

COMMERCE BANCSHARES INC /MO/

Form 10-K

February 26, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2006 Commission File No. 0-2989

COMMERCE BANCSHARES, INC.

(Exact name of registrant as specified in its charter)

Missouri
(State of Incorporation)

43-0889454
(IRS Employer Identification No.)

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

64106
(Zip Code)

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

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

Title of class

\$5 Par Value Common Stock

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

NONE

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

Yes No

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

Yes No

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

Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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 February 8, 2007, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$2,850,000,000.

As of February 8, 2007, there were 69,985,876 shares of Registrant's \$5 Par Value Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement for its 2007 annual meeting of shareholders, which will be filed within 120 days of December 31, 2006, are incorporated by reference into Part III of this Report.

Commerce Bancshares, Inc.

Form 10-K

INDEX

Part I

| | | Page |
|-----------------|--|-------------|
| <u>Item 1.</u> | <u>Business</u> | 3 |
| <u>Item 1a.</u> | <u>Risk Factors</u> | 7 |
| <u>Item 1b.</u> | <u>Unresolved Staff Comments</u> | 9 |
| <u>Item 2.</u> | <u>Properties</u> | 9 |
| <u>Item 3.</u> | <u>Legal Proceedings</u> | 9 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> | 9 |

Part II

| | | |
|-----------------|---|----|
| <u>Item 5.</u> | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 11 |
| <u>Item 6.</u> | <u>Selected Financial Data</u> | 13 |
| <u>Item 7.</u> | <u>Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations</u> | 13 |
| <u>Item 7a.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 53 |
| <u>Item 8.</u> | <u>Consolidated Financial Statements and Supplementary Data</u> | 53 |
| <u>Item 9.</u> | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> | 93 |
| <u>Item 9a.</u> | <u>Controls and Procedures</u> | 93 |
| <u>Item 9b.</u> | <u>Other Information</u> | 95 |

Part III

| | | |
|-----------------|---|----|
| <u>Item 10.</u> | <u>Directors, Executive Officers and Corporate Governance</u> | 95 |
| <u>Item 11.</u> | <u>Executive Compensation</u> | 95 |
| <u>Item 12.</u> | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 95 |

| | | | |
|--------------------------|--|---|-----|
| <u>Item 13.</u> | <u>Certain Relationships and Related Transactions, and Director Independence</u> | 95 | |
| <u>Item 14.</u> | <u>Principal Accountant Fees and Services</u> | 95 | |
| Part IV | <u>Item 15.</u> | <u>Exhibits and Financial Statement Schedules</u> | 96 |
| <u>Signatures</u> | | | 97 |
| <u>Index to Exhibits</u> | | | E-1 |

PART I

Item 1. BUSINESS

General

Commerce Bancshares, Inc. (the Company), a bank holding company as defined in the Bank Holding Company Act of 1956, as amended, was incorporated under the laws of Missouri on August 4, 1966. The Company presently owns all of the outstanding capital stock of three national banking associations, which are headquartered in Missouri (the Missouri bank), Kansas (the Kansas bank), and Nebraska (the Nebraska bank). The Nebraska bank is limited in its activities to the issuance of credit cards. The remaining two banking subsidiaries engage in general banking business, providing a broad range of retail, corporate, investment, trust, and asset management products and services to individuals and businesses. The Company also owns, directly or through its banking subsidiaries, various non-banking subsidiaries. Their activities include owning real estate leased to the Company's banking subsidiaries, underwriting credit life and credit accident and health insurance, selling property and casualty insurance (relating to consumer loans made by the banking subsidiaries), venture capital investment, securities brokerage, mortgage banking, and leasing activities. The Company owns a second tier holding company that is the direct owner of both the Missouri and Kansas banks. A list of the Company's subsidiaries is included as Exhibit 21.

The Company is the largest independent bank holding company in the lower Midwest. At December 31, 2006, the Company had consolidated assets of \$15.2 billion, loans of \$10.0 billion, deposits of \$11.7 billion, and stockholders equity of \$1.4 billion. All of the Company's operations conducted by subsidiaries are consolidated for purposes of preparing the Company's consolidated financial statements. The Company does not utilize unconsolidated subsidiaries or special purpose entities to provide off-balance sheet borrowings.

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

The Missouri bank is the Company's largest, with total assets of \$13.9 billion and comprising approximately 92% of the Company's total banking assets. The bank's facilities are located throughout Missouri, eastern Kansas, and central Illinois, including major markets in Peoria and Bloomington. The Kansas bank has total assets of \$1.3 billion. It has significant operations and banking facilities in the areas of Wichita, Hays, Hutchinson, and Garden City, Kansas.

The markets these banks serve, being centrally located in the Midwest, provide natural sites for production and distribution facilities and also serve as transportation hubs. The economy has been well-diversified with many major industries represented, including telecommunications, automobile manufacturing, aircraft manufacturing, health care, numerous service industries, food production, and agricultural production and related industries. In addition, several of the Illinois markets are located in areas with some of the most productive farmland in the world. The banks operate in areas with stable real estate markets, which in the past have avoided the volatile prices that other parts of the country have experienced.

The Company regularly evaluates the potential acquisition of, and holds discussions with, various financial institutions eligible for bank holding company ownership or control. In addition, the Company regularly considers the potential disposition of certain of its assets and branches. The Company seeks merger or acquisition partners that are

culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. In July 2006, the Company acquired certain assets and assumed certain liabilities of the banking business of Boone National Savings and Loan Association, located in Columbia, Missouri. In September 2006, the Company completed the acquisition of the outstanding stock of West Pointe Bancorp, Inc., located in Belleville, Illinois, adjacent to St. Louis, Missouri. In December 2006,

the Company announced a merger agreement with South Tulsa Financial Corporation, Tulsa, Oklahoma, which is expected to be completed in the second quarter of 2007. Prior to 2006, the Company's most recent acquisition was in January 2003 when it purchased The Vaughn Group, Inc., a direct equipment lessor based in Cincinnati, Ohio, with a portfolio of direct financing, sales type and operating leases. For additional information on acquisition and branch disposition activity, refer to pages 15 and 62.

Operating Segments

The Company is managed in three operating segments. The Consumer segment includes the retail branch network, consumer installment lending, personal mortgage banking, bank card activities, student lending, and discount brokerage services. It provides services through a network of 204 full-service branches, a widespread ATM network of 400 machines, and the use of alternative delivery channels such as extensive online banking and telephone banking services. In 2006 this retail segment contributed 57% of total segment pre-tax income. The Commercial segment provides a full array of corporate lending, leasing, and international services, as well as business and government deposit and cash management services. In 2006 it contributed 35% of total segment pre-tax income. The Money Management segment provides traditional trust and estate tax planning services, and advisory and discretionary investment portfolio management services to both personal and institutional corporate customers. This segment also manages the Company's family of proprietary mutual funds, which are available for sale to both trust and general retail customers. Fixed income investments are sold to individuals and institutional investors through the Capital Markets group, which is also included in this segment. At December 31, 2006 the Money Management segment managed investments with a market value of \$11.5 billion and administered an additional \$9.7 billion in non-managed assets. Additional information relating to operating segments can be found on pages 42 and 81.

Supervision and Regulation

General

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

The Company is required to file with the Federal Reserve Board various reports and such additional information as the Federal Reserve Board may require. The Federal Reserve Board also makes regular examinations of the Company and its subsidiaries. The Company's three banking subsidiaries are organized as national banking associations and are subject to regulation, supervision and examination by the Office of the Comptroller of the Currency (OCC). All banks are also subject to regulation by the Federal Deposit Insurance Corporation (FDIC). In addition, there are numerous other federal and state laws and regulations which control the activities of the Company and its banking subsidiaries, including requirements and limitations relating to capital and reserve requirements, permissible investments and lines of business, transactions with affiliates, loan limits, mergers and acquisitions, issuance of securities, dividend

payments, and extensions of credit. If the Company fails to comply with these or other applicable laws and regulations, it may be subject to civil monetary penalties, imposition of cease and desist orders or other written directives, removal of management and, in certain circumstances, criminal penalties. This regulatory framework is

intended primarily for the protection of depositors and the preservation of the federal deposit insurance funds, and not for the protection of security holders. Statutory and regulatory controls increase a bank holding company's cost of doing business and limit the options of its management to employ assets and maximize income.

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

Subsidiary Banks

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

Substantially all of the deposits of the Company's subsidiary banks are insured up to the applicable limits by the Bank Insurance Fund of the FDIC, generally up to \$100,000 per insured depositor and up to \$250,000 for retirement accounts. The banks pay deposit insurance premiums to the FDIC based on an assessment rate established by the FDIC for Bank Insurance Fund member institutions. The FDIC has established a risk-based assessment system under which institutions are classified and pay premiums according to their perceived risk to the federal deposit insurance funds. The FDIC is not required to charge deposit insurance premiums when the ratio of deposit insurance reserves to insured deposits is maintained above specified levels. During the past several years, the ratio has been above the minimum level and, accordingly, the Company has not been required to pay premiums. However, in 2006 legislation was passed reforming the bank deposit insurance system. The reform act allowed the FDIC to raise the minimum reserve ratio and allowed eligible insured institutions an initial one-time credit to be used against premiums due. As a result, beginning in 2007 the Company will be assessed insurance premiums, which in years 2007 and 2008 may be partly or totally offset by the one-time credit. The Company's one-time credit is approximately \$12 million.

Payment of Dividends

The principal source of the Company's cash revenues is dividends from the subsidiary banks. The Federal Reserve Board may prohibit the payment of dividends by bank holding companies if their actions constitute unsafe or unsound practices. The OCC limits the payment of dividends by bank subsidiaries in any calendar year to the net profit of the current year combined with the retained net profits of the preceding two years. Permission must be obtained from the OCC for dividends exceeding these amounts. The payment of dividends by the bank subsidiaries may also be affected by factors such as the maintenance of adequate capital.

Capital Adequacy

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

In addition, the Federal Reserve also requires bank holding companies to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization's Tier I capital to its total consolidated quarterly average assets (as defined for regulatory purposes), net of the allowance for loan losses, goodwill and certain other intangible assets. The minimum leverage ratio for bank holding companies is 4%. At December 31, 2006 all of the subsidiary banks were well-capitalized under regulatory capital adequacy standards, as further discussed on page 85.

Legislation

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

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

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, a major reform of the bankruptcy system, was passed by Congress and signed into law by President Bush in April 2005. Changes instituted by this new law took effect on October 17, 2005. Under the new bankruptcy law, bankruptcy applicants who wish to file under Chapter 7 must meet certain eligibility requirements under a means test. While the immediate impact on the banking industry was a surge in bankruptcy filings in the fourth quarter of 2005, the long-term effect of the change is expected to be a reduction in bankruptcy filings, thereby limiting bankruptcy-related loan charge-offs.

Competition

The Company's locations in regional markets throughout Missouri, Kansas and central Illinois face intense competition from hundreds of financial service providers. The Company competes with national and

state banks for deposits, loans and trust accounts, and with savings and loan associations and credit unions for deposits and consumer lending products. In addition, the Company competes with other financial intermediaries such as securities brokers and dealers, personal loan companies, insurance companies, finance companies, and certain governmental agencies. The passage of the GLB Act, which removed barriers between banking and the securities and insurance industries, has resulted in greater competition among these industries. The Company generally competes on the basis of customer services and responsiveness to customer needs, interest rates on loans and deposits, lending limits and customer convenience, such as location of offices.

Employees

The Company and its subsidiaries employed 4,478 persons on a full-time basis and 664 persons on a part-time basis at December 31, 2006. The Company provides a variety of benefit programs including a 401K plan as well as group life, health, accident, and other insurance. The Company also maintains training and educational programs designed to prepare employees for positions of increasing responsibility.

Available Information

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

Statistical Disclosure

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

| | Page |
|--|--------------|
| I. Distribution of Assets, Liabilities and Stockholders Equity; Interest Rates and Interest Differential | 18, 48-51 |
| II. Investment Portfolio | 32-34, 66-69 |
| III. Loan Portfolio | |
| Types of Loans | 23 |
| Maturities and Sensitivities of Loans to Changes in Interest Rates | 23 |
| Risk Elements | 29-32 |
| IV. Summary of Loan Loss Experience | 26-29 |
| V. Deposits | 48-49, 71 |
| VI. Return on Equity and Assets | 14 |
| VII. Short-Term Borrowings | 71-72 |

Item 1a. RISK FACTORS

Making or continuing an investment in securities issued by Commerce Bancshares, Inc., including our common stock, involves certain risks that you should carefully consider. The risks and uncertainties described below are not the only risks that may have a material adverse effect on the Company. Additional risks and uncertainties also could adversely affect our business and our results. If any of the following risks actually occur, our business, financial condition or

results of operations could be negatively affected, the market price for your securities could decline, and you could lose all or a part of your investment. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important

factors that could cause the Company's actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of Commerce Bancshares, Inc.

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

The Company's success is heavily influenced by the general economic conditions of the states of Missouri, Kansas and central Illinois and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers in such metropolitan areas as Kansas City, St. Louis, and Springfield in Missouri, Peoria and Bloomington in Illinois, and Wichita, Kansas. Since the Company does not have significant presence in other parts of the country, a prolonged economic downturn in these markets could have a material adverse effect on the Company's financial condition and results of operations.

The Company is subject to Interest Rate Risk.

The Company's net interest income is the largest source of overall revenue to the Company, representing 59% of total revenue. Interest rates are beyond the Company's control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits, and the rates received on loans and investment securities and paid on deposits. Management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations. However, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations.

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

The Company operates in the financial services industry, a rapidly changing environment having numerous competitors including other banks and insurance companies, securities dealers, brokers, trust and investment companies and mortgage bankers. The pace of consolidation among financial service providers is accelerating and there are many new changes in technology, product offerings and regulation. In the past 12 months there have been several new entrants into our markets offering competitive products. The Company must continue to make investments in its products and delivery systems to stay competitive with the industry as a whole or its financial performance may suffer.

Potential future loan losses could increase.

The Company maintains an allowance for possible loan losses that represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, and unidentified losses inherent in the current loan portfolio. Historical losses have been low and the Company's credit ratios trend above industry averages, in part due to the low level of commercial credit losses. The industry has experienced very low levels of credit loss for an extended period. Should these trends change and losses increase, the statement of operations would be negatively impacted. See the section captioned "Allowance for Loan Losses" in Item 7 Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations located elsewhere in this report for further discussion related to the Company's process for determining the appropriate level of the allowance for possible loan loss.

The Company's reputation and future growth prospects could be impaired if events occurred which breached our customers' privacy.

The Company relies heavily on communications and information systems to conduct its business, and as part of our business we maintain significant amounts of data about our customers and the products they use. While the Company has policies and procedures designed to prevent or limit the effect of failure, interruption

or security breach of its information systems, there can be no assurances that any such failures, interruptions or security breaches will not occur, or if they do occur, that they will be adequately addressed. Should any of these systems become compromised, the reputation of the Company could be damaged, relationships with existing customers impaired and result in lost business and incur significant expenses trying to remedy the compromise.

The Company may not attract and retain skilled employees.

The Company's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Company can be intense and the Company may not be able to hire people or to retain them. The unexpected loss of the services of one or more the Company's key personnel could have a material adverse impact on the Company's business because of their skills, knowledge of the Company's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel.

Item 1b. UNRESOLVED STAFF COMMENTS

None

Item 2. PROPERTIES

The bank subsidiaries maintain their main offices in various multi-story office buildings. The Missouri bank owns its main offices and leases unoccupied premises to the public. The larger offices include:

| Building | Net rentable square footage | % occupied in total | % occupied by bank |
|--|-----------------------------|---------------------|--------------------|
| 922 Walnut Kansas City, MO | 256,000 | 93% | 91% |
| 1000 Walnut Kansas City, MO | 403,000 | 83 | 33 |
| 811 Main Kansas City, MO | 237,000 | 100 | 100 |
| 8000 Forsyth Clayton, MO | 178,000 | 95 | 92 |
| 1551 N. Waterfront Pkwy Wichita, KS | 120,000 | 100 | 32 |

The Nebraska credit card bank leases its offices in Omaha, Nebraska. Additionally, certain other installment loan, trust and safe deposit functions operate out of leased offices in downtown Kansas City. The Company has an additional 198 branch locations in Missouri, Illinois and Kansas which are owned or leased, and 150 off-site ATM locations.

Item 3. LEGAL PROCEEDINGS

The information required by this item is set forth in Item 8 under Note 18, Commitments, Contingencies and Guarantees on page 89.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the fourth quarter of 2006 to a vote of security holders through the solicitation of proxies or otherwise.

Executive Officers of the Registrant

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

| Name and Age | Positions with Registrant |
|-------------------------|--|
| Jeffery D. Aberdeen, 53 | Controller of the Company since December 1995. Prior thereto he was Assistant Controller of the Company. He is Controller of the Company's subsidiary banks, Commerce Bank, N.A. (Missouri, Kansas and Omaha). |
| Kevin G. Barth, 46 | Executive Vice President of the Company since April 2005 and Executive Vice President of Commerce Bank, N.A. (Missouri), since October 1998. Senior Vice President of the Company and Officer of Commerce Bank, N.A. (Missouri) prior thereto. |
| A. Bayard Clark, 61 | Chief Financial Officer and Executive Vice President of the Company since December 1995. Executive Vice President of the Company prior thereto. Treasurer of the Company from December 1995 until February 2007. |
| Sara E. Foster, 46 | Senior Vice President of the Company since February 1998 and Vice President of the Company prior thereto. |
| David W. Kemper, 56 | Chairman of the Board of Directors of the Company since November 1991, Chief Executive Officer of the Company since June 1986, and President of the Company since April 1982. He is Chairman of the Board, President and Chief Executive Officer of Commerce Bank, N.A. (Missouri). He is the son of James M. Kemper, Jr. (a former Director and former Chairman of the Board of the Company) and the brother of Jonathan M. Kemper, Vice Chairman of the Company. |
| Jonathan M. Kemper, 53 | Vice Chairman of the Company since November 1991 and Vice Chairman of Commerce Bank, N.A. (Missouri) since December 1997. Prior thereto, he was Chairman of the Board, Chief Executive Officer, and President of Commerce Bank, N.A. (Missouri). He is the son of James M. Kemper, Jr. (a former Director and former Chairman of the Board of the Company) and the brother of David W. Kemper, Chairman, President, and Chief Executive Officer of the Company. |
| Charles G. Kim, 46 | Executive Vice President of the Company since April 1995 and Executive Vice President of Commerce Bank, N.A. (Missouri) since January 2004. Prior thereto, he was Senior Vice President of Commerce Bank, N.A. (Clayton, MO), a former subsidiary of the Company. |
| Seth M. Leadbeater, 56 | Vice Chairman of the Company since January 2004. Prior thereto he was Executive Vice President of the Company. He has been Vice Chairman of |

Commerce Bank, N.A. (Missouri) since September 2004. Prior thereto he was Executive Vice President of Commerce Bank, N.A. (Missouri) and President of Commerce Bank, N.A. (Clayton, MO).

| Name and Age | Positions with Registrant |
|-----------------------------|---|
| Robert C. Matthews, Jr., 59 | Executive Vice President of the Company since December 1989. Executive Vice President of Commerce Bank, N.A. (Missouri) since December 1997. |
| Michael J. Petrie, 50 | Senior Vice President of the Company since April 1995. Prior thereto, he was Vice President of the Company. |
| Robert J. Rauscher, 49 | Senior Vice President of the Company since October 1997. Senior Vice President of Commerce Bank, N.A. (Missouri) prior thereto. |
| V. Raymond Stranghoener, 55 | Executive Vice President of the Company since July 2005 and Senior Vice President of the Company prior thereto. Prior to his employment with the Company in October 1999, he was employed at BankAmerica Corp. as National Executive of the Bank of America Private Bank Wealth Strategies Group. He joined Boatmen's Trust Company in 1993, which subsequently merged with BankAmerica Corp. |

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Commerce Bancshares, Inc. Common Stock Data

The following table sets forth the high and low prices of actual transactions for the Company's common stock (CBSH) and cash dividends paid for the periods indicated (restated for the 5% stock dividend distributed in December 2006).

| | Quarter | High | Low | Cash Dividends |
|-------------|---------------|-----------------|-----------------|-------------------|
| 2006 | First | \$ 50.03 | \$ 46.80 | \$.233 |
| | Second | 50.67 | 46.99 | .233 |
| | Third | 48.81 | 46.30 | .233 |
| | Fourth | 50.60 | 45.60 | .233 |
| 2005 | First | \$ 45.35 | \$ 42.01 | \$.218 |
| | Second | 46.20 | 41.85 | .218 |
| | Third | 49.63 | 44.97 | .218 |
| | Fourth | 51.08 | 45.30 | .218 |
| 2004 | First | \$ 43.19 | \$ 38.66 | \$.199 |

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| | | | |
|--------|-------|-------|------|
| Second | 41.61 | 38.01 | .199 |
| Third | 42.54 | 38.23 | .199 |
| Fourth | 45.57 | 40.44 | .199 |

Commerce Bancshares, Inc. common shares are listed on The Nasdaq Stock Market LLC (NASDAQ), a national securities exchange and highly-regulated electronic securities market comprised of competing Market Makers whose trading is supported by a communications network linking them to quotation dissemination, trade reporting, and order execution systems. The Company had 4,739 shareholders of record as of December 31, 2006.

Performance Graph

The following graph presents a comparison of Company (CBSH) performance to the indices named below. It assumes \$100 invested 12/31/2001 with dividends invested on a Total Return basis.

Effective December 31, 2006, the Company selected a different index, the Nasdaq Bank Stocks index, to compare with its cumulative five year Total Return. In prior years the Company has used the Nasdaq Financial Stocks index, which is comprised of various financial institutions, including insurance agents and carriers and security and commodity brokers. The Company believes the Nasdaq Bank Stocks index, comprised solely of bank holding companies and commercial banks, provides a better comparison and a more appropriate benchmark against which to measure stock performance. In accordance with SEC regulations, the graph above presents both indices for the five year period.

The following table sets forth information about the Company's purchases of its \$5 par value common stock, its only class of stock registered pursuant to Section 12 of the Exchange Act, during the fourth quarter of 2006.

| 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 |
|-----------------------|---|------------------------------------|--|--|
| October 1 - 31, 2006 | 235,605 | \$ 48.83 | 235,605 | 2,270,414 |
| November 1 - 30, 2006 | 509,232 | \$ 49.53 | 509,232 | 1,761,182 |
| December 1 - 31, 2006 | 378,067 | \$ 48.52 | 378,067 | 1,383,115 |
| Total | 1,122,904 | \$ 49.04 | 1,122,904 | 1,383,115 |

The Company's stock purchases shown above were made under a 5,000,000 share authorization by the Board of Directors on October 21, 2005. Under this authorization, 1,383,115 shares remained available for purchase at December 31, 2006. On February 2, 2007, the Company's Board of Directors approved a new authorization for the purchase of up to 4,000,000 shares of Company common stock.

Item 6. SELECTED FINANCIAL DATA

The required information is set forth below in Item 7.

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

Overview

Commerce Bancshares, Inc. (the Company) operates as a super-community bank offering an array of sophisticated financial products delivered with high-quality, personal customer service. It is the largest bank holding company headquartered in Missouri, with its principal offices in Kansas City and St. Louis, Missouri. Customers are served from approximately 350 locations in Missouri, Kansas, and Illinois, using delivery platforms which include an extensive network of branches and ATM machines, full-featured online banking, and a central contact center.

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

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

Growth in earnings per share Diluted earnings per share rose 2.7% over 2005 and has risen 8.0% and 9.4%, compounded annually, over the last 5 and 10 years, respectively.

Growth in total revenue Total revenue is comprised of net interest income and non-interest income, excluding securities gains and losses. Total revenue in 2006 grew 3.5% over 2005, which resulted from growth of \$11.5 million, or 2.3%, in net interest income coupled with growth of \$17.7 million, or 5.3%, in non-interest income. Total revenue has risen 3.2%, compounded annually, over the last five years.

Expense control Total non-interest expense grew by 5.8% this year due to prudent management oversight and expanded use of technology, creating productivity enhancements. Salaries and employee benefits, the largest expense component, grew by 5.5%. The efficiency ratio was 60.6% in 2006.

Asset quality Net loan charge-offs in 2006 were \$6.7 million less than in 2005, and averaged .28% of loans compared to .38% in the previous year. While non-performing assets at year end 2006 increased \$6.5 million compared to the previous year, the balance remains low, comprising .18% of total loans at year end 2006.

Shareholder return Total shareholder return, including the change in stock price and dividend reinvestment, was 11.6% over the past 5 years and 11.7% over the past 10 years.

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

Key Ratios

| <i>(Based on average balance sheets):</i> | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|--------------|-------|-------|-------|-------|
| Return on total assets | 1.54% | 1.60% | 1.56% | 1.52% | 1.58% |
| Return on stockholders equity | 15.96 | 16.19 | 15.19 | 14.27 | 14.42 |
| Tier I capital ratio | 11.25 | 12.21 | 12.21 | 12.31 | 12.67 |
| Total capital ratio | 12.56 | 13.63 | 13.57 | 13.70 | 14.05 |
| Leverage ratio | 9.05 | 9.43 | 9.60 | 9.71 | 10.18 |
| Equity to total assets | 9.68 | 9.87 | 10.25 | 10.68 | 10.97 |
| Non-interest income to revenue* | 40.72 | 40.48 | 38.84 | 37.16 | 35.71 |
| Efficiency ratio** | 60.55 | 59.30 | 59.16 | 58.83 | 58.62 |
| Loans to deposits | 84.73 | 81.34 | 78.71 | 79.96 | 79.29 |
| Net yield on interest earning assets (tax equivalent basis) | 3.92 | 3.89 | 3.81 | 4.04 | 4.39 |
| Non-interest bearing deposits to total deposits | 5.78 | 6.23 | 12.47 | 10.81 | 9.96 |
| Cash dividend payout ratio | 30.19 | 28.92 | 28.26 | 25.19 | 21.78 |

* Revenue includes net interest income and non-interest income, excluding net securities gains/losses.

** The efficiency ratio is calculated as non-interest expense (excluding intangibles amortization) as a percent of net interest income and non-interest income (excluding net securities gains/losses).

Selected Financial Data

| <i>(In thousands, except per share data)</i> | 2006 | 2005 | 2004 | 2003 | 2002 |
|--|-------------------|------------|------------|------------|------------|
| Net interest income | \$ 513,199 | \$ 501,702 | \$ 497,331 | \$ 502,392 | \$ 499,965 |
| Provision for loan losses | 25,649 | 28,785 | 30,351 | 40,676 | 34,108 |
| Non-interest income | 361,621 | 341,199 | 326,931 | 301,667 | 280,572 |
| Non-interest expense | 525,425 | 496,522 | 482,769 | 472,144 | 458,200 |
| Net income | 219,842 | 223,247 | 220,341 | 206,524 | 196,310 |
| Net income per share-basic* | 3.13 | 3.05 | 2.85 | 2.58 | 2.37 |
| Net income per share-diluted* | 3.09 | 3.01 | 2.81 | 2.54 | 2.34 |

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| | | | | | |
|----------------------------|-------------------|------------|------------|------------|------------|
| Cash dividends | 65,758 | 63,421 | 61,135 | 51,266 | 42,185 |
| Cash dividends per share* | .933 | .871 | .795 | .642 | .509 |
| Market price per share* | 48.41 | 49.64 | 45.53 | 42.35 | 32.32 |
| Book value per share* | 20.62 | 18.85 | 18.96 | 18.46 | 17.46 |
| Common shares outstanding* | 69,953 | 70,989 | 75,254 | 78,593 | 81,475 |
| Total assets | 15,230,349 | 13,885,545 | 14,250,368 | 14,287,164 | 13,308,415 |
| Loans | 9,960,118 | 8,899,183 | 8,305,359 | 8,142,679 | 7,875,944 |
| Investment securities | 3,496,323 | 3,770,181 | 4,837,368 | 5,039,194 | 4,275,248 |
| Deposits | 11,744,854 | 10,851,813 | 10,434,309 | 10,206,208 | 9,913,311 |
| Long-term debt | 553,934 | 269,390 | 389,542 | 300,977 | 338,457 |
| Stockholders equity | 1,442,114 | 1,337,838 | 1,426,880 | 1,450,954 | 1,422,452 |
| Non-performing assets | 18,223 | 11,713 | 18,775 | 33,685 | 29,539 |

* Restated for the 5% stock dividend distributed in December 2006.

Results of Operations

| <i>(Dollars in thousands)</i> | 2006 | 2005 | 2004 | \$ Change | | % Change | |
|-------------------------------|-------------------|-------------------|-------------------|-------------------|-----------------|---------------|-------------|
| | | | | 06- 05 | 05- 04 | 06- 05 | 05- 04 |
| Net interest income | \$ 513,199 | \$ 501,702 | \$ 497,331 | \$ 11,497 | \$ 4,371 | 2.3% | .9% |
| Provision for loan losses | (25,649) | (28,785) | (30,351) | (3,136) | (1,566) | (10.9) | (5.2) |
| Non-interest income | 361,621 | 341,199 | 326,931 | 20,422 | 14,268 | 6.0 | 4.4 |
| Non-interest expense | (525,425) | (496,522) | (482,769) | 28,903 | 13,753 | 5.8 | 2.8 |
| Income taxes | (103,904) | (94,347) | (90,801) | 9,557 | 3,546 | 10.1 | 3.9 |
| Net income | \$ 219,842 | \$ 223,247 | \$ 220,341 | \$ (3,405) | \$ 2,906 | (1.5)% | 1.3% |

The Company's fully diluted earnings per share amounted to \$3.09 in 2006 compared to \$3.01 in 2005, an increase of 2.7%. Net income for 2006 was \$219.8 million, a 1.5% decline compared to 2005. The return on average assets amounted to 1.54% compared to 1.60% last year and the return on average equity totaled 15.96% compared to 16.19% last year. The efficiency ratio was 60.55% in 2006 compared with 59.30% in 2005.

Financial results for 2006 compared to 2005 included an increase in net interest income, growth in non-interest income, and a lower loan loss provision. These positive effects on net income were offset by higher non-interest expense and income tax expense. Net interest income increased \$11.5 million, or 2.3%, reflecting the effects of higher average overall rates earned on loans and growth in average loan balances, partly offset by declining average balances in investment securities. Also, interest expense on deposit accounts and short-term borrowings rose, mainly related to increases in interest rates on virtually all deposit accounts and borrowings, coupled with growth in certificate of deposit balances. Non-interest income rose \$20.4 million, or 6.0%, largely due to increases of 10.0% in bank card fees, 2.2% in deposit account fees, and 5.7% in trust revenues. Non-interest expense grew 5.8%, mainly the result of higher salaries and benefits (up 5.5%), with additional increases of 6.5% in occupancy, 10.6% in equipment, and 5.7% in data processing and software costs. The provision for loan losses decreased \$3.1 million to \$25.6 million, reflecting lower credit card and personal banking loan net charge-offs, partly offset by lower business loan net recoveries. Income tax expense increased 10.1% in 2006 and resulted in an effective tax rate of 32.1%, which increased from a tax rate of 29.7% in the prior year. The increase in income tax expense in 2006 occurred largely because tax benefits of \$13.7 million, representing the effects of certain corporate restructuring initiatives, were recognized in 2005 and these benefits did not recur in 2006.

The increase in net income in 2005 compared to 2004 was due to growth in non-interest income and an improving net interest margin, combined with effective expense management and a lower loan loss provision. Non-interest income rose \$14.3 million, or 4.4%, largely due to increases of 10.3% in bank card fees, 7.2% in deposit account fees, and 6.3% in trust revenues. The growth in non-interest expense was constrained to 2.8%, mainly the result of lower costs for supplies and communications (down 1.2%), coupled with increases in salaries and benefits (up 2.9%) and modest increases in occupancy, equipment, and data processing and software costs. Net interest income increased \$4.4 million, reflecting similar trends in interest rates and loan growth mentioned above. The provision for loan losses

decreased \$1.6 million to \$28.8 million, reflecting lower business loan net charge-offs, partly offset by higher credit card and personal banking net loan charge-offs. Income tax expense increased 3.9% in 2005 and resulted in an effective tax rate of 29.7%, which was comparable to 29.2% in the prior year. Income tax expense in 2005 included the recognition of tax benefits of \$13.7 million mentioned above, which compared to \$18.9 million of similar benefits recorded in 2004.

On July 21, 2006, Commerce Bank, N.A., (Missouri) (the Bank) a subsidiary of the Company, acquired certain assets and assumed certain liabilities comprising the banking business of Boone National Savings and Loan Association (Boone) through a purchase and assumption agreement, paying a cash premium of \$16 million. Boone operated four branches in Columbia, Missouri, and loan production offices in Ashland and Lake Ozark, Missouri. The Bank acquired loans and deposits of \$126.4 million and \$100.9 million, respectively, and assumed debt of \$26.7 million. Goodwill of \$15.6 million, core deposit premium of \$2.6 million, and \$300 thousand of mortgage servicing rights were recorded as a result of the transaction.

On September 1, 2006, the Company completed the acquisition of the common stock of West Pointe Bancorp, Inc. (West Pointe) in Belleville, Illinois. West Pointe was purchased for \$13.1 million in cash and

1.4 million shares of Company stock valued at \$67.5 million. The Company's acquisition of West Pointe was accounted for as a purchase and added \$508.8 million in assets (including \$255.0 million in loans), \$381.8 million in deposits, and five branch locations. Intangible assets recognized as a result of the transaction consisted of approximately \$37.0 million of goodwill, \$17.4 million of core deposit premium, and \$531 thousand of mortgage servicing rights.

