

COMMERCE BANCSHARES INC /MO/

Form 10-Q

August 08, 2006

Table of Contents

**SECURITIES AND EXCHANGE COMMISSION**

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

(Mark One)

☒

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

For the quarterly period ended June 30, 2006  
OR

☐

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File No. 0-2989  
**COMMERCE BANCSHARES, INC.**  
-----

(Exact name of registrant as specified in its charter)

**Missouri**

**43-0889454**

(State of Incorporation)

(IRS Employer Identification No.)

**1000 Walnut,  
Kansas City, MO**

**64106**

(Address of principal executive offices)

(Zip Code)

**(816) 234-2000**

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

Indicate by checkmark 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 August 2, 2006, the registrant had outstanding 66,320,723 shares of its \$5 par value common stock, registrant's only class of common stock.

---

**Commerce Bancshares, Inc. and Subsidiaries**  
**Form 10-Q**

**INDEX**

	<b>Page</b>
<b><u>Part I</u></b>	
<b><u>Financial Information</u></b>	
<u>Item 1.</u> <u>Financial Statements</u>	
<u>Consolidated Balance Sheets as of June 30, 2006</u> <u>(unaudited) and December 31, 2005</u>	3
<u>Consolidated Statements of Income for the Three and Six</u> <u>Months Ended June 30, 2006 and 2005 (unaudited)</u>	4
<u>Consolidated Statements of Stockholders' Equity for the Six</u> <u>Months Ended June 30, 2006 and 2005 (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows for the Six Months</u> <u>Ended June 30, 2006 and 2005 (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<u>Management's Discussion and Analysis of Consolidated</u> <u>Financial Condition and Results of Operations</u>	15
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	34
<u>Item 4.</u> <u>Controls and Procedures</u>	34
 <b><u>Part II</u></b>	
<b><u>Other Information</u></b>	
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	35
<u>Item 4.</u> <u>Submission of Matters to a Vote of Security Holders</u>	35
<u>Item 6.</u> <u>Exhibits</u>	35
 <u>Signatures</u>	36
 <u>Index to Exhibits</u>	37
<u>Certification</u>	
<u>Certification</u>	
<u>Certification</u>	

**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****Commerce Bancshares, Inc. and Subsidiaries  
CONSOLIDATED BALANCE SHEETS**

	<b>June 30</b>	<b>December 31</b>
<i>(In thousands)</i>	<b>2006</b>	<b>2005</b>
	<i>(Unaudited)</i>	
<b>ASSETS</b>		
Loans, net of unearned income	<b>\$ 9,379,893</b>	<b>\$ 8,899,183</b>
Allowance for loan losses	<b>(128,446)</b>	<b>(128,447)</b>
<b>Net loans</b>	<b>9,251,447</b>	<b>8,770,736</b>
Investment securities:		
Available for sale	<b>3,337,477</b>	<b>3,667,901</b>
Trading	<b>17,001</b>	<b>24,959</b>
Non-marketable	<b>81,401</b>	<b>77,321</b>
<b>Total investment securities</b>	<b>3,435,879</b>	<b>3,770,181</b>
Federal funds sold and securities purchased under agreements to resell	<b>237,072</b>	<b>128,862</b>
Cash and due from banks	<b>662,790</b>	<b>545,273</b>
Land, buildings and equipment, net	<b>367,954</b>	<b>374,192</b>
Goodwill	<b>48,522</b>	<b>48,522</b>
Other assets	<b>269,733</b>	<b>247,779</b>
<b>Total assets</b>	<b>\$14,273,397</b>	<b>\$13,885,545</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Deposits:		
Non-interest bearing demand	<b>\$ 1,326,787</b>	<b>\$ 1,399,934</b>
Savings, interest checking and money market	<b>6,439,068</b>	<b>6,490,326</b>
Time open and C.D. s of less than \$100,000	<b>2,028,700</b>	<b>1,831,980</b>
Time open and C.D. s of \$100,000 and over	<b>1,247,790</b>	<b>1,129,573</b>
<b>Total deposits</b>	<b>11,042,345</b>	<b>10,851,813</b>
Federal funds purchased and securities sold under agreements to repurchase	<b>1,586,511</b>	<b>1,326,427</b>
Other borrowings	<b>144,919</b>	<b>269,390</b>
Other liabilities	<b>168,227</b>	<b>100,077</b>
<b>Total liabilities</b>	<b>12,942,002</b>	<b>12,547,707</b>

<b>Stockholders' equity:</b>		
Preferred stock, \$1 par value		
Authorized and unissued 2,000,000 shares		
Common stock, \$5 par value		
Authorized 100,000,000 shares; issued 69,409,882 shares	<b>347,049</b>	347,049
Capital surplus	<b>385,358</b>	388,552
Retained earnings	<b>768,608</b>	693,021
Treasury stock of 3,009,713 shares in 2006 and 1,716,413 shares in 2005, at cost	<b>(152,189)</b>	(86,901)
Accumulated other comprehensive loss	<b>(17,431)</b>	(3,883)
<b>Total stockholders' equity</b>	<b>1,331,395</b>	1,337,838
<b>Total liabilities and stockholders' equity</b>	<b>\$14,273,397</b>	\$13,885,545

*See accompanying notes to consolidated financial statements.*

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

	For the Three Months Ended June 30		For the Six Months Ended June 30	
(In thousands, except per share data)	2006	2005	2006	2005
	(Unaudited)			
INTEREST INCOME				
Interest and fees on loans	\$ 161,188	\$ 125,242	\$ 311,062	\$ 243,765
Interest on investment securities	36,261	46,394	73,391	88,140
Interest on federal funds sold and securities purchased under agreements to resell	1,801	1,164	3,424	1,748
Total interest income	199,250	172,800	387,877	333,653
INTEREST EXPENSE				
Interest on deposits:				
Savings, interest checking and money market	23,002	12,192	42,609	22,649
Time open and C.D. s of less than \$100,000	19,448	12,051	36,179	22,443
Time open and C.D. s of \$100,000 and over	13,906	7,973	27,093	14,325
Interest on federal funds purchased and securities sold under agreements to repurchase	14,024	10,163	26,605	19,581
Interest on other borrowings	2,391	3,034	5,177	5,791
Total interest expense	72,771	45,413	137,663	84,789
Net interest income	126,479	127,387	250,214	248,864
Provision for loan losses	5,672	5,503	10,104	7,871
Net interest income after provision for loan losses	120,807	121,884	240,110	240,993
NON-INTEREST INCOME				
Deposit account charges and other fees	28,910	27,476	56,407	51,777
Bank card transaction fees	23,558	21,295	45,266	40,802
Trust fees	17,992	17,040	35,811	33,434
Trading account profits and commissions	2,010	2,450	4,575	5,064
Consumer brokerage services	2,771	2,338	5,160	5,163
Loan fees and sales	2,745	4,805	6,488	8,245
Investment securities gains, net	3,284	1,372	5,687	4,984
Other	10,193	8,204	21,517	16,202
Total non-interest income	91,463	84,980	180,911	165,671
NON-INTEREST EXPENSE				

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

Salaries and employee benefits	71,239	67,585	142,964	137,765
Net occupancy	10,230	9,527	21,207	19,305
Equipment	6,071	5,701	12,020	11,392
Supplies and communication	7,872	8,257	16,265	16,470
Data processing and software	12,631	12,069	25,024	23,524
Marketing	4,657	4,687	8,975	8,549
Other	16,850	15,186	33,056	29,929
<b>Total non-interest expense</b>	<b>129,550</b>	<b>123,012</b>	<b>259,511</b>	<b>246,934</b>
Income before income taxes	82,720	83,852	161,510	159,730
Less income taxes	27,387	29,484	53,233	55,516
<b>Net income</b>	<b>\$ 55,333</b>	<b>\$ 54,368</b>	<b>\$ 108,277</b>	<b>\$ 104,214</b>
Net income per share basic	\$ .83	\$ .78	\$ 1.62	\$ 1.48
Net income per share diluted	\$ .82	\$ .77	\$ 1.60	\$ 1.46

*See accompanying notes to consolidated financial statements.*



Table of Contents

## Commerce Bancshares, Inc. and Subsidiaries

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

<i>(Dollars in thousands, except per share data)</i>	<b>Number of Shares Issued</b>	<b>Common Stock</b>	<b>Capital Surplus</b>	<b>Retained Earnings</b>	<b>Treasury Stock</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Total</b>
<i>(Unaudited)</i>							
<b>Balance January 1, 2006</b>	<b>69,409,882</b>	<b>\$347,049</b>	<b>\$388,552</b>	<b>\$693,021</b>	<b>\$ (86,901)</b>	<b>\$ (3,883)</b>	<b>\$1,337,838</b>
Net income				<b>108,277</b>			<b>108,277</b>
Change in unrealized gain (loss) on available for sale securities, net of tax						<b>(13,548)</b>	<b>(13,548)</b>
Total comprehensive income							<b>94,729</b>
Purchase of treasury stock					<b>(75,773)</b>		<b>(75,773)</b>
Issuance of stock under purchase and equity compensation plans			<b>(4,943)</b>		<b>9,408</b>		<b>4,465</b>
Net tax benefit related to equity compensation plans			<b>747</b>				<b>747</b>
Stock-based compensation			<b>2,079</b>				<b>2,079</b>
Issuance of restricted stock awards			<b>(1,077)</b>		<b>1,077</b>		
Cash dividends paid (\$ .490 per share)				<b>(32,690)</b>			<b>(32,690)</b>
<b>Balance June 30, 2006</b>	<b>69,409,882</b>	<b>\$347,049</b>	<b>\$385,358</b>	<b>\$768,608</b>	<b>\$ (152,189)</b>	<b>\$ (17,431)</b>	<b>\$1,331,395</b>
Balance January 1, 2005	69,409,882	\$347,049	\$388,614	\$703,293	\$ (51,646)	\$ 39,570	\$1,426,880
Net income				104,214			104,214
Change in unrealized gain (loss) on available for sale securities, net of tax						(14,271)	(14,271)

Total comprehensive income							89,943
Purchase of treasury stock				(121,573)			(121,573)
Issuance of stock under purchase and equity compensation plans	(8,557)			16,477			7,920
Net tax benefit related to equity compensation plans	1,024						1,024
Stock-based compensation	4,078						4,078
Issuance of restricted stock awards	(993)			993			
Cash dividends paid (\$1.457 per share)				(32,103)			(32,103)

Balance June 30, 2005	69,409,882	\$347,049	\$384,166	\$775,404	\$(155,749)	\$ 25,299	\$1,376,169
-----------------------	------------	-----------	-----------	-----------	-------------	-----------	-------------

