

COMMERCE BANCORP INC /NJ/  
Form 10-Q  
May 09, 2007

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

**Form 10-Q**

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2007

OR

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

Commission File #1-12069

(Exact name of registrant as specified in its charter)

New Jersey  
(State or other jurisdiction of  
incorporation or organization)

22-2433468  
(IRS Employer Identification  
Number)

Commerce Atrium, 1701 Route 70 East, Cherry Hill, New Jersey 08034-5400  
(Address of Principal Executive Offices) (Zip Code)

(856) 751-9000  
(Registrant's telephone number, including area code)

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

Yes  X

No  \_\_\_

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

Large accelerated filer  X

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  X

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

Common Stock  
(Title of Class)

191,373,248  
(No. of Shares Outstanding  
as of May 1, 2007)

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**PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements**

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

|                     |   | <b>March 31,</b>     | <b>December 31,</b> |
|---------------------|---|----------------------|---------------------|
|                     |   | <b>2007</b>          | <b>2006</b>         |
|                     | (dollars in thousands)  |                      |                     |
| <b>Assets</b>       | Cash and due from banks   | <b>\$ 1,237,008</b>  | \$ 1,207,390        |
|                     | Federal funds sold  | <b>506,400</b>       | 9,300               |
|                     | Cash and cash equivalents   | <b>1,743,408</b>     | 1,216,690           |
|                     | Loans held for sale   | <b>48,447</b>        | 52,741              |
|                     | Trading securities  | <b>156,241</b>       | 106,007             |
|                     | Securities available for sale   | <b>12,333,705</b>    | 11,098,113          |
|                     | Securities held to maturity<br>(market value 03/07-\$14,587,667;<br>12/06-\$14,617,765) | <b>14,811,708</b>    | 14,884,982          |
|                     | Loans   | <b>15,934,006</b>    | 15,607,049          |
|                     | Less allowance for loan and lease losses  | <b>155,912</b>       | 152,053             |
|                     |   | <b>15,778,094</b>    | 15,454,996          |
|                     | Bank premises and equipment, net  | <b>1,801,998</b>     | 1,753,670           |
|                     | Goodwill and other intangible assets  | <b>145,923</b>       | 141,631             |
|                     | Other assets  | <b>552,108</b>       | 562,986             |
|                     | Total assets  | <b>\$ 47,371,632</b> | \$45,271,816        |
| <b>Liabilities</b>  | Deposits:   |                      |                     |
|                     | Demand:   |                      |                     |
|                     | Noninterest-bearing   | <b>\$ 9,321,584</b>  | \$ 8,936,824        |
|                     | Interest-bearing  | <b>18,682,011</b>    | 16,853,457          |
|                     | Savings   | <b>10,580,371</b>    | 10,459,306          |
|                     | Time  | <b>5,391,900</b>     | 5,038,624           |
|                     | Total deposits  | <b>43,975,866</b>    | 41,288,211          |
|                     | Other borrowed money  | <b>122,725</b>       | 777,404             |
|                     | Other liabilities   | <b>391,848</b>       | 405,103             |
|                     | Total liabilities   | <b>44,490,439</b>    | 42,470,718          |
| <b>Stockholders</b> | Common stock, 192,751,235 shares<br>issued (189,738,423 shares in 2006)                 | <b>192,751</b>       | 189,738             |
| <b>Equity</b>       | Capital in excess of par value  | <b>1,779,523</b>     | 1,744,691           |
|                     | Retained earnings   | <b>1,007,299</b>     | 958,770             |
|                     | Accumulated other comprehensive loss  | <b>(49,364)</b>      | (65,240)            |
|                     |   | <b>2,930,209</b>     | 2,827,959           |
|                     | Less treasury stock, at cost, 1,874,923 shares<br>(1,231,081 shares in 2006)            | <b>49,016</b>        | 26,861              |
|                     | Total stockholders' equity  | <b>2,881,193</b>     | 2,801,098           |

|  |                      |              |
|--|----------------------|--------------|
| Total liabilities and stockholders' equity | <b>\$ 47,371,632</b> | \$45,271,816 |
|--|----------------------|--------------|

See accompanying notes.

**COMMERCE BANCORP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(unaudited)

|                            |  | <b>Three Months Ended</b> |             |
|----------------------------|--|---------------------------|-------------|
|                            |  | <b>March 31,</b>          |             |
|                            |  | <b>2007</b>               | <b>2006</b> |
|                            | (dollars in thousands, except per share amounts)         |                           |             |
| <b>Interest income</b>     | Interest and fees on loans                               | <b>\$ 270,770</b>         | \$ 214,974  |
|                            | Interest on investments                                  | <b>355,308</b>            | 295,076     |
|                            | Other interest   | <b>5,733</b>              | 413         |
|                            | Total interest income                                    | <b>631,811</b>            | 510,463     |
| <b>Interest expense</b>    | Interest on deposits:                                    |                           |             |
|                            | Demand   | <b>163,742</b>            | 97,940      |
|                            | Savings  | <b>72,118</b>             | 54,004      |
|                            | Time   | <b>58,863</b>             | 36,261      |
|                            | Total interest on deposits                               | <b>294,723</b>            | 188,205     |
|                            | Interest on other borrowed money                         | <b>4,132</b>              | 14,328      |
|                            | Total interest expense                                   | <b>298,855</b>            | 202,533     |
|                            | Net interest income                                      | <b>332,956</b>            | 307,930     |
|                            | Provision for credit losses                              | <b>10,000</b>             | 6,501       |
|                            | Net interest income after provision for credit losses    | <b>322,956</b>            | 301,429     |
| <b>Noninterest income</b>  | Deposit charges and service fees                         | <b>105,206</b>            | 82,281      |
|                            | Other operating income                                   | <b>51,366</b>             | 48,721      |
|                            | Net investment securities gains                          | <b>2,879</b>              |             |
|                            | Total noninterest income                                 | <b>159,451</b>            | 131,002     |
| <b>Noninterest expense</b> | Salaries and benefits                                    | <b>167,759</b>            | 144,825     |
|                            | Occupancy  | <b>58,072</b>             | 46,240      |
|                            | Furniture and equipment                                  | <b>42,852</b>             | 35,960      |
|                            | Office   | <b>16,303</b>             | 15,473      |
|                            | Marketing  | <b>10,433</b>             | 7,811       |
|                            | Other  | <b>67,366</b>             | 65,025      |
|                            | Total noninterest expenses                               | <b>362,785</b>            | 315,334     |
|                            | Income before income taxes                               | <b>119,622</b>            | 117,097     |
|                            | Provision for federal and state income taxes             | <b>41,686</b>             | 39,800      |
|                            | Net income   | <b>\$ 77,936</b>          | \$ 77,297   |
|                            | Net income per common and common equivalent share:       |                           |             |
|                            | Basic  | <b>\$ 0.41</b>            | \$ 0.43     |
|                            | Diluted  | <b>\$ 0.40</b>            | \$ 0.41     |
|                            | Average common and common equivalent shares outstanding: |                           |             |
|                            | Basic  | <b>189,278</b>            | 180,917     |
|                            | Diluted  | <b>196,505</b>            | 189,867     |
|                            | Dividends declared, common stock                         | <b>\$ 0.13</b>            | \$ 0.12     |

See accompanying notes.