The Boone and West Pointe transactions discussed above are collectively referred to as "bank acquisitions" throughout the remainder of this report.

On December 4, 2006, the Company and South Tulsa Financial Corporation (South Tulsa) signed a definitive merger agreement in which the Company will acquire all outstanding shares of South Tulsa. Simultaneously, South Tulsa's wholly-owned subsidiary, Bank South, will merge into the Bank. The Company's acquisition of South Tulsa will add approximately \$124 million in assets (including \$107 million in loans), \$101 million in deposits, and two branch locations in Tulsa, Oklahoma. The acquisition will result in the Company's first full-service banking facilities in Oklahoma.

The Company continually evaluates the profitability of its network of bank branches throughout Missouri, Kansas and Illinois. As a result of this evaluation process, the Company may periodically sell the assets and liabilities of certain branches, or may sell the premises of specific banking facilities. In 2006, the Company sold three bank facilities, realizing pre-tax gains of \$579 thousand on the sales. The Company sold four bank facilities during 2005 and three facilities during 2004. The gains and losses realized on the sales of those premises in 2005 and 2004 were not significant. Also during 2004, the Company sold a bank branch with loans of \$12.9 million and deposits of \$16.5 million, realizing a pre-tax gain of \$1.1 million.

The Company distributed a 5% stock dividend for the thirteenth consecutive year on December 13, 2006. All per share and average share data in this report has been restated to reflect the 2006 stock dividend.

Critical Accounting Policies

The Company's consolidated financial statements are prepared based on the application of certain accounting policies, the most significant of which are described in Note 1 to the consolidated financial statements. Certain of these policies require numerous estimates and strategic or economic assumptions that may prove inaccurate or be subject to variations which may significantly affect the Company's reported results and financial position for the period or in future periods. The use of estimates, assumptions, and judgments are necessary most often when financial assets and liabilities are required to be recorded at, or adjusted to reflect, fair value. Assets and liabilities carried at fair value inherently result in more financial statement volatility. Fair values and the information used to record valuation adjustments for certain assets and liabilities are based on either quoted market prices or are provided by other independent third-party sources, when available. When such information is not available, management estimates valuation adjustments primarily by using internal cash flow and other financial modeling techniques. Changes in underlying factors, assumptions, or estimates in any of these areas could have a material impact on the Company's future financial condition and results of operations.

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 non-marketable investments, and accounting for income taxes.

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

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

The Company, through its direct holdings and its Small Business Investment subsidiaries, has numerous private equity and venture capital investments, which totaled \$44.1 million at December 31, 2006. These private equity and venture capital securities are reported at fair value. The values assigned to these securities where no market quotations exist are based upon available information and management's judgment. Although management believes its estimates of fair value reasonably reflect the fair value of these securities, key assumptions regarding the projected financial performance of these companies, the evaluation of the investee company's management team, and other economic and market factors may affect the amounts that will ultimately be realized from these investments.

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences, including the effects of IRS examinations and examinations by other state agencies, could materially impact the Company's financial position and its results of operations. Further discussion of income taxes is presented in the Income Taxes section of this discussion and in Note 9 on Income Taxes in the consolidated financial statements.

Net Interest Income

Net interest income, the largest source of revenue, results from the Company's lending, investing, borrowing, and deposit gathering activities. It is affected by both changes in the level of interest rates and changes in the amounts and mix of interest earning assets and interest bearing liabilities. The following table summarizes the changes in net interest income on a fully taxable equivalent basis, by major category of interest earning assets and interest bearing liabilities, identifying changes related to volumes and rates. Changes not solely due to volume or rate changes are allocated to rate.

| <i>(In thousands)</i> | 2006 | | | 2005 | | |
|--|------------------------------------|-----------------|----------------|------------------------------------|-----------------|---------------|
| | Change due to Average Volume | Average Rate | Total | Change due to Average Volume | Average Rate | Total |
| Interest income, fully taxable equivalent basis | | | | | | |
| Loans | \$ 52,399 | \$ 91,933 | \$ 144,332 | \$ 22,000 | \$ 74,224 | \$ 96,224 |
| Investment securities: | | | | | | |
| U.S. government and federal agency obligations | (15,977) | (1,174) | (17,151) | (25,872) | (2,148) | (28,020) |
| State and municipal obligations | 11,923 | 713 | 12,636 | 3,182 | (682) | 2,500 |
| Mortgage and asset-backed securities | (24,993) | 6,285 | (18,708) | (1,240) | 10,391 | 9,151 |
| Other securities | (75) | 5,205 | 5,130 | 1,238 | 5,342 | 6,580 |
| Federal funds sold and securities purchased under agreements to resell | 5,965 | 5,570 | 11,535 | 543 | 2,247 | 2,790 |
| Total interest income | 29,242 | 108,532 | 137,774 | (149) | 89,374 | 89,225 |
| Interest expense | | | | | | |
| Interest bearing deposits: | | | | | | |
| Savings | (29) | 974 | 945 | 4 | 5 | 9 |
| Interest checking and money market | 321 | 41,805 | 42,126 | 189 | 25,216 | 25,405 |
| Time open and C.D. s of less than \$100,000 | 10,150 | 24,677 | 34,827 | 247 | 11,426 | 11,673 |
| Time open and C.D. s of \$100,000 and over | 9,579 | 18,023 | 27,602 | 2,861 | 13,006 | 15,867 |
| Federal funds purchased and securities sold under agreements to repurchase | (7,785) | 29,163 | 21,378 | (2,270) | 28,486 | 26,216 |
| Other borrowings | (5,819) | 2,099 | (3,720) | (1,021) | 4,966 | 3,945 |

| | | | | | | |
|--|------------------|-------------------|------------------|-----------------|-----------------|-----------------|
| Total interest expense | 6,417 | 116,741 | 123,158 | 10 | 83,105 | 83,115 |
| Net interest income, fully taxable equivalent basis | \$ 22,825 | \$ (8,209) | \$ 14,616 | \$ (159) | \$ 6,269 | \$ 6,110 |

Net interest income was \$513.2 million in 2006, representing an increase of \$11.5 million, or 2.3%, compared to \$501.7 million in 2005. Net interest income increased \$4.4 million, or less than 1.0%, in 2005 compared to \$497.3 million in 2004. The increase in net interest income in 2006 was the result of growth of \$144.3 million in tax equivalent loan interest income as a result of higher rates and higher average balances, partly offset by a decline of \$18.1 million in tax equivalent interest earned on investment securities due primarily to lower average balances. Interest expense incurred on deposits increased \$105.5 million, or 78.3%, due to higher rates and higher average balances. Additionally, interest expense on federal funds purchased and repurchase agreements increased \$21.4 million primarily due to increased rates. These increases in interest expense were partially offset by a \$3.6 million decrease in interest expense on other borrowings caused by a decrease in volume, which had a greater impact than the increase in interest rate. The increase in rates on both interest earning assets and interest bearing liabilities was the result of increases in the federal funds rate initiated by the Federal Reserve throughout 2005 and 2006. As a result of these rate changes and the change in the mix of assets and liabilities on the Company's balance sheet, the net yield on interest earning assets was 3.92% in 2006 compared to 3.89% in 2005, remaining fairly constant during these periods.

During 2005, net interest income increased over 2004 primarily as a result of growth in loan interest income resulting from higher rates and higher average balances, partly offset by increases in interest expense due to increases in interest rates. The rise in interest rates was due to the increases in the federal funds rate initiated by the Federal Reserve throughout 2005. Yields on earning assets increased 73 basis points over 2004, while rates paid on deposits increased 47 basis points and rates paid on borrowings increased 172 basis points. As a result, the Company's net interest margin increased to 3.89% from 3.81% in 2004.

Total interest income in 2006 was \$832.3 million compared to \$697.6 million in 2005 and \$610.1 million in 2004. Interest income increased in 2006 by \$134.7 million, or 19.3%, as a result of a \$144.3 million increase in tax equivalent loan interest income, offset slightly by an \$18.1 million decrease in interest income from investment securities. The tax equivalent average yield on interest earning assets was 6.32% in 2006 compared to 5.40% in 2005, representing a 92 basis point increase. Interest income on loans increased in 2006 over 2005 as a result of a 98 basis point increase in the average yield, coupled with an \$859.9 million, or 10.0%, increase in average balances. The increase in average loan balances resulted from growth in the Company's business and consumer lending products. Approximately \$137.1 million of the increase in average loan balances was the result of bank acquisitions in 2006, which contributed \$10.2 million to interest income earned on loans in 2006. Excluding the impact of the acquisitions, the increase in average loan balances compared to 2005 was \$722.8 million, or 8.4%. The increase in interest income on loans was offset by a decrease in interest income on investment securities. The average yield on investment securities increased 36 basis points, which was offset by a \$763.5 million, or 17.7%, decrease in investment securities average balances, resulting in an overall decrease of \$18.1 million in interest income earned on the investment portfolio in 2006 compared to 2005. The Company has funded its loan growth principally by reducing its investment securities portfolio through both maturities and sales, in addition to growth in its overall deposit base.

Interest expense increased \$123.2 million, or 62.9%, in 2006 compared to 2005 and was impacted by the rising rate environment noted above. Interest expense on deposits increased \$105.5 million, or 78.3%, in 2006 over the previous year as a result of a 92 basis point average rate increase, coupled with a \$607.9 million, or 6.2%, growth in average interest bearing deposit balances. Approximately \$147.8 million of the increase in average interest bearing deposit balances was a result of bank acquisitions in 2006. Bank acquisitions incurred \$5.1 million of deposit interest expense in 2006. Excluding the impact of bank acquisitions, the increase in average interest bearing deposits compared to 2005 was \$460.1 million, or 4.7%. Average rates paid on interest checking and money market accounts increased 63 basis points in 2006 compared to 2005, while the average balances remained largely unchanged at \$6.7 billion during 2006 and 2005. Excluding the 2006 bank acquisitions, these balances would have declined 1.1% from 2005. The average rate paid on certificates of deposit increased 128 basis points in 2006. The average balances of certificates of deposit increased \$645.6 million, or 23.7%, from \$2.7 billion in 2005 to \$3.4 billion in 2006. Approximately \$88.3 million of the increase in average certificates of deposit was due to the bank acquisitions in 2006. Additionally, interest expense on federal funds purchased and repurchase agreements increased \$21.4 million, or 43.8%, resulting primarily from an increase of 179 basis points in rates paid. Average borrowings of federal funds purchased and repurchase agreements declined 9.6% primarily due to a decrease in federal funds purchased as a result of lower liquidity needs, offset by growth in average repurchase agreement balances. Contributing to the increase in repurchase agreements was the addition of \$500.0 million in structured repurchase agreements which were purchased in the third quarter of 2006 to mitigate the risk of falling interest rates. Interest rates paid on interest bearing deposits and short-term borrowings will continue to be impacted by the changing interest rate environment as the Company competes for funding sources to support loan growth.

Total interest income increased \$87.5 million, or 14.3%, in 2005 compared to 2004. The increase was primarily due to an increase in loan yields coupled with an increase in average loan balances, offset slightly by reduced interest income from investment securities. Average loan balances increased \$431.4 million, or 5.3%, during 2005 compared to 2004 and this growth generated \$22.0 million of interest income. The increase in average loan balances, coupled with an

86 basis point increase in rates, increased tax equivalent interest income by \$96.2 million.

The average rate incurred on interest bearing liabilities was 1.65% in 2005 compared to 1.00% in 2004. Interest expense on deposits increased \$53.0 million in 2005 over 2004 as a result of a 47 basis point average rate increase coupled with 9.2% growth in average interest bearing deposit balances. Average rates paid on premium money market accounts increased 99 basis points, and both average rates and average balances of short-term certificates of deposit increased. Additionally, interest expense on borrowings grew by \$30.2 million, resulting mainly from an increase in rates of 184 basis points on federal funds purchased.

Provision for Loan Losses

The provision for loan losses was \$25.6 million in 2006, compared with \$28.8 million in 2005 and \$30.4 million in 2004. The \$3.1 million decline in the 2006 provision for loan losses reflected lower personal banking loan net charge-offs and lower credit card net charge-offs. The provision for loan losses is recorded to bring the allowance for loan losses to a level deemed adequate by management based on the factors mentioned in the following Allowance for Loan Losses section of this discussion.

Non-Interest Income

| <i>(Dollars in thousands)</i> | 2006 | 2005 | 2004 | % Change | |
|--|-------------------|------------|------------|-----------------|--------|
| | | | | 06- 05 | 05- 04 |
| Deposit account charges and other fees | \$ 115,453 | \$ 112,979 | \$ 105,382 | 2.2% | 7.2% |
| Bank card transaction fees | 94,928 | 86,310 | 78,253 | 10.0 | 10.3 |
| Trust fees | 72,180 | 68,316 | 64,257 | 5.7 | 6.3 |
| Trading account profits and commissions | 8,132 | 9,650 | 12,288 | (15.7) | (21.5) |
| Consumer brokerage services | 9,954 | 9,909 | 9,846 | .5 | .6 |
| Loan fees and sales | 10,503 | 12,838 | 13,654 | (18.2) | (6.0) |
| Investment securities gains, net | 9,035 | 6,362 | 11,092 | 42.0 | (42.6) |
| Other | 41,436 | 34,835 | 32,159 | 18.9 | 8.3 |
| Total non-interest income | \$ 361,621 | \$ 341,199 | \$ 326,931 | 6.0% | 4.4% |
| Total non-interest income excluding net securities gains/losses | \$ 352,586 | \$ 334,837 | \$ 315,839 | 5.3% | 6.0% |
| Non-interest income as a % of total revenue* | 40.7% | 40.5% | 39.7% | | |
| Total revenue per full-time equivalent employee | \$ 175.5 | \$ 172.9 | \$ 168.7 | | |

* Total revenue is calculated as net interest income plus non-interest income, excluding net securities gains/losses.

Non-interest income was \$361.6 million in 2006, which was a \$20.4 million, or 6.0%, increase over 2005. In 2006, deposit account fees rose \$2.5 million, or 2.2%, as a result of higher deposit account overdraft fees, which grew \$3.7 million, or 4.7%. This growth was partly offset by lower cash management fee income and lower deposit account service charges. The growth in overdraft fees was mainly due to higher unit prices, partly offset by lower transaction volumes. The decline in corporate cash management fees continued to be affected by the higher interest rate environment, which tends to reduce cash fees paid by corporate customers. Bank card fees rose \$8.6 million, or 10.0% overall, primarily due to solid growth in corporate card and debit card fee income, which grew by 21.8% and 17.5%, respectively. The strong growth in corporate card fees was attributable to transaction fees from commercial businesses and non-profit enterprises who are utilizing these electronic transactions in greater proportions. Debit card transaction fees continue to grow as a result of greater utilization by consumers and acceptance by retail business, which increased volumes. Trust fees increased \$3.9 million, or 5.7%, due to a 5.2% increase in private client account fees and a 6.4% increase in corporate and institutional trust account fees. Sales efforts in 2006 resulted in new annualized fees of \$4.5 million for private client trust accounts and \$1.5 million for corporate and institutional trust accounts. Total trust assets, which are the basis upon which fees are charged, grew to \$21.2 billion, an increase of 7.7%. Bond trading income fell \$1.5 million due to lower sales of fixed income securities to bank and corporate customers, while consumer brokerage income was relatively flat. Loan fees and sales decreased by \$2.3 million as gains on sales of student loans declined from \$8.0 million in 2005 to \$6.3 million

in 2006, and fewer transactions occurred. Net gains on securities transactions amounted to \$9.0 million, which was an increase of \$2.7 million over the previous year. Included in these amounts were realized gains and fair value adjustments on venture capital and private equity investments, which totaled \$8.3 million in 2006 compared to \$1.3 million recorded in 2005. In addition, during 2006, the Company recorded a gain of \$2.8 million on the sale of MasterCard Inc. restricted shares, which was partly offset by a \$2.1 million loss on the sale of mortgage and asset-backed securities. Other non-interest income rose \$6.6 million, which included growth of \$2.2 million in operating lease-related income, in addition to \$1.2 million in non-recurring income from a Parent company equity investment. Higher sweep fees and check sales income were also recorded.

In 2005, non-interest income increased \$14.3 million, or 4.4%, to \$341.2 million, and included net securities gains of \$6.4 million in 2005 compared to \$11.1 million in 2004. Excluding these net securities gains, non-interest income grew 6.0%. In 2005, deposit account fees increased 7.2%, or \$7.6 million, due to a \$15.5 million increase in overdraft and return item fees, partly offset by a \$4.9 million decline in fees earned on commercial cash management accounts. The growth in overdraft and return item fees over 2004 was the result of increasing transaction volumes during 2005 and pricing changes initiated in the third quarter of 2005. The decline in corporate cash management fee income was largely the effect of the rising interest rate environment. Compared to 2004, bank card fees increased \$8.1 million, or 10.3%, mainly due to higher fees earned on debit, credit and corporate card transactions, which grew by 14.3%, 10.3% and 16.3%, respectively. Trust fees increased \$4.1 million, or 6.3%, as a result of increasing market values of trust account assets and new business, occurring largely in private client trust product lines. Trading account fees, consisting of fees from sales of fixed income securities, declined 21.5% in 2005 due to lower demand by business and correspondent bank customers. Consumer brokerage service fees increased slightly, mainly due to higher revenues from mutual fund and insurance sales, partly offset by lower annuity sales. Loan fees and sales declined \$816 thousand as gains on student loan sales declined from \$8.5 million in 2004 to \$8.0 million in 2005. Net gains on securities transactions amounted to \$6.4 million in 2005, which was a decrease of \$4.7 million compared to the previous year. During 2005, the Company sold available for sale securities totaling \$1.8 billion and recorded net gains of \$5.1 million. These sales were comprised mainly of \$533.9 million in U.S. government agency securities, \$768.4 million in asset-backed securities, and \$359.1 million in inflation-indexed treasury securities. Also included in 2005 activity were net gains of \$1.3 million recognized on fair value adjustments and sales of private equity investments.

Non-Interest Expense

| <i>(Dollars in thousands)</i> | 2006 | 2005 | 2004 | % Change | |
|-----------------------------------|-------------------|------------|------------|-----------------|--------|
| | | | | 06- 05 | 05- 04 |
| Salaries | \$ 244,887 | \$ 234,440 | \$ 225,526 | 4.5% | 4.0% |
| Employee benefits | 43,386 | 38,737 | 39,943 | 12.0 | (3.0) |
| Net occupancy | 43,276 | 40,621 | 39,558 | 6.5 | 2.7 |
| Equipment | 25,665 | 23,201 | 22,903 | 10.6 | 1.3 |
| Supplies and communication | 32,670 | 33,342 | 33,760 | (2.0) | (1.2) |
| Data processing and software | 50,982 | 48,244 | 46,000 | 5.7 | 4.9 |
| Marketing | 17,317 | 17,294 | 16,688 | .1 | 3.6 |
| Other | 67,242 | 60,643 | 58,391 | 10.9 | 3.9 |
| Total non-interest expense | \$ 525,425 | \$ 496,522 | \$ 482,769 | 5.8% | 2.8% |

| | | | |
|--|--------------|-------|-------|
| Efficiency ratio | 60.6% | 59.3% | 59.2% |
| Salaries and benefits as a % of total non-interest expense | 54.9% | 55.0% | 55.0% |
| Number of full-time equivalent employees | 4,932 | 4,839 | 4,821 |

Non-interest expense rose 5.8% in 2006 to a total of \$525.4 million, compared to \$496.5 million in 2005. In total, salaries and benefits expense grew \$15.1 million, or 5.5%, due to normal merit increases and higher costs for incentive compensation, medical insurance, and payroll taxes. In addition, the effects of the

previously mentioned bank acquisitions increased salaries and benefits by approximately \$2.4 million in 2006. Partly offsetting these increases was a decline in stock-based compensation of \$1.8 million, which resulted from the 2006 adoption of FAS 123R estimated forfeiture accounting requirements and a slightly longer vesting period for 2006 grants. FAS 123R is discussed further in the note on Stock-Based Compensation and Directors Stock Purchase Plan in the consolidated financial statements. Net occupancy costs grew \$2.7 million, or 6.5%, compared to the prior year, mainly as a result of a full year of depreciation, real estate taxes and utilities expense incurred on two office buildings purchased in 2005, in addition to costs related to several branch facilities constructed during 2006. These increases were partly offset by lower net rent expense as certain banking offices were moved from leased facilities to the new buildings and office space was leased to outside tenants. In addition, in 2006, the Company recorded an asbestos abatement obligation on an office building in downtown Kansas City, which increased occupancy expense by \$854 thousand. Equipment expense increased \$2.5 million, or 10.6%, mainly due to higher equipment depreciation expense and the relocation of a check processing function in 2006. Data processing and software expense increased \$2.7 million, or 5.7%, due to higher bank card processing fees, online banking fees and software amortization expense. Software amortization expense increased mainly due to the installation of new data system applications, while bank card processing fees increased commensurate with the increase in bank card fee income mentioned above. Smaller variances occurred in marketing, which increased slightly, while lower telephone and network costs resulted in a reduction in supplies and communication expense of \$672 thousand. Other non-interest expense increased \$6.6 million due to increases in legal and professional fees, operating lease depreciation, foreclosed property expense (related to a single property acquired and subsequently sold in 2006) and minority interest expense relating to investment gains recorded by venture capital affiliates. Partly offsetting these increases were lower processing losses and bank card fraud losses.

In 2005, non-interest expense was \$496.5 million, an increase of \$13.8 million, or 2.8%, over 2004. Compared with the prior year, salary and employee benefits expense increased \$7.7 million, or 2.9%, as a result of higher staff salaries expense, partly offset by declines in retirement and medical insurance costs. Net occupancy expense rose 2.7% over the prior year, mainly as a result of higher depreciation and utilities expense on two new office buildings mentioned above. These increases were partly offset by lower net rent expense. Equipment expense increased 1.3%, with the slight increase due to higher costs for small equipment purchases and maintenance contract expense. Data processing costs increased \$2.2 million, or 4.9%, due to higher bank card processing costs and higher online banking processing fees, partly offset by lower software license fees. Marketing expense increased only \$606 thousand, or 3.6%, compared to the previous year. Other non-interest expense increased \$2.3 million, or 3.9%, over the prior year mainly due to increases in proprietary mutual fund expense subsidies, bank card fraud losses, and minority interest expense relating to investment gains recorded by venture capital affiliates. These increases were partly offset by decreases in loan collection expense and professional fees, in addition to higher capitalized loan costs.

Income Taxes

Income tax expense was \$103.9 million, compared to \$94.3 million in 2005 and \$90.8 million in 2004. Income tax expense in 2006 increased 10.1% over 2005, compared to a 1.9% increase in pre-tax income. The effective tax rate on income from operations was 32.1%, 29.7% and 29.2% in 2006, 2005 and 2004, respectively. The Company's effective tax rates were lower than the federal statutory rate of 35% mainly due to tax exempt interest on state and municipal obligations, state and federal tax credits realized and, in 2005 and 2004, the recognition of additional tax benefits from various corporate reorganization initiatives. These tax benefits amounted to \$13.7 million in 2005, compared to similar tax benefits of \$18.9 million in 2004. Such tax benefits did not reoccur in 2006.

Financial Condition**Loan Portfolio Analysis**

A schedule of average balances invested in each category of loans appears on page 48. Classifications of consolidated loans by major category at December 31 for each of the past five years are as follows:

| <i>(In thousands)</i> | Balance at December 31 | | | | |
|--|-------------------------------|--------------|--------------|--------------|--------------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| Business | \$ 2,860,692 | \$ 2,527,654 | \$ 2,246,287 | \$ 2,102,605 | \$ 2,277,365 |
| Real estate construction | 658,148 | 424,561 | 427,124 | 427,083 | 404,519 |
| Real estate business | 2,148,195 | 1,919,045 | 1,743,293 | 1,875,069 | 1,736,646 |
| Real estate personal | 1,493,481 | 1,358,511 | 1,340,574 | 1,338,604 | 1,282,223 |
| Consumer | 1,435,038 | 1,287,348 | 1,193,822 | 1,150,732 | 1,088,808 |
| Home equity | 441,851 | 448,507 | 411,541 | 352,047 | 305,274 |
| Student | 263,786 | 330,238 | 357,991 | 355,763 | 268,719 |
| Credit card | 648,326 | 592,465 | 561,054 | 526,653 | 502,058 |
| Overdrafts | 10,601 | 10,854 | 23,673 | 14,123 | 10,332 |
| Total loans, net of unearned income | \$ 9,960,118 | \$ 8,899,183 | \$ 8,305,359 | \$ 8,142,679 | \$ 7,875,944 |

The contractual maturities of loan categories at December 31, 2006, and a breakdown of those loans between fixed rate and floating rate loans are as follows:

| <i>(In thousands)</i> | Principal Payments Due | | | | Total |
|---|------------------------------------|--|---------------------------------|------------------|--------------|
| | In One Year or Less | After One Year Through Five Years | After Five Years | | |
| Business | \$ 1,568,297 | \$ 1,158,104 | \$ 134,291 | \$ 2,860,692 | |
| Real estate construction | 387,699 | 251,096 | 19,353 | 658,148 | |
| Real estate business | 689,370 | 1,272,862 | 185,963 | 2,148,195 | |
| Real estate personal | 96,698 | 309,101 | 1,087,682 | 1,493,481 | |
| Total business and real estate loans | \$ 2,742,064 | \$ 2,991,163 | \$ 1,427,289 | 7,160,516 | |

| | |
|----------------------------|-----------|
| Consumer ⁽¹⁾ | 1,435,038 |
| Home equity ⁽²⁾ | 441,851 |
| Student ⁽³⁾ | 263,786 |
| Credit card ⁽⁴⁾ | 648,326 |
| Overdrafts | 10,601 |

Total loans, net of unearned income \$ 9,960,118

| | | | | |
|---------------------------|------------|--------------|------------|--------------|
| Loans with fixed rates | \$ 489,944 | \$ 1,636,650 | \$ 477,302 | \$ 2,603,896 |
| Loans with floating rates | 2,252,120 | 1,354,513 | 949,987 | 4,556,620 |

Total business and real estate loans \$ 2,742,064 \$ 2,991,163 \$ 1,427,289 \$ 7,160,516

(1) Consumer loans with floating rates totaled \$98.0 million.

(2) Home equity loans with floating rates totaled \$433.6 million.

(3) Student loans with floating rates totaled \$257.5 million.

(4) Credit card loans with floating rates totaled \$516.5 million.

Total period end loans at December 31, 2006 were \$10.0 billion, an increase of \$1.1 billion, or 11.9%, over balances at December 31, 2005. Loan growth came principally from business, construction, business real estate, personal real estate and consumer loans, as demand for loan products remained solid during 2006. The 2006 bank acquisitions also contributed to the higher loan balances, adding approximately \$361.3 million to the year end 2006 balance, consisting mainly of business loans (\$64.3 million), construction loans

(\$75.8 million), business real estate loans (\$125.1 million), and personal real estate loans (\$68.6 million). Excluding these acquired loans, business loans grew \$268.7 million, or 10.6%, and business real estate loans grew \$104.1 million, or 5.4%, both mainly as a result of new customer activity and added borrowings from existing customers. Lease balances, included in the business category, increased \$41.1 million, or 18.6%, compared with the previous year end balance. Construction loans rose \$157.8 million, or 37.2%. Consumer loans grew \$128.8 million, or 10.0%, during the year mainly as a result of continued growth in marine and recreational vehicle lending. Personal real estate loans grew by \$66.3 million, or 4.9%. Credit card loans increased \$55.9 million, or 9.4%, and saw solid growth, especially at year end when holiday activity is normally at its peak. Home equity loans decreased to \$441.9 million, a decline of \$6.7 million, or 1.5%, during 2006 due to lower activity in the housing market. Student loans declined by \$66.5 million, or 20.1%, mainly due to planned loan sales from the portfolio, greater numbers of loan payoffs, and consolidations with other lenders during 2006.

Period end loans increased \$593.8 million, or 7.1%, in 2005 compared to 2004, resulting from increases in business, business real estate and consumer loans.

The Company currently generates approximately 33% of its loan portfolio in the St. Louis regional market and 28% in the Kansas City regional market. The portfolio is diversified from a business and retail standpoint, with 57% in loans to businesses and 43% in loans to consumers. A balanced approach to loan portfolio management and an historical aversion toward credit concentrations, from an industry, geographic and product perspective, have contributed to low levels of problem loans and loan losses.

Business

Total business loans amounted to \$2.9 billion at December 31, 2006 and include loans used mainly to fund customer accounts receivable, inventories, and capital expenditures. This portfolio also includes sales type and direct financing leases totaling \$262.4 million, which are used by commercial customers to finance capital purchases ranging from computer equipment to office and transportation equipment. These leases comprise 2.6% of the Company's total loan portfolio. Business loans are made primarily to customers in the regional trade area of the Company, generally the central Midwest, encompassing the states of Missouri, Kansas, Illinois, and nearby Midwestern markets, including Iowa, Oklahoma and Indiana. The portfolio is diversified from an industry standpoint and includes businesses engaged in manufacturing, wholesaling, retailing, agribusiness, insurance, financial services, public utilities, and other service businesses. Emphasis is upon middle-market and community businesses with known local management and financial stability. The Company participates in credits of large, publicly traded companies when business operations are maintained in the local communities or regional markets and opportunities to provide other banking services are present. Consistent with management's strategy and emphasis upon relationship banking, most borrowing customers also maintain deposit accounts and utilize other banking services. There were net loan recoveries in this category of \$823 thousand in 2006 compared to net recoveries of \$3.0 million in 2005, mainly due to two smaller lease-related recoveries in 2006 compared to a single large recovery in 2005. Non-accrual business loans were \$5.8 million (.2% of business loans) at December 31, 2006 compared to \$5.9 million at December 31, 2005. Included in these totals were lease-related loans of \$1.2 million and \$2.8 million at December 31, 2006 and 2005, respectively. Opportunities for growth in business loans will be based upon strong solicitation efforts in a highly competitive market environment for quality loans. Asset quality is, in part, a function of management's consistent application of underwriting standards and credit terms through stages in economic cycles. Therefore, portfolio growth in 2007 will be dependent upon 1) the strength of the economy, 2) the actions of the Federal Reserve with regard to targets for economic growth, interest rates, and inflationary tendencies, and 3) the competitive environment.

Real Estate-Construction

The portfolio of loans in this category amounted to \$658.1 million at December 31, 2006 and comprised 6.6% of the Company's total loan portfolio. This group of loans includes residential construction loans totaling \$182.9 million at December 31, 2006, or 28% of the category, and commercial construction and land development loans totaling \$475.2 million, or 72%. These loans are predominantly made to businesses in

the local markets of the Company's banking subsidiaries. Commercial construction loans are made during the construction phase for small and medium-sized office and medical buildings, manufacturing and warehouse facilities, apartment complexes, shopping centers, hotels and motels, and other commercial properties. Exposure to larger speculative office properties remains low. Residential construction and land development loans are primarily for projects located in the Kansas City and St. Louis metropolitan areas. Credit losses in this portfolio are normally low, as there were net charge-offs of \$62 thousand in 2006 and there were no net charge-offs in 2005. At year end 2006, construction non-accrual loans were \$120 thousand, while there were no construction loans in non-accrual status at year end 2005.

Real Estate-Business

Total business real estate loans were \$2.1 billion at December 31, 2006 and comprised 21.6% of the Company's total loan portfolio. This category includes mortgage loans for small and medium-sized office and medical buildings, manufacturing and warehouse facilities, shopping centers, hotels and motels, and other commercial properties. Emphasis is placed on owner-occupied and income producing commercial real estate properties which present lower risk levels. The borrowers and/or the properties are generally located in the local and regional markets of the affiliate banks. At December 31, 2006, non-accrual balances amounted to \$9.8 million, or .5% of the loans in this category, compared to \$3.1 million at year end 2005. The Company experienced net recoveries of \$36 thousand in 2006 compared to net charge-offs of \$497 thousand in 2005.

Real Estate-Personal

At December 31, 2006, there were \$1.5 billion in outstanding personal real estate loans, which comprised 15.0% of the Company's total loan portfolio. The mortgage loans in this category are extended, predominately, for owner-occupied residential properties. The Company originates both adjustable rate and fixed rate mortgage loans. The Company retains adjustable rate mortgage loans, and may from time to time retain certain fixed rate loans (typically 15-year fixed rate loans) as directed by its Asset/Liability Management Committee. Other fixed rate loans in the portfolio have resulted from previous bank acquisitions. At December 31, 2006, 63% of the portfolio was comprised of adjustable rate loans while 37% was comprised of fixed rate loans. Levels of mortgage loan origination activity declined in 2006 compared to 2005, with originations of \$352 million in 2006 compared with \$367 million in 2005. Growth in mortgage loan originations was limited in 2006 as a result of the rising interest rate environment, slower housing starts, and lower resales within the Company's markets. The Company typically does not experience significant loan losses in this category. There were net charge-offs of \$92 thousand in 2006 compared to \$30 thousand in 2005. The non-accrual balances of loans in this category increased to \$384 thousand at December 31, 2006, compared to \$261 thousand at year end 2005. The five year history of net charge-offs in the personal real estate loan category reflects nominal losses, and the credit quality of these loans is considered to be strong.

A portion of this portfolio, certain fixed rate loans, is categorized as held for sale. These are generally sold in the secondary market within three months of origination. Such loans were \$14.8 million and \$6.2 million at December 31, 2006 and 2005, respectively.

