COMMERCE BANCORP INC /NJ/
Form 10-K
March 16, 2005

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

FORM 10-K

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________ to ________________.
Commission File #1-12609

Commerce Bancorp, Inc
[GRAPHIC OMITTED]
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| New Jersey | 22-2433468 |
| (State of other jurisdiction of incorporation or organization) | (I.R.S. Employee Identification Number) |

| | |
|---|---|
| Commerce Atrium<br>1701 Route 70 East<br>Cherry Hill, New Jersey | 08034-5400 |
| (Address of principal executive offices) | (Zip Code) |

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

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

| | |
|---|---|
| Common Stock | New York Stock Exchange |
| Title of Class | Name of Each Exchange on Which Registered |

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).Yes X No __.

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $3,611,075,918.(1)

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

| Title of Class | No. of Shares Outstanding as of 3/8/05 |
|---|---|
| Common Stock $1.00 Par Value | 161,188,028 |

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the Registrant's Proxy Statement for the 2005 Annual Meeting of Shareholders.

(1) The aggregate dollar amount of the voting stock set forth equals the number of shares of the Registrant's Common Stock outstanding reduced by the number of shares of Common Stock held by officers, directors, and shareholders owning 10% or more of the Registrant's Common Stock, multiplied by $27.22 (as adjusted for the two-for-one stock split effective March 7, 2005), the last sale price for the Registrant's Common Stock on June 30, 2004 the last business day of the Registrant's most recently completed second fiscal quarter. The information provided shall in no way be construed as an admission that any person whose holdings are excluded from this figure is an affiliate of the Registrant or that such person is the beneficial owner of the shares reported as being held by him, and any such inference is hereby disclaimed. The information provided herein is included solely for the recordkeeping purposes of the Securities and Exchange Commission.

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PART I

Item 1. Business

Forward-Looking Statements

Commerce Bancorp, Inc. (the "Company") may from time to time make various written or oral "forward looking statements" including statements contained in the Company's filings with the Securities and Exchange Commission ("SEC") (including this Annual Report on Form 10-K and the exhibits hereto), in its reports to shareholders and in other communications by the Company, which are made in good faith by the Company pursuant to 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 that are sometimes beyond the Company's control. You will generally be able to recognize a forward-looking statement because it contains the words "anticipate," "believe," "estimate," "expect," "project," "objective," "may," "could," "should," "would," "intend," "forecast," "plan" or similar expressions to identify it as a forward-looking statement.

The following factors, among others, could cause the Company's financial performance to differ materially from that expressed in such forward-looking statements: the strength of the United States and world economies in general and the strength of the local economies in which the Company conducts its 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 Company's timely development of competitive new products and services 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; changes in consumer spending and saving habits; and the Company's success at managing the risks involved in the foregoing. The Company cautions that the foregoing list of important factors is not exclusive.

The Company cautions you 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 Annual Report on Form 10-K 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 or incorporated by reference in this document. 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.

General

The Company is a New Jersey business corporation registered as a bank holding company under the Bank Holding Company Act of 1956, as amended ("Holding Company Act"). The Company was incorporated on December 9, 1982 and became an active bank holding company on June 30, 1983 through the acquisition of Commerce Bank, N.A., referred to as Commerce NJ.

As of December 31, 2004, the Company had total assets of $30.5 billion, total loans of $9.5 billion, and total deposits of $27.7 billion. The address of the Company's principal executive office is Commerce Atrium, 1701 Route 70 East, Cherry Hill, New Jersey, 08034-5400 and the telephone number is (856) 751-9000. The Company operates:

- three nationally chartered bank subsidiaries:
  - Commerce Bank, N.A., Cherry Hill, New Jersey;
  - Commerce Bank/Pennsylvania, N.A., Devon, Pennsylvania;
  - Commerce Bank/Delaware, N.A., Wilmington, Delaware; and
- one New Jersey state chartered bank subsidiary:
  - Commerce Bank/North, Ramsey, New Jersey.



These four bank subsidiaries, referred to collectively as the banks, as of December 31, 2004 had 319 full service retail stores located in the states of New Jersey, Pennsylvania, Delaware and New York. These banks provide a full range of retail and commercial banking services for consumers and small and mid-sized companies. Lending services are focused on commercial real estate and commercial and consumer loans to local borrowers. These banks' lending and investment activities are funded principally by retail deposits gathered through each bank's retail store network.

Stock Split

On February 15, 2005, the Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend distributed on March 7, 2005 to stockholders of record on February 25, 2005. Per share data and other appropriate share information for all periods presented have been restated to reflect the stock split.

Acquisitions

The Company's primary growth strategy is the opening of new full service stores of which 49 opened in 2004 and 46 opened in 2003. The Company expects to open an additional 55 - 60 full service stores in 2005, including its first stores in the Metro Washington, D.C. market. The Company has also developed its full service office network through certain acquisitions including:

- on January 2, 1987, the Company acquired all of the outstanding shares of Commerce Bank/Pennsylvania, N.A., referred to as Commerce PA;

- on December 31, 1988 the Company acquired all of the outstanding shares of Citizens State Bank of New Jersey, Forked River, which was subsequently converted to a national charter and renamed Commerce Bank/Shore, N.A., referred to as Commerce Shore. Commerce Shore was merged with and into Commerce NJ in 2004;

- on January 21, 1997, the Company acquired Independence Bancorp, Inc., a bank holding company headquartered in Bergen County, New Jersey. Independence Bancorp, Inc.'s wholly-owned state-chartered bank subsidiary, Independence Bank of New Jersey, was subsequently renamed Commerce Bank/North, referred to as Commerce North; and

- on January 15, 1999, the Company acquired Prestige Financial Corp., referred to as PFC, a one-bank holding company headquartered in Flemington, New Jersey. PFC's wholly-owned state-chartered bank subsidiary, Prestige State Bank, was subsequently re-chartered as a national bank and renamed Commerce Bank/Central, N.A. Commerce Central was merged with and into Commerce NJ in 2001.

In 1998, the Company received regulatory approvals to open Commerce Bank/Delaware, N.A., referred to as Commerce Delaware. Commerce Delaware's first store opened in New Castle County, Delaware, on December 18, 1999.

Commerce NJ operates a non-bank subsidiary, Commerce Capital Markets, Inc. (CCMI), Philadelphia, Pennsylvania, referred to as Commerce Capital Markets, which engages in various securities, investment banking and brokerage activities.

In addition, the Company, through Commerce Insurance Services, Inc., a non-bank subsidiary of Commerce Bank/North, referred to as Commerce Insurance, operates an insurance brokerage agency concentrating on commercial property, casualty and surety as well as personal lines of insurance and employee benefits for clients in multiple states, primarily Delaware, New Jersey, New York and Pennsylvania. Since 1996, Commerce Insurance has completed several strategic acquisitions of insurance brokerage agencies.

Dividends

As a legal entity separate and distinct from its bank and non-bank subsidiaries, the Company's principal sources of revenues are dividends and fees from its bank and non-bank subsidiaries. The subsidiaries that operate in the banking, insurance and securities business can pay dividends only if they are in compliance with the applicable regulatory requirements imposed on them by federal and state regulatory authorities.

The Banks

As of December 31, 2004, Commerce NJ had total assets of $21.4 billion, total deposits of $19.1 billion, and total shareholders' equity of $1.3 billion; Commerce PA had total assets of $5.7 billion, total deposits of $5.3 billion and total shareholders' equity of $340.4 million; Commerce North had total assets of $3.2 billion, total deposits of $2.9 billion, and total shareholders' equity of $203.3 million; and Commerce Delaware had total assets of $381.0 million, total deposits of $356.7 million, and total shareholders' equity of $23.0 million.

Service Areas

The Company's primary service areas include New Jersey, Metropolitan Philadelphia and New York, and Northern Delaware. The Company has attempted to locate its stores in the fastest growing communities within its service areas. Retail deposits gathered through these focused branching activities are used to support lending throughout the Company.



Commerce NJ provides retail and commercial banking services through 208 retail stores in Central and Southern New Jersey, and Metropolitan New York.; Commerce PA provides retail and commercial banking services through 68 retail stores in Philadelphia, Bucks, Chester, Delaware and Montgomery Counties in Southeastern Pennsylvania; Commerce North provides retail and commercial banking services through 35 retail stores in Bergen, Essex, Hudson and Passaic Counties, New Jersey; and Commerce Delaware provides retail and commercial banking services through 8 retail stores in New Castle and Kent Counties, Delaware.

Retail Banking Services and Products

Each bank provides a broad range of retail banking services and products, including free checking accounts, subject to minimum balances, savings programs, money market accounts, negotiable orders of withdrawal accounts, certificates of deposit, safe deposit facilities, free coin counting, consumer loan programs, including installment loans for home improvement and the purchase of consumer goods and automobiles, home equity and revolving lines of credit, overdraft checking and automated teller facilities. Each bank also offers construction loans and permanent mortgages for houses.

Trust Services

Commerce NJ, Commerce PA and Commerce Delaware each offer trust services primarily focusing on corporate trust services, particularly as bond trustee, paying agent, and registrar for municipal bond offerings.

Commercial Banking Services and Products

Each bank offers a broad range of commercial banking services, including free checking accounts, subject to minimum balance, night depository facilities, money market accounts, certificates of deposit, short-term loans for seasonal or working capital purposes, term loans for fixed assets and expansion purposes, revolving credit plans and other commercial loans and leases to fit the needs of its customers. Each bank also finances the construction of business properties and makes real estate mortgage loans on completed buildings. Where the needs of a customer exceed a bank's legal lending limit for any one customer, such bank may participate with other banks, including the other banks owned by the Company, in making a loan.