*See accompanying notes to consolidated financial statements.*

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

	For the Six Months Ended June 30	
(In thousands)	2006	2005
	(Unaudited)	
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 108,277	\$ 104,214
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	10,104	7,871
Provision for depreciation and amortization	23,219	20,362
Amortization of investment security premiums, net	6,209	8,941
Investment securities gains, net <sup>(A)</sup>	(5,687)	(4,984)
Net gains on sales of loans held for sale	(4,889)	(613)
Originations of loans held for sale	(166,857)	(40,560)
Proceeds from sales of loans held for sale	242,192	40,354
Net decrease in trading securities	2,156	3,527
Stock based compensation	2,079	4,078
(Increase) decrease in interest receivable	(1,574)	3,408
Increase in interest payable	9,897	5,404
Increase in income taxes payable	8,691	14,104
Net tax benefit related to equity compensation plans	(747)	(1,024)
Other changes, net	7,642	1,162
<b>Net cash provided by operating activities</b>	<b>240,712</b>	<b>166,244</b>
<b>INVESTING ACTIVITIES:</b>		
Proceeds from sales of investment securities <sup>(A)</sup>	17,528	1,299,648
Proceeds from maturities/pay downs of investment securities <sup>(A)</sup>	562,754	623,914
Purchases of investment securities <sup>(A)</sup>	(277,268)	(1,554,499)
Net increase in loans	(561,317)	(203,793)
Purchases of land, buildings and equipment	(16,614)	(44,463)
Sales of land, buildings and equipment	1,690	464
<b>Net cash provided by (used in) investing activities</b>	<b>(273,227)</b>	<b>121,271</b>
<b>FINANCING ACTIVITIES:</b>		
Net decrease in non-interest bearing demand, savings, interest checking and money market deposits	(89,138)	(136,125)
Net increase in time open and C.D. s	314,937	348,567
Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	260,084	(319,143)
Repayment of long-term borrowings	(124,390)	(17,676)
Purchases of treasury stock	(75,773)	(121,573)

Issuance of stock under stock purchase and equity compensation plans	4,465	7,920
Net tax benefit related to equity compensation plans	747	1,024
Cash dividends paid on common stock	(32,690)	(32,103)
<b>Net cash provided by (used in) financing activities</b>	<b>258,242</b>	<b>(269,109)</b>
Increase in cash and cash equivalents	225,727	18,406
Cash and cash equivalents at beginning of year	674,135	654,720
<b>Cash and cash equivalents at June 30</b>	<b>\$ 899,862</b>	<b>\$ 673,126</b>

(A) Available for sale and non-marketable securities

Income tax payments, net of refunds	\$ 44,460	\$ 41,564
Interest paid on deposits and borrowings	\$ 127,766	\$ 79,385

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Commerce Bancshares, Inc. and Subsidiaries****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****June 30, 2006** (Unaudited)**1. Principles of Consolidation and Presentation**

The accompanying consolidated financial statements include the accounts of Commerce Bancshares, Inc. and all majority-owned subsidiaries (the Company). The consolidated financial statements in this report have not been audited. All significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to 2005 data to conform to current year presentation. In the opinion of management, all adjustments necessary to present fairly the financial position and the results of operations for the interim periods have been made. All such adjustments are of a normal recurring nature. The results of operations for the three and six month periods ended June 30, 2006 are not necessarily indicative of results to be attained for the full year or any other interim periods.

The significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the 2005 Annual Report on Form 10-K.

**2. Acquisitions**

On July 21, 2006, Commerce Bank, N.A., (Missouri) (the Bank) a subsidiary of the Company, acquired the banking business of Boone National Savings and Loan Association (Boone). Boone operates four branches in Columbia, Missouri, and loan production offices in Ashland and Lake Ozark, Missouri. The Bank acquired loans and deposits of approximately \$128 million and \$101 million, respectively, assumed other liabilities of approximately \$27 million, and paid a purchase price premium of approximately \$16 million in cash. Goodwill and core deposit intangible of approximately \$19 million is expected to be recorded as a result of the transaction. No other intangible assets were recognized as a result of the transaction.

On April 13, 2006, the Company and West Pointe Bancorp, Inc. (West Pointe) signed a definitive merger agreement in which the Company will acquire West Pointe in a transaction to be valued at \$80.9 million in stock and cash. The Company's acquisition of West Pointe will add approximately \$477 million in assets (including \$256 million in loans), \$402 million in deposits, five branch locations and 25 ATMs in St. Clair County, Illinois (southwestern Illinois region of metropolitan St. Louis).

Under terms of the agreement, shareholders of West Pointe will be entitled to elect to receive either cash or stock, with the cash portion of the transaction not to exceed 25% of the total consideration of \$80.9 million. Elections will be subject to proration procedures. It is anticipated that the transaction will be completed in the third quarter of 2006, pending regulatory approvals and certain closing conditions.

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

Major classifications of loans at June 30, 2006 and December 31, 2005 are as follows.

<i>(In thousands)</i>	<b>June 30 2006</b>	<b>December 31 2005</b>
Business	<b>\$2,786,701</b>	\$2,527,654
Real estate - construction	<b>525,162</b>	424,561
Real estate - business	<b>2,004,221</b>	1,919,045
Real estate - personal	<b>1,392,529</b>	1,358,511
Consumer	<b>1,356,927</b>	1,287,348
Home equity	<b>442,136</b>	448,507
Student	<b>256,724</b>	330,238
Credit card	<b>606,433</b>	592,465
Overdrafts	<b>9,060</b>	10,854

**Total loans**

**\$9,379,893**

\$8,899,183

**Table of Contents**

At June 30, 2006, loans held for sale amounted to \$267,059,000, consisting of \$256,724,000 in student loans and \$10,335,000 in certain fixed rate residential mortgage loans, which are included in the Real estate - personal category in the table above. In 2006, the Company elected to classify its student loan portfolio as held for sale in accordance with its student loan sale policy. Held for sale real estate loans outstanding at December 31, 2005 amounted to \$6,172,000.

Impaired loans include loans on non-accrual status and other loans on the Company's watch list classified as substandard and more than 60 days past due. Impaired loans were \$14,586,000 at June 30, 2006 compared to \$9,973,000 at December 31, 2005.

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

	For the Three Months Ended June 30		For the Six Months Ended June 30	
<i>(In thousands)</i>	2006	2005	2006	2005
<b>Balance, beginning of period</b>	<b>\$128,468</b>	\$130,960	<b>\$128,447</b>	\$132,394
Additions:				
Provision for loan losses	<b>5,672</b>	5,503	<b>10,104</b>	7,871
<b>Total additions</b>	<b>5,672</b>	5,503	<b>10,104</b>	7,871
Deductions:				
Loan losses	<b>9,223</b>	9,754	<b>18,569</b>	19,254
Less recoveries on loans	<b>3,529</b>	2,719	<b>8,464</b>	8,417
<b>Net loan losses</b>	<b>5,694</b>	7,035	<b>10,105</b>	10,837
<b>Balance, June 30</b>	<b>\$128,446</b>	\$129,428	<b>\$128,446</b>	\$129,428

**4. Investment Securities**

Investment securities, at fair value, consist of the following at June 30, 2006 and December 31, 2005.

<i>(In thousands)</i>	June 30 2006	December 31 2005
Available for sale:		
U.S. government and federal agency obligations	\$ 62,334	\$ 61,803
Government-sponsored enterprise obligations	556,587	772,854
State and municipal obligations	425,127	249,018
Mortgage-backed securities	1,461,115	1,631,675
Other asset-backed securities	569,389	684,724
Other debt securities	39,431	40,017
Equity securities	223,494	227,810
Trading	17,001	24,959
Non-marketable	81,401	77,321

<b>Total investment securities</b>	<b>\$3,435,879</b>	<b>\$3,770,181</b>
------------------------------------	--------------------	--------------------

Available for sale equity securities included short-term investments in money market mutual funds of \$113,090,000 at June 30, 2006 and \$111,736,000 at December 31, 2005. Equity securities also included FNMA and other corporate preferred stock of \$29,850,000 at June 30, 2006 and \$36,850,000 at December 31, 2005.

Non-marketable securities included securities held for debt and regulatory purposes, which amounted to \$39,986,000 and \$45,417,000 at June 30, 2006 and December 31, 2005, respectively, in addition to venture capital and private equity investments, which amounted to \$41,327,000 and \$31,836,000 at the respective dates. During the first six months of 2006, net gains of \$5,003,000 were recognized on venture capital and private equity investments, which consisted of both realized gains and fair value adjustments.



**Table of Contents****5. Intangible Assets**

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

	June 30, 2006		December 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<i>(In thousands)</i>				
Amortized intangible assets:				
Mortgage servicing rights	\$513	\$(471)	\$522	\$(475)

The Company does not have any intangible assets that are not currently being amortized. Aggregate amortization expense on intangible assets was \$3,000 and \$67,000, respectively, for the three month periods ended June 30, 2006 and 2005, and \$4,000 and \$448,000 for the six month periods ended June 30, 2006 and 2005.

**6. Guarantees**

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

Upon issuance of standby letters of credit, the Company recognizes a liability for the fair value of the obligation undertaken, which is estimated to be equivalent to the amount of fees to be received from the customer over the life of the agreement. At June 30, 2006 that net liability was \$6,893,000, which will be amortized into income over the remaining life of the respective commitments. The contract amount of these letters of credit, which represents the maximum potential future payments guaranteed by the Company, was \$437,304,000 at June 30, 2006.

The Company guarantees payments to holders of certain trust preferred securities issued by a wholly owned grantor trust. The securities are due in 2030 and may be redeemed beginning in 2010. The maximum potential future payments guaranteed by the Company, which includes future interest and principal payments through maturity, was approximately \$14,301,000 at June 30, 2006. At June 30, 2006, the Company had a recorded liability of \$4,145,000 in principal and accrued interest to date, representing amounts owed to the security holders.

**Table of Contents****7. Pension**

The amount of net pension cost (income) is as follows:

	<b>For the Three Months Ended June 30</b>		<b>For the Six Months Ended June 30</b>	
<i>(In thousands)</i>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Service cost – benefits earned during the period	<b>\$ 276</b>	\$ 365	<b>\$ 552</b>	\$ 730
Interest cost on projected benefit obligation	<b>1,191</b>	1,170	<b>2,382</b>	2,340
Expected return on plan assets	<b>(1,800)</b>	(1,705)	<b>(3,600)</b>	(3,410)
Amortization of unrecognized net loss	<b>257</b>	280	<b>515</b>	560
<b>Net periodic pension cost (income)</b>	<b>\$ (76)</b>	\$ 110	<b>\$ (151)</b>	\$ 220

Substantially all benefits under the Company's defined benefit pension plan were frozen effective January 1, 2005. During the first six months of 2006, the Company made no funding contributions to its defined benefit pension plan, and made minimal funding contributions to a supplemental executive retirement plan (the CERP), which carries no segregated assets. The Company has no plans to make any further contributions, other than those related to the CERP, during the remainder of 2006. The income recognized for the defined benefit pension plan for the first six months of 2006 was primarily due to the greater than expected return on plan assets for the year ended September 30, 2005 (the valuation date).

**8. Common Stock**

Presented below is a summary of the components used to calculate basic and diluted earnings per share.

	<b>For the Three Months Ended June 30</b>		<b>For the Six Months Ended June 30</b>	
<i>(In thousands, except per share data)</i>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Basic earnings per share:</b>				
Net income available to common shareholders	<b>\$55,333</b>	\$54,368	<b>\$108,277</b>	\$104,214
Weighted average basic common shares outstanding	<b>66,551</b>	70,071	<b>66,769</b>	70,544
Basic earnings per share	<b>\$ .83</b>	\$ .78	<b>\$ 1.62</b>	\$ 1.48
<b>Diluted earnings per share:</b>				
Net income available to common shareholders	<b>\$55,333</b>	\$54,368	<b>\$108,277</b>	\$104,214
Weighted average common shares outstanding	<b>66,551</b>	70,071	<b>66,769</b>	70,544

Net effect of nonvested restricted stock and  
the assumed exercise of stock options based  
on the treasury stock method using the  
average market price for the respective  
periods

**909**                      965                      **923**                      977

Weighted average diluted common shares  
outstanding

**67,460**                      71,036                      **67,692**                      71,521

Diluted earnings per share

**\$ .82**                      \$ .77                      **\$ 1.60**                      \$ 1.46

**Table of Contents****9. Comprehensive Income (Loss)**

The Company's only component of other comprehensive income (loss) during the periods presented below was the unrealized holding gains and losses on available for sale securities.

