CITY NATIONAL CORP
Form 10-Q
May 12, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-10521

CITY NATIONAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware	**95-2568550**
(State of Incorporation)	(I.R.S. Employer Identification No.)

City National Center

400 North Roxbury Drive, Beverly Hills, California, 90210

(Address of principal executive offices)(Zip Code)

(310) 888-6000

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for at least the past 90 days. Yes x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

As of May 1, 2008, there were 47,924,450 shares of Common Stock outstanding.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEET

Dollars in thousands, except share amounts	**March 31, 2008 (Unaudited)**	**December 31, 2007**	**March 31, 2007 (Unaudited)**
Assets			
Cash and due from banks	$ 514,878	$ 365,918	$ 494,231
Due from banks - interest-bearing	77,567	88,151	77,214
Federal funds sold	1,000		210,000
Securities available-for-sale - cost $2,405,948, $2,484,903, and $2,950,124 at March 31, 2008, December 31, 2007 and March 31, 2007, respectively			
Securities pledged as collateral	210,529	212,233	108,480
Held in portfolio	2,178,930	2,250,422	2,793,905
Trading account securities	121,152	293,355	35,981
Loans and leases	11,754,865	11,630,638	10,649,598
Less allowance for loan and lease losses	168,278	168,523	161,005
Net loans and leases	11,586,587	11,462,115	10,488,593
Premises and equipment, net	119,243	118,067	103,259
Deferred tax asset	129,793	129,403	129,681
Goodwill	449,595	452,480	366,007
Customer-relationship intangibles, net	65,216	67,647	54,190
Bank-owned life insurance	72,875	72,220	70,780
Affordable housing investments	72,260	73,640	66,011
Customers acceptance liability	2,752	3,549	4,100
Other assets	331,655	300,090	261,521
Total assets	$ 15,934,032	$ 15,889,290	$ 15,263,953
Liabilities			
Demand deposits	$ 5,680,845	$ 5,858,497	$ 5,690,413
Interest checking deposits	826,341	879,062	783,846
Money market deposits	3,709,142	3,421,691	3,746,925
Savings deposits	134,825	135,519	155,825
Time deposits-under $100,000	215,401	220,928	296,312
Time deposits-$100,000 and over	1,225,815	1,306,808	1,933,060
Total deposits	11,792,369	11,822,505	12,606,381
Federal funds purchased and securities sold under repurchase agreements	1,118,478	1,544,411	310,738
Other short-term borrowings	720,992	100,000	50,667
Subordinated debt	162,813	273,559	270,174
Long-term debt	243,439	233,465	224,079
Reserve for off-balance sheet credit commitments	24,863	19,704	17,005
Other liabilities	153,799	204,814	162,080
Acceptances outstanding	2,752	3,549	4,100
Total liabilities	14,219,505	14,202,007	13,645,224
Minority interest in consolidated subsidiaries-includes redeemable minority interests with a redemption value of $24,140, $26,065, and $21,679 at March 31, 2008, December 31, 2007 and March 31, 2007, respectively	32,199	31,676	28,285

Commitments and contingencies			
Shareholders Equity			
Preferred Stock authorized - 5,000,000, none outstanding			
Common Stock-par value-$1.00; authorized - 75,000,000, Issued - 50,982,387, 50,824,178, and 50,802,792 shares at March 31, 2008, December 31, 2007 and March 31, 2007, respectively	50,982	50,824	50,803
Additional paid-in capital	419,044	420,168	421,990
Accumulated other comprehensive loss	(3,431)	(9,349)	(31,034)
Retained earnings	1,390,781	1,369,999	1,271,092
Treasury shares, at cost - 2,607,208, 2,588,299, and 1,769,592 shares at March 31, 2008, December 31, 2007 and March 31, 2007, respectively	(175,048)	(176,035)	(122,407)
Total shareholders equity	1,682,328	1,655,607	1,590,444
Total liabilities and shareholders equity	$ 15,934,032	$ 15,889,290	$ 15,263,953

