CITY NATIONAL CORP
Form 10-Q
May 10, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

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 xNo o

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

Large Accelerated filer x Accelerated filer o Non-accelerated filer 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, 2007, there were 48,773,064 shares of Common Stock outstanding.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEET

Dollars in thousands, except per share amounts	**March 31, 2007 (Unaudited)**	**December 31, 2006**	**March 31, 2006 (Unaudited)**
Assets			
Cash and due from banks	$ 494,231	$ 423,114	$ 457,156
Due from banks - interest-bearing	77,214	60,940	48,890
Federal funds sold	210,000	127,000	
Securities available-for-sale - cost $2,951,124; $3,018,190; and $3,963,816 at March 31, 2007, December 31, 2006 and March 31, 2006, respectively	2,903,546	2,954,372	3,850,173
Trading account securities	35,981	147,907	57,353
Loans	10,649,598	10,386,005	9,567,403
Less allowance for loan and lease losses	161,005	155,342	156,482
Net loans	10,488,593	10,230,663	9,410,921
Premises and equipment, net	103,259	94,745	84,884
Deferred tax asset	129,614	125,992	136,573
Goodwill	366,007	249,641	246,681
Intangibles	54,190	37,920	36,961
Bank-owned life insurance	70,780	70,156	68,094
Affordable housing investments	66,011	65,800	66,422
Customers acceptance liability	4,100	3,877	3,142
Other assets	260,521	292,254	270,996
Total assets	$ 15,264,047	$ 14,884,381	$ 14,738,246
Liabilities			
Demand deposits	$ 5,690,413	$ 6,002,068	$ 5,945,485
Interest checking deposits	783,846	755,098	786,513
Money market deposits	3,746,925	3,216,949	3,402,368
Savings deposits	155,825	153,417	179,376
Time deposits-under $100,000	296,312	198,329	175,360
Time deposits-$100,000 and over	1,933,060	1,846,955	1,419,427
Total deposits	12,606,381	12,172,816	11,908,529
Federal funds purchased and securities sold under repurchase agreements	310,738	422,903	526,920
Other short-term borrowings	50,667	97,525	151,522
Subordinated debt	270,174	269,848	269,785
Long-term debt	224,079	217,569	213,819
Reserve for off-balance sheet credit commitments	17,005	16,424	15,752
Other liabilities	162,080	164,079	154,162
Acceptances outstanding	4,100	3,877	3,142
Total liabilities	13,645,224	13,365,041	13,243,631
Minority interest in consolidated subsidiaries	28,285	28,425	25,225
Commitments and contingencies			
Shareholders Equity			
Preferred Stock authorized - 5,000,000; none outstanding			
Common Stock-par value-$1.00; authorized - 75,000,000; Issued - 50,802,792; 50,718,794; and 50,693,108 shares at March 31, 2007, December 31, 2006 and March 31, 2006, respectively	50,803	50,719	50,693
Additional paid-in capital	421,990	412,248	399,974
Accumulated other comprehensive loss	(30,940)	(41,386)	(73,248)

Retained earnings	1,271,092	1,264,697	1,148,116
Treasury shares, at cost - 1,769,592; 2,835,908; and 826,230 shares at March 31, 2007, December 31, 2006 and March 31, 2006, respectively	(122,407)	(195,363)	(56,145)
Total shareholders equity	1,590,538	1,490,915	1,469,390
Total liabilities and shareholders equity	$15,264,047	$ 14,884,381	$ 14,738,246

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF INCOME

(Unaudited)