	<b>For the Three Months Ended June 30</b>		<b>For the Six Months Ended June 30</b>	
<i>(In thousands)</i>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Unrealized holding gains (losses)	<b>\$(5,109)</b>	\$33,110	<b>\$(21,851)</b>	\$(19,145)
Reclassification adjustment for gains included in net income		(1,044)		(3,873)
Net unrealized gains (losses) on securities	<b>(5,109)</b>	32,066	<b>(21,851)</b>	(23,018)
Income tax expense (benefit)	<b>(1,941)</b>	12,185	<b>(8,303)</b>	(8,747)
<b>Other comprehensive income (loss)</b>	<b>\$(3,168)</b>	\$19,881	<b>\$(13,548)</b>	\$(14,271)

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

<i>(In thousands)</i>	<b>Consumer</b>	<b>Commercial</b>	<b>Money Management</b>	<b>Segment Totals</b>	<b>Other/ Elimination</b>	<b>Consolidated Totals</b>
<b>Three Months Ended June 30, 2006:</b>						
Net interest income	<b>\$94,041</b>	<b>\$51,618</b>	<b>\$ 2,410</b>	<b>\$148,069</b>	<b>\$(21,590)</b>	<b>\$126,479</b>
Provision for loan losses	<b>5,320</b>	<b>393</b>		<b>5,713</b>	<b>(41)</b>	<b>5,672</b>
Non-interest income	<b>45,738</b>	<b>19,444</b>	<b>21,169</b>	<b>86,351</b>	<b>5,112</b>	<b>91,463</b>
Non-interest expense	<b>71,908</b>	<b>36,421</b>	<b>14,938</b>	<b>123,267</b>	<b>6,283</b>	<b>129,550</b>
Income before income taxes	<b>\$62,551</b>	<b>\$34,248</b>	<b>\$ 8,641</b>	<b>\$105,440</b>	<b>\$(22,720)</b>	<b>\$ 82,720</b>

Three Months Ended June 30, 2005:						
Net interest income	\$82,216	\$47,707	\$ 2,230	\$132,153	\$ (4,766)	\$127,387
Provision for loan losses	7,113	(72)		7,041	(1,538)	5,503
Non-interest income	44,435	17,792	20,568	82,795	2,185	84,980
Non-interest expense	69,927	34,611	14,710	119,248	3,764	123,012
Income before income taxes						
	\$49,611	\$30,960	\$ 8,088	\$ 88,659	\$ (4,807)	\$ 83,852

**Table of Contents**

<i>(In thousands)</i>	Consumer	Commercial	Money Management	Segment Totals	Other/ Elimination	Consolidated Totals
<b>Six Months Ended June 30, 2006:</b>						
Net interest income	<b>\$183,090</b>	<b>\$101,291</b>	<b>\$ 5,034</b>	<b>\$289,415</b>	<b>\$(39,201)</b>	<b>\$250,214</b>
Provision for loan losses	<b>10,967</b>	<b>(854)</b>		<b>10,113</b>	<b>(9)</b>	<b>10,104</b>
Non-interest income	<b>89,219</b>	<b>38,613</b>	<b>42,855</b>	<b>170,687</b>	<b>10,224</b>	<b>180,911</b>
Non-interest expense	<b>143,012</b>	<b>71,930</b>	<b>30,650</b>	<b>245,592</b>	<b>13,919</b>	<b>259,511</b>
Income before income taxes	<b>\$118,330</b>	<b>\$ 68,828</b>	<b>\$17,239</b>	<b>\$204,397</b>	<b>\$(42,887)</b>	<b>\$161,510</b>
<b>Six Months Ended June 30, 2005:</b>						
Net interest income	\$159,404	\$ 94,012	\$ 4,168	\$257,584	\$ (8,720)	\$248,864
Provision for loan losses	13,740	(2,905)		10,835	(2,964)	7,871
Non-interest income	82,228	35,786	40,697	158,711	6,960	165,671
Non-interest expense	139,107	69,392	29,525	238,024	8,910	246,934
Income before income taxes	\$ 88,785	\$ 63,311	\$15,340	\$167,436	\$ (7,706)	\$159,730

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

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

**11. Derivative Instruments**

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. At June 30, 2006, the Company had entered into two interest rate swaps with a notional amount of \$14,849,000, 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. These swaps are offset by matching contracts purchased by the Company from other financial institutions. Because of the matching terms of the offsetting contracts, the effect of these transactions on net income is minimal. The notional amount of these types of swaps at June 30, 2006 was \$170,858,000. These swaps are accounted for as free-standing derivatives and changes in their fair value were recorded in other non-interest income.

Through its International Department, the Company enters into foreign exchange contracts consisting mainly of contracts to purchase or deliver foreign currencies for customers at specific future dates. Also, mortgage loan commitments and forward sales contracts result from the Company's mortgage banking operation, in which fixed rate personal real estate loans are originated and sold to other institutions.

**Table of Contents**

The Company's derivative instruments are listed below.

	June 30, 2006			December 31, 2005		
(In thousands)	Notional Amount	Positive Fair Value	Negative Fair Value	Notional Amount	Positive Fair Value	Negative Fair Value
<b>Interest rate contracts:</b>						
Swap contracts	\$185,707	\$2,937	\$(3,390)	\$162,698	\$798	\$(1,782)
Option contracts	6,970	28	(28)	6,970	6	(6)
<b>Foreign exchange contracts:</b>						
Forward contracts	1,690	3	(15)	14,184	159	(77)
Option contracts	2,760	4	(4)	2,560	3	(3)
Mortgage loan commitments	6,945		(34)	5,353	12	
Mortgage loan forward sale contracts	13,246	89		9,251	7	(18)
<b>Total</b>	<b>\$217,318</b>	<b>\$3,061</b>	<b>\$(3,471)</b>	<b>\$201,016</b>	<b>\$985</b>	<b>\$(1,886)</b>

**12. Income Taxes**

For the second quarter of 2006, income tax expense amounted to \$27,387,000 compared to \$29,484,000 in the second quarter of 2005. The effective income tax rate for the Company was 33.1% in the current quarter compared to 35.2% in the same quarter last year. For the six months ended June 30, 2006 and 2005, income tax expense amounted to \$53,233,000 and \$55,516,000, resulting in effective income tax rates of 33.0% and 34.8%, respectively.

**13. Stock-Based Compensation**

During 2005 and previous years, stock-based awards were issued to key employees under several stock option and award plans, all of which had been approved by shareholders. During this period, awards were comprised of stock options and nonvested stock. 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 the first six months of 2006, stock-based compensation was issued in the form of stock appreciation rights (SARs) and non-vested stock, and at June 30, 2006, 3,721,178 shares remained available for issuance under the new plan. The stock-based compensation expense that has been charged against income was \$1,280,000 and \$1,305,000 for the three month periods ended June 30, 2006 and 2005, respectively, and \$2,079,000 and \$4,078,000, respectively, for the six month periods ended June 30, 2006 and 2005. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$480,000 and \$489,000 for the three month periods ended June 30, 2006 and 2005, respectively, and \$780,000 and \$1,530,000, respectively for the six month periods ended June 30, 2006 and 2005. The decline in stock-based compensation in 2006 compared to 2005 occurred because of a change in the vesting period of certain awards granted in the first quarter of 2006, in addition to the effects of the forfeiture accounting requirements of Statement of Financial Accounting Standards 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 and a consideration of



other factors. 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

**Table of Contents**

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 an exercise price 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.

	<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>
Weighted per share average fair value at grant date	<b>\$14.08</b>	\$11.89
Assumptions:		
Dividend yield	<b>1.7%</b>	2.0%
Volatility	<b>21.07%</b>	23.4%
Risk-free interest rate	<b>4.6%</b>	4.2%
Expected term	<b>7.4 years</b>	7.1 years

A summary of option activity during the first six months of 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	3,412,808	\$33.86		
Granted				
Cancelled	(5,776)	43.49		
Exercised	(186,887)	24.13		
<b>Outstanding at June 30, 2006</b>	<b>3,220,145</b>	<b>\$34.40</b>	<b>5.5 years</b>	<b>\$50,389</b>
<b>Exercisable at June 30, 2006</b>	<b>2,872,409</b>	<b>\$33.10</b>	<b>5.2 years</b>	<b>\$48,686</b>
<b>Vested and expected to vest at June 30, 2006</b>	<b>3,210,010</b>	<b>\$34.37</b>	<b>5.5 years</b>	<b>\$50,339</b>

A summary of SAR activity during the first six months of 2006 is presented below.

	Weighted Average	Weighted Average Remaining	Aggregate
--	---------------------	----------------------------------	-----------

<i>(Dollars in thousands, except per share data)</i>	Shares	Exercise Price	Contractual Term	Intrinsic Value
Outstanding at January 1, 2006		\$		
Granted	459,450	51.75		
Cancelled	(2,850)	51.55		
Exercised				
<b>Outstanding at June 30, 2006</b>	456,600	\$51.75	9.7 years	\$
<b>Exercisable at June 30, 2006</b>		\$		\$
<b>Vested and expected to vest at June 30, 2006</b>	388,179	\$51.75	9.7 years	\$

**Table of Contents**

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

	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
<i>(Dollars in thousands)</i>	<b>2006</b>	2005	<b>2006</b>	2005
Intrinsic value of options exercised	<b>\$432</b>	\$3,933	<b>\$5,051</b>	\$8,739
Cash received from options exercised	<b>\$563</b>	\$4,870	<b>\$4,458</b>	\$7,919
Tax benefit realized from options exercised	<b>\$108</b>	\$ 889	<b>\$ 747</b>	\$1,024

Nonvested stock is awarded to key employees, by action of the Board of Directors. These awards generally vest after 5 years of continued employment. 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 June 30, 2006, and changes during the six month period then ended is presented below.

	Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2006	163,420	\$39.37
Granted	22,722	51.61
Vested	(28,503)	30.61
Forfeited	(1,658)	43.35
<b>Nonvested at June 30, 2006</b>	<b>155,981</b>	<b>\$42.71</b>

As of June 30, 2006, there was \$3,574,000 of total unrecognized compensation cost (net of estimated forfeitures) related to nonvested shares. That cost is expected to be recognized over a weighted-average period of 3.5 years. The total fair value (at vest date) of shares vested during the three month periods ended June 30, 2006 and 2005 was \$180,000 and \$61,000, respectively, and during the six month periods ended June 30, 2006 and 2005 was \$1,477,000 and \$1,188,000, respectively.

The Company adopted Financial Accounting Statement 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 consolidated income statement.

The Company has a stock repurchase program under which 5,000,000 shares of common stock were authorized for repurchase by the Board of Directors in October 2005. At June 30, 2006, 2,587,833 shares remain available to be

purchased under this authorization. A portion of shares repurchased during the next twelve months will be used to satisfy share option exercises, which are expected to range from 600,000 to 700,000 shares.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and with the statistical information and financial data appearing in this report as well as the Company's 2005 Annual Report on Form 10-K. Results of operations for the three and six month periods ended June 30, 2006 are not necessarily indicative of results to be attained for any other period.