Additional information pertaining to the Company's segments is set forth in Note 18 - Segment Reporting of the Notes to Consolidated Financial Statements, which appears elsewhere herein.

Commerce Insurance

Commerce Insurance operates one of the nation's largest regional insurance brokerage firms concentrating on commercial property, casualty and surety as well as personal lines. In addition, Commerce Insurance offers a line of employee benefit programs including group as well as individual medical, life, disability, pension, and risk management services. Commerce Insurance currently operates out of 12 locations in New Jersey, 2 locations in Pennsylvania, and 3 locations in Delaware. Commerce Insurance places insurance for clients in multiple states, primarily New Jersey, Pennsylvania, New York, and Delaware.

Commerce Capital Markets

Commerce Capital Markets engages in various securities, investment management and brokerage activities. Commerce Capital Markets' principal place of business is Philadelphia, Pennsylvania, with locations in Cherry Hill, South Plainfield, Ramsey and Mount Laurel, New Jersey and New York, New York.

Commerce Capital Trust II

Commerce Capital Trust II is a statutory business trust created under Delaware law. On March 11, 2002 the Company issued $200.0 million of 5.95% Convertible Trust Capital Securities through Commerce Capital Trust II.

Other Activities

NA Asset Management, a Delaware corporation, is a wholly-owned subsidiary of Commerce NJ that purchases, holds and sells investments of Commerce NJ. Commerce Mortgage Acceptance Corp., a Delaware corporation, is a wholly-owned subsidiary of Commerce NJ that is utilized in the securitization of residential mortgage loans. North Asset Management, a Delaware corporation, is a wholly-owned subsidiary of Commerce North that purchases, holds, and sells investments of Commerce North. Delaware Asset Management, a New Jersey corporation, is a wholly-owned subsidiary of Commerce Delaware that purchases, holds, and sells investments of Commerce Delaware. Commerce Commercial Leasing LLC, a New Jersey Limited Liability Company, is a wholly-owned subsidiary of Commerce NJ that provides business leasing services.

The Company has an investment in Pennsylvania Commerce Bancorp, Inc., Camp Hill, Pennsylvania (15.50% beneficial ownership assuming the exercise of all outstanding warrants held by the Company). The Company and its subsidiaries provide marketing support and technical support services to Pennsylvania Commerce Bancorp, Inc. and its wholly-owned subsidiary, Commerce Bank/Harrisburg.



Risk Factors

The Company is subject to a number of risk factors including, among others, business and economic conditions, monetary and other governmental policies, and competition. These factors, and others, could impact the Company's business, financial condition and results of operations. In the normal course of business, the Company assumes various types of risk, which include, among others, credit risk, interest rate risk, liquidity risk and risk associated with trading activities. The Company has risk management processes designed to provide for risk identification, measurement and monitoring. Additional information pertaining to the Company's risk factors is set forth in the Forward-Looking Statements, which appear on page 3.

Competition

The Company's service area is characterized by intense competition in all aspects and areas of its business from commercial banks, savings and loan associations, mutual savings banks and other financial institutions. The Company's competitors, including credit unions, consumer finance companies, factors, insurance companies and money market mutual funds, compete with lending and deposit gathering services offered by the Company. Many competitors have substantially greater financial resources with larger lending limits and larger branch systems than the Company.

In commercial transactions, Commerce NJ's, Commerce PA's, Commerce North's, and Commerce Delaware's legal lending limit to a single borrower (approximately $204.0 million, $53.3 million, $31.7 million, and $3.7 million, respectively, as of December 31, 2004) enables the banks to compete effectively for the business of smaller and mid-sized businesses. The combined legal lending limit of the Company is $292.7 million. These legal lending limits are lower than that of various competing institutions and may act as a constraint on the bank's effectiveness in competing to provide financing in excess of these limits.

The Company believes that it is able to compete on a substantially equal basis with larger financial institutions because its banks offer longer hours of operation than those offered by most of the Company's competitors, free checking accounts for customers maintaining minimum balances and competitive interest rates on savings and time accounts with low minimum deposit requirements.

The Company seeks to provide personalized services through management's knowledge and awareness of its market area, customers and borrowers. The Company believes this knowledge and awareness provides a business advantage in serving the retail depositors and the small and mid-sized commercial borrowers that comprise the Company's customer base.

Supervision and Regulation

THE FOLLOWING DISCUSSION SETS FORTH CERTAIN OF THE MATERIAL ELEMENTS OF THE REGULATORY FRAMEWORK APPLICABLE TO BANK HOLDING COMPANIES AND THEIR SUBSIDIARIES AND PROVIDES CERTAIN SPECIFIC INFORMATION RELEVANT TO THE COMPANY AND ITS SUBSIDIARIES. THE REGULATORY FRAMEWORK IS INTENDED PRIMARILY FOR THE PROTECTION OF DEPOSITORS, OTHER CUSTOMERS AND THE FEDERAL DEPOSIT INSURANCE FUNDS AND NOT FOR THE PROTECTION OF SECURITY HOLDERS. TO THE EXTENT THAT THE FOLLOWING INFORMATION DESCRIBES STATUTORY AND REGULATORY PROVISIONS, IT IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO THE PARTICULAR STATUTORY AND REGULATORY PROVISIONS. A CHANGE IN APPLICABLE STATUTES, REGULATIONS OR REGULATORY POLICY MAY HAVE A MATERIAL EFFECT ON THE BUSINESS OF THE COMPANY.

The Company

The Company is registered as a bank holding company under the Holding Company Act, and is therefore subject to supervision and regulation by the Federal Reserve Board ("FRB"). The Company is also regulated by the New Jersey Department of Banking and Insurance (the "Department").

Under the Holding Company Act, the Company is required to secure the prior approval of the FRB before it can merge or consolidate with any other bank holding company or acquire all or substantially all of the assets of any bank or acquire direct or indirect ownership or control of any voting shares of any bank that is not already majority owned by it, if after such acquisition it would directly or indirectly own or control more than 5% of the voting shares of such bank.

The Company is generally prohibited under the Holding Company Act from engaging in, or acquiring direct or indirect ownership or control or more than 5% of the voting shares of any company engaged in non-banking activities unless the FRB, by order or regulation, has found such activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In making such a determination, the FRB considers whether the performance of these activities by a bank holding company can reasonably be expected to produce benefits to the public which outweigh the possible adverse effects.

Satisfactory financial condition, particularly with regard to capital adequacy, and satisfactory Community Reinvestment Act, as amended ("CRA") ratings are generally prerequisites to obtaining federal regulatory approval to make acquisitions and open branches. Under the CRA, Commerce NJ, Commerce Delaware and Commerce North are currently rated "outstanding", while Commerce Pennsylvania is currently rated "satisfactory".

In addition, under the Holding Company Act, the Company is required to file periodic reports of its operations with, and is subject to examination by, the FRB.



The Company is under the jurisdiction of the SEC and various state securities commissions for matters relating to the offering and sale of its securities and is subject to the SEC's rules and regulations relating to periodic reporting, reporting to shareholders, proxy solicitation and insider trading.

There are various legal restrictions on the extent to which the Company and its non-bank subsidiaries can borrow or otherwise obtain credit from its banking subsidiaries. In general, these restrictions require that any such extensions of credit must be secured by designated amounts of specified collateral and are limited, as to any one of the Company or such non-bank subsidiaries, to ten percent of the lending bank's capital stock and surplus, and as to the Company and all such non-bank subsidiaries in the aggregate, to 20% of such lending bank's capital stock and surplus. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

The Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") contains a "cross-guarantee" provision that could result in any insured depository institution owned by the Company being assessed for losses incurred by the FDIC in connection with assistance provided to, or the failure of, any other depository institution owned by the Company. Also, under FRB policy, the Company is expected to act as a source of financial strength to each of its banking subsidiaries and to commit resources to support each such bank in circumstances where such bank might not be in a financial position to support itself. Consistent with the "source of strength" policy for subsidiary banks, the FRB has stated that, as a matter of prudent banking, a bank holding company generally should not maintain a rate of cash dividends unless its net income available to common shareholders has been sufficient to fully fund the dividends and the prospective rate of earnings retention appears to be consistent with the corporation's capital needs, asset quality and overall financial condition.

A discussion of capital guidelines and capital is included in the section entitled "Stockholders' Equity and Dividends" contained within "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere herein.

Commerce NJ, Commerce PA, Commerce North, and Commerce Delaware

Commerce NJ, Commerce PA, and Commerce Delaware, as national banks, are subject to the National Bank Act. Each is also subject to the supervision of, and is regularly examined by, the Office of the Comptroller of the Currency ("OCC") and is required to furnish quarterly reports to the OCC. The approval of the OCC is required for the establishment of additional stores by any national bank, subject to applicable state law restrictions.

Commerce North, as a New Jersey state-chartered bank, is subject to the New Jersey Banking Act. Commerce North is also subject to the supervision of, and is regularly examined by, the Department and the FDIC, and is required to furnish quarterly reports to each agency. The approval of the Department and the FDIC is necessary for the establishment of any additional stores by any New Jersey state-chartered bank, subject to applicable state law restrictions.

Under present New Jersey law, Commerce NJ, and Commerce North are permitted to operate stores at any location in New Jersey, subject to prior regulatory approval. Under present New York law, Commerce NJ is permitted to operate stores at any location in New York, subject to certain home office protection rules and subject to regulatory approval. Under present Pennsylvania law, Commerce PA is permitted to operate stores within any county in Pennsylvania, subject to prior regulatory approval. Under present Delaware law, Commerce Delaware is permitted to operate stores at any location in Delaware at which deposits are received, checks are paid, or money is lent, subject to prior regulatory approval.