In thousands, except per share amounts	**For the three months ended March 31, 2007**	**2006**
Interest Income		
Loans	$ 180,643	$ 155,433
Securities available-for-sale	32,120	41,850
Trading account	787	556
Due from banks - interest-bearing	531	213
Federal funds sold and securities purchased under resale agreements	183	140
Total interest income	214,264	198,192
Interest Expense		
Deposits	50,324	27,453
Federal funds purchased and securities sold under repurchase agreements	7,556	8,933
Subordinated debt	4,024	3,493
Other long-term debt	3,597	3,329
Other short-term borrowings	1,471	2,578
Total interest expense	66,972	45,786
Net interest income	147,292	152,406
Provision for credit losses		
Net interest income after provision for credit losses	147,292	152,406
Noninterest Income		
Trust and investment fees	30,254	21,774
Brokerage and mutual fund fees	13,780	11,684
Cash management and deposit transaction charges	8,471	8,064
International services	6,463	5,989
Bank-owned life insurance	624	934
Gain on sale of securities	269	708
Loss on sale of loans and other assets	(46)	
Other	6,160	5,777
Total noninterest income	65,975	54,930
Noninterest Expense		
Salaries and employee benefits	77,984	71,616
Net occupancy of premises	9,458	9,012
Legal and professional fees	9,274	9,417
Depreciation and amortization	5,000	4,660
Information services	4,999	4,456
Marketing and advertising	3,998	4,016
Office services	2,747	2,691
Amortization of intangibles	1,630	1,891
Equipment	718	632
Other operating	5,955	5,704
Total noninterest expense	121,763	114,095
Minority interest expense	2,076	1,228
Income before income taxes	89,428	92,013
Income taxes	32,883	34,781
Net income	$ 56,545	$ 57,232
Net income per share, basic	$ 1.18	$ 1.16
Net income per share, diluted	$ 1.15	$ 1.12
Shares used to compute income per share, basic	47,968	49,484
Shares used to compute income per share, diluted	49,087	51,309
Dividends per share	$ 0.46	$ 0.41

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, 2005	50,600,943	$ 50,601	$ 396,659	$ (51,551)	$ 1,121,474	$ (59,175)	$ 1,458,008
Adjustment to initially apply Staff Accounting Bulletin No. 108					(10,174)		(10,174)
Balance, January 1, 2006	50,600,943	50,601	396,659	(51,551)	1,111,300	(59,175)	1,447,834
Net income					57,232		57,232
Other comprehensive loss net of tax							
Net unrealized loss on securities available-for-sale				(20,817)			(20,817)
Net unrealized loss on cash flow hedges, net of reclassification of $1.2 million net loss included in net income				(634)			(634)
Other net unrealized loss				(246)			(246)
Total other comprehensive loss				(21,697)			(21,697)
Issuance of shares for stock options	68,246	68	(1,128)			6,118	5,058
Restricted stock grants	23,919	24	(24)				
Stock-based employee compensation expense			2,680				2,680
Tax benefit from stock options			1,787				1,787
Cash dividends paid					(20,416)		(20,416)
Repurchased shares, net						(3,088)	(3,088)
Balance, March 31, 2006	50,693,108	$ 50,693	$ 399,974	$ (73,248)	$ 1,148,116	$ (56,145)	$ 1,469,390
Balance, December 31, 2006	50,718,794	$ 50,719	$ 412,248	$ (41,386)	$ 1,264,697	$ (195,363)	$ 1,490,915
Adjustment to initially apply FASB Interpretation 48					(28,036)		(28,036)
Balance, January 1, 2007	50,718,794	50,719	412,248	(41,386)	1,236,661	(195,363)	1,462,879
Net income					56,545		56,545
Other comprehensive income net of tax							
Change due to amortization of prior service cost				40			40
Net unrealized gain on securities available-for-sale				9,278			9,278
Net unrealized gain on cash flow hedges, net of reclassification of $1.1 million net loss included in net income				1,128			1,128
Total other comprehensive income				10,446			10,446
Issuance of shares for stock options			(8,481)			15,286	6,805
Restricted stock grants	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			11,381			76,634	88,015
Balance, March 31, 2007	50,802,792	$ 50,803	$ 421,990	$ (30,940)	$ 1,271,092	$ (122,407)	$1,590,538