15

---

## **Table of Contents**

### **Forward Looking Information**

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

### **Critical Accounting Policies**

The Company's consolidated financial statements are prepared based on the application of certain accounting policies, some of which require numerous estimates and strategic or economic assumptions that may prove inaccurate or be subject to variations which may significantly affect the Company's reported results and financial position for the current period or future periods. The use of estimates, assumptions, and judgments are necessary when financial assets and liabilities are required to be recorded at, or adjusted to reflect, fair value. 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 discussion of the methodologies used in establishing the allowance is provided in the Provision and 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 \$46.0 million at June 30, 2006. These private equity and venture capital securities are reported at estimated fair values in the absence of readily

**Table of Contents**

ascertainable fair values. 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.

**Selected Financial Data**

	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Per Share Data</b>				
Net income basic	\$ .83	\$ .78	\$ 1.62	\$ 1.48
Net income diluted	.82	.77	1.60	1.46
Cash dividends	.245	.229	.490	.457
Book value			20.08	19.83
Market price			50.05	48.01
<b>Selected Ratios</b>				
(Based on average balance sheets)				
Loans to deposits	84.27%	79.35%	83.80%	79.40%
Non-interest bearing deposits to total deposits	6.06	5.93	5.80	6.63
Equity to loans	14.48	16.29	14.62	16.56
Equity to deposits	12.21	12.92	12.26	13.15
Equity to total assets	9.69	9.85	9.70	9.93
Return on total assets	1.61	1.55	1.59	1.50
Return on total stockholders' equity	16.59	15.78	16.37	15.07
(Based on end-of-period data)				
Efficiency ratio*	60.35	58.27	61.00	60.18
Tier I capital ratio			11.51	11.77
Total capital ratio			12.85	13.12
Leverage ratio			9.47	9.37

\* 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)

**Results of Operations****Summary****Three Months Ended June 30****Six Months Ended June 30**

<i>(Dollars in thousands)</i>	<b>2006</b>	2005	% Change	<b>2006</b>	2005	% Change
Net interest income	<b>\$ 126,479</b>	\$ 127,387	(.7)%	<b>\$ 250,214</b>	\$ 248,864	.5%
Provision for loan losses	<b>(5,672)</b>	(5,503)	3.1	<b>(10,104)</b>	(7,871)	28.4
Non-interest income	<b>91,463</b>	84,980	7.6	<b>180,911</b>	165,671	9.2
Non-interest expense	<b>(129,550)</b>	(123,012)	5.3	<b>(259,511)</b>	(246,934)	5.1
Income taxes	<b>(27,387)</b>	(29,484)	(7.1)	<b>(53,233)</b>	(55,516)	(4.1)
<b>Net income</b>	<b>\$ 55,333</b>	\$ 54,368	1.8%	<b>\$ 108,277</b>	\$ 104,214	3.9%



**Table of Contents**

For the quarter ended June 30, 2006, net income amounted to \$55.3 million, an increase of \$965 thousand, or 1.8%, over the second quarter of the previous year. For the current quarter, the annualized return on average assets was 1.61%, the annualized return on average equity was 16.59%, and the efficiency ratio was 60.35%. Compared to the second quarter of last year, net interest income decreased .7% while non-interest income grew 7.6%, with increases in bank card, deposit account and trust fee income. Additionally, the provision for loan losses amounted to \$5.7 million for the quarter, while non-interest expense grew by 5.3%. Diluted earnings per share was \$.82, an increase of 6.5% over \$.77 per share in the second quarter of 2005.

Net income for the first six months of 2006 was \$108.3 million, a \$4.1 million, or 3.9%, increase over the first six months of 2005. The increase in net income was primarily due to a 9.2% increase in non-interest income, an improvement in net interest income, and a lower effective tax rate. These effects were partly offset by a 5.1% increase in non-interest expense and a \$2.2 million increase in the provision for loan losses. Diluted earnings per share increased 9.6% to \$1.60, compared to \$1.46 for the first six months of last year.

On July 21, 2006, Commerce Bank, N.A., (Missouri) (the Bank) a subsidiary of the Company, acquired the banking business of Boone National Savings and Loan Association (Boone). Boone operates four branches in Columbia, Missouri, and loan production offices in Ashland and Lake Ozark, Missouri. The Bank acquired loans and deposits of approximately \$128 million and \$101 million, respectively, assumed other liabilities of approximately \$27 million, and paid a purchase price premium of approximately \$16 million in cash. Goodwill and core deposit intangible of approximately \$19 million is expected to be recorded as a result of the transaction. No other intangible assets were recognized as a result of the transaction.

On April 13, 2006, the Company and West Pointe Bancorp, Inc. (West Pointe) signed a definitive merger agreement in which the Company will acquire West Pointe in a transaction to be valued at \$80.9 million in stock and cash. The Company's acquisition of West Pointe will add approximately \$477 million in assets (including \$256 million in loans), \$402 million in deposits, five branch locations and 25 ATMs in St. Clair County, Illinois (southwestern Illinois region of metropolitan St. Louis).

Under terms of the agreement, shareholders of West Pointe will be entitled to elect to receive either cash or stock, with the cash portion of the transaction not to exceed 25% of the total consideration of \$80.9 million. Elections will be subject to proration procedures. It is anticipated that the transaction will be completed in the third quarter of 2006, pending regulatory approvals and certain closing conditions.

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

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

**Analysis of Changes in Net Interest Income**

	<b>Three Months Ended June 30, 2006 vs. 2005</b>			<b>Six Months Ended June 30, 2006 vs. 2005</b>		
	<b>Change due to</b>			<b>Change due to</b>		
<i>(In thousands)</i>	<b>Average Volume</b>	<b>Average Rate</b>	<b>Total</b>	<b>Average Volume</b>	<b>Average Rate</b>	<b>Total</b>
<b>Interest income, fully taxable equivalent basis:</b>						
Loans	\$ 11,114	\$ 24,957	\$ 36,071	\$ 20,300	\$ 47,221	\$ 67,521
<b>Investment securities:</b>						
U.S. government and federal agency securities	(4,947)	(1,938)	(6,885)	(9,908)	(1,396)	(11,304)
State and municipal obligations	3,058	(21)	3,037	5,179	(48)	5,131
Mortgage and asset-backed securities	(7,780)	1,042	(6,738)	(13,012)	3,372	(9,640)
Other securities	38	1,126	1,164	22	2,406	2,428
Total interest on investment securities	(9,631)	209	(9,422)	(17,719)	4,334	(13,385)
Federal funds sold and securities purchased under agreements to resell	(86)	723	637	346	1,330	1,676
<b>Total interest income</b>	<b>1,397</b>	<b>25,889</b>	<b>27,286</b>	<b>2,927</b>	<b>52,885</b>	<b>55,812</b>
<b>Interest expense:</b>						
<b>Deposits:</b>						
Savings	(16)	247	231	(31)	461	430
Interest checking and money market	(97)	10,676	10,579	(432)	19,962	19,530
Time open & C.D. s of less than \$100,000	1,767	5,630	7,397	3,155	10,581	13,736
Time open & C.D. s of \$100,000 and over	1,281	4,652	5,933	3,299	9,469	12,768
Total interest on deposits	2,935	21,205	24,140	5,991	40,473	46,464

Federal funds purchased and securities sold under agreements to repurchase	(2,244)	6,105	3,861	(5,237)	12,261	7,024
Other borrowings	(1,375)	695	(680)	(2,269)	1,534	(735)
<b>Total interest expense</b>	<b>(684)</b>	<b>28,005</b>	<b>27,321</b>	<b>(1,515)</b>	<b>54,268</b>	<b>52,753</b>
<b>Net interest income, fully taxable equivalent basis</b>	<b>\$ 2,081</b>	<b>\$ (2,116)</b>	<b>\$ (35)</b>	<b>\$ 4,442</b>	<b>\$ (1,383)</b>	<b>\$ 3,059</b>

Net interest income in the second quarter of 2006 amounted to \$126.5 million, which decreased \$908 thousand, or .7%, compared to the second quarter of last year. The decline in net interest income was the result of higher rates paid on interest bearing deposits and borrowings, in addition to lower balances in investment securities. These reductions to net interest income were partly offset by income generated from higher loan yields and higher loan balances. During the second quarter of 2006, the net yield on earning assets (tax equivalent) was 3.98%, compared with 3.93% in the same quarter last year. For the first six months of 2006, net interest income totaled \$250.2 million, a \$1.4 million increase over net interest income of \$248.9 million in the first six months of 2005. The net yield on earning assets improved by 12 basis points during the first six months of 2006 to 3.98%, compared with 3.86% in the same period last year.

Total interest income increased \$26.5 million, or 15.3%, over the second quarter of 2005. The increase was the result of higher loan interest income, which grew \$35.9 million, or 28.7%. The growth in loan interest income was due to an overall increase of 109 basis points in average rates earned on nearly all

**Table of Contents**

lending products, in addition to an increase of \$752.8 million in average loan balances outstanding. Higher rates and balances in business and business real estate loans contributed most of the income growth. Additionally, as a result of the Company's decision to classify its student loan portfolio as held for sale, the Company ceased amortization of deferred loan costs into interest income, increasing interest income by \$1.3 million this quarter, of which \$622 thousand pertained to the first quarter of 2006. Partly offsetting this growth was a decline in investment securities interest income due to lower average balances in the securities portfolio. While the total portfolio declined \$915.8 million on average compared to the prior year, investments in state and municipal securities rose from 1.6% of the portfolio in the first six months of 2005 to 9.9% in 2006 and contributed \$3.0 million on a tax equivalent basis. The average tax equivalent yield on interest earning assets was 6.25% in the second quarter of 2006 compared to 5.33% in the second quarter of 2005.

Compared to the first six months of 2005, total interest income increased \$54.2 million, or 16.3%. The increase reflects similar trends as noted in the quarterly comparison above, with higher average rates earned on higher loan balances, contributing an increase of \$67.3 million to interest income. The rate increase was a result of a 200 basis point increase in the federal funds rate initiated by the Federal Reserve throughout 2005 and an additional 100 basis point increase initiated by the Federal Reserve in the first six months of 2006. Securities interest income declined \$14.7 million due to lower average balances, as proceeds from maturities and pay downs were shifted to fund loan growth and reduce borrowings. Average tax equivalent yields on total interest earning assets for the six months were 6.14% in 2006 and 5.18% in 2005.

Total interest expense increased \$27.4 million, or 60.2%, compared to the second quarter of 2005. This increase was mainly the result of higher average rates paid on all deposit products (especially on money market accounts and certificates of deposit) which rose 91 basis points overall and increased interest expense by \$21.2 million. Rates on overnight borrowings also increased, causing interest expense on federal funds purchased and securities sold under agreements to repurchase to increase \$6.1 million. Average rates paid on all interest bearing liabilities increased to 2.49% in the second quarter of 2006 compared to 1.53% in the second quarter of 2005.

For the first six months of 2006, total interest expense increased \$52.9 million, or 62.4%, compared with the previous year. Most of the increase resulted from an 87 basis point increase in average rates paid on deposit balances. Also contributing to the increase were higher rates paid on borrowings and higher average balances in certificates of deposit, partly offset by lower average borrowings. Average balances of federal funds purchased and securities sold under agreements to repurchase decreased by \$347.3 million. Increases in rates incurred on interest bearing liabilities were a result of the rate increases initiated by the Federal Reserve as mentioned above. The overall average cost of total interest bearing liabilities was 2.37% for the first six months of 2006 compared to 1.44% for the same period in 2005.