Personal Banking

Total personal banking loans, which include consumer, revolving home equity and student loans, totaled \$2.1 billion at December 31, 2006 and increased 3.6% during 2006. These categories comprised 21.5% of the total loan portfolio at December 31, 2006. Consumer loans consist of auto, marine, recreational vehicle (RV) and fixed rate home equity loans, and totaled \$1.4 billion at year end 2006. Approximately 65% are originated indirectly from auto and other dealers, while the remaining 35% are direct loans made to consumers. Approximately 42% of the consumer portfolio consists of automobile loans, 35% in marine and RV loans and 9% in fixed rate home equity lending.

Revolving home equity loans, of which 98% are adjustable rate loans, totaled \$441.9 million at year end 2006. An additional \$646.7 million was outstanding in unused lines of credit, which can be drawn at the discretion of the borrower. Home equity loans are secured mainly by second mortgages (and less frequently, first mortgages) on residential property of the borrower. The underwriting terms for the home equity line

product permit borrowing availability, in the aggregate, generally up to 80% or 90% of the appraised value of the collateral property, although a small percentage may permit borrowing up to 100% of appraised value. Given reasonably stable real estate values over time, the collateral margin improves with the regular amortization of mortgages against the properties.

The Company originates loans to students attending colleges and universities, which totaled \$263.8 million at year end 2006. These loans are categorized as held for sale and are normally sold to the secondary market when the students graduate and the loans enter into repayment status. Primary markets are the Missouri Higher Education Loan Authority and Sallie Mae. Nearly all of these loans are based on a variable rate.

Net charge-offs for total personal banking loans were \$6.2 million in 2006 compared to \$8.8 million in 2005. Net charge-offs decreased to .30% of average personal banking loans in 2006 compared to .43% in 2005. The decline in net charge-offs in 2006 compared to 2005 was mainly the result of higher bankruptcies and related personal banking loan charge-offs in the fourth quarter of 2005, corresponding with new bankruptcy legislation which took effect during the same quarter.

Credit Card

Total credit card loans amounted to \$648.3 million at December 31, 2006 and comprised 6.5% of the Company's total loan portfolio. The credit card portfolio is concentrated within regional markets served by the Company. The Company offers a variety of credit card products, including affinity cards, rewards cards, and standard and premium credit cards. It emphasizes its credit card relationship product, Special Connections, which allows the customer ATM access to their deposit accounts using the same card. The Company has found this product to be more profitable by incurring fewer credit losses than other card products, and it allows for better cross sale into other bank products. Approximately 61% of the households in Missouri that own a Commerce credit card product also maintain a deposit relationship with a subsidiary bank. Approximately 80% of the outstanding credit card loans have a floating interest rate. Net charge-offs amounted to \$17.9 million in 2006, which was a \$6.6 million decrease from 2005. The decrease in credit card loan net charge-offs occurred mainly due to the bankruptcy legislation mentioned above. The ratio of net loan charge-offs to total average loans of 3.0% in 2006 and 4.4% in 2005 remained below national loss averages. The Company refrains from national pre-approved mailing techniques which have caused some of the problems experienced by credit card issuers.

Allowance for Loan Losses

The Company has an established process to determine the amount of the allowance for loan losses, which assesses the risks and losses inherent in its portfolio. This process provides an allowance consisting of an allocated and an unallocated component. To determine the allocated component of the allowance, the Company combines estimates of the reserves needed for loans evaluated on an individual basis with estimates of reserves needed for pools of loans with similar risk characteristics.

Loans subject to individual evaluation are defined by the Company as impaired, and generally consist of commercial and commercial real estate loans on non-accrual status or graded substandard and delinquent 60 days or more. These loans are evaluated individually for the impairment of repayment potential and collateral adequacy, and in conjunction with current economic conditions and loss experience, allowances are estimated. Loans not individually evaluated are aggregated and reserves are recorded using a consistent methodology that considers historical loan loss experience by loan type, delinquencies, current economic factors, loan risk ratings and industry concentrations. Although management has allocated a portion of the allowance to specific loan categories, the adequacy of the allowance must be considered in its entirety.

The Company's estimate of the allowance for loan losses and the corresponding provision for loan losses rests upon various judgments and assumptions made by management. Factors that influence these judgments include past loan loss experience, current loan portfolio composition and characteristics, trends in

portfolio risk ratings, levels of non-performing assets, prevailing regional and national economic conditions, and the Company's ongoing examination process including that of its regulators. The Company has internal credit administration and loan review staffs that continuously review loan quality and report the results of their reviews and examinations to the Company's senior management and Board of Directors. Such reviews also assist management in establishing the level of the allowance. The Company's subsidiary banks continue to be subject to examination by the Office of the Comptroller of the Currency (OCC) and examinations are conducted throughout the year targeting various segments of the loan portfolio for review. In addition to the examination of subsidiary banks by the OCC, the parent holding company and its non-bank subsidiaries are examined by the Federal Reserve Bank.

The allowance for loan losses was \$131.7 million and \$128.4 million at December 31, 2006 and 2005, respectively, and was 1.32% and 1.44% of loans outstanding. The decline in the percentage of the allowance to loans outstanding resulted from loan growth compared to the allowance, which grew slightly in 2006. The increase in allowance resulted from bank acquisitions in 2006, which added \$3.7 million to the allowance. Credit quality remained high during 2006, evidenced by a decrease in net loan charge-offs from 2005.

Net charge-offs totaled \$26.1 million in 2006, and decreased \$6.7 million, or 20.4%, compared to \$32.7 million in 2005. The decrease primarily related to decreases in net personal loan charge-offs of \$2.6 million and net credit card loan charge-offs of \$6.6 million, offset by a \$2.2 million increase in net business loan charge-offs. The decrease in personal and credit card net charge-offs was partially a result of the accelerated bankruptcies experienced in 2005 caused by the change in the bankruptcy laws. The higher bankruptcies in the fourth quarter of 2005 led to lower charge-offs in the personal and credit card portfolio in the first two quarters of 2006. Personal and credit card loan net charge-offs were returning to normal levels in the third and fourth quarter of 2006. The increase in business loan net charge-offs was due to lower recoveries in 2006 than in 2005, primarily the result of one large recovery in 2005 of \$2.4 million. The ratio of net charge-offs to average loans outstanding in 2006 was .28% compared to .38% in 2005 and .41% in 2004. The provision for loan losses was \$25.6 million, compared to a provision of \$28.8 million in 2005 and \$30.4 million in 2004.

Approximately 68.5% of total net loan charge-offs during 2006 were related to credit card loans. Net credit card charge-offs decreased to 3.0% of average credit card loans in 2006 compared to 4.4% in 2005. The decrease was a result of higher bankruptcies claimed in 2005 due to the new bankruptcy legislation discussed above. The delinquency rate on credit card loans at year end 2006 was 3.1% compared to 2.8% at year end 2005.

The Company considers the allowance for loan losses of \$131.7 million adequate to cover losses inherent in the loan portfolio at December 31, 2006.

The schedule which follows summarizes the relationship between loan balances and activity in the allowance for loan losses:

| <i>(Dollars in thousands)</i> | Years Ended December 31 | | | | |
|---|--------------------------------|--------------|--------------|--------------|--------------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| Net loans outstanding at end of year^(A) | \$ 9,960,118 | \$ 8,899,183 | \$ 8,305,359 | \$ 8,142,679 | \$ 7,875,944 |
| Average loans outstanding^(A) | \$ 9,421,382 | \$ 8,561,482 | \$ 8,130,113 | \$ 8,009,459 | \$ 7,761,742 |
| Allowance for loan losses: | | | | | |
| Balance at beginning of year | \$ 128,447 | \$ 132,394 | \$ 135,221 | \$ 130,618 | \$ 129,973 |
| Additions to allowance through charges to expense | 25,649 | 28,785 | 30,351 | 40,676 | 34,108 |
| Allowances of acquired companies | 3,688 | | | 500 | |
| Loans charged off: | | | | | |
| Business | 1,343 | 1,083 | 8,047 | 9,297 | 7,324 |
| Real estate construction | 62 | | 7 | | 65 |
| Real estate business | 854 | 827 | 747 | 1,525 | 973 |
| Real estate personal | 119 | 87 | 355 | 660 | 296 |
| Personal banking ^(B) | 11,522 | 13,475 | 12,764 | 13,856 | 11,979 |
| Credit card | 22,104 | 28,263 | 23,682 | 23,689 | 22,305 |
| Overdrafts | 4,940 | 3,485 | 2,551 | 4,830 | 4,943 |
| Total loans charged off | 40,944 | 47,220 | 48,153 | 53,857 | 47,885 |
| Recovery of loans previously charged off: | | | | | |
| Business | 2,166 | 4,099 | 2,405 | 4,192 | 1,283 |
| Real estate construction | | | 3 | 122 | 123 |
| Real estate business | 890 | 330 | 978 | 1,009 | 677 |
| Real estate personal | 27 | 57 | 138 | 196 | 66 |
| Personal banking ^(B) | 5,286 | 4,675 | 5,288 | 5,386 | 5,080 |
| Credit card | 4,250 | 3,851 | 4,249 | 4,202 | 5,164 |
| Overdrafts | 2,271 | 1,476 | 1,914 | 2,177 | 2,029 |

| | | | | | |
|---|-------------------|------------|------------|------------|------------|
| Total recoveries | 14,890 | 14,488 | 14,975 | 17,284 | 14,422 |
| Net loans charged off | 26,054 | 32,732 | 33,178 | 36,573 | 33,463 |
| Balance at end of year | \$ 131,730 | \$ 128,447 | \$ 132,394 | \$ 135,221 | \$ 130,618 |
| Ratio of net charge-offs to average loans outstanding | .28% | .38% | .41% | .46% | .43% |
| Ratio of allowance to loans at end of year | 1.32% | 1.44% | 1.59% | 1.66% | 1.66% |
| Ratio of provision to average loans outstanding | .27% | .34% | .37% | .51% | .44% |

(A) Net of unearned income; before deducting allowance for loan losses

(B) Personal banking loans include consumer, home equity, and student

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

| (in thousands) | 2006 | | 2005 | | 2004 | | 2003 | | 2002 |
|----------------|----------------------|---------------------------|----------------------|---------------------------|----------------------|---------------------------|----------------------|---------------------------|----------------------|
| | Loan Loss | % of Loans to Total Loans | Loan Loss | % of Loans to Total Loans | Loan Loss | % of Loans to Total Loans | Loan Loss | % of Loans to Total Loans | Loan Loss |
| | Allowance Allocation | | Allowance Allocation | | Allowance Allocation | | Allowance Allocation | | Allowance Allocation |
| | \$ 28,529 | 28.7% | \$ 26,211 | 28.4% | \$ 39,312 | 27.0% | \$ 39,411 | 25.8% | \$ 36,359 |
| Construction | 4,605 | 6.6 | 3,375 | 4.8 | 1,420 | 5.2 | 4,717 | 5.3 | 4,731 |
| Business | 19,343 | 21.6 | 19,432 | 21.6 | 15,910 | 21.0 | 20,971 | 23.0 | 20,913 |
| Commercial | 2,243 | 15.0 | 4,815 | 15.3 | 7,620 | 16.1 | 4,423 | 16.4 | 3,871 |
| Banking | 23,690 | 21.5 | 25,364 | 23.2 | 22,652 | 23.6 | 21,793 | 22.8 | 20,343 |
| Other | 39,965 | 6.5 | 35,513 | 6.6 | 28,895 | 6.8 | 26,544 | 6.5 | 23,337 |
| | 3,592 | .1 | 2,739 | .1 | 4,895 | .3 | 4,796 | .2 | 4,498 |
| | 9,763 | | 10,998 | | 11,690 | | 12,566 | | 16,566 |
| | \$ 131,730 | 100.0% | \$ 128,447 | 100.0% | \$ 132,394 | 100.0% | \$ 135,221 | 100.0% | \$ 130,618 |

Risk Elements Of Loan Portfolio

Management reviews the loan portfolio continuously for evidence of problem loans. During the ordinary course of business, management becomes aware of borrowers that may not be able to meet the contractual requirements of loan agreements. Such loans are placed under close supervision with consideration given to placing the loan on non-accrual status, the need for an additional allowance for loan loss, and (if appropriate) partial or full loan charge-off. Loans are placed on non-accrual status when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment. Loans that are 90 days past due as to principal and/or interest payments are generally placed on non-accrual, unless they are both well-secured and in the process of collection, or they are 1-4 family first mortgage loans or consumer loans that are exempt under regulatory rules from being classified as non-accrual. Accrual of interest on consumer installment loans is suspended when any payment of principal or interest is more than 120 days delinquent. Credit card loans and the related accrued interest are charged off when the receivable is more than 180 days past due. After a loan is placed on non-accrual status, any interest previously accrued but not yet collected is reversed against current income. Interest is included in income only as received and only after all previous loan charge-offs have been recovered, so long as management is satisfied there is no impairment of collateral values. The loan is returned to accrual status only when the borrower has brought all past due principal and interest payments current and, in the opinion of management, the borrower has demonstrated the ability to make future payments of principal and interest as scheduled.

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

| <i>(Dollars in thousands)</i> | December 31 | | | | |
|---|--------------------|-----------|-----------|-----------|-----------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| Non-accrual loans: | | | | | |
| Business | \$ 5,808 | \$ 5,916 | \$ 9,547 | \$ 19,162 | \$ 15,224 |
| Real estate construction | 120 | | 685 | 795 | 301 |
| Real estate business | 9,845 | 3,149 | 6,558 | 9,372 | 10,646 |
| Real estate personal | 384 | 261 | 458 | 2,447 | 1,428 |
| Consumer | 551 | 519 | 370 | 747 | 466 |
| Total non-accrual loans | 16,708 | 9,845 | 17,618 | 32,523 | 28,065 |
| Real estate acquired in foreclosure | 1,515 | 1,868 | 1,157 | 1,162 | 1,474 |
| Total non-performing assets | \$ 18,223 | \$ 11,713 | \$ 18,775 | \$ 33,685 | \$ 29,539 |
| Non-performing assets as a percentage of total loans | .18% | .13% | .23% | .41% | .38% |
| Non-performing assets as a percentage of total assets | .12% | .08% | .13% | .24% | .22% |
| Past due 90 days and still accruing interest: | | | | | |
| Business | \$ 2,814 | \$ 1,026 | \$ 357 | \$ 817 | \$ 4,777 |
| Real estate construction | 593 | | | 38 | |
| Real estate business | 1,336 | 1,075 | 520 | 3,934 | 3,734 |
| Real estate personal | 3,994 | 2,998 | 3,165 | 5,750 | 4,727 |
| Consumer | 1,255 | 1,069 | 916 | 1,079 | 1,282 |
| Home equity | 659 | 429 | 317 | 218 | 91 |
| Student | 1 | 74 | 199 | 1,252 | 27 |
| Credit card | 9,724 | 7,417 | 7,311 | 7,735 | 7,734 |
| Overdrafts | | | 282 | 78 | 56 |
| Total past due 90 days and still accruing interest | \$ 20,376 | \$ 14,088 | \$ 13,067 | \$ 20,901 | \$ 22,428 |

The effect on interest income in 2006 of loans on non-accrual status at year end is presented below:

(In thousands)

| | |
|---|----------|
| Gross amount of interest that would have been recorded at original rate | \$ 1,835 |
| Interest that was reflected in income | 459 |
| | |
| Interest income not recognized | \$ 1,376 |

Total non-accrual loans at year end 2006 increased \$6.9 million over 2005 levels. This increase resulted mainly from an increase of \$6.7 million in business real estate non-accrual loans. The increase in business real estate non-accrual loans was mainly related to two borrowers, which were placed on non-accrual status in June and August of 2006. Business non-accrual loans decreased slightly in 2006, mainly due to a decline of \$1.5 million in lease-related non-accrual loans, partly offset by \$1.6 million in other business non-accrual loans acquired in the 2006 bank acquisitions. Real estate that was acquired in foreclosure, which is comprised mainly of small residential properties, decreased \$353 thousand from year end 2005. Total non-performing assets remain low compared to the Company's peers, with the non-performing loans to total loans ratio at .17%. Loans past due 90 days and still accruing interest increased \$6.3 million at year end 2006 compared to 2005. This increase was mainly due to higher delinquencies in business, personal real estate and credit card loans.

In addition to the non-accrual 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. These loans are primarily classified as substandard for regulatory purposes 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 \$41.9 million at December 31, 2006

compared with \$52.8 million at December 31, 2005. The lower balance at December 31, 2006 resulted primarily from customer payments or improvements in assigned credit grade.

Within the loan portfolio, certain types of loans are considered at higher risk of loss due to their terms, location, or special conditions. Certain mortgage products have contractual features that could increase credit exposure in a market of declining real estate prices, when interest rates are steadily increasing, or when a geographic area experiences an economic downturn. Loans might be considered at higher risk when 1) loan terms require a minimum monthly payment that covers only interest, or 2) loan-to-collateral value (LTV) ratios are above 80%, with no private mortgage insurance. Out of the Company's \$1.4 billion personal real estate portfolio, approximately 2.3% of the current outstandings are structured with interest only payments. The following table presents information about personal real estate loans with these risk characteristics.

| <i>(Dollars in thousands)</i> | Principal Outstanding at December 31 2006 | % of Loan Portfolio |
|---|--|------------------------|
| Loans with interest only payments | \$ 32,175 | 2.3% |
| Loans with no insurance and LTV: | | |
| Between 80% and 90% | 84,588 | 5.9 |
| Between 90% and 100% | 66,351 | 4.7 |
| Over 100% | 6,953 | .5 |
| Over 80% with no insurance | 157,892 | 11.1 |
| Total loan portfolio from which above loans were identified | 1,428,475 | |

Within the personal loan portfolio, another popular product, generally collateralized by real estate, is the anytime line (ATL) home equity line. Most ATL's (92.2%) are written with terms requiring interest only monthly payments. The following table presents risk information about ATL home equity loans.

| Principal Outstanding at | New Lines | Unused Portion of ATL Lines at | Balances |
|--------------------------------|-----------|---|----------|
|--------------------------------|-----------|---|----------|

| | December 31 | | Originated During | | December 31 | | Over 30 Days Past Due | |
|---|-------------|-------|----------------------|-------|-------------|--------|--------------------------------|-----|
| <i>(Dollars in thousands)</i> | 2006 | * | 2006 | * | 2006 | * | | * |
| Loans with interest only payments | \$ 407,539 | 92.2% | \$ 175,226 | 39.7% | \$ 621,977 | 140.8% | \$ 2,832 | .6% |
| Loans with LTV: | | | | | | | | |
| Between 80% and 90% | 55,367 | 12.5 | 18,311 | 4.1 | 47,559 | 10.8 | 468 | .1 |
| Between 90% and 100% | 26,830 | 6.1 | 14,141 | 3.2 | 17,746 | 4.0 | 112 | |
| Over 100% | | | | | | | | |
| Over 80% | 82,197 | 18.6 | 32,452 | 7.3 | 65,305 | 14.8 | 580 | .1 |
| Total loan portfolio from which above loans were identified | 441,851 | | 201,864 | | 646,700 | | | |

* Percentage of total principal outstanding ATL home equity loans of \$441,851,000 at December 31, 2006

Management does not believe these loans collateralized by real estate represent any unusual concentrations of risk, as evidenced by low net charge-offs in 2006 of \$92 thousand in personal real estate loans and \$135 thousand in ATL loan balances. 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 majority of the personal real estate portfolio (95.7%) consists of loans written within the Company's familiar branch network territories of Missouri, Kansas, and Illinois. Customer's credit scoring requirements also play an important part in credit line approvals and they can be increased as another means of mitigating risk when considering high LTV agreements.

Additionally, the Company uses automated credit scoring processes for underwriting such products as consumer, ATL, bank card, and personal real estate loans. Loan underwritings which do not meet certain credit scoring levels are manually reviewed for compensating factors and approved only by senior lending employees. The Company does not make a practice of originating sub-prime loans and does not offer sub-prime lending products.

The Company originates certain loans which are categorized as held for sale. These consist of student loans and certain fixed rate residential real estate loans, which were \$263.8 million and \$14.8 million, respectively, at December 31, 2006.

There were no loan concentrations of multiple borrowers in similar activities at December 31, 2006, which exceeded 10% of total loans. The Company's aggregate legal lending limit to any single or related borrowing entities is in excess of \$182 million. The largest exposures, consisting of either outstanding balances or available lines of credit, generally do not exceed \$70 million.

Investment Securities Analysis

Investment securities are comprised of securities which are available for sale, non-marketable, and held for trading. During 2006, total investment securities decreased \$297.3 million to \$3.5 billion (excluding unrealized gains/losses) compared to \$3.8 billion at the previous year end. The decrease was due to lower purchases of securities during the year, as proceeds from maturities were mainly re-invested in new loan growth. During 2006, securities of \$888.1 million were purchased, excluding those acquired in bank acquisitions, and were comprised mainly of \$313.5 million in state and municipal obligations and \$409.8 million in mortgage and asset-backed securities. Maturities and paydowns amounted to \$1.1 billion. Proceeds from sales of securities, consisting mainly of mortgage and asset-backed securities, were \$170.4 million. The average tax equivalent yield on total investment securities was 4.41% in 2006 and 4.05% in 2005.

At December 31, 2006, the fair value of available for sale securities was \$3.4 billion, and included a net unrealized gain in fair value of \$17.2 million, compared to a net loss of \$6.3 million at December 31, 2005. The amount of the related after tax unrealized gain reported in stockholders' equity was \$10.7 million at year end 2006. The unrealized gain in fair value was the result of unrealized gains of \$50.3 million on marketable equity securities held by Commerce Bancshares, Inc., the parent holding company (the Parent), partly offset by unrealized losses of \$37.0 million in the bank portfolios. Most of the unrealized loss in fair value in the bank portfolios related to mortgage and asset-backed securities and federal agency securities. The fair value of the available for sale portfolio will vary according to changes in market interest rates and the mix and duration of investments in the portfolio. Available for sale securities which mature during the next 12 months total approximately \$652 million, and management expects these proceeds to meet the expected liquidity needs of the Company.

Investment securities at year end for the past two years are shown below:

| <i>(In thousands)</i> | December 31 | |
|---|---------------------|--------------|
| | 2006 | 2005 |
| Amortized Cost | | |
| Available for sale: | | |
| U.S. government and federal agency obligations* | \$ 480,343 | \$ 845,612 |
| State and municipal obligations | 593,816 | 251,803 |
| Mortgage-backed securities | 1,809,741 | 1,662,454 |
| Other asset-backed securities | 358,114 | 691,877 |
| Other debt securities | 36,528 | 40,919 |
| Equity securities | 119,723 | 181,499 |
| | | |
| Total available for sale | 3,398,265 | 3,674,164 |
| | | |
| Non-marketable: | | |
| Debt securities | 17,225 | 16,566 |
| Equity securities | 56,982 | 60,755 |
| | | |
| Total non-marketable | 74,207 | 77,321 |
| | | |
| Trading securities | 6,676 | 24,959 |
| | | |
| Total | \$ 3,479,148 | \$ 3,776,444 |
| | | |
| Fair Value | | |
| Available for sale: | | |
| U.S. government and federal agency obligations* | \$ 474,218 | \$ 834,657 |
| State and municipal obligations | 594,824 | 249,018 |
| Mortgage-backed securities | 1,782,443 | 1,631,675 |
| Other asset-backed securities | 354,465 | 684,724 |
| Other debt securities | 36,009 | 40,017 |
| Equity securities | 173,481 | 227,810 |
| | | |
| Total available for sale | 3,415,440 | 3,667,901 |
| | | |
| Non-marketable: | | |

| | | |
|----------------------|---------------------|--------------|
| Debt securities | 17,225 | 16,566 |
| Equity securities | 56,982 | 60,755 |
| | | |
| Total non-marketable | 74,207 | 77,321 |
| | | |
| Trading securities | 6,676 | 24,959 |
| | | |
| Total | \$ 3,496,323 | \$ 3,770,181 |

** This category includes obligations of government sponsored enterprises, such as FNMA and FHLMC, which are not backed by the full faith and credit of the United States government. Such obligations are separately disclosed in Note 4 on Investment Securities in the consolidated financial statements.*

Other available for sale debt securities, as shown in the table above, include corporate bonds, notes and commercial paper. Available for sale equity securities are comprised of short-term investments in money market mutual funds and publicly traded stock. These are primarily held by the Parent and the fair values of these investments at December 31, 2006 were \$60.0 million and \$107.8 million, respectively.

Non-marketable securities, which totaled \$74.2 million at December 31, 2006, included \$35.6 million in Federal Reserve Bank stock and Federal Home Loan Bank (Des Moines) stock held by bank subsidiaries in accordance with debt and regulatory requirements. These are restricted securities which, lacking a market, are carried at cost. Other non-marketable securities also include private equity and venture capital securities which are carried at estimated fair value.

The Company engages in private equity and venture capital activities through direct private equity investments and in three private equity/venture capital subsidiaries. CFB Venture Fund I, Inc., a wholly-owned subsidiary, held \$5.6 million in private equity investments at December 31, 2006. Another subsidiary,

CFB Venture Fund II, L.P., is a limited partnership venture fund with 47% outside ownership. This partnership held venture capital investments of \$5.3 million at year end 2006 and is fully funded. A new series partnership, CFB Venture Fund, L.P., was organized in 2005 with approximately 20% outside ownership. Two new funds are active in this partnership, which held combined investments of \$25.8 million at December 31, 2006. The Company plans to fund an additional \$15.0 million to the new partnership in the future. In addition to investments held by its private equity/venture capital subsidiaries, the Company has direct investments in several private equity concerns, which totaled \$7.5 million at year end 2006. Most of the venture capital and private equity investments are not readily marketable. While the nature of these investments carries a higher degree of risk than the normal lending portfolio, this risk is mitigated by the overall size of the investments and oversight provided by management, which believes the potential for long-term gains in these investments outweighs the potential risks.

A summary of maturities by category of investment securities and the weighted average yield for each range of maturities as of December 31, 2006, is presented in Note 4 on Investment Securities in the consolidated financial statements. At December 31, 2006, mortgage and asset-backed securities comprised 61% of the investment portfolio with a weighted average yield of 4.59% and an estimated average maturity of 2.5 years; state and municipal obligations comprised 17% with a weighted average tax equivalent yield of 3.73% and an estimated average maturity of 5.4 years; and U.S. government and federal agency obligations comprised 14% with a weighted average yield of 3.66% and an estimated average maturity of 1.4 years.

Deposits and Borrowings

Deposits are the primary funding source for the Company's banks, and are acquired from a broad base of local markets, including both individual and corporate customers. Total deposits were \$11.7 billion at December 31, 2006, compared to \$10.9 billion last year, reflecting an increase of \$893.0 million, or 8.2%. Average deposits grew by \$594.7 million, or 5.7%, in 2006 compared to 2005 with most of this growth centered around certificates of deposit. The Federal Reserve permits certain reporting reclassifications between deposit categories. Excluding the effects of these reclassifications, overall average non-interest bearing demand deposits grew by \$7.5 million, or less than 1%, with most of the growth coming from commercial customers. The Company's premium money market deposits grew on average by \$25.7 million, or 1.1%, in 2006 compared to 2005; however, other interest-bearing transaction and savings accounts declined by \$84.1 million. Certificates of deposit with balances under \$100,000 grew on average by \$340.5 million, or 19.6%, while certificates of deposit over \$100,000 grew \$305.1 million, or 31.0%. The previously mentioned bank acquisitions added approximately \$166.3 million in new average deposit balances in 2006.

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

| | December 31 | |
|---|--------------------|-------------|
| | 2006 | 2005 |
| Non-interest bearing demand | 11.2% | 12.9% |
| Savings, interest checking and money market | 58.6 | 59.8 |
| Time open and C.D. s of less than \$100,000 | 19.6 | 16.9 |
| Time open and C.D. s of \$100,000 and over | 10.6 | 10.4 |
| Total deposits | 100.0% | 100.0% |

Core deposits (defined as all non-interest and interest bearing deposits, excluding short-term C.D. s of \$100,000 and over) supported 77% of average earning assets in 2006 and 76% in 2005. Average balances by major deposit category for the last six years appear at the end of this discussion. A maturity schedule of time deposits outstanding at December 31, 2006 is included in Note 7 on Deposits in the consolidated financial statements.

The Company s primary borrowings consist of federal funds purchased and securities sold under agreements to repurchase. Balances in these accounts can fluctuate significantly on a day-to-day basis, and generally have overnight maturities. Balances outstanding at year end 2006 were \$1.8 billion, a \$444.9 million increase over \$1.3 billion outstanding at year end 2005. On an average basis, federal funds

purchased declined \$495.9 million in 2006 compared to 2005, which was partly offset by an increase of \$341.5 million in repurchase agreement deposits. The decline in average federal funds purchased resulted mainly from the added liquidity generated by the reduction in the investment securities portfolio and the purchase of a \$500.0 million structured repurchase agreement in the third quarter of 2006. The structured repurchase agreement has a term of four years with a LIBOR-based floating interest rate and an embedded floor that will provide further reductions to interest costs if rates drop below 4.25%. The average rate paid on federal funds purchased and repurchase agreements was 4.82% during 2006 and 3.03% during 2005.

Long-term debt includes borrowings by subsidiary banks from the Federal Home Loan Bank (FHLB). These advances declined \$223.6 million during the year to \$28.2 million outstanding at December 31, 2006 due to maturities of advances which were not renewed. The average rate paid on FHLB advances was 4.88% during 2006 and 3.40% during 2005. The weighted average year end rate on outstanding FHLB advances at December 31, 2006 was 3.86%. Other long-term debt also includes \$10.9 million borrowed from insurance companies by a venture capital subsidiary in order to fund certain investing activity as a Missouri Certified Capital Company.

Liquidity and Capital Resources

Liquidity Management

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

A portfolio of liquid assets including marketable investment securities and overnight investments,

A large customer deposit base and limited exposure to large, volatile certificates of deposit,

Lower long-term borrowings that might place a demand on Company cash flow,

Relatively low loan to deposit ratio promoting strong liquidity,

Excellent debt ratings from both Standard & Poor's and Moody's national rating services, and

Available borrowing capacity from outside sources.

The Company's most liquid assets include available for sale marketable investment securities, federal funds sold, and securities purchased under agreements to resell (resale agreements). At December 31, 2006 and 2005, such assets were as follows:

| <i>(In thousands)</i> | 2006 | 2005 |
|--|---------------------|--------------|
| Available for sale investment securities | \$ 3,415,440 | \$ 3,667,901 |
| Federal funds sold and resale agreements | 527,816 | 128,862 |
| Total | \$ 3,943,256 | \$ 3,796,763 |

Federal funds sold and resale agreements normally have overnight maturities and are used for general daily liquidity purposes. The Company's available for sale investment portfolio has maturities of approximately \$652 million which come due during 2007 and offers substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. Furthermore, in the normal course of business the Company pledges portions of its investment securities portfolio to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowing capacity at the Federal Reserve. Total pledged investment securities for these purposes comprised 61% of the total investment portfolio, leaving approximately \$1.4 billion of unpledged securities.

Additionally, the Company maintains a large base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At December 31, 2006, such deposits totaled \$8.2 billion and represented 70% of the Company's total deposits. At December 31, 2005 these deposits totaled \$7.9 billion. These core deposits are normally less volatile, often with customer relationships tied to other products offered by the Company promoting long lasting relationships and stable funding sources.

Time open and certificates of deposit of \$100,000 or greater totaled \$1.3 billion and \$1.1 billion at December 31, 2006 and 2005, respectively. These deposits are normally considered more volatile and higher costing, but comprised just 10.7% and 10.4% of total deposits at December 31, 2006 and 2005, respectively.

At December 31, 2006 and 2005, the Company's borrowings were comprised of federal funds purchased, securities sold under agreements to repurchase, and longer-term debt as follows:

| <i>(In thousands)</i> | 2006 | 2005 |
|--|---------------------|--------------|
| Federal funds purchased | \$ 715,475 | \$ 849,504 |
| Securities sold under agreements to repurchase | 1,055,807 | 476,923 |
| Other borrowings | 53,934 | 269,390 |
| Total | \$ 1,825,216 | \$ 1,595,817 |

Federal funds purchased are funds generally borrowed overnight and are obtained mainly from upstream correspondent banks to assist in balancing overall bank liquidity needs. Securities sold under agreements to repurchase are comprised mainly of non-insured customer funds, normally with maturities of 90 days or less, and the Company pledges portions of its own investment portfolio to secure these deposits. These funds are offered to customers wishing to earn interest in highly liquid balances and are used by the Company as a funding source considered to be stable, but short-term in nature. The increase in securities sold under agreements to repurchase in 2006 was partly due to a \$500.0 million structured repurchase agreement purchased in the third quarter of 2006.

The Company's other borrowings are comprised mainly of advances from the FHLB, debentures funded by trust preferred securities, and debt related to the Company's venture capital business. At December 31, 2006 and 2005, debt from the FHLB amounted to \$28.2 million and \$251.8 million, respectively. The decline in FHLB borrowings during 2006 was due to repayments on maturing debt. All the FHLB debt outstanding at year end 2006 has fixed interest rates, and \$17.9 million mature in 2007. The debt maturing in 2007 may be refinanced or may be repaid with funds generated by maturities of loans or investment securities, or by deposit growth or other types of borrowings. The overall long-term debt position of the Company is small relative to the Company's overall liability position.

