9,627 | \$151,188 | \$2,623 | \$153,811 |
| Provision for loan losses | (8,500) | (313) | (199) | (9,012) | 3,431 | (5,581) |
| Non-interest income | 29,030 | 45,352 | 27,094 | 101,476 | (554) | 100,922 |
| Investment securities gains, net | — | — | — | — | 3,180 | 3,180 |
| Non-interest expense | (67,353) | (57,114) | (21,926) | (146,393) | (6,998) | (153,391) |
| Income before income taxes | \$21,871 | \$60,792 | \$14,596 | \$97,259 | \$1,682 | \$98,941 |
| Nine Months Ended September 30, 2012 | | | | | | |
| Net interest income | \$206,348 | \$217,756 | \$29,092 | \$453,196 | \$25,457 | \$478,653 |
| Provision for loan losses | (26,960) | (601) | (751) | (28,312) | 9,351 | (18,961) |
| Non-interest income | 84,477 | 133,190 | 80,470 | 298,137 | (1,816) | 296,321 |
| Investment securities gains, net | — | — | — | — | 8,556 | 8,556 |
| Non-interest expense | (200,675) | (169,101) | (66,929) | (436,705) | (23,487) | (460,192) |
| Income before income taxes | \$63,190 | \$181,244 | \$41,882 | \$286,316 | \$18,061 | \$304,377 |
| Three Months Ended September 30, 2011 | | | | | | |
| Net interest income | \$71,050 | \$70,907 | \$9,725 | \$151,682 | \$6,948 | \$158,630 |
| Provision for loan losses | (10,826) | (3,445) | (583) | (14,854) | 3,459 | (11,395) |
| Non-interest income | 35,849 | 41,757 | 25,296 | 102,902 | (1,270) | 101,632 |
| Investment securities gains, net | — | — | — | — | 2,587 | 2,587 |
| Non-interest expense | (65,364) | (55,041) | (21,181) | (141,586) | (12,160) | (153,746) |
| Income before income taxes | \$30,709 | \$54,178 | \$13,257 | \$98,144 | \$(436) | \$97,708 |
| Nine Months Ended September 30, 2011 | | | | | | |
| Net interest income | \$213,580 | \$209,686 | \$28,962 | \$452,228 | \$32,085 | \$484,313 |
| Provision for loan losses | (36,158) | (11,942) | (611) | (48,711) | 9,339 | (39,372) |
| Non-interest income | 102,656 | 121,212 | 76,711 | 300,579 | (1,697) | 298,882 |
| Investment securities gains, net | — | — | — | — | 5,870 | 5,870 |
| Non-interest expense | (203,217) | (165,411) | (66,559) | (435,187) | (26,032) | (461,219) |
| Income before income taxes | \$76,861 | \$153,545 | \$38,503 | \$268,909 | \$19,565 | \$288,474 |

The information presented above was derived from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. This information is based on internal management accounting policies, which have been developed to reflect the underlying economics of the businesses. The policies address the methodologies applied in connection with funds transfer pricing and assignment of overhead costs among segments. Funds transfer pricing was used in the determination of net interest income by assigning a standard cost (credit) for funds used (provided) by assets and liabilities based on their maturity, prepayment and/or repricing characteristics.

The segment activity, as shown above, includes both direct and allocated items. Amounts in the "Other/Elimination" column include activity not related to the segments, such as that relating to administrative functions, the investment securities portfolio,

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

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

10. Derivative Instruments

The notional amounts of the Company's derivative instruments are shown in the table below. These contractual amounts, along with other terms of the derivative, are used to determine amounts to be exchanged between counterparties and are not a measure of loss exposure. The largest group of notional amounts relate to interest rate swaps, which are discussed in more detail below. The Company also contracts with other financial institutions, as a guarantor or beneficiary, to share credit risk associated with certain interest rate swaps through risk participation agreements. The Company's risks and responsibilities as guarantor are further discussed in Note 5 on Guarantees.

Through its International Department, the Company enters into foreign exchange contracts consisting mainly of contracts to purchase or deliver foreign currencies for customers at specific future dates. Also, the Company's past practice of originating and selling fixed rate personal real estate loans to other institutions resulted in mortgage loan commitments and forward sales contracts. In mid 2011, the Company curtailed the sales of these types of loans and, at September 30, 2012, did not hold such loans for sale.

| (In thousands) | September 30, 2012 | December 31, 2011 |
|--------------------------------------|-----------------------|----------------------|
| Interest rate swaps | \$450,188 | \$486,207 |
| Interest rate caps | 28,236 | 29,736 |
| Credit risk participation agreements | 40,160 | 41,414 |
| Foreign exchange contracts | 48,198 | 80,535 |
| Mortgage loan commitments | — | 1,280 |
| Mortgage loan forward sale contracts | — | 3,650 |
| Total notional amount | \$566,782 | \$642,822 |

The Company's interest rate risk management strategy includes the ability to modify the repricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. At September 30, 2012, the Company had entered into three interest rate swaps with a notional amount of \$13.5 million, included in the table above, which are designated as fair value hedges of certain fixed rate loans. Gains and losses on these derivative instruments, as well as the offsetting loss or gain on the hedged loans attributable to the hedged risk, are recognized in current earnings. These gains and losses are reported in interest and fees on loans in the accompanying statements of income. The table below shows gains and losses related to fair value hedges.

| (In thousands) | For the Three Months Ended September 30 | | For the Nine Months Ended September 30 | |
|------------------------------------|---|---------|--|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Gain (loss) on interest rate swaps | \$76 | \$(101) | \$221 | \$(31) |
| Gain (loss) on loans | (83) |)101 | (218) |)37 |
| Amount of hedge ineffectiveness | \$(7) |)\$— | \$3 | \$6 |

The Company's other derivative instruments are accounted for as free-standing derivatives, and changes in their fair value are recorded in current earnings. These instruments include interest rate swap contracts sold to customers who wish to modify their interest rate sensitivity. These swaps are offset by matching contracts purchased by the Company from other financial institutions. Because of the matching terms of the offsetting contracts, in addition to collateral provisions which mitigate the impact of non-performance risk, changes in fair value subsequent to initial recognition have a minimal effect on earnings. The notional amount of these types of swaps at September 30, 2012 was \$436.7 million. The Company is party to master netting arrangements with several other financial institutions; however, the Company does not offset assets and liabilities under these arrangements for balance sheet presentation, as the effect of offsetting is not significant. Collateral, usually in the form of marketable securities, is posted by the counterparty with liability positions, in accordance with contract thresholds. At September 30, 2012, the Company had only net liability positions with its financial institution counterparties totaling \$18.2 million and had posted \$18.0 million in collateral.

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

The banking customer counterparties are engaged in a variety of businesses, including real estate, building materials, education, communications, consumer products, and manufacturing. At September 30, 2012, the largest loss exposures were in the groups related to real estate, education and manufacturing. If the counterparties in these groups failed to perform, and if the underlying collateral proved to be of no value, the Company estimates that it would incur losses of \$3.9 million (education), \$3.7 million (real estate and building materials) and \$2.7 million (manufacturing) at September 30, 2012.

The fair values of the Company's derivative instruments, whose notional amounts are listed above, are shown in the table below. Information about the valuation methods used to determine fair value is provided in Note 12 on Fair Value Measurements.

| (In thousands) | Asset Derivatives | | Liability Derivatives | | | |
|---|------------------------|------------------------------|----------------------------|------------------------|------------------------------|----------------------------|
| | Balance Sheet Location | Sept. 30, 2012 Fair Value | Dec 31, 2011 Fair Value | Balance Sheet Location | Sept. 30, 2012 Fair Value | Dec 31, 2011 Fair Value |
| Derivatives designated as hedging instruments: | | | | | | |
| Interest rate swaps | Other assets | \$— | \$— | Other liabilities | \$(833) | \$(1,053) |
| Total derivatives designated as hedging instruments | | \$— | \$— | | \$(833) | \$(1,053) |
| Derivatives not designated as hedging instruments: | | | | | | |
| Interest rate swaps | Other assets | \$17,892 | \$19,051 | Other liabilities | \$(18,040) | \$(19,157) |
| Interest rate caps | Other assets | 2 | 11 | Other liabilities | (2) | (11) |
| Credit risk participation agreements | Other assets | 10 | 9 | Other liabilities | (176) | (141) |
| Foreign exchange contracts | Other assets | 959 | 2,440 | Other liabilities | (816) | (2,343) |
| Mortgage loan commitments | Other assets | — | 20 | Other liabilities | — | — |
| Mortgage loan forward sale contracts | Other assets | — | 6 | Other liabilities | — | (17) |
| Total derivatives not designated as hedging instruments | | \$18,863 | \$21,537 | | \$(19,034) | \$(21,669) |
| Total derivatives | | \$18,863 | \$21,537 | | \$(19,867) | \$(22,722) |

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

| Location of Gain or (Loss) Recognized in Income on Derivatives | Amount of Gain or (Loss) Recognized in Income on Derivatives |
|--|--|
|--|--|

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| (In thousands) | | For the Three | | For the Nine | |
|--|----------------------------|---------------|----------|--------------|---------|
| | | Months Ended | | Months Ended | |
| | | September 30 | | September 30 | |
| | | 2012 | 2011 | 2012 | 2011 |
| Derivatives in fair value hedging relationships: | | | | | |
| Interest rate swaps | Interest and fees on loans | \$76 | \$(101) | \$221 | \$(31) |
| Total | | \$76 | \$(101) | \$221 | \$(31) |
| Derivatives not designated as hedging instruments: | | | | | |
| Interest rate swaps | Other non-interest income | \$52 | \$(27) | \$250 | \$529 |
| Credit risk participation agreements | Other non-interest income | 1 | 224 | 6 | 259 |
| Foreign exchange contracts | Other non-interest income | 40 | (177) | 47 | (24) |
| Mortgage loan commitments | Loan fees and sales | — | 185 | (20) | 214 |
| Mortgage loan forward sale contracts | Loan fees and sales | — | (25) | 11 | (457) |
| Total | | \$93 | \$180 | \$294 | \$521 |

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11. Stock-Based Compensation

Stock-based compensation expense that has been charged against income was \$1.2 million in both of the three month periods ended September 30, 2012 and 2011, and \$3.7 million and \$3.6 million in the nine month periods ended September 30, 2012 and 2011, respectively. The Company has historically issued stock-based compensation in the form of options, stock appreciation rights (SARs) and nonvested stock. During 2011 and the first nine months of 2012, stock-based compensation has been issued solely in the form of nonvested stock awards.

The 2012 stock awards generally vest in 5 to 7 years and contain restrictions as to transferability, sale, pledging, or assigning, among others, prior to the end of the vesting period. Dividend and voting rights are conferred upon grant. A summary of the status of the Company's nonvested share awards as of September 30, 2012, and changes during the nine month period then ended, is presented below.

| | Shares | Weighted Average Grant Date Fair Value |
|---------------------------------|----------|---|
| Nonvested at January 1, 2012 | 653,782 | \$35.48 |
| Granted | 225,782 | 38.60 |
| Vested | (41,424) |) 37.32 |
| Forfeited | (8,383) |) 33.68 |
| Nonvested at September 30, 2012 | 829,757 | \$36.26 |

In previous years, SARs and stock options have also been granted, with exercise prices equal to the market price of the Company's stock at the date of grant. SARs, which the Company granted in 2006 through 2009, vest on a graded basis over 4 years of continuous service and have 10-year contractual terms. All SARs must be settled in stock under provisions of the plan. Stock options, which were granted in 2005 and previous years, vest on a graded basis over 3 years of continuous service and also have 10-year contractual terms. In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of SARs and options on date of grant.

A summary of option activity during the first nine months of 2012 is presented below.

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|-----------|--|---|---------------------------------|
| (Dollars in thousands, except per share data) | | | | |
| Outstanding at January 1, 2012 | 1,352,644 | \$30.26 | | |
| Granted | — | — | | |
| Forfeited | — | — | | |
| Expired | (849) |) 19.61 | | |
| Exercised | (386,646) |) 26.28 | | |
| Outstanding at September 30, 2012 | 965,149 | \$31.86 | 1.6 years | \$8,171 |

A summary of SAR activity during the first nine months of 2012 is presented below.

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|-----------|--|---|---------------------------------|
| (Dollars in thousands, except per share data) | | | | |
| Outstanding at January 1, 2012 | 1,739,126 | \$37.83 | | |

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| | | | | |
|-----------------------------------|-----------|---------|-----------|---------|
| Granted | — | — | | |
| Forfeited | — | — | | |
| Expired | — | — | | |
| Exercised | (35,795 |) 35.75 | | |
| Outstanding at September 30, 2012 | 1,703,331 | \$37.87 | 4.4 years | \$4,190 |

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12. Fair Value Measurements

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

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

Level 1 – inputs to the valuation methodology are quoted prices for identical assets or liabilities in active markets.
Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and inputs that are observable for the assets or liabilities, either directly or indirectly (such as interest rates, yield curves, and prepayment speeds).
Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value. These may be internally developed, using the Company's best information and assumptions that a market participant would consider. When determining the fair value measurements for assets and liabilities required or permitted to be recorded or disclosed at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to observable market data for similar assets and liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets, and the Company must use alternative valuation techniques to derive an estimated fair value measurement.

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Instruments Measured at Fair Value on a Recurring Basis

The table below presents the September 30, 2012 and December 31, 2011 carrying values of assets and liabilities measured at fair value on a recurring basis. There were no transfers among levels during the first nine months of 2012 or the year ended December 31, 2011.

| (In thousands) | Total Fair Value | Fair Value Measurements Using | | |
|--|------------------|--|---|---|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| September 30, 2012 | | | | |
| Assets: | | | | |
| Available for sale securities: | | | | |
| U.S. government and federal agency obligations | \$367,497 | \$367,497 | \$— | \$— |
| Government-sponsored enterprise obligations | 380,190 | — | 380,190 | — |
| State and municipal obligations | 1,461,251 | — | 1,333,520 | 127,731 |
| Agency mortgage-backed securities | 3,471,262 | — | 3,471,262 | — |
| Non-agency mortgage-backed securities | 255,172 | — | 255,172 | — |
| Other asset-backed securities | 2,930,810 | — | 2,930,810 | — |
| Other debt securities | 121,623 | — | 121,623 | — |
| Equity securities | 33,146 | 19,253 | 13,893 | — |
| Trading securities | 13,595 | — | 13,595 | — |
| Private equity investments | 67,044 | — | — | 67,044 |
| Derivatives * | 18,863 | — | 18,853 | 10 |
| Assets held in trust | 5,404 | 5,404 | — | — |
| Total assets | \$9,125,857 | \$392,154 | \$8,538,918 | \$194,785 |
| Liabilities: | | | | |
| Derivatives * | \$19,867 | \$— | \$19,691 | \$176 |
| Total liabilities | \$19,867 | \$— | \$19,691 | \$176 |
| December 31, 2011 | | | | |
| Assets: | | | | |
| Available for sale securities: | | | | |
| U.S. government and federal agency obligations | \$364,665 | \$357,155 | \$7,510 | \$— |
| Government-sponsored enterprise obligations | 315,698 | — | 315,698 | — |
| State and municipal obligations | 1,245,284 | — | 1,109,663 | 135,621 |
| Agency mortgage-backed securities | 4,106,059 | — | 4,106,059 | — |
| Non-agency mortgage-backed securities | 316,902 | — | 316,902 | — |
| Other asset-backed securities | 2,693,143 | — | 2,693,143 | — |
| Other debt securities | 141,260 | — | 141,260 | — |
| Equity securities | 41,691 | 27,808 | 13,883 | — |
| Trading securities | 17,853 | — | 17,853 | — |
| Private equity investments | 66,978 | — | — | 66,978 |
| Derivatives * | 21,537 | — | 21,502 | 35 |
| Assets held in trust | 4,506 | 4,506 | — | — |
| Total assets | \$9,335,576 | \$389,469 | \$8,743,473 | \$202,634 |
| Liabilities: | | | | |
| Derivatives * | \$22,722 | \$— | \$22,564 | \$158 |

| | | | | |
|-------------------|----------|-----|----------|-------|
| Total liabilities | \$22,722 | \$— | \$22,564 | \$158 |
|-------------------|----------|-----|----------|-------|

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

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

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

Available for sale investment securities

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

Valuation methods and inputs, by class of security:

U.S. government and federal agency obligations

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

Government-sponsored enterprise obligations

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

State and municipal obligations, excluding auction rate securities

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

Mortgage and asset-backed securities

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

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

Other debt securities

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

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Equity securities

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

At September 30, 2012, the Company held in its available for sale portfolio certain auction rate securities. The auction process by which auction rate securities are normally priced has not functioned since 2008, and due to the illiquidity in the market, the fair value of these securities cannot be based on observable market prices. The fair values of the auction rate securities are estimated using a discounted cash flows analysis which is discussed more fully in the Level 3 Inputs section of this note. Because several of the inputs significant to the measurement are not observable, these measurements are classified as Level 3 measurements.