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

Table of Contents**Non-Interest Income**

	<b>Three Months Ended June 30</b>			<b>Six Months Ended June 30</b>		
<i>(Dollars in thousands)</i>	<b>2006</b>	2005	% Change	<b>2006</b>	2005	% Change
Deposit account charges and other fees	<b>\$28,910</b>	\$27,476	5.2%	<b>\$ 56,407</b>	\$ 51,777	8.9%
Bank card transaction fees	<b>23,558</b>	21,295	10.6	<b>45,266</b>	40,802	10.9
Trust fees	<b>17,992</b>	17,040	5.6	<b>35,811</b>	33,434	7.1
Trading account profits and commissions	<b>2,010</b>	2,450	(18.0)	<b>4,575</b>	5,064	(9.7)
Consumer brokerage services	<b>2,771</b>	2,338	18.5	<b>5,160</b>	5,163	(.1)
Loan fees and sales	<b>2,745</b>	4,805	(42.9)	<b>6,488</b>	8,245	(21.3)
Investment securities gains, net	<b>3,284</b>	1,372	139.4	<b>5,687</b>	4,984	14.1
Other	<b>10,193</b>	8,204	24.2	<b>21,517</b>	16,202	32.8
<b>Total non-interest income</b>	<b>\$91,463</b>	\$84,980	7.6%	<b>\$180,911</b>	\$165,671	9.2%
Non-interest income as a % of total revenue*	<b>41.1%</b>	39.6%		<b>41.2%</b>	39.2%	

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

For the second quarter of 2006 total non-interest income amounted to \$91.5 million compared with \$85.0 million in the same quarter last year. Excluding investment securities gains, non-interest income grew 5.5% over the same period last year. This growth was mainly the result of higher bank card, deposit account and trust fee income, which was partly offset by lower gains on sales of student loans. Deposit account fees increased \$1.4 million, or 5.2%, compared with the second quarter of 2005, mainly due to growth in deposit account overdraft fees, which grew \$2.2 million, or 11.5%, over the same period last year. This growth over last year continued to be the result of higher transaction volumes coupled with pricing changes initiated in the third quarter of 2005. Offsetting this growth was an 8.1% decline in corporate cash management fees, which continue to be affected by the higher interest rate environment. Bank card fees for the quarter increased \$2.3 million, or 10.6%, over the same period last year, due mainly to higher fees earned on debit and corporate card transactions, which grew by 16.1% and 19.0%, respectively. Trust fees for the quarter increased \$952 thousand, or 5.6%, mainly as a result of higher fees on personal trust accounts. Bond trading income declined \$440 thousand from amounts recorded in the same period last year, while consumer brokerage services revenue increased \$433 thousand. Loan fees and sales decreased by \$2.1 million, as gains on student loan sales declined from \$3.6 million in the second quarter of 2005 to \$1.8 million in 2006. Other non-interest income increased \$2.0 million over the same period last year as a result of increased income on leasing activities and higher sweep fee and check sales income. Other non-interest income also included a \$1.3 million gain on the sale of a parking garage.

Non-interest income for the six months ended June 30, 2006 was \$180.9 million compared to \$165.7 million in the first six months of 2005, resulting in a \$15.2 million, or 9.2% increase. Deposit account fees rose \$4.6 million, or 8.9%, as a result of higher deposit account overdraft fees, which grew \$5.8 million, or 17.0%. This growth was partly offset by lower cash management revenue and lower deposit account service charges. Bank card fees rose \$4.5 million, or 10.9% overall, due to increases of 17.6% and 25.9%, respectively, in debit and corporate card transaction fees. Trust fees rose \$2.4 million, or 7.1%, due to a 7.0% increase in personal trust account fees. Bond trading income fell \$489 thousand due to lower sales activity, while consumer brokerage income was relatively flat.

Loan fees and sales decreased by \$1.8 million as gains on student loan sales declined from \$5.9 million in the first six months of 2005 to \$4.5 million in 2006. Other non-interest income rose \$5.3 million, which included growth of \$1.3 million in lease-related income, \$1.2 million in non-recurring income from a Parent company equity investment, and net gains on real estate transactions.

During the current quarter, net securities gains amounted to \$3.3 million compared with \$1.4 million in the same period last year. On a year to date basis, such gains amounted to \$5.7 million and \$5.0 million for 2006 and 2005, respectively. Included in the second quarter results were net gains of \$2.6 million in realized gains and fair value adjustments on certain private equity investments held by the Company's

**Table of Contents**

majority-owned venture capital subsidiaries. Minority interest related to this income totaled \$748 thousand for the second quarter of 2006 and was reported in other non-interest expense. In addition, the Company received cash of \$683 thousand in conjunction with its investment in MasterCard Inc. and its conversion to a public company. This receipt was recorded as a realized gain. There were no other realized gains or losses on the Company's investment securities portfolio during 2006.

**Non-Interest Expense**

	<b>Three Months Ended June 30</b>			<b>Six Months Ended June 30</b>		
<i>(Dollars in thousands)</i>	<b>2006</b>	<b>2005</b>	<b>% Change</b>	<b>2006</b>	<b>2005</b>	<b>% Change</b>
Salaries and employee benefits	<b>\$ 71,239</b>	\$ 67,585	5.4%	<b>\$142,964</b>	\$137,765	3.8%
Net occupancy	<b>10,230</b>	9,527	7.4	<b>21,207</b>	19,305	9.9
Equipment	<b>6,071</b>	5,701	6.5	<b>12,020</b>	11,392	5.5
Supplies and communication	<b>7,872</b>	8,257	(4.7)	<b>16,265</b>	16,470	(1.2)
Data processing and software	<b>12,631</b>	12,069	4.7	<b>25,024</b>	23,524	6.4
Marketing	<b>4,657</b>	4,687	(.6)	<b>8,975</b>	8,549	5.0
Other	<b>16,850</b>	15,186	11.0	<b>33,056</b>	29,929	10.4
<b>Total non-interest expense</b>	<b>\$129,550</b>	\$123,012	5.3%	<b>\$259,511</b>	\$246,934	5.1%

Non-interest expense for the quarter amounted to \$129.6 million, which represented an increase of \$6.5 million, or 5.3%, over the expense recorded in the second quarter of last year. Compared with the second quarter of last year, salaries and benefits expense increased \$3.7 million, or 5.4%, mainly as a result of normal merit increases, higher incentives, payroll taxes and medical insurance costs. Occupancy costs grew \$703 thousand, or 7.4%, over the same quarter last year, mainly as a result of higher depreciation expense offset by increased tenant rent received. Equipment and data processing expenses increased 6.5% and 4.7%, respectively, due to higher depreciation and amortization charges, while lower telephone and network costs resulted in a reduction in overall supplies and communication costs of 4.7%. The increase in other expense over the same quarter last year resulted from higher costs for minority interests, operating lease depreciation and foreclosed property costs.

Non-interest expense increased \$12.6 million, or 5.1%, over the first six months of 2005. Salaries and benefits expense grew \$5.2 million, or 3.8%, due to merit increases, incentive compensation, medical insurance costs and payroll taxes. Partly offsetting these increases was a decline in stock-based compensation, 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 Stock-Based Compensation note to the consolidated financial statements. Full-time equivalent employees totaled 4,868 and 4,826 at June 30, 2006 and 2005, respectively. Occupancy costs grew by \$1.9 million, or 9.9%, over the same period last year, mainly as a result of additional depreciation expense on two new office buildings, partly offset by an increase in tenant rent received. In addition, in 2006 the Company recorded an asbestos abatement obligation on an office building in downtown Kansas City, which increased occupancy expense by \$814 thousand. Data processing and software expense increased \$1.5 million, or 6.4%, due to higher bank card processing fees, online banking fees and software amortization expense. Smaller variances occurred in equipment and marketing, which increased \$628 thousand and \$426 thousand, respectively, and supplies and communication which declined \$205 thousand. Other non-interest expense increased \$3.1 million due to increases in legal and professional fees, operating lease depreciation, and minority interest expense relating to investment gains recorded by venture capital affiliates. Partly offsetting these increases was a reduction in operating losses and intangible asset amortization.





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

	<b>Three Months Ended</b>			<b>Six Months Ended June 30</b>	
<i>(Dollars in thousands)</i>	<b>June 30, 2006</b>	June 30, 2005	March 31, 2006	<b>2006</b>	2005
<b>Provision for loan losses</b>	<b>\$5,672</b>	\$5,503	\$ 4,432	<b>\$10,104</b>	\$ 7,871
Net loan charge-offs (recoveries):					
Business	<b>259</b>	(48)	(1,081)	<b>(822)</b>	(2,669)
Credit card	<b>4,387</b>	5,430	3,748	<b>8,135</b>	10,027
Personal banking*	<b>446</b>	1,474	1,649	<b>2,095</b>	3,422
Real estate	<b>80</b>	(19)	(255)	<b>(175)</b>	(225)
Overdrafts	<b>522</b>	198	350	<b>872</b>	282
<b>Total net loan charge-offs</b>	<b>\$5,694</b>	\$7,035	\$ 4,411	<b>\$10,105</b>	\$10,837
Annualized total net charge-offs as a percentage of average loans	<b>.25%</b>	.33%	.20%	<b>.22%</b>	.26%

\* Includes consumer, student and home equity loans

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. The Company combines estimates of the reserves needed for loans evaluated on an individual basis for impairment with estimates of the reserves needed for pools of loans with similar risk characteristics. This process to determine reserves uses such tools as the Company's watch loan list and actual loss experience to identify both individual loans and pools of loans and the amount of reserves that are needed. Additionally, management determines the amount of reserves necessary to offset credit risk issues associated with loan concentrations, economic uncertainties, industry concerns, adverse market changes in estimated or appraised collateral values, and other subjective factors.

In using this process and the information available, management must consider various assumptions and exercise considerable judgment to determine the overall level of the allowance for loan losses. Because of these subjective factors, actual outcomes of inherent losses can differ from original estimates. The process of determining adequate levels of the allowance for loan losses is subject to regular review by the Company's Credit Administration personnel and outside regulators.

Net loan charge-offs for the second quarter of 2006 amounted to \$5.7 million, compared with \$4.4 million in the prior quarter and \$7.0 million in the second quarter of last year. The increase in net charge-offs in the second quarter of 2006 compared to the previous year was the result of slightly higher credit card charge-offs. Second quarter 2006 net charge-offs increased over the first quarter of 2006 because of a large lease loan recovery in the previous quarter. Personal banking loan net charge-offs remained at low levels during the second quarter of 2006, declining to .09% of average personal loans on an annualized basis, compared to .29% in the same quarter last year and .32% in the prior quarter. For the second quarter of 2006, annualized net charge-offs on average credit card loans were 3.01%, compared with 3.93% in the same quarter last year and 2.63% in the prior quarter. The provision for loan losses for the current quarter totaled \$5.7 million, and was \$1.2 million higher than in the first quarter 2006 provision and slightly higher than the second quarter 2005 provision. The amount of the provision to expense in each quarter was

determined by management's review and analysis of the adequacy of the allowance for loan losses, involving all the activities and factors described above regarding that process.

Net charge-offs during the first six months of 2006 amounted to \$10.1 million, compared to \$10.8 million in the comparable prior period. The decline occurred because of lower credit card and personal banking loan charge-offs in 2006, offset by lower business loan recoveries in 2006. The annualized net charge-off ratios were .22% in the first six months of 2006 and .26% in the same period in 2005. The provision for loan losses was \$10.1 million in the first six months of 2006 compared to \$7.9 million in the same period in 2005.

The allowance for loan losses at June 30, 2006 was \$128.4 million, or 1.37% of total loans, compared to \$128.4 million, or 1.44%, at December 31, 2005 and \$129.4 million, or 1.52%, at June 30, 2005. The

**Table of Contents**

decrease in the allowance at June 30, 2006 compared to June 30, 2005 was the result of increased credit quality. The Company considers the allowance for loan losses adequate to cover losses inherent in the loan portfolio at June 30, 2006.