In addition to the sources and uses of funds noted above, the Company had an average loans to deposits ratio of 85% at December 31, 2006, which is considered in the banking industry to be a conservative measure of good liquidity. Also, the Company receives outside ratings from both Standard & Poor's and Moody's on both the consolidated company and its lead bank, Commerce Bank, N.A. (Missouri). These ratings are as follows:

| | Standard & Poor's | Moody's |
|----------------------------------|-------------------|---------|
| Commerce Bancshares, Inc. | | |
| Bank holding company rating | A-1 | Aa3 |
| Short term/commercial paper | A-1 | P-1 |
| Commerce Bank, N. A. | | |

| | | |
|----------------------------|----|-----|
| Counterparty credit rating | A+ | |
| Certificate of deposit | A+ | Aa3 |

The Company considers these ratings to be indications of a sound capital base and good liquidity, and believes that these ratings would enable its commercial paper to be readily marketable should the need arise. No commercial paper was outstanding over the past three years. The Company's excellent credit standing has resulted in lead bank ratings which are significantly higher than those of many of its peers in the community banking arena.

In addition to the sources of liquidity as noted above, the Company has temporary borrowing capacity at the Federal Reserve discount window of \$580.2 million, for which it has pledged \$298.5 million in loans and \$359.7 million in investment securities. Also, because of its lack of significant long-term debt, the Company believes that, through its Capital Markets Group, it could generate additional liquidity from sources such as jumbo certificates of deposit or privately-placed corporate notes.

The cash flows from the operating, investing and financing activities of the Company resulted in a net increase in cash and cash equivalents of \$480.2 million in 2006, as reported in the consolidated statements of cash flows on page 56 of this report. Operating activities, consisting mainly of net income adjusted for certain non-cash items, provided cash flow of \$451.4 million and has historically been a stable source of funds. Investing activities, consisting mainly of purchases and maturities of available for sale investment securities and changes in the level of the Company's loan portfolio, used total cash of \$389.4 million in 2006. Investing activities are somewhat unique to financial institutions in that, while large sums of cash flow are normally used to fund growth in investment securities, loans, or other bank assets, they are normally dependent on financing activities described below.

Financing activities provided total cash of \$418.3 million, resulting from a \$417.4 million increase in borrowings of federal funds purchased and securities sold under agreements to repurchase and a \$444.5 million increase in deposits. Partly offsetting these cash inflows were repayments on FHLB advances of \$250.3 million, treasury stock purchases of \$135.0 million, and cash dividend payments of \$65.8 million. Future short-term liquidity needs for daily operations are not expected to vary significantly and the Company maintains adequate liquidity to meet these cash flows. The Company's sound equity base, along with its low debt level, common and preferred stock availability, and excellent debt ratings, provide several alternatives for future financing. Future acquisitions may utilize partial funding through one or more of these options.

Cash used for treasury stock purchases, net of cash received in connection with stock programs, and dividend payments were as follows:

| <i>(In millions)</i> | 2006 | 2005 | 2004 |
|--|-----------------|----------|----------|
| Purchases of treasury stock | \$ 135.0 | \$ 234.5 | \$ 173.8 |
| Exercise of stock options and sales to affiliate non- employee directors | (7.3) | (18.4) | (15.3) |
| Cash dividends | 65.8 | 63.4 | 61.1 |
| Total | \$ 193.5 | \$ 279.5 | \$ 219.6 |

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

| <i>(In millions)</i> | 2006 | 2005 | 2004 |
|--------------------------------------|-----------------|----------|----------|
| Dividends received from subsidiaries | \$ 140.5 | \$ 220.0 | \$ 253.3 |
| Management fees | 37.7 | 33.0 | 33.0 |
| Total | \$ 178.2 | \$ 253.0 | \$ 286.3 |

These sources of funds are used mainly to purchase treasury stock and pay cash dividends on outstanding common stock as noted above. At December 31, 2006, the Parent had no third party short-term borrowings or long-term debt and maintained \$166.2 million in available for sale investment securities. This portfolio is very liquid, consisting of \$57.9 million in money market mutual funds, \$81.1 million in publicly traded common stock, and \$26.8 million in FMNA and SLMA preferred stock.

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

Capital Management

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

| | 2006 | 2005 | 2004 | Well-Capitalized Regulatory Guidelines |
|-----------------------------------|--------|--------|--------|--|
| Risk-based capital ratios: | | | | |
| Tier I capital | 11.25% | 12.21% | 12.21% | 6.00% |
| Total capital | 12.56 | 13.63 | 13.57 | 10.00 |
| Leverage ratio | 9.05 | 9.43 | 9.60 | 5.00 |
| Common equity/assets | 9.68 | 9.87 | 10.25 | |
| Dividend payout ratio | 30.19 | 28.92 | 28.26 | |

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

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|---------------------------------------|--------------|--------------|--------------|
| Regulatory risk-based capital: | | | |
| Tier I capital | \$ 1,345,378 | \$ 1,295,898 | \$ 1,342,275 |
| Tier II capital | 157,008 | 150,510 | 149,734 |
| Total capital | 1,502,386 | 1,446,408 | 1,492,009 |
| Total risk-weighted assets | 11,959,757 | 10,611,322 | 10,993,542 |

In February 2007, the Board of Directors authorized the Company to purchase additional shares of common stock under its repurchase program, which brought the total purchase authorization to 4,000,000 shares. The Company has routinely used these shares to fund the Company's annual 5% stock dividend and various stock compensation programs. During 2006, approximately 2,705,000 shares were acquired under a prior Board authorization at an average price of \$49.89.

The Company's common stock dividend policy reflects its earnings outlook, desired payout ratios, the need to maintain adequate capital levels and alternative investment options. Per share cash dividends paid by the Company increased 7.1% in 2006 compared with 2005.

Commitments, Contractual Obligations, and Off-Balance Sheet Arrangements

Various commitments and contingent liabilities arise in the normal course of business, which are not required to be recorded on the balance sheet. The most significant of these are loan commitments totaling \$7.5 billion (including approximately \$3.7 billion in unused approved credit card lines) and standby letters of credit totaling \$452.2 million at December 31, 2006. The Company has various other financial instruments with off-balance sheet risk, such as commercial letters of credit and commitments to purchase and sell when-issued securities. Since many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. Management does not anticipate any material losses arising from commitments and contingent liabilities and believes there are no material commitments to extend credit that represent risks of an unusual nature.

A table summarizing contractual cash obligations of the Company at December 31, 2006 and the expected timing of these payments follows:

Payments Due by Period

| <i>(In thousands)</i> | In One Year or Less | After One Year Through Three Years | After Three Years Through Five Years | After Five Years | Total |
|--|------------------------|--|---|------------------------|---------------------|
| Long-term debt obligations, including | | | | | |
| structured repurchase agreements* | \$ 21,302 | \$ 8,248 | \$ 501,839 | \$ 22,545 | \$ 553,934 |
| Operating lease obligations | 5,625 | 9,024 | 5,953 | 25,137 | 45,739 |
| Purchase obligations | 22,950 | 7,903 | 518 | | 31,371 |
| Time open and C.D. s * | 2,934,454 | 551,971 | 65,846 | 1,136 | 3,553,407 |
| Total | \$ 2,984,331 | \$ 577,146 | \$ 574,156 | \$ 48,818 | \$ 4,184,451 |

* Includes principal payments only.

The Company has investments in several low-income housing partnerships within the area served by the banking affiliates. At December 31, 2006, these investments totaled \$2.9 million and were recorded as other assets in the Company's consolidated balance sheet. These partnerships supply funds for the construction and operation of apartment complexes that provide affordable housing to that segment of the population with lower family income. If these developments successfully attract a specified percentage of residents falling in that lower income range, state and/or federal income tax credits are made available to the partners. The tax credits are normally recognized over ten years, and they play an important part in the anticipated yield from these investments. In order to continue receiving the tax credits each year over the life of the partnership, the low-income residency targets must be maintained. Under the terms of the partnership agreements, the Company has a commitment to fund a specified amount that will be due in installments over the life of the agreements, which ranges from 10 to 15 years. These unfunded commitments are recorded as liabilities on the Company's consolidated balance sheet, and aggregated \$2.1 million at December 31, 2006.

The Company periodically purchases various state tax credits arising from third-party property redevelopment. Most of the tax credits are resold to third parties, although some may be retained for use by the Company. During 2006, purchases and sales of tax credits amounted to \$31.1 million and \$32.6 million, respectively, generating combined gains on sales and tax savings of \$1.7 million. At December 31, 2006, the Company had outstanding purchase commitments totaling \$77.1 million.

The Parent has investments in several private equity concerns which are classified as non-marketable securities in the Company's consolidated balance sheet. Under the terms of the agreements with six of these concerns, the Parent has unfunded commitments outstanding of \$2.4 million at December 31, 2006. The Parent also has commitments to fund \$15.0 million to venture capital subsidiaries over the next several years.

Interest Rate Sensitivity

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

The Company's main interest rate measurement tool, income simulations, projects net interest income under various rate change scenarios in order to quantify the magnitude and timing of potential rate-related changes. Income simulations are able to capture option risks within the balance sheet where expected cash flows may be altered under various rate environments. Modeled rate movements include shocks, ramps and twists. Shocks are intended to capture interest rate risk under extreme conditions by immediately shifting

rates up and down, while ramps measure the impact of gradual changes and twists measure yield curve risk. The size of the balance sheet is assumed to remain constant so that results are not influenced by growth predictions. The table below shows the expected effect that gradual basis point shifts in the LIBOR/swap curve over a twelve month period would have on the Company's net interest income, given a static balance sheet.

| <i>(Dollars in millions)</i> | December 31, 2006 | | September 30, 2006 | | December 31, 2005 | |
|------------------------------|--------------------------------|---|------------------------|--------------------|------------------------|--------------------|
| | Increase (Decrease) | % of Net Interest Income | Increase (Decrease) | Interest Income | Increase (Decrease) | Interest Income |
| 200 basis points rising | \$ (4.3) | (.80)% | \$ (4.6) | (.86)% | \$ (5.8) | (1.14)% |
| 100 basis points rising | (.9) | (.17) | (1.3) | (.24) | (1.9) | (.37) |
| 100 basis points falling | (.6) | (.10) | (.5) | (.09) | (1.7) | (.33) |
| 200 basis points falling | (.7) | (.13) | (1.5) | (.29) | (4.7) | (.93) |

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

The Company also uses market value analyses to help identify longer-term risks that may reside on the balance sheet. This is considered a secondary risk measurement tool by management. The Company measures the market value of equity as the net present value of all asset and liability cash flows discounted along the current LIBOR/swap curve plus appropriate market risk spreads. It is the change in the market value of equity under different rate environments, or effective duration, that gives insight into the magnitude of risk to future earnings due to rate changes. Market value analyses also help management understand the price sensitivity of non-marketable bank products under different rate environments.

The Company's modeling of interest rate risk continues to show the Company as mildly susceptible to lower net interest income in a rising rate environment. However, this risk has been reduced over the last four quarters of 2006. At December 31, 2006, the Company calculated that a gradual increase in rates of 100 basis points would reduce net interest income by \$900 thousand, or .17%, compared with a reduction of \$1.9 million calculated at December 31, 2005. Also, a 200 basis point gradual rise in rates calculated at December 31, 2006 would reduce net interest income by \$4.3 million, or .80%, down from a reduction of \$5.8 million last year. This result is mainly due to assumptions in the models which immediately reprice the Company's interest bearing demand and money market accounts and overnight borrowings.

The continued improvement in the overall interest rate risk is the result of several changes in 2006. These changes included growth in average loans of \$859.9 million, mainly variably-priced construction, commercial real estate, residential mortgage and credit card loans. In addition, average available for sale investment securities declined \$776.8 million during 2006, while certificates of deposit increased by \$645.6 million, which both have mostly fixed rates. Also, the average balance of short-term borrowings, mostly federal funds purchased, declined by \$154.3 million in 2006, thereby limiting the expense impact of rising short-term interest rates. The Company remains somewhat

susceptible to interest rate risk from falling rates because of 2006 growth in both certificates of deposit with fixed interest costs, and the loan portfolio with its ability to re-price downward. The current size and characteristics of the investment portfolio help to provide a natural hedge in limiting this risk. Additionally, the Company added a structured repurchase agreement, containing an embedded floor to hedge against a reduction in rates, which averaged \$198.6 million during 2006. The Company has attempted to structure its overall interest risk profile, as demonstrated above, such that over the next 24 months, the impact of rising or falling rates of 100 basis points would have a minimal effect on the Company.

The Company's balance sheet remains well-diversified with moderate interest rate risk and is well-positioned for future growth. The use of derivative products is limited and the deposit base is strong and

stable. The loan to deposit ratio is still at relatively low levels, which should present the Company with opportunities to fund future loan growth at reasonable costs.

Derivative Financial Instruments

The Company maintains an overall interest rate risk management strategy that permits the use of derivative instruments to modify exposure to interest rate risk. The Company's interest rate risk management strategy includes the ability to modify the re-pricing characteristics of certain assets and liabilities so that changes in interest rates do not adversely affect the net interest margin and cash flows. Interest rate swaps are used on a limited basis as part of this strategy. As of December 31, 2006, the Company had entered into two interest rate swaps with a notional amount of \$14.4 million which are designated as fair value hedges of certain fixed rate loans. The Company also sells swap contracts to customers who wish to modify their interest rate sensitivity. The Company offsets the interest rate risk of these swaps by purchasing matching contracts with offsetting pay/receive rates from other financial institutions. Because of the matching terms of the offsetting contracts, the net effect of changes in the fair value of the paired swaps is minimal. The notional amount of these types of swaps at December 31, 2006 was \$167.1 million.

The Company enters into foreign exchange derivative instruments as an accommodation to customers and offsets the related foreign exchange risk by entering into offsetting third-party forward contracts with approved reputable counterparties. In addition, the Company takes proprietary positions in such contracts based on market expectations. This trading activity is managed within a policy of specific controls and limits. Most of the foreign exchange contracts outstanding at December 31, 2006 mature within 90 days, and the longest period to maturity is 9 months.

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

The Company is exposed to credit risk in the event of nonperformance by counterparties to financial instruments. The Company controls the credit risk of its financial contracts through credit approvals, limits and monitoring procedures. Because the Company generally enters into transactions only with high quality counterparties, there have been no losses associated with counterparty nonperformance on derivative financial instruments. The amount of credit risk associated with these instruments is limited to the cost of replacing a contract in a gain position, on which a counterparty may default.

The following table summarizes the notional amounts and estimated fair values of the Company's derivative instruments at December 31, 2006 and 2005. Notional amount, along with the other terms of the derivative, is used to determine the amounts to be exchanged between the counterparties. Because the notional amount does not represent amounts exchanged by the parties, it is not a measure of loss exposure related to the use of derivatives nor of exposure to liquidity risk. Positive fair values are recorded in other assets and negative fair values are recorded in other liabilities in the consolidated balance sheets.

| | Notional Amount | 2006 | | Notional Amount | 2005 | |
|--------------------------|--------------------|---------------------------|---------------------------|--------------------|---------------------------|---------------------------|
| | | Positive Fair Value | Negative Fair Value | | Positive Fair Value | Negative Fair Value |
| <i>(In thousands)</i> | | | | | | |
| Interest rate contracts: | | | | | | |
| Swap contracts | \$ 181,464 | \$ 1,185 | \$ (2,003) | \$ 162,698 | \$ 798 | \$ (1,782) |

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| | | | | | | |
|--------------------------------------|-------------------|-----------------|-------------------|------------|--------|------------|
| Option contracts | 6,970 | 10 | (10) | 6,970 | 6 | (6) |
| Foreign exchange contracts: | | | | | | |
| Forward contracts | 16,117 | 29 | (20) | 14,184 | 159 | (77) |
| Option contracts | 2,670 | 16 | (16) | 2,560 | 3 | (3) |
| Mortgage loan commitments | 11,529 | | (43) | 5,353 | 12 | |
| Mortgage loan forward sale contracts | 21,269 | 60 | (14) | 9,251 | 7 | (18) |
| Total at December 31 | \$ 240,019 | \$ 1,300 | \$ (2,106) | \$ 201,016 | \$ 985 | \$ (1,886) |

Operating Segments

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

The Company uses a funds transfer pricing method to value funds used (e.g., loans, fixed assets, cash, etc.) and funds provided (deposits, borrowings, and equity) by the business segments and their components. This process assigns a specific value to each new source or use of funds with a maturity, based on current LIBOR interest rates, thus determining an interest spread at the time of the transaction. Non-maturity assets and liabilities are assigned to LIBOR based funding pools. This method helps to provide a more accurate means of valuing fund sources and uses in a varying interest rate environment. The Company also assigns loan charge-offs and recoveries directly to each operating segment instead of allocating a portion of actual loan loss provision to the segments. The operating segments also include a number of allocations of income and expense from various support and overhead centers within the Company. Management periodically makes changes to the method of assigning costs and income to its business segments to better reflect operating results. If appropriate, these changes are reflected in the prior year information in the table below.

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

| <i>(Dollars in thousands)</i> | 2006 | 2005 | 2004 | % Change | |
|-----------------------------------|-------------------|------------|------------|-----------------|--------|
| | | | | 06- 05 | 05- 04 |
| Consumer | \$ 244,490 | \$ 193,253 | \$ 138,644 | 26.5% | 39.4% |
| Commercial | 147,625 | 133,937 | 115,345 | 10.2 | 16.1 |
| Money management | 34,540 | 31,716 | 28,671 | 8.9 | 10.6 |
| | | | | | |
| Total segments | 426,655 | 358,906 | 282,660 | 18.9 | 27.0 |
| | | | | | |
| Other/elimination | (102,909) | (41,312) | 28,482 | NM | NM |
| | | | | | |
| Income before income taxes | \$ 323,746 | \$ 317,594 | \$ 311,142 | 1.9% | 2.1% |

Consumer

The Consumer segment includes the retail branch network, consumer finance, bankcard, student loans and discount brokerage services. Pre-tax income for 2006 was \$244.5 million, an increase of \$51.2 million, or 26.5%, over 2005. This increase was due to an increase of \$42.9 million in net interest income, coupled with a \$9.2 million increase in non-interest income. The increase in net interest income resulted mainly from an \$85.2 million increase in net allocated funding credits assigned to the Consumer segment's deposit and loan portfolios, and higher loan interest income of \$43.2 million, which more than offset growth of \$85.2 million in deposit interest expense. The rising interest rate environment assigns a greater value, and thus income, to customer deposits in this segment. The increase in non-interest income resulted mainly from higher overdraft fees, bank card transaction fees and gains on the sale of MasterCard Inc. restricted shares, partly offset by a decline in gains on the sale of student loans. Non-interest expense increased \$9.3 million, or 3.3%, over the previous year mainly due to higher salaries expense, occupancy expense, loan servicing costs, bank card processing expense, and online banking processing costs. These increases were partly offset by declines in corporate management fees and credit card fraud losses. Net loan charge-offs declined \$8.4 million in the Consumer segment, mainly relating to personal and credit card loans, as a result of lower bankruptcy notices received in 2006. Total average assets directly related to the segment rose 3.8% over 2005. During 2006, total average loans increased 3.5%, compared to a 5.2% increase in 2005. The increase in average loans during

2006 resulted mainly from growth in consumer, personal real estate and credit card loans, partly offset by a decline in student loans. Average deposits increased 6.4% over the prior year, mainly due to growth in long-term certificates of deposit.

Pre-tax income for 2005 was \$193.3 million, an increase of \$54.6 million, or 39.4%, over 2004. This growth was mainly due to growth in net interest income of \$52.7 million and an \$18.9 million increase in non-interest income. Partly offsetting these increases were a \$9.6 million increase in non-interest expense and a \$7.3 million increase in net loan charge-offs. The increase in net interest income resulted mainly from a \$93.7 million increase in allocated funding credits assigned to the deposit portfolio, which more than offset growth in deposit interest. Non-interest income increased 12.2%, primarily due to higher overdraft and return item fees and bank card fees. Non-interest expense increased 3.6% over the prior year due to higher salaries expense, bank card processing expense, online banking processing costs, and corporate management fees. These increases were partly offset by decreases in assigned overhead costs. Net loan charge-offs increased \$7.3 million in 2005 over the previous year and were directly related to higher consumer and credit card loan charge-offs in the fourth quarter as a result of higher bankruptcy notices received. Total average assets directly related to the segment rose 3.3% over 2004. Average segment loans increased 5.2% compared to 2004 mainly as a result of growth in consumer, home equity and credit card loans, while average deposits increased only slightly.

Commercial

The Commercial segment provides corporate lending, leasing, international services, and corporate cash management services. Income before income taxes for the Commercial segment increased \$13.7 million, or 10.2%, in 2006 compared to 2005. Most of the increase was due to an \$18.1 million, or 9.3%, increase in net interest income and a \$6.2 million increase in non-interest income. The growth in net interest income, as in the Consumer segment, resulted from an increase in the cost of funds credit assigned to the segment's deposits due to the rising rate environment in 2006. This credit increased by \$26.2 million in 2006 compared with the growth in deposit interest expense of \$7.3 million, thus creating a larger interest spread on deposits. Also, while interest on loans grew by \$97.7 million, this growth was offset by higher assigned funding costs. Non-interest income increased by 8.4% over the previous year mainly as a result of higher operating lease-related income and commercial bank card transaction fees. The \$8.6 million, or 6.3%, increase in non-interest expense included increases in salaries expense, operating lease depreciation, foreclosed property expense, commercial deposit account processing fees, and bank card servicing expense. Net loan recoveries were \$313 thousand in 2006 compared to net recoveries of \$2.3 million in 2005, which also had a negative impact on the year to year comparison of the Commercial segment profitability. Total average assets directly related to the segment rose 14.7% over 2005. Average segment loans increased 14.4% compared to 2005 mainly as a result of growth in business and business real estate loans, while average deposits decreased slightly.

In 2005, pre-tax income increased \$18.6 million, or 16.1%, over 2004. This increase resulted from growth in net interest income and lower net loan charge-offs, coupled with well-controlled expense growth but lower non-interest income. The growth in net interest income resulted from an increase in the cost of funds credit assigned to the segment's deposits. This credit increased by \$22.2 million in 2005 compared with the growth in deposit interest expense of \$4.8 million. Net loan charge-offs were \$5.6 million in 2004 compared to net recoveries of \$2.3 million in 2005, and resulted from a large loan charge-off in 2004, which was partly recovered in 2005. Non-interest income decreased \$3.1 million, or 4.1%, as a result of lower commercial cash management fees, partly offset by growth in commercial bank card transaction fee income. Non-interest expense increased \$2.1 million, or 1.5%, due to higher salaries expense, commercial deposit account processing fees, and overhead cost allocations. Partly offsetting these expense increases were lower operating losses and higher deferred loan origination costs. During 2005, total average loans increased 5.2%, compared to a 1.6% decrease during 2004. The increase in loans during 2005 resulted mainly from growth in business loans and construction real estate loans, partly offset by a decline in business real estate loans. Average deposits increased 1.8% during 2005 compared to a 9.0% increase during 2004, as growth in business

demand accounts slowed in 2005.

Money Management

The Money Management segment consists of the trust and capital markets activities. The Trust group provides trust and estate planning services, and advisory and discretionary investment management services. At December 31, 2006 the Trust group managed investments with a market value of \$11.5 billion and administered an additional \$9.7 billion in non-managed assets. It also provides investment management services to The Commerce Funds, a series of mutual funds with \$1.7 billion in total assets at December 31, 2006. The Capital Markets Group sells primarily fixed-income securities to individuals, corporations, correspondent banks, public institutions, and municipalities, and also provides investment safekeeping and bond accounting services. Pre-tax income for the segment was \$34.5 million in 2006 compared to \$31.7 million in 2005, an increase of \$2.8 million, or 8.9%. The increase over the prior year was mainly due to higher non-interest income. Non-interest income was up \$2.7 million, or 3.3%, mainly in private client revenues, partly offset by lower bond trading income in the Capital Markets Group. Net interest income, which increased \$1.6 million, or 20.3%, over the prior year, was higher mainly due to higher assigned funding credits attributed to the deposit portfolio of this segment. The \$1.6 million increase in non-interest expense in the Money Management segment was mainly due to higher salaries expense and corporate management fees. Average assets increased \$216.0 million during 2006 because of higher overnight investments of liquid funds. Average deposits increased \$37.0 million during 2006, mainly due to continuing growth in short-term certificates of deposit over \$100,000.

Pre-tax income for the segment was \$31.7 million in 2005 compared to \$28.7 million in 2004, an increase of \$3.0 million, or 10.6%. The increase was due to growth in net interest income coupled with higher non-interest income of \$1.5 million and slightly lower non-interest expense. The improvement in net interest income resulted from higher funding credits assigned to the deposits and overnight borrowings in this segment. The growth in non-interest income occurred mainly in private client revenues and proprietary mutual fund administration fees, partly offset by lower bond trading revenues. Non-interest expense decreased slightly due to lower incentive compensation costs and trust processing costs, partly offset by higher proprietary mutual funds expense subsidies. Average assets decreased \$9.3 million during 2005 because of lower trading account investments and overnight investments of liquid funds. Average deposits increased \$84.2 million during 2005, mainly due to growth in short-term certificates of deposit over \$100,000.

The Other/elimination category shown in the table above includes support and overhead operating units of the Company which contain various operating expenses such as salaries, occupancy, etc. Also included in this category is the Company's available for sale investment securities portfolio, which totaled \$3.4 billion at December 31, 2006. The pre-tax profitability in the Other/elimination category decreased \$61.6 million in 2006 compared to 2005, and decreased \$69.8 million in 2005 compared to 2004. These declines were mainly the result of higher cost of funds charges assigned to this category and allocated to the investment portfolio. Interest earned on the investment portfolio is primarily based on fixed rates. However, the cost of funds charges assigned are variable and in a rising rate environment have increased significantly, causing most of the decline in pre-tax profitability for this category.

Impact of Recently Issued Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised), *Share-Based Payment*. The revision requires entities to recognize the cost in their statements of income of employee services received in exchange for awards of equity instruments, based on the grant date fair value of those awards. The Statement requires several accounting changes in the areas of award modifications and forfeitures. It contains additional guidance in several areas, including measuring fair value, classifying an award as equity or as a liability, and attributing compensation cost to reporting periods. For calendar year companies, the Statement was effective January 1, 2006. The Company implemented provisions of the original Statement 123

beginning in 2003 and has recorded the cost of stock-based awards in its statements of income. The Company's adoption of Statement 123 (revised) is further discussed in the Stock-Based Compensation and Directors' Stock Purchase Plan note to the consolidated financial statements, and did not have a material effect on its consolidated financial statements in 2006.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, *Accounting Changes and Error Corrections*. The Statement changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This Statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. The Statement carries forward previously issued guidance on reporting changes in accounting estimate (which shall be accounted for in the period of change and future periods, if affected) and errors in previously issued financial statements (which shall be reported as a prior period adjustment by restating the prior period financial statements). For calendar year companies, the Statement was effective for accounting changes and corrections of errors made after January 1, 2006. The Company's initial adoption of the Statement did not have a material effect on its consolidated financial statements.

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments*—an amendment of FASB Statements No. 133 and 140. The Statement permits fair value remeasurement for certain hybrid financial instruments containing embedded derivatives, and clarifies the derivative accounting requirements for interest and principal-only strip securities and interests in securitized financial assets. It also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and eliminates a previous prohibition on qualifying special-purpose entities from holding certain derivative financial instruments. For calendar year companies, the Statement is effective for all financial instruments acquired or issued after January 1, 2007. The Company does not expect that adoption of the Statement will have a material effect on its consolidated financial statements. Certain of the provisions of the Statement which apply to the bifurcation of embedded prepayment derivatives and the measurement of asset-backed securities at fair value are currently under review by the FASB.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, *Accounting for Servicing of Financial Assets*—an amendment of FASB Statement No. 140. The Statement specifies under what situations servicing assets and servicing liabilities must be recognized. It requires these assets and liabilities to be initially measured at fair value and specifies acceptable measurement methods subsequent to their recognition. Separate presentation in the financial statements and additional disclosures are also required. For calendar year companies, the Statement is effective beginning January 1, 2007. The Company does not expect that adoption of the Statement will have a material effect on its consolidated financial statements.

In April 2006, the FASB issued Staff Position FIN 46(R)-6, which addresses how a reporting enterprise should determine the variability to be considered in applying FASB Interpretation No. 46(R) (revised December 2003), *Consolidation of Variable Interest Entities*. The Staff Position requires that variability be based on an analysis of the design of the entity, as outlined by (1) analyzing the nature of the risks in the entity and (2) determining the purpose for which the entity was created and the variability the entity is designed to create and pass to its interest holders. Prospective application of the Staff Position is effective July 1, 2006. The Company's involvement with variable interest entities is very limited, and it does not expect that adoption of the Staff Position will have a material effect on its consolidated financial statements.

In June 2006, the FASB issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, which prescribes the recognition threshold and measurement attribute necessary for recognition in the financial statements of a tax position taken, or expected to be taken, in a tax return. Under FIN 48, an income tax position will be recognized if it is more likely than not that it will be sustained upon IRS examination, based upon its technical merits. Once that status is met, the amount recorded will be the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. It also provides guidance on

derecognition, classification, interest and penalties, interim period accounting, disclosure, and transition requirements. For calendar year companies, this Interpretation is effective January 1, 2007. The adoption of FIN 48 is not expected to have a material effect on the Company's financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 108, which provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. Prior year misstatements must be considered in quantifying misstatements in current year financial statements and if the effect of those misstatements is material to the current year, the prior year financial statements must be corrected even though such revision previously was and continues to be immaterial to the prior year financial statements. The Company's analysis under SAB No. 108 of prior year and current year misstatements did not result in any adjustment to prior year or current year financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. It does not require any new fair value measurements. For calendar year companies, the Statement is effective beginning January 1, 2008. The Company does not expect that adoption of the Statement will have a material effect on its consolidated financial statements.

The FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, in September 2006. The Statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. It also requires an employer to measure the funded status of a plan as of the date of its year end statement of financial position. For calendar year companies with publicly traded stock, the funded status must be initially recognized at December 31, 2006, while the measurement requirement is effective in 2008. The Company's initial recognition at December 31, 2006 of the funded status of its defined benefit pension plan reduced its prepaid pension asset by \$17.5 million, reduced deferred tax liabilities by \$6.6 million, and reduced the equity component of accumulated other comprehensive income by \$10.9 million.

In September 2006, the Emerging Issues Task Force Issue 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements, was ratified. This EITF Issue addresses accounting for separate agreements which split life insurance policy benefits between an employer and employee. The Issue requires the employer to recognize a liability for future benefits payable to the employee under these agreements. The effects of applying this Issue must be recognized through either a change in accounting principle through an adjustment to equity or through the retrospective application to all prior periods. For calendar year companies, the Issue is effective beginning January 1, 2008. The Company does not expect the adoption of the Issue to have a material effect on the Company's consolidated financial statements.

Effects of Inflation

The impact of inflation on financial institutions differs significantly from that exerted on industrial entities. Financial institutions are not heavily involved in large capital expenditures used in the production, acquisition or sale of products. Virtually all assets and liabilities of financial institutions are monetary in nature and represent obligations to pay or receive fixed and determinable amounts not affected by future changes in prices. Changes in interest rates have a significant effect on the earnings of financial institutions. Higher interest rates generally follow the rising demand of borrowers and the corresponding increased funding requirements of financial institutions. Although interest rates are viewed as the price of borrowing funds, the behavior of interest rates differs significantly from the behavior of the prices of goods and services. Prices of goods and services may be directly related to that of other goods and services while the price of borrowing relates more closely to the inflation rate in the prices of those goods and services. As a result, when the rate of inflation slows, interest rates tend to decline while absolute prices for goods and services remain at higher levels. Interest rates are also subject to restrictions imposed through monetary policy, usury laws and

other artificial constraints.