Under the CRA, a bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with CRA. CRA requires that the applicable regulatory agency assess an institution's record of meeting the credit needs of its community. The CRA requires public disclosure of an institution's CRA rating and requires that the applicable regulatory agency provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. An institution's CRA rating is considered in determining whether to grant charters, stores and other deposit facilities, relocations, mergers, consolidations and acquisitions. Performance less than satisfactory may be the basis for denying an application. For their most recent examinations, Commerce NJ, Commerce Delaware and Commerce North each received an "outstanding" rating while Commerce PA received a "satisfactory" rating.

Commerce NJ, Commerce PA, Commerce North, and Commerce Delaware are also members of the FDIC and, except for Commerce North, members of the FRB and, therefore, are subject to additional regulation by these agencies. Some of the aspects of the lending and deposit business of Commerce NJ, Commerce PA, Commerce North, and Commerce Delaware which are regulated by these agencies include personal lending, mortgage lending and reserve requirements. The operation of Commerce NJ, Commerce PA, Commerce North, and Commerce Delaware is also subject to numerous federal, state and local laws and regulations which set forth specific restrictions and procedural requirements with respect to interest rates on loans, the extension of credit, credit practices, the disclosure of credit terms and discrimination in credit transactions.

Commerce NJ, Commerce PA, Commerce North, and Commerce Delaware are subject to certain limitations on the amount of cash dividends that they can pay. See Note 17 - Condensed Financial Statements of the Parent Company and Other Matters of the Notes to Consolidated Financial Statements, which appears elsewhere herein.

A discussion of capital guidelines and capital is included in the section entitled "Stockholders' Equity and Dividends" contained within "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere herein.

The OCC has authority under the Financial Institutions Supervisory Act to prohibit national banks from engaging in any activity which, in the OCC's opinion, constitutes an unsafe or unsound practice in conducting their businesses. The FRB has similar authority with respect to the Company and the Company's non-bank subsidiaries. The FDIC has similar authority with respect to Commerce North.

All of the deposits of the banking subsidiaries are insured up to applicable limits by the FDIC and are subject to deposit insurance assessments. The insurance assessments are based upon a matrix that takes into account a bank's capital level and supervisory rating. Effective January 1, 1996, the FDIC reduced the insurance premiums it charged on bank deposits to the statutory minimum of $2,000 annually for "well capitalized" banks. At December 31, 2004 the Company's consolidated capital levels and each of the Company's banking subsidiaries meet the regulatory definition of a "well capitalized" financial institution.

Commerce Insurance/ Commerce Capital Markets

Commerce Insurance, a non-bank subsidiary of Commerce North, is currently subject to supervision, regulation and examination by the Department, as well as other state insurance departments where it operates. Commerce Capital Markets, a non-bank subsidiary of Commerce NJ, engages in certain permitted securities and brokerage activities and is regulated by the SEC. Commerce Capital Markets is also subject to rules and regulations promulgated by the National Association of Securities Dealers, Inc., the Securities Investors Protection Corporation and various state securities commissions and with respect to municipal securities activities the Municipal Securities Rulemaking Board.

Both Commerce Insurance and Commerce Capital Markets are also subject to various state laws and regulations in which they do business. These laws and regulations are primarily intended to benefit clients and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the carrying on of business for failure to comply with such laws and regulations. In such event, the possible sanctions which may be imposed include the suspension of individual employees, limitations on engaging in business for specific periods, censures and fines.

Gramm-Leach-Bliley Act

On November 12, 1999 the Gramm-Leach-Bliley Act (the "Act") became law, repealing the 1933 Glass-Steagall Act's separation of the commercial and investment banking industries. The Act expanded the range of non-banking activities a bank holding company may engage in, while preserving existing authority for bank holding companies to engage in activities that are closely related to banking. The Act created a category of holding company called a "Financial Holding Company," a subset of bank holding companies that satisfy the following criteria: (1) all of the depository institution subsidiaries must be well capitalized and well managed; and (2) the holding company must have made an effective election with the FRB that it elects to be a financial holding company to engage in activities that would not have been permissible before the Act. In order for the election to be effective, all of the depository institution subsidiaries must have a CRA rating of "satisfactory" or better as of its most recent examination. The Company has not elected to be a financial holding company. Financial holding companies may engage in any activity that (i) is financial in nature or incidental to such financial activity or (ii) is complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. The Act specifies certain activities that are financial in nature. These activities include acting as principal, agent or broker for insurance; underwriting, dealing in or making a market in securities; and providing financial and investment advice. The FRB and the Secretary of the Treasury have authority to decide whether other activities are also financial in nature or incidental to financial activity, taking into account changes in technology, changes in the banking marketplace, competition for banking services and so on.

These financial activities authorized by the Act may also be engaged in by a "financial subsidiary" of a national or state bank, except for annuity underwriting, insurance company portfolio investments, real estate investment and development, and merchant banking, which must be conducted in a financial holding company. In order for the new financial activities to be engaged in by a financial subsidiary of a national or state bank, the Act requires each of the parent bank (and its sister-bank affiliates) to be well capitalized and well managed; the aggregate consolidated assets of all of that bank's financial subsidiaries may not exceed the lesser of 45% of its consolidated total assets or $50.0 billion; the bank must have at least a satisfactory CRA rating; and, if that bank is one of the 100 largest national banks, it must meet certain financial rating or other comparable requirements.

The Act establishes a system of functional regulation, under which the federal banking agencies will regulate the banking activities of financial holding companies and banks' financial subsidiaries, the SEC will regulate their securities activities and state insurance regulators will regulate their insurance activities. The Act also provides new protections against the transfer and use by financial institutions of consumers' nonpublic, personal information.



The foregoing discussion is qualified in its entirety by reference to the statutory provisions of the Act and the implementing regulations, which are adopted by various government agencies pursuant to the Act.

THE RULES GOVERNING THE REGULATION OF FINANCIAL SERVICES INSTITUTIONS AND THEIR HOLDING COMPANIES ARE VERY DETAILED AND TECHNICAL. ACCORDINGLY, THE ABOVE DISCUSSION IS GENERAL IN NATURE AND DOES NOT PURPORT TO BE COMPLETE OR TO DESCRIBE ALL OF THE LAWS AND REGULATIONS THAT APPLY TO THE COMPANY AND ITS SUBSIDIARIES.

National Monetary Policy

In addition to being affected by general economic conditions, the Company's earnings and growth are affected by the policies of regulatory authorities, including the OCC, the FRB and the FDIC. An important function of the FRB, is to regulate the money supply and credit conditions. Among the instruments used to implement these objectives are open market operations in U.S. Government securities, setting the discount rate, and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of credit, bank loans, investments and deposits, and their use may also affect interest rates charged on loans or paid on deposits.

The monetary policies and regulations of the FRB have had significant effects on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of these policies upon the Company's future business, earnings and growth cannot be predicted.

Employees

As of December 31, 2004 the Company had in excess of 9,800 full-time equivalent employees.

Available Information

The Company's internet address is www.commerceonline.com. The Company makes available free of charge on www.commerceonline.com its annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. In addition, the Company makes available free of charge on www.commerceonline.com its Corporate Governance Guidelines, Code of Business Conduct and Ethics, Code of Ethics for Senior Financial Officers, and the charters of its Audit, Compensation and Nominating and Governance Committees.

In addition, the Company will provide, at no cost, paper or electronic copies of its reports and other filings (excluding exhibits) made with the SEC and its Corporate Governance Guidelines, Code of Business Conduct and Ethics, Code of Ethics for Senior Financial Officers, and the charters of its Audit, Compensation and Nominating and Governance Committees. Requests should be directed to:

Commerce Bancorp, Inc.
Commerce Atrium
1701 Route 70 East
Cherry Hill, NJ 08034-5400
Attn: C. Edward Jordan, Jr.
Executive Vice President

The information on the website listed above, is not, and should not, be considered part of this annual report on Form 10-K and is not incorporated by reference in this document. This website is and is only intended to be an inactive textual reference.

Item 2. Properties

The executive and administrative offices of the Company and Commerce NJ are located at 1701 Route 70 East, Cherry Hill, New Jersey. This six-story structure is owned by the Company.The Company and its subsidiaries own or lease numerous other premises for use in conducting business activities. The facilities owned or occupied under lease by the Company's subsidiaries are considered by management to be adequate.

Additional information pertaining to the Company's properties is set forth in Note 6 - Bank Premises, Equipment, and Leases of the Notes to Consolidated Financial Statements, which appears elsewhere herein.

Item 3. Legal Proceedings

During July and August 2004, six class action complaints were filed in the United States District Court for the District of New Jersey and the Eastern District of Pennsylvania against the Company and certain Company (or subsidiary) current and former officers and directors. All class action complaints have been consolidated in the United States District Court for the District of New Jersey, Camden Division. As a result of the consolidation, a single consolidated complaint has been filed. It alleges that the defendants violated federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. The plaintiffs seek unspecified damages on behalf of a purported class of purchasers of the Company's securities during various periods. The Company believes these class action complaints are without merit. No accrual for a loss contingency has been recorded, as the risk of loss is considered remote.

Other than routine litigation arising in the normal course of business, the Company and its subsidiaries are not parties to any other material litigation.

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

There were no matters submitted to a vote of security holders in the fourth quarter of 2004.

Part II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

See Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Stockholders' Equity and Dividends and Capital Resources, which appear elsewhere herein.

See Item 12, Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, which appears elsewhere herein, for disclosure regarding the Company's Equity Compensation Plans.