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

|                             |  | <b>Three Months Ended</b> |              |
|-----------------------------|--|---------------------------|--------------|
|                             |  | <b>March 31,</b>          |              |
| (dollars in thousands)      |  | <b>2007</b>               | <b>2006</b>  |
| <b>Operating activities</b> | Net income   | \$ 77,936                 | \$ 77,297    |
|                             | Adjustments to reconcile net income to net cash provided by operating activities:        |                           |              |
|                             | Provision for credit losses  | 10,000                    | 6,501        |
|                             | Provision for depreciation, amortization and accretion                                   | 40,805                    | 37,553       |
|                             | Stock-based compensation expense   | 2,352                     | 403          |
|                             | Net gain on sales of securities  | (2,879)                   |              |
|                             | Proceeds from sales of loans held for sale   | 222,900                   | 114,892      |
|                             | Originations of loans held for sale  | (218,606)                 | (122,150)    |
|                             | Net (increase) decrease in trading securities  | (50,234)                  | 19,548       |
|                             | Decrease in other assets, net  | 3,705                     | 11,373       |
|                             | Decrease in other liabilities  | (18,175)                  | (46,537)     |
|                             | Net cash provided by operating activities  | 67,804                    | 98,880       |
| <b>Investing activities</b> | Proceeds from the sales of securities available for sale                                 | 457,890                   |              |
|                             | Proceeds from the maturity of securities available for sale                              | 827,743                   | 447,545      |
|                             | Proceeds from the maturity of securities held to maturity                                | 697,774                   | 446,707      |
|                             | Purchase of securities available for sale  | (2,493,218)               | (1,276,562)  |
|                             | Purchase of securities held to maturity  | (626,614)                 | (1,150,822)  |
|                             | Net increase in loans  | (333,071)                 | (826,378)    |
|                             | Capital expenditures   | (86,094)                  | (59,081)     |
|                             | Net cash used by investing activities  | (1,555,590)               | (2,418,591)  |
| <b>Financing activities</b> | Net increase in demand and savings deposits  | 2,334,379                 | 2,072,460    |
|                             | Net increase in time deposits  | 353,276                   | 312,934      |
|                             | Net decrease in other borrowed money   | (654,679)                 | (236,690)    |
|                             | Dividends paid   | (24,511)                  | (21,479)     |
|                             | Proceeds from issuance of common stock under dividend reinvestment and other stock plans | 6,039                     | 87,582       |
|                             | Other  |                           | 33           |
|                             | Net cash provided by financing activities  | 2,014,504                 | 2,214,840    |
|                             | Increase (decrease) in cash and cash equivalents   | 526,718                   | (104,871)    |
|                             | Cash and cash equivalents at beginning of year   | 1,216,690                 | 1,296,764    |
|                             | Cash and cash equivalents at end of period   | \$ 1,743,408              | \$ 1,191,893 |
|                             | Supplemental disclosures of cash flow information:                                       |                           |              |
|                             | Cash paid during the period for:   |                           |              |
|                             | Interest   | \$ 286,784                | \$ 201,341   |

|  |            |        |
|--|------------|--------|
| Income taxes   | <b>839</b> | 573    |
| Other noncash activities:                              |            |        |
| Fair value of noncash assets and liabilities acquired: |            |        |
| Assets acquired  | <b>75</b>  | 680    |
| Liabilities assumed                                    | <b>24</b>  | 10,076 |

See accompanying notes.

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

Three months ended March 31, 2007  
(in thousands)

|  | <b>Common<br/>Stock</b> | <b>Capital in<br/>Excess of<br/>Par<br/>Value</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Loss</b> | <b>Total</b>       |
|--|-------------------------|---|------------------------------|---------------------------|---|--------------------|
| <b>Balances at December 31, 2006</b>   | <b>\$189,738</b>        | <b>\$1,744,691</b>                                | <b>\$958,770</b>             | <b>\$(26,861)</b>         | <b>\$(65,240)</b>                                       | <b>\$2,801,098</b> |
| Net income   |                         |   | 77,936                       |                           |   | 77,936             |
| Other comprehensive loss, net of tax   |                         |   |                              |                           |   |                    |
| Unrealized gain on securities (pre-tax<br>\$27,817)  |                         |   |                              |                           | 17,438  | 17,438             |
| Reclassification adjustment (pre-tax<br>\$2,403)   |                         |   |                              |                           | (1,562)   | (1,562)            |
| Other comprehensive loss   |                         |   |                              |                           |   | 15,876             |
| Total comprehensive income   |                         |   |                              |                           |   | 93,812             |
| Cash dividends declared  |                         |   |                              | (24,821)                  |   | (24,821)           |
| Shares issued under dividend<br>reinvestment<br>and compensation and benefit plans<br>(2,787 shares) | 2,787                   | 25,406  |                              |                           |   | 28,193             |
| Acquisition of insurance brokerage<br>agency (226 shares)  | 226                     | 7,074   |                              |                           |   | 7,300              |
| Other  |                         | 2,352   | (4,586)                      | (22,155)                  |   | (24,389)           |
| <b>Balances at March 31, 2007</b>  | <b>\$192,751</b>        | <b>\$1,779,523</b>                                | <b>\$1,007,299</b>           | <b>\$(49,016)</b>         | <b>\$(49,364)</b>                                       | <b>\$2,881,193</b> |

See accompanying notes.

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

**A. Consolidated Financial Statements**

The consolidated financial statements included herein have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements were compiled in accordance with the accounting policies set forth in Note 1 - Significant Accounting Policies of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The accompanying consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to reflect a fair statement of the results for the interim periods presented. Such adjustments are of a normal recurring nature.

These consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the registrant's Annual Report on Form 10-K for the year ended December 31, 2006. The results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

The consolidated financial statements include the accounts of Commerce Bancorp, Inc. and its consolidated subsidiaries. All material intercompany transactions have been eliminated. Certain amounts from prior periods have been reclassified to conform with 2007 presentation.

**B. Income Taxes**

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted FIN 48 effective January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a \$7.1 million increase in its liability for unrecognized tax benefits, which was accounted for as a \$4.6 million reduction, net of the federal tax benefit, to the January 1, 2007 balance of retained earnings. As of January 1, 2007, the Company's unrecognized tax benefits totaled \$13.1 million, of which \$8.5 million, if recognized, would result in a reduction of the Company's effective tax rate.

The Company recognizes interest and penalties related to its tax contingencies as income tax expense. At January 1, 2007 the Company had approximately \$1.0 million accrued for interest and no accrual for penalties.

The Company files income tax returns in the U.S. federal jurisdiction and numerous state and local jurisdictions. The Company is no longer subject to Internal Revenue Service examination for periods prior to 2002. All state and local returns have been concluded and are no longer subject to examination through 2001, with certain returns concluded through 2006.

**C. Commitments**

In the normal course of business, there are various outstanding commitments to extend credit, such as letters of credit and unadvanced loan commitments. Management does not anticipate any material losses as a result of these transactions. Fees associated with standby letters of credit have been deferred and recorded in "Other liabilities" on the Consolidated Balance Sheets. These fees are immaterial to the Company's consolidated financial statements at March 31, 2007.

**D. Comprehensive Income**

Total comprehensive income, which for the Company included net income and changes in unrealized gains and losses on the Company's available for sale securities, amounted to \$93.8 million and \$14.5 million, respectively, for the three months ended March 31, 2007 and 2006.