**Risk Elements of Loan Portfolio**

The following table presents non-performing assets and loans which are past due 90 days and still accruing interest. Non-performing assets include non-accruing loans and foreclosed real estate. Loans are placed on non-accrual status when management does not expect to collect payments consistent with acceptable and agreed upon terms of repayment. Loans that are 90 days past due as to principal and/or interest payments are generally placed on non-accrual, unless they are both well-secured and in the process of collection, or they are 1-4 family first mortgage loans or consumer loans that are exempt under regulatory rules from being classified as non-accrual.

<i>(Dollars in thousands)</i>	<b>June 30 2006</b>	<b>December 31 2005</b>
Non-accrual loans	<b>\$14,155</b>	\$ 9,845
Foreclosed real estate	<b>1,793</b>	1,868
<b>Total non-performing assets</b>	<b>\$15,948</b>	\$11,713
Non-performing assets to total loans	<b>.17%</b>	.13%
Non-performing assets to total assets	<b>.11%</b>	.08%
<b>Loans past due 90 days and still accruing interest</b>	<b>\$15,186</b>	\$14,088

Non-accrual loans, which are also considered impaired, totaled \$14.2 million at June 30, 2006, and increased \$4.3 million over amounts recorded at December 31, 2005. The increase was mainly due to \$5.9 million in business and business real estate loans of a single creditor which were placed on non-accrual status in June 2006, partly offset by a \$664 thousand decline in lease-related loans. Lease-related loans comprised 14.8% of the June 30, 2006 non-accrual loan total, with the remainder primarily relating to business (24.3%) or business real estate loans (55.4%).

Total loans past due 90 days or more and still accruing interest amounted to \$15.2 million as of June 30, 2006, and increased \$1.1 million since December 31, 2005. The increase in past due loans at June 30, 2006 compared to December 31, 2005 occurred mainly because of a \$1.6 million rise in business and business real estate delinquencies, partly offset by a \$919 thousand decline in personal real estate delinquencies.

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. They are primarily classified as substandard for regulatory purposes. 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 \$45.9 million at June 30, 2006 compared with \$52.8 million at December 31, 2005. The lower balance at June 30, 2006 resulted primarily from customer payments or changes in credit grade.

**Income Taxes**

Income tax expense was \$27.4 million in the second quarter of 2006, compared to \$25.8 million in the first quarter of 2006 and \$29.5 million in the second quarter of 2005. The effective income tax rate on income from operations was 33.1% in the second quarter of 2006, compared with 32.8% in the first quarter of 2006 and 35.2% in the second quarter of 2005. Income tax expense was \$53.2 million in the first six months of 2006 compared to \$55.5 million in the previous year, resulting in effective income tax rates of 33.0% and 34.8%, respectively.



**Table of Contents**

Effective tax rates were lower in 2006 compared to 2005 because of earnings on higher average balances in tax exempt state and municipal investment securities, coupled with higher levels of income from the Company's real estate investment trust subsidiaries, which are not taxable in some states.

**Financial Condition**

**Balance Sheet**

Total assets of the Company were \$14.3 billion at June 30, 2006 compared to \$13.9 billion at December 31, 2005. Earning assets at June 30, 2006 were \$13.1 billion and consisted of 72% loans and 26% investment securities, compared to \$12.8 billion at December 31, 2005.

During the first six months of 2006, total period end loans increased \$480.7 million, or 5.4%, compared with balances at December 31, 2005. The increase was the result of increases of \$259.0 million in business loans, \$100.6 million in construction loans, \$85.2 million in business real estate loans, \$69.6 million in consumer loans, and \$34.0 million in personal real estate loans, offset by a decrease of \$73.5 million in student loans. Growth in business loans reflected new business, especially in regional markets, and increased borrowings by existing customers. Consumer loan growth reflected increased demand for marine, recreational vehicle and fixed rate home equity loans. Student loans declined mainly due to planned sales from the portfolio in the second quarter of 2006.

On an average basis, loans increased \$699.8 million during the first six months of 2006 compared to the same period in 2005, or an increase of 8.3%. This increase occurred mainly in the business, business real estate and consumer loan categories, which increased \$343.0 million, \$222.4 million, and \$101.6 million, respectively.

Available for sale investment securities, excluding fair value adjustments, decreased \$308.6 million, or 8.4%, at June 30, 2006 compared to December 31, 2005 as the Company continued to reduce its investment securities portfolio, mainly through normal maturities. Since December 31, 2005, sales, maturities and principal paydowns of securities totaled \$580.3 million. During the same period, purchases of securities totaled \$277.3 million and primarily consisted of tax free municipal obligations (\$173.1 million) and treasury and agency securities (\$55.4 million).

On an average basis, available for sale investment securities, excluding fair value adjustments, declined \$956.2 million during the first six months of 2006 compared to 2005, primarily in government and agency securities, which declined \$511.0 million and mortgage and asset-backed securities, which declined \$657.6 million, partly offset by an increase of \$236.8 million in state and municipal obligations.

Total deposits increased by \$190.5 million, or 1.8%, at June 30, 2006 compared to December 31, 2005. The increase in deposits over year end 2005 balances was due to increases of \$196.7 million in retail certificates of deposit, \$118.2 million in jumbo certificates of deposit and \$15.4 million in savings accounts. This growth was partly offset by declines of \$79.6 million in business and personal demand deposits, \$47.9 million in interest checking accounts and \$18.7 million in money market accounts.

On an average basis, total deposits increased \$277.6 million during the first six months of 2006 compared to the same period in 2005, mainly due to increases of \$229.0 million in retail certificates of deposit and \$238.9 million in jumbo certificates of deposit, partly offset by declines of \$59.0 million in money market accounts and \$71.9 million in non-interest bearing demand accounts.

Compared to 2005 year end balances, total short-term borrowings at June 30, 2006 increased \$260.1 million due to increases in both federal funds purchased and repurchase agreements. This increase reflects temporary liquidity requirements at June 30, 2006, as average short-term borrowings have declined from \$1.6 billion during the first six months of 2005 to \$1.2 billion during the same period in 2006. Other longer-term borrowings declined \$124.5 million from 2005 year end balances due to scheduled payments on Federal Home Loan Bank borrowings, of which \$128.7 million remained outstanding at June 30, 2006.

Table of ContentsLiquidity and Capital ResourcesLiquidity Management

The Company's most liquid assets are comprised of available for sale marketable investment securities, federal funds sold, and securities purchased under agreements to resell (resale agreements). Federal funds sold and resale agreements totaled \$237.1 million at June 30, 2006. These investments normally have overnight maturities and are used for general daily liquidity purposes. The fair value of the available for sale investment portfolio was \$3.3 billion at June 30, 2006, and included an unrealized loss of \$28.1 million. The portfolio includes maturities of approximately \$641 million over the next 12 months, which offer substantial resources to meet either new loan demand or reductions in the Company's deposit funding base. The Company pledges portions of its investment securities portfolio to secure public fund deposits, securities sold under agreements to repurchase, trust funds, and borrowing capacity at the Federal Reserve. At June 30, 2006, total investment securities pledged for these purposes comprised 64% of the total investment portfolio, leaving \$1.2 billion of unpledged securities.

<i>(In thousands)</i>	<b>June 30 2006</b>	<b>March 31 2006</b>	<b>December 31 2005</b>
<b>Liquid assets:</b>			
Federal funds sold	<b>\$ 112,072</b>	\$ 64,385	\$ 108,862
Securities purchased under agreements to resell	<b>125,000</b>	25,000	20,000
Available for sale investment securities	<b>3,337,477</b>	3,401,823	3,667,901
<b>Total</b>	<b>\$3,574,549</b>	\$3,491,208	\$3,796,763

Liquidity is also available from the Company's large base of core customer deposits, defined as demand, interest checking, savings, and money market deposit accounts. At June 30, 2006, such deposits totaled \$7.8 billion and represented 70.3% of the Company's total deposits. These core deposits are normally less volatile and are often tied to other products of the Company through long lasting relationships. Time open and certificates of deposit of \$100,000 and over totaled \$1.2 billion at June 30, 2006. These accounts are normally considered more volatile and higher costing, but comprised just 11.3% of total deposits at June 30, 2006.

<i>(In thousands)</i>	<b>June 30 2006</b>	<b>March 31 2006</b>	<b>December 31 2005</b>
<b>Core deposit base:</b>			
Non-interest bearing demand	<b>\$1,326,787</b>	\$1,418,387	\$1,399,934
Interest checking	<b>463,640</b>	464,597	511,583
Savings and money market	<b>5,975,428</b>	5,985,234	5,978,743
<b>Total</b>	<b>\$7,765,855</b>	\$7,868,218	\$7,890,260

Other important components of liquidity are the level of borrowings from third party sources and the availability of future credit. The Company's outside borrowings are comprised of federal funds purchased, securities sold under agreements to repurchase, and longer-term debt. Federal funds purchased and securities sold under agreements to repurchase are generally borrowed overnight, and amounted to \$1.6 billion at June 30, 2006. Federal funds purchased

are obtained mainly from upstream correspondent banks with whom the Company maintains approved lines of credit, while securities sold under agreements to repurchase are comprised of non-insured customer funds secured by a portion of the Company's investment portfolio. The Company's long-term debt is relatively small compared to its overall liability position. It is comprised mainly of advances from the Federal Home Loan Bank of Des Moines (FHLB), which totaled \$128.7 million at June 30, 2006. Most of these advances have floating rates and mature in 2006. The Company has \$4.0 million in outstanding subordinated debentures issued to a wholly-owned grantor

**Table of Contents**

trust, funded by preferred securities issued by the trust. Other outstanding long-term borrowings relate mainly to the Company's leasing and venture capital operations.

<i>(In thousands)</i>	<b>June 30 2006</b>	<b>March 31 2006</b>	<b>December 31 2005</b>
<b>Borrowings:</b>			
Federal funds purchased	<b>\$1,005,430</b>	\$ 438,879	\$ 849,504
Securities sold under agreements to repurchase	<b>581,081</b>	463,044	476,923
FHLB advances	<b>128,689</b>	241,733	251,776
Subordinated debentures	<b>4,000</b>	4,000	4,000
Other long-term debt	<b>12,230</b>	12,789	13,614
Other short-term debt		94	
<b>Total</b>	<b>\$1,731,430</b>	\$ 1,160,539	\$ 1,595,817

In addition to those mentioned above, several other sources of liquidity are available. The Company believes that its sound short-term commercial paper ratings of A-1 from Standard & Poor's and Prime-1 from Moody's would ensure the ready marketability of its commercial paper, should the need arise. No commercial paper has been issued or outstanding during the past ten years. In addition, the Company has temporary borrowing capacity at the Federal Reserve discount window, for which it has pledged \$329.5 million in loans and \$732.8 million in investment securities. Also, because of its lack of significant long-term debt, the Company believes that it could generate additional liquidity through its Capital Markets Group from sources such as jumbo certificates of deposit or privately placed debt offerings. Future financing could also include the issuance of common or preferred stock.