Dividend Policy

It is the present intention of the Company's Board of Directors to pay quarterly cash dividends on the Company's common stock. However, the declaration and payment of future dividends will be subject to determination and declaration by the Board of Directors, which will consider the Company's earnings, financial condition and capital needs and applicable regulatory requirements. See Note 17 - Condensed Financial Statements of the Parent Company and Other Matters of the Notes to Consolidated Financial Statements, which appears elsewhere herein.

Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's consolidated financial statements and accompanying notes included elsewhere herein. Per share data and other appropriate share information for all periods presented have been restated for the two-for-one stock split in the form of a 100% stock dividend effective March 7, 2005. In addition, prior year diluted net income per share amounts have been restated to reflect the impact of the Company's 5.95% Convertible Trust Capital Securities. Refer to Note 1 - Significant Accounting Policies of the Notes to Consolidated Financial Statements, which appears elsewhere herein, under Recent Accounting Statements for further discussion of the required restatement.



| | Year Ended December | | |
|---|---|---|---|
| (dollars in thousands, except per share data) | 2004 | 2003 | 2002 |
| Income Statement Data: | | | |
| Net interest income | $ 1,017,785 | $ 755,866 | $ 572,755 |
| Provision for loan losses | 39,238 | 31,850 | 33,150 |
| Noninterest income | 375,071 | 332,478 | 257,466 |
| Noninterest expense | 938,778 | 763,392 | 579,168 |
| Income before income taxes | 414,840 | 293,102 | 217,903 |
| Net income | 273,418 | 194,287 | 144,815 |
| Balance Sheet Data: | | | |
| Total assets | $30,501,645 | $22,712,180 | $16,403,981 |
| Loans (net) | 9,318,991 | 7,328,519 | 5,731,856 |
| Securities available for sale | 8,044,150 | 10,650,655 | 7,806,779 |
| Securities held to maturity | 10,463,658 | 2,490,484 | 763,026 |
| Trading securities | 169,103 | 170,458 | 326,479 |
| Deposits | 27,658,885 | 20,701,400 | 14,548,841 |
| Long-term debt | 200,000 | 200,000 | 200,000 |
| Stockholders' equity | 1,665,705 | 1,277,288 | 918,010 |
| Per Share Data: | | | |
| Net income-basic | $ 1.74 | $ 1.36 | $ 1.08 |
| Net income-diluted | 1.63 | 1.29 | 1.01 |
| Dividends declared | 0.40 | 0.34 | 0.31 |
| Book value | 10.42 | 8.35 | 6.77 |
| Average shares outstanding: | | | |
| Basic | 156,625 | 142,169 | 133,590 |
| Diluted | 172,603 | 156,507 | 149,389 |
| Selected Ratios: | | | |
| Performance | | | |
| Return on average assets | 1.03 % | 0.99 % | 1.05 |
| Return on average equity | 18.78 | 18.81 | 18.50 |
| Net interest margin | 4.28 | 4.36 | 4.69 |
| Liquidity and Capital | | | |
| Average loans to average deposits | 34.49 % | 36.93 % | 42.48 |
| Dividend payout-basic | 22.99 | 25.00 | 28.70 |
| Stockholders' equity to total assets | 5.46 | 5.62 | 5.60 |
| Risk-based capital: | | | |
| Tier 1 | 12.30 | 12.66 | 11.47 |
| Total | 13.25 | 13.62 | 12.51 |
| Leverage ratio | 6.19 | 6.61 | 6.37 |

| | | | |
|---|---|---|---|
| Asset Quality | | | |
| Non-performing assets to total year-end assets | 0.11 % | 0.10 % | 0.11 |
| Net charge-offs to average loans outstanding | 0.19 | 0.16 | 0.18 |
| Non-performing loans to total year-end loans | 0.35 | 0.29 | 0.24 |
| Allowance for loan losses to total end of year loans | 1.43 | 1.51 | 1.56 |
| Allowance for loan losses to non-performing loans | 412.88 | 515.39 | 640.18 |



Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company analyzes the major elements of the Company's consolidated balance sheets and statements of income. This section should be read in conjunction with the Company's consolidated financial statements and accompanying notes.

Executive Summary

The Commerce model is built on the gathering and retention of low cost core deposits as being essential to shareholder value. Management believes core deposit growth has been and will continue to be the primary driver of the Company's success, and that service and a great retail experience, not rates, drives deposit growth. The consistent inflow of low cost, long lived core deposits allows the Company to avoid taking excessive risks in growing its loan and investment portfolios. In addition, the Company's significant cash flow provides ongoing reinvestment opportunities as interest rates change.

During 2004, the Company's total assets grew 34%. The interest rate environment was difficult for the Company's growth model, with overall low interest rates and the flattening of the yield curve during the second half of the year. The flattening curve contributed to the compression of the Company's net interest margin to 4.28%, the lowest level in over 10 years. Despite this, the Company's continued low cost deposit growth significantly outpaced the current year margin compression and enabled the Company to grow revenue 28%, net income 41%, and diluted net income per share by 26%.

The Company's financial performance for 2004 and projected performance for 2005 are further discussed below.

The 2004 financial highlights are summarized below.

- Net income increased 41% and earnings per share increased 26%.
- Total deposits grew 34% and total (net) loans grew 27%.
- Total revenues (net interest income plus noninterest income) increased 28%.

| | 2004 | 2003 | Increase |
|---|---|---|---|

| | | | |
|---|---|---|---|
| (amounts in billions) | | | |
| Total Assets | $ 30.5 | $ 22.7 | 34% |
| Total Loans (net) | 9.3 | 7.3 | 27% |
| Total Investments | 18.7 | 13.3 | 41% |
| Total Deposits | 27.7 | 20.7 | 34% |
| (amounts in millions) | | | |
| Total Revenues | $ 1,392.9 | $ 1,088.3 | 28% |
| Net Income | 273.4 | 194.3 | 41% |
| Net Income per Share Diluted | 1.63 | 1.29 | 26% |

The Company's 26% increase in diluted net income per share includes a full year impact of the additional 5,000,000 shares resulting from the Company's common stock offering during September 2003.

The Company remains a deposit-driven financial institution with emphasis on core deposit accumulation and retention as a basis for sound growth and profitability. The Company's unique business model continues to produce strong top-line revenue growth that is driven by strong deposit growth.

The continued ability to grow deposits has resulted in significant earning asset growth. This growth resulted in $1.0 billion of net interest income on a tax equivalent basis in 2004, an increase of $264.7 million or 34% over 2003. As more fully depicted in the chart below, the increase in net interest income in both 2004 and 2003 was due to volume increases in the Company's earning assets.

Net Interest Income
(dollars in millions)

| | Volume Increase | Rate Change | Total | Increase |
|---|---|---|---|---|
| 2004 | $285.0 | ($20.3) | $264.7 | 34% |
| 2003 | $227.1 | ($41.5) | $185.6 | 32% |

The Company continues to reiterate its future growth targets, which management expects to meet or exceed.

| | Growth Target | Actual 2004 Growth |
|---|---|---|
| Total Deposits | 25% | 34% |
| Comp Store Deposits | 18% | 24% |
| Total Revenue | 25% | 28% |
| Net Income | 25% | 41% |
| Earnings Per Share | 20% | 26% |

The Company opened 49 stores in 2004 and plans to open 55 - 60 more during 2005, including its first stores in the Metro Washington, D.C. market. The Company plans to open approximately 35 stores in 2005 in the metro New York market. This market has seen the highest deposit growth per store and management expects these stores to continue to lead the deposit growth of the Company.

Per share data and other appropriate share information for all periods presented have been restated for the two-for-one stock split in the form of a 100% stock dividend effective March 7, 2005. In addition, prior year net income per share amounts have been restated to reflect the impact of the Company's 5.95%

Convertible Trust Capital Securities. Refer to Note 1 - Significant Accounting Policies of the Notes to Consolidated Financial Statements, which appears elsewhere herein, under Recent Accounting Statements for further discussion of the required restatement.



Application of Critical Accounting Policies

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the industry in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

The Company's accounting policies are fundamental to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations. The Company has identified the policy related to the allowance for loan losses as being critical. The Company, in consultation with the Audit Committee, has reviewed and approved this critical accounting policy (further described in Note 1 - Significant Accounting Policies of the Notes to Consolidated Financial Statements, which appears elsewhere herein.)

Allowance for loan losses. The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio of the Company. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Note 1 - Significant Accounting Policies of the Notes to Consolidated Financial Statements describes the methodology used to determine the allowance for loan losses, and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in the Allowance for Loan Losses discussion within this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Segment Reporting

The Company operates one reportable segment of business, Community Banks, as more fully described in Note 18 - Segment Reporting of the Notes to Consolidated Financial Statements, which appears elsewhere herein. The following table summarizes net income by segment for each of the last three years (amounts in thousands):

| | Net Income | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |

| | | | |
|---|---|---|---|
| Community Banks | $267,466 | $183,068 | $139,560 |
| Parent/Other | 5,952 | 11,219 | 5,255 |
| Consolidated Total | $273,418 | $194,287 | $144,815 |

Average Balances and Net Interest Income

The table on page 15 sets forth balance sheet items on a daily average basis for the years ended December 31, 2004, 2003 and 2002 and presents the daily average interest rates earned on assets and the daily average interest rates paid on liabilities for such periods. During 2004, average interest earning assets totaled $24.2 billion, an increase of $6.5 billion, or 37% over 2003. This increase resulted primarily from the increase in the average balance of investments, which rose $4.6 billion, and the average balance of loans, which rose $1.8 billion during 2004. The growth in the average balance of interest earning assets was funded primarily by an increase in the average balance of deposits (including noninterest-bearing demand deposits) of $6.6 billion.