Trading securities

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

Private equity investments

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

Derivatives

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

Valuations for interest rate swaps are derived from a proprietary model whose significant inputs are readily observable market parameters, primarily yield curves used to calculate current exposure. Counterparty credit risk is incorporated into the model and calculated by applying a net credit spread over LIBOR to the swap's total expected exposure over time. The net credit spread is comprised of spreads for both the Company and its counterparty, derived from probability of default and other loss estimate information obtained from a third party credit data provider or from the Company's Credit Department when not otherwise available. The credit risk component is not significant compared to the overall fair value of the swaps. The results of the model are constantly validated through comparison to active trading in the marketplace. These fair value measurements are classified as Level 2.

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

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

The Company's contracts related to credit risk guarantees are valued under a proprietary model which uses unobservable inputs and assumptions about the creditworthiness of the counterparty (generally a Bank customer). Customer credit spreads, which are based on probability of default and other loss estimates, are calculated internally by the Company's Credit Department, as mentioned above, and are based on the Company's internal risk rating for each customer. Because these inputs are significant to the measurements, they are classified as Level 3.

Assets held in trust

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

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

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | | | |
|--|---|----------------------------------|-------------|--------------|
| | State and Municipal Obligation | Private Equity Investments | Derivatives | Total |
| (In thousands) | | | | |
| For the three months ended September 30, 2012 | | | | |
| Balance June 30, 2012 | \$ 127,540 | \$ 65,766 | \$ (99 |) \$ 193,207 |
| Total gains or losses (realized/unrealized): | | | | |
| Included in earnings | — | 2,774 | 1 | 2,775 |
| Included in other comprehensive income | 3,015 | — | — | 3,015 |
| Investment securities called | (3,000 |)— | — | (3,000) |
| Discount accretion | 176 | — | — | 176 |
| Sale/pay down of private equity investments | — | (1,614 |)— | (1,614) |
| Capitalized interest/dividends | — | 118 | — | 118 |
| Sale of risk participation agreement | — | — | (68 |) (68) |
| Balance September 30, 2012 | \$ 127,731 | \$ 67,044 | \$ (166 |) \$ 194,609 |
| Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2012 | \$— | \$ 2,774 | \$ (37 |) \$ 2,737 |
| For the nine months ended September 30, 2012 | | | | |
| Balance January 1, 2012 | \$ 135,621 | \$ 66,978 | \$ (123 |) \$ 202,476 |
| Total gains or losses (realized/unrealized): | | | | |
| Included in earnings | — | 8,374 | (3 |) 8,371 |
| Included in other comprehensive income | (1,923 |)— | — | (1,923) |
| Investment securities called | (6,350 |)— | — | (6,350) |
| Discount accretion | 383 | — | — | 383 |
| Purchase of private equity securities | — | 3,275 | — | 3,275 |
| Sale/pay down of private equity investments | — | (11,893 |)— | (11,893) |
| Capitalized interest/dividends | — | 310 | — | 310 |
| Purchase of risk participation agreement | — | — | 28 | 28 |
| Sale of risk participation agreement | — | — | (68 |) (68) |
| Balance September 30, 2012 | \$ 127,731 | \$ 67,044 | \$ (166 |) \$ 194,609 |
| Total gains or losses for the nine months included in earnings attributable to the change in unrealized gains or losses relating to assets still held at September 30, 2012 | \$— | \$ 6,949 | \$ (40 |) \$ 6,909 |
| For the three months ended September 30, 2011 | | | | |
| Balance June 30, 2011 | \$ 141,940 | \$ 61,173 | \$ (288 |) \$ 202,825 |
| Total gains or losses (realized/unrealized): | | | | |
| Included in earnings | — | 2,921 | 384 | 3,305 |
| Included in other comprehensive income | (1,028 |)— | — | (1,028) |
| Investment securities called | (1,300 |)— | — | (1,300) |
| Discount accretion | 112 | — | — | 112 |
| Purchase of private equity investments | — | 75 | — | 75 |
| Sale/pay down of private equity securities | — | (1,121 |)— | (1,121) |
| Balance September 30, 2011 | \$ 139,724 | \$ 63,048 | \$ 96 | \$ 202,868 |
| Total gains or losses for the three months included in earnings attributable to the change in unrealized gains or losses relating to assets | \$— | \$ 2,921 | \$ 237 | \$ 3,158 |

still held at September 30, 2011

For the nine months ended September 30, 2011

| | | | | |
|---|-----------|-----------|--------|-----------|
| Balance January 1, 2011 | \$150,089 | \$ 53,860 | \$ 352 | \$204,301 |
| Total gains or losses (realized/unrealized): | | | | |
| Included in earnings | — | 6,951 | 16 | 6,967 |
| Included in other comprehensive income | (2,639 |)— | — | (2,639) |
| Investment securities called | (8,243 |)— | — | (8,243) |
| Discount accretion | 517 | — | — | 517 |
| Purchase of private equity investments | — | 3,314 | — | 3,314 |
| Sale/pay down of private equity securities | — | (1,121 |)— | (1,121) |
| Capitalized interest/dividends | — | 44 | — | 44 |
| Purchase of risk participation agreement | — | — | 79 | 79 |
| Sales of risk participation agreements | — | — | (351 |) (351) |
| Balance September 30, 2011 | \$139,724 | \$ 63,048 | \$ 96 | \$202,868 |
| Total gains or losses for the nine months included in earnings | | | | |
| attributable to the change in unrealized gains or losses relating to assets | \$— | \$ 7,026 | \$ 223 | \$7,249 |
| still held at September 30, 2011 | | | | |

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

| (In thousands) | Loan Fees and Sales | Other Non-Interest Income | Investment Securities Gains (Losses), Net | Total |
|--|------------------------|---------------------------------|---|---------|
| For the three months ended September 30, 2012 | | | | |
| Total gains or losses included in earnings | \$— | \$ 1 | \$2,774 | \$2,775 |
| Change in unrealized gains or losses relating to assets still held at September 30, 2012 | \$— | \$ (37) | \$2,774 | \$2,737 |
| For the nine months ended September 30, 2012 | | | | |
| Total gains or losses included in earnings | \$— | \$ (3) | \$8,374 | \$8,371 |
| Change in unrealized gains or losses relating to assets still held at September 30, 2012 | \$— | \$ (40) | \$6,949 | \$6,909 |
| For the three months ended September 30, 2011 | | | | |
| Total gains or losses included in earnings | \$160 | \$ 224 | \$2,921 | \$3,305 |
| Change in unrealized gains or losses relating to assets still held at September 30, 2011 | \$239 | \$ (2) | \$2,921 | \$3,158 |
| For the nine months ended September 30, 2011 | | | | |
| Total gains or losses included in earnings | \$(243) | \$ 259 | \$6,951 | \$6,967 |
| Change in unrealized gains or losses relating to assets still held at September 30, 2011 | \$239 | \$ (16) | \$7,026 | \$7,249 |

Level 3 Inputs

As shown above, the Company's significant Level 3 measurements which employ unobservable inputs that are readily quantifiable pertain to auction rate securities (ARS) and investments in portfolio concerns held by the Company's private equity subsidiaries. ARS are included in state and municipal securities and totaled \$127.7 million at September 30, 2012, while private equity investments, included in non-marketable securities, totaled \$67.0 million.

Information about these inputs is presented in the table and discussions below.

Quantitative Information about Level 3 Fair Value Measurements

| | Valuation Technique | Unobservable Input | Range |
|----------------------------|-----------------------------|---|------------------------|
| Auction rate securities | Discounted cash flow | Estimated market recovery period Estimated market rate | 5 years 2.6% - 3.7% |
| Private equity investments | Market comparable companies | EBITDA multiple | 4.0 - 5.5 |

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

increase in the estimated market rate (the discount rate) alone would result in a lower fair value measurement. The valuation of ARS is reviewed at least quarterly by members of the Company's Asset/Liability Committee.

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

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Instruments Measured at Fair Value on a Nonrecurring Basis

For assets measured at fair value on a nonrecurring basis during the first nine months of 2012 and 2011, and still held as of September 30, 2012 and 2011, the following table provides the adjustments to fair value recognized during the respective periods, the level of valuation inputs used to determine each adjustment, and the carrying value of the related individual assets or portfolios at September 30, 2012 and 2011.

| (In thousands) | Fair Value | Fair Value Measurements Using | | | Total Gains (Losses) Recognized During the Nine Months Ended Sept. 30 |
|-------------------------------------|------------|--|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | |
| September 30, 2012 | | | | | |
| Collateral dependent impaired loans | \$24,749 | \$— | \$— | \$ 24,749 | \$(7,669) |
| Mortgage servicing rights | 515 | — | — | 515 | 37 |
| Foreclosed assets | 538 | — | — | 538 | (277) |
| Long-lived assets | 5,622 | — | — | 5,622 | (3,428) |
| September 30, 2011 | | | | | |
| Collateral dependent impaired loans | \$44,937 | \$— | \$— | \$ 44,937 | \$(11,859) |
| Mortgage servicing rights | 896 | — | — | 896 | (166) |
| Foreclosed assets | 2,778 | — | — | 2,778 | (592) |
| Long-lived assets | 11,864 | — | — | 11,864 | (3,168) |

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

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

Collateral dependent impaired loans

While the overall loan portfolio is not carried at fair value, the Company periodically records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral dependent loans when establishing the allowance for loan losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan. In determining the value of real estate collateral, the Company relies on external and internal appraisals of property values depending on the size and complexity of the real estate collateral. The Company maintains a staff of qualified appraisers who also review third party appraisal reports for reasonableness. In the case of non-real estate collateral, reliance is placed on a variety of sources, including external estimates of value and judgments based on the experience and expertise of internal specialists. Values of all loan collateral are regularly reviewed by credit administration. Unobservable inputs to these measurements, which include estimates and judgments often used in conjunction with appraisals, are not readily quantifiable. These measurements are classified as Level 3. Changes in fair value recognized for partial charge-offs of loans and loan impairment reserves on loans held by the Company at September 30, 2012 and 2011 are shown in the table above.

Loans held for sale

Loans held for sale are carried at the lower of cost or fair value. At September 30, 2012, this portfolio consisted of student loans. Most of the portfolio is under contract to agencies which have been unable to consistently purchase loans under existing contractual terms. These loans have been evaluated using a fair value measurement method based on a discounted cash flows analysis, which is classified as Level 3. The fair value of these loans was \$5.8 million at September 30, 2012, net of an impairment reserve of \$148 thousand. The measurement of fair value for other student loans is based on the specific prices mandated in the underlying sale contracts, and the estimated exit price and is classified as Level 2.

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Private equity investments and restricted stock

These assets are included in non-marketable investment securities in the consolidated balance sheets. They include certain investments in private equity concerns held by the Parent company which are carried at cost, reduced by other-than-temporary impairment. These investments are periodically evaluated for impairment based on their estimated fair value as determined by review of available information, most of which is provided as monthly or quarterly internal financial statements, annual audited financial statements, investee tax returns, and in certain situations, through research into and analysis of the assets and investments held by those private equity concerns.

Restricted stock consists of stock issued by the Federal Reserve Bank and FHLB and is held by the bank subsidiary as required for regulatory purposes. Generally, there are restrictions on the sale and/or liquidation of these investments, and they are carried at cost, reduced by other-than-temporary impairment. Fair value measurements for these securities are classified as Level 3.

Mortgage servicing rights

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

Goodwill and core deposit premium

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

Core deposit premiums are recognized at the time a portfolio of deposits is acquired. Core deposit premiums are recognized using valuation techniques which calculate the present value of the estimated net cost savings attributable to the core deposit base, relative to alternative costs of funds and tax benefits, if applicable, over the expected remaining economic life of the depositors. Subsequent evaluations are made when facts or circumstances indicate potential impairment may have occurred. The Company uses estimates of discounted future cash flows, comparisons with alternative sources for deposits, consideration of income potential generated in other product lines by current customers, geographic parameters, and other demographics to estimate a current fair value of a specific deposit base. If the calculated fair value is less than the carrying value, impairment is considered to have occurred. This measurement is classified as Level 3.

Foreclosed assets

Foreclosed assets consist of loan collateral which has been repossessed through foreclosure. This collateral is comprised of commercial and residential real estate and other non-real estate property, including auto, marine and

recreational vehicles. Foreclosed assets are recorded as held for sale initially at the lower of the loan balance or fair value of the collateral less estimated selling costs. Subsequent to foreclosure, valuations are updated periodically, and the assets may be marked down further, reflecting a new cost basis. Fair value measurements may be based upon appraisals, third-party price opinions, or internally developed pricing methods. These measurements are classified as Level 3.

Long-lived assets

In accordance with ASC 360-10-35, investments in branch facilities and various office buildings are written down to estimated fair value, or estimated fair value less cost to sell if the property is held for sale. Fair value is estimated in a process which considers current local commercial real estate market conditions and the judgment of the sales agent and often involves obtaining third party appraisals from certified real estate appraisers. The carrying amounts of these real estate holdings are regularly monitored by real estate professionals employed by the Company. These fair value measurements are classified as Level 3. Unobservable inputs to these measurements, which include estimates and judgments often used in conjunction with appraisals, are not readily quantifiable. The loss recognized in the first nine months of 2012 resulted primarily from the Company's decision to market certain property adjacent to a downtown Kansas City office building, also held for sale, which required a write-down to fair value less selling costs.