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

In thousands, except per share amounts	For the three months ended March 31, 2008	2007
Interest Income		
Loans and leases	$ 179,311	$ 180,670
Securities available-for-sale	27,276	32,119
Trading account assets	579	787
Due from banks - interest-bearing	523	482
Federal funds sold and securities purchased under resale agreements	63	183
Total interest income	207,752	214,241
Interest Expense		
Deposits	38,831	50,324
Federal funds purchased and securities sold under repurchase agreements	9,630	7,556
Subordinated debt	2,227	4,024
Other long-term debt	3,053	3,597
Other short-term borrowings	5,846	1,471
Total interest expense	59,587	66,972
Net interest income	148,165	147,269
Provision for credit losses	17,000	
Net interest income after provision for credit losses	131,165	147,269
Noninterest Income		
Trust and investment fees	36,349	30,254
Brokerage and mutual fund fees	17,422	13,780
Cash management and deposit transaction charges	11,124	8,471
International services	7,687	6,463
Bank-owned life insurance	655	624
Loss on sale of other assets		(46)
Gain on sale of securities	969	269
Other	5,610	6,133
Total noninterest income	79,816	65,948
Noninterest Expense		
Salaries and employee benefits	90,179	77,984
Net occupancy of premises	11,512	9,458
Legal and professional fees	8,560	8,721
Information services	6,206	5,551
Depreciation and amortization	5,502	5,000
Marketing and advertising	5,595	3,998
Office services	2,986	2,747
Amortization of intangibles	2,431	1,630
Equipment	913	718
Other operating	5,957	5,906
Total noninterest expense	139,841	121,713
Minority interest expense	3,306	2,076
Income before income taxes	67,834	89,428
Income taxes	23,847	32,883
Net income	$ 43,987	$ 56,545
Net income per share, basic	$ 0.92	$ 1.18
Net income per share, diluted	$ 0.91	$ 1.15
Shares used to compute income per share, basic	47,829	47,968

Shares used to compute income per share, diluted		48,517		49,087
Dividends per share	$	0.48	$	0.46

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

Dollars in thousands	For the three months ended March 31, 2008	2007
Cash Flows From Operating Activities		
Net income	$ 43,987	$ 56,545
Adjustments to net income:		
Provision for credit losses	17,000	
Amortization of intangibles	2,431	1,630
Depreciation and amortization	5,502	5,000
Amortization of cost and discount on long-term debt	132	177
Stock-based employee compensation expense	3,512	3,349
Loss on sale of other assets		46
Gain on sales of securities	(969)	(269)
Other, net	608	(11,545)
Net change in:		
Trading account assets	172,203	111,926
Deferred income tax asset	(4,686)	36
Other assets and other liabilities, net	(53,237)	1,982
Net cash provided by operating activities	186,483	168,877
Cash Flows From Investing Activities		
Purchase of securities available-for-sale	(106,898)	(41,839)
Sales of securities available-for-sale	84,509	48,499
Maturities and paydowns of securities	101,062	124,703
Loan originations, net of principal collections	(138,743)	127,757
Purchase of premises and equipment	(6,678)	(7,338)
Acquisition of BBNV, net of cash acquired		(50,398)
Other investing activities	(3,503)	(2,752)
Net cash (used in) provided by investing activities	(70,251)	198,632
Cash Flows From Financing Activities		
Net decrease in deposits	(30,136)	(7,442)
Net decrease in federal funds purchased and securities sold under repurchase agreements	(425,933)	(112,165)
Net increase (decrease) in short-term borrowings	620,992	(46,858)
Net (decrease) increase in other borrowings	(115,107)	43
Proceeds from exercise of stock options	5,792	6,805
Tax benefit from exercise of stock options	1,827	3,577
Stock repurchases	(11,086)	(18,964)
Cash dividends paid	(23,205)	(22,114)
Net cash provided by (used in) financing activities	23,144	(197,118)
Net increase in cash and cash equivalents	139,376	170,391
Cash and cash equivalents at beginning of year	454,069	611,054
Cash and cash equivalents at end of period	$ 593,445	$ 781,445
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 76,121	$ 76,985

Income taxes		37,139		2,000
Non-cash investing activities:				
Transfer of loan to OREO	$	3,812	$	

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY

AND COMPREHENSIVE INCOME

(Unaudited)