**E. Segment Information**

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

Selected segment information is as follows (in thousands):

|                                     | Three Months Ended<br>March 31, 2007 |                  |            | Three Months Ended<br>March 31, 2006 |                  |            |
|-------------------------------------|--------------------------------------|------------------|------------|--------------------------------------|------------------|------------|
|                                     | Community<br>Banks                   | Parent/<br>Other | Total      | Community<br>Banks                   | Parent/<br>Other | Total      |
| Net interest income                 | \$ 331,917                           | \$ 1,039         | \$ 332,956 | \$ 307,057                           | \$ 873           | \$ 307,930 |
| Provision for loan losses           | 10,000                               |                  | 10,000     | 6,501                                |                  | 6,501      |
| Net interest income after provision | 321,917                              | 1,039            | 322,956    | 300,556                              | 873              | 301,429    |
| Noninterest income                  | 130,315                              | 29,136           | 159,451    | 100,284                              | 30,718           | 131,002    |
| Noninterest expense                 | 334,875                              | 27,910           | 362,785    | 289,884                              | 25,450           | 315,334    |
| Income before income taxes          | 117,357                              | 2,265            | 119,622    | 110,956                              | 6,141            | 117,097    |
| Income tax expense                  | 40,661                               | 1,025            | 41,686     | 37,499                               | 2,301            | 39,800     |
| Net income                          | \$ 76,696                            | \$ 1,240         | \$ 77,936  | \$ 73,457                            | \$ 3,840         | \$ 77,297  |
| Average assets (in millions)        | \$ 42,618                            | \$ 3,186         | \$ 45,804  | \$ 36,597                            | \$ 2,691         | \$ 39,288  |

**F. Net Income Per Share**

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

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31,</b>          |             |
|  | <b>2007</b>               | <b>2006</b> |
| <b>Basic:</b>  |                           |             |
| Net income available to common shareholders - basic              | \$ 77,936                 | \$ 77,297   |
| Average common shares outstanding - basic                        | 189,278                   | 180,917     |
| Net income per common share - basic                              | \$ 0.41                   | \$ 0.43     |
| <b>Diluted:</b>  |                           |             |
| Net income available to common shareholders - diluted            | \$ 77,936                 | \$ 77,297   |
| Average common shares outstanding                                | 189,278                   | 180,917     |
| Additional shares considered in diluted computation<br>assuming: |                           |             |
| Exercise of stock options  | 7,227                     | 8,950       |
| Average common shares outstanding - diluted                      | 196,505                   | 189,867     |
| Net income per common share - diluted                            | \$ 0.40                   | \$ 0.41     |

**G. New Accounting Pronouncements**

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (FAS 159). Under FAS 159, entities are provided with an option to report selected financial assets and liabilities at fair value, on an instrument-by-instrument basis. The objective is to improve financial reporting by mitigating volatility in reported earnings caused by measuring related assets and liabilities under different methods. FAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement methods for similar types of assets and liabilities. FAS 159 is effective for fiscal years beginning after November 15, 2007; however, it provides for early adoption as of January 1, 2007 assuming certain conditions are met. The Company did not early adopt FAS 159 and is currently evaluating the impact, if any, that it will have on its results of operations.

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

During the first three months of 2007, the Company continued its core deposit growth, which is the primary driver of the Company's success. Core deposits grew to \$42.7 billion, an increase of 19% over March 31, 2006, and 7% on a linked quarter basis. Comparable store core deposit growth per store was 17%. Total assets increased to \$47.4 billion, an increase of 16% over March 31, 2006, while total loans increased \$2.5 billion, or 18%, from \$13.5 billion at March 31, 2006 to \$15.9 billion. Net income was \$77.9 million and net income per share was \$0.40 for the first three months of 2007. These results were impacted by the continued difficult interest rate environment, which has impeded the Company's historical net interest income growth.

**Critical Accounting Policy**

The Company has identified the policy related to the allowance for credit losses as being critical. The foregoing critical accounting policy is more fully described in the Company's annual report on Form 10-K for the year ended December 31, 2006. During the first three months of 2007, there were no material changes to the estimates or methods by which estimates are derived with regard to the policy related to the allowance for credit losses.

**Capital Resources**

At March 31, 2007, stockholders' equity totaled \$2.9 billion or 6.08% of total assets, compared to \$2.8 billion or 6.19% of total assets at December 31, 2006.

The Company and its subsidiaries are subject to risk-based capital standards issued by bank regulatory authorities. Under these standards, the Company is required to have Tier 1 capital (as defined in the regulations) of at least 4% and total capital (as defined in the regulations) of at least 8% of risk-adjusted assets (as defined in the regulations). Bank regulatory authorities have also issued leverage ratio requirements. The leverage ratio requirement is measured as the ratio of Tier 1 capital to adjusted average assets (as defined in the regulations).

The table below presents the Company's and Commerce N.A.'s risk-based and leverage ratios at March 31, 2007 and 2006 (amounts in thousands):

|                            | Actual       |        | Per Regulatory Guidelines |       |                           |       |
|----------------------------|--------------|--------|---------------------------|-------|---------------------------|-------|
|                            | Amount       | Ratio  | Minimum Amount            | Ratio | "Well Capitalized" Amount | Ratio |
| <b>March 31, 2007:</b>     |              |        |                           |       |                           |       |
| Company                    |              |        |                           |       |                           |       |
| Risk based capital ratios: |              |        |                           |       |                           |       |
| Tier 1                     | \$ 2,784,634 | 11.63% | \$ 957,928                | 4.00% | \$ 1,436,892              | 6.00% |
| Total capital              | 2,953,572    | 12.33  | 1,915,857                 | 8.00  | 2,394,821                 | 10.00 |
| Leverage ratio             | 2,784,634    | 6.09   | 1,829,702                 | 4.00  | 2,287,128                 | 5.00  |
| Commerce N.A.              |              |        |                           |       |                           |       |
| Risk based capital ratios: |              |        |                           |       |                           |       |
| Tier 1                     | \$ 2,457,367 | 11.17% | \$ 879,619                | 4.00% | \$ 1,319,428              | 6.00% |
| Total capital              | 2,603,385    | 11.84  | 1,759,237                 | 8.00  | 2,199,047                 | 10.00 |
| Leverage ratio             | 2,457,367    | 5.91   | 1,663,461                 | 4.00  | 2,079,327                 | 5.00  |



|                            | Actual       |        | Per Regulatory Guidelines |       |                                    |       |
|----------------------------|--------------|--------|---------------------------|-------|------------------------------------|-------|
|                            | Amount       | Ratio  | Minimum<br>Amount         | Ratio | "Well Capitalized"<br>Amount Ratio |       |
| <b>March 31, 2006:</b>     |              |        |                           |       |                                    |       |
| Company                    |              |        |                           |       |                                    |       |
| Risk based capital ratios: |              |        |                           |       |                                    |       |
| Tier 1                     | \$ 2,389,749 | 11.80% | \$ 810,055                | 4.00% | \$ 1,215,083                       | 6.00% |
| Total capital              | 2,538,043    | 12.53  | 1,620,111                 | 8.00  | 2,025,139                          | 10.00 |
| Leverage ratio             | 2,389,749    | 6.09   | 1,570,680                 | 4.00  | 1,963,350                          | 5.00  |
| Commerce N.A.              |              |        |                           |       |                                    |       |
| Risk based capital ratios: |              |        |                           |       |                                    |       |
| Tier 1                     | \$ 2,135,415 | 11.50% | \$ 742,788                | 4.00% | \$ 1,114,182                       | 6.00% |
| Total capital              | 2,262,134    | 12.18  | 1,485,576                 | 8.00  | 1,856,970                          | 10.00 |
| Leverage ratio             | 2,135,415    | 6.01   | 1,422,289                 | 4.00  | 1,777,861                          | 5.00  |

At March 31, 2007, the Company's consolidated capital levels and each of the Company's bank subsidiaries met the regulatory definition of a "well capitalized" financial institution, i.e., a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6%, and a total risk-based capital ratio exceeding 10%. Management believes that as of March 31, 2007, the Company and its subsidiaries meet all capital adequacy requirements to which they are subject.