Corporate Governance

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

Forward-Looking Statements

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

AVERAGE BALANCE SHEETS AVERAGE RATES AND YIELDS

| | Years Ended December 31 | | | | | | | |
|----------------------|--------------------------------|---|---|----------------------------|---|---|----------------------------|---|
| | 2006 | | | 2005 | | | 2004 | |
| (thousands) | Average Balance | Interest Income/ Expense | Average Rates Earned/ Paid | Average Balance | Interest Income/ Expense | Average Rates Earned/ Paid | Average Balance | Interest Income/ Expense |
| | \$ 2,688,722 | \$ 177,313 | 6.59% | \$ 2,336,681 | \$ 125,417 | 5.37% | \$ 2,119,823 | \$ 88,199 |
| construction | 540,574 | 40,477 | 7.49 | 480,864 | 28,422 | 5.91 | 427,976 | 18,068 |
| business | 2,053,455 | 140,659 | 6.85 | 1,794,269 | 106,167 | 5.92 | 1,823,302 | 90,601 |
| personal | 1,425,311 | 80,830 | 5.67 | 1,351,809 | 71,879 | 5.32 | 1,334,859 | 69,273 |
| | 1,352,047 | 95,074 | 7.03 | 1,242,163 | 80,431 | 6.48 | 1,188,018 | 75,633 |
| | 445,376 | 33,849 | 7.60 | 429,911 | 26,463 | 6.16 | 381,111 | 17,481 |
| | 305,960 | 20,774 | 6.79 | 357,319 | 17,050 | 4.77 | 326,120 | 9,790 |
| | 595,252 | 77,737 | 13.06 | 554,471 | 66,552 | 12.00 | 515,585 | 57,112 |
| | 14,685 | | | 13,995 | | | 13,319 | |
| including | 9,421,382 | 666,713 | 7.08 | 8,561,482 | 522,381 | 6.10 | 8,130,113 | 426,157 |
| securities: | | | | | | | | |
| government & federal | 640,239 | 22,817 | 3.56 | 1,066,304 | 39,968 | 3.75 | 1,721,301 | 67,988 |
| municipal | 414,282 | 18,546 | 4.48 | 137,007 | 5,910 | 4.31 | 70,846 | 3,410 |
| and asset-backed | 2,201,685 | 96,270 | 4.37 | 2,812,757 | 114,978 | 4.09 | 2,846,093 | 105,827 |
| securities | 17,444 | 762 | 4.37 | 10,624 | 422 | 3.98 | 14,250 | 498 |
| table | 200,013 | 11,248 | 5.62 | 216,984 | 9,316 | 4.29 | 163,843 | 3,747 |
| table securities | 85,211 | 7,475 | 8.77 | 78,709 | 4,617 | 5.87 | 75,542 | 3,530 |
| investment | 3,558,874 | 157,118 | 4.41 | 4,322,385 | 175,211 | 4.05 | 4,891,875 | 185,000 |
| securities sold and | 299,554 | 15,637 | 5.22 | 116,553 | 4,102 | 3.52 | 84,113 | 1,312 |
| purchased under | | | | | | | | |

to resell

| | | | | | | | | |
|---------------------------|----------------------|----------------|-------------|----------------------|---------|------|----------------------|---------|
| Net earnings | 13,279,810 | 839,468 | 6.32 | 13,000,420 | 701,694 | 5.40 | 13,106,101 | 612,469 |
| Provision for loan | (129,224) | | | (129,272) | | | (132,554) | |
| Gain (loss) on securities | (9,443) | | | 22,607 | | | 90,692 | |
| Income from banks | 470,826 | | | 508,389 | | | 553,074 | |
| Expenses and other | | | | | | | | |
| Net | 376,375 | | | 369,471 | | | 340,188 | |
| | 250,260 | | | 201,829 | | | 191,655 | |
| | \$ 14,238,604 | | | \$ 13,973,444 | | | \$ 14,149,156 | |

DEPOSITS AND

| | | | | | | | | |
|---|-------------------|----------------|--------------|------------|---------|-------|------------|---------|
| Checking deposits: | \$ 393,870 | 2,204 | .56 | \$ 403,158 | 1,259 | .31 | \$ 401,935 | 1,250 |
| Money market and | | | | | | | | |
| Net | 6,717,280 | 94,238 | 1.40 | 6,745,714 | 52,112 | .77 | 6,171,456 | 26,707 |
| Time deposits & C.D. s of less than 12 months | 2,077,257 | 85,424 | 4.11 | 1,736,804 | 50,597 | 2.91 | 1,678,659 | 38,924 |
| Time deposits & C.D. s of 12 months or more | 1,288,845 | 58,381 | 4.53 | 983,703 | 30,779 | 3.13 | 788,800 | 14,912 |
| Net deposits bearing interest | 10,477,252 | 240,247 | 2.29 | 9,869,379 | 134,747 | 1.37 | 9,040,850 | 81,793 |
| Securities purchased and sold under repurchase agreements | 1,455,544 | 70,154 | 4.82 | 1,609,868 | 48,776 | 3.03 | 1,827,428 | 22,560 |
| Repurchase agreements | 182,940 | 8,744 | 4.78 | 366,072 | 12,464 | 3.40 | 419,215 | 8,519 |
| Net borrowings | 1,638,484 | 78,898 | 4.82 | 1,975,940 | 61,240 | 3.10 | 2,246,643 | 31,079 |
| Net deposits bearing interest | 12,115,736 | 319,145 | 2.63% | 11,845,319 | 195,987 | 1.65% | 11,287,493 | 112,872 |
| | 642,545 | | | 655,729 | | | 1,288,434 | |

| | | | |
|-----------------------|----------------------|---------------|---------------|
| bearing | | | |
| osits | | | |
| ties | 102,668 | 93,708 | 123,048 |
| s equity | 1,377,655 | 1,378,688 | 1,450,181 |
| ties and | | | |
| | \$ 14,238,604 | \$ 13,973,444 | \$ 14,149,156 |
| margin (T/E) | \$ 520,323 | \$ 505,707 | \$ 499,597 |
| net interest | | | |
| ets | 3.92% | 3.89% | |
| increase | | | |
| n net interest | | | |
| (E) compared | | | |
| year | 2.89% | 1.22% | |

- (A) Loans on non-accrual status are included in the computation of average balances. Included in interest income above are loan fees and late charges, net of amortization of deferred loan origination fees and costs, which are immaterial. Credit card income from merchant discounts and net interchange fees are not included in loan income.
- (B) Interest income and yields are presented on a fully-taxable equivalent basis using the Federal statutory income tax rate. Business loan interest income includes tax free loan income of \$5,883,000 in 2006, \$2,393,000 in 2005, \$2,379,000 in 2004, \$2,466,000 in 2003 and \$3,355,000 in 2002, including tax equivalent adjustments of \$1,596,000 in 2006, \$1,097,000 in 2005, \$819,000 in 2004, \$847,000 in 2003 and \$1,142,000 in 2002. State and municipal interest income includes tax equivalent adjustments of \$3,698,000

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| | Years Ended December 31 | | | | | | | | |
|-----------|-------------------------|---------|--------------|------------|---------|--------------|------------|---------|---------|
| | 2003 | | | 2002 | | | 2001 | | |
| | Average | Average | Average | Average | Average | Average | Average | Average | Average |
| | Interest | Rates | | Interest | Rates | | Interest | Rates | |
| | Income/ | Earned/ | Balance | Income/ | Earned/ | Balance | Income/ | Earned/ | Compou |
| Balance | Expense | Paid | Balance | Expense | Paid | Balance | Expense | Paid | Growtl |
| | | | | | | | | | Rate |
| 2,173,765 | \$ 90,860 | 4.18% | \$ 2,433,041 | \$ 115,058 | 4.73% | \$ 2,566,503 | \$ 169,747 | 6.61% | .9 |
| 404,058 | 17,324 | 4.29 | 474,307 | 23,894 | 5.04 | 409,262 | 29,598 | 7.23 | 5.7 |
| 1,831,575 | 93,731 | 5.12 | 1,483,012 | 88,645 | 5.98 | 1,398,366 | 103,551 | 7.41 | 7.9 |
| 1,304,677 | 73,568 | 5.64 | 1,247,209 | 82,382 | 6.61 | 1,339,436 | 98,283 | 7.34 | 1.2 |
| 1,129,267 | 79,571 | 7.05 | 1,046,173 | 83,266 | 7.96 | 1,095,809 | 92,339 | 8.43 | 4.2 |
| 324,375 | 14,372 | 4.43 | 283,466 | 14,336 | 5.06 | 239,599 | 18,077 | 7.54 | 13.2 |
| 339,577 | 9,606 | 2.83 | 316,910 | 13,124 | 4.14 | 280,846 | 18,223 | 6.49 | 1.7 |
| 490,534 | 55,310 | 11.28 | 463,474 | 52,337 | 11.29 | 460,157 | 61,789 | 13.43 | 5.2 |
| 11,631 | | | 14,150 | | | 19,953 | | | (5.9) |
| 8,009,459 | 434,342 | 5.42 | 7,761,742 | 473,042 | 6.09 | 7,809,931 | 591,607 | 7.58 | 3.8 |
| 1,543,269 | 67,236 | 4.36 | 1,233,040 | 57,159 | 4.64 | 892,248 | 48,666 | 5.45 | (6.4) |
| 80,687 | 4,139 | 5.13 | 41,103 | 3,079 | 7.49 | 55,379 | 4,225 | 7.63 | 49.5 |
| 2,504,514 | 103,681 | 4.14 | 2,118,460 | 112,703 | 5.32 | 1,284,355 | 77,066 | 6.00 | 11.3 |
| 17,003 | 662 | 3.90 | 10,931 | 532 | 4.86 | 15,924 | 774 | 4.86 | 1.8 |
| 220,499 | 4,603 | 2.09 | 124,648 | 4,258 | 3.42 | 159,897 | 6,742 | 4.22 | 4.5 |
| 74,501 | 4,923 | 6.61 | 66,666 | 2,781 | 4.17 | 68,299 | 3,246 | 4.75 | 4.5 |
| 4,440,473 | 185,244 | 4.17 | 3,594,848 | 180,512 | 5.02 | 2,476,102 | 140,719 | 5.68 | 7.5 |
| 63,232 | 831 | 1.31 | 84,278 | 1,486 | 1.76 | 541,930 | 22,386 | 4.13 | (11.1) |
| 2,513,164 | 620,417 | 4.96 | 11,440,868 | 655,040 | 5.73 | 10,827,963 | 754,712 | 6.97 | 4.1 |
| (132,057) | | | (129,960) | | | (129,978) | | | (.1) |

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| | | | | | | | | | | |
|-----------|------------|-------|---------------|------------|-------|---------------|------------|---------|--|--------|
| 143,309 | | | 114,908 | | | 56,296 | | | | NM |
| 513,733 | | | 511,798 | | | 532,715 | | | | (2.4) |
| 336,665 | | | 329,553 | | | 286,166 | | | | 5.6 |
| 167,944 | | | 146,671 | | | 162,661 | | | | 9.0 |
| 3,542,758 | | | \$ 12,413,838 | | | \$ 11,735,823 | | | | 3.9 |
| 380,323 | 1,351 | .36 | \$ 353,779 | 2,146 | .61 | \$ 323,462 | 3,345 | 1.03 | | 4.0 |
| 6,015,827 | 27,391 | .46 | 5,762,465 | 43,101 | .75 | 5,253,024 | 97,746 | 1.86 | | 5.0 |
| 1,838,137 | 48,440 | 2.64 | 2,046,041 | 70,367 | 3.44 | 2,259,161 | 121,851 | 5.39 | | (1.6) |
| 699,241 | 14,278 | 2.04 | 651,336 | 18,252 | 2.80 | 530,874 | 27,699 | 5.22 | | 19.4 |
| 8,933,528 | 91,460 | 1.02 | 8,813,621 | 133,866 | 1.52 | 8,366,521 | 250,641 | 3.00 | | 4.6 |
| 1,550,211 | 15,289 | .99 | 771,646 | 9,853 | 1.28 | 601,865 | 19,164 | 3.18 | | 19.3 |
| 395,026 | 8,269 | 2.09 | 371,902 | 9,363 | 2.52 | 301,363 | 13,956 | 4.63 | | (9.5) |
| 1,945,237 | 23,558 | 1.21 | 1,143,548 | 19,216 | 1.68 | 903,228 | 33,120 | 3.67 | | 12.6 |
| 0,878,765 | 115,018 | 1.06% | 9,957,169 | 153,082 | 1.54% | 9,269,749 | 283,761 | 3.06% | | 5.5 |
| 1,083,207 | | | 974,941 | | | 1,101,174 | | | | (10.2) |
| 133,813 | | | 120,143 | | | 137,832 | | | | (5.7) |
| 1,446,973 | | | 1,361,585 | | | 1,227,068 | | | | 2.3 |
| 3,542,758 | | | \$ 12,413,838 | | | \$ 11,735,823 | | | | 3.9 |
| | \$ 505,399 | | | \$ 501,958 | | | \$ 470,951 | | | |
| | | 4.04% | | | 4.39% | | | 4.35% | | |
| | | .69% | | | 6.58% | | | (2.80)% | | |

in 2006, \$1,445,000 in 2005, \$1,093,000 in 2004, \$1,301,000 in 2003 and \$999,000 in 2002. Interest income on other marketable securities includes tax equivalent adjustments of \$1,868,000 in 2006, \$1,586,000 in 2005, \$467,000 in 2004, \$859,000 in 2003 and \$346,000 in 2002.

(C) Interest expense of \$38,000, \$123,000, \$113,000 and \$494,000 which was capitalized on construction projects in 2006, 2005, 2004 and 2002, respectively, is not deducted from the interest expense shown above.

QUARTERLY AVERAGE BALANCE SHEETS AVERAGE RATES AND YIELDS

| <i>(Dollars in millions)</i> | Year Ended December 31, 2006 | | | | | | | |
|--|------------------------------|-------------------------------------|--------------------|-------------------------------------|--------------------|-------------------------------------|--------------------|-------------------------------------|
| | Fourth Quarter | | Third Quarter | | Second Quarter | | First Quarter | |
| | Average Balance | Average Rates Earned/ Paid | Average Balance | Average Rates Earned/ Paid | Average Balance | Average Rates Earned/ Paid | Average Balance | Average Rates Earned/ Paid |
| ASSETS | | | | | | | | |
| Loans: | | | | | | | | |
| Business ^(A) | \$ 2,806 | 6.82% | \$ 2,709 | 6.81% | \$ 2,694 | 6.48% | \$ 2,543 | 6.23% |
| Real estate construction | 628 | 7.70 | 582 | 7.72 | 508 | 7.37 | 442 | 7.00 |
| Real estate business | 2,161 | 7.07 | 2,082 | 6.99 | 1,997 | 6.80 | 1,971 | 6.50 |
| Real estate personal | 1,505 | 5.77 | 1,462 | 5.70 | 1,373 | 5.63 | 1,358 | 5.56 |
| Consumer | 1,412 | 7.30 | 1,373 | 7.12 | 1,333 | 6.90 | 1,288 | 6.78 |
| Home equity | 443 | 7.84 | 445 | 7.79 | 446 | 7.54 | 447 | 7.22 |
| Student | 300 | 6.94 | 279 | 7.03 | 286 | 7.58 | 360 | 5.83 |
| Credit card | 612 | 13.16 | 607 | 13.09 | 585 | 12.93 | 578 | 13.04 |
| Overdrafts | 13 | | 14 | | 12 | | 20 | |
| Total loans, including held for sale | 9,880 | 7.27 | 9,553 | 7.22 | 9,234 | 7.02 | 9,007 | 6.76 |
| Investment securities: | | | | | | | | |
| U.S. government & federal agency | 492 | 3.66 | 592 | 3.58 | 697 | 3.47 | 784 | 3.58 |
| State & municipal obligations ^(A) | 573 | 4.57 | 472 | 4.48 | 348 | 4.40 | 260 | 4.36 |
| Mortgage and asset-backed securities | 2,178 | 4.52 | 2,172 | 4.38 | 2,166 | 4.30 | 2,293 | 4.30 |
| Trading securities | 15 | 4.49 | 14 | 4.57 | 21 | 4.34 | 19 | 4.15 |
| Other marketable securities ^(A) | 198 | 6.12 | 213 | 5.66 | 194 | 5.47 | 194 | 5.22 |
| Non-marketable securities | 84 | 14.86 | 86 | 6.51 | 87 | 6.88 | 84 | 6.90 |
| Total investment securities | 3,540 | 4.74 | 3,549 | 4.39 | 3,513 | 4.27 | 3,634 | 4.26 |
| Federal funds sold and securities purchased under agreements to resell | 530 | 5.34 | 379 | 5.33 | 143 | 5.06 | 142 | 4.64 |

| | | | | | | | | |
|--|------------------|--------------|------------------|--------------|------------------|--------------|------------------|--------------|
| Total interest earning assets | 13,950 | 6.56 | 13,481 | 6.42 | 12,890 | 6.25 | 12,783 | 6.03 |
| Less allowance for loan losses | (131) | | (130) | | (128) | | (128) | |
| Unrealized gain (loss) on investment securities | 9 | | (16) | | (21) | | (9) | |
| Cash and due from banks | 471 | | 462 | | 471 | | 481 | |
| Land, buildings and equipment net | 389 | | 377 | | 367 | | 371 | |
| Other assets | 312 | | 258 | | 221 | | 208 | |
| Total assets | \$ 15,000 | | \$ 14,432 | | \$ 13,800 | | \$ 13,706 | |
| LIABILITIES AND EQUITY | | | | | | | | |
| Interest bearing deposits: | | | | | | | | |
| Savings | \$ 401 | .57 | \$ 394 | .57 | \$ 397 | .56 | \$ 384 | .54 |
| Interest checking and money market | 6,862 | 1.56 | 6,678 | 1.53 | 6,666 | 1.35 | 6,661 | 1.16 |
| Time open & C.D. s under \$100,000 | 2,293 | 4.50 | 2,156 | 4.28 | 1,974 | 3.95 | 1,881 | 3.61 |
| Time open & C.D. s \$100,000 & over | 1,292 | 4.79 | 1,320 | 4.72 | 1,257 | 4.44 | 1,286 | 4.16 |
| Total interest bearing deposits | 10,848 | 2.53 | 10,548 | 2.45 | 10,294 | 2.20 | 10,212 | 1.97 |
| Borrowings: | | | | | | | | |
| Federal funds purchased and securities sold under agreements to repurchase | 1,793 | 5.15 | 1,581 | 5.09 | 1,214 | 4.63 | 1,227 | 4.16 |
| Other borrowings | 104 | 5.86 | 163 | 4.91 | 205 | 4.67 | 260 | 4.34 |
| Total borrowings | 1,897 | 5.19 | 1,744 | 5.07 | 1,419 | 4.64 | 1,487 | 4.19 |
| Total interest bearing liabilities | 12,745 | 2.92% | 12,292 | 2.83% | 11,713 | 2.49% | 11,699 | 2.25% |
| Non-interest bearing demand deposits | 664 | | 644 | | 664 | | 598 | |

| | | | | |
|---|------------------|------------------|------------------|------------------|
| Other liabilities | 133 | 112 | 86 | 79 |
| Stockholders equity | 1,458 | 1,384 | 1,337 | 1,330 |
| Total liabilities and equity | \$ 15,000 | \$ 14,432 | \$ 13,800 | \$ 13,706 |
| Net interest margin (T/E) | \$ 136 | \$ 131 | \$ 128 | \$ 125 |
| Net yield on interest earning assets | 3.89% | 3.84% | 3.98% | 3.97% |

(A) Includes tax equivalent calculations.

| <i>(Dollars in millions)</i> | Year Ended December 31, 2005 | | | | | | | |
|--|------------------------------|-------------------------------------|--------------------|-------------------------------------|--------------------|-------------------------------------|--------------------|-------------------------------------|
| | Fourth Quarter | | Third Quarter | | Second Quarter | | First Quarter | |
| | Average Balance | Average Rates Earned/ Paid | Average Balance | Average Rates Earned/ Paid | Average Balance | Average Rates Earned/ Paid | Average Balance | Average Rates Earned/ Paid |
| ASSETS | | | | | | | | |
| Loans: | | | | | | | | |
| Business ^(A) | \$ 2,436 | 5.84% | \$ 2,357 | 5.50% | \$ 2,305 | 5.12% | \$ 2,246 | 4.96% |
| Real estate construction | 483 | 6.58 | 519 | 6.10 | 479 | 5.68 | 443 | 5.19 |
| Real estate business | 1,877 | 6.32 | 1,775 | 6.02 | 1,766 | 5.74 | 1,758 | 5.56 |
| Real estate personal | 1,361 | 5.37 | 1,367 | 5.31 | 1,344 | 5.28 | 1,335 | 5.30 |
| Consumer | 1,281 | 6.67 | 1,268 | 6.52 | 1,225 | 6.38 | 1,193 | 6.31 |
| Home equity | 447 | 6.84 | 437 | 6.34 | 423 | 5.89 | 413 | 5.47 |
| Student | 325 | 5.27 | 321 | 5.08 | 374 | 4.57 | 410 | 4.31 |
| Credit card | 561 | 12.36 | 556 | 12.20 | 554 | 11.82 | 547 | 11.61 |
| Overdrafts | 13 | | 15 | | 12 | | 16 | |
| Total loans, including held for sale | 8,784 | 6.47 | 8,615 | 6.21 | 8,482 | 5.93 | 8,361 | 5.76 |
| Investment securities: | | | | | | | | |
| U.S. government & federal agency | 849 | 3.58 | 919 | 3.47 | 1,130 | 4.58 | 1,374 | 3.35 |
| State & municipal obligations ^(A) | 246 | 4.32 | 164 | 4.21 | 71 | 4.44 | 64 | 4.43 |
| Mortgage and asset-backed securities | 2,574 | 4.24 | 2,905 | 4.14 | 2,925 | 4.11 | 2,848 | 3.87 |
| Trading securities | 13 | 4.24 | 11 | 4.01 | 8 | 3.98 | 11 | 3.66 |
| Other marketable securities ^(A) | 210 | 5.55 | 222 | 4.68 | 219 | 3.82 | 218 | 3.13 |
| Non-marketable securities | 81 | 8.77 | 81 | 3.51 | 76 | 5.45 | 77 | 5.67 |
| Total investment securities | 3,973 | 4.26 | 4,302 | 4.02 | 4,429 | 4.24 | 4,592 | 3.72 |
| Federal funds sold and securities purchased under agreements to resell | 109 | 4.23 | 127 | 3.74 | 145 | 3.22 | 85 | 2.79 |

| | | | | | | | | |
|--|-----------|-------|-----------|-------|-----------|-------|-----------|-------|
| Total interest earning assets | 12,866 | 5.77 | 13,044 | 5.46 | 13,056 | 5.33 | 13,038 | 5.02 |
| Less allowance for loan losses | (127) | | (128) | | (130) | | (132) | |
| Unrealized gain (loss) on investment securities | (3) | | 20 | | 26 | | 48 | |
| Cash and due from banks | 493 | | 478 | | 503 | | 560 | |
| Land, buildings and equipment net | 377 | | 376 | | 370 | | 354 | |
| Other assets | 209 | | 197 | | 199 | | 202 | |
| Total assets | \$ 13,815 | | \$ 13,987 | | \$ 14,024 | | \$ 14,070 | |
| LIABILITIES AND EQUITY | | | | | | | | |
| Interest bearing deposits: | | | | | | | | |
| Savings | \$ 388 | .31 | \$ 404 | .31 | \$ 417 | .31 | \$ 404 | .31 |
| Interest checking and money market | 6,701 | .94 | 6,759 | .83 | 6,821 | .70 | 6,702 | .61 |
| Time open & C.D. s under \$100,000 | 1,796 | 3.27 | 1,753 | 3.02 | 1,732 | 2.79 | 1,665 | 2.53 |
| Time open & C.D. s \$100,000 & over | 968 | 3.71 | 903 | 3.26 | 1,086 | 2.95 | 979 | 2.63 |
| Total interest bearing deposits | 9,853 | 1.62 | 9,819 | 1.42 | 10,056 | 1.29 | 9,750 | 1.13 |
| Borrowings: | | | | | | | | |
| Federal funds purchased and securities sold under agreements to repurchase | 1,579 | 3.76 | 1,724 | 3.27 | 1,481 | 2.75 | 1,655 | 2.31 |
| Other borrowings | 325 | 3.96 | 371 | 3.53 | 380 | 3.24 | 389 | 2.96 |
| Total borrowings | 1,904 | 3.80 | 2,095 | 3.32 | 1,861 | 2.85 | 2,044 | 2.43 |
| Total interest bearing liabilities | 11,757 | 1.97% | 11,914 | 1.76% | 11,917 | 1.53% | 11,794 | 1.36% |
| Non-interest bearing | | | | | | | | |
| demand deposits | 617 | | 602 | | 633 | | 773 | |
| Other liabilities | 90 | | 96 | | 92 | | 95 | |
| Stockholders equity | 1,351 | | 1,375 | | 1,382 | | 1,408 | |

| | | | | |
|---|-----------|-----------|-----------|-----------|
| Total liabilities and equity | \$ 13,815 | \$ 13,987 | \$ 14,024 | \$ 14,070 |
| Net interest margin (T/E) | \$ 129 | \$ 127 | \$ 128 | \$ 122 |
| Net yield on interest earning assets | 3.97% | 3.86% | 3.93% | 3.79% |

(A) Includes tax equivalent calculations.

SUMMARY OF QUARTERLY STATEMENTS OF INCOME

| Year Ended December 31, 2006 <i>(In thousands, except per share data)</i> | For the Quarter Ended | | | |
|--|-----------------------|------------|------------|------------|
| | 12/31/06 | 9/30/06 | 6/30/06 | 3/31/06 |
| Interest income | \$ 228,159 | \$ 216,270 | \$ 199,250 | \$ 188,627 |
| Interest expense | (93,927) | (87,517) | (72,771) | (64,892) |
| Net interest income | 134,232 | 128,753 | 126,479 | 123,735 |
| Non-interest income | 90,054 | 90,656 | 91,463 | 89,448 |
| Salaries and employee benefits | (73,140) | (72,169) | (71,239) | (71,725) |
| Other expense | (60,470) | (60,135) | (58,311) | (58,236) |
| Provision for loan losses | (7,970) | (7,575) | (5,672) | (4,432) |
| Income before income taxes | 82,706 | 79,530 | 82,720 | 78,790 |
| Income taxes | (25,689) | (24,982) | (27,387) | (25,846) |
| Net income | \$ 57,017 | \$ 54,548 | \$ 55,333 | \$ 52,944 |
| Net income per share basic* | \$.81 | \$.78 | \$.79 | \$.75 |
| Net income per share diluted* | \$.80 | \$.77 | \$.78 | \$.74 |
| Weighted average shares basic* | 70,454 | 70,036 | 69,879 | 70,339 |
| Weighted average shares diluted* | 71,372 | 70,961 | 70,833 | 71,323 |

| Year Ended December 31, 2005 <i>(In thousands, except per share data)</i> | For the Quarter Ended | | | |
|--|-----------------------|------------|------------|------------|
| | 12/31/05 | 9/30/05 | 6/30/05 | 3/31/05 |
| Interest income | \$ 185,343 | \$ 178,570 | \$ 172,800 | \$ 160,853 |
| Interest expense | (58,337) | (52,738) | (45,413) | (39,376) |
| Net interest income | 127,006 | 125,832 | 127,387 | 121,477 |
| Non-interest income | 88,633 | 86,895 | 84,980 | 80,691 |
| Salaries and employee benefits | (68,730) | (66,682) | (67,585) | (70,180) |
| Other expense | (58,471) | (55,705) | (55,427) | (53,742) |
| Provision for loan losses | (11,980) | (8,934) | (5,503) | (2,368) |

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| | | | | |
|----------------------------------|-----------|-----------|-----------|-----------|
| Income before income taxes | 76,458 | 81,406 | 83,852 | 75,878 |
| Income taxes | (20,216) | (18,615) | (29,484) | (26,032) |
| Net income | \$ 56,242 | \$ 62,791 | \$ 54,368 | \$ 49,846 |
| Net income per share basic* | \$.78 | \$.86 | \$.74 | \$.67 |
| Net income per share diluted* | \$.77 | \$.85 | \$.73 | \$.66 |
| Weighted average shares basic* | 71,620 | 72,707 | 73,575 | 74,574 |
| Weighted average shares diluted* | 72,492 | 73,704 | 74,588 | 75,612 |

| Year Ended December 31, 2004 (In thousands, except per share data) | For the Quarter Ended | | | |
|---|-----------------------|------------|------------|------------|
| | 12/31/04 | 9/30/04 | 6/30/04 | 3/31/04 |
| Interest income | \$ 157,271 | \$ 151,592 | \$ 152,440 | \$ 148,787 |
| Interest expense | (33,069) | (27,908) | (25,979) | (25,803) |
| Net interest income | 124,202 | 123,684 | 126,461 | 122,984 |
| Non-interest income | 77,753 | 78,920 | 84,289 | 85,969 |
| Salaries and employee benefits | (66,208) | (65,549) | (65,696) | (68,016) |
| Other expense | (56,221) | (54,943) | (55,240) | (50,896) |
| Provision for loan losses | (7,215) | (6,606) | (6,280) | (10,250) |
| Income before income taxes | 72,311 | 75,506 | 83,534 | 79,791 |
| Income taxes | (19,651) | (12,987) | (29,696) | (28,467) |
| Net income | \$ 52,660 | \$ 62,519 | \$ 53,838 | \$ 51,324 |
| Net income per share basic* | \$.69 | \$.81 | \$.70 | \$.65 |
| Net income per share diluted* | \$.68 | \$.80 | \$.69 | \$.64 |
| Weighted average shares basic* | 76,043 | 76,850 | 77,567 | 78,376 |
| Weighted average shares diluted* | 77,207 | 77,947 | 78,646 | 79,619 |

* Restated for the 5% stock dividend distributed in 2006.

Item 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is set forth on pages 39 through 41 of Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations.

Item 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Commerce Bancshares, Inc. and Subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 26, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

As discussed in Note 10 to the consolidated statements, the Company changed its method of accounting for defined benefit and postretirement obligations in 2006.

Kansas City, Missouri
February 26, 2007

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

| | December 31 | |
|--|-----------------------|----------------------|
| | 2006 | 2005 |
| | <i>(In thousands)</i> | |
| ASSETS | | |
| Loans: | | |
| Loans held for sale | \$ 278,598 | \$ 6,172 |
| Loans, net of unearned income | 9,681,520 | 8,893,011 |
| Allowance for loan losses | (131,730) | (128,447) |
| Net loans | 9,828,388 | 8,770,736 |
| Investment securities: | | |
| Available for sale (\$526,430,000 pledged in 2006 to secure structured repurchase agreement) | 3,415,440 | 3,667,901 |
| Trading | 6,676 | 24,959 |
| Non-marketable | 74,207 | 77,321 |
| Total investment securities | 3,496,323 | 3,770,181 |
| Federal funds sold and securities purchased under agreements to resell | 527,816 | 128,862 |
| Cash and due from banks | 626,500 | 545,273 |
| Land, buildings and equipment net | 386,095 | 374,192 |
| Goodwill | 97,643 | 48,522 |
| Other intangible assets net | 19,633 | 47 |
| Other assets | 247,951 | 247,732 |
| Total assets | \$ 15,230,349 | \$ 13,885,545 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Deposits: | | |
| Non-interest bearing demand | \$ 1,312,400 | \$ 1,399,934 |
| Savings, interest checking and money market | 6,879,047 | 6,490,326 |
| Time open and C.D. s of less than \$100,000 | 2,302,567 | 1,831,980 |
| Time open and C.D. s of \$100,000 and over | 1,250,840 | 1,129,573 |

| | | |
|---|----------------------|---------------|
| Total deposits | 11,744,854 | 10,851,813 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,771,282 | 1,326,427 |
| Other borrowings | 53,934 | 269,390 |
| Other liabilities | 218,165 | 100,077 |
| Total liabilities | 13,788,235 | 12,547,707 |
| 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 70,465,922 shares in 2006 and 69,409,882 shares in 2005 | 352,330 | 347,049 |
| Capital surplus | 427,421 | 388,552 |
| Retained earnings | 683,176 | 693,021 |
| Treasury stock of 422,468 shares in 2006 and 1,716,413 shares in 2005, at cost | (20,613) | (86,901) |
| Accumulated other comprehensive loss | (200) | (3,883) |
| Total stockholders' equity | 1,442,114 | 1,337,838 |
| Total liabilities and stockholders' equity | \$ 15,230,349 | \$ 13,885,545 |

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME

| <i>(In thousands, except per share data)</i> | For the Years Ended December 31 | | |
|--|--|----------------|----------------|
| | 2006 | 2005 | 2004 |
| INTEREST INCOME | | | |
| Interest and fees on loans | \$ 665,117 | \$ 521,283 | \$ 425,338 |
| Interest on investment securities | 151,552 | 172,181 | 183,440 |
| Interest on federal funds sold and securities purchased under agreements to resell | 15,637 | 4,102 | 1,312 |
| Total interest income | 832,306 | 697,566 | 610,090 |
| INTEREST EXPENSE | | | |
| Interest on deposits: | | | |
| Savings, interest checking and money market | 96,442 | 53,371 | 27,957 |
| Time open and C.D. s of less than \$100,000 | 85,424 | 50,597 | 38,924 |
| Time open and C.D. s of \$100,000 and over | 58,381 | 30,779 | 14,912 |
| Interest on federal funds purchased and securities sold under agreements to repurchase | 70,154 | 48,776 | 22,560 |
| Interest on other borrowings | 8,706 | 12,341 | 8,406 |
| Total interest expense | 319,107 | 195,864 | 112,759 |
| Net interest income | 513,199 | 501,702 | 497,331 |
| Provision for loan losses | 25,649 | 28,785 | 30,351 |
| Net interest income after provision for loan losses | 487,550 | 472,917 | 466,980 |
| NON-INTEREST INCOME | | | |
| Deposit account charges and other fees | 115,453 | 112,979 | 105,382 |
| Bank card transaction fees | 94,928 | 86,310 | 78,253 |
| Trust fees | 72,180 | 68,316 | 64,257 |
| Trading account profits and commissions | 8,132 | 9,650 | 12,288 |
| Consumer brokerage services | 9,954 | 9,909 | 9,846 |
| Loan fees and sales | 10,503 | 12,838 | 13,654 |
| Investment securities gains, net | 9,035 | 6,362 | 11,092 |
| Other | 41,436 | 34,835 | 32,159 |

| | | | |
|-----------------------------------|-------------------|------------|------------|
| Total non-interest income | 361,621 | 341,199 | 326,931 |
| NON-INTEREST EXPENSE | | | |
| Salaries and employee benefits | 288,273 | 273,177 | 265,469 |
| Net occupancy | 43,276 | 40,621 | 39,558 |
| Equipment | 25,665 | 23,201 | 22,903 |
| Supplies and communication | 32,670 | 33,342 | 33,760 |
| Data processing and software | 50,982 | 48,244 | 46,000 |
| Marketing | 17,317 | 17,294 | 16,688 |
| Other | 67,242 | 60,643 | 58,391 |
| Total non-interest expense | 525,425 | 496,522 | 482,769 |
| Income before income taxes | 323,746 | 317,594 | 311,142 |
| Less income taxes | 103,904 | 94,347 | 90,801 |
| Net income | \$ 219,842 | \$ 223,247 | \$ 220,341 |
| Net income per share basic | \$ 3.13 | \$ 3.05 | \$ 2.85 |
| Net income per share diluted | \$ 3.09 | \$ 3.01 | \$ 2.81 |