See accompanying Notes to Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

Dollars in thousands	For the three months ended March 31, 2007	2006
Cash Flows From Operating Activities		
Net income	$ 56,545	$ 57,232
Adjustments to net income:		
Provision for credit losses		
Amortization of restricted stock grants	1,475	1,070
Amortization of intangibles	1,630	1,891
Depreciation and amortization	5,000	4,660
Amortization of cost and discount on long-term debt	177	177
Stock-based employee compensation expense	1,874	1,610
Net change in deferred income tax benefit	7,533	(15,545)
Loss on sale of loans and other assets	46	
Gain on sales of securities	(269)	(708)
Net change in other assets and other liabilities	(11,545)	(70,397)
Net decrease in trading securities	111,926	1,991
Other, net	(5,515)	63,071
Net cash provided by operating activities	168,877	45,052
Cash Flows From Investing Activities		
Purchase of securities available-for-sale	(41,839)	(53,276)
Sales of securities available-for-sale	48,499	1
Maturities and paydowns of securities	124,703	119,177
(Loan originations), net of principal collections	127,757	(301,801)
Purchase of premises and equipment	(7,338)	(6,676)
Acquisition of BBNV, net of cash acquired	(50,398)	
Other investing activities	(2,752)	(942)
Net cash provided (used) by investing activities	198,632	(243,517)
Cash Flows From Financing Activities		
Net decrease in deposits	(7,442)	(229,943)
Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements	(112,165)	336,730
Net (decrease) increase in short-term borrowings, net of transfers from long-term debt	(46,858)	51,522
Net increase (decrease) in other borrowings	43	(159)
Proceeds from exercise of stock options	6,805	5,058
Tax benefit from exercise of stock options	3,577	1,787
Stock repurchases	(18,964)	(3,088)
Cash dividends paid	(22,114)	(20,416)
Net cash (used) provided by financing activities	(197,118)	141,491
Net increase (decrease) in cash and cash equivalents	170,391	(56,974)
Cash and cash equivalents at beginning of year	611,054	563,020
Cash and cash equivalents at end of period	$ 781,445	$ 506,046
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		

Interest	$ 76,985	$ 50,534
Income taxes	2,000	17,600

See accompanying Notes to the 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 (CNB) and Business Bank of Nevada (BBNV). CNB and BBNV (together the banks) deliver banking, trust and investment services through 61 offices in Southern California, the San Francisco Bay area, Nevada and New York City. As of March 31, 2007, the Corporation had a majority ownership interest in eight investment advisor subsidiaries and minority interests in one other firm. The Company also has an unconsolidated subsidiary, Business Bancorp Capital Trust I. Because the banks comprise substantially all of the business of the Corporation, references to the Company mean the Corporation and the banks together. The Corporation is approved as a financial holding company pursuant to the Gramm-Leach-Bliley Act of 1999. The financial statements of the Company include the accounts of the Corporation, its non-bank subsidiaries, CNB, CNB s wholly-owned subsidiaries and BBNV, after the elimination of all material intercompany transactions.

2. **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 CNB.

On March 27, 2007, City National Corporation announced a definitive agreement to acquire Lydian Wealth Management in an all-cash transaction. Founded in 1994, Lydian Wealth Management now manages or advises on client assets totaling $7.3 billion. The firm is headquartered in Rockville, Md., and has offices in the Washington, D.C. area, New York, Philadelphia, Atlanta, Seattle and Portland. The acquisition closed on May 1, 2007 and Lydian Wealth Management became an affiliate of Convergent Capital Management LLC, the Chicago-based asset management holding company that the Company acquired in 2003. At the same time, Lydian Wealth Management changed its name to Convergent Wealth Advisors. All of its senior executives signed employment agreements and acquired a significant minority ownership interest in their company. As of May 1, 2007, the Corporation had a majority ownership interest in nine investor advisor subsidiaries and a minority interest in one other firm.

3. **Accounting Policies** - Our accounting and reporting policies conform to generally accepted accounting principles (GAAP) and practices in the financial services industry. The Company is on the accrual basis of accounting for income and expense. 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. The results of operations reflect any interim adjustments, all of which are of a normal recurring nature, and which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. 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, 2006. The results for the 2007 interim periods are not necessarily indicative of the results expected for the full year.