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13. Fair Value of Financial Instruments

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

The fair values of loans are estimated by discounting the expected future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. This method of estimating fair value does not incorporate the exit-price concept of fair value prescribed by ASC 820 "Fair Value Measurements and Disclosures". Expected future cash flows for each individual loan are based on contractual features, and for loans with optionality, such as variable rates and prepayment features, are based on a multi-rate path process. Each loan's expected future cash flows are discounted using the LIBOR/swap curve plus an appropriate spread. For business, construction and business real estate loans, internally-developed pricing spreads are developed which are based on loan type, term and credit score. The spread for personal real estate loans is generally based on newly originated loans with similar characteristics. For consumer loans, the spread is calculated at loan origination as part of the Bank's funds transfer pricing process (mentioned in Note 9), which is indicative of individual borrower credit worthiness. All consumer credit card loans are discounted at the same spread, depending on whether the rate is variable or fixed.

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The methods and inputs used in the estimation of fair value for the other financial instruments in the table below are discussed in the preceding Fair Value Measurements note and in the Fair Value of Financial Instruments note in the Company's 2011 Annual Report on Form 10-K. There have been no changes in these methods and inputs since December 31, 2011.

The estimated fair values of the Company's financial instruments and the classification of their fair value measurement within the valuation hierarchy are as follows:

| (In thousands) | Fair Value September 30, 2012 | | December 31, 2011 | | |
|--|-------------------------------|-----------------|----------------------|-----------------|----------------------|
| | Hierarchy Level | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial Assets | | | | | |
| Loans: | | | | | |
| Business | Level 3 | \$3,098,908 | \$3,114,822 | \$2,808,265 | \$2,820,005 |
| Real estate - construction and land | Level 3 | 335,113 | 337,794 | 386,598 | 388,723 |
| Real estate - business | Level 3 | 2,193,206 | 2,224,323 | 2,180,100 | 2,197,535 |
| Real estate - personal | Level 3 | 1,556,754 | 1,606,018 | 1,428,777 | 1,485,028 |
| Consumer | Level 3 | 1,243,400 | 1,268,928 | 1,114,889 | 1,136,798 |
| Revolving home equity | Level 3 | 453,527 | 461,776 | 463,587 | 471,086 |
| Consumer credit card | Level 3 | 748,885 | 757,702 | 788,701 | 780,808 |
| Overdrafts | Level 3 | 8,852 | 8,852 | 6,561 | 6,561 |
| Loans held for sale | Level 2 | 2,909 | 2,920 | 24,394 | 26,597 |
| Loans held for sale | Level 3 | 5,832 | 5,832 | 6,682 | 6,682 |
| Investment securities: | | | | | |
| Available for sale | Level 1 | 386,750 | 386,750 | 384,963 | 384,963 |
| Available for sale | Level 2 | 8,506,470 | 8,506,470 | 8,704,118 | 8,704,118 |
| Available for sale | Level 3 | 127,731 | 127,731 | 135,621 | 135,621 |
| Trading | Level 2 | 13,595 | 13,595 | 17,853 | 17,853 |
| Non-marketable | Level 3 | 117,540 | 117,540 | 115,832 | 115,832 |
| Federal funds sold | Level 1 | 10,475 | 10,475 | 11,870 | 11,870 |
| Securities purchased under agreements to resell | Level 3 | 850,000 | 869,003 | 850,000 | 864,089 |
| Interest earning deposits with banks | Level 1 | 132,144 | 132,144 | 39,853 | 39,853 |
| Cash and due from banks | Level 1 | 426,742 | 426,742 | 465,828 | 465,828 |
| Derivative instruments | Level 2 | 18,853 | 18,853 | 21,502 | 21,502 |
| Derivative instruments | Level 3 | 10 | 10 | 35 | 35 |
| Financial Liabilities | | | | | |
| Non-interest bearing deposits | Level 1 | \$5,814,932 | \$5,814,932 | \$5,377,549 | \$5,377,549 |
| Savings, interest checking and money market deposits | Level 1 | 9,025,688 | 9,025,688 | 8,933,941 | 8,933,941 |
| Time open and certificates of deposit | Level 3 | 2,009,010 | 2,019,699 | 2,488,393 | 2,493,727 |
| Federal funds purchased | Level 1 | 207,975 | 207,975 | 153,330 | 153,330 |
| Securities sold under agreements to repurchase | Level 3 | 1,049,974 | 1,047,899 | 1,102,751 | 1,099,883 |
| Other borrowings | Level 3 | 103,744 | 118,512 | 111,817 | 126,397 |
| Derivative instruments | Level 2 | 19,691 | 19,691 | 22,564 | 22,564 |
| Derivative instruments | Level 3 | 176 | 176 | 158 | 158 |

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14. Legal Proceedings

The Company has various lawsuits pending at September 30, 2012, arising in the normal course of business. While some matters pending against the Company specify damages claimed by plaintiffs, others do not seek a specified amount of damages or are at very early stages of the legal process. The Company records a loss accrual for all legal matters for which it deems a loss is probable and can be reasonably estimated. Some legal matters, which are at early stages in the legal process, have not yet progressed to the point where a loss amount can be estimated.

On July 13, 2012, Visa U.S.A. Inc. (Visa) and MasterCard each announced a preliminary settlement to resolve the plaintiffs' claims in the multi-district interchange litigation and also announced an agreement in principle to resolve the claims brought against them by certain individual retailers in that same litigation. The proposed settlement includes a cash payment to certain merchants of \$6.6 billion, of which Visa is responsible for \$4.4 billion, and a provision which would reduce credit card interchange income by 10 basis points over an eight month period likely to begin in mid-2013, 60 days after a court-ordered period. Other provisions include the ability for merchants to surcharge customers for credit card usage, the ability for merchant buying groups to negotiate together with Visa and MasterCard, and the ability to cancel this proposed agreement if more than 25% of all affected merchants opt out of the agreement.

The Company estimates that the pre-tax cost of the future reduction of 10 basis points in interchange income for an eight month period, which is part of the above settlement, would amount to approximately \$5.2 million. Accordingly, the Company has established a liability for these anticipated costs.

On July 26, 2012, the Bank signed the formal Settlement Agreement and Release related to the class action lawsuit captioned Wolfgeher v. Commerce Bank, which was settled in December 2011, and which alleged unfair assessment and collection of overdraft fees based upon a high-to-low posting order utilized on debit card transactions. The Bank, while admitting no wrongdoing, agreed to the settlement in order to resolve the litigation and avoid further expense. In accordance with the terms of the Settlement Agreement and Release (which remains subject to final court approval), the Bank agrees to post debit card transactions in chronological order, beginning no later than April 2013. As a result of this change in the posting order of debit card transactions, the Company currently estimates that overdraft income will be reduced on an annual basis by \$6 million to \$8 million.

15. Subsequent Event

On November 2, 2012, the Board of Directors approved the Company's 19th consecutive annual 5% stock dividend, payable on December 17, 2012 to shareholders of record at the close of business on November 30, 2012. The effect of this 5% stock dividend on diluted income per share for the three and nine months ended September 30, 2012 is shown in the table below.

| | For the Three Months Ended September 30, 2012 | For the Nine Months Ended September 30, 2012 |
|--|--|---|
| Diluted income per common share as reported | \$.75 | \$ 2.29 |
| Diluted income per common share restated for 5% stock dividend | \$.72 | \$ 2.18 |

The Board also approved a regular quarterly dividend of \$.23 on the Company's common stock and a special common stock dividend payment of \$1.50 per share, with the same record and payable dates as the stock dividend. The cash

dividends will not be payable on any shares issued pursuant to the stock dividend. The Board approved the special dividend at this time because of the potential significant increases in tax rates on dividends beginning next year. After this special dividend, the Company's capital ratios will continue to be very strong, and together with its ongoing earnings power, the Company expects to have ample capital to support balance sheet growth and continue its stock buyback program and regular dividend practices.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company's 2011 Annual Report on Form 10-K. Results of operations for the three and nine month periods ended September 30, 2012 are not necessarily indicative of results to be attained for any other period.

Forward Looking Information

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

Critical Accounting Policies

The Company has identified several policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for loan losses, the valuation of certain investment securities, and accounting for income taxes. A discussion of these policies can be found in the sections captioned "Critical Accounting Policies" and "Allowance for Loan Losses" in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2011 Annual Report on Form 10-K. There have been no changes in the Company's application of critical accounting policies since December 31, 2011.

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Selected Financial Data

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|---------|-------------------|---------|
| | September 30 | | September 30 | |
| | 2012 | 2011 | 2012 | 2011 |
| Per Share Data | | | | |
| Net income per common share — basic | \$.75 | \$.72 | \$ 2.29 | \$ 2.14 |
| Net income per common share — diluted | .75 | .72 | 2.29 | 2.13 |
| Cash dividends | .230 | .219 | .690 | .657 |
| Book value | | | 26.33 | 23.95 |
| Market price | | | 40.33 | 33.10 |
| Selected Ratios | | | | |
| (Based on average balance sheets) | | | | |
| Loans to deposits ⁽¹⁾ | 56.89 | % 58.29 | % 55.89 | % 60.27 |
| Non-interest bearing deposits to total deposits | 33.30 | 30.49 | 32.18 | 29.75 |
| Equity to loans ⁽¹⁾ | 24.00 | 23.35 | 23.97 | 22.54 |
| Equity to deposits | 13.65 | 13.61 | 13.40 | 13.59 |
| Equity to total assets | 11.06 | 10.85 | 10.88 | 11.03 |
| Return on total assets | 1.28 | 1.32 | 1.32 | 1.37 |
| Return on total equity | 11.57 | 12.15 | 12.13 | 12.41 |
| (Based on end-of-period data) | | | | |
| Non-interest income to revenue ⁽²⁾ | 39.62 | 39.05 | 38.24 | 38.16 |
| Efficiency ratio ⁽³⁾ | 59.99 | 58.71 | 59.14 | 58.57 |
| Tier I risk-based capital ratio | | | 14.92 | 14.58 |
| Total risk-based capital ratio | | | 16.25 | 15.92 |
| Tangible common equity to assets ratio ⁽⁴⁾ | | | 10.47 | 9.72 |
| Tier I leverage ratio | | | 10.00 | 9.74 |

(1) Includes loans held for sale.

(2) Revenue includes net interest income and non-interest income.

(3) The efficiency ratio is calculated as non-interest expense (excluding intangibles amortization) as a percent of revenue.

(4) The tangible common equity ratio is calculated as stockholders' equity reduced by goodwill and other intangible assets (excluding mortgage servicing rights) divided by total assets reduced by goodwill and other intangible assets (excluding mortgage servicing rights).

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Results of Operations

Summary

| (Dollars in thousands) | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|--|---------------------------------|------------|----------|--------------------------------|------------|----------|
| | 2012 | 2011 | % change | 2012 | 2011 | % change |
| Net interest income | \$153,811 | \$158,630 | (3.0)% | \$478,653 | \$484,313 | (1.2)% |
| Provision for loan losses | (5,581) | (11,395) | (51.0) | (18,961) | (39,372) | (51.8) |
| Non-interest income | 100,922 | 101,632 | (.7) | 296,321 | 298,882 | (.9) |
| Investment securities gains, net | 3,180 | 2,587 | 22.9 | 8,556 | 5,870 | 45.8 |
| Non-interest expense | (153,391) | (153,746) | (.2) | (460,192) | (461,219) | (.2) |
| Income taxes | (32,155) | (31,699) | 1.4 | (99,541) | (91,898) | 8.3 |
| Non-controlling interest expense | (780) | (657) | 18.7 | (2,298) | (1,737) | 32.3 |
| Net income attributable to Commerce Bancshares, Inc. | \$66,006 | \$65,352 | 1.0 % | \$202,538 | \$194,839 | 4.0 % |

For the quarter ended September 30, 2012, net income attributable to Commerce Bancshares, Inc. (net income) amounted to \$66.0 million, an increase of \$654 thousand, or 1.0%, compared to the third quarter of the previous year, and a decrease of \$4.7 million compared to the previous quarter. For the current quarter, the annualized return on average assets was 1.28%, the annualized return on average equity was 11.57%, and the efficiency ratio was 59.99%. Diluted earnings per share was \$.75, an increase of 4.2% compared to \$.72 per share in the third quarter of 2011.

Compared to the third quarter of last year, net interest income decreased \$4.8 million, or 3.0%, mainly due to a decrease of \$5.2 million in interest on investment securities (which included a \$2.8 million decrease in interest on holdings of U.S. Treasury inflation-protected securities), coupled with a decrease of \$3.1 million in interest and fees on loans. These declines were partly offset by a decrease of \$2.7 million in interest expense on deposits. Non-interest income declined \$710 thousand, or .7%, and non-interest expense decreased \$355 thousand, or .2%. The decrease in non-interest income was mainly attributable to declines in debit card and overdraft fees, partly offset by higher corporate card and trust fees. The decline in non-interest expense resulted from \$5.9 million accrued in the third quarter of 2011 relating to debit card overdraft litigation (not repeated in the current quarter), and smaller declines in various other expense categories, partly offset by higher salaries and data processing expense. The provision for loan losses totaled \$5.6 million for the current quarter, representing a decrease of \$5.8 million, or 51.0%, from the third quarter of 2011.

Net income for the first nine months of 2012 was \$202.5 million, an increase of \$7.7 million, or 4.0%, over the same period last year and included a decline of \$20.4 million, or 51.8%, in the provision for loan losses. Diluted earnings per share was \$2.29, an increase of 7.5% compared to \$2.13 per share in the same period last year. For the first nine months of 2012, the annualized return on average assets was 1.32%, the annualized return on average equity was 12.13%, and the efficiency ratio was 59.14%. Net interest income decreased \$5.7 million, or 1.2%, due to lower earnings on the Company's loan and investment security portfolios, partly offset by lower expense incurred on deposits. Non-interest income decreased \$2.6 million, or .9%, mainly due to a decline of \$19.7 million in debit card interchange fees (the effect of new debit card fee regulations effective late in 2011). The decline in debit card fees was partly offset by increases of \$10.8 million in merchant and corporate card fees, \$4.1 million in trust fees and \$1.7 million in capital market fees. Net securities gains increased \$2.7 million, mainly due to fair value adjustments and sales of private equity investments. Non-interest expense decreased \$1.0 million, or .2%, compared to the same period last year and included a decline in FDIC insurance costs, offset by higher salaries and benefits and data processing costs. The decline in non-interest expense also included a \$5.2 million accrual in 2012 for anticipated costs resulting from Visa debit card interchange litigation, offset by \$10.9 million expense recorded during the first nine months of 2011 for debit card overdraft litigation costs. Both of these lawsuits are further discussed in Note 14 of the

consolidated financial statements.

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Net Interest Income

The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates. Changes not solely due to volume or rate changes are allocated to rate.