### Deposits

Total deposits at March 31, 2007 were \$44.0 billion, an increase of \$6.9 billion, or 18% over total deposits of \$37.1 billion at March 31, 2006, and up by \$2.7 billion, or 7% from year-end 2006. Year over year deposit growth included core deposit growth in all product and customer categories. The Company regards core deposits as all deposits other than public certificates of deposit. Core deposit growth by type of customer is as follows (in thousands):

|            | March 31,<br>2007 | % of<br>Total | March 31,<br>2006 | % of<br>Total | Annual<br>Growth % |
|------------|-------------------|---------------|-------------------|---------------|--------------------|
| Consumer   | \$ 17,906,912     | 42%           | \$ 15,643,435     | 44%           | 14%                |
| Commercial | 16,895,083        | 40            | 13,641,723        | 38            | 24                 |
| Government | 7,896,701         | 18            | 6,627,282         | 18            | 19                 |
| Total      | \$ 42,698,696     | 100%          | \$ 35,912,440     | 100%          | 19%                |

Comparable store core deposit growth is measured as the year over year percentage increase in core deposits for stores open one year or more at the balance sheet date. At March 31, 2007, the comparable store core deposit growth was 17%.

### Interest Rate Sensitivity and Liquidity

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

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

In March 2007, the ALCO Committee of the Board of Directors approved revised guidelines for the Company's income simulation model. The revised income simulation guidelines measure interest rate sensitivity by projecting net interest income, as opposed to net income, in alternative interest rate environments. The revisions were made based on ALCO's view that the measurement of changes in net interest income in alternative interest rate environments is a more appropriate indicator of the Company's interest rate risk.

The Company's income simulation model analyzes interest rate sensitivity by projecting net interest income over the next twelve months in a flat rate scenario, versus net interest income in alternative interest rate scenarios. Management continually reviews and refines its interest rate risk management process in response to the changing economic climate. Currently, the Company's model projects a proportionate plus 200 and minus 100 basis point change over a twelve month period. The Company's ALCO policy has established that interest income sensitivity will be considered acceptable if net interest income in the above interest rate scenarios are within 10% of forecasted net interest income in the flat rate scenario over the next twelve months. The following table illustrates the impact on projected net interest income at March 31, 2007 and 2006 of a plus 200 and minus 100 basis point change in interest rates.

|                 | <b>Basis Point Change</b> |                  |
|-----------------|---------------------------|------------------|
|                 | <b>Plus 200</b>           | <b>Minus 100</b> |
| March 31, 2007: |                           |                  |
| Twelve Months   | (8.5)%                    | 2.9%             |
| March 31, 2006: |                           |                  |
| Twelve Months   | (3.7)%                    | 1.4%             |

These forecasts are within an acceptable level of interest rate risk per the policies established by ALCO. In the event the model indicates an unacceptable level of risk, the Company could undertake a number of actions that would reduce this risk, including the sale of a portion of its available for sale investment portfolio, the use of risk management strategies such as interest rate swaps and caps, or fixing the cost of its short-term borrowings.

Many assumptions were used by the Company to calculate the impact of changes in interest rates, including the proportionate shift in rates. Actual results may not be similar to the Company's projections due to several factors including the timing and frequency of rate changes, market conditions and the shape of the yield curve. Actual results may also differ due to the Company's actions, if any, in response to the changing rates.

Management also monitors interest rate risk by utilizing a market value of equity model. The model assesses the impact of a change in interest rates on the market value of all the Company's assets and liabilities, as well as any off balance sheet items. The model calculates the market value of the Company's assets and liabilities in excess of book value in the current rate scenario, and then compares the excess of market value over book value given an immediate plus 200 and minus 100 basis point change in rates. The Company's revised ALCO guidelines indicates that the level of interest rate risk is unacceptable if the immediate plus 200 and minus 100 basis point change would result in the loss of 25% or more of the excess of market value over book value in the current rate scenario. At March 31, 2007, the market value of equity model indicates an acceptable level of interest rate risk.



The market value of equity model reflects certain estimates and assumptions regarding the impact on the market value of the Company's assets and liabilities given an immediate plus 200 or minus 100 basis point change in interest rates. One of the key assumptions is the market value assigned to the Company's core deposits, or the core deposit premium. Utilizing an independent consultant, the Company has completed and updated comprehensive core deposit studies in order to assign its own core deposit premiums. The studies have consistently confirmed management's assertion that the Company's core deposits have stable balances over long periods of time, are generally insensitive to changes in interest rates and have significantly longer average lives and durations than the Company's loans and investment securities. Thus, these core deposit balances provide a natural hedge to market value fluctuations in the Company's fixed rate assets. At March 31, 2007, the average life of the Company's core deposit transaction accounts was 17.7 years.

The market value of equity model analyzes both sides of the balance sheet and, as indicated below, demonstrates the inherent value of the Company's core deposits in a rising rate environment. As rates rise, the value of the Company's core deposits increases which helps offset the decrease in value of the Company's fixed rate assets. The following table summarizes the market value of equity at March 31, 2007 (in millions, except for per share amounts):

|                        | <b>Market Value<br/>of Equity</b> |        | <b>Per Share</b> |       |
|------------------------|-----------------------------------|--------|------------------|-------|
| Plus 200 basis points  | \$                                | 9,551  | \$               | 49.55 |
| Current Rate           | \$                                | 10,154 | \$               | 52.68 |
| Minus 100 basis points | \$                                | 9,154  | \$               | 47.49 |

Liquidity involves the Company's ability to raise funds to support asset growth or reduce assets to meet deposit withdrawals and other borrowing needs, to maintain reserve requirements and to otherwise operate the Company on an ongoing basis. The Company's liquidity needs are primarily met by growth in core deposits, its cash position and cash flow from its amortizing investment and loan portfolios. If necessary, the Company has the ability to raise liquidity through collateralized borrowings, FHLB advances, or the sale of its available for sale investment portfolio. As of March 31, 2007 the Company had in excess of \$17.7 billion in available liquidity which includes securities that could be sold or used for collateralized borrowings, cash on hand, and borrowing capacities under existing lines of credit. During the first three months of 2007, deposit growth, short-term borrowings and maturing investment securities were used to fund growth in the loan portfolio and purchase additional investment securities.

### **Short-Term Borrowings**

Short-term borrowings, or other borrowed money, typically consist of securities sold under agreements to repurchase, federal funds purchased or lines of credit, and are used to meet short-term funding needs. During the first three months of 2007, the Company reduced its short-term borrowings, primarily through increased deposits. At March 31, 2007, short-term borrowings aggregated \$122.7 million and had an average rate of 5.26%, as compared to \$777.4 million at an average rate of 5.29% at December 31, 2006.

### **Interest Earning Assets**

The Company's cash flow from deposit growth and repayments from its investment portfolio totaled approximately \$4.2 billion for the first three months of 2007. This significant cash flow provides the Company with ongoing reinvestment opportunities as interest rates change. For the three month period ended March 31, 2007, interest earning assets increased \$2.0 billion from \$41.8 billion at December 31, 2006 to \$43.8 billion. This increase was primarily in

investment securities and the loan portfolio as described below.