Dollars in thousands	Shares issued	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained Earnings	Treasury stock	Total shareholders equity
Balance, December 31, 2006	50,718,794	$ 50,719	$ 412,249	$ (41,459)	$ 1,264,697	$ (195,363)	1,490,843
Adjustment to initially apply FASB interpretation 48					(28,036)		(28,036)
Balance, January 1, 2007	50,718,794	50,719	412,249	(41,459)	1,236,661	(195,363)	1,462,807
Net income					56,545		56,545
Other comprehensive loss net of tax:							
Amortization of prior service cost				40			40
Net unrealized gain on securities available-for-sale, net of taxes of $6.7 million and reclassification of $0.1 million for net loss included in net income				9,257			9,257
Net unrealized gain on cash flow hedges, net of taxes of $0.8 million and reclassification of $1.1 million net loss included in net income				1,128			1,128
Total other comprehensive income				10,425			10,425
Issuance of shares for stock options			(8,481)			15,286	6,805
Restricted stock grants, net of cancellations	83,998	84	(84)				
Stock-based employee compensation expense			3,349				3,349
Tax benefit from stock options			3,577				3,577
Cash dividends paid					(22,114)		(22,114)
Repurchased shares, net						(18,964)	(18,964)
Issuance of shares for acquisition			11,380			76,634	88,014
Balance, March 31, 2007	50,802,792	$ 50,803	$ 421,990	$ (31,034)	$ 1,271,092	$ (122,407)	$ 1,590,444
Balance, January 1, 2008	50,824,178	50,824	420,168	(9,349)	1,369,999	(176,035)	1,655,607
Net income					43,987		43,987
Other comprehensive income net of tax:							
Amortization of prior service cost				(13)			(13)
Net unrealized gain on securities available-for-sale, net of taxes of $2.4 million and reclassification of $0.2 million for net loss included in net income				3,349			3,349
Net unrealized gain on cash flow hedges, net of taxes of $1.9 million and reclassification of $0.6 million net income included in net income				2,582			2,582
Total other comprehensive income				5,918			5,918
Issuance of shares for stock options			(6,281)			12,073	5,792
Restricted stock grants, net of cancellations	158,209	158	(158)				
Stock-based employee compensation expense			3,488				3,488

Tax benefit from stock options			1,827				1,827
Cash dividends paid					(23,205)		(23,205)
Repurchased shares, net						(11,086)	(11,086)
Issuance of shares for acquisition							
Balance, March 31, 2008	50,982,387	$ 50,982	$ 419,044	$ (3,431)	$ 1,390,781	$ (175,048)	$ 1,682,328

See accompanying Notes to Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. **Basis of Presentation** - City National Corporation (the Corporation) is the holding company for City National Bank (the Bank). The Bank delivers banking, trust and investment services through 62 offices in Southern California, the San Francisco Bay area, Nevada and New York City. As of March 31, 2008, the Corporation had a majority ownership interest in eight investment advisory affiliates and a minority interest in one other firm. The Corporation also has an unconsolidated subsidiary, Business Bancorp Capital Trust I. The Corporation is approved as a financial holding company pursuant to the Gramm-Leach-Bliley Act of 1999. References to the Company mean the Corporation, Bank, all subsidiaries and affiliates together.

2. **Consolidation** - The financial statements of the Company include the accounts of the Corporation, its non-bank subsidiaries, the Bank and the Bank s wholly owned subsidiaries, after the elimination of all material intercompany transactions. Preferred stock, issued by the Company s REITs, and third-party equity ownership in affiliates are reflected as Minority interest in consolidated subsidiaries in the Consolidated Balance Sheet. The related minority interest in earnings is shown as Minority interest expense in the Consolidated Statement of Income.

The Company s investment management and wealth advisory affiliates are organized as limited liability companies. The Corporation generally owns a majority position in each affiliate and certain management members of each affiliate own the remaining shares. The Corporation has contractual arrangements with its affiliates whereby a percentage of revenue is allocable to fund affiliate operating expenses (operating share) while the remaining portion of revenue (distributable revenue) is allocable to the Corporation and the minority owners. All majority-owned affiliates are consolidated. The Corporation s interest in one investment management affiliate in which it holds a minority share is accounted for using the equity method.

3. **Acquisitions** - On February 28, 2007, the Company completed the acquisition of Business Bank Corporation, the parent of Business Bank of Nevada (BBNV) and an unconsolidated subsidiary, Business Bancorp Capital Trust I, in a cash and stock transaction valued at $167 million. BBNV operated as a wholly-owned subsidiary of City National Corporation until after the close of business on April 30, 2007, at which time it was merged into the Bank.