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

| <i>(In thousands)</i> | For the Years Ended December 31 | | |
|---|--|------------------|------------------|
| | 2006 | 2005 | 2004 |
| OPERATING ACTIVITIES | | | |
| Net income | \$ 219,842 | \$ 223,247 | \$ 220,341 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | 25,649 | 28,785 | 30,351 |
| Provision for depreciation and amortization | 48,436 | 42,318 | 41,562 |
| Amortization of investment security premiums, net | 12,318 | 16,730 | 25,840 |
| Provision (benefit) for deferred income taxes | (1,380) | (1,757) | 2,717 |
| Net gains on securities transactions | (9,035) | (6,362) | (11,092) |
| Net gains on sales of loans held for sale | (7,259) | (1,401) | (1,535) |
| Proceeds from sales of loans held for sale | 410,462 | 94,763 | 98,792 |
| Originations of loans held for sale | (344,243) | (88,504) | (95,802) |
| Net (increase) decrease in trading securities | 24,292 | (15,536) | 1,289 |
| Stock based compensation | 4,786 | 6,628 | 6,465 |
| (Increase) decrease in interest receivable | (11,051) | 676 | 1,630 |
| Increase (decrease) in interest payable | 25,467 | 16,213 | (372) |
| Increase (decrease) in income taxes payable | 14,576 | 22 | (20,039) |
| Net tax benefit related to equity compensation plans | (2,108) | (4,288) | (2,305) |
| Other changes, net | 40,611 | (17,900) | (33,187) |
| Net cash provided by operating activities | 451,363 | 293,634 | 264,655 |
| INVESTING ACTIVITIES | | | |
| Net cash paid in acquisitions | (8,498) | | |
| Cash paid in sales of branches | | | (2,280) |
| Proceeds from sales of available for sale securities | 170,421 | 1,816,865 | 252,464 |
| Proceeds from maturities/pay downs of available for sale securities | 1,142,763 | 1,197,556 | 1,451,726 |
| Purchases of available for sale securities | (888,132) | (2,012,483) | (1,570,659) |
| Net increase in loans | (764,519) | (631,391) | (210,252) |
| Purchases of land, buildings and equipment | (44,951) | (64,231) | (33,471) |
| Sales of land, buildings and equipment | 3,470 | 2,475 | 2,260 |
| Net cash provided by (used in) investing activities | (389,446) | 308,791 | (110,212) |
| FINANCING ACTIVITIES | | | |
| | 103,916 | (143,463) | 233,672 |

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| | | | |
|--|---------------------|------------|------------|
| Net increase (decrease) in non-interest bearing demand, savings, interest checking and money market deposits | | | |
| Net increase in time open and C.D. s | 340,559 | 543,130 | 15,042 |
| Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase | 417,441 | (587,451) | (192,166) |
| Repayment of long-term borrowings | (252,320) | (119,985) | (111,260) |
| Additional long-term borrowings | | | 100,000 |
| Net decrease in short-term borrowings | | | (2,876) |
| Purchases of treasury stock | (134,956) | (234,501) | (173,829) |
| Issuance of stock under stock purchase and equity compensation plans | 7,274 | 18,393 | 15,281 |
| Net tax benefit related to equity compensation plans | 2,108 | 4,288 | 2,305 |
| Cash dividends paid on common stock | (65,758) | (63,421) | (61,135) |
| Net cash provided by (used in) financing activities | 418,264 | (583,010) | (174,966) |
| Increase (decrease) in cash and cash equivalents | 480,181 | 19,415 | (20,523) |
| Cash and cash equivalents at beginning of year | 674,135 | 654,720 | 675,243 |
| Cash and cash equivalents at end of year | \$ 1,154,316 | \$ 674,135 | \$ 654,720 |

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

| <i>(In thousands, except per share data)</i> | Common Stock | Capital Surplus | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total |
|---|-------------------------|----------------------------|------------------------------|---------------------------|--|--------------|
| Balance, December 31, 2003 | \$ 343,183 | \$ 357,337 | \$ 707,136 | \$ (29,573) | \$ 72,871 | \$ 1,450,954 |
| Net income | | | 220,341 | | | 220,341 |
| Change in unrealized gain (loss) on available for sale securities, net of tax | | | | | (33,301) | (33,301) |
| Total comprehensive income | | | | | | 187,040 |
| Purchase of treasury stock | | | | (173,829) | | (173,829) |
| Cash dividends paid (\$.795 per share) | | | (61,135) | | | (61,135) |
| Net tax benefit related to equity compensation plans | | 2,305 | | | | 2,305 |
| Stock based compensation | | 6,465 | | | | 6,465 |
| Issuance under stock purchase and equity compensation plans, net | | (17,850) | | 33,131 | | 15,281 |
| 5% stock dividend, net | 3,866 | 40,357 | (163,049) | 118,625 | | (201) |
| Balance, December 31, 2004 | 347,049 | 388,614 | 703,293 | (51,646) | 39,570 | 1,426,880 |
| Net income | | | 223,247 | | | 223,247 |
| Change in unrealized gain (loss) on available for sale securities, net of tax | | | | | (43,453) | (43,453) |
| Total comprehensive income | | | | | | 179,794 |
| Purchase of treasury stock | | | | (234,501) | | (234,501) |
| Cash dividends paid (\$.871 per share) | | | (63,421) | | | (63,421) |
| Net tax benefit related to equity compensation plans | | 4,288 | | | | 4,288 |
| Stock based compensation | | 6,628 | | | | 6,628 |
| Issuance under stock purchase and equity compensation plans, net | | (18,656) | | 37,049 | | 18,393 |
| 5% stock dividend, net | | 7,678 | (170,098) | 162,197 | | (223) |

| | | | | | | |
|---|-------------------|-------------------|-------------------|--------------------|-----------------|---------------------|
| Balance, December 31, 2005 | 347,049 | 388,552 | 693,021 | (86,901) | (3,883) | 1,337,838 |
| Net income | | | 219,842 | | | 219,842 |
| Change in unrealized gain (loss) on available for sale securities, net of tax | | | | | 14,553 | 14,553 |
| Total comprehensive income | | | | | | 234,395 |
| Purchase of treasury stock | | | | (134,956) | | (134,956) |
| Cash dividends paid (\$.933 per share) | | | (65,758) | | | (65,758) |
| Net tax benefit related to equity compensation plans | | 2,108 | | | | 2,108 |
| Stock based compensation | | 4,786 | | | | 4,786 |
| Issuance under stock purchase and equity compensation plans, net | | (9,830) | | 17,104 | | 7,274 |
| Issuance in West Pointe Bancorp, Inc. acquisition | | (1,268) | | 68,752 | | 67,484 |
| 5% stock dividend, net | 5,281 | 43,073 | (163,929) | 115,388 | | (187) |
| Adoption of SFAS No. 158, net of tax | | | | | (10,870) | (10,870) |
| Balance, December 31, 2006 | \$ 352,330 | \$ 427,421 | \$ 683,176 | \$ (20,613) | \$ (200) | \$ 1,442,114 |

See accompanying notes to consolidated financial statements.

Commerce Bancshares, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Nature of Operations

Commerce Bancshares, Inc. (the Company) conducts its principal activities through its banking and non-banking subsidiaries from approximately 350 locations throughout Missouri, Illinois and Kansas. Principal activities include retail and commercial banking, investment management, securities brokerage, mortgage banking, credit related insurance, venture capital and real estate activities.

Basis of Presentation

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

Cash and Cash Equivalents

In the accompanying consolidated statements of cash flows, cash and cash equivalents include Cash and due from banks and Federal funds sold and securities purchased under agreements to resell as segregated in the accompanying consolidated balance sheets.

Loans and Related Earnings

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances, net of undisbursed loan proceeds, the allowance for loan losses, and any deferred fees and costs on originated loans. Origination fee income received on loans and amounts representing the estimated direct costs of origination are deferred and amortized to interest income over the life of the loan using the interest method, or recognized when the loan is sold.

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

Loans held for sale include student loans and fixed rate residential mortgage loans. These loans are typically classified as held for sale upon origination based upon management's intent to sell all the production of these loans. They are carried at the lower of aggregate cost or fair value. Fair value is determined based on prevailing market prices for

loans with similar characteristics or on sale contract prices. Declines in fair value below cost are recognized in loan fees and sales. Deferred fees and costs related to these loans are not amortized but are recognized as part of the cost basis of the loan at the time it is sold. Gains or losses on sales are recognized upon delivery and included in loan fees and sales.

Loans, including those that are considered to be impaired, are evaluated regularly by management. Business, lease, construction and business real estate loans are placed on non-accrual status when the

collection of interest or principal is 90 days or more past due, unless the loan is adequately secured and in the process of collection. Accrual of interest on consumer installment loans is suspended when any payment of principal or interest is more than 120 days delinquent, and there is no assurance that collateral values will fully recover principal and interest. Accrual of interest on personal real estate loans is discontinued if payments are more than 90 days past due and management determines that the net proceeds from sale of the collateral will not cover the outstanding principal and accrued interest. When a loan is placed on non-accrual status, any interest previously accrued but not collected is reversed against current income. Loans may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Interest payments received on non-accrual loans are generally applied to principal unless the remaining principal balance has been determined to be fully collectible. Credit card loans are charged off against the allowance for loan losses when the receivable is more than 180 days past due. The interest and fee income previously capitalized but not collected on credit card charge-offs is reversed against interest income.

Allowance/Provision for Loan Losses

The allowance for loan losses is maintained at a level believed to be appropriate by management to provide for probable loan losses inherent in the portfolio as of the balance sheet date, including known or anticipated problem loans as well as for loans which are not currently known to require specific allowances. Management's judgment as to the amount of the allowance is a result of the review of larger individual loans, collateral values, the overall risk characteristics of the portfolio, changes in the character or size of the portfolio, the level of impaired and non-performing assets, historical charge-off amounts, geographic location, prevailing economic conditions and other relevant factors. Loans are considered impaired when it becomes probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Included in impaired loans are all non-accrual business, lease, construction, and business real estate loans. Consumer, personal real estate, home equity, student and credit card loans (collectively personal loans) are excluded from the definition of an impaired loan. Impairment is measured as the present value of the expected future cash flows at the loan's initial effective interest rate or the fair value of the collateral for collateral-dependent loans. Personal loans are segregated by loan type and by sub-type, and are evaluated on a group basis. Loans are charged off to the extent they are deemed to be uncollectible, reducing the allowance. Recoveries of loans previously charged off are added to the allowance. The amount of the allowance for loan losses is highly dependent on management's estimates of variables affecting valuation, appraisals of collateral, evaluations of performance and status, and the amount and timing of future cash flows expected to be received on impaired loans. Such estimates, appraisals, evaluations, and cash flows may be subject to frequent adjustments due to changing economic prospects of borrowers or properties. These estimates are reviewed periodically and adjustments, if necessary, are recorded in the provision for loan losses in the periods in which they become known.

Operating, Direct Financing and Sales Type Leases

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

Investments in Debt and Equity Securities

The Company has classified the majority of its investment portfolio as available for sale. From time to time, the Company sells securities and utilizes the proceeds to reduce borrowings, fund loan growth, or

modify its interest rate profile. Securities classified as available for sale are carried at fair value. Their related unrealized gains and losses, net of tax, are reported in accumulated other comprehensive income (loss), a component of stockholders' equity. Premiums and discounts are amortized to interest income over the estimated lives of the securities. Realized gains and losses, including other-than-temporary declines in fair value, are calculated using the specific identification method and included in non-interest income.

Non-marketable securities include certain private equity and venture capital investments, consisting of both debt and equity instruments, which are accounted for at fair value. In the absence of readily ascertainable market values, fair value is determined based on observable market values or at estimated fair values. Changes in fair value and gains and losses from sales are recognized in non-interest income. Other non-marketable securities acquired for debt and regulatory purposes are accounted for at cost.

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

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

Land, Buildings and Equipment

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

Foreclosed Assets

Foreclosed assets consist of property that has been repossessed. Collateral obtained through foreclosure is comprised of commercial and residential real estate and other non-real estate property, including automobiles. The assets are initially recorded at the lower of the related loan balance or fair value of the collateral less estimated selling costs, with any valuation adjustments charged to the allowance for loan losses. Fair values are estimated primarily based on appraisals when available or quoted market prices of liquid assets. Subsequently, foreclosed assets are valued at the lower of the amount recorded at acquisition date or the current fair value less estimated costs to sell. Further valuation adjustments on these assets, gains and losses realized on sales, and net operating expenses are recorded in other non-interest expense.

Intangible Assets

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

When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the asset carrying value, using estimates of undiscounted future cash flows over the remaining asset life. Any impairment loss is measured by the excess of carrying value over fair value. Goodwill impairment tests are performed on an annual basis or when events or circumstances dictate. In these tests, the fair value of each

reporting unit, or segment, is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated. If so, the implied fair value of the reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value. There has been no impairment resulting from goodwill

impairment tests. However, adverse changes in the economic environment, operations of the reporting unit, or other factors could result in a decline in the implied fair value.

Income Taxes

The Company and its eligible subsidiaries file consolidated income tax returns. Amounts provided for income tax expense are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable under tax laws. Deferred income taxes are provided for temporary differences between the financial reporting bases and income tax bases of the Company's assets and liabilities. Deferred tax assets and liabilities are measured using the tax rates and laws that are expected to be in effect when the differences are anticipated to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the change. A valuation allowance is recorded when necessary to reduce deferred tax assets to amounts which are deemed more likely than not to be realized.

Derivatives

The Company is exposed to market risk, including changes in interest rates and currency exchange rates. To manage the volatility relating to these exposures, the Company's risk management policies permit its use of derivative products. The Company manages potential credit exposure through established credit approvals, risk control limits and other monitoring procedures. The Company uses derivatives on a limited basis mainly to stabilize interest rate margins and hedge against interest rate movements. The Company more often manages normal asset and liability positions by altering the products it offers and by selling portions of specific loan or investment portfolios as necessary.

Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities", requires that all derivative financial instruments be recorded on the balance sheet at fair value, with the adjustment to fair value recorded in current earnings. Derivatives that qualify under the Statement in a hedging relationship can be designated, based on the exposure being hedged, as fair value or cash flow hedges. Under the fair value hedging model, gains or losses attributable to the change in fair value of the derivative, as well as gains and losses attributable to the change in fair value of the hedged item, are recognized in current earnings. Under the cash flow hedging model, the effective portion of the gain or loss related to the derivative is recognized as a component of other comprehensive income. The ineffective portion is recognized in current earnings.

The Company formally documents all hedging relationships between hedging instruments and the hedged item, as well as its risk management objective. At December 31, 2006, the Company had two interest rate swaps designated as fair value hedges. The Company performs quarterly assessments, using the regression method, to determine whether the hedging relationship has been highly effective in offsetting changes in fair values.

Derivative contracts are also offered to customers to assist in hedging their risks of adverse changes in interest rates and foreign exchange rates. The Company serves as an intermediary between its customers and the markets. Each contract between the Company and its customers is offset by a contract between the Company and various counterparties. These contracts do not qualify for hedge accounting. They are carried at fair value with changes in fair value recorded in other non-interest income. Since each customer contract is paired with an offsetting contract, there is no significant impact to net income.

The Company enters into interest rate lock commitments on mortgage loans, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding. The Company also has corresponding forward sales contracts related to these interest rate lock commitments. Both the mortgage loan commitments and the related sales contracts are accounted for as derivatives and carried at fair value with changes in fair value recorded in

loan fees and sales. Fair values are based upon quoted prices and exclude the value of loan servicing rights or other ancillary values.

Pension Plan

The Company sponsors a noncontributory defined benefit pension plan under which participation is limited to employees hired before June 30, 2003. Substantially all benefits accrued under the plan were frozen effective January 1, 2005.

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

The Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, and at December 31, 2006 adjusted its prepaid pension asset to reflect the funded status of the pension plan, resulting in a reduction in equity. The effect of the adoption is further described in Note 10, *Employee Benefit Plans*.

Stock-Based Compensation

The Company's stock-based employee compensation plan is described in Note 11, *Stock-Based Compensation and Directors Stock Purchase Plan*. Prior to January 1, 2006, the Company accounted for stock-based compensation under the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. The Company adopted SFAS No. 123 (revised), *Share-Based Payment* on January 1, 2006. SFAS No. 123 (revised) contains additional guidance in several areas including award modifications and forfeitures, measuring fair value, classifying an award as equity or as a liability, and attributing compensation cost to reporting periods. It also contains additional disclosure requirements. The Company's adoption of SFAS No. 123 (revised) did not have a material effect on its consolidated financial statements.

Treasury Stock

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

Income per Share

Basic income per share is computed using the weighted average number of common shares outstanding during each year. Diluted income per share includes the effect of all dilutive potential common shares (primarily stock options, stock appreciation rights and nonvested stock awards) outstanding during each year. All per share data has been restated to reflect the 5% stock dividend distributed in December 2006.

2. Acquisitions

On July 21, 2006, Commerce Bank, N.A., (Missouri) (the Bank) a subsidiary of the Company, acquired certain assets and assumed certain liabilities of Boone National Savings and Loan Association (Boone) through a purchase and assumption agreement for cash of \$19.1 million. Boone operated four branches in central Missouri. The Bank acquired loans and deposits of \$126.4 million and \$100.9 million, respectively, and assumed debt of \$26.7 million. Goodwill of \$15.6 million, core deposit premium of \$2.6 million, and \$300 thousand of mortgage servicing rights were recorded as a result of the transaction.

On September 1, 2006, the Company acquired the outstanding stock of West Pointe Bancorp, Inc. (West Pointe) in Belleville, Illinois, which operated five branch locations in the greater St. Louis area. The total purchase price of \$80.5 million consisted of cash of \$13.1 million and 1.4 million shares of Company stock valued at \$67.5 million. The valuation of Company stock was based on the average closing price of Company stock during the measurement period of August 24 through August 30. The Company's acquisition of West Pointe added \$508.8 million in assets, with \$255.0 million in loans, and \$381.8 million in deposits. Intangible

assets recognized as a result of the transaction consisted of approximately \$37.0 million of goodwill, \$17.4 million of core deposit premium, and \$531 thousand of mortgage servicing rights.

The fair value of core deposit premiums acquired were estimated by a third party using a net cost savings method. This methodology calculates the present value of the estimated net cost savings attributable to the core deposit base, relative to alternative costs of funds and tax benefit, if applicable, over the expected remaining economic life of the depositors. Based on an estimation of the expected remaining economic life of the depositors, the core deposit premiums are being amortized over periods of 8 to 14 years, with a weighted average period of 4.7 years, using accelerated methods. Goodwill recognized in the West Pointe acquisition is not deductible for income tax purposes.

The following table summarizes the amount assigned to each major asset and liability caption of the Boone and West Pointe acquisitions at their acquisition dates.

| <i>(In thousands)</i> | Boone | West Pointe | Combined |
|------------------------------------|-------------------|-------------------|-------------------|
| ASSETS | | | |
| Loans, net of unearned income | \$ 126,398 | \$ 255,035 | \$ 381,433 |
| Allowance for loan losses | (1,129) | (2,559) | (3,688) |
| Net loans | 125,269 | 252,476 | 377,745 |
| Investment securities | | 152,714 | 152,714 |
| Cash and due from banks | 891 | 22,755 | 23,646 |
| Land, buildings and equipment, net | 2,024 | 9,898 | 11,922 |
| Goodwill | 15,611 | 37,031 | 52,642 |
| Core deposit premium | 2,560 | 17,360 | 19,920 |
| Mortgage servicing rights | 300 | 531 | 831 |
| Other assets | 557 | 16,013 | 16,570 |
| Total assets | \$ 147,212 | \$ 508,778 | \$ 655,990 |
| LIABILITIES | | | |
| Deposits | \$ 100,867 | \$ 381,802 | \$ 482,669 |
| Other borrowings | 26,714 | 37,724 | 64,438 |
| Other liabilities | 539 | 8,716 | 9,255 |
| Total liabilities | 128,120 | 428,242 | 556,362 |
| Net assets acquired | \$ 19,092 | \$ 80,536 | \$ 99,628 |

West Pointe's results of operations were included in the Company's consolidated financial results beginning September 1, 2006. Pro forma consolidated operating results giving effect to the purchase of West Pointe as if the transaction had occurred January 1, 2005 is included in the table below. These pro forma results combine historical results of West Pointe into the Company's operating results, with certain adjustments made for the estimated impact of purchase accounting adjustments and interest costs on acquisition funding. In addition, pro forma information does not include the effect of anticipated savings resulting from the merger. Pro forma data is not necessarily indicative of the results that would have occurred had the acquisition taken place at the beginning of the periods presented or of future results.

| <i>(In thousands, except per share data)</i> | 2006 | 2005 |
|--|-------------------|------------|
| Net interest income plus non-interest income | \$ 884,706 | \$ 860,879 |
| Net income | 215,272 | 225,476 |
| Net income per share - basic | 3.03 | 3.03 |
| Net income per share - diluted | 2.99 | 2.99 |

On December 4, 2006, the Company and South Tulsa Financial Corporation (South Tulsa) signed a definitive merger agreement in which the Company will acquire all outstanding shares of South Tulsa. Simultaneously, South Tulsa's wholly-owned subsidiary, Bank South, will merge into the Bank. The Company's acquisition of South Tulsa will add approximately \$124 million in assets (including \$107 million

in loans), \$101 million in deposits, and two branch locations in Tulsa, Oklahoma. Under terms of the agreement, the Company will issue approximately 539,000 shares of Company common stock for all outstanding shares of South Tulsa. Total consideration is estimated to be approximately \$26.3 million. It is anticipated that the transaction will be completed in the second quarter of 2007, pending regulatory approvals and certain closing conditions.

3. Loans and Allowance for Loan Losses

Major classifications of loans at December 31, 2006 and 2005 are as follows:

| <i>(In thousands)</i> | 2006 | 2005 |
|---|---------------------|---------------------|
| Business | \$ 2,860,692 | \$ 2,527,654 |
| Real estate construction | 658,148 | 424,561 |
| Real estate business | 2,148,195 | 1,919,045 |
| Real estate personal | 1,493,481 | 1,358,511 |
| Consumer | 1,435,038 | 1,287,348 |
| Home equity | 441,851 | 448,507 |
| Student | 263,786 | 330,238 |
| Credit card | 648,326 | 592,465 |
| Overdrafts | 10,601 | 10,854 |
| Total loans, including held for sale | \$ 9,960,118 | \$ 8,899,183 |

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

| <i>(In thousands)</i> | |
|----------------------------------|----------------|
| Balance at January 1, 2006 | \$ 106,969 |
| Additions | 117,041 |
| Amounts collected | (104,378) |
| Amounts written off | |
| Balance at December 31, 2006 | \$ 119,632 |

Management believes all loans to directors and executive officers have been made in the ordinary course of business with normal credit terms, including interest rate and collateral considerations, and do not represent more than a normal risk of collection. There were no outstanding loans at December 31, 2006 to principal holders of the Company's common stock.

The Company's lending activity is generally centered in Missouri, Illinois, Kansas and other nearby states including Iowa, Oklahoma, Colorado, Indiana, and others. The Company maintains a diversified portfolio with limited industry concentrations of credit risk. Loans and loan commitments are extended under the Company's normal credit standards, controls, and monitoring features. Most loan commitments are short and intermediate term in nature. Loan maturities, with the exception of residential mortgages, generally do not exceed five years. Collateral is commonly required and would include such assets as marketable securities and cash equivalent assets, accounts receivable and inventory, equipment, other forms of personal property, and real estate. At December 31, 2006, unfunded loan commitments totaled \$7,518,089,000 (which included \$3,701,433,000 in unused approved lines of credit related to credit card loan agreements) which could be drawn by customers subject to certain review and terms of agreement. At December 31, 2006, loans of \$1,246,323,000 were pledged at the Federal Home Loan Bank (FHLB) by subsidiary banks as collateral for borrowings and letters of credit obtained to secure public deposits. Additional loans of \$298,533,000 were pledged at the Federal Reserve as collateral for discount window borrowings. There were no discount window borrowings at December 31, 2006 or 2005.

The Company has a net investment in direct financing and sales type leases of \$262,359,000 and \$221,306,000, at December 31, 2006 and 2005, respectively, which is included in business loans on the Company's consolidated balance sheets. This investment includes deferred income of \$37,412,000 and

\$24,719,000 at December 31, 2006 and 2005, respectively. The net investment in operating leases amounted to \$22,981,000 and \$20,838,000 at December 31, 2006 and 2005, respectively, and is included in other assets on the Company's consolidated balance sheets.

Loans classified as held for sale consist of residential mortgage loans and student loans. Mortgage loans, which are included in the Real estate-personal category in the table above, are fixed rate loans which are sold in the secondary market, generally within three months of origination, and totaled \$14,812,000 and \$6,172,000 at December 31, 2006 and 2005, respectively. Gains on sales of these loans were \$986,000, \$1,401,000 and \$1,535,000 in 2006, 2005 and 2004, respectively. In 2006, the Company elected to classify its student loan portfolio as held for sale in accordance with its lending policies, since these loans are now being more routinely sold. These loans totaled \$263,786,000 at December 31, 2006. Gains on sales of student loans were \$6,273,000, \$7,990,000 and \$8,526,000 in 2006, 2005 and 2004, respectively. Total loans, as disclosed in this note and throughout the report, include held for sale loans.

A summary of the allowance for loan losses is as follows:

| <i>(In thousands)</i> | Years Ended December 31 | | |
|---------------------------------|--------------------------------|-------------------|-------------------|
| | 2006 | 2005 | 2004 |
| Balance, January 1 | \$ 128,447 | \$ 132,394 | \$ 135,221 |
| Additions: | | | |
| Provision for loan losses | 25,649 | 28,785 | 30,351 |
| Allowance of acquired companies | 3,688 | | |
| Total additions | 29,337 | 28,785 | 30,351 |
| Deductions: | | | |
| Loan losses | 40,944 | 47,220 | 48,153 |
| Less recoveries | 14,890 | 14,488 | 14,975 |
| Net loan losses | 26,054 | 32,732 | 33,178 |
| Balance, December 31 | \$ 131,730 | \$ 128,447 | \$ 132,394 |

The Company had ceased recognition of interest income on loans with a carrying value of \$16,708,000 and \$9,845,000 at December 31, 2006 and 2005, respectively. The interest income not recognized on non-accrual loans was \$1,376,000, \$1,017,000 and \$2,583,000 during 2006, 2005 and 2004, respectively. Loans 90 days delinquent and still accruing interest amounted to \$20,376,000 and \$14,088,000 at December 31, 2006 and 2005, respectively.

The following table presents information on impaired loans at December 31:

| <i>(In thousands)</i> | 2006 | 2005 |
|---|------------------|----------|
| Impaired loans for which an allowance has been provided | \$ 15,537 | \$ 9,175 |
| Impaired loans for which no related allowance has been provided | 2,699 | 798 |
| Total impaired loans | \$ 18,236 | \$ 9,973 |
| Allowance related to impaired loans | \$ 4,644 | \$ 2,573 |

Impaired loans include loans on non-accrual status and other loans classified as substandard and more than 60 days past due. Average impaired loans were \$15,333,000 during 2006, \$18,670,000 during 2005 and \$24,667,000 during 2004. The amount of interest income recorded on these loans during their impairment period was not significant.

4. Investment Securities

A summary of the available for sale investment securities by maturity groupings as of December 31, 2006 is shown below. The weighted average yield for each range of maturities was calculated using the yield on each security within that range weighted by the amortized cost of each security at December 31, 2006. Yields on tax exempt securities have not been adjusted for tax exempt status. The investment portfolio includes fixed and floating-rate mortgage-related securities, predominantly underwritten to the standards of and guaranteed by the government-sponsored agencies of FHLMC, FNMA and GNMA. These securities differ from traditional debt securities primarily in that they have uncertain maturity dates and are priced based on estimated prepayment rates on the underlying mortgages. Also included are certain other asset-backed securities (primarily credit card, automobile and commercial loan backed securities).

| <i>(Dollars in thousands)</i> | Amortized Cost | Fair Value | Weighted Average Yield |
|---|-------------------|------------------|------------------------------|
| U.S. government and federal agency obligations: | | | |
| Within 1 year | \$ 3,605 | \$ 3,643 | 5.52% |
| After 1 but within 5 years | 199 | 197 | 4.17 |
| After 5 but within 10 years | 5,454 | 5,811 | 5.79 |
| Total U.S. government and federal agency obligations | 9,258 | 9,651 | 5.65 |
| Government-sponsored enterprise obligations: | | | |
| Within 1 year | 200,104 | 198,751 | 3.29 |
| After 1 but within 5 years | 240,883 | 236,535 | 3.81 |
| After 5 but within 10 years | 30,071 | 29,251 | 4.31 |
| After 10 years | 27 | 30 | 6.77 |
| Total government-sponsored enterprise obligations | 471,085 | 464,567 | 3.62 |
| State and municipal obligations: | | | |
| Within 1 year | 24,857 | 24,663 | 3.62 |
| After 1 but within 5 years | 403,523 | 403,049 | 3.65 |
| After 5 but within 10 years | 111,773 | 112,425 | 3.82 |
| After 10 years | 53,663 | 54,687 | 4.16 |
| Total state and municipal obligations | 593,816 | 594,824 | 3.73 |
| Mortgage and asset-backed securities | 2,167,855 | 2,136,908 | 4.59 |

| | | |
|---|---------------------|---------------------|
| Other debt securities: | | |
| Within 1 year | 14,664 | 14,550 |
| After 1 but within 5 years | 21,864 | 21,459 |
| Total other debt securities | 36,528 | 36,009 |
| Equity securities | 119,723 | 173,481 |
| Total available for sale investment securities | \$ 3,398,265 | \$ 3,415,440 |

The unrealized gains and losses by type are as follows:

| <i>(In thousands)</i> | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--|---------------------|------------------------------|-------------------------------|---------------------|
| December 31, 2006 | | | | |
| U.S. government and federal agency obligations | \$ 9,258 | \$ 430 | \$ 37 | \$ 9,651 |
| Government-sponsored enterprise obligations | 471,085 | 123 | 6,641 | 464,567 |
| State and municipal obligations | 593,816 | 3,267 | 2,259 | 594,824 |
| Mortgage and asset-backed securities | 2,167,855 | 2,334 | 33,281 | 2,136,908 |
| Other debt securities | 36,528 | 4 | 523 | 36,009 |
| Equity securities | 119,723 | 53,758 | | 173,481 |
| Total | \$ 3,398,265 | \$ 59,916 | \$ 42,741 | \$ 3,415,440 |
| December 31, 2005 | | | | |
| U.S. government and federal agency obligations | \$ 61,402 | \$ 563 | \$ 162 | \$ 61,803 |
| Government-sponsored enterprise obligations | 784,210 | 425 | 11,781 | 772,854 |
| State and municipal obligations | 251,803 | 291 | 3,076 | 249,018 |
| Mortgage and asset-backed securities | 2,354,331 | 2,244 | 40,176 | 2,316,399 |
| Other debt securities | 40,919 | 56 | 958 | 40,017 |
| Equity securities | 181,499 | 46,496 | 185 | 227,810 |
| Total | \$ 3,674,164 | \$ 50,075 | \$ 56,338 | \$ 3,667,901 |

The table above shows that some of the securities in the portfolio were temporarily impaired as of December 31, 2006 and 2005. This temporary impairment represents the estimated amount of loss that would be realized if the securities were sold at the valuation date. Most of the impairment relates to debt securities and occurs as a result of changes in overall bond yields between the date the bond was acquired and the valuation date. Securities which were temporarily impaired at December 31, 2006 and 2005 are shown below, along with the length of the impairment period. Management does not believe that any individual unrealized loss as of December 31, 2006 represents an other-than-temporary impairment, and believes that the Company has the intent and ability to hold these securities until their maturity.

| <i>(In thousands)</i> | Less than 12 months | | 12 months or longer | | Total | |
|--|----------------------------|-------------------|----------------------------|-------------------|---------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| At December 31, 2006 | | | | | | |
| U.S. government and federal agency obligations | \$ 500 | \$ 35 | \$ 197 | \$ 2 | \$ 697 | \$ 37 |
| Government-sponsored enterprise obligations | | | 422,466 | 6,641 | 422,466 | 6,641 |
| State and municipal obligations | 123,791 | 257 | 178,542 | 2,002 | 302,333 | 2,259 |
| Mortgage and asset-backed securities | 301,756 | 2,841 | 1,467,216 | 30,440 | 1,768,972 | 33,281 |
| Other debt securities | | | 32,395 | 523 | 32,395 | 523 |
| Total temporarily impaired securities | \$ 426,047 | \$ 3,133 | \$ 2,100,816 | \$ 39,608 | \$ 2,526,863 | \$ 42,741 |

| <i>(In thousands)</i> | Less than 12 months | | 12 months or longer | | Total | |
|--|----------------------------|-------------------|----------------------------|-------------------|--------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| At December 31, 2005 | | | | | | |
| U.S. government and federal agency obligations | \$ 49,985 | \$ 162 | \$ | \$ | \$ 49,985 | \$ 162 |
| Government-sponsored enterprise obligations | 164,610 | 2,124 | 504,235 | 9,657 | 668,845 | 11,781 |
| State and municipal obligations | 220,312 | 2,958 | 11,827 | 118 | 232,139 | 3,076 |
| Mortgage and asset-backed securities | 1,508,962 | 24,969 | 624,615 | 15,207 | 2,133,577 | 40,176 |
| Other debt securities | 8,474 | 85 | 27,833 | 873 | 36,307 | 958 |
| Subtotal, debt securities | 1,952,343 | 30,298 | 1,168,510 | 25,855 | 3,120,853 | 56,153 |
| Equity securities | 31,711 | 185 | | | 31,711 | 185 |

| | | | | | | |
|--|--------------|-----------|--------------|-----------|--------------|-----------|
| Total temporarily impaired securities | \$ 1,984,054 | \$ 30,483 | \$ 1,168,510 | \$ 25,855 | \$ 3,152,564 | \$ 56,338 |
|--|--------------|-----------|--------------|-----------|--------------|-----------|

In addition to the available for sale portfolio, investment securities held by the Company include certain securities which are not readily marketable, and are classified as non-marketable on the Company's consolidated balance sheets. These securities totaled \$74,207,000 and \$77,321,000 at December 31, 2006 and 2005, respectively. This category includes holdings of Federal Reserve Bank (FRB) stock and Federal Home Loan Bank of Des Moines (FHLB) stock which are required to be held for regulatory purposes and for borrowing availability, and are carried at cost. Investment in FRB stock is based on the capital structure of the bank, and investment in FHLB stock is tied to the borrowings level. At December 31, 2006, investment in FRB stock totaled \$23,282,000 and investment in FHLB stock totaled \$12,310,000. The remainder of the securities in the non-marketable category are comprised of investments in venture capital and private equity concerns. In the absence of readily ascertainable market values, these securities are carried at estimated fair value.