Analysis of Changes in Net Interest Income

| (In thousands) | Three Months Ended September 30, 2012 vs. 2011 | | | Nine Months Ended September 30, 2012 vs. 2011 | | |
|---|---|-----------------|-----------|--|-----------------|------------|
| | Change due to Average Volume | Average Rate | Total | Change due to Average Volume | Average Rate | Total |
| Interest income, fully taxable equivalent basis: | | | | | | |
| Loans | \$4,150 | \$(7,140) | \$(2,990) | \$1,319 | \$(15,361) | \$(14,042) |
| Loans held for sale | (213) |)28 | (185) | (704) |)105 | (599) |
| Investment securities: | | | | | | |
| U.S. government and federal agency securities | 11 | (2,882) | (2,871) | (1,590) | (5,740) | (7,330) |
| Government-sponsored enterprise obligations | 106 | (889) | (783) | 725 | (1,099) | (374) |
| State and municipal obligations | 2,136 | (1,101) | 1,035 | 5,817 | (4,880) | 937 |
| Mortgage-backed securities | 13 | (3,168) | (3,155) | 18,977 | (19,657) | (680) |
| Asset-backed securities | 1,376 | (386) | 990 | 4,585 | (3,598) | 987 |
| Other securities | (420) |)334 | (86) | (509) |)1,166 | 657 |
| Total interest on investment securities | 3,222 | (8,092) | (4,870) | 28,005 | (33,808) | (5,803) |
| Short-term federal funds sold and securities purchased under agreements to resell | 10 | 1 | 11 | 32 | (7) |)25 |
| Long-term securities purchased under agreements to resell | (10) |)1,010 | 1,000 | 1,346 | 3,184 | 4,530 |
| Interest earning deposits with banks | (160) | (11) | (171) | (201) | (3) | (204) |
| Total interest income | 6,999 | (14,204) | (7,205) | 29,797 | (45,890) | (16,093) |
| Interest expense: | | | | | | |
| Deposits: | | | | | | |
| Savings | 23 | (58) | (35) | 57 | (73) | (16) |
| Interest checking and money market | 475 | (2,262) | (1,787) | 1,933 | (7,296) | (5,363) |
| Time open & C.D.'s of less than \$100,000 | (225) | (243) | (468) | (1,314) | (1,752) | (3,066) |
| Time open & C.D.'s of \$100,000 and over | (266) | (121) | (387) | (473) | (1,282) | (1,755) |
| Total interest on deposits | 7 | (2,684) | (2,677) | 203 | (10,403) | (10,200) |
| Federal funds purchased and securities sold under agreements to repurchase | 30 | (101) | (71) | 255 | (1,233) | (978) |
| Other borrowings | 2 | (76) | (74) | (8) | (118) | (126) |
| Total interest expense | 39 | (2,861) | (2,822) | 450 | (11,754) | (11,304) |
| Net interest income, fully taxable equivalent basis | \$6,960 | \$(11,343) | \$(4,383) | \$29,347 | \$(34,136) | \$(4,789) |

Net interest income for the third quarter of 2012 was \$153.8 million, a \$4.8 million decrease from the third quarter of 2011. On a tax equivalent (T/E) basis, net interest income totaled \$159.9 million, down from \$171.2 million in the second quarter of 2012 and down from \$164.3 million in the same quarter last year. The decrease in net interest income compared to the previous quarter was mainly due to declines in rates earned on loans and investment securities. The decline from the same period last year was also due to lower yields, which were partly offset by lower rates paid on deposits and higher balances of loans and investment securities. The lower overall rate earned on

investment securities was partly due to lower interest earned on the Company's holdings of U.S. Treasury inflation-protected securities (TIPS), which declined \$2.8 million in the current quarter compared to the same quarter last year, and declined \$7.4 million in the first nine months of 2012 compared to the same period last year. The Company's net interest rate margin was 3.30% for the third quarter of 2012, compared to 3.55% in the previous quarter and 3.51% in the third quarter of 2011.

Total interest income (T/E) decreased \$7.2 million, or 4.1%, from the third quarter of 2011. Interest income on loans, including loans held for sale, declined \$3.2 million due to a 29 basis point decrease in average rates earned, while average loan balances increased 3.5%. The higher balances contributed \$3.9 million to interest income and occurred mainly in business, consumer and personal real estate loans. The overall average rate earned on total loans declined to 4.76% during the current quarter compared

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to 5.05% in the third quarter of 2011, which resulted in a \$7.1 million decrease in interest income. Most of the rate impact occurred in business real estate, personal real estate, business and consumer loans. The average rate earned on business real estate loans decreased 35 basis points and was partly offset by higher average balances of \$59.6 million, or 2.8%. The average yield on personal real estate loans declined 44 basis points, while the average balance increased \$93.1 million, or 6.5%. Average business loans increased \$203.4 million, or 7.2%, which was partly offset by a decline of 17 basis points in rates earned. Average consumer loans increased \$100.6 million, while the average yield fell 66 basis points. Reflected in the increase in average consumer loan balances were higher auto and fixed-rate home equity loan balances of \$185.6 million, offset by a decrease of \$100.7 million in marine and RV loans as that portfolio continues to pay down (since the Company no longer originates these types of loans). Average consumer credit card loans decreased \$5.1 million compared to the third quarter of 2011, while the average rate earned on these balances increased to 11.83% from 11.59%.

Interest income on investment securities (T/E) was \$51.1 million during the third quarter of 2012 compared to \$56.0 million during the same period last year, which was a decrease of \$4.9 million. As mentioned above, this decline included a \$2.8 million decrease in TIPS inflation interest, which decreased from \$1.4 million in the third quarter of 2011 to (\$1.4) million in the current quarter. The lower inflation interest in the current quarter was directly related to the lower Consumer Price Indices published in the current quarter, on which this interest is based. Also, lower average rates were earned on the remainder of the portfolio, especially in mortgage-backed and state and municipal securities, which saw declines of 33 and 31 basis points, respectively. The average balance of the total portfolio (excluding fair value adjustments) increased \$654.9 million, or 7.9%, compared to the third quarter of 2011. This growth mainly occurred in state and municipal obligations and asset-backed securities, which increased by \$202.4 million and \$475.9 million, respectively. The effect of the higher average total portfolio balance was offset by a lower overall average yield, which declined to 2.29% compared to 2.69% during the third quarter of 2011. Since December 31, 2011, the period end portfolio balance (excluding fair value adjustments) has declined \$293.6 million.

Interest income on long-term securities purchased under agreements to resell increased \$1.0 million over the third quarter of 2011 due to an increase in the average rate earned of 48 basis points.

The average tax equivalent yield on total interest earning assets was 3.49% in the third quarter of 2012 compared to 3.77% in the third quarter of 2011.

Total interest expense decreased \$2.8 million, or 23.1%, compared to the third quarter of 2011, primarily due to a \$2.7 million decrease in interest expense on interest bearing deposits. The decrease in interest expense on deposits resulted primarily from an 11 basis point decrease in average rates paid on money market accounts, coupled with a decrease of 8 basis points in average rates paid on certificates of deposit of less than \$100,000. Total average interest bearing deposits increased slightly over the third quarter of 2011, as money market account balances increased \$587.6 million, or 7.8%, and certificate of deposit balances declined \$498.0 million, or 19.1%. The overall average rate incurred on all interest bearing liabilities decreased to .30% in the third quarter of 2012 compared to .40% in the third quarter of 2011.

Net interest income (T/E) for the first nine months of 2012 was \$496.8 million compared to \$501.6 million for the same period in 2011. For the first nine months of 2012, the net yield on total interest earning assets on a tax equivalent basis was 3.43% compared to 3.73% in the first nine months of 2011. The components of net interest income for the first nine months of 2012 compared to the same period in 2011 reflected trends similar to the quarterly discussion above.

Total interest income (T/E) for the first nine months of 2012 decreased \$16.1 million from the same period last year primarily due to lower interest earned on loans and investment securities, partially offset by an increase in interest earned on securities purchased under agreements to resell. Loan interest income (T/E, including loans held for sale) declined \$14.6 million due to a 21 basis point decrease in the average interest rate earned, coupled with a slight decline in loan balances. Similar to trends noted in the quarterly comparison, increases occurred in average business real estate, personal real estate, and consumer loan balances, while both construction and consumer credit card loans decreased. Average business loans, however, decreased slightly in the nine month period. Investment securities interest income (T/E) decreased \$5.8 million and resulted from a decrease in average rates earned of 56 basis points, partly offset by an increase in average investment securities balances. As noted in the quarterly discussion above, the

year over year decline in interest income was also mainly due to lower TIPS inflation interest of \$7.4 million, which totaled \$11.1 million in the first nine months of 2011 compared to \$3.8 million in the first nine months of 2012. Average investment securities balances (excluding fair value adjustments) were \$9.1 billion for the first nine months of 2012 compared to \$7.7 billion for the same period in 2011, primarily due to increases of \$734.7 million and \$471.2 million, respectively, in average mortgage-backed and asset-backed securities. Interest income on long-term securities purchased under agreements to resell increased \$4.5 million in the first nine months of 2012 compared to the prior period due to an increase of 50 basis points in the average rate earned.

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The decrease of \$11.3 million in interest expense for the first nine months of 2012 compared to the same period in the prior year was due to a \$10.2 million, or 28.3%, decrease in interest expense on interest bearing deposits. The decrease in interest expense on deposits primarily resulted from declines in average rates paid on all deposit types, which decreased 13 basis points overall. Interest expense on repurchase agreements also declined, as the average rate paid dropped 16 basis points. For the first nine months of 2012, the overall cost of total interest bearing liabilities decreased 14 basis points to .31% compared to .45% in the same period in the prior year.

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

Non-Interest Income

| (Dollars in thousands) | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|--|---------------------------------|-----------|----------|--------------------------------|-----------|----------|
| | 2012 | 2011 | % change | 2012 | 2011 | % change |
| Bank card transaction fees | \$39,488 | \$42,149 | (6.3)% | \$112,655 | \$120,915 | (6.8)% |
| Trust fees | 23,681 | 22,102 | 7.1 | 70,328 | 66,218 | 6.2 |
| Deposit account charges and other fees | 19,873 | 21,939 | (9.4) | 59,184 | 62,028 | (4.6) |
| Capital market fees | 5,110 | 5,556 | (8.0) | 16,991 | 15,255 | 11.4 |
| Consumer brokerage services | 2,441 | 2,333 | 4.6 | 7,543 | 7,876 | (4.2) |
| Loan fees and sales | 1,358 | 2,034 | (33.2) | 4,625 | 5,933 | (22.0) |
| Other | 8,971 | 5,519 | 62.5 | 24,995 | 20,657 | 21.0 |
| Total non-interest income | \$100,922 | \$101,632 | (.7)% | \$296,321 | \$298,882 | (.9)% |
| Non-interest income as a % of total revenue* | 39.6 | %39.0 | % | 38.2 | %38.2 | % |

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

For the third quarter of 2012, total non-interest income amounted to \$100.9 million compared with \$101.6 million in the same quarter last year, which was a decrease of \$710 thousand, or .7%. Bank card fees for the quarter declined \$2.7 million, or 6.3%, from the third quarter of last year, as a result of a decline in debit card interchange fees of \$6.8 million, or 43.8% (mainly the effect of new pricing limitations effective in late 2011), which was partly offset by growth in corporate card fees of \$3.3 million, or 21.8%. Corporate card and debit card fees for the current quarter totaled \$18.5 million and \$8.7 million, respectively. Merchant fees grew by 8.1% due to higher transaction volumes, and totaled \$6.5 million for the quarter, while credit card fees grew 6.2% and totaled \$5.8 million. Trust fees for the quarter increased \$1.6 million, or 7.1%, over the same quarter last year, resulting mainly from growth in personal, institutional and corporate trust fees. Deposit account fees declined \$2.1 million, or 9.4%, compared to last year as overdraft fees declined by \$2.9 million, but were partly offset by growth in various other deposit fees of \$759 thousand, or 29.2%. Capital market fees for the current quarter decreased \$446 thousand, to \$5.1 million, while consumer brokerage services revenue increased \$108 thousand, or 4.6%. Loan fees and sales revenue was down \$676 thousand, or 33.2%, from the same period last year mainly due to a decline in mortgage banking revenue (mainly because the Company is retaining first mortgage loan originations in the current year). Other non-interest income for the current quarter increased \$3.5 million over the same quarter last year and included higher leasing revenue, letter of credit fees, and tax credit sales income. Also, in the third quarter of 2011, the Company wrote down the value of certain banking properties held for sale by \$1.7 million.

Non-interest income for the first nine months of 2012 was \$296.3 million compared to \$298.9 million in the first nine months of 2011, resulting in a decrease of \$2.6 million, or .9%. Bank card fees decreased \$8.3 million, or 6.8%, as a result of a \$19.7 million, or 43.3%, decline in debit card interchange fees, partly offset by growth in corporate card and merchant fees of 21.4% and 9.4%, respectively. Trust fee income increased \$4.1 million, or 6.2%, as a result of growth in personal and institutional trust fees. Deposit account fees decreased \$2.8 million, or 4.6%, mainly due to a decline in overdraft and return item fees of \$5.4 million, while various other deposit fees increased \$2.4 million. Capital market fees increased \$1.7 million, or 11.4%, resulting from growth in sales of mainly fixed income securities

to correspondent banks and other commercial customers. Consumer brokerage services revenue decreased by \$333 thousand, or 4.2%, mainly due to a decline in annuity and life insurance fee income, partly offset by growth in advisory fees. Loan fees and sales decreased \$1.3 million, or 22.0%, due to a decline in mortgage banking revenue. Other non-interest income increased by \$4.3 million, or 21.0%, mainly due to higher tax credit sales income, lease-related fees and letter of credit fees, in addition to the write-downs on banking properties in 2011, as mentioned above.

As discussed in Note 14 to the consolidated financial statements, the Company has agreed to change the posting order of debit card transactions. The change in posting order is expected to begin no later than April 2013. As a result of this change, overdraft income is expected to be reduced on an annual basis by \$6 million to \$8 million.

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Investment Securities Gains (Losses), Net

Net gains and losses on investment securities which were recognized in earnings during the three and nine months ended September 30, 2012 and 2011 are shown in the table below. Net securities gains amounted to \$3.2 million in the third quarter of 2012, while net securities gains of \$8.6 million were recorded in the first nine months of 2012.