Cash and cash equivalents (defined as Cash and due from banks and Federal funds sold and securities purchased under agreements to resell as segregated in the accompanying balance sheets) was \$899.9 million at June 30, 2006 compared to \$673.1 million at December 31, 2005. The \$225.7 million increase resulted from changes in the various cash flows produced by the operating, investing and financing activities of the Company, as shown in the accompanying statement of cash flows for June 30, 2006. The cash flow provided by operating activities is considered a very stable source of funds and consists mainly of net income adjusted for certain non-cash items. Operating activities provided cash flow of \$240.7 million during the first six months of 2006. Investing activities, consisting mainly of purchases, sales and maturities of available for sale securities and changes in the level of the loan portfolio, used total cash of \$273.2 million. Most of the cash outflow was due to \$561.3 million in loan growth and \$277.3 million in purchases of investment securities, partly offset by \$562.8 million in maturities and pay downs. Financing activities provided cash of \$258.2 million, resulting from a \$260.1 million increase in overnight borrowings and an increase of \$225.8 million in deposits. Partly offsetting these cash inflows was a reduction of \$124.4 million in long-term borrowings. In addition, cash of \$75.8 million was required by the Company's treasury stock repurchase program and cash dividend payments were \$32.7 million. Future short-term liquidity needs arising from daily operations are not expected to vary significantly, and the Company believes it will be able to meet these cash flow needs.



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

The Company maintains regulatory capital ratios, including those of its principal banking subsidiaries, which exceed the well-capitalized guidelines under federal banking regulations. Information about the Company's risk-based capital is shown below.

<i>(Dollars in thousands)</i>	<b>June 30 2006</b>	<b>December 31 2005</b>	<b>Minimum Ratios for Well- Capitalized Banks</b>
Risk-adjusted assets	<b>\$11,322,781</b>	\$10,611,322	
Tier I capital	<b>1,303,344</b>	1,295,898	
Total capital	<b>1,454,738</b>	1,446,408	
Tier I capital ratio	<b>11.51%</b>	12.21%	6.00%
Total capital ratio	<b>12.85%</b>	13.63%	10.00%
Leverage ratio	<b>9.47%</b>	9.43%	5.00%

The Company maintains a treasury stock buyback program, and in October 2005, was authorized by the Board of Directors to repurchase up to 5,000,000 shares of its common stock. The Company has routinely used these shares to fund its annual 5% stock dividend and various stock compensation programs. During the current quarter, the Company purchased 486,460 shares of treasury stock at an average cost of \$50.70 per share. At June 30, 2006, 2,587,833 shares remained available for purchase under the current Board authorization.

The Company's common stock dividend policy reflects its earnings outlook, desired payout ratios, the need to maintain adequate capital levels, and alternative investment options. The Company increased its per share cash dividend to \$.245 in the first quarter of 2006, an increase of 7% compared to the fourth quarter of 2005, and maintained the same dividend payout in the second quarter of 2006. The year 2006 represents the 38th consecutive year of per share dividend increases.

**Commitments 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, which at June 30, 2006 totaled \$7.0 billion (including approximately \$3.5 billion in unused approved credit card lines of credit). In addition, the Company enters into standby and commercial letters of credit with its business customers. These contracts amounted to \$437.3 million and \$31.2 million, respectively, at June 30, 2006. Since many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. The carrying value of the guarantee obligations associated with the standby letters of credit, which has been recorded as a liability on the balance sheet, amounted to \$6.9 million at June 30, 2006. 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.

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 are retained for use by the Company. During the first six months of 2006, purchases and sales of tax credits amounted to \$11.4 million and \$12.0 million, respectively, and at June 30, 2006, outstanding purchase commitments totaled \$78.3 million. The Company has additional funding commitments arising from several investments in private equity concerns, classified as non-marketable investment securities in the accompanying consolidated balance sheets. These funding commitments amounted to \$3.0 million at June 30, 2006. The Company also has unfunded commitments relating to its investments in low-income housing partnerships, which amounted to \$2.2 million at June 30, 2006.



Table of ContentsSegment Results

The table below is a summary of segment pre-tax income results for the first six months of 2006 and 2005. Please refer to Note 10 in the notes to the consolidated financial statements for additional information about the Company's operating segments.

	Six Months Ended June 30		Increase (decrease)	
	2006	2005	Amount	Percent
<i>(Dollars in thousands)</i>				
Consumer	<b>\$118,330</b>	\$ 88,785	\$ 29,545	33.3%
Commercial	<b>68,828</b>	63,311	5,517	8.7
Money management	<b>17,239</b>	15,340	1,899	12.4
Total segments	<b>204,397</b>	167,436	36,961	22.1
Other/elimination	<b>(42,887)</b>	(7,706)	(35,181)	N.M.
<b>Income before income taxes</b>	<b>\$161,510</b>	\$159,730	\$ 1,780	1.1%

For the six months ended June 30, 2006, income before income taxes for the Consumer segment increased \$29.5 million, or 33.3%, compared to the same period in the prior year. The increase was mainly due to an increase of \$23.7 million in net interest income, coupled with an 8.5% increase in non-interest income. The increase in net interest income resulted mainly from a \$40.2 million increase in allocated funding credits assigned to the Consumer segment's deposit portfolio and higher loan interest income of \$20.4 million, which more than offset growth of \$36.8 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 and bank card transaction fees, partly offset by a decline in gains on sales of student loans. Non-interest expense increased \$3.9 million, or 2.8%, over the previous year mainly due to higher salaries expense, occupancy expense, loan servicing costs, bank card servicing expense and assigned processing costs. These increases were partly offset by declines in corporate management fees and miscellaneous losses. Net loan charge-offs declined \$2.8 million in the Consumer segment, mainly relating to personal and credit card loans.

For the six months ended June 30, 2006, income before income taxes for the Commercial segment increased \$5.5 million, or 8.7%, compared to the same period in the previous year. Most of the increase was due to a \$7.3 million, or 7.7%, increase in net interest income and a \$2.8 million increase in non-interest income. Included in net interest income were higher allocated funding credits on deposits, which increased for the same reasons as mentioned in the Consumer segment discussion above. Also, while interest on loans grew by \$47.3 million, this growth was offset by higher assigned funding costs. Non-interest income increased by 7.9% over the previous year mainly as a result of higher operating lease-related income and commercial bank card transaction fees, partly offset by lower commercial cash management fees. The \$2.5 million, or 3.7%, increase in non-interest expense included increases in salaries expense, operating lease depreciation and bank card servicing expense. These increases were partly offset by declines in loan servicing charges and the provision for off-balance sheet credit exposures. Net loan recoveries were \$854 thousand in the first six months of 2006 compared to net recoveries of \$2.9 million in the first six months of 2005, which also had a negative impact on the year to year comparison of the Commercial segment profitability.

Money Management segment pre-tax profitability for the first six months of 2006 was up \$1.9 million, or 12.4%, over the previous year mainly due to higher non-interest income, which was up \$2.2 million, or 5.3%, mainly in trust fees. Net interest income, which increased 20.8% over the prior year, was higher mainly due to higher assigned

funding credits attributed to the deposit portfolio of this segment. The increase in non-interest expense was mainly due to higher salaries expense and corporate management fees.

As shown in the table above, the pre-tax profitability in the Other/elimination category decreased \$35.2 million in the first six months of 2006 compared to the same period in 2005. This decrease was mainly the result of higher cost of fund charges assigned to this category related to investment securities.

**Table of Contents**

**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 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 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.

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.

Also in March 2006, the FASB issued Staff Position 85-4-1, which provides initial and subsequent measurement guidance and financial statement presentation and disclosure guidance for investments by third-party investors in life settlement contracts. The investments must be accounted for by either (a) recognizing the initial investment at transaction price plus direct external costs and capitalizing continuing costs, with no gain recognized in earnings until the insured dies, or (b) recognizing the initial investment at transaction price and remeasuring the investment at fair value at each reporting period, with fair value changes recognized in earnings as they occur. For calendar year companies, the guidance in

**Table of Contents**

this Staff Position must be applied beginning January 1, 2007. The Company does not expect that adoption of the Staff Position 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 Company does not expect that adoption of FIN 48 will have a material effect on its consolidated financial statements.

**Table of Contents****AVERAGE BALANCE SHEETS    AVERAGE RATES AND YIELDS**  
**Three Months Ended June 30, 2006 and 2005**

<i>(Dollars in thousands)</i>	Second Quarter 2006			Second Quarter 2005		
	Average Balance	Interest Income/Expense	Avg. Rates Earned/Paid	Average Balance	Interest Income/Expense	Avg. Rates Earned/Paid
<b>ASSETS:</b>						
Loans:						
Business(A)	\$ 2,694,246	\$ 43,529	6.48%	\$ 2,305,000	\$ 29,449	5.12%
Real estate construction	508,127	9,331	7.37	478,675	6,776	5.68
Real estate business	1,997,502	33,844	6.80	1,765,896	25,259	5.74
Real estate personal	1,373,444	19,294	5.63	1,344,203	17,704	5.28
Consumer	1,333,105	22,935	6.90	1,225,386	19,494	6.38
Home equity	446,094	8,381	7.54	422,637	6,211	5.89
Student	285,540	5,396	7.58	374,176	4,262	4.57
Credit card	584,508	18,846	12.93	553,965	16,330	11.82
Overdrafts	11,836			11,651		
<b>Total loans</b>	<b>9,234,402</b>	<b>161,556</b>	<b>7.02</b>	<b>8,481,589</b>	<b>125,485</b>	<b>5.93</b>
Investment securities:						
U.S. government and federal agency	696,820	6,030	3.47	1,130,042	12,915	4.58
State and municipal obligations(A)	348,289	3,820	4.40	70,746	783	4.44
Mortgage and asset-backed securities	2,165,999	23,211	4.30	2,925,252	29,949	4.11
Trading securities	21,144	229	4.34	7,864	78	3.98
Other marketable securities(A)	194,419	2,649	5.47	219,289	2,091	3.82
Non-marketable securities	86,658	1,487	6.88	75,968	1,032	5.45
<b>Total investment securities</b>	<b>3,513,329</b>	<b>37,426</b>	<b>4.27</b>	<b>4,429,161</b>	<b>46,848</b>	<b>4.24</b>
Federal funds sold and securities purchased under agreements to resell						
	142,651	1,801	5.06	145,135	1,164	3.22
<b>Total interest earning assets</b>	<b>12,890,382</b>	<b>200,783</b>	<b>6.25</b>	<b>13,055,885</b>	<b>173,497</b>	<b>5.33</b>

Less allowance for loan losses	(128,063)	(129,995)
Unrealized gain (loss) on investment securities	(21,378)	26,119
Cash and due from banks	470,660	502,834
Land, buildings and equipment, net	367,190	370,587
Other assets	221,522	198,816
<b>Total assets</b>	<b>\$13,800,313</b>	<b>\$14,024,246</b>

**LIABILITIES AND EQUITY:**

## Interest bearing deposits:

Savings	\$ 396,959	556	.56	\$ 417,059	325	.31
Interest checking and money market	6,666,190	22,446	1.35	6,820,516	11,867	.70
Time open and C.D. s of less than \$100,000	1,973,722	19,448	3.95	1,732,288	12,051	2.79
Time open and C.D. s of \$100,000 and over	1,257,161	13,906	4.44	1,085,769	7,973	2.95
<b>Total interest bearing deposits</b>	<b>10,294,032</b>	<b>56,356</b>	<b>2.20</b>	<b>10,055,632</b>	<b>32,216</b>	<b>1.29</b>

## Borrowings:

Federal funds purchased and securities sold under agreements to repurchase	1,213,925	14,024	4.63	1,481,135	10,163	2.75
Other borrowings(B)	205,472	2,394	4.67	380,043	3,074	3.24
<b>Total borrowings</b>	<b>1,419,397</b>	<b>16,418</b>	<b>4.64</b>	<b>1,861,178</b>	<b>13,237</b>	<b>2.85</b>