On May 1, 2007, the Corporation completed the acquisition of Lydian Wealth Management in an all-cash transaction. The investment advisory firm is headquartered in Rockville, Maryland and now manages or advises on client assets totaling $8.8 billion. Lydian Wealth Management changed its name to Convergent Wealth Advisors (Convergent Wealth) and became a subsidiary of Convergent Capital Management LLC, the Chicago-based asset management holding company that the Company acquired in 2003. All of the senior executives of Convergent Wealth signed employment agreements and acquired a significant minority ownership interest in Convergent Wealth.

4. **Accounting Policies** - Our accounting and reporting policies conform to generally accepted accounting principles (GAAP) and practices in the financial services industry. To prepare the financial statements in conformity with GAAP , management must make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and income and expenses during the reporting period. Circumstances and events that differ significantly from those underlying our estimates and assumptions could cause actual financial results to differ from our estimates. The material estimates included in the financial statements relate to the allowance for loan and lease losses, the reserve for off-balance sheet credit commitments, valuation of stock options, income taxes, goodwill and intangible asset values and valuation of financial assets and liabilities reported at fair value. The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these financial statements to the periods in which they applied. The allowance for loan and lease losses reflects management s ongoing assessment of the credit quality of the company s portfolio, which is affected by various economic trends, including weakness in the housing sector. Additional factors affecting the provision include net loan charge-offs, nonaccrual loans, risk-rating migration and growth in the portfolio. It is possible that a change in estimate may occur in subsequent periods.

The Company is on the accrual basis of accounting for income and expense. The results of operations reflect any interim adjustments, all of which are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q, and which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. In accordance with the usual practice of banks, assets and liabilities of individual trust, agency and fiduciary funds have not been included in the financial statements. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007. The results for the 2008 interim period are not necessarily indicative of the results expected for the full year.

Certain prior period balances have been reclassified to conform to the current period presentation.

During the three months ended March 31, 2008, the following accounting pronouncements were issued or became effective:

- The Company adopted FASB Statement No. 157, *Fair Value Measurements* (SFAS 157) effective January 1, 2008. SFAS 157 defines fair value for financial reporting purposes, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 does not require new fair value measurements, but does apply under other accounting pronouncements where fair value is required or permitted. The provisions of the statement are being applied prospectively. The Company was not required to record a transition adjustment upon adoption of the Statement.

- On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (the FSP). The FSP amends FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), to delay the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of non-financial assets for the Company include goodwill and intangible assets associated with acquisitions. The FSP defers the effective date of SFAS 157 for items within its scope to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years.

- On February 15, 2007 the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value on an instrument-by-instrument basis. Unrealized gains and losses on instruments for which the fair value option has been elected would be reported in earnings at each subsequent reporting date. The objective of the Statement is to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS 159 became effective for the Company on January 1, 2008. The Company has not elected the fair value option for any financial assets or liabilities previously reported at cost.

- On April 30, 2007 the FASB issued Staff Position, (FSP) FIN 39-1, which amends certain aspects of FASB Interpretation Number 39, *Offsetting of Amounts Related to Certain Contracts--an interpretation of APB Opinion No. 10 and FASB Statement No. 105* (FIN 39). The FSP amends paragraph 10 of FIN 39 to permit a reporting entity to offset fair value amounts recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) against fair value amounts, including amounts that approximate fair value, recognized for **derivative instruments** executed with the same counterparty under the same master netting arrangement. Derivative instruments permitted to be netted for the purposes of the FSP include those instruments that meet the definition of a derivative in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* including those that are not included in the scope of Statement 133. The FSP only impacts the presentation of the derivative s fair value and the related collateral on the balance sheet. The FSP became effective for the Company on January 1, 2008. From time to time the Company may require or accept cash collateral, but as of March 31, 2008 the Company did not have any cash collateral receivables and payables with the same counterparty that could be offset. The FSP is not expected to have any impact on the Company s financial statements in the future as the Company does not expect to have any cash collateral receivables and payables with the same counterparty that could be offset.

- EITF Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards*, ratified by the EITF on June 14, 2007, provides that realized income tax benefits from dividends or dividend equivalents that are charged to retained earnings and paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options are to be recognized as an increase to additional paid-in capital. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on those awards are to be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards. The Company previously recognized tax benefits associated with dividend payments on unvested shares as a reduction of income tax expense. The EITF became effective for the

Company on January 1, 2008. The change in accounting for these tax benefits under the EITF did not have a significant impact on the Company s financial statements.