Included in these gains and losses are credit-related impairment losses on certain non-agency guaranteed mortgage-backed securities which have been identified as other-than-temporarily impaired. These identified securities had a total fair value of \$108.1 million at September 30, 2012. During the current quarter, additional credit-related impairment losses of \$557 thousand were recorded, bringing the total credit-related impairment losses during the first nine months of 2012 to \$1.2 million. The cumulative credit-related impairment loss on these securities, recorded in earnings, amounted to \$11.3 million. Also shown below are net gains and losses relating to non-marketable private equity investments, which are primarily held by the Parent's majority-owned private equity subsidiaries. These include fair value adjustments, in addition to gains and losses realized upon disposition. The portion of this activity attributable to minority interests is reported as non-controlling interest in the consolidated statements of income, and resulted in expense of \$1.7 million during the first nine months of 2012 and \$1.4 million during the same period last year.

| (In thousands) | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|------------------------------------|---------|-----------------------------------|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Available for sale: | | | | |
| Municipal bonds | \$— | \$— | \$— | \$177 |
| Agency mortgage-backed bonds | — | — | 342 | — |
| OTTI losses on non-agency mortgage-backed bonds | (557 |)(831 |)(1,227 |)(1,755 |
| Non-marketable: | | | | |
| Private equity investments | 3,737 | 3,418 | 9,441 | 7,448 |
| Total investment securities gains, net | \$3,180 | \$2,587 | \$8,556 | \$5,870 |

Non-Interest Expense

| (Dollars in thousands) | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|--------------------------------|---------------------------------|-----------|----------|--------------------------------|-----------|----------|
| | 2012 | 2011 | % change | 2012 | 2011 | % change |
| Salaries and employee benefits | \$89,292 | \$85,700 | 4.2 % | \$266,346 | \$257,315 | 3.5 % |
| Net occupancy | 11,588 | 11,510 | .7 | 33,953 | 34,760 | (2.3) |
| Equipment | 4,976 | 5,390 | (7.7) | 15,164 | 16,669 | (9.0) |
| Supplies and communication | 5,400 | 5,674 | (4.8) | 16,680 | 16,898 | (1.3) |
| Data processing and software | 19,279 | 16,232 | 18.8 | 55,030 | 50,230 | 9.6 |
| Marketing | 4,100 | 4,545 | (9.8) | 12,391 | 13,298 | (6.8) |
| Deposit insurance | 2,608 | 2,772 | (5.9) | 7,746 | 10,443 | (25.8) |
| Other | 16,148 | 21,923 | (26.3) | 52,882 | 61,606 | (14.2) |
| Total non-interest expense | \$153,391 | \$153,746 | (.2)% | \$460,192 | \$461,219 | (.2)% |

Non-interest expense for the third quarter of 2012 amounted to \$153.4 million, a decrease of \$355 thousand, or .2%, compared with \$153.7 million in the third quarter of last year. Salaries and benefits expense increased \$3.6 million, or 4.2%, mainly due to an increase in salary costs of \$1.7 million, or 2.3%, coupled with an increase in medical costs, which grew by \$1.1 million. Full-time equivalent employees totaled 4,707 at September 30, 2012 compared to 4,762 at September 30, 2011. Equipment expense declined \$414 thousand due to lower depreciation expense, while supplies and communication expense declined \$274 thousand due to lower postage and data network costs. Data processing and software costs increased \$3.0 million, or 18.8%, mainly due to \$2.5 million in higher bank card-related costs. Other non-interest expense decreased \$5.8 million, or 26.3%, from the same quarter last year. This decline mainly

resulted from an expense accrual in the third quarter of 2011 of \$5.9 million related to debit card overdraft litigation. Other non-interest expense also decreased due to higher deferred loan origination costs, which were partly offset by higher professional fees.

For the first nine months of 2012, non-interest expense amounted to \$460.2 million, a decrease of \$1.0 million, or .2%, compared with \$461.2 million in the same period last year. Salaries and benefits expense increased by \$9.0 million, or 3.5%, largely due to higher salaries, incentive compensation, medical, and retirement expense. Occupancy expense declined \$807 thousand, or 2.3%, primarily resulting from lower depreciation and outside services expense. Equipment expense decreased \$1.5 million, or 9.0%, also due to lower depreciation expense. Supplies and communication expense decreased by \$218 thousand, or 1.3%, while marketing expense was lower by \$907 thousand, or 6.8%. FDIC insurance expense decreased \$2.7 million, or 25.8%, as a result

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of new assessment rules, which became effective in the second quarter of 2011. Data processing and software expense increased \$4.8 million, or 9.6%, mainly due to higher bank card processing expense. Other non-interest expense decreased \$8.7 million, or 14.2%, mainly due to the \$10.9 million debit card overdraft litigation accrual recorded in the first nine months of 2011, partly offset by the accrual of \$5.2 million for anticipated costs resulting from the proposed settlement of certain Visa-related interchange litigation recorded in the second quarter of 2012. Other reductions to non-interest expense in 2012 included a \$1.1 million decline in regulatory fees and an increase of \$1.3 million in deferred loan origination costs.

Provision and Allowance for Loan Losses

| (In thousands) | Three Months Ended | | | Nine Months Ended September 30 | |
|------------------------------------|--------------------|---------------|----------------|--------------------------------|----------|
| | Sept. 30, 2012 | June 30, 2012 | Sept. 30, 2011 | 2012 | 2011 |
| Provision for loan losses | \$5,581 | \$5,215 | \$11,395 | \$18,961 | \$39,372 |
| Net loan charge-offs (recoveries): | | | | | |
| Business | 202 | (3,600) | 889 | (3,288) | 4,338 |
| Real estate-construction and land | (102) | 116 | 1,215 | 234 | 4,326 |
| Real estate-business | (25) | 1,839 | 1,429 | 3,309 | 2,832 |
| Consumer credit card | 6,277 | 5,930 | 7,103 | 18,380 | 24,631 |
| Consumer | 1,791 | 1,974 | 3,232 | 6,396 | 9,474 |
| Revolving home equity | 314 | 943 | 72 | 1,617 | 783 |
| Real estate-personal | 267 | 679 | 673 | 1,015 | 1,974 |
| Overdrafts | 358 | 333 | 282 | 798 | 514 |
| Total net loan charge-offs | \$9,082 | \$8,214 | \$14,895 | \$28,461 | \$48,872 |

| | Three Months Ended | | | Nine Months Ended September 30 | |
|--|--------------------|---------------|----------------|--------------------------------|------|
| | Sept. 30, 2012 | June 30, 2012 | Sept. 30, 2011 | 2012 | 2011 |
| Annualized net loan charge-offs (recoveries)*: | | | | | |
| Business | .03 | %(.50) | %.13 | %(.15) | %.20 |
| Real estate-construction and land | (.12) | .13 | 1.17 | .09 | 1.34 |
| Real estate-business | — | .34 | .27 | .20 | .18 |
| Consumer credit card | 3.42 | 3.35 | 3.83 | 3.39 | 4.38 |
| Consumer | .59 | .70 | 1.16 | .74 | 1.13 |
| Revolving home equity | .28 | .84 | .06 | .48 | .22 |
| Real estate-personal | .07 | .19 | .19 | .09 | .18 |
| Overdrafts | 26.61 | 23.65 | 16.13 | 17.20 | 9.96 |
| Total annualized net loan charge-offs | .38 | %.36 | %.65 | %.41 | %.71 |

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

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

Loans subject to individual evaluation generally consist of business, construction, business real estate and personal real estate loans on non-accrual status, and include troubled debt restructurings that are on non-accrual status. These

non-accrual loans are evaluated individually for impairment based on factors such as payment history, borrower financial condition, collateral, current economic conditions and loss experience. For collateral dependent loans, appraisals of collateral (including exit costs) are normally obtained annually but discounted based on date last received and market conditions. From these evaluations of expected cash flows and collateral values, specific allowances are determined.

Loans which are not individually evaluated are segregated by loan type and sub-type and are collectively evaluated. These loans include commercial loans (business, construction and business real estate) which have been graded pass, special mention or substandard and all personal banking loans, except personal real estate loans on non-accrual status. Collectively-evaluated loans

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

The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses is based upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in delinquencies, portfolio risk ratings, levels of non-performing assets, and prevailing regional and national economic conditions. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company's senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The Company's subsidiary bank continues to be subject to examination by several regulatory agencies, and throughout the year, examinations are conducted targeting various segments of the loan portfolio for review. Note 1 in the 2011 Annual Report on Form 10-K contains additional discussion on the allowance and charge-off policies.

Net loan charge-offs in the third quarter of 2012 amounted to \$9.1 million, compared with \$8.2 million in the prior quarter and \$14.9 million in the third quarter of last year. Net business loan charge-offs in the third quarter of 2012 were \$202 thousand compared to net recoveries of \$3.6 million in the previous quarter related to several large commercial loans. Also, net charge-offs on consumer credit card loans increased \$347 thousand over the previous quarter. Lower net charge-offs were recorded in most other loan categories, which included a recovery in the current quarter of \$819 thousand on a single business real estate loan. For the three months ended September 30, 2012, the ratio of annualized net loan charge-offs to total average loans was .38%, compared to .36% in the previous quarter and .65% in the same quarter last year.

For the third quarter of 2012, annualized net charge-offs on average consumer credit card loans amounted to 3.42%, compared with 3.35% in the previous quarter and 3.83% in the same period last year. Consumer loan net charge-offs for the quarter amounted to .59% of average consumer loans, compared to .70% in the previous quarter and 1.16% in the same quarter last year.

The provision for loan losses for the current quarter totaled \$5.6 million, an increase of \$366 thousand over the previous quarter and \$5.8 million lower than in the same period last year. The current quarter provision for loan losses was \$3.5 million less than net loan charge-offs for the current quarter, thereby reducing the allowance to \$175.0 million. At September 30, 2012 the allowance for loan losses was 1.82% of total loans, excluding loans held for sale, and was 317% of total non-accrual loans.

Net charge-offs during the first nine months of 2012 were \$28.5 million compared to \$48.9 million in the same period of 2011. The \$20.4 million decrease was due to lower commercial loan net charge-offs, including the \$4.4 million recovery of the large loans discussed above, along with lower net charge-offs on consumer credit card, construction and land, and consumer loans.

Risk Elements of Loan Portfolio

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

| (Dollars in thousands) | September 30, December 31, | | |
|--|----------------------------|----------|---|
| | 2012 | 2011 | |
| Non-accrual loans | \$55,201 | \$75,482 | |
| Foreclosed real estate | 18,234 | 18,321 | |
| Total non-performing assets | \$73,435 | \$93,803 | |
| Non-performing assets as a percentage of total loans | .76 | % 1.02 | % |
| Non-performing assets as a percentage of total assets | .35 | %.45 | % |
| Total loans past due 90 days and still accruing interest | \$12,232 | \$14,958 | |

Non-accrual loans, which are also classified as impaired, totaled \$55.2 million at September 30, 2012, and decreased \$20.3 million from December 31, 2011. The decline from December 31, 2011 occurred mainly in business and construction non-accrual

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loans, which decreased \$11.6 million and \$7.3 million, respectively. At September 30, 2012, non-accrual loans were comprised mainly of business real estate (33.4%), construction and land (27.9%), and business (25.5%) loans. Foreclosed real estate at September 30, 2012, totaled \$18.2 million, a slight decrease when compared to December 31, 2011. Total loans past due 90 days or more and still accruing interest amounted to \$12.2 million as of September 30, 2012, a decrease of \$2.7 million when compared to December 31, 2011, resulting mainly from decreases in consumer credit card, personal real estate and consumer loan delinquencies. Balance by classes for non-accrual loans and loans past due 90 days and still accruing interest is shown in the "Delinquent and non-accrual loans" section in Note 2 to the consolidated financial statements.

In addition to the non-performing and past due loans mentioned above, the Company also has identified loans for which management has concerns about the ability of the borrowers to meet existing repayment terms. They are classified as substandard under the Company's internal rating system. The loans are generally secured by either real estate or other borrower assets, reducing the potential for loss should they become non-performing. Although these loans are generally identified as potential problem loans, they may never become non-performing. Such loans totaled \$166.9 million at September 30, 2012 compared with \$250.7 million at December 31, 2011, resulting in a decrease of \$83.8 million, or 33.4%. The change in potential problem loans was largely due to decreases of \$41.4 million in business real estate loans, \$24.7 million in business loans and \$18.5 million in construction and land real estate loans.

| (In thousands) | September 30, 2012 | December 31, 2011 |
|-------------------------------------|-----------------------|----------------------|
| Potential problem loans: | | |
| Business | \$ 50,478 | \$ 75,213 |
| Real estate – construction and land | 36,225 | 54,696 |
| Real estate – business | 72,257 | 113,652 |
| Real estate – personal | 7,938 | 6,900 |
| Consumer | — | 208 |
| Total potential problem loans | \$ 166,898 | \$ 250,669 |

At September 30, 2012, the Company had approximately \$87.3 million of loans whose terms have been modified or restructured under a troubled debt restructuring. These loans have been extended to borrowers who are experiencing financial difficulty and who have been granted a concession, as defined by accounting guidance. Of this balance, \$27.5 million have been placed on non-accrual status. Of the remaining \$59.8 million, approximately \$44.4 million are performing under their modified terms, and the Company believes it probable that all amounts due under the modified terms of the agreements will be collected. Most of these are commercial loans (business, construction and business real estate) classified as substandard, which were renewed at interest rates that were not judged to be market rates for new debt with similar risk. However, because of their substandard classification, they are included as potential problem loans in the table above. An additional \$15.4 million in troubled debt restructurings were composed of certain credit card loans under various debt management and assistance programs. These restructured loans are considered impaired loans for purposes of determining the allowance for loan losses, as discussed in the Summary of Significant Accounting Policies in the Company's 2011 Annual Report on Form 10-K.

Loans with Special Risk Characteristics

Management relies primarily on an internal risk rating system, in addition to delinquency status, to assess risk in the loan portfolio, and these statistics are presented in Note 2 to the consolidated financial statements. However, certain types of loans are considered at high risk of loss due to their terms, location, or special conditions. Additional information about the major types of loans in these categories and their risk features are provided below. Information based on loan-to-value (LTV) ratios was generally calculated with valuations at loan origination date. The Company does not attempt to obtain updated appraisals or valuations unless the loans become significantly delinquent or are in

the process of being foreclosed upon.

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Real Estate – Construction and Land Loans

The Company's portfolio of construction and land loans, as shown in the table below, amounted to 3.5% of total loans outstanding at September 30, 2012. The balance in this portfolio decreased \$51.5 million, or 13.3%, since December 31, 2011, which was mainly a reflection of weak loan demand.

| (Dollars in thousands) | September 30, 2012 | % of Total Loans | % of Total Loans | December 31, 2011 | % of Total Loans | % of Total Loans | |
|---|-----------------------|---------------------|------------------------|----------------------|---------------------|------------------------|---|
| Residential land and land development | \$ 58,948 | 17.6 | %.6 | 70,708 | 18.3 | %.8 | % |
| Residential construction | 71,398 | 21.3 | .8 | 70,009 | 18.1 | .7 | |
| Commercial land and land development | 86,186 | 25.7 | .9 | 97,379 | 25.2 | 1.1 | |
| Commercial construction | 118,581 | 35.4 | 1.2 | 148,502 | 38.4 | 1.6 | |
| Total real estate - construction and land loans | \$ 335,113 | 100.0 | %3.5 | \$ 386,598 | 100.0 | %4.2 | % |

Real Estate – Business Loans

Total business real estate loans were \$2.2 billion at September 30, 2012 and comprised 22.8% of the Company's total loan portfolio. These loans include properties such as manufacturing and warehouse buildings, small office and medical buildings, churches, hotels and motels, shopping centers, and other commercial properties. Approximately 46% of these loans were for owner-occupied real estate properties, which present lower risk profiles.

| (Dollars in thousands) | September 30, 2012 | % of Total Loans | % of Total Loans | December 31, 2011 | % of Total Loans | % of Total Loans | |
|------------------------------------|-----------------------|---------------------|------------------------|----------------------|---------------------|------------------------|---|
| Owner-occupied | \$ 1,006,899 | 45.9 | %10.5 | \$ 1,057,652 | 48.5 | %11.5 | % |
| Office | 278,213 | 12.7 | 2.9 | 270,200 | 12.3 | 3.0 | |
| Retail | 245,723 | 11.2 | 2.5 | 226,447 | 10.4 | 2.5 | |
| Multi-family | 179,316 | 8.2 | 1.9 | 174,285 | 8.0 | 1.9 | |
| Hotels | 158,301 | 7.2 | 1.6 | 119,039 | 5.5 | 1.3 | |
| Farm | 119,176 | 5.4 | 1.2 | 121,966 | 5.6 | 1.3 | |
| Industrial | 103,710 | 4.7 | 1.1 | 98,092 | 4.5 | 1.1 | |
| Other | 101,868 | 4.7 | 1.1 | 112,419 | 5.2 | 1.2 | |
| Total real estate - business loans | \$ 2,193,206 | 100.0 | %22.8 | \$ 2,180,100 | 100.0 | %23.8 | % |

Real Estate – Personal Loans

The Company's \$1.6 billion personal real estate loan portfolio is composed mainly of residential first mortgage real estate loans. As shown on page 44, the loss rates in both 2012 and 2011 have remained low and at September 30, 2012, past due loans have declined slightly compared to December 31, 2011. Also, as shown in Note 2, only 6.0% of this portfolio has FICO scores of less than 660. Approximately \$13.5 million of personal real estate loans were structured with interest only payments. These loans are typically made to high net-worth borrowers and generally have low LTV ratios or have additional collateral pledged to secure the loan, and therefore, they are not perceived to represent above normal credit risk. At September 30, 2012, the Company had loans with no mortgage insurance and an original LTV higher than 80% totaling \$138.7 million compared to \$142.6 million at December 31, 2011.