Net Interest Margin and Net Interest Income

Net interest margin on a tax equivalent basis was 4.28% for 2004, a decrease of 8 basis points from 2003. The decrease was due to the overall low interest rate environment in 2004 and the flattening yield curve in the second half of the year. During the third and fourth quarters of 2004, short-term interest rates increased by 125 basis points, increasing the Company's overall cost of funds by approximately 30 basis points. With no significant change in long-term interest rates over the same time periods, the Company did not experience a similar increase in its interest earning assets. While the Company's continuing ability to grow core deposits produces net interest income growth despite rate compression, management does not expect net interest margin expansion until long term rates increase and/or the yield curve steepens. The net interest margin is calculated by dividing net interest income by average earning assets.

Net interest income is the difference between the interest income on loans, investments and other interest-earning assets and the interest paid on deposits and other interest-bearing liabilities. Net interest income is the primary source of earnings for the Company. There are several factors that affect net interest income, including:

- the volume, pricing, mix and maturity of earning assets and interest-bearing liabilities;
- market interest rate fluctuations; and
- asset quality.



Net interest income on a tax-equivalent basis (which adjusts for the tax-exempt status of income earned on certain loans and investments to express such income as if it were taxable) for 2004 was $1.0 billion, an increase of $264.7 million, or 34%, over 2003. Interest income on a tax-equivalent basis increased to $1.3 billion from $931.3 million, or 35%. This increase was primarily related to volume increases in the loan and investment portfolios. Interest expense for 2004 increased $60.7 million to $220.5 million from $159.8 million in 2003. This increase was primarily related to increases in the Company's average deposit balances.

The tax-equivalent yield on interest earning assets during 2004 was 5.19%, a decrease of 7 basis points from 5.26% in 2003. The cost of interest-bearing liabilities increased 2 basis points in 2004 to 1.13% from 1.11% in 2003. The cost of total funding sources increased slightly to 0.91% in 2004 from 0.90% in 2003.

The following table presents the major factors that contributed to the changes in net interest income on a tax equivalent basis for the years ended December 31, 2004 and 2003 as compared to the respective previous periods.

| | 2004 vs. 2003 Increase (Decrease) Due to Changes in (1) | | | 2003 vs. 2002 Increase (Decrease) Due to Changes in (1) | | |
|---|---|---|---|---|---|---|
| | Volume | Rate | Total | Volume | Rate | Total |
| | (dollars in thousands) | | | | | |
| Interest on Investments: | | | | | | |
| Taxable | $ 216,828 | $ 10,630 | $ 227,458 | $ 186,070 | ($65,123) | $ 120,947 |
| Tax-exempt | 8,015 | (2,772) | 5,243 | 6,277 | 706 | 6,983 |
| Trading | (1,225) | 180 | (1,045) | (1,029) | (1,527) | (2,556) |
| Federal Funds sold | 633 | 15 | 648 | (356) | (254) | (610) |
| Interest on loans: | | | | | | |
| Commercial mortgages | 41,216 | (4,115) | 37,101 | 24,352 | (10,574) | 13,778 |
| Commercial | 22,840 | (206) | 22,634 | 21,154 | (6,710) | 14,444 |
| Consumer | 39,258 | (9,545) | 29,713 | 24,965 | (17,970) | 6,995 |
| Tax-exempt | 5,163 | (1,507) | 3,656 | 4,515 | (1,701) | 2,814 |
| Total interest income | 332,728 | (7,320) | 325,408 | 265,948 | (103,153) | 162,795 |
| Interest expense: | | | | | | |
| Savings | 15,174 | 3,910 | 19,084 | 9,453 | (12,089) | (2,636) |
| Interest bearing demand | 29,354 | 15,188 | 44,542 | 17,665 | (22,367) | (4,702) |
| Time deposits | 2,253 | (9,792) | (7,539) | 10,405 | (18,077) | (7,672) |
| Public funds | 404 | 828 | 1,232 | (1,069) | (6,711) | (7,780) |
| Other borrowed money | 598 | 2,824 | 3,422 | 2,349 | (924) | 1,425 |
| Long-term debt | | | | 32 | (1,517) | (1,485) |
| Total interest | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| expense | 47,783 | 12,958 | 60,741 | 38,835 | (61,685) | (22,850) |
| Net change | $ 284,945 | ($20,278) | $ 264,667 | $ 227,113 | ($41,468) | $ 185,645 |

(1) Changes due to both volume and rate have been allocated to volume or rate changes in proportion to the absolute dollar amounts of the change in each.



Commerce Bancorp, Inc. and Subsidiaries Average Balances

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2004 | | | 2003 | | |
| (dollars in thousands) Earning Assets | Average Balance | Interest | Average Rate | Average Balance | Interest | Average Rate |
| Investment securities | | | | | | |
| Taxable | $15,276,797 | $736,216 | 4.82 % | $10,777,538 | $508,758 | 4.72 |
| Tax-exempt | 347,979 | 19,078 | 5.48 | 201,775 | 13,835 | 6.86 |
| Trading | 169,242 | 8,592 | 5.08 | 193,376 | 9,637 | 4.98 |
| Total investment securities | 15,794,018 | 763,886 | 4.84 | 11,172,689 | 532,230 | 4.76 |
| Federal funds sold | 75,269 | 903 | 1.20 | 22,530 | 255 | 1.13 |
| Loans | | | | | | |
| Commercial mortgages | 3,091,350 | 189,743 | 6.14 | 2,419,855 | 152,642 | 6.31 |
| Commercial | 2,024,648 | 110,416 | 5.45 | 1,605,845 | 87,782 | 5.47 |
| Consumer | 2,908,561 | 166,851 | 5.74 | 2,224,197 | 137,138 | 6.17 |
| Tax-exempt | 340,172 | 24,886 | 7.32 | 269,592 | 21,230 | 7.87 |
| Total loans | 8,364,731 | 491,896 | 5.88 | 6,519,489 | 398,792 | 6.12 |
| Total earning assets | $24,234,018 | $1,256,685 | 5.19 % | $17,714,708 | $931,277 | 5.26 |
| Sources of Funds | | | | | | |
| Interest-bearing liabilities | | | | | | |
| Savings | $5,446,713 | $46,680 | 0.86 % | $3,676,147 | $27,596 | 0.75 |
| Interest-bearing demand | 10,066,187 | 95,253 | 0.95 | 6,964,158 | 50,711 | 0.73 |
| Time deposits | 2,454,910 | 46,182 | 1.88 | 2,335,124 | 53,721 | 2.30 |
| Public funds | 878,310 | 13,626 | 1.55 | 852,319 | 12,394 | 1.45 |
| Total deposits | 18,846,120 | 201,741 | 1.07 | 13,827,748 | 144,422 | 1.04 |
| Other borrowed money | 465,137 | 6,685 | 1.44 | 423,538 | 3,263 | 0.77 |
| Long-term debt | 200,000 | 12,080 | 6.04 | 200,000 | 12,080 | 6.04 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total deposits and interest-bearing liabilities | 19,511,257 | 220,506 | 1.13 | 14,451,286 | 159,765 | 1.11 |
| Noninterest-bearing funds (net) | 4,722,761 | | | 3,263,422 | | |
| Total sources to fund earning assets | $24,234,018 | $220,506 | 0.91 | $17,714,708 | $159,765 | 0.90 |
| Net interest income and margin tax-equivalent basis | | $1,036,179 | 4.28 | | $771,512 | 4.36 |
| Tax-exempt adjustment | | 18,394 | | | 15,646 | |
| Net interest income and margin | | $1,017,785 | 4.20 % | | $755,866 | 4.27 |
| Other Balances | | | | | | |
| Cash and due from banks | $1,134,991 | | | $922,188 | | |
| Other assets | 1,376,006 | | | 1,053,283 | | |
| Total assets | 26,618,555 | | | 19,590,319 | | |
| Demand deposits (noninterest-bearing) | 5,408,094 | | | 3,826,885 | | |
| Other liabilities | 243,284 | | | 279,203 | | |
| Stockholders' equity | 1,455,920 | | | 1,032,945 | | |

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.

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Noninterest Income

For 2004, noninterest income totaled $375.1 million, an increase of $42.6 million or 13% from 2003. Deposit charges and service fees increased $57.4 million, or 36%. Other operating income, which includes the Company's insurance and capital markets divisions, decreased by $13.6 million, or 8%. The decrease in other operating income is more fully depicted in the following chart.

| | 2004 | 2003 |
|---|---|---|
| Other Operating Income: | | |
| Insurance | $ 72,479 | $ 66,482 |
| Capital Markets | 28,053 | 42,518 |
| Loan Brokerage Fees | 13,189 | 27,169 |
| Other | 40,585 | 31,780 |
| Total Other | $154,306 | $167,949 |

Commerce Insurance, the Company's insurance brokerage subsidiary, recorded increased revenues of $6.0 million, or 9%, while Commerce Capital Markets recorded decreased revenues of $14.5 million, or 34%. The decrease in revenues for Commerce Capital Markets was primarily attributable to the exit from the government public finance business and lower municipal trading results.

The decrease in loan brokerage fees resulted primarily from the reduced volume of mortgage refinancing activity in 2004, as compared to the record levels in 2003 as well as the Company's decision to hold certain loans in its portfolio. Other increased by $8.8 million, or 28%, primarily due to increased letter of credit fees and revenues generated by the Company's leasing division. Included in other noninterest income are gains on sale of SBA loans of $9.1 million and $11.7 million during 2004 and 2003, respectively.