- On March 19, 2008, the FASB issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). The Statement expands disclosure requirements for derivative instruments and hedging activities. The new disclosures will address how derivative instruments are used, how derivatives and the related hedged items are accounted for under SFAS 133, how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. In addition, companies will be required to disclose the fair values of derivative instruments and their gains and losses in a tabular format. SFAS 161 is effective for fiscal years beginning after November 15, 2008.

5. **Fair Value Measurements** - The Company adopted FASB Statement No. 157, *Fair Value Measurements* (*SFAS 157*) effective January 1, 2008 on a prospective basis. SFAS 157 defines fair value for financial reporting purposes as the price that would be received to sell an asset or paid to transfer a liability in an orderly market transaction between market participants at the measurement date (reporting date). Under the statement, fair value is based on an exit price in the principal market or most advantageous market in which the reporting entity could transact.

For each asset and liability required to be reported at fair value, management has identified the unit of account and valuation premise to be applied for purposes of measuring fair value. The unit of account is the level at which an asset or liability is aggregated or disaggregated for purposes of applying SFAS 157. The valuation premise is a concept that determines whether an asset is measured on a standalone basis or in combination with other assets. For purposes of applying the provisions of SFAS 157, the Company measures its assets and liabilities on a standalone basis then aggregates assets and liabilities with similar characteristics for disclosure purposes.

Fair Value Hierarchy

Management employs market standard valuation techniques in determining the fair value of assets and liabilities. Inputs used in valuation techniques are based on assumptions that market participants would use in pricing an asset or liability. SFAS 157 prioritizes inputs used in valuation techniques as follows:

Level 1-Quoted market prices in an active market for identical assets and liabilities.

Level 2-Observable inputs including quoted prices (other than level 1) in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability such as interest rates, yield curves, volatilities and default rates, and inputs that are derived principally from or corroborated by observable market data.

Level 3-Unobservable inputs reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available.

If the determination of fair value measurement for a particular asset or liability is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Management s assessment of the significance of a particular input to the fair value measurement requires judgment and considers factors specific to the asset or liability measured.

Valuation Techniques

Fair values for U.S. Treasury securities, marketable equity securities and trading securities, with the exception of agency securities held in the trading account, are based on quoted market prices. Fair values for the Company s portfolio of Federal agency, mortgage-backed, state and municipal securities are calculated with models using quoted prices and other inputs directly or indirectly observable for the asset or liability. Prices for 99 percent of these securities are obtained through a third-party valuation source. Management reviewed the valuation techniques and assumptions used by the provider and determined that the provider utilizes widely accepted valuation techniques based on observable market inputs appropriate for the type of security being measured. Prices for the remaining securities are obtained from dealer quotes.

The Company does not record loans at fair value with the exception of impaired loans which are measured for impairment in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114). Under SFAS 114, loans measured for impairment based on the fair value of collateral or observable market prices are within the scope of SFAS 157. Loans reported at fair value in the table below were measured for impairment by valuing the underlying collateral based on third-party appraisals.

The Company uses interest rate swaps to manage its interest rate risk. The fair value of these swaps is obtained through third-party valuation sources that use conventional valuation algorithms. The pricing model is a discounted cash flow model that relies on inputs, such as interest rate futures, from highly liquid and active markets. The Company also enters into interest rate swap contracts with certain clients. These contracts are offset by paired trades with derivative dealers. The fair value of these derivatives is obtained from a third-party valuation source that uses conventional valuation algorithms.

To comply with the provisions of FAS 157, the Company incorporates credit valuation adjustments to appropriately reflect nonperformance risk for both the Company and counterparties in the fair value measurements. Although the Company has determined that the majority of the inputs used to value derivative contracts fall within Level 2 of the fair value hierarchy, the credit valuation adjustments utilize Level 3 inputs, such as estimates of credit spreads. The Company has determined that the impact of the credit valuation adjustments is not significant to the overall valuation of these derivatives. As a result, the Company has classified the derivative contract valuations in their entirety in Level 2 of the fair value hierarchy.

The fair value of foreign exchange options and transactions are derived from market spot and/or forward foreign exchange rates.