Revolving Home Equity Loans

The Company has \$453.5 million in revolving home equity loans at September 30, 2012 that are generally collateralized by residential real estate. Most of these loans (94.4%) are written with terms requiring interest only monthly payments. These loans are offered in three main product lines: LTV up to 80%, 80% to 90%, and 90% to 100%. As of September 30, 2012, the outstanding principal of loans with an original LTV higher than 80% was \$112.3 million compared to \$70.2 million as of December 31, 2011. Total revolving home equity loan balances over 30 days past due were \$3.0 million at September 30, 2012 compared to \$1.6 million at December 31, 2011. Approximately 8.0% of the portfolio has FICO scores lower than 660.

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Fixed Rate Home Equity Loans

In addition to the residential real estate mortgage and the revolving home equity products mentioned above, the Company offers a third choice to those consumers desiring a fixed rate home equity loan with a fixed maturity date and a determined amortization schedule. The fixed rate home equity loan is typically used to finance a specific home repair or remodeling project. This portfolio of loans approximated \$187.3 million and \$142.0 million at September 30, 2012 and December 31, 2011, respectively. At the end of the third quarter of 2012, \$49.1 million of this portfolio had an LTV higher than 80%, up from a balance of \$37.9 million at the end of 2011.

At times, these loans are written with interest only monthly payments and a balloon payoff at maturity; however, such loans totaled less than 3% of the outstanding balance of fixed rate home equity loans at September 30, 2012. The Company has limited the offering of fixed rate home equity loans with LTV ratios over 90% during the past several years, and only \$5.3 million in new fixed rate home equity loans were written with these LTV ratios during the first nine months of 2012.

Management does not believe these loans collateralized by real estate (personal real estate, revolving home equity, and fixed rate home equity) represent any unusual concentrations of risk, as evidenced by net charge-offs on these loans in the first nine months of 2012 of \$1.0 million, \$1.6 million and \$350 thousand, respectively. The amount of any increased potential loss on high LTV agreements relates mainly to amounts advanced that are in excess of the 80% collateral calculation, not the entire approved line. The Company currently offers no subprime first mortgage or home equity loans. These are characterized as new loans to customers with FICO scores below 650 for home equity loans, 660 for government-insured first mortgages, and 680 for all other conventional first mortgages. The Company does not purchase brokered loans.

Other Consumer Loans

Within the consumer loan portfolio are several direct and indirect product lines, comprised mainly of loans secured by automobiles, marine and RVs. Outstanding balances for these loans were \$856.6 million and \$777.7 million at September 30, 2012 and December 31, 2011, respectively. The balances over 30 days past due amounted to \$11.9 million at September 30, 2012 compared to \$13.0 million at the end of 2011. For the nine months ended September 30, 2012, \$319.2 million of new loans, the majority being automobile loans, were originated, compared to \$223.8 million during the full year of 2011. The Company has curtailed new marine and RV loans since 2008, and at September 30, 2012, outstanding balances totaled \$346.9 million. The loss ratios experienced for marine and RV loans have been higher than other consumer loan products in recent years, and the annualized ratios were 1.9% and 2.0% in the first nine months of 2012 and 2011, respectively.

Additionally, the Company offers low introductory rates on selected consumer credit card products. Out of a portfolio at September 30, 2012 of \$748.9 million in consumer credit card loans outstanding, approximately \$132.3 million, or 17.7%, carried a low introductory rate. Within the next six months, \$45.9 million of these loans are scheduled to convert to the ongoing higher contractual rate. To mitigate some of the risk involved with this credit card product, the Company performs credit checks and detailed analysis of the customer borrowing profile before approving the loan application. Management believes that the risks in the consumer loan portfolio are reasonable and the anticipated loss ratios are within acceptable parameters.

Shared National Credits

The Company participates in credits of large, publicly traded companies which are defined by regulation as shared national credits, or SNCs. Regulations define SNCs as loans exceeding \$20 million that are shared by three or more financial institutions. The Company typically participates in these loans when business operations are maintained in

the local communities or regional markets and opportunities to provide other banking services are present. The balance of SNC loans totaled \$515.4 million at September 30, 2012, with an additional \$1.1 billion in unfunded commitments.

Income Taxes

Income tax expense was \$32.2 million in the third quarter of 2012, compared to \$34.5 million in the second quarter of 2012 and \$31.7 million in the third quarter of 2011. The Company's effective tax rate, including the effect of non-controlling interest, was 32.8% in both the second and third quarters of 2012, compared with 32.7% in the third quarter of 2011. Additionally, income tax expense was \$99.5 million in the first nine months of 2012 compared to \$91.9 million for the same period during the previous year, resulting in effective tax rates of 33.0% and 32.0%, respectively. The change in the effective tax rate for the first nine months of 2012 compared to the same period in 2011 was primarily due to increased state and local taxes in 2012.

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Financial Condition

Balance Sheet

Total assets of the Company were \$20.9 billion at September 30, 2012 compared to \$20.6 billion at December 31, 2011. Earning assets (excluding fair value adjustments on investment securities) amounted to \$19.5 billion at September 30, 2012, compared to \$19.3 billion at December 31, 2011, and consisted of 49% in loans and 45% in investment securities.

At September 30, 2012, total loans, including loans held for sale, increased \$438.8 million, or 4.8%, compared with balances at December 31, 2011. Business, business real estate and personal real estate loans increased \$290.6 million, \$13.1 million, and \$128.0 million, respectively. Within the consumer loan portfolio, marine and RV loans decreased by \$73.3 million; however, home equity fixed rate loans increased by \$45.3 million and consumer auto loans and other consumer loans increased \$156.4 million due to higher new loan originations. The demand for construction loans continues to be affected by the weak housing industry, and overall, these loans declined by \$51.5 million. Consumer credit card loans decreased by \$39.8 million compared with balances at December 31, 2011.

Loans held for sale decreased \$22.3 million compared with balances at December 31, 2011. This group of loans has historically included guaranteed student loans, which the Company no longer originates, and fixed-rate personal real estate loans, which the Company no longer actively sells to third parties. The \$8.7 million balance at September 30, 2012 is comprised solely of student loans under sale contracts.

Available for sale investment securities, (excluding fair value adjustments) decreased \$291.1 million at September 30, 2012 compared to December 31, 2011. The decrease in available for sale securities was primarily driven by a \$752.5 million decrease in mortgage-backed securities. This decrease was partly offset by increases in state and municipal obligations of \$205.2 million, asset-backed securities of \$224.8 million, and government-sponsored enterprise obligations of \$63.0 million. At September 30, 2012, the duration of the investment portfolio was 2.0 years.

Deposits at September 30, 2012 totaled \$16.8 billion; an increase of \$49.7 million, or less than 1% compared to December 31, 2011. Non-interest bearing deposits increased \$437.4 million, or 8.1%, and savings, interest checking and money market accounts increased \$91.7 million. These increases were offset by a decrease of \$479.4 million, or 19.3%, in time open and certificates of deposit balances.

In the second quarter of 2012, the Company entered into several agreements commonly known as collateral swaps. These agreements involve the exchange of collateral under simultaneous repurchase and resell agreements with the same financial institution counterparty. These repurchase and resell agreements have the same principal amounts, inception dates, and maturity dates and have been offset against each other in the balance sheet, as permitted under the netting provisions of ASC 210-20-45. At September 30, 2012, the Company had posted collateral consisting of \$317.2 million in agency mortgage-backed securities and accepted \$335.6 million in investment grade asset-backed, commercial mortgage-backed, and corporate bonds on collateral swaps of \$300.0 million. The agreements mature in 2013 through 2015, and the Company will earn an average of approximately 86 basis points during this period.

Liquidity and Capital Resources

Liquidity Management

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

follows:

| (In thousands) | September 30, 2012 | June 30, 2012 | December 31, 2011 |
|---|-----------------------|---------------|----------------------|
| Liquid assets: | | | |
| Available for sale investment securities | \$9,020,951 | \$9,206,451 | \$9,224,702 |
| Federal funds sold | 10,475 | 7,455 | 11,870 |
| Long-term securities purchased under agreements to resell | 850,000 | 850,000 | 850,000 |
| Balances at the Federal Reserve Bank | 132,144 | 92,544 | 39,853 |
| Total | \$10,013,570 | \$10,156,450 | \$10,126,425 |

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Federal funds sold, which are sold to the Company's correspondent bank customers and have overnight maturities, totaled \$10.5 million as of September 30, 2012. Long-term resell agreements, maturing later in 2012 through 2015, totaled \$850.0 million at September 30, 2012. Under these agreements, the Company holds marketable securities as collateral, which totaled \$887.3 million in fair value at September 30, 2012. Interest earning balances at the Federal Reserve Bank, which also have overnight maturities and are used for general liquidity purposes, totaled \$132.1 million at September 30, 2012. The fair value of the available for sale investment portfolio was \$9.0 billion at September 30, 2012 and included an unrealized net gain in fair value of \$299.9 million. The total net unrealized gain included gains of \$187.3 million on mortgage and asset-backed securities, \$43.0 million on U.S. government securities and \$35.2 million on state and municipal obligations. An additional \$24.7 million unrealized gain was included in the fair value of common stock held by the Parent.

Approximately \$2.1 billion of the available for sale investment portfolio is expected to mature or pay down during the next 12 months, which offers substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits, securities sold under agreements to repurchase, trust funds, letters of credit issued by the FHLB, and borrowing capacity at the Federal Reserve Bank. Total investment securities pledged for these purposes were as follows:

| (In thousands) | September 30, 2012 | June 30, 2012 | December 31, 2011 |
|--|-----------------------|---------------|----------------------|
| Investment securities pledged for the purpose of securing: | | | |
| Federal Reserve Bank borrowings | \$644,777 | \$632,812 | \$642,306 |
| FHLB borrowings and letters of credit | 79,496 | 89,376 | 111,860 |
| Securities sold under agreements to repurchase | 2,061,555 | 1,900,099 | 2,048,074 |
| Other deposits | 1,242,146 | 1,491,950 | 1,564,105 |
| Total pledged securities | 4,027,974 | 4,114,237 | 4,366,345 |
| Unpledged and available for pledging | 3,499,312 | 3,776,561 | 3,260,695 |
| Ineligible for pledging | 1,493,665 | 1,315,653 | 1,597,662 |
| Total available for sale securities, at fair value | \$9,020,951 | \$9,206,451 | \$9,224,702 |

Liquidity is also available from the Company's large base of core customer deposits, defined as non-interest bearing, interest checking, savings, and money market deposit accounts. At September 30, 2012, such deposits totaled \$14.8 billion and represented 88.1% of total deposits. These core deposits are normally less volatile, as they are often with customer relationships tied to other products offered by the Company, promoting long lasting relationships and stable funding sources. Time open and certificates of deposit of \$100,000 and over totaled \$914.8 million at September 30, 2012. These accounts are normally considered more volatile and higher costing and comprised 5.4% of total deposits at September 30, 2012.

| (In thousands) | September 30, 2012 | June 30, 2012 | December 31, 2011 |
|--------------------------|-----------------------|---------------|----------------------|
| Core deposit base: | | | |
| Non-interest bearing | \$5,814,932 | \$5,637,373 | \$5,377,549 |
| Interest checking | 629,755 | 786,712 | 968,430 |
| Savings and money market | 8,395,933 | 8,196,378 | 7,965,511 |
| Total | \$14,840,620 | \$14,620,463 | \$14,311,490 |

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

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| (In thousands) | September 30, 2012 | June 30, 2012 | December 31, 2011 |
|--|--------------------|--------------------|--------------------|
| Borrowings: | | | |
| Federal funds purchased | \$207,975 | \$340,300 | \$153,330 |
| Securities sold under agreements to repurchase | 1,049,974 | 965,445 | 1,102,751 |
| FHLB advances | 103,744 | 103,777 | 104,302 |
| Other debt | — | 7,515 | 7,515 |
| Total | \$1,361,693 | \$1,417,037 | \$1,367,898 |

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Federal funds purchased are unsecured overnight borrowings obtained mainly from upstream correspondent banks with which the Company maintains approved lines of credit. Securities sold under agreements to repurchase are secured by a portion of the Company's investment portfolio and are comprised of both non-insured customer funds totaling \$650.0 million, which generally mature overnight, and structured repurchase agreements of \$400.0 million. The structured repurchase agreements have variable rates and mature in 2013 and 2014. The Company also borrows on a secured basis through advances from the FHLB, which totaled \$103.7 million at September 30, 2012. These advances have fixed interest rates and most mature in 2017. Previously, the Company held \$7.5 million in other outstanding long-term borrowings, which related to the Company's private equity investment activity. This debt matured in September 2012.

The Company pledges certain assets, including loans and investment securities, to both the Federal Reserve Bank and the FHLB as security to establish lines of credit and borrow from these entities. Based on the amount and type of collateral pledged, the FHLB establishes a collateral value from which the Company may draw advances against the collateral. Also, this collateral is used to enable the FHLB to issue letters of credit in favor of public fund depositors of the Company. The Federal Reserve Bank also establishes a collateral value of assets pledged to support borrowings from the discount window. The following table reflects the collateral value of assets pledged, borrowings, and letters of credit outstanding, in addition to the estimated future funding capacity available to the Company at September 30, 2012:

| (In thousands) | September 30, 2012 | | |
|-------------------------------|--------------------|-----------------|-------------|
| | FHLB | Federal Reserve | Total |
| Collateral value pledged | \$1,935,863 | \$1,510,863 | \$3,446,726 |
| Advances outstanding | (103,744) |)— | (103,744) |
| Letters of credit issued | (52,950) |)— | (52,950) |
| Available for future advances | \$1,779,169 | \$1,510,863 | \$3,290,032 |

In addition to those mentioned above, several other sources of liquidity are available. The Bank has strong issuer ratings from Standard & Poor's and Moody's of A and Aa2, respectively. Additionally, the Parent's sound commercial paper rating of P-1 from Moody's would help ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been issued or outstanding during the past ten years. The Company has no subordinated debt or hybrid instruments which could affect future borrowing capacity. Because of its lack of significant long-term debt, the Company believes that it could generate additional liquidity through its Capital Markets Group from sources such as jumbo certificates of deposit or privately placed corporate debt. Financing may also include the issuance of common or preferred stock.