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**Loans**

Total loans at March 31, 2007 were \$15.9 billion, an increase of \$2.5 billion or 18% over total loans of \$13.4 billion at March 31, 2006, and up by \$327.0 million, or 2% from year-end 2006. The following table summarizes the loan portfolio of the Company by type of loan as of March 31, 2007 and December 31, 2006.

|                                    | <b>March 31,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|------------------------------------|---------------------------|------------------------------|
|                                    | (in thousands)            |                              |
| Commercial:                        |                           |                              |
| Term                               | \$ 2,432,065              | \$ 2,392,889                 |
| Line of credit                     | 1,790,734                 | 1,843,545                    |
|                                    | 4,222,799                 | 4,236,434                    |
| Owner-occupied                     | 3,007,211                 | 2,845,791                    |
|                                    | 7,230,010                 | 7,082,225                    |
| Consumer:                          |                           |                              |
| Mortgages (1-4 family residential) | 2,256,222                 | 2,235,247                    |
| Installment                        | 282,667                   | 287,151                      |
| Home equity                        | 3,119,327                 | 2,958,893                    |
| Credit lines                       | 138,794                   | 137,429                      |
|                                    | 5,797,010                 | 5,618,720                    |
| Commercial real estate:            |                           |                              |
| Investor developer                 | 2,562,842                 | 2,625,628                    |
| Construction                       | 344,144                   | 280,476                      |
|                                    | 2,906,986                 | 2,906,104                    |
| Total loans                        | \$ 15,934,006             | \$ 15,607,049                |

**Investments**

Total investments at March 31, 2007 were \$27.1 billion, an increase of \$3.2 billion, or 13% over total investments of \$23.9 billion at March 31, 2006, and up by \$1.2 billion, or 4% from year-end 2006. The available for sale portfolio increased \$1.2 billion to \$12.3 billion at March 31, 2007 from \$11.1 billion at December 31, 2006, and the held to maturity portfolio decreased \$73.3 million to \$14.8 billion at March 31, 2007 from \$14.9 billion at year-end 2006.

Detailed below is information regarding the composition and characteristics of the Company's investment portfolio, excluding trading securities, as of March 31, 2007.

| Product Description  | Available<br>For Sale | Held to<br>Maturity<br>(in thousands) | Total         |
|--|-----------------------|---------------------------------------|---------------|
| Mortgage-backed Securities:<br>Federal Agencies Pass Through<br>Certificates (AAA Rated) | \$ 1,378,225          | \$ 1,981,996                          | \$ 3,360,221  |
| Collateralized Mortgage<br>Obligations (AAA Rated)                                       | 9,951,830             | 10,572,692                            | 20,524,522    |
| U.S. Government agencies/Other   | 1,003,650             | 2,257,020                             | 3,260,670     |
| Total  | \$ 12,333,705         | \$ 14,811,708                         | \$ 27,145,413 |
| Duration (in years)  | 2.86                  | 3.47                                  | 3.19          |
| Average Life (in years)  | 4.99                  | 5.18                                  | 5.09          |
| Quarterly Average Yield  | 5.77%                 | 5.48%                                 | 5.61%         |

At March 31, 2007, the after tax depreciation of the Company's available for sale portfolio was \$49.4 million.

The Company's mortgage-backed securities (MBS) portfolio comprises 88% of the total investment portfolio. The MBS portfolio consists of Federal Agencies Pass-Through Certificates and Collateralized Mortgage Obligations (CMO's) which are issued by federal agencies and other private sponsors. The Company's investment policy does not permit investments in inverse floaters, IO's, PO's and other similar issues.

A summary of the amortized cost and market value of securities available for sale and securities held to maturity (in thousands) at March 31, 2007 and December 31, 2006 follows:

|  | At March 31, 2007 |                              |                               |                 |
|--|-------------------|------------------------------|-------------------------------|-----------------|
|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Market<br>Value |
| U.S. Government agency and<br>mortgage-backed<br>obligations | \$ 12,309,189     | \$ 16,814                    | \$ (106,474)                  | \$ 12,219,529   |
| Obligations of state and political<br>subdivisions           | 54,372            | 62                           | (191)                         | 54,243          |
| Equity securities  | 9,679             | 10,846                       |                               | 20,525          |
| Other  | 39,486            |                              | (78)                          | 39,408          |
| Securities available for sale                                | \$ 12,412,726     | \$ 27,722                    | \$ (106,743)                  | \$ 12,333,705   |
| U.S. Government agency and<br>mortgage-backed<br>obligations | \$ 14,117,958     | \$ 12,957                    | \$ (238,193)                  | \$ 13,892,722   |
|  | 555,253           | 1,511                        | (316)                         | 556,448         |

Obligations of state and political  
subdivisions

|                             |    |            |    |        |    |           |    |            |
|-----------------------------|----|------------|----|--------|----|-----------|----|------------|
| Other                       |    | 138,497    |    |        |    | 138,497   |    |            |
| Securities held to maturity | \$ | 14,811,708 | \$ | 14,468 | \$ | (238,509) | \$ | 14,587,667 |

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|  | <b>At December 31, 2006</b> |                                       |  |                         |
|--|-----------------------------|---------------------------------------|--|-------------------------|
|  | <b>Amortized<br/>Cost</b>   | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Market<br/>Value</b> |
| U.S. Government agency and mortgage-backed obligations | \$ 11,098,131               | \$ 16,047                             | \$ (129,931)                           | \$ 10,984,247           |
| Obligations of state and political subdivisions        | 54,517                      | 229                                   | (1)                                    | 54,745                  |
| Equity securities                                      | 9,679                       | 9,392                                 |  | 19,071                  |
| Other  | 40,221                      |                                       | (171)                                  | 40,050                  |
| Securities available for sale                          | \$ 11,202,548               | \$ 25,668                             | \$ (130,103)                           | \$ 11,098,113           |
| U.S. Government agency and mortgage-backed obligations | \$ 14,205,534               | \$ 14,843                             | \$ (283,519)                           | \$ 13,936,858           |
| Obligations of state and political subdivisions        | 554,189                     | 1,881                                 | (422)                                  | 555,648                 |
| Other  | 125,259                     |                                       |  | 125,259                 |
| Securities held to maturity                            | \$ 14,884,982               | \$ 16,724                             | \$ (283,941)                           | \$ 14,617,765           |

Gross gains and losses on securities sold during the first quarter of 2007 were \$2.9 million and \$0, respectively.

During the first quarter of 2007, \$84.2 million of securities were sold which had unrealized losses at December 31, 2006. Gross gains and losses on these securities sold were \$477 thousand and \$0, respectively.

There were no securities sold during the first quarter of 2006.

As described in Note 1 - Significant Accounting Policies of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, the Company reviews the investment portfolio to determine if other-than-temporary impairment has occurred. Management does not believe any individual unrealized loss as of March 31, 2007 represents an other-than-temporary impairment.

### **Net Income**

Net income for the first quarter of 2007 was \$77.9 million, a slight increase over the \$77.3 million recorded for the first quarter of 2006. On a per share basis, diluted net income was \$0.40 for the first quarter of 2007, compared to \$0.41 per common share for the first quarter of 2006.

Return on average assets (ROA) and return on average equity (ROE) for the first quarter of 2007 were 0.68% and 10.87%, respectively, compared to 0.79% and 13.00%, respectively, for the same 2006 period. Both ROA and ROE for the first quarter of 2007 continue to be impacted by the current interest rate environment and the resulting impact on the Company's net interest income.

**Net Interest Income**

Net interest income totaled \$333.0 million for the first quarter of 2007, an 8% increase over the \$307.9 million in the first quarter of 2006. The increase in net interest income during the first quarter of 2007 was due to the Company's continued ability to grow deposits as well as its loan and investment portfolios, offset by rate changes due to the current interest rate environment.