Noninterest Expenses

Noninterest expenses totaled $938.8 million for 2004, an increase of $175.4 million, or 23% over 2003. Contributing to this increase was the opening of 49 new stores during 2004. With the addition of these new stores, staff, facilities, marketing, and related expenses rose accordingly.

Other noninterest expense increased by $44.8 million, or 30%. The increase in other noninterest expenses is depicted in the following chart.

| | 2004 | 2003 |
|---|---|---|
| Other Noninterest Expenses: | | |
| Business Development Costs | $ 29,516 | $ 24,937 |
| Bank-Card Related Service Charges | 35,728 | 25,382 |
| Professional Services/Insurance | 40,515 | 24,597 |
| Provisions for Non-Credit-Related Losses | 22,243 | 15,546 |
| Other | 66,919 | 59,623 |
| Total Other | $194,921 | $150,085 |

The growth in business development costs, bank-card related service charges and non-credit-related losses, which includes fraud and forgery losses on deposit and other non-credit related items, was due to the Company's growth in new stores and customer accounts. The growth in professional services and insurance expense was primarily attributable to increased consulting and insurance costs related to the Company's growth as well as increased legal fees.

The Company experienced positive operating leverage in 2004, as revenue growth of 28% exceeded noninterest expense growth of 23%. One important factor influencing the growth in noninterest expense is that the Company absorbed significant start-up expenses related to the New York City and Long Island markets in prior years. As a result, the impact of the growth in noninterest expenses in these markets declined in 2004. A key industry productivity measure is the operating efficiency ratio. This ratio expresses the relationship of noninterest expenses (excluding other real estate expenses) to net interest income plus noninterest income (excluding non-recurring gains). This ratio equaled 67.62%, 70.38%, and 69.73%, in 2004, 2003, and 2002, respectively. Management believes the Company's aggressive growth activities will keep its efficiency ratio above its peer group.

Income Taxes

The provision for federal and state income taxes for 2004 was $141.4 million compared to $98.8 million in 2003 and $73.1 million in 2002. The effective tax rate was 34.1%, 33.7% and 33.5% in 2004, 2003, and 2002, respectively. The increase in the effective income tax rate for 2004 was primarily due to the reduced impact of tax free interest income.

Net Income

Net income for 2004 was $273.4 million, an increase of $79.1 million, or 41% over the $194.3 million recorded for 2003.

Diluted net income per share of common stock for 2004 was $1.63 compared to $1.29 per common share for 2003.

Return on Average Equity and Average Assets

Two industry measures of performance by a banking institution are its return on average assets and return on average equity. Return on average assets ("ROA") measures net income in relation to total average assets and indicates a company's ability to employ its resources profitably. The Company's ROA was 1.03%, 0.99%, and 1.05% for 2004, 2003, and 2002, respectively. The increase in the Company's 2004 ROA as compared to the 2003 ROA was the result of the Company's positive operating leverage for 2004, which contributed to net income growth of 41%. Prior year ROA's were impacted in part by the significant start-up expenses related to the New York City and Long Island markets.

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Return on average equity ("ROE") is determined by dividing annual net income by average stockholders' equity and indicates how effectively a company can generate net income on the capital invested by its stockholders. The Company's ROE was 18.78%, 18.81%, and 18.50% for 2004, 2003, and 2002, respectively.

Loan Portfolio

The following table summarizes the loan portfolio of the Company by type of loan as of December 31, for each of the years 2000 through 2004.

| | December 31, | | | |
|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 20 |
| (dollars in thousands) | | | | |
| Commercial: | | | | |
| Term | $1,283,476 | $1,027,526 | 842,869 | 6 |
| Line of credit | 1,168,542 | 959,158 | 683,640 | 5 |
| Demand | | 1,077 | 317 | |
| | 2,452,018 | 1,987,761 | 1,526,826 | 1,1 |
| Owner-occupied | 1,998,203 | 1,619,079 | 1,345,306 | 1,0 |
| Consumer: | | | | |
| Mortgages | | | | |

| | | | | |
|---|---|---|---|---|
| (1-4 family residential) | 1,340,009 | 918,686 | 626,652 | 4 |
| Installment | 132,646 | 138,437 | 140,493 | 1 |
| Home equity | 1,799,841 | 1,405,795 | 1,139,589 | 8 |
| Credit lines | 69,079 | 60,579 | 56,367 | |
| | 3,341,575 | 2,523,497 | 1,963,101 | 1,5 |
| Commercial real estate: | | | | |
| Investor developer | 1,455,891 | 1,167,672 | 885,276 | 7 |
| Construction | 206,924 | 142,567 | 102,080 | |
| | 1,662,815 | 1,310,239 | 987,356 | 8 |
| Total loans | $9,454,611 | $7,440,576 | $5,822,589 | $4,5 |

The Company manages risk associated with its loan portfolio through diversification, underwriting policies and procedures, and ongoing loan monitoring efforts. The commercial real estate portfolio includes investor/ developer permanent and construction loans and residential construction loans. The owner-occupied portfolio is comprised primarily of commercial real estate loans in which the borrower occupies a majority of the commercial space. Owner-occupied and investor/ developer loans generally have five year call provisions and bear the personal guarantees of the principals involved. Financing for investor/developer construction is generally for pre-leased or pre-sold property, while residential construction is provided against firm agreements of sale with speculative construction generally limited to three samples per project. The commercial loan portfolio is comprised of loans to businesses in the Philadelphia and New York City metropolitan areas. These loans are generally secured by business assets, personal guarantees, and/or personal assets of the borrower. The consumer loan portfolio is comprised primarily of loans secured by first and second mortgage liens on residential real estate.

The contractual maturity ranges of the loan portfolio and the amount of loans with predetermined interest rates and floating rates in each maturity range, as of December 31, 2004, are summarized in the following table.

| | December 31, 2004 | | | |
|---|---|---|---|---|
| | Due in One Year or Less | Due in One to Five Years | Due in Over Five Years | Total |
| (dollars in thousands) | | | | |
| Commercial: | | | | |
| Term | $ 378,421 | $ 802,481 | $ 102,574 | $1,283,476 |
| Line of credit | 1,112,853 | 55,689 | | 1,168,542 |
| | 1,491,274 | 858,170 | 102,574 | 2,452,018 |
| Owner-occupied | 375,001 | 1,059,003 | 564,199 | 1,998,203 |
| Consumer: | | | | |
| Mortgages (1-4 family residential) | 40,654 | 152,452 | 1,146,903 | 1,340,009 |
| Installment | 45,045 | 51,421 | 36,180 | 132,646 |
| Home equity | 137,615 | 503,920 | 1,158,306 | 1,799,841 |

| | | | | |
|---|---|---|---|---|
| Credit lines | 23,737 | 45,342 | | 69,079 |
| | 247,051 | 753,135 | 2,341,389 | 3,341,575 |
| Commercial real estate: | | | | |
| Investor developer | 392,612 | 813,982 | 249,297 | 1,455,891 |
| Construction | 119,535 | 87,389 | | 206,924 |
| | 512,147 | 901,371 | 249,297 | 1,662,815 |
| Total loans | $2,625,473 | $3,571,679 | $3,257,459 | $9,454,611 |
| Interest rates: | | | | |
| Predetermined | $ 721,526 | $2,421,222 | $2,205,961 | $5,348,709 |
| Floating | 1,903,947 | 1,150,457 | 1,051,498 | 4,105,902 |
| Total loans | $2,625,473 | $3,571,679 | $3,257,459 | $9,454,611 |

During 2004, loans increased $2.0 billion, or 27% from $7.4 billion to $9.4 billion. At December 31, 2004, loans represented 34% of total deposits and 31% of total assets. All segments of the loan portfolio experienced growth in 2004. Geographically, the metro Philadelphia market contributed 48% of the total growth in the loan portfolio while the northern New Jersey and metro New York markets contributed 25% and 27%, respectively. During 2004, the metro New York market continued to mature and its loan portfolio grew by almost 100%. The loan portfolios in metro Philadelphia and northern New Jersey grew by 21% and 23%, respectively.

The Company has traditionally been an active provider of real estate loans to creditworthy local borrowers, with such loans secured by properties within the Company's primary trade area. During 2004, commercial real estate lending increased $352.6 million or 27%, which was consistent with the overall growth in the loan portfolio. Loans to finance owner-occupied properties grew $379.1 million or 23%. Commercial loan growth of $464.3 million or 23% was led by activity in the middle market and healthcare sectors. Growth in consumer loans of $818.1 million, or 32%, was primarily in mortgage lending. The residential mortgage portfolio increased $421.3 million, or 46%, during 2004, due to the Company's decision to hold jumbo mortgage loans in its portfolio as opposed to selling them in the secondary market. The Company's home equity portfolio grew $394.0 million or 28%, which was consistent with the overall growth in the loan portfolio.

Non-Performing Loans and Assets

Non-performing assets (non-performing loans and other real estate, excluding loans past due 90 days or more and still accruing interest) at December 31, 2004 were $33.5 million or .11% of total assets, as compared to $23.6 million or .10% of total assets at December 31, 2003.



Total non-performing loans (non-accrual loans, and restructured loans, excluding loans past due 90 days or more and still accruing interest) at December 31, 2004 were $32.8 million as compared to $21.7 million a year ago. The Company generally places a loan on non-accrual status and ceases accruing interest when loan payment performance is deemed unsatisfactory. During 2004, commercial non-accrual loans increased $6.9 million or 63%. The increase in commercial non-accrual loans was primarily due to one large credit of approximately $9.3 million that was placed on non-accrual status during the third quarter of 2004. This increase was offset by a commercial credit of $3.5 million that was restructured and reclassified as a restructured loan during 2004. Generally loans past due 90 days are placed on non-accrual status, unless the loan is both well secured and in the process of collection. At December 31, 2004, loans past due 90 days or more and still accruing interest amounted to $602 thousand, compared to $538 thousand at December 31, 2003. Additional loans considered by the Company's internal loan review department as potential problem loans of $37.7 million at December 31, 2004, compared to $47.7 million at December 31, 2003, have been evaluated as to risk exposure in determining the adequacy of the allowance for loan losses.