The cash flows from the operating, investing and financing activities of the Company resulted in a net increase in cash and cash equivalents of \$51.8 million during the first nine months of 2012, as reported in the consolidated statements of cash flows in this report. Operating activities, consisting mainly of net income adjusted for certain non-cash items, provided cash flow of \$295.4 million and has historically been a stable source of funds. Investing activities, which occur mainly in the loan and investment securities portfolios, used cash of \$186.8 million. These activities included a net increase in loans of \$489.6 million and \$2.0 billion in purchases of investment securities, offset by \$2.4 billion in sales, maturities and pay downs of investment securities. Financing activities used cash of \$56.8 million, resulting mainly from purchases of treasury stock of \$75.5 million and cash dividends paid on common stock of \$60.8 million, which were partly offset by a net increase of \$74.8 million in deposit accounts. Future short-term liquidity needs arising from daily operations are not expected to vary significantly, and the Company believes it will be able to meet these cash flow needs.

Capital Management

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

| (Dollars in thousands) | September 30, 2012 | December 31, 2011 | Minimum Ratios for Well-Capitalized Banks | |
|---------------------------------|-----------------------|----------------------|--|---|
| Risk-adjusted assets | \$13,481,838 | \$13,115,261 | | |
| Tier I risk-based capital | 2,011,277 | 1,928,690 | | |
| Total risk-based capital | 2,190,993 | 2,103,401 | | |
| Tier I risk-based capital ratio | 14.92 | % 14.71 | % 6.00 | % |
| Total risk-based capital ratio | 16.25 | % 16.04 | % 10.00 | % |
| Tier I leverage ratio | 10.00 | % 9.55 | % 5.00 | % |

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The Company maintains a treasury stock buyback program, and during the quarter ended September 30, 2012, the Company purchased 97,940 shares of stock at an average cost of \$39.66 per share. At September 30, 2012, 2,902,060 shares remained available for purchase under the current Board authorization. At a July 2012 meeting, the Board of Directors approved the purchase of additional shares, bringing the total shares authorized for future purchase to 3,000,000 shares.

The Company's common stock dividend policy reflects its earnings outlook, desired payout ratios, the need to maintain adequate capital levels, and alternative investment options. The Company paid a first quarter dividend of \$.23 per share in 2012, which was a 5.0% increase compared to the fourth quarter of 2011, and maintained the same payout in the second and third quarters of 2012. As mentioned in Note 15 to the consolidated financial statements, the Board of Directors approved a special dividend of \$1.50 per share at its November 2012 meeting.

Commitments, Off-Balance Sheet Arrangements and Contingencies

In the normal course of business, various commitments and contingent liabilities arise which are not required to be recorded on the balance sheet. The most significant of these are loan commitments, which at September 30, 2012 totaled \$8.1 billion (including approximately \$3.9 billion in unused approved credit card lines). In addition, the Company enters into standby and commercial letters of credit. These contracts amounted to \$371.9 million and \$13.7 million, respectively, at September 30, 2012. As many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. The carrying value of the guarantee obligations associated with the standby letters of credit, which has been recorded as a liability on the balance sheet, amounted to \$4.5 million at September 30, 2012.

The Company regularly purchases various state tax credits arising from third-party property redevelopment. While most of the tax credits are resold to third parties, some are periodically retained for use by the Company. During the first nine months of 2012, purchases and sales of tax credits amounted to \$41.3 million and \$19.0 million, respectively, and at September 30, 2012, outstanding purchase commitments totaled \$132.9 million.

At September 30, 2012, the Parent had additional funding commitments of \$1.3 million arising from directly-held investments in private equity concerns, classified as non-marketable securities in the accompanying balance sheets. In addition, the Parent expects to fund \$8.6 million to private equity subsidiaries over the next several years. Management does not anticipate any material losses arising from commitments and contingent liabilities and believes there are no material commitments to extend credit that represent risks of an unusual nature.

Segment Results

The table below is a summary of segment pre-tax income results for the first nine months of 2012 and 2011.

| (Dollars in thousands) | Consumer | Commercial | Wealth | Segment Totals | Other/ Elimination | Consolidated Totals |
|--------------------------------------|------------|------------|-----------|-------------------|-----------------------|------------------------|
| Nine Months Ended September 30, 2012 | | | | | | |
| Net interest income | \$206,348 | \$217,756 | \$29,092 | \$453,196 | \$25,457 | \$478,653 |
| Provision for loan losses | (26,960) | (601) | (751) | (28,312) | 9,351 | (18,961) |
| Non-interest income | 84,477 | 133,190 | 80,470 | 298,137 | (1,816) | 296,321 |
| Investment securities gains, net | — | — | — | — | 8,556 | 8,556 |
| Non-interest expense | (200,675) | (169,101) | (66,929) | (436,705) | (23,487) | (460,192) |
| Income before income taxes | \$63,190 | \$181,244 | \$41,882 | \$286,316 | \$18,061 | \$304,377 |

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Nine Months Ended September
30, 2011

| | | | | | | | |
|---|-------------|------------|-----------|------------|------------|------------|---|
| Net interest income | \$213,580 | \$209,686 | \$28,962 | \$452,228 | \$32,085 | \$484,313 | |
| Provision for loan losses | (36,158) | (11,942) | (611) | (48,711) | 9,339 | (39,372) | |
| Non-interest income | 102,656 | 121,212 | 76,711 | 300,579 | (1,697) | 298,882 | |
| Investment securities gains, net | — | — | — | — | 5,870 | 5,870 | |
| Non-interest expense | (203,217) | (165,411) | (66,559) | (435,187) | (26,032) | (461,219) | |
| Income before income taxes | \$76,861 | \$153,545 | \$38,503 | \$268,909 | \$19,565 | \$288,474 | |
| Increase (decrease) in income before income taxes: | | | | | | | |
| Amount | \$(13,671) | \$27,699 | \$3,379 | \$17,407 | \$(1,504) | \$15,903 | |
| Percent | (17.8) | %18.0 | %8.8 | %6.5 | %(7.7) | %5.5 | % |

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Consumer

For the nine months ended September 30, 2012, income before income taxes for the Consumer segment decreased \$13.7 million, or 17.8%, compared to the first nine months of 2011. This decrease was mainly due to a decline of \$7.2 million, or 3.4%, in net interest income, coupled with a decline of \$18.2 million, or 17.7%, in non-interest income. These income reductions were partly offset by a decrease of \$9.2 million in the provision for loan losses and a \$2.5 million, or 1.3%, decrease in non-interest expense. Net interest income declined due to a \$6.7 million decrease in loan interest income and a \$7.8 million decrease in net allocated funding credits assigned to the Consumer segment's loan and deposit portfolios, partly offset by a decline of \$7.3 million in deposit interest expense. Non-interest income decreased mainly due to declines in bank card fee income (primarily in debit card fees) and deposit account fees (mainly overdraft charges). Non-interest expense declined from the same period in the previous year due to lower FDIC insurance expense and corporate management fees, partly offset by higher salaries expense. The provision for loan losses totaled \$27.0 million, a \$9.2 million decrease from the first nine months of 2011, which was due mainly to lower losses on consumer credit card loans, marine and RV loans, and other consumer loans.

Commercial

For the nine months ended September 30, 2012, income before income taxes for the Commercial segment increased \$27.7 million, or 18.0%, compared to the same period in the previous year, mainly due to a lower provision for loan losses and growth in net interest income and non-interest income. Net interest income increased \$8.1 million, or 3.8%, due to higher net allocated funding credits of \$14.7 million (related to higher average deposit balances), partly offset by an \$8.2 million decline in loan interest income. The provision for loan losses in this segment totaled \$601 thousand in the first nine months of 2012, a decrease of \$11.3 million from the first nine months of 2011. During 2012, net charge-offs on business loans declined \$7.0 million, partly due to recoveries of \$3.6 million on two non-performing loans in the second quarter of 2012. In addition, net charge-offs on construction loans decreased \$4.1 million. Non-interest income increased by \$12.0 million, or 9.9%, over the previous year due to growth in bank card fees (mainly corporate card) and capital market fees. Non-interest expense increased \$3.7 million, or 2.2%, over the previous year, mainly due to higher salaries expense and bank card related expenses, partly offset by lower corporate management fees.

Wealth

Wealth segment pre-tax profitability for the nine months ended September 30, 2012 increased \$3.4 million, or 8.8%, over the same period in the previous year. Net interest income increased \$130 thousand, or .4%, and was impacted by a \$1.4 million decline in deposit interest expense, partly offset by a \$901 thousand decrease in net allocated funding credits. Non-interest income increased \$3.8 million, or 4.9%, over the prior year due to higher personal and institutional trust fees. Non-interest expense increased \$370 thousand, or .6%, mainly due to higher salary and benefit costs, partly offset by lower fraud losses and legal and professional expenses.

The Other/Elimination category in the preceding table includes the activity of various support and overhead operating units of the Company, in addition to the investment securities portfolio and other items not allocated to the segments. In accordance with the Company's transfer pricing policies, the difference between the total provision and total net charge-offs is not allocated to a business segment, and is included in this category. The pre-tax profitability of this category was lower than in the previous period by \$1.5 million. This decrease was mainly due to a \$6.6 million decline in net interest income in this category, related to earnings of the investment portfolio and interest expense on borrowings not allocated to a segment. This effect was partly offset by lower unallocated non-interest expense of \$2.5 million, in addition to a \$2.7 million increase in unallocated securities gains.

Regulatory Changes Affecting the Banking Industry

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was signed into law. The Dodd-Frank Act was sweeping legislation intended to overhaul regulation of the financial services industry. Among its many provisions were rules which established a new council of “systemic risk” regulators, created a new consumer protection division within the Federal Reserve, empower the Federal Reserve to supervise the largest, most complex financial companies, allow the government to seize and liquidate failing financial companies, and gave regulators new powers to oversee the derivatives market.

Because the Company has maintained a strong balance sheet with solid amounts of capital and has not offered many of the complex financial products that were prevalent in the marketplace, there are a number of provisions within the Dodd-Frank Act, including higher capital standards and improved lending transparency, that management does not expect to negatively affect the Company’s future results. New risk-based FDIC rules for insurance assessments have lowered costs for the Company. However, other provisions in the Dodd-Frank Act, such as limitations on debit card interchange fees, have lowered revenues. Higher

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regulatory and compliance burdens are likely, as evidenced in the derivatives market. Next year, new regulations will require the Company to centrally clear specified derivative transactions on an exchange, and to register swap transactions with a central data repository for reporting and recordkeeping. Although the implementation process will be burdensome, the Company will continue to offer derivative products to customers, who will be largely unaffected by the new regulations. The many provisions of the Dodd-Frank Act are so extensive that implementation by regulators is still ongoing, and an assessment of its full effect on the Company is not possible at this time.

In June 2012, the Federal Reserve released for comment a proposal to enact in the United States the international agreement referred to as Basel III. The proposed rules include higher capital requirements and would raise minimum capital levels, redefine the significant inputs to the capital ratio calculation, and be phased in over a period of years through 2019. The initial comment period for the proposed rules ended in October 2012, and while the Company's current capital ratios are higher than those required in Basel III, an assessment of the full effect of these proposed regulations on the Company is not possible at this time.

In October 2012, the Federal Reserve, as required by the Dodd-Frank Act, approved new stress testing regulations applicable to certain financial companies with total consolidated assets of more than \$10 billion. The rule requires that these financial companies conduct stress tests on an annual basis. The stress tests will have an as-of date of September 30 using scenarios provided by the Federal Reserve in November, and the Company is required to submit regulatory reports to the Federal Reserve on its stress tests by March 31 of the following year. During June of that year, the Company will be required to make public disclosures of the results. Implementation of the stress testing requirements for bank holding companies and state member banks with total consolidated assets of greater than \$10 billion but less than \$50 billion will begin in September 2013.

Impact of Recently Issued Accounting Standards

Fair Value Measurements In May 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs". The ASU contains guidance on the application of the highest and best use and valuation premise concepts, the measurement of fair values of instruments classified in shareholders' equity, the measurement of fair values of financial instruments that are managed within a portfolio, and the application of premiums and discounts in a fair value measurement. It also requires additional disclosures about fair value measurements, including information about the unobservable inputs used in fair value measurements within Level 3 of the fair value hierarchy, the sensitivity of recurring fair value measurements within Level 3 to changes in unobservable inputs and the interrelationships between those inputs, and the categorization by level of the fair value hierarchy for items that are not measured at fair value but for which the fair value is required to be disclosed. These amendments were applied prospectively, effective January 1, 2012, and their application did not have a significant effect on the Company's consolidated financial statements.

Repurchase Agreements In April 2011, the FASB issued ASU 2011-03, "Reconsideration of Effective Control for Repurchase Agreements". The guidance in the ASU is intended to improve the accounting for repurchase agreements and other similar agreements. Specifically, the ASU modifies the criteria for determining when these transactions would be recorded as a financing arrangement as opposed to a purchase or sale arrangement with a commitment to resell or repurchase. It removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. This new guidance was effective January 1, 2012, and the adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

Other Comprehensive Income In June 2011, the FASB issued ASU 2011-05, "Presentation of Comprehensive Income". The ASU increases the prominence of other comprehensive income in financial statements by requiring comprehensive income to be reported in either a single statement or in two consecutive statements which report both

net income and other comprehensive income. It eliminates the option to report the components of other comprehensive income in the statement of changes in equity. The ASU was effective for periods beginning January 1, 2012 and required retrospective application. The ASU did not change the components of other comprehensive income, the timing of items reclassified to net income, or the net income basis for income per share calculations. The Company has chosen to present net income and other comprehensive income in two consecutive statements in the accompanying consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05". The amendments are being made to allow the FASB time to consider whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. Until the FASB has reached a resolution, entities are required to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05.

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Goodwill In September 2011, the FASB issued ASU 2011-08, "Testing Goodwill for Impairment". The ASU allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Previous guidance required, on an annual basis, testing goodwill for impairment by comparing the fair value of a reporting unit to its carrying amount (including goodwill). As a result of this amendment, an entity will not be required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The ASU was effective for annual and interim goodwill impairment tests performed for periods beginning January 1, 2012. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

Balance Sheet In December 2011, the FASB issued ASU 2011-11, "Disclosures about Offsetting Assets and Liabilities". The ASU is a joint requirement by the FASB and International Accounting Standards Board to enhance current disclosures and increase comparability of GAAP and International Financial Reporting Standards (IFRS) financial statements. Under the ASU, an entity will be required to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet, as well as instruments and transactions subject to an agreement similar to a master netting agreement. The scope of the ASU includes derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The ASU is effective for annual and interim periods beginning January 1, 2013. Adoption of the ASU is not expected to have a significant effect on the Company's consolidated financial statements.