During the three months ended March 31, 2007, the following accounting pronouncements were issued or became effective:

- The Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) on January 1, 2007. FIN 48 provides a single model for addressing uncertainty in tax positions and requires expanded annual disclosures about tax positions. Upon adoption, the Company recognized a cumulative effect adjustment as a charge to January 1, 2007 retained earnings and the contingent tax reserve of $28.0 million.

- 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. SFAS 159 s objective 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 will be effective for the Company as of January 1, 2008. The implementation may result in recognizing certain financial assets and liabilities (for which the fair value option was selected) at fair value, with the effect of the adoption recorded as a cumulative effect adjustment to beginning retained earnings. Additional disclosures will be required upon implementation. The statement is not expected to have a significant impact on the Company s financial statements.

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

4. **Investment Securities** - 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. 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 available-for-sale are recorded using the specific identification method. Trading securities are valued at market value with any unrealized gains or losses included in net income.

5. **Equity Securities** - 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 Exchange Act during the quarter ended March 31, 2007:

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	
03/01/07 - 03/31/07	263,000	$ 72.11	263,000		794,700	
	263,000	72.11	263,000	(1)	794,700	(1)

(1) On July 6, 2006, the Company s Board of Directors authorized the Company to repurchase 1.5 million additional shares of the Company s stock following 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. During the first quarter of 2007, the Company repurchased an aggregate of 263,000 shares of our common stock pursuant to this repurchase program and there are 794,700 shares remaining to be purchased. We received no shares in payment for the exercise price of stock options.

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, 2007, there were 759,937 antidilutive options compared to no antidilutive options at March 31, 2006.

6. **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, 2007, 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 $3.4 million for the three months ended March 31, 2007, compared to $2.7 million for the three-month period ended March 31, 2006. The total income tax benefit recognized in the income statement for stock-based compensation arrangements was $1.4 million and $1.1 million for the three months ended March 31, 2007 and 2006, respectively.

Stock Option Plan

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 not to exceed 3.9 million shares of common stock. The Company believes that such awards better align the interest 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. 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. The Company uses historical data to predict option exercise and employee termination behavior. The expected term of options granted is

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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.

	For the three months ended March 31, 2007		2006	
Expected volatility	21.81	%	25.34	%
Weighted-average volatility	21.83	%	24.99	%
Expected dividends	2.52	%	2.14	%
Expected term (in years)	6.0		6.0	
Risk-free rate	4.70	%	4.50	%

Using the Black-Scholes model, the weighted-average grant-date fair values of options granted during the three-month periods ended March 31, 2007 and 2006 were $17.13 and $19.89, respectively. The total intrinsic values of options exercised during the three-month periods ended March 31, 2007 and 2006 were $8.7 million, and $5.1 million, respectively.

A summary of option activity under the Plan as of March 31, 2007 are presented below:

Options	Shares (000 s)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2007	4,295	$ 49.54	5.14	$ 103,349
Granted	343	74.76	9.89	(397)
Exercised	(221)	34.41	2.11	(8,673)
Forfeited or expired	(21)	58.01	6.12	(324)
Outstanding at March 31, 2007	4,396	52.23	5.65	93,955
Exercisable at March 31, 2007	3,158	45.23	4.49	89,580

A summary of the changes in the Company s unvested options during the three-month period ended March 31, 2007 is presented below:

Unvested Shares	Shares (000 s)	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2007	1,139	17.23
Granted	343	17.13
Vested	(228)	17.46
Forfeited	(16)	16.23
Unvested at March 31, 2007	1,238	17.20

The number of shares vested during the three-month period ended March 31, 2007 was 228,089. As of March 31, 2007, there was $39.6 million of total unrecognized compensation cost related to unvested stock-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 2.5 years.