<b>Total interest bearing liabilities</b>	<b>11,713,429</b>	<b>72,774</b>	<b>2.49%</b>	<b>11,916,810</b>	<b>45,453</b>	<b>1.53%</b>
---	-------------------	---------------	--------------	-------------------	---------------	--------------

Non-interest bearing demand deposits	663,820	633,473
Other liabilities	85,641	92,403
Stockholders' equity	1,337,423	1,381,560

<b>Total liabilities and equity</b>	<b>\$13,800,313</b>	<b>\$14,024,246</b>
-------------------------------------	---------------------	---------------------

<b>Net interest margin (T/E)</b>	<b>\$128,009</b>	<b>\$128,044</b>
----------------------------------	------------------	------------------

<b>Net yield on interest earning assets</b>	<b>3.98%</b>	<b>3.93%</b>
---	--------------	--------------



(A) *Stated on a tax equivalent basis using a federal income tax rate of 35%.*

(B) *Interest expense capitalized on construction projects is not deducted from the interest expense shown above.*

**Table of Contents****AVERAGE BALANCE SHEETS    AVERAGE RATES AND YIELDS**  
**Six Months Ended June 30, 2006 and 2005**

<i>(Dollars in thousands)</i>	Six Months 2006			Six Months 2005		
	Average Balance	Interest Income/Expense	Avg. Rates Earned/Paid	Average Balance	Interest Income/Expense	Avg. Rates Earned/Paid
<b>ASSETS:</b>						
Loans:						
Business(A)	\$ 2,618,783	\$ 82,614	6.36%	\$ 2,275,806	\$ 56,902	5.04%
Real estate construction	474,992	16,955	7.20	460,673	12,440	5.45
Real estate business	1,984,422	65,461	6.65	1,762,040	49,342	5.65
Real estate personal	1,365,986	37,924	5.60	1,339,639	35,151	5.29
Consumer	1,310,865	44,480	6.84	1,209,314	38,050	6.34
Home equity	446,638	16,347	7.38	417,525	11,771	5.69
Student	322,545	10,573	6.61	391,999	8,617	4.43
Credit card	581,042	37,422	12.99	550,475	31,982	11.72
Overdrafts	15,952			13,961		
<b>Total loans</b>	<b>9,121,225</b>	<b>311,776</b>	<b>6.89</b>	<b>8,421,432</b>	<b>244,255</b>	<b>5.85</b>
Investment securities:						
U.S. government and federal agency	740,544	12,954	3.53	1,251,566	24,258	3.91
State and municipal obligations(A)	304,469	6,619	4.38	67,643	1,488	4.44
Mortgage and asset-backed securities	2,229,066	47,505	4.30	2,886,712	57,145	3.99
Trading securities	20,084	423	4.25	9,607	180	3.77
Other marketable securities(A)	194,136	5,145	5.34	218,463	3,771	3.48
Non-marketable securities	85,340	2,917	6.89	76,408	2,106	5.56
<b>Total investment securities</b>	<b>3,573,639</b>	<b>75,563</b>	<b>4.26</b>	<b>4,510,399</b>	<b>88,948</b>	<b>3.98</b>
Federal funds sold and securities purchased under agreements to resell						
	142,203	3,424	4.86	115,227	1,748	3.06
<b>Total interest earning assets</b>	<b>12,837,067</b>	<b>390,763</b>	<b>6.14</b>	<b>13,047,058</b>	<b>334,951</b>	<b>5.18</b>

Less allowance for loan losses	(128,247)	(130,928)
Unrealized gain (loss) on investment securities	(15,096)	36,982
Cash and due from banks	475,607	531,431
Land, buildings and equipment, net	369,352	362,206
Other assets	214,860	200,439

<b>Total assets</b>	<b>\$13,753,543</b>	<b>\$14,047,188</b>
---------------------	---------------------	---------------------

**LIABILITIES AND EQUITY:**

## Interest bearing deposits:

Savings	\$ 390,450	1,065	.55	\$ 410,488	635	.31
Interest checking and money market	6,663,358	41,544	1.26	6,761,696	22,014	.66
Time open and C.D. s of less than \$100,000	1,927,755	36,179	3.78	1,698,742	22,443	2.66
Time open and C.D. s of \$100,000 and over	1,271,576	27,093	4.30	1,032,685	14,325	2.80

<b>Total interest bearing deposits</b>	<b>10,253,139</b>	<b>105,881</b>	<b>2.08</b>	<b>9,903,611</b>	<b>59,417</b>	<b>1.21</b>
--	-------------------	----------------	-------------	------------------	---------------	-------------

## Borrowings:

Federal funds purchased and securities sold under agreements to repurchase	1,220,338	26,605	4.40	1,567,611	19,581	2.52
Other borrowings(B)	232,874	5,180	4.49	384,383	5,915	3.10

<b>Total borrowings</b>	<b>1,453,212</b>	<b>31,785</b>	<b>4.41</b>	<b>1,951,994</b>	<b>25,496</b>	<b>2.63</b>
-------------------------	------------------	---------------	-------------	------------------	---------------	-------------

<b>Total interest bearing liabilities</b>	<b>11,706,351</b>	<b>137,666</b>	<b>2.37%</b>	<b>11,855,605</b>	<b>84,913</b>	<b>1.44%</b>
---	-------------------	----------------	--------------	-------------------	---------------	--------------

Non-interest bearing demand deposits	630,839	702,786
Other liabilities	82,455	93,884
Stockholders' equity	1,333,898	1,394,913

<b>Total liabilities and equity</b>	<b>\$13,753,543</b>	<b>\$14,047,188</b>
-------------------------------------	---------------------	---------------------

<b>Net interest margin (T/E)</b>	<b>\$253,097</b>	<b>\$250,038</b>
----------------------------------	------------------	------------------

<b>Net yield on interest earning assets</b>	<b>3.98%</b>	<b>3.86%</b>
---	--------------	--------------

*(A) Stated on a tax equivalent basis using a federal income tax rate of 35%.*

*(B) Interest expense capitalized on construction projects is not deducted from the interest expense shown above.*

**Table of Contents****Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Interest rate risk management focuses on maintaining consistent growth in net interest income within Board-approved policy limits. The Company primarily uses earnings simulation models to analyze net interest sensitivity to movement in interest rates. The Company performs monthly simulations which model interest rates movements and risk in accordance with changes to its balance sheet composition. For further discussion of the Company's market risk, see the Interest Rate Sensitivity section of Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations included in the Company's 2005 Annual Report on Form 10-K.

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

	June 30, 2006		March 31, 2006		December 31, 2005	
	\$ Change in Net Interest Income	% Change in Net Interest Income	\$ Change in Net Interest Income	% Change in Net Interest Income	\$ Change in Net Interest Income	% Change in Net Interest Income
<i>(Dollars in millions)</i>						
200 basis points rising	<b>\$(5.1)</b>	<b>(1.00)%</b>	\$(2.6)	(.52)%	\$(5.8)	(1.14)%
100 basis points rising	<b>(1.7)</b>	<b>(.32)</b>	(.2)	(.04)	(1.9)	(.37)
100 basis points falling	<b>(.9)</b>	<b>(.19)</b>	(1.5)	(.29)	(1.7)	(.33)
200 basis points falling	<b>(3.6)</b>	<b>(.71)</b>	(4.9)	(.96)	(4.7)	(.93)

The table reflects a slight decrease in the exposure of the Company's net interest income to declining rates during the second quarter of 2006. As of June 30, 2006, under a 200 basis point falling rate scenario, net interest income is expected to decrease by \$3.6 million, compared with a decline of \$4.9 million at March 31, 2006 and a decline of \$4.7 million at December 31, 2005. Under a 100 basis point decrease, as of June 30, 2006 net interest income is expected to decline \$900 thousand compared with declines of \$1.5 million at March 31, 2006 and \$1.7 million at December 31, 2005. The Company's exposure to rising rates during the current quarter saw an increase over the prior quarter, as under a 100 basis point rising rate scenario net interest income would decrease by \$1.7 million compared with a \$200 thousand decline in the previous quarter, while under a 200 basis point increase, net interest income would decline by \$5.1 million compared with \$2.6 million in the prior quarter.

As shown in the table above, the Company's interest rate simulations for this quarter reflect slightly greater risk to rising interest rates than in the previous quarters. This is partly the result of lower student loan balances which have variable rates, plus the addition of other commercial and consumer loans which in part have fixed rates. Also, while the overall balance of investment securities has declined, the Company continued to add fixed rate municipal investments to the portfolio. While the simulation model does utilize a twelve month gradual rate scenario, certain non-maturity deposits are assumed to re-price faster since they currently are at comparatively low levels. Conversely, while under a falling rate environment the Company is subject to lower levels of net interest income, this risk has improved somewhat this quarter as greater levels of fixed rate assets, primarily loans, were added this quarter in conjunction with higher variable rate overnight borrowings. The Company continues to believe that its overall interest rate management has appropriately considered its susceptibility to both rising and falling rates and has adopted strategies which minimized impacts to interest rate risk.

**Item 4. CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of June 30, 2006. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective. There were not any significant changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents****PART II: OTHER INFORMATION****Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

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

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as part of Publicly Announced Program</b>	<b>Maximum Number that May Yet Be Purchased Under the Program</b>
April 1 30, 2006	862	\$51.85	862	3,073,431
May 1 31, 2006	305,878	\$50.65	305,878	2,767,553
June 1 30, 2006	179,720	\$50.77	179,720	2,587,833
<b>Total</b>	<b>486,460</b>	<b>\$50.70</b>	<b>486,460</b>	<b>2,587,833</b>

In October 2005, the Board of Directors approved the purchase of up to 5,000,000 shares of the Company's common stock. At June 30, 2006, 2,587,833 shares remain available to be purchased under the current authorization.

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

The annual meeting of shareholders of the Company was held on April 19, 2006. The following proposals were submitted by the Board of Directors to a vote of security holders:

(1) Election of four directors to the 2009 Class for a term of three years. Proxies for the meeting were solicited pursuant to Regulation 14A of the Securities Exchange Act of 1934, and there was no solicitation in opposition to management's nominees, as listed in the proxy statement. The four nominees for the four directorships received the following votes:

<b>Name of Director</b>	<b>Votes For</b>	<b>Votes Withheld</b>
Jonathan M. Kemper	51,511,449	308,269
Seth M. Leadbeater	51,488,313	331,405
Terry O. Meek	51,530,666	289,052
Mary Ann Van Lokeren	51,529,685	290,033

Other directors whose term of office as director continued after the meeting were: John R. Capps, W. Thomas Grant II, James B. Hebenstreit, David W. Kemper, Thomas A. McDonnell, Benjamin F. Rassieur III, Andrew C. Taylor, and Robert H. West.

(2) Ratification of the selection of KPMG LLP as the Company's independent public accountant. The proposal received the following votes:

<b>Votes For</b>	<b>Votes Against</b>	<b>Votes Abstain</b>
51,048,260	1,258,537	107,752

**Item 6. EXHIBITS**

See Index to Exhibits

35

---



**Table of Contents**

**SIGNATURES**

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

Commerce Bancshares, Inc.

By */s/ J. Daniel Stinnett*

J. Daniel Stinnett

*Vice President & Secretary*

Date: August 8, 2006

By */s/ Jeffery D. Aberdeen*

Jeffery D. Aberdeen

*Controller*

*(Chief Accounting Officer)*

Date: August 8, 2006

**Table of Contents**

**INDEX TO EXHIBITS**

- 31.1 Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certifications of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002