On a tax equivalent basis, the Company recorded \$340.5 million in net interest income in the first quarter of 2007, an increase of \$26.7 million or 9% over the first quarter of 2006. As shown below, the increase in net interest income on a tax equivalent basis was due to volume increases in the Company's earning assets, which were fueled by the Company's continued growth of low-cost core deposits (in thousands).

| Quarter Ended<br>March 31 | Volume<br>Increase | Net Interest Income |                   |               |
|---------------------------|--------------------|---------------------|-------------------|---------------|
|                           |                    | Rate<br>Change      | Total<br>Increase | %<br>Increase |
| <b>2007 vs. 2006</b>      | \$ 50,707          | \$ (24,010)         | \$ 26,697         | 9%            |

The net interest margin for the first quarter of 2007 was 3.27%, compared to 3.25% for the fourth quarter of 2006, and down 26 basis points from the 3.53% margin for the first quarter of 2006. The year over year compression in net interest margin was primarily caused by the current interest rate environment.

The following table sets forth balance sheet items on a daily average basis for the three months ended March 31, 2007, December 31, 2006 and March 31, 2006 and presents the daily average interest earned on assets and paid on liabilities for such periods.

## Average Balances and Net Interest Income

| <i>(dollars in thousands)</i>                       | March 2007    |            |         | December 2006 |            |         | March 2006    |            |       |
|---|---------------|------------|---------|---------------|------------|---------|---------------|------------|-------|
|   | Average       | Average    | Average | Average       | Average    | Average | Average       | Average    |       |
|   | Balance       | Interest   | Rate    | Balance       | Interest   | Rate    | Balance       | Interest   | Rate  |
| <b>Earning Assets</b>                               |               |            |         |               |            |         |               |            |       |
| Investment securities                               |               |            |         |               |            |         |               |            |       |
| Taxable   | \$ 25,237,398 | \$ 348,630 | 5.60%   | \$ 24,610,625 | \$ 335,665 | 5.41%   | \$ 22,325,450 | \$ 289,739 | 5.26% |
| Tax-exempt  | 611,725       | 8,984      | 5.96    | 586,903       | 8,596      | 5.81    | 549,794       | 6,956      | 5.13  |
| Trading   | 96,838        | 1,290      | 5.40    | 103,468       | 1,157      | 4.44    | 108,670       | 1,255      | 4.69  |
| Total investment securities                         | 25,945,961    | 358,904    | 5.61    | 25,300,996    | 345,418    | 5.42    | 22,983,914    | 297,950    | 5.26  |
| Federal funds sold                                  | 436,031       | 5,733      | 5.33    | 323,652       | 4,345      | 5.33    | 36,594        | 413        | 4.58  |
| <b>Loans</b>  |               |            |         |               |            |         |               |            |       |
| Commercial mortgages                                | 5,447,516     | 95,522     | 7.11    | 5,192,406     | 92,553     | 7.07    | 4,491,557     | 76,193     | 6.88  |
| Commercial  | 4,024,615     | 77,457     | 7.81    | 3,764,466     | 74,777     | 7.88    | 3,221,996     | 59,125     | 7.44  |
| Consumer  | 5,711,130     | 90,500     | 6.43    | 5,533,248     | 88,846     | 6.37    | 4,817,562     | 74,127     | 6.24  |
| Tax-exempt  | 599,202       | 11,217     | 7.59    | 538,746       | 10,104     | 7.44    | 492,283       | 8,506      | 7.01  |
| Total loans   | 15,782,463    | 274,696    | 7.06    | 15,028,866    | 266,280    | 7.03    | 13,023,398    | 217,951    | 6.79  |
| Total earning assets                                | \$ 42,164,455 | \$ 639,333 | 6.14%   | \$ 40,653,514 | \$ 616,043 | 6.01%   | \$ 36,043,906 | \$ 516,314 | 5.81% |
| <b>Sources of Funds</b>                             |               |            |         |               |            |         |               |            |       |
| Interest-bearing liabilities                        |               |            |         |               |            |         |               |            |       |
| Savings   | \$ 10,448,840 | \$ 72,118  | 2.80%   | \$ 10,643,889 | \$ 72,947  | 2.72%   | \$ 9,712,691  | \$ 54,004  | 2.25% |
| Interest bearing demand                             | 17,886,395    | 163,742    | 3.71    | 16,280,718    | 146,773    | 3.58    | 13,584,371    | 97,940     | 2.92  |
| Time deposits                                       | 3,999,233     | 43,284     | 4.39    | 3,723,163     | 39,578     | 4.22    | 3,131,039     | 25,850     | 3.35  |
| Public funds  | 1,197,869     | 15,579     | 5.27    | 1,525,472     | 20,556     | 5.35    | 952,132       | 10,411     | 4.43  |
| Total deposits                                      | 33,532,337    | 294,723    | 3.56    | 32,173,242    | 279,854    | 3.45    | 27,380,233    | 188,205    | 2.79  |
| Other borrowed money                                | 314,552       | 4,132      | 5.33    | 267,992       | 3,568      | 5.28    | 1,316,437     | 14,328     | 4.41  |
| Total deposits and interest-bearing liabilities     | 33,846,889    | 298,855    | 3.58    | 32,441,234    | 283,422    | 3.47    | 28,696,670    | 202,533    | 2.86  |
| Noninterest-bearing funds (net)                     | 8,317,566     |            |         | 8,212,280     |            |         | 7,347,236     |            |       |
| Total sources to fund earning assets                | \$ 42,164,455 | 298,855    | 2.87    | \$ 40,653,514 | 283,422    | 2.76    | \$ 36,043,906 | 202,533    | 2.28  |
| Net interest income and margin tax-equivalent basis |               | \$ 340,478 | 3.27%   |               | \$ 332,621 | 3.25%   |               | \$ 313,781 | 3.53% |
| <b>Other Balances</b>                               |               |            |         |               |            |         |               |            |       |

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|                                       |              |              |              |
|---------------------------------------|--------------|--------------|--------------|
| Cash and due from banks               | \$ 1,182,810 | \$ 1,174,831 | \$ 1,286,259 |
| Other assets                          | 2,613,080    | 2,451,297    | 2,094,400    |
| Total assets                          | 45,804,220   | 44,127,353   | 39,288,182   |
| Total deposits                        | 42,232,192   | 40,704,685   | 35,295,835   |
| Demand deposits (noninterest-bearing) | 8,699,855    | 8,531,443    | 7,915,602    |
| Other liabilities                     | 390,627      | 379,025      | 298,278      |
| Stockholders' equity                  | 2,866,849    | 2,775,651    | 2,377,632    |

Notes - Weighted average yields on tax-exempt obligations have been computed on a tax-equivalent basis assuming a federal tax rate of 35%.

- Non-accrual loans have been included in the average loan balance.

**Noninterest Income**

Excluding net investment securities gains, noninterest income totaled \$156.6 million for the first quarter of 2007, an increase of \$25.6 million or 20% from \$131.0 million in the first quarter of 2006. Deposit charges and service fees increased \$22.9 million, or 28%, during the first quarter of 2007 as compared to the same period in 2006, primarily due to the Company's growth in customer accounts and transaction volumes. Other operating income, which includes the Company's insurance and capital markets divisions, increased \$2.6 million, or 5%, during the first quarter of 2007 as compared to the same period in 2006. The increase in other operating income is more fully depicted in the following chart (in thousands):

|                          | <b>Three Months Ended</b> |             |
|--------------------------|---------------------------|-------------|
|                          | <b>March 31,</b>          |             |
|                          | <b>2007</b>               | <b>2006</b> |
| Other operating income:  |                           |             |
| Commerce Banc Insurance  | \$ 22,650                 | \$ 21,944   |
| Commerce Capital Markets | 7,267                     | 6,235       |
| Operating lease revenue  | 5,254                     | 3,502       |
| Loan brokerage fees      | 2,963                     | 1,937       |
| Other                    | 13,232                    | 15,103      |
| Total other              | \$ 51,366                 | \$ 48,721   |

All other operating income decreased \$1.9 million for the first quarter of 2007 as compared to the same period in 2006. Included in all other operating income for the first quarter of 2007 were \$5.0 million of net losses related to the Company's equity method investments which were partially offset by increased letter of credit fees and revenues generated by eMoney Advisor.