7. **Interest Rate Risk Management** - As part of its asset and liability management strategies, the Company uses interest-rate swaps to reduce cash flow variability and to moderate changes in the fair value of financial instruments. In accordance with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended (SFAS 133), the

Company recognizes derivatives as assets or liabilities on the balance sheet at their fair value. The treatment of changes in the fair value of derivatives depends on the character of the transaction.

In accordance with SFAS 133, the Company documents its hedge relationships, including identification of the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction at the time the derivative contract is executed. This includes designating each derivative contract as either (i) a fair value hedge which is a hedge of a recognized asset or liability, (ii) a cash flow hedge which hedges a forecasted transaction or the variability of the cash flows to be received or paid related to a recognized asset or liability or (iii) an undesignated hedge , a derivative instrument not designated as a hedging instrument whose change in fair value is recognized directly in the consolidated statement of income. All derivatives designated as fair value or cash flow hedges are linked to specific hedged items or to groups of specific assets and liabilities on the balance sheet. Effectiveness is measured retrospectively and prospectively, and the Company expects that the hedges will continue to be effective in the future. The Company did not have any undesignated hedges as of March 31, 2007 and did not have any significant undesignated hedges during 2007 or 2006.

Both at inception and at least quarterly thereafter, the Company assesses whether the derivatives used in hedging transactions are highly effective (as defined in SFAS 133) in offsetting changes in either the fair value or cash flows of the hedged item. Retroactive effectiveness is assessed, as well as the expectation that the hedge will remain effective prospectively.

For cash flow hedges, in which derivatives hedge the variability of cash flows (interest payments) on loans that are indexed to U.S. dollar LIBOR or the Bank s prime interest rate, the effectiveness is assessed prospectively at the inception of the hedge, and prospectively and retrospectively at least quarterly thereafter. Ineffectiveness of the cash flow hedges is measured on a quarterly basis using the hypothetical derivative method. For cash flow hedges, the effective portion of the changes in the derivatives fair value is not included in current earnings but is reported as other comprehensive income. When the cash flows associated with the hedged item are realized, the gain or loss included in other comprehensive income is recognized on the same line in the consolidated statement of income as the hedged item, i.e. included in interest income on loans. Any ineffective portion of the changes of fair value of cash flow hedges is recognized immediately in other noninterest income in the consolidated statement of income.

For fair value hedges, in which derivatives hedge the fair value of certain certificates of deposits, subordinated debt and other long-term debt, the interest-rate swaps are structured so that all key terms of the swaps match those of the underlying debt transactions, therefore ensuring hedge effectiveness at inception. On a quarterly basis, fair value hedges are analyzed to ensure that the key terms of the hedged items and hedging instruments remain unchanged, and the hedging counterparties are evaluated to ensure that there are no adverse developments regarding counterparty default, therefore ensuring continuous effectiveness. For fair value hedges, the effective portion of the changes in the fair value of derivatives is reflected in current earnings, on the same line in the consolidated statement of income as the related hedged item.

Fair values are determined from verifiable third-party sources that have considerable experience with the interest-rate swap market. For both fair value and cash flow hedges, the periodic accrual of interest receivable or payable on interest rate swaps is recorded as an adjustment to net interest income for the hedged items.

The Company discontinues hedge accounting prospectively when (i) a derivative is no longer highly effective in offsetting changes in the fair value or cash flows of a hedged item, (ii) a derivative expires or is sold, terminated, or exercised, (iii) a derivative is un-designated as a hedge, because it is unlikely that a forecasted transaction will occur; or (iv) the Company determines that designation of a derivative as a hedge is no longer appropriate. If a derivative instrument in a fair value hedge is terminated or the hedge designation removed, the previous adjustments to the carrying amount of the hedged asset or liability would be subsequently accounted for in the same manner as other components of the carrying amount of that asset or liability. For interest-earning assets and interest-bearing liabilities, such adjustments would be amortized into earnings over the remaining life of the respective asset or liability. If a derivative instrument in a cash flow hedge is terminated or the hedge designation is removed, related amounts reported in other comprehensive income is reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings.