The fair value of OREO is based on a third-party appraisal of the property performed in accordance with professional appraisal standards and Bank regulatory requirements under FIRREA. Appraisals are reviewed and approved by the Company s appraisal department.

The Company records securities available-for-sale, trading securities and derivative contracts at fair value on a recurring basis. Certain other assets such as impaired loans, private equity investments and OREO are recorded at fair value on a nonrecurring basis. Nonrecurring fair value measurements typically involve assets that are evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed. At March 31, 2008, the fair values reported for the Company s assets and liabilities measured at fair value are based on Level 1 or Level 2 inputs. A distribution of asset and liability fair values according to the fair value hierarchy is provided in the table below:

Asset or Liability Measured at Fair Value	March 31, 2008	Fair Value Measurements at Reporting Date Using (Dollars in thousands) Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Measured on a Recurring Basis				
Assets				
Securities available-for-sale				
Debt portfolio	$ 2,271,528	$ 40,078	$ 2,231,450	$
Other equity securities	$ 117,931	48,097	$ 69,834	
Trading account securities	121,152	114,157	6,995	
Mark-to-market derivatives (1)	42,676	2,652	40,024	
Total assets at fair value	$ 2,553,287	$ 204,984	$ 2,348,303	$
Liabilities				
Mark-to-market derivatives (2)	$ 6,569	$ 2,446	$ 4,123	$
Total liabilities at fair value	$ 6,569	$ 2,446	$ 4,123	$
Measured on a Nonrecurring Basis				
Assets				
Collateral dependent impaired loans (3)	$ 42,687	$	$ 42,687	$
Other real estate owned (4)	4,241		4,241	
Total assets at fair value	$ 46,928	$	$ 46,928	$

(1) Reported in Other assets in the Consolidated Balance Sheet.

(2) Reported in Other liabilities in the Consolidated Balance Sheet.

(3) Impaired loans for which fair value was calculated using the collateral valuation method.

(4) OREO balance of $3,812 included in Other assets is net of costs to sell.

FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (the FSP) issued on February 12, 2008, amends FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), to delay the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Therefore, the Company s goodwill and customer-relationship intangibles will be subject to the provisions of SFAS 157 effective January 1, 2009.

6. **Investment Securities** Securities are classified based on management s intention on the date of purchase. All securities other than trading securities are classified as available-for-sale and are valued at fair value. Unrealized gains or losses on securities available-for-sale are excluded from net income but are included as separate components of other comprehensive income, net of taxes. Premiums or discounts on securities available-for-sale are amortized or accreted into income using the interest method over the expected lives of the individual securities. For all of the Company s investments, fair values are determined based upon externally verifiable quoted prices or other observable inputs. On a quarterly basis, the Company makes an assessment to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. The Company considers such factors as the length of time and the extent to which the market value has been less than cost and the Company s intent with regard to the securities in evaluating them for other-than-temporary impairment. The value of securities is reduced when unrealized losses are considered other-than-temporary, and a new cost basis is established for the securities. Any other-than-temporary loss is included

in net income. Realized gains or losses on sales of securities are recorded using the specific identification method. Trading securities are valued at fair value with any unrealized gains or losses included in net income.

7. **Shareholders Equity -** The following table provides information about purchases by the Company of equity securities that are registered by the Company pursuant to Section 12 of the Securities and Exchange Act of 1934 during the quarter ended March 31, 2008:

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
01/1/08 - 01/31/08	10,000	$ 54.09	10,000	1,551,900
02/1/08 - 02/29/08	136,000	$ 55.66	136,000	1,415,900
03/1/08 - 03/31/08	45,500	$ 50.05	45,500	1,370,400
	191,500	$ 54.24	191,500(1)	1,370,400(1)

(1) On January 24, 2008 the Company s Board of Directors authorized the Company to repurchase 1 million additional shares of the Company s stock following the completion of its previously approved initiative. Unless terminated earlier by resolution of our Board of Directors, the program will expire when the Company has repurchased all shares authorized for repurchase thereunder. We received no shares in payment for the exercise price of stock options.

On April 23, 2008 the Corporation s shareholders approved the reservation of an additional 3.5 million shares for issuance under the Corporation s 2008 Omnibus Plan. As of May 1, 2008 none of these shares had been issued.