Other real estate (ORE) totaled $626 thousand at December 31, 2004 as compared to $1.8 million at December 31, 2003. These properties have been written down to the lower of cost or fair value less disposition costs.

The Company has, on an ongoing basis, updated appraisals on non-performing loans secured by real estate. In those instances where updated appraisals reflect reduced collateral values, an evaluation of the borrowers' overall financial condition is made to determine the need, if any, for possible writedowns or appropriate additions to the allowance for loan losses.

The following summary presents information regarding non-performing loans and assets as of December 31, 2000 through 2004.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| (dollars in thousands) | | | | | |
| Non-accrual loans (1): | | | | | |
| Commercial | $17,874 | $10,972 | $ 6,829 | $ 9,104 | $ 7,468 |
| Consumer | 10,138 | 9,242 | 6,326 | 4,390 | 3,467 |
| Real estate | | | | | |
| Construction | | 138 | 131 | 1,590 | 1,459 |
| Mortgage | 1,317 | 1,389 | 882 | 1,749 | 1,155 |
| Total non-accrual Loans | 29,329 | 21,741 | 14,168 | 16,833 | 13,549 |
| Restructured loans (1): | | | | | |
| Commercial | 3,518 | 1 | 5 | 8 | 11 |
| Real estate mortgage | | | | | 82 |
| Total restructured loans | 3,518 | 1 | 5 | 8 | 93 |
| Total non-performing loans | 32,847 | 21,742 | 14,173 | 16,841 | 13,642 |
| Other real estate | 626 | 1,831 | 3,589 | 1,549 | 2,959 |
| Total non-performing assets(1): | $33,473 | $23,573 | $17,762 | $18,390 | $16,601 |
| Non-performing | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| assets as a percent of total assets | 0.11% | 0.10% | 0.11% | 0.16% | 0.20% |
| Loans past due 90 days or more and still accruing interest | $ 602 | $ 538 | $ 620 | $ 519 | $ 489 |

(1) Interest income of approximately $2,906,000, $1,908,000, $1,352,000, $2,092,000, and $1,731,000 would have been recorded in 2004, 2003, 2002, 2001, and 2000 respectively, on non-performing loans in accordance with their original terms. Actual interest recorded on these loans amounted to $1,070,000 in 2004, $418,000 in 2003, $275,000 in 2002, $237,000 in 2001, and $525,000 in 2000.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb losses inherent in the loan portfolio. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risks on a timely basis so that an appropriate allowance can be maintained. Based on an evaluation of the loan portfolio, management presents a quarterly review of the loan loss reserve to the Board of Directors, indicating any changes in the reserve since the last review and any recommendations as to adjustments in the reserve. In making its evaluation, in addition to the factors discussed below, management considers the results of regulatory examinations, which typically include a review of the allowance for loan losses as an integral part of the examination process.

In establishing the allowance, management evaluates individual large classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. At December 31, 2004, approximately 26.4% of the allowance was attributed to individually evaluated loans. An allowance for the remainder of the loan portfolio is also determined based on historical loss experience within the components of the portfolio. These allocations may be modified if current conditions indicate that loan losses may differ from historical experience, based on economic factors and changes in portfolio mix and volume. At December 31, 2004, approximately 58.5% of the allowance was attributed to historical loss experience.



In addition, a portion of the allowance is established for losses inherent in the loan portfolio which have not been identified by the more quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in the Company's historical loss experience. Those factors include changes in levels and trends of charge-offs, delinquencies, and nonaccrual loans, trends in volume and terms of loans, changes in underwriting standards and practices, portfolio mix, tenure of loan officers and management, entrance into new geographic markets, changes in credit concentrations, and national and local economic trends and conditions. At December 31, 2004, approximately 15.1% of the allowance was attributed to these qualitative factors.

While the allowance for loan losses is maintained at a level believed to be adequate by management for estimated losses in the loan portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods.

The allowance for loan losses is increased by provisions charged to expense and reduced by loan charge-offs net of recoveries. Charge-offs occur when loans are deemed to be uncollectible. During 2004, net charge-offs amounted to $15.7 million, or .19% of average loans outstanding for the year, compared to $10.5 million, or .16% of average loans outstanding for 2003. Total charge-offs increased $6.1 million or 51% during 2004. The commercial and commercial real estate categories experienced increases of $3.8 million or 68% and $1.5 million or 612%, respectively. Both categories were impacted by a few large credits, relative to each portfolio, that were charged-off during the year. During 2004, the Company recorded provisions of $39.2 million to the allowance for loan losses compared to $31.9 million for 2003. The Company continued to proactively manage its exposure to credit risk in 2004. Based upon the application of the Company's reserve methodology, allowance levels increased by $23.6 million to $135.6 million at December 31, 2004, but decreased as a percentage of the total loans due to growth in the portfolio (1.43% at December 31, 2004 versus 1.51% at December 31, 2003).

The following table presents, for the periods indicated, an analysis of the allowance for loan losses and other related data.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2004 | 2003 | 2002 | 2001 | 2000 |
| (dollars in thousands) | | | | | |
| Balance at beginning of period | $112,057 | $90,733 | $66,981 | $48,680 | $38,382 |
| Provisions charged to operating expenses | 39,238 | 31,850 | 33,150 | 26,384 | 13,931 |
| | 151,295 | 122,583 | 100,131 | 75,064 | 52,313 |
| Recoveries of loans previously charged-off: | | | | | |
| Commercial | 1,000 | 669 | 815 | 552 | 313 |
| Consumer | 1,123 | 584 | 339 | 288 | 249 |
| Commercial real estate | 52 | 11 | 176 | 134 | 14 |
| Total recoveries | 2,175 | 1,264 | 1,330 | 974 | 576 |
| Loans charged-off: | | | | | |
| Commercial | (9,416) | (5,601) | (7,181) | (5,862) | (2,936) |
| Consumer | (6,733) | (5,950) | (3,514) | (2,784) | (1,220) |
| Commercial real estate | (1,701) | (239) | (33) | (411) | (53) |
| Total charged-off | (17,850) | (11,790) | (10,728) | (9,057) | (4,209) |
| Net charge-offs | (15,675) | (10,526) | (9,398) | (8,083) | (3,633) |

| | | | | | |
|---|---|---|---|---|---|
| Balance at end of period | $135,620 | $112,057 | $90,733 | $66,981 | $48,680 |
| Net charge-offs as a percentage of average loans outstanding | 0.19% | 0.16% | 0.18% | 0.19% | 0.11% |
| Allowance for loan losses as a percentage of year-end loans | 1.43% | 1.51% | 1.56% | 1.46% | 1.32% |

Allocation of the Allowance for Loan Losses

The following table details the allocation of the allowance for loan losses to the various loan categories. The current year evaluation of the Company's allowance for loan losses by loan category has been expanded to include analyses under multiple economic and portfolio assumptions. The allocation is made for analytical purposes and it is not necessarily indicative of the categories in which future loan losses may occur. The total allowance is available to absorb losses from any segment of loans.

| | Allowance for Loan Losses at December 31, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2004 | | 2003 | | 2002 | | 2001 | |
| | Amount | % Gross Loans | Amount | % Gross Loans | Amount | % Gross Loans | Amount | % Gros Loans |
| (dollars in thousands) | | | | | | | | |
| Commercial | $ 47,230 | 26% | $ 50,400 | 27% | $33,708 | 26% | $24,110 | 2 |
| Owner-occupied | 29,488 | 21 | 26,862 | 22 | 24,539 | 23 | 18,060 | 2 |
| Consumer | 38,100 | 35 | 13,082 | 34 | 14,497 | 34 | 9,915 | 3 |
| Commercial real estate | 20,802 | 18 | 21,713 | 17 | 17,989 | 17 | 14,896 | 1 |
| | $135,620 | 100% | $112,057 | 100% | $90,733 | 100% | $66,981 | 10 |



Investment Securities

The following table summarizes the Company's securities available for sale and securities held to maturity as of the dates shown.

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| (dollars in thousands) | | | |
| U.S. Government agency and mortgage-backed obligations | $ 7,902,816 | $10,511,545 | $ 7,659,737 |
| Obligations of state and political subdivisions | 87,910 | 30,927 | 23,185 |
| Equity securities | 23,303 | 16,588 | 24,054 |
| Other | 30,121 | 91,595 | 99,803 |
| Securities available for sale | $ 8,044,150 | $10,650,655 | $ 7,806,779 |
| U.S. Government agency and mortgage-backed obligations | $ 9,967,041 | $ 2,193,577 | $ 624,688 |
| Obligations of state and political subdivisions | 398,963 | 227,199 | 91,204 |
| Other | 97,654 | 69,708 | 47,134 |
| Securities held to maturity | $10,463,658 | $ 2,490,484 | $ 763,026 |

The Company has segregated a portion of its investment portfolio as securities available for sale. The balance of the investment portfolio (excluding trading securities) is categorized as securities held to maturity. Investment securities are classified as available for sale if they might be sold in response to changes in interest rates, prepayment risk, the Company's income tax position, the need to increase regulatory capital, liquidity needs or other similar factors. These securities are carried at fair market value with unrealized gains and losses, net of income tax effects, recognized in Stockholders' Equity. Investment securities are classified as held to maturity when the Company has the intent and ability to hold those securities to maturity. Securities held to maturity are carried at cost and adjusted for accretion of discounts and amortization of premiums. Trading securities, primarily municipal securities, are carried at market value, with gains and losses, both realized and unrealized, included in other operating income.