**Noninterest Expense**

For the first quarter of 2007, noninterest expense totaled \$362.8 million, an increase of \$47.5 million, or 15%, over the same period in 2006. Contributing to this increase was new store activity over the past twelve months, with the number of stores increasing from 378 at March 31, 2006 to 437 at March 31, 2007. With the addition of these new stores, staff, facilities, and related expenses rose accordingly.

Other noninterest expense increased \$2.3 million, or 4%, over the first quarter of 2006. The increase in other noninterest expense is more fully depicted in the following chart (in thousands):

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31,</b>          |             |
|   | <b>2007</b>               | <b>2006</b> |
| Other noninterest expense:              |                           |             |
| Business development costs              | \$ 9,873                  | \$ 9,583    |
| Bank-card related service charges       | 12,310                    | 12,371      |
| Professional services/Insurance         | 14,130                    | 11,316      |
| Provision for non-credit-related losses | 6,321                     | 7,812       |
| Other                                   | 24,732                    | 23,943      |
| Total other                             | \$ 67,366                 | \$ 65,025   |



The provision for non-credit-related losses, which includes fraud and forgery losses on deposit and other non-credit-related items, decreased from the prior period as the Company has implemented several loss prevention initiatives. Other expenses were impacted by the Company's continued focus on controlling costs while continuing to execute its growth model.

The Company's operating efficiency ratio (noninterest expenses, less other real estate expense, divided by net interest income plus noninterest income excluding non-recurring gains) was 73.99% for the first three months of 2007 as compared to 71.85% for the same 2006 period. The increase in the operating efficiency ratio is primarily due to the current interest rate environment and the resulting impact on the Company's net interest income. The Company's efficiency ratio remains above its peer group primarily due to its aggressive growth expansion activities.

### **Loan and Asset Quality**

Total non-performing assets (non-performing loans and other real estate, excluding loans past due 90 days or more and still accruing interest) at March 31, 2007 were \$51.7 million, or 0.11% of total assets compared to \$53.2 million or 0.12% of total assets at December 31, 2006 and \$33.6 million or 0.08% of total assets at March 31, 2006.

Total non-performing loans (non-accrual loans and restructured loans, excluding loans past due 90 days or more and still accruing interest) at March 31, 2007 were \$46.7 million or 0.29% of total loans compared to \$50.6 million or 0.32% of total loans at December 31, 2006 and \$33.1 million or 0.25% of total loans at March 31, 2006. At March 31, 2007, loans past due 90 days or more and still accruing interest amounted to \$658 thousand compared to \$620 thousand at December 31, 2006 and \$332 thousand at March 31, 2006. Additional loans considered as potential problem loans by the Company's credit review process (\$121.3 million at March 31, 2007, compared to \$105.8 million at December 31, 2006 and \$79.4 million at March 31, 2006) have been evaluated as to risk exposure in determining the adequacy of the allowance for loan losses.

Total non-performing loans decreased by \$3.9 million during the first quarter of 2007, which was primarily due to a \$13.2 million decrease in commercial non-accrual loans that was offset by increases of \$3.5 million and \$5.0 million in consumer and construction non-accrual loans, respectively. During the first quarter of 2007, a large not-for-profit healthcare credit that was added to non-accrual in 2006 was paid off. Other real estate/foreclosed assets totaled \$5.0 million at March 31, 2007 as compared to \$2.6 million at December 31, 2006 and \$435 thousand at March 31, 2006. These properties/assets have been written down to the lower of cost or fair market value less disposition costs. As of March 31, 2007, the overall asset quality of the Company, as measured in terms of non-performing assets to total assets, coverage ratios and non-performing assets to stockholders' equity, remained strong.

The following summary presents information regarding non-performing loans and assets as of March 31, 2007 and the preceding four quarters (dollar amounts in thousands).

|  | <b>March 31,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> | <b>September<br/>30,<br/>2006</b> | <b>June 30,<br/>2006</b> | <b>March 31,<br/>2006</b> |
|--|---------------------------|----------------------------------|-----------------------------------|--------------------------|---------------------------|
| Non-accrual loans:   |                           |                                  |                                   |                          |                           |
| Commercial   | \$ 20,526                 | \$ 33,686                        | \$ 33,658                         | \$ 34,904                | \$ 16,975                 |
| Consumer   | 15,343                    | 11,820                           | 9,325                             | 8,927                    | 9,285                     |
| Real estate:   |                           |                                  |                                   |                          |                           |
| Construction   | 8,575                     | 3,531                            | 496                               | 1,708                    | 1,726                     |
| Mortgage   | 2,277                     | 1,565                            | 1,828                             | 2,523                    | 2,096                     |
| Total non-accrual loans  | 46,721                    | 50,602                           | 45,307                            | 48,062                   | 30,082                    |
| Restructured loans:  |                           |                                  |                                   |                          |                           |
| Commercial   |                           |                                  |                                   | 2,941                    | 3,037                     |
| Total restructured loans   |                           |                                  |                                   | 2,941                    | 3,037                     |
| Total non-performing loans   | 46,721                    | 50,602                           | 45,307                            | 51,003                   | 33,119                    |
| Other real estate/foreclosed assets  | 5,000                     | 2,610                            | 2,022                             | 1,369                    | 435                       |
| Total non-performing assets  | 51,721                    | 53,212                           | 47,329                            | 52,372                   | 33,554                    |
| Loans past due 90 days or more<br>and still accruing   | 658                       | 620                              | 441                               | 583                      | 332                       |
| Total non-performing assets and<br>loans past due 90 days or more  | \$ 52,379                 | \$ 53,832                        | \$ 47,770                         | \$ 52,955                | \$ 33,886                 |
| Total non-performing loans as a<br>percentage of total period-end loans  | 0.29%                     | 0.32%                            | 0.31%                             | 0.36%                    | 0.25%                     |
| Total non-performing assets as a<br>percentage of total period-end assets  | 0.11%                     | 0.12%                            | 0.11%                             | 0.12%                    | 0.08%                     |
| Total non-performing assets and<br>loans<br>past due 90 days or more as a<br>percentage of total period-end assets | 0.11%                     | 0.12%                            | 0.11%                             | 0.12%                    | 0.08%                     |
| Allowance for credit losses as a<br>percentage<br>of total non-performing loans                                    | 351%                      | 317%                             | 341%                              | 291%                     | 432%                      |
| Allowance for credit losses as a<br>percentage<br>of total period-end loans  | 1.03%                     | 1.03%                            | 1.05%                             | 1.04%                    | 1.06%                     |

|  |    |    |    |    |    |
|--|----|----|----|----|----|
| Total non-performing assets and loans past due 90 days or more as a percentage of stockholders' equity and allowance for loan losses | 2% | 2% | 2% | 2% | 1% |
|--|----|----|----|----|----|

The Company maintains an allowance for losses inherent in the loan and lease portfolio and an allowance for losses on unfunded credit commitments. The following table presents, for the periods indicated, an analysis of the allowance for credit losses and other related data (dollar amounts in thousands).