The following table presents proceeds from sales of securities and the components of net securities gains and losses, including fair value adjustments.

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|----------------------------|-------------------|--------------|------------|
| Proceeds from sales | \$ 170,421 | \$ 1,816,865 | \$ 252,464 |
| Gains | \$ 13,086 | \$ 29,750 | \$ 12,517 |
| Losses | 4,051 | 23,388 | 1,425 |
| Net gains | \$ 9,035 | \$ 6,362 | \$ 11,092 |

Investment securities with a fair value of \$2,142,651,000 and \$2,412,255,000 were pledged at December 31, 2006 and 2005, respectively, to secure public deposits, securities sold under repurchase agreements, trust funds, and borrowings at the Federal Reserve discount window. Securities pledged under agreements pursuant to which the collateral may be sold or re-pledged by the secured parties approximated \$526,430,000, while securities pledged under agreements pursuant to which the secured parties may not sell or re-pledge the collateral approximated \$1,616,221,000 at December 31, 2006. Except for obligations of various government-sponsored enterprises such as FNMA, FHLB and FHLMC, no investment in a single issuer exceeds 10% of stockholders' equity.

5. Land, Buildings and Equipment

Land, buildings and equipment consist of the following at December 31, 2006 and 2005:

| <i>(In thousands)</i> | 2006 | 2005 |
|--|-------------------|------------|
| Land | \$ 86,471 | \$ 79,920 |
| Buildings and improvements | 458,974 | 428,861 |
| Equipment | 214,114 | 203,324 |
| Total | 759,559 | 712,105 |
| Less accumulated depreciation and amortization | 373,464 | 337,913 |
| Net land, buildings and equipment | \$ 386,095 | \$ 374,192 |

Depreciation expense of \$35,375,000, \$32,015,000 and \$30,674,000 for 2006, 2005 and 2004, respectively, was included in occupancy expense and equipment expense in the consolidated income statements. Repairs and maintenance expense of \$18,044,000, \$18,695,000 and \$17,723,000 for 2006, 2005 and 2004, respectively, was included in occupancy expense and equipment expense. Interest expense capitalized on construction projects was \$38,000, \$123,000 and \$113,000 in 2006, 2005 and 2004, respectively.

6. Goodwill and Other Intangible Assets

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

| <i>(In thousands)</i> | December 31, 2006 | | | December 31, 2005 | | |
|---|-----------------------|--------------------------|------------------|-----------------------|--------------------------|------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Amount | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| Amortizable intangible assets: | | | | | | |
| Core deposit premium | \$ 19,920 | \$ (1,093) | \$ 18,827 | \$ | \$ | \$ |
| Mortgage servicing rights | 1,338 | (532) | 806 | 522 | (475) | 47 |
| Total | \$ 21,258 | \$ (1,625) | \$ 19,633 | \$ 522 | \$ (475) | \$ 47 |
| Unamortizable intangible assets: | | | | | | |
| Goodwill included in Consumer segment | \$ 58,879 | | \$ 58,879 | \$ 33,540 | | \$ 33,540 |
| Goodwill included in Commercial segment | 38,018 | | 38,018 | 14,236 | | 14,236 |
| Goodwill included in Money Management segment | 746 | | 746 | 746 | | 746 |
| Total | \$ 97,643 | | \$ 97,643 | \$ 48,522 | | \$ 48,522 |

In conjunction with the 2006 bank acquisitions discussed previously, the Company recorded goodwill of \$52,642,000, which was allocated to the Consumer and Commercial segments as shown in the table above. As a result of routine annual assessments, no impairment of intangible assets was recorded in 2006, 2005 or 2004.

Aggregate amortization expense on intangible assets for the years ended December 31, 2006, 2005 and 2004 was \$1,165,000, \$455,000 and \$1,699,000, respectively. The following table shows the estimated future amortization expense based on existing asset balances and the interest rate environment as of December 31, 2006. The Company's actual amortization expense in any given period may be different from the estimated amounts depending upon the addition of new intangible assets, changes in mortgage interest rates, prepayment rates and other market conditions.

(In thousands)

| | |
|------|----------|
| 2007 | \$ 3,198 |
| 2008 | 2,891 |
| 2009 | 2,589 |
| 2010 | 2,291 |
| 2011 | 1,962 |

Changes in the net carrying amount of goodwill for the years ended December 31, 2005 and 2006 are as follows:

| <i>(In thousands)</i> | Consumer Segment | Commercial Segment | Money Management Segment | Total |
|--|------------------|--------------------|--------------------------|------------------|
| Balance at December 31, 2004 | \$ 33,540 | \$ 14,236 | \$ 746 | \$ 48,522 |
| Balance at December 31, 2005 | 33,540 | 14,236 | 746 | \$ 48,522 |
| Current year acquisitions | 25,339 | 27,303 | | 52,642 |
| Adjustments to prior year acquisitions | | (3,521) | | (3,521) |
| Balance at December 31, 2006 | \$ 58,879 | \$ 38,018 | \$ 746 | \$ 97,643 |

7. Deposits

At December 31, 2006, the scheduled maturities of total time open and certificates of deposit were as follows:

(In thousands)

| | | |
|--------------|-----------|------------------|
| Due in 2007 | \$ | 2,934,454 |
| Due in 2008 | | 478,002 |
| Due in 2009 | | 73,969 |
| Due in 2010 | | 43,359 |
| Due in 2011 | | 22,487 |
| Thereafter | | 1,136 |
| Total | \$ | 3,553,407 |

At December 31, 2006, the scheduled maturities of time open and certificates of deposit over \$100,000 were as follows:

| <i>(In thousands)</i> | Certificates of Deposit over \$100,000 | Other Time Deposits over \$100,000 | Total |
|---------------------------------|--|---------------------------------------|---------------------|
| Due in 3 months or less | \$ 523,679 | \$ 4,398 | \$ 528,077 |
| Due in over 3 through 6 months | 216,154 | 2,306 | 218,460 |
| Due in over 6 through 12 months | 362,293 | 12,312 | 374,605 |
| Due in over 12 months | 109,827 | 19,871 | 129,698 |
| Total | \$ 1,211,953 | \$ 38,887 | \$ 1,250,840 |

Regulations of the Federal Reserve System require reserves to be maintained by all banking institutions according to the types and amounts of certain deposit liabilities. Reserves refer to non-earning cash held at the Federal Reserve Bank. The minimum reserve requirements for the subsidiary banks at December 31, 2006 totaled \$64,827,000.

8. Borrowings

Borrowings of the Company primarily consist of federal funds purchased and securities sold under agreements to repurchase (repurchase agreements), which generally mature within 90 days. The following table presents balance and interest rate information on these borrowings.

| <i>(Dollars in thousands)</i> | Year End Weighted Rate | Average Weighted Rate | Average Balance Outstanding | Maximum Outstanding at any Month End | Balance at December 31 |
|--|---------------------------------|-----------------------------|-----------------------------------|---|---------------------------|
| 2006 | | | | | |
| Federal funds purchased and short-term repurchase agreements | 4.8% | 4.7% | \$ 1,256,914 | \$ 1,586,511 | \$ 1,271,282 |
| Long-term repurchase agreements | 5.5 | 5.6 | 198,630 | 500,000 | 500,000 |
| Total federal funds purchased and repurchase agreements | | | | | 1,771,282 |
| 2005 | | | | | |
| Federal funds purchased and repurchase agreements | 3.8 | 3.0 | 1,609,868 | 2,020,498 | 1,326,427 |
| 2004 | | | | | |
| Federal funds purchased and repurchase agreements | 2.0 | 1.2 | 1,827,428 | 2,157,542 | 1,913,878 |

Total securities sold under agreements to repurchase at December 31, 2006 were comprised of non-insured customer funds totaling \$555.8 million and structured repurchase agreements of \$500.0 million

which were purchased in the third quarter of 2006 from an unaffiliated financial institution. The structured repurchase agreements mature in 2010 and have a LIBOR-based floating interest rate and an embedded floor. All securities sold under agreements to repurchase are secured by a portion of the Company's investment portfolio.

Other borrowings of the Company consisted of the following at December 31, 2006.

| <i>(Dollars in thousands)</i> | Borrower | Maturity Date | Year End Weighted Rate | Year End Balance |
|-----------------------------------|----------------------------|------------------|------------------------------|---------------------|
| FHLB advances | Subsidiary bank | 2007 | 3.7% | \$ 17,850 |
| | | 2008 | 4.1 | 7,535 |
| | | 2009-13 | 4.2 | 2,830 |
| Nonrecourse lease financing notes | Bank leasing subsidiary | 2007 | 8.7 | 53 |
| | | 2008 | 6.0 | 73 |
| | | 2011 | 6.3 | 369 |
| Subordinated debentures | Subsidiary holding company | 2030 | 10.9 | 4,000 |
| | | 2034 | 7.6 | 10,310 |
| Structured notes payable | Venture capital subsidiary | 2007 | 0.0 | 3,399 |
| | | 2012 | 0.0 | 7,515 |
| Total | | | | \$ 53,934 |

Banking subsidiaries of the Company are members of the FHLB and have access to term financing from the FHLB. These borrowings are secured under a blanket collateral agreement including primarily residential mortgages as well as all unencumbered assets and stock of the respective borrowing bank. During 2006, advances of \$250,275,000 were repaid by the Company, which primarily consisted of \$238,000,000 maturing in 2006 and a portion of the advances assumed in the Boone acquisition. All of the advances outstanding at December 31, 2006 have fixed interest rates and contain prepayment penalties. The total outstanding at December 31, 2006 was \$28,215,000, which included borrowings of \$16,215,000 assumed in the Boone acquisition. The FHLB has issued letters of credit, totaling \$102,100,000 at December 31, 2006, to secure the Company's obligations to depositors of public funds.

Specified amounts of the Company's lease receivables and underlying equipment in leasing transactions serve as collateral for non-recourse lease financing notes from other financial institutions, which totaled \$495,000 at December 31, 2006. In the event of a default by a lessee, the other financial institution has a first lien on the underlying lease equipment and chattel paper, with no further recourse against the Company.

In certain acquisition transactions, the Company has assumed subordinated debentures which were issued by acquired bank holding companies to wholly owned grantor trusts. The trusts were formed to issue preferred securities representing undivided beneficial interests in the assets of the trusts and to invest the gross proceeds of such preferred securities in the debentures. While the trusts are accounted for as unconsolidated equity investments, the preferred securities issued by the trusts qualify as Tier I Capital for regulatory purposes. In the 2006 acquisition of West Pointe Bancorp, Inc., debentures of \$10,310,000 were assumed which are due in 2034 and may be redeemed beginning in 2009. These securities have a variable interest rate based on LIBOR, which resets on a quarterly basis. The Company

also assumed \$4,000,000 of subordinated debentures as a result of its acquisition of Breckenridge Bancshares Company in 2001. These debentures, which are due in 2030 and are redeemable beginning in 2010, have a 10.875% interest rate throughout their term.

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

Cash payments for interest on deposits and borrowings during 2006, 2005 and 2004 on a consolidated basis amounted to \$294,555,000, \$179,651,000 and \$113,131,000, respectively.

9. Income Taxes

Income tax expense (benefit) from operations for the years ended December 31, 2006, 2005 and 2004 consists of:

| <i>(In thousands)</i> | Current | Deferred | Total |
|-------------------------------|-------------------|-------------------|-------------------|
| Year ended December 31, 2006: | | | |
| U.S. federal | \$ 104,730 | \$ (1,394) | \$ 103,336 |
| State and local | 554 | 14 | 568 |
| | \$ 105,284 | \$ (1,380) | \$ 103,904 |
| Year ended December 31, 2005: | | | |
| U.S. federal | \$ 90,240 | \$ (2,517) | \$ 87,723 |
| State and local | 5,864 | 760 | 6,624 |
| | \$ 96,104 | \$ (1,757) | \$ 94,347 |
| Year ended December 31, 2004: | | | |
| U.S. federal | \$ 80,515 | \$ 2,957 | \$ 83,472 |
| State and local | 7,569 | (240) | 7,329 |
| | \$ 88,084 | \$ 2,717 | \$ 90,801 |

Income tax expense (benefit) allocated directly to stockholders' equity for the years ended December 31, 2006, 2005 and 2004 consists of:

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|--|-----------------|-------------|-------------|
| Unrealized gain (loss) on securities available for sale | \$ 8,885 | \$ (26,633) | \$ (20,410) |
| Compensation expense for tax purposes in excess of amounts recognized for financial reporting purposes | (2,108) | (4,288) | (2,305) |
| Accumulated pension loss | (6,662) | | |
| | \$ 115 | \$ (30,921) | \$ (22,715) |

**Income tax expense (benefit) allocated to
stockholders equity**

73

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are presented below.

| <i>(In thousands)</i> | 2006 | 2005 |
|---|------------------|-----------|
| Deferred tax assets: | | |
| Loans, principally due to allowance for loan losses | \$ 57,490 | \$ 56,364 |
| Unearned fee income | 1,121 | 1,038 |
| Deferred compensation | 3,706 | 1,876 |
| Accrued expenses | 3,074 | 2,390 |
| Stock options | 9,269 | 8,419 |
| Net operating loss carryforward of acquired company | 1,010 | 1,079 |
| Unrealized loss on securities available for sale | | 2,380 |
| Total deferred tax assets | 75,670 | 73,546 |
| Deferred tax liabilities: | | |
| Accretion on investment securities | 1,079 | 1,118 |
| Capitalized interest | 392 | 412 |
| Unrealized gain on securities available for sale | 6,505 | |
| Land, buildings and equipment | 45,606 | 44,498 |
| Pension benefit obligations | 2,799 | 8,692 |
| Core deposit premiums | 5,569 | |
| Other | 1,786 | 1,893 |
| Total deferred tax liabilities | 63,736 | 56,613 |
| Net deferred tax asset (liability) | \$ 11,934 | \$ 16,933 |

The Company acquired a net operating loss carryforward (NOL) of approximately \$4,343,000 in connection with the 2003 acquisition of The Vaughn Group, Inc. At December 31, 2006, the tax benefit on the remaining NOL is \$1,010,000. Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the deferred tax assets above including the NOL, which expires no earlier than 2020.

Actual income tax expense differs from the amounts computed by applying the U.S. federal income tax rate of 35% as a result of the following:

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|-----------------------|-------------|------|------|
|-----------------------|-------------|------|------|

| | | | |
|--|-------------------|------------|------------|
| Computed expected tax expense | \$ 113,311 | \$ 111,158 | \$ 108,900 |
| Increase (reduction) in income taxes resulting from: | | | |
| Tax exempt income | (6,264) | (2,116) | (1,226) |
| Tax deductible dividends on allocated shares held by the Company's | | | |
| ESOP | (1,068) | (1,035) | (994) |
| Contribution of appreciated assets | (900) | | (136) |
| Federal tax credits | (370) | (326) | (406) |
| State and local income taxes, net of federal benefit | 369 | 4,305 | 4,764 |
| Corporate reorganization activities | | (13,705) | (18,910) |
| Other, net | (1,174) | (3,934) | (1,191) |
| Total income tax expense | \$ 103,904 | \$ 94,347 | \$ 90,801 |

Cash payments of income taxes, net of refunds and interest received, amounted to \$97,331,000, \$96,677,000 and \$107,529,000 on a consolidated basis during 2006, 2005 and 2004, respectively. The Parent had net receipts of \$5,689,000, \$9,680,000 and \$5,500,000 during 2006, 2005 and 2004, respectively, from tax benefits.

10. Employee Benefit Plans

Employee benefits charged to operating expenses are summarized in the table below. Substantially all of the Company's employees are covered by a contributory defined contribution (401K) plan. Under the plan, the Company makes matching contributions, which increased in years subsequent to 2004 due to plan enhancements mentioned below.

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|--------------------------------|------------------|-----------|-----------|
| Payroll taxes | \$ 18,078 | \$ 16,962 | \$ 17,197 |
| Medical plans | 15,868 | 12,287 | 12,909 |
| 401K plan | 8,046 | 7,647 | 4,197 |
| Pension plans | (382) | 146 | 4,148 |
| Other | 1,775 | 1,695 | 1,492 |
| Total employee benefits | \$ 43,385 | \$ 38,737 | \$ 39,943 |

A majority of the Company's current employees are covered by a noncontributory defined benefit pension plan, but participation in the pension plan is not available to employees hired after June 30, 2003. Participants are fully vested after five years of service and the benefits are based on years of participation and average annualized earnings. Certain key executives also participate in a supplemental executive retirement plan (the CERP) that the Company funds only as retirement benefits are disbursed. The CERP carries no segregated assets.

Effective January 1, 2005 substantially all benefits accrued under the pension plan were frozen. Enhancements were then made to the 401K plan, which have increased employer contributions to the 401K plan. Enhancements were also made to the CERP, providing credits based on hypothetical contributions in excess of those permitted under the 401K plan.

SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, was issued in September 2006. It requires an employer to recognize the funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The funded status of the Company's defined benefit pension plan at September 30, 2006 (the Company's measurement date) was \$7,998,000, which is equal to the excess of the fair value of the plan assets of \$97,215,000 over the plan's projected benefit obligation of \$89,217,000. The adjustment necessary to reflect this amount on the consolidated balance sheet at December 31, 2006 was a \$17,532,000 reduction to the previously recorded prepaid pension cost of \$25,530,000. The incremental effect of applying this Statement on individual line items in the Company's December 31, 2006 consolidated balance sheet is shown in the table below.

| Before Application of | After Application of |
|--------------------------|-------------------------|
|--------------------------|-------------------------|

| <i>(In thousands)</i> | SFAS No. 158 | Adjustments | SFAS No. 158 |
|---|--------------|-------------|--------------|
| Prepaid pension cost | \$ 25,530 | \$ (17,532) | \$ 7,998 |
| Deferred tax benefits | 5,272 | 6,662 | 11,934 |
| Total assets | 15,241,219 | (10,870) | 15,230,349 |
| Accumulated other comprehensive income (loss) | 10,670 | (10,870) | (200) |
| Total stockholders' equity | 1,452,984 | (10,870) | 1,442,114 |

Under the Company's funding policy for the defined benefit pension plan, contributions are made to a trust as necessary to provide for current service and for any unfunded accrued actuarial liabilities over a reasonable period. To the extent that these requirements are fully covered by assets in the trust, a contribution might not be made in a particular year. The Company elected to make cash contributions to the defined benefit pension plan and the CERP of \$8,000, \$8,000 and \$6,009,000 during fiscal 2006, 2005 and 2004, respectively. The minimum required contribution to the defined benefit pension plan for 2007 is expected to be zero. The Company does not expect to make any further contributions other than the necessary funding contributions to the CERP.

Benefit obligations of the CERP at the September 30 valuation date are shown in the table immediately below. In all other tables presented, the pension plan and the CERP are presented on a combined basis, even though the CERP is unfunded. Although the CERP is unfunded, the foregoing description and the following tables describe payments under the CERP as contributions .

| <i>(In thousands)</i> | 2006 | 2005 |
|--------------------------------|-----------------|----------|
| Projected benefit obligation | \$ 1,484 | \$ 1,176 |
| Accumulated benefit obligation | \$ 1,484 | \$ 1,176 |

The following items are components of the net pension cost for the years ended December 31, 2006, 2005 and 2004.

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|---|-----------------|----------|----------|
| Service cost-benefits earned during the year | \$ 997 | \$ 1,011 | \$ 4,984 |
| Interest cost on projected benefit obligation | 4,718 | 4,693 | 4,460 |
| Expected return on plan assets | (7,199) | (6,816) | (6,403) |
| Amortization of prior service cost | | | (101) |
| Amortization of unrecognized net loss | 1,102 | 1,258 | 1,208 |
| Net periodic pension cost | \$ (382) | \$ 146 | \$ 4,148 |

The following table sets forth the pension plans funded status, using valuation dates of September 30, 2006 and 2005.

| <i>(In thousands)</i> | 2006 | 2005 |
|--|------------------|-----------|
| Change in projected benefit obligation | | |
| Projected benefit obligation at prior valuation date | \$ 87,927 | \$ 83,613 |
| Service cost | 997 | 911 |
| Interest cost | 4,718 | 4,693 |
| Benefits paid | (4,508) | (5,176) |
| Actuarial loss | 1,567 | 3,886 |
| Projected benefit obligation at valuation date | 90,701 | 87,927 |
| Change in plan assets | | |
| Fair value of plan assets at prior valuation date | 92,430 | 87,577 |

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| | | |
|--|-----------------|------------------|
| Actual return (loss) on plan assets | 9,285 | 10,021 |
| Employer contributions | 8 | 8 |
| Benefits paid | (4,508) | (5,176) |
| | | |
| Fair value of plan assets at valuation date | 97,215 | 92,430 |
| | | |
| Funded status | 6,514 | 4,503 |
| Unrecognized net loss from past experience different from that assumed and effects of changes in assumptions | | 19,156 |
| | | |
| Net amount recognized at valuation date | \$ 6,514 | \$ 23,659 |

Employer contributions made after the September 30 valuation date but before the December 31 fiscal year end amounted to \$2,000 in both 2006 and 2005. Amounts recognized on the December 31 balance sheets are as follows:

| | | |
|---|-----------------|------------------|
| <i>(In thousands)</i> | 2006 | 2005 |
| Prepaid pension cost | \$ 7,998 | \$ 24,834 |
| Accrued benefit liability | (1,482) | (1,173) |
| | | |
| Net amount recognized at December 31 | \$ 6,516 | \$ 23,661 |

The accumulated benefit obligation for both plans was \$90,701,000 and \$87,927,000 on September 30, 2006 and 2005, respectively.

Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive income (loss), on a pre-tax basis, at December 31, 2006 are as follows:

(In thousands)

| | | |
|--|----|----------|
| Prior service credit (cost) | \$ | |
| Accumulated gain (loss) | | (17,532) |
| Accumulated other comprehensive income (loss) | | (17,532) |
| Cumulative employer contributions in excess of net periodic benefit cost | | 24,048 |
| Net amount recognized on the December 31 balance sheet | | 6,516 |
| Accumulated other comprehensive income (loss) before application of SFAS No. 158 | | |
| Change in accumulated other comprehensive income (loss) due to application of SFAS No. 158 | | (17,532) |

The amount in accumulated other comprehensive income (loss) that is expected to be recognized as a component of net periodic pension cost during 2007 is \$820,000, consisting entirely of accumulated loss.

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

| | 2006 | 2005 | 2004 |
|--|--------------|-------|-------|
| Determination of benefit obligation at year end: | | | |
| Discount rate | 5.75% | 5.50% | 5.75% |
| Rate of increase in future compensation levels | NA | NA | 5.20% |
| Assumed credit on cash balance accounts | 5.00% | 5.00% | NA |
| Determination of net periodic benefit cost for year ended: | | | |
| Discount rate | 5.50% | 5.75% | 6.00% |
| Rate of increase in future compensation levels | NA | 5.20% | 5.20% |
| Long-term rate of return on assets | 8.00% | 8.00% | 8.00% |
| Assumed credit on cash balance accounts | 5.00% | 5.00% | NA |

The weighted average asset allocations as of September 30 by asset category were as follows:

| | 2006 | 2005 |
|-------------------|-------------|-------------|
| Equity securities | 62% | 66% |
| Debt securities | 34% | 30% |
| Money market | 4% | 4% |
| Total | 100% | 100% |

The investment policy of the pension plan is designed for growth in value within limits designed to safeguard against significant losses within the portfolio. The current long-term investment mix target for the plan is 60% equity securities and 40% fixed income; equities may range 15% above or below the 60% target. There are guidelines regarding the type of investments held that may change from time to time, currently including items such as holding bonds rated investment grade or better, and prohibiting investment in Company stock. The plan does not utilize derivatives, although some investment fund managers employ currency hedging strategies that involve derivatives.

The discount rate is consistently determined by reference to a published long-term bond index.

The assumed overall expected long-term rate of return on pension plan assets used in calculating 2006 pension plan expense was 8%. Determination of the plan's rate is based upon historical returns for equities and fixed income indexes. The average 10-year rolling return for an asset mix comparable to the Company's

pension plan is 7.6%. The rate used in plan calculations may be adjusted by management for current trends in the economic environment. As shown above, with a target of over half of the plan's investment to be in equities, the actual return for any one plan year may fluctuate significantly with changes in the stock market.

The following future benefit payments are expected to be paid:

(In thousands)

| | |
|-----------|----------|
| 2007 | \$ 4,577 |
| 2008 | 4,780 |
| 2009 | 4,996 |
| 2010 | 5,197 |
| 2011 | 5,449 |
| 2012-2016 | 29,986 |

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

During 2005 and previous years, stock option and nonvested stock awards were issued to key employees under several stock option and award plans, all of which had been approved by shareholders. At December 31, 2005, these plans were replaced by the Company's 2005 Equity Incentive Plan which was approved by shareholders on April 20, 2005. The new plan allows for issuance of various types of awards, including stock options, stock appreciation rights, restricted stock and restricted stock units, performance awards and stock-based awards. During 2006, stock-based compensation was issued in the form of stock appreciation rights (SARs) and nonvested stock, and at December 31, 2006, 3,903,550 shares remained available for issuance under the new plan. The stock-based compensation expense that was charged against income was \$4,786,000, \$6,628,000 and \$6,465,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$1,796,000, \$2,488,000 and \$2,426,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The decline in stock-based compensation in 2006 compared to the previous years occurred because of a change in the vesting period of certain awards granted in 2006, in addition to the effects of the forfeiture accounting requirements of SFAS No. 123 (revised), Share-Based Payment, both of which are discussed below.

In determining compensation cost, the Black-Scholes option-pricing model is used to estimate the fair value of options and SARs on date of grant. The Black-Scholes model is a closed-end model that uses the assumptions in the following table. Expected volatility is based on historical volatility of the Company's stock. The Company uses historical exercise behavior and other factors to estimate the expected term of the options and SARs, which represents the period of time that the options and SARs granted are expected to be outstanding. The risk-free rate for the expected term is based on the U.S. Treasury zero coupon spot rates in effect at the time of grant.

Below are the fair values of SARs and stock options granted, using the Black-Scholes option-pricing model, including the model assumptions for those grants. SARs and stock options were granted with exercise prices equal to the market price of the Company's stock at the date of grant and have 10-year contractual terms. SARs, which were granted for the first time in 2006, vest on a graded basis over 4 years of continuous service. All SARs must be settled in stock under provisions of the plan. Stock options, which were granted in 2005 and previous years, vest on a graded basis over 3 years of continuous service.

| | 2006 | 2005 | 2004 |
|---|------------------|-----------|-----------|
| Weighted per share average fair value at grant date | \$13.41 | \$11.32 | \$11.23 |
| Assumptions: | | | |
| Dividend yield | 1.7% | 2.0% | 1.9% |
| Volatility | 21.1% | 23.4% | 24.1% |
| Risk-free interest rate | 4.6% | 4.2% | 3.5% |
| Expected term | 7.4 years | 7.1 years | 7.3 years |

A summary of option activity during 2006 is presented below.

| <i>(Dollars in thousands, except per share data)</i> | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|------------------|--|---|---------------------------------|
| Outstanding at January 1, 2006 | 3,582,902 | \$ 32.24 | | |
| Granted | | | | |
| Forfeited | (8,206) | 41.87 | | |
| Exercised | (349,596) | 23.72 | | |
| Outstanding at December 31, 2006 | 3,225,100 | \$ 33.14 | 5.2 years | \$ 49,239 |
| Exercisable at December 31, 2006 | 2,862,979 | \$ 31.89 | 4.8 years | \$ 47,283 |
| Vested and expected to vest at December 31, 2006 | 3,220,459 | \$ 33.13 | 5.2 years | \$ 49,214 |

A summary of SAR activity during 2006 is presented below.

| <i>(Dollars in thousands, except per share data)</i> | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|----------------|--|---|---------------------------------|
| Outstanding at January 1, 2006 | | \$ | | |
| Granted | 482,416 | 49.29 | | |
| Forfeited | (5,407) | 49.10 | | |
| Exercised | | | | |
| Outstanding at December 31, 2006 | 477,009 | \$ 49.29 | 9.2 years | \$ |
| Exercisable at December 31, 2006 | | \$ | | \$ |
| Vested and expected to vest at December 31, 2006 | 435,479 | \$ 49.29 | 9.2 years | \$ |

Additional information about stock options exercised is presented below. The SARs granted during 2006 are not exercisable until 2007.

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|---|-----------------|-----------|-----------|
| Intrinsic value of options exercised | \$ 8,645 | \$ 19,191 | \$ 16,597 |
| Cash received from options exercised | 6,548 | 17,693 | 14,599 |
| Tax benefit realized from options exercised | 1,818 | 4,288 | 2,305 |

Nonvested stock is awarded to key employees, by action of the Board of Directors. These awards generally vest after 5 years of continued employment, but vesting terms may vary according to the specifics of the individual grant agreement. There are restrictions as to transferability, sale, pledging, or assigning, among others, prior to the end of the 5 year vesting period. Dividend and voting rights are conferred upon grant. A summary of the status of the Company's nonvested share awards as of December 31, 2006 and changes during the year then ended is presented below.

| | Shares | Weighted Average Grant Date Fair Value |
|---------------------------------------|----------------|---|
| Nonvested at January 1, 2006 | 171,536 | \$ 37.52 |
| Granted | 31,016 | 48.90 |
| Vested | (31,651) | 29.04 |
| Forfeited | (3,341) | 44.44 |
| Nonvested at December 31, 2006 | 167,560 | \$ 41.09 |

The total fair value (at vest date) of shares vested during 2006, 2005 and 2004 was \$1,557,000, \$1,337,000 and \$898,000, respectively.

As of December 31, 2006, there was \$9,530,000 of unrecognized compensation cost (net of estimated forfeitures) related to unvested options, SARs and stock awards. That cost is expected to be recognized over a weighted-average period of 2.1 years.

The Company adopted SFAS No. 123R on January 1, 2006. As a result of adoption, the Company recorded a reduction of \$543,000 in stock-based compensation expense in the first quarter of 2006. This adjustment resulted from a change by the Company from its former policy of recognizing the effect of forfeitures only as they occurred to the Statement's requirement to estimate the number of outstanding instruments for which the requisite service is not expected to be rendered. The adjustment was not considered to be material to the Company's financial statements and, accordingly, was not presented separately as the cumulative effect of a change in accounting principle in the accompanying 2006 consolidated income statement.

A portion of shares repurchased under the Company's stock repurchase program during the next twelve months will be used to satisfy share option exercises, which are expected to range from 500,000 to 600,000 shares.

The Company has a directors stock purchase plan whereby outside directors of the Company and its subsidiaries may elect to use their directors' fees to purchase Company stock at market value each month end. Remaining shares available for issuance under this plan were 121,376 at December 31, 2006. In 2006, 14,972 shares were purchased at an average price of \$48.49 and in 2005, 15,180 shares were purchased at an average price of \$46.13.

** All share and per share amounts in this note have been restated for the 5% stock dividend distributed in 2006.*

12. Comprehensive Income

Comprehensive income is the total of net income and all other non-owner changes in equity. Items that are to be recognized under accounting standards as components of comprehensive income are displayed in the consolidated statements of stockholders' equity. The Company's only component of other comprehensive income during the years shown in the table below is the unrealized holding gains and losses on available for sale securities. In the calculation of other comprehensive income, certain reclassification adjustments are made to avoid double counting items that are included as part of net income for a period that also had been included as part of other comprehensive income in that period or earlier periods. The reclassification amounts and the related income tax expense or benefit for the three years ended December 31 are shown in the table below.