Basic earnings per share are based on the weighted average shares of common stock outstanding less unvested restricted shares and units. Diluted earnings per share give effect to all potential dilutive common shares, which consist of stock options and restricted shares and units that were outstanding during the period. At March 31, 2008, there were 2,827,732 antidilutive options compared to 759,937 antidilutive options at March 31, 2007.

8. **Stock-Based Compensation** - The Company applies FASB Statement No. 123 (revised), Share Based Payment, (SFAS 123R) in accounting for stock option plans. The Company uses a Black-Scholes model to determine the stock-based compensation expense for these plans. On March 31, 2008, the Company had one stock-based compensation plan, which provides for granting of stock options, restricted shares and restricted units. The compensation cost that has been charged against income for all stock-based awards was $3.5 million for the three months ended March 31, 2008, compared to $3.4 million for the three-month period ended March 31, 2007. The Company received $5.8 million and $6.8 million in cash for the exercise of stock options during the three month periods ended March 31, 2008 and March 31, 2007, respectively. The total income tax benefit recognized in the income statement for stock-based compensation arrangements was $1.8 million and $3.6 million for the three months ended March 31, 2008 and 2007, respectively.

Plan Description

The City National Corporation Amended and Restated Omnibus Plan, (the Plan), approved by shareholders, permits the grant of stock options and restricted stock or restricted units to its employees. At March 31, 2008 there were approximately 0.8 million shares available for future grants. The Company believes that such awards better align the interests of its employees with those of its shareholders. Employee option awards are granted with an exercise price equal to the market price of the Company s stock at the date of grant. These awards vest in four years and have 10-year contractual terms. Restricted stock awards generally vest over five years, during which time the holder receives dividends and has full voting rights. Certain option and stock awards provide for accelerated vesting if there is a change in control (as defined in the Plan), or upon retirement, for options issued prior to January 31, 2006. All unexercised options expire 10 years from the grant date.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model that uses the assumptions noted in the following table. The Company evaluates exercise behavior and values options separately for executive and non-executive employees. Expected volatilities are based on the historical volatility of the Company s stock using a look back period at least equal to the expected term of the options. As of February 2008, the Company began using a 20-year look back period to calculate the volatility factor. The longer look back period reduces the impact of the recent disruptions in the capital markets, and provides values that management believes are more representative of expected future volatility. Prior to this date, the Company used a look back period equal to the expected term of the options. The Company uses historical data to predict option exercise and employee termination behavior. The expected term of options granted is derived from the historical exercise activity over the past 20 years and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within

the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield is equal to the dividend yield of the Company s stock at the time of the grant.

To estimate the fair value of stock option awards, we use the Black-Scholes valuation method, which incorporates the assumptions summarized in the table below:

Stock Option Valuation Assumptions

	For the three months ended March 31,	
	2008	**2007**
Weighted-average volatility	29.27%	22.01%
Dividend yield	3.51%	2.46%
Expected term (in years)	6.04	6.13
Risk-free interest rate	3.97%	4.67%

Using the Black-Scholes model, the weighted-average grant-date fair values of options granted during the three-month periods ended March 31, 2008 and 2007 were $12.66 and $17.13, respectively. The total intrinsic values of options exercised during the three-month periods ended March 31, 2008 and 2007 were $4.1 million, and $8.7 million, respectively.

A summary of option activity and related information under the Plan for the three-month period ended March 31, 2008 is presented below:

Options	**Shares (000)**	**Weighted-Average Exercise Price**	**Aggregate Intrinsic Value (1) ($ 000)**	**Weighted-Avg. Remaining Contractual Term**
Outstanding at January 1, 2008	4,171	$ 52.60	$ 23,378	5.03
Granted	574	54.89		
Exercised	(186)	31.22	(4,090)	
Forfeited or expired	(15)	66.16	(5)	
Outstanding at March 31, 2008	4,544	$ 53.72	$ 19,990	5.58
Exercisable at March 31, 2008	3,143	$ 48.35	$ 19,990	4.14

(1) Aggregate intrinsic value of in-the-money options only

A summary of changes in unvested options and related information for the three-month period ended March 31, 2008 is presented below:

	Shares	**Weighted-Average Grant-Date**

Unvested Shares	(000s)	Fair Value
Unvested at January 1, 2008	1,141	$ 17.29
Granted	574	12.66
Vested	(307)	16.62
Forfeited		