|  | Three Months Ended<br>March 31, |            | Year Ended<br>December 31, |
|--|---------------------------------|------------|----------------------------|
|  | 2007                            | 2006       | 2006                       |
| Balance at beginning of period                               | \$ 160,269                      | \$ 141,464 | \$ 141,464                 |
| Provisions charged to operating expenses                     | 10,000                          | 6,501      | 33,700                     |
|  | 170,269                         | 147,965    | 175,164                    |
| Recoveries on loans previously charged-off:                  |                                 |            |                            |
| Commercial   | 1,121                           | 533        | 5,987                      |
| Consumer   | 289                             | 511        | 1,604                      |
| Commercial real estate                                       | 235                             | 1          | 385                        |
| Total recoveries   | 1,645                           | 1,045      | 7,976                      |
| Loans charged-off:   |                                 |            |                            |
| Commercial   | (4,294)                         | (4,186)    | (14,107)                   |
| Consumer   | (2,974)                         | (1,712)    | (8,179)                    |
| Commercial real estate                                       | (589)                           | (199)      | (585)                      |
| Total charge-offs  | (7,857)                         | (6,097)    | (22,871)                   |
| Net charge-offs  | (6,212)                         | (5,052)    | (14,895)                   |
| Balance at end of period                                     | \$ 164,057                      | \$ 142,913 | \$ 160,269                 |
| Net charge-offs as a percentage of average loans outstanding | 0.16%                           | 0.16%      | 0.11%                      |
| Net Reserve Additions  | \$ 3,788                        | \$ 1,449   | \$ 18,805                  |
| Components:  |                                 |            |                            |
| Allowance for loan and lease losses                          | \$ 155,912                      | \$ 135,745 | \$ 152,053                 |
| Allowance for unfunded credit commitments                    | 8,145                           | 7,168      | 8,216                      |
| Total allowance for credit losses                            | \$ 164,057                      | \$ 142,913 | \$ 160,269                 |

During the first three months of 2007, net charge-offs as a percentage of average loans outstanding were 0.16%, which was consistent with the same period in 2006. The increase in net reserve additions for the first quarter of 2007 was reflective of the growth in the Company's loan portfolio.

The Company considers the allowance for credit losses of \$164.1 million adequate to cover probable credit losses in the loan and lease portfolio and on unfunded credit commitments. The allowance for credit losses is increased by provisions charged to expense and reduced by charge-offs net of recoveries. The level of the allowance for loan and lease losses is based on an evaluation of individual large classified loans and nonaccrual loans, estimated losses based on risk characteristics of loans in the portfolio and other qualitative factors. The level of the allowance for losses on unfunded credit commitments is based on a risk characteristic methodology similar to that used in determining the allowance for loan and lease losses, taking into consideration the probability of funding these commitments. While the allowance for credit losses is maintained at a level considered to be adequate by management for estimated credit losses, determination of the allowance is inherently subjective, as it requires estimates that may be susceptible to significant change.



### **Forward-Looking Statements**

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

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

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

The Company cautions that any such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors which may cause the Company’s actual results, performance or achievements to differ materially from the future results, performance or achievements the Company has anticipated in such forward-looking statements. You should note that many factors, some of which are discussed in this Form 10-Q could affect the Company’s future financial results and could cause those results to differ materially from those expressed or implied in the Company’s forward-looking statements contained in this document.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

### **Item 4. Controls and Procedures**

#### ***Evaluation of disclosure controls and procedures.***

The Company's management, with the participation of its principal executive officer and principal financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of March 31, 2007. Based on this evaluation, the principal executive officer and principal financial officer concluded that, as of March 31, 2007, the Company's disclosure controls and procedures, as defined in Securities Exchange Act of 1934 ("Exchange Act") Rule 13a - 15(e), were effective, at the reasonable assurance level, to ensure that (i) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms and (ii) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### ***Changes in internal control over financial reporting.***

The Company's management, with the participation of its principal executive officer and principal financial officer, also conducted an evaluation of changes in the Company's internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f). Based on this evaluation, the Company's management determined that no changes, other than the changes discussed below, were made to the Company's internal control over financial reporting, as defined in Exchange Act Rule 13a - 15(f), during the first quarter of 2007 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

As previously disclosed in Item 9A. Controls and Procedures in the Company's Annual Report on Form 10-K, filed with the SEC on March 16, 2007, the Company disclosed material weaknesses in internal control over financial reporting as of December 31, 2006 with respect to the evaluation and interpretation of the applicability of tax laws to the Company's activities.

The Company's management, including the principal executive officer and principal financial officer, believe that the material weakness in the Company's internal control over financial reporting, with respect to the evaluation and interpretation of the applicability of tax laws to the Company's activities, was remediated during the quarter ended March 31, 2007. The remedial actions included the design and implementation of enhanced controls, including additional reviews, of the Company's evaluation and interpretation of the applicability of tax laws.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company conducts periodic evaluations to enhance, where necessary its procedures and controls.



**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

On January 22, 2007, a purported shareholder derivative complaint was filed in the United States District Court for the District of New Jersey, by a party identifying itself as a shareholder of Bancorp purporting to act on behalf of Bancorp against the Chairman and Chief Executive Officer of Bancorp and possibly certain present and former directors and officers of Bancorp and their related interests. Bancorp is also named as a “nominal defendant.” The suit alleges breaches of fiduciary duty, waste of corporate assets and unjust enrichment arising from certain related party transactions. The complaint seeks monetary damages, disgorgement, and other relief against the defendants on behalf of Bancorp. The complaint does not seek monetary damages from Bancorp but does seek that Bancorp take certain corrective actions.

Bancorp has received two demand letters from law firms not involved in the derivative action described above, on behalf of shareholders who also are not involved in the derivative action, demanding that the Board bring claims on behalf of Bancorp against certain present and former directors and officers of Bancorp and their related interests based on allegations substantially similar to those that were alleged in the proposed shareholder derivative action described above and, separately, demand that certain records of Bancorp be made available for inspection.

In response to the complaint and demand letters, the Board adopted a board resolution establishing a Special Litigation Committee (made up of independent directors) to independently investigate, review and analyze the facts and circumstances surrounding the allegations made in the complaint and demand letters. The Special Litigation Committee has engaged independent outside counsel to advise it. Bancorp intends to file a motion to stay the complaint and the demands set forth in the demand letters pending the outcome of the investigation being conducted by the Special Litigation Committee.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

| Period                          | (a)<br>Total Number of<br>Shares Purchased<br>(1) | (b)<br>Average Price<br>Paid per Share | (c)<br>Total Number<br>of Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | (d)<br>Maximum<br>Number of<br>Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|---------------------------------|---|--|---|--|
| January 1 to January 31, 2007   | 643,842   | \$ 34.41                               |   |  |
| February 1 to February 28, 2007 |   |  |   |  |
| March 1 to March 31, 2007       |   |  |   |  |
| Total                           | 643,842   | \$ 34.41                               |   |  |

(1) Purchases were made by the Company for the payment of income taxes on the exercise of stock options by an executive officer.



**Item 6. Exhibits**

Exhibits

Exhibit 10.1 \*Description of Named Executive Officer's compensation.

Exhibit 31.1 Certification of the Company's Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

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

\* Management contract or compensation plan or arrangement.

**SIGNATURES**

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

COMMERCE BANCORP, INC.  
(Registrant)

MAY 9, 2007  
(Date)

/s/ DOUGLAS J. PAULS  
DOUGLAS J. PAULS  
EXECUTIVE VICE PRESIDENT AND  
CHIEF FINANCIAL OFFICER  
(PRINCIPAL FINANCIAL AND ACCOUNTING  
OFFICER)