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AVERAGE BALANCE SHEETS — AVERAGE RATES AND YIELDS

Three Months Ended September 30, 2012 and 2011

| (Dollars in thousands) | Third Quarter 2012 | | | Third Quarter 2011 | | |
|--|--------------------|-------------------------|------------------------|--------------------|-------------------------|------------------------|
| | Average Balance | Interest Income/Expense | Avg. Rates Earned/Paid | Average Balance | Interest Income/Expense | Avg. Rates Earned/Paid |
| ASSETS: | | | | | | |
| Loans: | | | | | | |
| Business ^(A) | \$3,018,475 | \$ 25,720 | 3.39 % | \$2,815,064 | \$ 25,236 | 3.56 % |
| Real estate — construction and land | 339,908 | 3,674 | 4.30 | 412,490 | 4,591 | 4.42 |
| Real estate — business | 2,182,584 | 24,079 | 4.39 | 2,123,034 | 25,376 | 4.74 |
| Real estate — personal | 1,523,148 | 16,490 | 4.31 | 1,430,014 | 17,134 | 4.75 |
| Consumer | 1,205,318 | 16,782 | 5.54 | 1,104,684 | 17,271 | 6.20 |
| Revolving home equity | 444,076 | 4,658 | 4.17 | 466,503 | 5,020 | 4.27 |
| Consumer credit card | 730,104 | 21,712 | 11.83 | 735,179 | 21,477 | 11.59 |
| Overdrafts | 5,353 | — | — | 6,936 | — | — |
| Total loans | 9,448,966 | 113,115 | 4.76 | 9,093,904 | 116,105 | 5.07 |
| Loans held for sale | 8,753 | 85 | 3.86 | 41,677 | 270 | 2.57 |
| Investment securities: | | | | | | |
| U.S. government and federal agency | 329,172 | (58) | (.07) | 327,916 | 2,813 | 3.40 |
| Government-sponsored enterprise obligations | 276,505 | 1,145 | 1.65 | 262,087 | 1,928 | 2.92 |
| State and municipal obligations ^(A) | 1,387,624 | 13,580 | 3.89 | 1,185,263 | 12,545 | 4.20 |
| Mortgage-backed securities | 3,766,602 | 24,794 | 2.62 | 3,764,822 | 27,949 | 2.95 |
| Asset-backed securities | 2,878,941 | 7,940 | 1.10 | 2,403,062 | 6,950 | 1.15 |
| Other marketable securities ^(A) | 121,596 | 1,375 | 4.50 | 172,588 | 1,857 | 4.27 |
| Trading securities ^(A) | 24,337 | 143 | 2.34 | 20,770 | 132 | 2.52 |
| Non-marketable securities ^(A) | 117,210 | 2,221 | 7.54 | 110,585 | 1,836 | 6.59 |
| Total investment securities | 8,901,987 | 51,140 | 2.29 | 8,247,093 | 56,010 | 2.69 |
| Short-term federal funds sold and securities | | | | | | |
| purchased under agreements to resell | 19,400 | 24 | .49 | 10,927 | 13 | .47 |
| Long-term securities purchased | | | | | | |
| under agreements to resell | 847,829 | 4,913 | 2.31 | 850,000 | 3,913 | 1.83 |
| Interest earning deposits with banks | 81,139 | 40 | .20 | 326,302 | 211 | .26 |
| Total interest earning assets | 19,308,074 | 169,317 | 3.49 | 18,569,903 | 176,522 | 3.77 |
| Allowance for loan losses | (177,394) | | | (190,021) | | |
| Unrealized gain on investment securities | 275,109 | | | 185,547 | | |
| Cash and due from banks | 365,811 | | | 347,304 | | |
| Land, buildings and equipment, net | 353,371 | | | 375,036 | | |
| Other assets | 392,398 | | | 376,295 | | |
| Total assets | \$20,517,369 | | | \$19,664,064 | | |
| LIABILITIES AND EQUITY: | | | | | | |
| Interest bearing deposits: | | | | | | |
| Savings | \$581,819 | 223 | .15 | \$534,295 | 258 | .19 |
| Interest checking and money market | 8,401,165 | 4,400 | .21 | 7,756,104 | 6,187 | .32 |
| Time open & C.D.'s of less than \$100,000 | 1,101,399 | 1,945 | .70 | 1,231,280 | 2,413 | .78 |

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| | | | | | | | |
|--|--------------|------------|------|--------------|------------|------|---|
| Time open & C.D.'s of \$100,000 and over | 1,004,708 | 1,743 | .69 | 1,372,842 | 2,130 | .62 | |
| Total interest bearing deposits | 11,089,091 | 8,311 | .30 | 10,894,521 | 10,988 | .40 | |
| Borrowings: | | | | | | | |
| Federal funds purchased and securities sold | | | | | | | |
| under agreements to repurchase | 1,217,036 | 221 | .07 | 1,016,623 | 292 | .11 | |
| Other borrowings | 108,819 | 851 | 3.11 | 111,930 | 925 | 3.28 | |
| Total borrowings | 1,325,855 | 1,072 | .32 | 1,128,553 | 1,217 | .43 | |
| Total interest bearing liabilities | 12,414,946 | 9,383 | .30 | % 12,023,074 | 12,205 | .40 | % |
| Non-interest bearing deposits | 5,536,274 | | | 4,778,780 | | | |
| Other liabilities | 296,178 | | | 728,974 | | | |
| Equity | 2,269,971 | | | 2,133,236 | | | |
| Total liabilities and equity | \$20,517,369 | | | \$19,664,064 | | | |
| Net interest margin (T/E) | | \$ 159,934 | | | \$ 164,317 | | |
| Net yield on interest earning assets | | | 3.30 | % | | 3.51 | % |
| (A) Stated on a tax equivalent basis using a federal income tax rate of 35%. | | | | | | | |

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AVERAGE BALANCE SHEETS — AVERAGE RATES AND YIELDS

Nine Months Ended September 30, 2012 and 2011

| (Dollars in thousands) | Nine Months 2012 | | | Nine Months 2011 | | |
|--|------------------|-------------------------|------------------------|------------------|-------------------------|------------------------|
| | Average Balance | Interest Income/Expense | Avg. Rates Earned/Paid | Average Balance | Interest Income/Expense | Avg. Rates Earned/Paid |
| ASSETS: | | | | | | |
| Loans: | | | | | | |
| Business ^(A) | \$2,936,173 | \$ 76,842 | 3.50 % | \$2,941,359 | \$ 79,523 | 3.61 % |
| Real estate — construction and land | 360,057 | 11,572 | 4.29 | 431,082 | 14,426 | 4.47 |
| Real estate — business | 2,190,982 | 74,767 | 4.56 | 2,101,859 | 76,534 | 4.87 |
| Real estate — personal | 1,480,356 | 49,261 | 4.44 | 1,438,106 | 52,430 | 4.87 |
| Consumer | 1,149,549 | 49,300 | 5.73 | 1,121,194 | 53,106 | 6.33 |
| Revolving home equity | 449,405 | 14,050 | 4.18 | 470,074 | 14,984 | 4.26 |
| Consumer credit card | 724,634 | 64,162 | 11.83 | 751,109 | 62,993 | 11.21 |
| Overdrafts | 6,198 | — | — | 6,903 | — | — |
| Total loans | 9,297,354 | 339,954 | 4.88 | 9,261,686 | 353,996 | 5.11 |
| Loans held for sale | 9,980 | 278 | 3.72 | 50,678 | 877 | 2.31 |
| Investment securities: | | | | | | |
| U.S. government and federal agency | 329,308 | 7,874 | 3.19 | 367,708 | 15,204 | 5.53 |
| Government-sponsored enterprise obligations | 275,211 | 3,923 | 1.90 | 235,502 | 4,297 | 2.44 |
| State and municipal obligations ^(A) | 1,324,868 | 39,919 | 4.02 | 1,152,988 | 38,982 | 4.52 |
| Mortgage-backed securities | 3,988,474 | 83,304 | 2.79 | 3,253,734 | 83,984 | 3.45 |
| Asset-backed securities | 2,847,103 | 24,058 | 1.13 | 2,375,950 | 23,071 | 1.30 |
| Other marketable securities ^(A) | 139,980 | 4,699 | 4.48 | 173,722 | 6,221 | 4.79 |
| Trading securities ^(A) | 26,563 | 532 | 2.68 | 20,087 | 409 | 2.72 |
| Non-marketable securities ^(A) | 118,905 | 7,329 | 8.23 | 106,495 | 5,273 | 6.62 |
| Total investment securities | 9,050,412 | 171,638 | 2.53 | 7,686,186 | 177,441 | 3.09 |
| Short-term federal funds sold and securities | | | | | | |
| purchased under agreements to resell | 18,415 | 70 | .51 | 10,868 | 45 | .55 |
| Long-term securities purchased | | | | | | |
| under agreements to resell | 849,271 | 13,770 | 2.17 | 741,575 | 9,240 | 1.67 |
| Interest earning deposits with banks | 110,603 | 207 | .25 | 218,178 | 411 | .25 |
| Total interest earning assets | 19,336,035 | 525,917 | 3.63 | 17,969,171 | 542,010 | 4.03 |
| Allowance for loan losses | (180,609) | | | (192,998) | | |
| Unrealized gain on investment securities | 249,326 | | | 154,193 | | |
| Cash and due from banks | 363,500 | | | 342,759 | | |
| Land, buildings and equipment, net | 356,841 | | | 379,718 | | |
| Other assets | 386,041 | | | 377,493 | | |
| Total assets | \$20,511,134 | | | \$19,030,336 | | |
| LIABILITIES AND EQUITY: | | | | | | |
| Interest bearing deposits: | | | | | | |
| Savings | \$572,040 | 607 | .14 | \$524,139 | 623 | .16 |
| Interest checking and money market | 8,360,883 | 13,731 | .22 | 7,579,863 | 19,094 | .34 |
| Time open & C.D.'s of less than \$100,000 | 1,128,566 | 6,055 | .72 | 1,326,496 | 9,121 | .92 |

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| | | | | | | | |
|--|--------------|------------|------|--------------|------------|------|---|
| Time open & C.D.'s of \$100,000 and over | 1,232,208 | 5,482 | .59 | 1,423,984 | 7,237 | .68 | |
| Total interest bearing deposits | 11,293,697 | 25,875 | .31 | 10,854,482 | 36,075 | .44 | |
| Borrowings: | | | | | | | |
| Federal funds purchased and securities sold | | | | | | | |
| under agreements to repurchase | 1,204,703 | 623 | .07 | 997,124 | 1,601 | .21 | |
| Other borrowings | 110,645 | 2,633 | 3.18 | 112,135 | 2,759 | 3.29 | |
| Total borrowings | 1,315,348 | 3,256 | .33 | 1,109,259 | 4,360 | .53 | |
| Total interest bearing liabilities | 12,609,045 | 29,131 | .31 | % 11,963,741 | 40,435 | .45 | % |
| Non-interest bearing deposits | 5,358,407 | | | 4,596,763 | | | |
| Other liabilities | 313,035 | | | 370,663 | | | |
| Equity | 2,230,647 | | | 2,099,169 | | | |
| Total liabilities and equity | \$20,511,134 | | | \$19,030,336 | | | |
| Net interest margin (T/E) | | \$ 496,786 | | | \$ 501,575 | | |
| Net yield on interest earning assets | | | 3.43 | % | | 3.73 | % |
| (A) Stated on a tax equivalent basis using a federal income tax rate of 35%. | | | | | | | |

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate risk management focuses on maintaining consistent growth in net interest income within Board-approved policy limits. The Company primarily uses earnings simulation models to analyze net interest sensitivity to movement in interest rates. The Company performs monthly simulations which model interest rate movements and risk in accordance with changes to its balance sheet composition. For further discussion of the Company's market risk, see the Interest Rate Sensitivity section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2011 Annual Report on Form 10-K.

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

| (Dollars in millions) | September 30, 2012 | | June 30, 2012 | | December 31, 2011 | |
|-------------------------|--|---------------------------------------|--|--|--|---------------------------------------|
| | \$ Change in Net Interest Income | % Change in Net Interest Income | \$ Change in Net Interest Income | % Change in Net Interest Income | \$ Change in Net Interest Income | % Change in Net Interest Income |
| 300 basis points rising | \$8.8 | 1.50 | \$4.1 | .67 | (\$2.0) | (.32)% |
| 200 basis points rising | 10.3 | 1.77 | 6.9 | 1.15 | 2.2 | .34 |
| 100 basis points rising | 8.3 | 1.41 | 7.3 | 1.21 | 3.5 | .56 |

Under the above scenarios at September 30, 2012, a gradual increase in interest rates of 100 basis points is expected to increase net interest income from the base calculation by \$8.3 million, or 1.4%, and a rise of 200 basis points is expected to increase net interest income by \$10.3 million, or 1.8%. Under a 300 basis points rising rate scenario, net interest income would increase by \$8.8 million, or 1.5%. Due to the already low interest rate environment, the Company did not model falling rate scenarios. The change in net interest income from the base calculation at September 30, 2012 for the three scenarios shown was higher than projections made at June 30, 2012 and largely reflective of continued pressure on net interest income as incorporated in the base calculation used at September 30, 2012 compared to the previous quarter. The updated base calculation at September 30, 2012 reflected an increase in mortgage prepayments and lower reinvestment rates on the Company's investment securities and loans, as well as growth in cash balances, all of which resulted in lower projected interest income. This was partially offset by growth in loans, especially those with variable rates, which was funded by security maturities. Funding costs were projected to remain stable but less reliant on fixed rate certificates of deposit. When comparing this lower base calculation at September 30, 2012 to the three rising interest rate scenarios above, the rising rate environments produce a greater benefit to net interest income than in the previous quarter because rising rates tend to reduce mortgage prepayments and limit the effects of reduced reinvestment rates described above. Also, with higher variable rate loans and cash balances projected in the updated base case, interest income would rise faster when interest rates rise. Further, in a rising rate environment and greater funding reliance on non-maturity deposits, it is assumed that these non-rate sensitive deposits will not immediately re-price upwards.

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

Item 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2012. Based upon that evaluation, the Chief

Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II: OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The information required by this item is set forth in Part I, Item 1 under Note 14, Legal Proceedings.

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

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

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as part of Publicly Announced Program | Maximum Number that May Yet Be Purchased Under the Program |
|------------------------|----------------------------------|------------------------------|--|--|
| July 1 — 31, 2012 | — | \$— | — | 3,000,000 |
| August 1 — 31, 2012 | 97,749 | \$39.66 | 97,749 | 2,902,251 |
| September 1 — 30, 2012 | 191 | \$40.42 | 191 | 2,902,060 |
| Total | 97,940 | \$39.66 | 97,940 | 2,902,060 |

In July 2012, the Board of Directors approved the purchase of up to 3,000,000 shares of the Company's common stock. At September 30, 2012, 2,902,060 shares remained available to be purchased under that authorization.

Item 6. EXHIBITS

See Index to Exhibits

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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 BANCSHARES, INC.

By /s/ JAMES L. SWARTS
James L. Swarts
Vice President & Secretary

Date: November 7, 2012

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

Date: November 7, 2012

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INDEX TO EXHIBITS

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

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

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

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