In total, investment securities increased $5.4 billion from $13.3 billion to $18.7 billion at December 31, 2004. Deposit growth and other funding sources were used to increase the Company's investment portfolio. The available for sale portfolio decreased $2.6 billion to $8.0 billion, and the securities held to maturity portfolio increased $8.0 billion to $10.5 billion at year-end 2004. The portfolio of trading securities decreased to $169.1 million at year-end 2004 from $170.5 million at year-end 2003. During the fourth quarter of 2004, the Company transferred $5.9 billion of securities classified as available for sale to the held to maturity classification based on the Company's anticipated liquidity needs and expected annual cash flow from deposit growth and bond and loan prepayments. The aggregate market value of the securities transferred equaled their book value, with no effect on stockholders' equity, regulatory capital or results of operations. During the fourth quarter of 2004, the Company sold $126.0 million of securities from its held to maturity portfolio. These securities experienced a deterioration in creditworthiness which meets the specific exception provided for a sale of a security classified as held to maturity. Gross gains of $768 thousand and gross losses of $1.2 million were realized on the sale of these securities.

At December 31, 2004, the average life and duration of the investment portfolio were approximately 3.8 years and 3.2 years, respectively, as compared to 4.9 years and 3.9 years, respectively, at December 31, 2003. The Company's significant cash flow provides reinvestment opportunities as interest rates change. In addition, management continually reviews and repositions the investment portfolio to adjust for current and anticipated interest rate and yield curve levels.

The Company's investment portfolio consists primarily of U.S. Government agency and mortgage-backed obligations. These securities have little, if any, credit risk since they are either backed by the full faith and credit of the U.S. Government, or are guaranteed by an agency of the U.S. Government, or are AAA rated. These investment securities carry fixed coupons whose rate does not change over the life of the securities. Certain securities are purchased at premiums or discounts. Their yield will change depending on any change in the estimated rate of prepayments. The Company amortizes premiums and accretes discounts over the estimated life of the securities in the investment portfolio. Changes in the estimated life of the securities in the investment portfolio will lengthen or shorten the period in which the premium or discount must be amortized or accreted, thus affecting the Company's investment yields. For the year ended December 31, 2004, the yield on the investment portfolio was 4.84%, an increase of 8 basis points from 4.76% in fiscal year 2003.

At December 31, 2004, the net unrealized appreciation in securities available for sale included in stockholders' equity totaled $21.0 million, net of tax, compared to net unrealized depreciation of $3.7 million, net of tax, at December 31, 2003.

The contractual maturity distribution and weighted average yield of the Company's investment portfolio (excluding equity and trading securities) at December 31, 2004, are summarized in the following table. Weighted average yield is calculated by dividing income within each maturity range by the outstanding amortized cost amount of the related investment and has been tax effected, assuming a federal tax rate of 35%, on tax-exempt obligations.

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| | December 31, 2004 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Due Under 1 Year | | Due 1-5 Years | | Due 5-10 Years | | Due Over 10 | |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Y |
| (dollars in thousands) | | | | | | | | |
| Securities available for sale: | | | | | | | | |
| U.S. Government agency and | | | | | | | | |
| mortgage-backed obligations | $61,927 | 1.44% | | | $428,928 | 4.87% | $7,411,961 | |
| Obligations of state and | | | | | | | | |
| political subdivisions | 3,395 | 7.12 | $4,663 | 6.72% | 3,038 | 3.22 | 76,814 | |
| Other securities | 2,289 | 0.99 | 275 | 4.00 | 2,180 | 5.97 | 25,377 | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | $67,611 | 1.71% | $4,983 | 6.57% | $434,146 | 4.87% | $7,514,152 |
| Securities held to maturity: | | | | | | | |
| U.S. Government agency and mortgage-backed obligations | | | $ 366 | 8.46% | $472,758 | 4.18% | $9,493,917 |
| Obligations of state and political subdivisions | $272,404 | 1.49% | 4,326 | 3.23 | 1,303 | 3.55 | 120,930 |
| Other securities | 97,654 | 2.36 | | | | | |
| | $370,058 | 1.72% | $4,692 | 3.64% | $474,061 | 4.18% | $9,614,847 |

Deposits

Total deposits at December 31, 2004 were $27.7 billion, an increase of $7.0 billion or 34% above total deposits of $20.7 billion at December 31, 2003. The Company remains a deposit-driven financial institution with emphasis on core deposit accumulation and retention as a basis for sound growth and profitability. The Company regards core deposits as all deposits other than public certificates of deposit. Deposits in the various core categories increased $6.9 billion from year-end 2003 to year-end 2004. Core deposits by type of customer is as follows (in millions):

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Consumer | $12,227 | $ 9,760 |
| Commercial | 9,138 | 6,599 |
| Government | 5,292 | 3,420 |
| Total | $26,657 | $19,779 |

Total deposits averaged $24.3 billion for 2004, an increase of $6.6 billion or 37% above the 2003 average. The average balance of noninterest-bearing demand deposits in 2004 was $5.4 billion, a $1.6 billion or 41% increase over the average balance for 2003. The average total balance of passbook and statement savings accounts increased $1.8 billion, or 48% compared to the prior year. The average balance of interest-bearing demand accounts for 2004 was $10.1 billion, a $3.1 billion or 44% increase over the average balance for the prior year. The average balance of time deposits and public funds for 2004 was $3.3 billion, a $145.8 million or 4% increase over the average balance for 2003. For 2004, the cost of total deposits was 0.83% as compared to 0.82% in 2003.

The Company believes that its record of sustaining core deposit growth is reflective of the Company's retail approach to banking which emphasizes a combination of superior customer service, convenient store locations, extended hours of operation, free checking accounts (subject to small minimum balance requirements) and active marketing. This approach is especially reflected in the Company's comparable store deposit growth. The Company's comparable store deposit growth is measured as the year over year percentage increase in core deposits at the balance sheet date. At December 31, 2004, the comparable store deposit growth for the Company's 224 stores open two years or more was 24% and for the Company's 270 stores open one year or more was 32%.

The average balances and weighted average rates of deposits for each of the years 2004, 2003, and 2002 are presented below.

| | 2004 | | 2003 | |
|---|---|---|---|---|
| | Average Balance | Average Rate | Average Balance | Average Rate |
| (dollars in thousands) | | | | |
| Demand deposits: | | | | |
| Noninterest-bearing | $ 5,408,094 | | $ 3,826,885 | |
| Interest-bearing (money market and N.O.W. accounts) | 10,066,187 | 0.95% | 6,964,158 | 0.73% |
| Savings deposits | 5,446,713 | 0.86 | 3,676,147 | 0.75 |
| Time deposits/public funds | 3,333,220 | 1.79 | 3,187,443 | 2.07 |
| Total deposits | $ 24,254,214 | | $ 17,654,633 | |

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The remaining maturity of certificates of deposit for $100,000 or more as of December 31, 2004, 2003 and 2002 is presented below:

| Maturity | 2004 | 2003 | 2002 |
|---|---|---|---|
| (dollars in thousands) | | | |
| 3 months or less | $ 983,909 | $1,076,960 | $ 983,698 |
| 3 to 6 months | 182,573 | 357,810 | 164,568 |
| 6 to 12 months | 206,326 | 322,204 | 266,779 |
| Over 12 months | 457,489 | 253,477 | 189,587 |
| Total | $ 1,830,297 | $2,010,451 | $1,604,632 |

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 those policies. The guidelines established by ALCO are reviewed and approved by the Company's Board of Directors.

An interest rate sensitive asset or liability is one that, within a defined time period, either matures or experiences an interest rate change in line with general market interest rates. Historically, the most common method of estimating interest rate risk was to measure the maturity and repricing relationships between interest-earning assets and interest-bearing liabilities at specific points in time ("GAP"), typically one year. Under this method, a company is considered liability sensitive when the amount of its interest-bearing liabilities exceeds the amount of its interest-earning assets within the one year horizon. However, assets and liabilities with similar repricing characteristics may not reprice at the same time or to the same degree. As a result, the Company's GAP does not necessarily predict the impact of changes in general levels of interest rates on net interest income.

The following table illustrates the GAP position of the Company as of December 31, 2004.

| | Interest Rate Sensitivity Gaps 31-Dec-04 | | | | | |
|---|---|---|---|---|---|---|
| | Jan-90 Days | 91-180 Days | 181-365 Days | 5-Jan Years | Beyond 5 Years | Total |
| (dollars in millions) | | | | | | |
| Rate sensitive: | | | | | | |
| Interest-earning assets | | | | | | |
| Loans | $4,762.6 | $120.8 | $238.7 | $2,154.9 | $2,189.0 | $9,466.0 |
| Investment securities | 1,049.0 | 993.0 | 1,829.5 | 9,158.1 | 5,647.3 | 18,676.9 |
| Total interest-earning assets | 5,811.6 | 1,113.8 | 2,068.2 | 11,313.0 | 7,836.3 | 28,142.9 |
| Interest-bearing liabilities | | | | | | |
| Transaction accounts | 5,674.9 | | | | 12,419.4 | 18,094.3 |
| Time deposits | 1,456.4 | 456.9 | 504.0 | 740.7 | | 3,158.0 |
| Other borrowed money | 661.2 | | | | | 661.2 |
| Long-term debt | | | | | | |