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|--|------------------|--------------------|--------------------|
| Unrealized holding gains (losses) on securities | \$ 21,344 | \$ (65,006) | \$ (42,452) |
| Tax (expense) benefit on unrealized gains/losses | (8,089) | 24,652 | 16,021 |
| Reclassification adjustment for (gains) losses realized and included in net income | 2,094 | (5,080) | (11,259) |
| Reclassification adjustment for tax expense (benefit) on realized gains/losses | (796) | 1,981 | 4,389 |
| Other comprehensive income (loss) | \$ 14,553 | \$ (43,453) | \$ (33,301) |

The end of period components of accumulated other comprehensive income (loss) are shown in the table below. In accordance with the adoption provisions of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which is discussed in the Employee Benefits Plan note, the Company reduced accumulated other comprehensive income by \$10,870,000 at December 31, 2006. This

amount represents an accumulated loss, net of tax, which has not yet been included in periodic benefit cost. Future changes in the loss will be reflected in other comprehensive income (loss).

| <i>(In thousands)</i> | Unrealized Gains (Losses) on Securities | Pension Components | Accumulated Other Comprehensive Income (Loss) |
|--|---|-----------------------|--|
| Balance at December 31, 2004 | \$ 39,570 | \$ | \$ 39,570 |
| Current period other comprehensive income | (43,453) | | (43,453) |
| Balance at December 31, 2005 | (3,883) | | (3,883) |
| Current period other comprehensive income | 14,553 | | 14,553 |
| Adjustment to initially apply SFAS No. 158 | | (10,870) | (10,870) |
| Balance at December 31, 2006 | \$ 10,670 | \$ (10,870) | \$ (200) |

13. Segments

The Company segregates financial information for use in assessing its performance and allocating resources among three operating segments. The Consumer segment includes the retail branch network, consumer finance, bankcard, student loans and discount brokerage services. The Commercial segment provides corporate lending, leasing, and international services, as well as business, government deposit and cash management services. The Money Management segment provides traditional trust and estate tax planning services, and advisory and discretionary investment management services. The Money Management segment also includes the Capital Markets Group, which sells fixed-income securities and provides investment safekeeping and bond accounting services.

The Company's business line reporting system derives segment information from the internal profitability reporting system used by management to monitor and manage the financial performance of the Company. This information is based on internal management accounting policies, which have been developed to reflect the underlying economics of the businesses. The policies address the methodologies applied in connection with funds transfer pricing and assignment of overhead costs among segments. Funds transfer pricing was used in the determination of net interest income by assigning a standard cost (credit) for funds used (provided) by assets and liabilities based on their maturity, prepayment and/or repricing characteristics. Income and expense that directly relate to segment operations are recorded in the segment when incurred. Expenses that indirectly support the segments are allocated based on the most appropriate method available.

The Company's reportable segments are strategic lines of business that offer different products and services. They are managed separately because each line services a specific customer need, requiring different performance measurement analyses and marketing strategies. The performance measurement of the segments is based on the management structure of the Company and is not necessarily comparable with similar information for any other financial institution. The information is also not necessarily indicative of the segments' financial condition and results of operations if they were independent entities.

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

Segment Income Statement Data

| <i>(In thousands)</i> | Consumer | Commercial | Money Management | Segment Totals | Other/ Elimination | Consolidated Totals |
|-------------------------------|------------|------------|---------------------|-------------------|-----------------------|------------------------|
| Year ended | | | | | | |
| December 31, 2006: | | | | | | |
| Net interest income | \$ 375,620 | \$ 212,606 | \$ 9,693 | \$ 597,919 | \$ (84,720) | \$ 513,199 |
| Provision for loan losses | 26,392 | (313) | | 26,079 | (430) | 25,649 |
| Non-interest income | 182,769 | 79,656 | 85,235 | 347,660 | 13,961 | 361,621 |
| Non-interest expense | 287,507 | 144,950 | 60,388 | 492,845 | 32,580 | 525,425 |
| Income before income taxes | \$ 244,490 | \$ 147,625 | \$ 34,540 | \$ 426,655 | \$ (102,909) | \$ 323,746 |
| Year ended | | | | | | |
| December 31, 2005: | | | | | | |
| Net interest income | \$ 332,700 | \$ 194,538 | \$ 8,059 | \$ 535,297 | \$ (33,595) | \$ 501,702 |
| Provision for loan losses | 34,814 | (2,280) | | 32,534 | (3,749) | 28,785 |
| Non-interest income | 173,560 | 73,487 | 82,494 | 329,541 | 11,658 | 341,199 |
| Non-interest expense | 278,193 | 136,368 | 58,837 | 473,398 | 23,124 | 496,522 |
| Income before income taxes | \$ 193,253 | \$ 133,937 | \$ 31,716 | \$ 358,906 | \$ (41,312) | \$ 317,594 |
| Year ended | | | | | | |
| December 31, 2004: | | | | | | |
| Net interest income | \$ 280,050 | \$ 178,633 | \$ 6,765 | \$ 465,448 | \$ 31,883 | \$ 497,331 |
| Provision for loan losses | 27,551 | 5,620 | | 33,171 | (2,820) | 30,351 |
| Non-interest income | 154,693 | 76,624 | 81,000 | 312,317 | 14,614 | 326,931 |
| Non-interest expense | 268,548 | 134,292 | 59,094 | 461,934 | 20,835 | 482,769 |
| Income before income taxes | \$ 138,644 | \$ 115,345 | \$ 28,671 | \$ 282,660 | \$ 28,482 | \$ 311,142 |

The segment activity, as shown above, includes both direct and allocated items. Amounts in the Other/Elimination column include activity not related to the segments, such as that relating to administrative functions, the investment securities portfolio, and the effect of certain expense allocations to the segments. Also included in this category is the

difference between loan charge-offs and recoveries assigned directly to the segments and the provision for loan loss expense. During 2006, the pre-tax profitability in the Other/Elimination column decreased \$61.6 million compared to 2005, and decreased \$69.8 million in 2005 compared to 2004. These declines resulted from LIBOR based cost of funds charges that rose faster than the investment securities yields in a rising interest rate environment, along with lower gains generated from the available for sale investment portfolio.

Segment Balance Sheet Data

| <i>(In thousands)</i> | Consumer | Commercial | Money Management | Segment Totals | Other/ Elimination | Consolidated Totals |
|--------------------------------------|--------------|--------------|---------------------|-------------------|-----------------------|------------------------|
| Average balances for 2006: | | | | | | |
| Assets | \$ 4,162,398 | \$ 5,396,072 | \$ 236,200 | \$ 9,794,670 | \$ 4,443,934 | \$ 14,238,604 |
| Loans | 4,043,128 | 5,308,467 | 17 | 9,351,612 | 69,770 | 9,421,382 |
| Goodwill and other intangible assets | 47,023 | 24,270 | 746 | 72,039 | | 72,039 |
| Deposits | 8,112,122 | 2,405,136 | 478,448 | 10,995,706 | 124,091 | 11,119,797 |
| Average balances for 2005: | | | | | | |
| Assets | \$ 4,008,299 | \$ 4,705,041 | \$ 20,189 | \$ 8,733,529 | \$ 5,239,915 | \$ 13,973,444 |
| Loans | 3,906,843 | 4,638,601 | 11 | 8,545,455 | 16,027 | 8,561,482 |
| Goodwill and other intangible assets | 33,669 | 14,236 | 746 | 48,651 | | 48,651 |
| Deposits | 7,626,588 | 2,420,289 | 441,471 | 10,488,348 | 36,760 | 10,525,108 |

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

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

14. Common Stock

On December 13, 2006, the Company distributed a 5% stock dividend on its \$5 par common stock for the thirteenth consecutive year. All per share data in this report has been restated to reflect the stock dividend.

Basic income per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted income per share gives effect to all dilutive potential common shares that were outstanding during the year. The calculations of basic and diluted income per share, which have been restated for all stock dividends, are as follows:

| <i>(In thousands, except per share data)</i> | 2006 | 2005 | 2004 |
|---|-------------------|------------|------------|
| Basic earnings per share: | | | |
| Net income available to common shareholders | \$ 219,842 | \$ 223,247 | \$ 220,341 |
| Weighted average basic common shares outstanding | 70,177 | 73,110 | 77,205 |
| Basic earnings per share | \$ 3.13 | \$ 3.05 | \$ 2.85 |
| Diluted earnings per share: | | | |
| Net income available to common shareholders | \$ 219,842 | \$ 223,247 | \$ 220,341 |
| Weighted average common shares outstanding | 70,177 | 73,110 | 77,205 |
| Net effect of nonvested stock and the assumed exercise of stock-based awards based on the treasury stock method using the average market price for the respective periods | 945 | 979 | 1,145 |
| Weighted average diluted common shares outstanding | 71,122 | 74,089 | 78,350 |
| Diluted earnings per share | \$ 3.09 | \$ 3.01 | \$ 2.81 |

The table below shows activity in the outstanding shares of the Company's common stock during 2006. Shares in the table below are presented on an historical basis and have not been restated for the 5% stock dividend in 2006.

(In thousands)

| | |
|---------------------------------------|--------|
| Shares outstanding at January 1, 2006 | 67,609 |
| Issuance of stock: | |

| | |
|--|---------------|
| Acquisition of West Pointe Bancorp, Inc. | 1,360 |
| Sales and awards under employee and director plans | 339 |
| 5% stock dividend | 3,356 |
| Purchases of treasury stock | (2,705) |
| Other | (6) |
| Shares outstanding at December 31, 2006 | 69,953 |

The Company maintains a treasury stock buyback program authorized by its Board of Directors. At December 31, 2006, 1,383,115 shares were available for purchase under the current Board authorization. In February 2007, the Board authorized the purchase of additional shares bringing the total authorization to 4,000,000 shares. The Company has routinely used these reacquired shares to fund employee benefit programs and annual stock dividends.

15. Regulatory Capital Requirements

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

under regulatory accounting practices. The Company's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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

The capital amounts and ratios for the Company (on a consolidated basis) and its full-service banking subsidiaries at the last two year ends are as follows:

| <i>(Dollars in thousands)</i> | 2006 | | Minimum Required ^(A) | 2005 | | Minimum Required ^(A) |
|--|------------------|--------|------------------------------------|------------------|--------|------------------------------------|
| | Actual Amount | Ratio | | Actual Amount | Ratio | |
| Total Capital (to risk-weighted assets): | | | | | | |
| Commerce Bancshares, Inc. (consolidated) | \$ 1,502,386 | 12.56% | \$ 956,782 | \$ 1,446,408 | 13.63% | \$ 848,906 |
| Commerce Bank, N.A. (Missouri) | 1,153,415 | 10.42 | 885,800 | 1,050,904 | 10.82 | 777,163 |
| Commerce Bank, N.A. (Kansas) | 109,988 | 16.04 | 54,873 | 107,725 | 17.03 | 50,608 |
| Tier I Capital (to risk-weighted assets): | | | | | | |
| Commerce Bancshares, Inc. (consolidated) | \$ 1,345,378 | 11.25% | \$ 478,391 | \$ 1,295,898 | 12.21% | \$ 424,453 |
| Commerce Bank, N.A. (Missouri) | 1,031,282 | 9.31 | 442,900 | 931,808 | 9.59 | 388,582 |
| Commerce Bank, N.A. (Kansas) | 101,395 | 14.78 | 27,436 | 99,790 | 15.77 | 25,304 |
| Tier I Capital (to adjusted quarterly average assets): (Leverage Ratio) | | | | | | |
| Commerce Bancshares, Inc. (consolidated) | \$ 1,345,378 | 9.05% | \$ 594,778 | \$ 1,295,898 | 9.43% | \$ 549,965 |
| Commerce Bank, N.A. (Missouri) | 1,031,282 | 7.58 | 544,206 | 931,808 | 7.47 | 498,750 |
| Commerce Bank, N.A. (Kansas) | 101,395 | 8.32 | 48,733 | 99,790 | 8.50 | 46,972 |

(A) *Dollar amount required to meet guidelines for adequately capitalized institutions.*

At December 31, 2006, the Company met all capital requirements to which it is subject and all of its banking subsidiaries exceeded the regulatory definition of well-capitalized.

16. Fair Value of Financial Instruments

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

Loans

Fair values are estimated for various groups of loans segregated by 1) type of loan, 2) fixed/adjustable interest terms and 3) performing/non-performing status. The fair value of performing loans is calculated by discounting all simulated cash flows. Cash flows include all principal and interest to be received, taking embedded optionality such as the customer's right to prepay into account. Discount rates are computed for each loan category using implied forward market rates adjusted to recognize each loan's approximate credit

risk. Fair value of impaired loans approximates their carrying value because such loans are recorded at the appraised or estimated recoverable value of the collateral or the underlying cash flow.

Investment Securities

The fair values of the debt and equity instruments in the available for sale and trading sections of the investment security portfolio are estimated based on prices published in financial newspapers or bid quotations received from securities dealers. Fair values are estimated for those investments for which a market source is not readily available.

A schedule of investment securities by category and maturity is provided in Note 4 on Investment Securities. Fair value estimates are based on the value of one unit without regard to any premium or discount that may result from concentrations of ownership, possible tax ramifications or estimated transaction costs.

Federal Funds Sold and Securities Purchased under Agreements to Resell and Cash and Due From Banks

The carrying amounts of federal funds sold and securities purchased under agreements to resell and cash and due from banks approximate fair value. Federal funds sold and securities purchased under agreements to resell generally mature in 90 days or less.

Accrued Interest Receivable/Payable

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

Derivative Instruments

The fair value of derivative financial instruments is based on the estimated amounts that the Company would receive or pay to terminate the contracts at the reporting date (i.e., mark-to-market value). Fair values are based on dealer quotes or pricing models.

Deposits

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

Borrowings

Federal funds purchased and securities sold under agreements to repurchase mature or reprice within 90 days; therefore, their fair value approximates carrying value. The fair value of long-term debt is estimated by discounting contractual maturities using an estimate of the current market rate for similar instruments.

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

| <i>(In thousands)</i> | 2006 | | 2005 | |
|--|-----------------|----------------------|-----------------|----------------------|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial Assets | | | | |
| Loans | \$ 9,960,118 | \$ 10,036,534 | \$ 8,899,183 | \$ 8,974,183 |
| Available for sale investment securities | 3,415,440 | 3,415,440 | 3,667,901 | 3,667,901 |
| Trading securities | 6,676 | 6,676 | 24,959 | 24,959 |
| Non-marketable securities | 74,207 | 74,207 | 77,321 | 77,321 |
| Federal funds sold and securities purchased under agreements to resell | 527,816 | 527,816 | 128,862 | 128,862 |
| Accrued interest receivable | 79,565 | 79,565 | 65,980 | 65,980 |
| Derivative instruments | 1,300 | 1,300 | 985 | 985 |
| Cash and due from banks | 626,500 | 626,500 | 545,273 | 545,273 |
| Financial Liabilities | | | | |
| Non-interest bearing demand deposits | \$ 1,312,400 | \$ 1,312,400 | \$ 1,399,934 | \$ 1,399,934 |
| Savings, interest checking and money market deposits | 6,879,047 | 6,879,047 | 6,490,326 | 6,490,326 |
| Time open and C.D. s | 3,553,407 | 3,589,259 | 2,961,553 | 2,960,630 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,771,282 | 1,771,282 | 1,326,427 | 1,326,427 |
| Other borrowings | 53,934 | 58,338 | 269,390 | 270,454 |
| Accrued interest payable | 63,593 | 63,593 | 36,507 | 36,507 |
| Derivative instruments | 2,106 | 2,106 | 1,886 | 1,886 |

Off-Balance Sheet Financial Instruments

The fair value of letters of credit and commitments to extend credit is based on the fees currently charged to enter into similar agreements. The aggregate of these fees is not material. These instruments are also referenced in Note 18 on Commitments, Contingencies and Guarantees.

Limitations

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

17. Derivative Instruments

One of the Company's primary risks associated with its lending activity is interest rate risk. Interest rates contain an ever-present volatility, as they are affected by the market's perception of the economy's health at any one point in time, as well as by specific actions of the Federal Reserve. These fluctuations can either compress or enhance fixed rate interest margins depending on the liability structure of the funding organization. Over the longer term, rising interest rates may have a negative effect on interest margins as funding sources become more expensive relative to any fixed rate loans that do not re-price as quickly with the change in interest rates. However, in order to maintain its competitive advantage, in certain circumstances the Company offers fixed rate commercial financing whose term extends beyond its traditional three to five year parameter. This exposes the Company to the risk that the fair value of the fixed rate loan may fall if market interest rates increase. To reduce this exposure for certain specified loans, the Company may enter into interest rate swaps, paying interest based on a fixed rate in exchange for interest based on a variable rate. The amount of hedge ineffectiveness on these swaps would be recorded in interest income in the

accompanying consolidated income statements. At December 31, 2006, the Company had two swaps, with a notional amount totaling \$14,398,000, which have been designated as fair value hedges. The Company also sells swaps to its borrowers to accommodate their interest rate risk profiles, and enters into identical dealer swaps with offsetting pay/receive terms. The notional amount of these types of swaps at December 31, 2006 was \$167,066,000. The changes in the fair values of these swaps were recorded in other non-interest income.

The Company's mortgage banking operation makes commitments to extend fixed rate loans secured by 1-4 family residential properties, which are considered to be derivative instruments. These commitments are recognized on the balance sheet at fair value from their inception through their expiration or funding. The fair value measurement includes only the difference between the guaranteed interest rate in the loan commitment and a market interest rate, and excludes any expected future cash flows related to the customer relationship or loan servicing. During the term of the loan commitment, the value of the loan commitment changes in inverse relation to changes in market interest rates. These commitments have an average term of 60 to 90 days. The Company's general practice is to sell such loans in the secondary market. The Company obtains forward sale contracts with investors in the secondary market in order to manage these risk positions. Most of the contracts are matched to a specific loan on a "best efforts" basis, in which the Company is obligated to deliver the loan only if the loan closes. The sale contracts are also accounted for as derivatives. Hedge accounting has not been applied to these activities. The unrealized gains and losses resulting from recording both the loan commitments and the sale contracts at fair value were included in loan fees and sales in the Company's consolidated income statements.

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

At December 31, 2006, the total notional amount of derivatives held by the Company amounted to \$240,019,000. Derivatives with positive fair values of \$1,300,000 were recorded in other assets and derivatives with negative fair values of \$2,106,000 were recorded as other liabilities at December 31, 2006. Changes in the fair values of the derivatives and hedged loans, as shown in the table below, were recognized in current earnings.

(In thousands)

| Unrealized gain (loss) resulting from change in fair value | 2006 | 2005 | 2004 |
|---|-------------|-------------|-------------|
| Swaps/hedged loans | \$ 130 | \$ 64 | \$ (1) |
| Mortgage loan commitments | (53) | 23 | (65) |
| Mortgage loan sale contracts | 56 | (46) | 31 |
| Foreign exchange contracts | (73) | 84 | 58 |

Total

\$ 60 \$ 125 \$ 23

18. Commitments, Contingencies and Guarantees

The Company leases certain premises and equipment, all of which were classified as operating leases. The rent expense under such arrangements amounted to \$5,527,000, \$5,313,000 and \$5,505,000 in 2006, 2005 and 2004, respectively. A summary of minimum lease commitments follows:

| <i>(In thousands)</i> | Type of Property | | |
|------------------------------|------------------|-----------|-----------|
| | Real | | |
| Year Ended December 31 | Property | Equipment | Total |
| 2007 | \$ 4,904 | \$ 721 | \$ 5,625 |
| 2008 | 4,238 | 586 | 4,824 |
| 2009 | 3,834 | 366 | 4,200 |
| 2010 | 3,114 | 90 | 3,204 |
| 2011 | 2,749 | | 2,749 |
| After | 25,137 | | 25,137 |
| Total minimum lease payments | | | \$ 45,739 |

All leases expire prior to 2055. It is expected that in the normal course of business, leases that expire will be renewed or replaced by leases on other properties; thus, the future minimum lease commitments are not expected to be less than the amounts shown for 2007.

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

| <i>(In thousands)</i> | 2006 | 2005 |
|--|--------------|--------------|
| Commitments to extend credit: | | |
| Credit card | \$ 3,701,433 | \$ 3,355,751 |
| Other | 3,816,656 | 3,534,075 |
| Standby letters of credit, net of participations | 452,219 | 412,022 |
| Commercial letters of credit | 30,088 | 18,905 |

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

Allowance for Loan Losses for further discussion.

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

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

At December 31, 2006, the Company had recorded a liability in the amount of \$5.5 million, representing the carrying value of the guarantee obligations associated with the standby letters of credit. This amount will be amortized into income over the life of the commitment. The contract amount of these letters of credit,

which represents the maximum potential future payments guaranteed by the Company, was \$452.2 million at December 31, 2006.

The Company guarantees payments to holders of certain trust preferred securities issued by two wholly owned grantor trusts as discussed in Note 8 on Borrowings. Preferred securities issued by Breckenridge Capital Trust I, amounting to \$4.0 million, are due in 2030 and may be redeemed beginning in 2010. Securities issued by West Pointe Statutory Trust I, amounting to \$10.0 million, are due in 2034 and may be redeemed beginning in 2009. The maximum potential future payments guaranteed by the Company, which includes future interest and principal payments through maturity, was estimated to be approximately \$45.4 million at December 31, 2006. At December 31, 2006, the Company had a recorded liability of \$14.2 million in principal and accrued interest to date, representing amounts owed to the security holders.

The Company periodically purchases various state tax credits arising from third-party property redevelopment. Most of the tax credits are resold to third parties, although some may be retained for use by the Company. During 2006, purchases and sales of tax credits amounted to \$31.1 million and \$32.6 million, respectively. At December 31, 2006, the Company had outstanding purchase commitments totaling \$77.1 million. The commitments are expected to be funded in 2007 through 2009.

In the normal course of business, the Company had certain lawsuits pending at December 31, 2006. In the opinion of management, after consultation with legal counsel, none of these suits will have a significant effect on the financial condition and results of operations of the Company.

19. Related Parties

The Company's Chief Executive Officer and its Vice Chairman are directors of Tower Properties Company (Tower) and together with members of their immediate families beneficially own approximately 76% of the outstanding stock of Tower. At December 31, 2006, Tower owned 158,244 shares of Company stock. Tower is primarily engaged in the business of owning, developing, leasing and managing real property. During 2006 and previous years, the Company and its affiliates occupied various facilities in downtown Kansas City which were owned by Tower. At December 31, 2006, all such premises had been sold by Tower or vacated by the Company, with the exception of several surface parking lots.

Payments from the Company and its affiliates to Tower are summarized below.

| <i>(In thousands)</i> | 2006 | 2005 | 2004 |
|---|-----------------|-----------------|-----------------|
| Rent on leased properties | \$ 556 | \$ 920 | \$ 1,824 |
| Leasing fees | 72 | 104 | 93 |
| Operation of parking garages | 101 | 98 | 46 |
| Building management fees | 1,621 | 1,432 | 1,315 |
| Property construction and repair costs | 2,824 | 2,503 | 2,473 |
| Dividends paid on Company stock held by Tower | 148 | 138 | 126 |
| Total | \$ 5,322 | \$ 5,195 | \$ 5,877 |

Tower has a \$13,500,000 line of credit with the Company's Missouri bank (Bank) which is subject to normal credit terms and has a variable interest rate. Outstanding loans to Tower under the line of credit were \$2,300,000 at December 31, 2005, which were repaid in 2006. Interest received by the Bank from Tower under the line of credit was \$49,000, \$192,000 and \$199,000 in 2006, 2005 and 2004, respectively. Fees received for letters of credit collateralized under the line of credit were \$35,000 annually in 2006, 2005 and 2004. From time to time, the Bank extends additional credit to Tower for construction and development projects. While no construction loans were outstanding during 2006 or at December 31, 2005, interest received on such loans was \$24,000 and \$189,000 in 2005 and 2004, respectively.

In 2006, the Bank purchased two parking facilities in downtown Kansas City from Tower for \$2,381,000. These parking facilities are adjacent to existing Company office buildings, and will be renovated and used for future parking expansion. In 2005, the Bank purchased a 12-story office building and attached garage in downtown Kansas City from Tower for \$18,000,000. The purchase prices were based upon independent

outside appraisals and the transactions were approved by the Company's Board of Directors and independent Audit Committee.

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

20. Parent Company Condensed Financial Statements

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

Condensed Balance Sheets

| <i>(In thousands)</i> | December 31 | |
|---|---------------------|---------------------|
| | 2006 | 2005 |
| Assets | | |
| Investment in consolidated subsidiaries: | | |
| Banks | \$ 1,197,369 | \$ 1,033,528 |
| Non-banks | 67,737 | 53,658 |
| Cash | 119 | 26 |
| Investment securities: | | |
| Available for sale | 166,239 | 223,000 |
| Non-marketable | 6,804 | 5,052 |
| Prepaid pension cost | 7,998 | 24,834 |
| Income tax benefits | 7,294 | 1,106 |
| Other assets | 11,918 | 12,016 |
| Total assets | \$ 1,465,478 | \$ 1,353,220 |
| Liabilities and stockholders' equity | | |
| Borrowings from subsidiaries, net of receivables | \$ 11,005 | \$ 3,028 |
| Other liabilities | 12,359 | 12,354 |
| Total liabilities | 23,364 | 15,382 |
| Stockholders' equity | 1,442,114 | 1,337,838 |
| Total liabilities and stockholders' equity | \$ 1,465,478 | \$ 1,353,220 |

Condensed Statements of Income

| <i>(In thousands)</i> | For the Years Ended December 31 | | |
|---|--|-------------------|-------------------|
| | 2006 | 2005 | 2004 |
| Income | | | |
| Dividends received from consolidated subsidiaries: | | | |
| Banks | \$ 140,200 | \$ 219,639 | \$ 253,017 |
| Non-banks | 300 | 315 | 280 |
| Earnings of consolidated subsidiaries, net of dividends | 82,677 | 10,540 | (22,786) |
| Interest and dividends on investment securities | 7,764 | 6,451 | 3,494 |
| Management fees charged subsidiaries | 37,731 | 32,952 | 32,989 |
| Investment securities gains (losses) | (149) | (164) | 50 |
| Other | 3,179 | 1,534 | 1,481 |
| Total income | 271,702 | 271,267 | 268,525 |
| Expense | | | |
| Salaries and employee benefits | 35,152 | 32,643 | 32,378 |
| Professional fees | 2,635 | 2,449 | 3,033 |
| Data processing fees paid to affiliates | 9,471 | 9,660 | 12,678 |
| Other | 10,784 | 10,601 | 7,695 |
| Total expense | 58,042 | 55,353 | 55,784 |
| Income tax expense (benefit) | (6,182) | (7,333) | (7,600) |
| Net income | \$ 219,842 | \$ 223,247 | \$ 220,341 |

Condensed Statements of Cash Flows

| <i>(In thousands)</i> | For the Years Ended December 31 | | |
|-----------------------------|--|-------------|-------------|
| | 2006 | 2005 | 2004 |
| Operating Activities | | | |
| Net income | \$ 219,842 | \$ 223,247 | \$ 220,341 |

Adjustments to reconcile net income to net cash provided by operating activities:

| | | | |
|--|-----------------|----------|--------|
| (Earnings) losses of consolidated subsidiaries, net of dividends | (82,677) | (10,540) | 22,786 |
| Other adjustments, net | 2,808 | 4,995 | 1,880 |

| | | | |
|--|----------------|---------|---------|
| Net cash provided by operating activities | 139,973 | 217,702 | 245,007 |
|--|----------------|---------|---------|

Investing Activities

| | | | |
|---|-----------------|-----------|-----------|
| Increase in investment in subsidiaries, net | (17,822) | (11,525) | (146) |
| Proceeds from sales of investment securities | 13,005 | 36 | 580 |
| Proceeds from maturities of investment securities | 90,594 | 173,938 | 99,260 |
| Purchases of investment securities | (41,828) | (107,820) | (130,493) |
| Net purchases of equipment | (474) | (485) | (29) |

| | | | |
|--|---------------|--------|----------|
| Net cash provided by (used in) investing activities | 43,475 | 54,144 | (30,828) |
|--|---------------|--------|----------|

Financing Activities

| | | | |
|--|------------------|-----------|-----------|
| Increase in borrowings from subsidiaries, net | 7,977 | 3,395 | 3,199 |
| Purchases of treasury stock | (134,956) | (234,501) | (173,829) |
| Issuance under equity compensation plans | 7,274 | 18,393 | 15,281 |
| Net tax benefit related to equity compensation plans | 2,108 | 4,288 | 2,305 |
| Cash dividends paid on common stock | (65,758) | (63,421) | (61,135) |

| | | | |
|--|------------------|-----------|-----------|
| Net cash used in financing activities | (183,355) | (271,846) | (214,179) |
|--|------------------|-----------|-----------|

| | | | |
|---------------------------|-----------|----|----|
| Increase in cash | 93 | | |
| Cash at beginning of year | 26 | 26 | 26 |

| | | | |
|----------------------------|---------------|-------|-------|
| Cash at end of year | \$ 119 | \$ 26 | \$ 26 |
|----------------------------|---------------|-------|-------|

Dividends paid by the Parent were substantially provided from subsidiary bank dividends. The subsidiary banks may distribute dividends without prior regulatory approval that do not exceed the sum of net

income for the current year and retained net income for the preceding two years, subject to maintenance of minimum capital requirements. The Parent charges fees to its subsidiaries for management services provided, which are allocated to the subsidiaries based primarily on total average assets. The Parent makes advances to non-banking subsidiaries and subsidiary bank holding companies. Advances are made to the Parent by subsidiary bank holding companies for investment in temporary liquid securities. Interest on such advances is based on market rates.

During 2006, the Parent contributed cash of \$13,052,000 to the acquiring bank subsidiary in the West Pointe acquisition. During 2006 and 2005, the Parent contributed \$6,075,000 and \$9,580,000, respectively, to venture capital subsidiaries in order to satisfy their investment funding requirements. In 2004, subsidiary banks distributed dividends in excess of current year net income, while remaining within regulatory capital guidelines. The excess distribution was not repeated in subsequent years.

For the past several years, the Parent has maintained a \$20,000,000 line of credit for general corporate purposes with a subsidiary bank. The line of credit is secured by marketable investment securities. During 2006 and 2005, the Parent had no borrowings from the subsidiary bank. The Parent plans to fund an additional \$17,325,000 relating to venture capital and private equity investments over the next several years.

Available for sale investment securities held by the Parent consist of short-term investments in mutual funds and marketable common and preferred stock. The fair value of these securities included an unrealized gain of \$50,270,000 at December 31, 2006. The corresponding net of tax unrealized gain included in stockholders' equity was \$31,189,000. Also included in stockholders' equity was an unrealized net of tax loss in fair value of investment securities held by subsidiaries, which amounted to \$20,519,000 at December 31, 2006.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

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

Item 9a. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

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

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which follows.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders.

Commerce Bancshares, Inc.:

We have audited management's assessment, included in the accompanying Management Report on Internal Control over Financial Reporting, that Commerce Bancshares, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on COSO. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated February 26, 2007 expressed an unqualified opinion on those consolidated financial statements.

Kansas City, Missouri
February 26, 2007

Item 9b. OTHER INFORMATION

None

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

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

The Company's financial officer code of ethics for the chief executive officer and senior financial officers of the Company is available at www.commercebank.com. Amendments to, and waivers of, the code of ethics are posted on this website.

Item 11. EXECUTIVE COMPENSATION

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

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

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

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

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

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required is included under the caption Approval of Independent Auditors in the definitive proxy statement, which is incorporated herein by reference.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

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

| | Page |
|---|-------------|
| (1) Financial Statements: | |
| Consolidated Balance Sheets | 54 |
| Consolidated Statements of Income | 55 |
| Consolidated Statements of Cash Flows | 56 |
| Consolidated Statements of Stockholders' Equity | 57 |
| Notes to Consolidated Financial Statements | 58 |
| Summary of Quarterly Statements of Income | 52 |
| (2) Financial Statement Schedules: | |
| All schedules are omitted as such information is inapplicable or is included in the financial statements. | |

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

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized this 26th day of February 2007.

Commerce Bancshares, Inc.

By: /s/ J. Daniel Stinnett

J. Daniel Stinnett
Vice President and Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on the 26th day of February 2007.

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

By: /s/ A. Bayard Clark
A. Bayard Clark
Chief Financial Officer

David W. Kemper
(Chief Executive Officer)
John R. Capps
W. Thomas Grant II
James B. Hebenstreit
Jonathan M. Kemper
Seth M. Leadbeater
Terry O. Meek
Benjamin F. Rassieur III
Kimberly G. Walker
Robert H. West

A majority of the Board of Directors*

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

By: /s/ J. Daniel Stinnett
J. Daniel Stinnett
Attorney-in-Fact

INDEX TO EXHIBITS

3 Articles of Incorporation and By-Laws:

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

(b) Restated By-Laws were filed in quarterly report on Form 10-Q dated May 8, 2001, and the same are hereby incorporated by reference.

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

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

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

(a) Commerce Bancshares, Inc. Executive Incentive Compensation Plan amended and restated as of July 31, 1998 was filed in quarterly report on Form 10-Q dated May 10, 2002, and the same is hereby incorporated by reference.

(b) Commerce Bancshares, Inc. 1987 Non-Qualified Stock Option Plan amended and restated as of October 4, 1996 was filed in quarterly report on Form 10-Q dated November 8, 1996, and the same is hereby incorporated by reference.

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

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

(e) Commerce Executive Retirement Plan amended and restated as of January 1, 2005 was filed in current report on Form 8-K dated January 4, 2005, and the same is hereby incorporated by reference.

(f) Commerce Bancshares, Inc. Restricted Stock Plan amended and restated as of April 21, 2004 was filed in quarterly report on Form 10-Q dated August 4, 2004, and the same is hereby incorporated by reference.

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

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

(i) Commerce Bancshares, Inc. 2007 Compensatory Arrangement with CEO and Named Executive Officers was filed in current report on Form 8-K dated February 6, 2007, and the same is hereby incorporated by reference.

(j) Commerce Bancshares, Inc. 2005 Equity Incentive Plan was filed in the Company's proxy statement dated March 11, 2005, and the same is hereby incorporated by reference.

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

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

E-1

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

21 Subsidiaries of the Registrant

23 Consent of Independent Registered Public Accounting Firm

24 Power of Attorney

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

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

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

E-2