8. **Income Taxes** - The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, (FIN 48) on January 1, 2007. Upon adoption, the Company recognized a cumulative effect adjustment as a charge to January 1, 2007 retained earnings and a reduction to the contingent tax reserve of $28.0 million, which is comprised of a $25.2 million tax liability and $2.8 million of accrued interest.

As previously reported, on December 31, 2003, the California Franchise Tax Board (FTB) announced that it had taken the position that certain REIT and regulated investment company (RIC) tax deductions would be disallowed. Prior to this announcement, the Company had created two REITs (one of which was formed as a RIC in 2000) to raise capital for the Bank. While company management continues to believe that the tax benefits related to the REITs are appropriate, the Company deemed it prudent to participate in the statutory Voluntary Compliance Initiative-Option 2, requiring payment of all California taxes and interest on potential tax exposures for the 2000-2002 tax years. The Company may then claim a refund for the taxes paid while avoiding potential penalties. The Company has elected to proceed with its claim for refund as allowed by law. At December 31, 2006, the Company had a state tax receivable of $43.1 million, or $28.0 million after giving effect to Federal tax benefits.

As mentioned above, in connection with the adoption of FIN 48, the Company reduced the state tax receivable balance to zero. Management continues to aggressively pursue its claims with the Franchise Tax Board for the REIT and RIC refunds for the tax years 2000 through 2004. While an outcome from the claims cannot be predicted with certainty, a potentially adverse result will not have any material impact on the Company s financial position.

The Company recognizes accrued interest and penalties relating to unrecognized tax benefits as an income tax provision expense. For the period ended March 31, 2007, the Company recognized approximately $372,000 in interest and penalties. The Company had approximately $9.8 million and $6.6 million of accrued interest and penalties as of March 31, 2007 and December 31, 2006, respectively.

The Company is currently under examination by the Internal Revenue Service (IRS) for the tax years 2002 and 2003. The Company expects to begin IRS appeals proceedings related to certain tax positions taken in these years. The potential financial statement impact of these items range from a tax benefit of $3.6 million to a tax expense of $6.8 million.

The Company is also under examination by the Franchise Tax Board for the tax years 1998 through 2004. The Company expects to complete its Franchise Tax Board examination for the years 1998 though 2003 within the next 12 months. The potential financial statement impact resulting from the completion of the audit is not determinable at this time.

9. **Retirement Plans** - The Company has a profit-sharing retirement plan with an Internal Revenue Code Section 401(k) feature covering eligible employees. Contributions are made annually into a trust fund and are allocated to participants based on their salaries. For the first quarter of 2007, the Company recorded profit sharing contributions expense of $3.9 million, compared to $4.0 million for the first quarter of 2006.

The Company has a Supplemental Executive Retirement Plan (SERP) for one of its executive officers. The SERP meets the definition of a pension plan per FASB Statement No. 87, *Employers Accounting for Pensions*. The Company applies FASB Statement No. 158, *Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158), in accounting for the SERP. At March 31, 2007, there was a $4.3 million unfunded pension liability. The total expense for both the first quarter of 2007 and the first quarter of 2006 was $0.2 million.

The Company does not provide any other post-retirement benefits.

10. **Segment Reporting** - The Company has one primary reportable segment, Commercial and Private Banking. All other subsidiaries, Wealth Management Services and the portion of corporate departments allocated to the operating segments other than Commercial and Private Banking are aggregated in a second reportable segment called Other. The factors considered in determining whether individual operating segments could be aggregated include that the operating segments (i) offer the same products and services, (ii) offer services to the same types of clients, (iii) provide services in the same manner and (iv) operate in the same regulatory environment.

The Commercial and Private Banking reportable segment is the aggregation of the Commercial and Private Banking, Real Estate, Entertainment and Core Banking operating segments. The Commercial and Private Banking segment provides banking products and services, including commercial and mortgage loans, lines of credit, deposits, cash management services, international trade finance and letters of credit to small and medium-sized businesses, entrepreneurs and affluent individuals. This segment primarily serves clients in California, New York and Nevada.

The Other segment includes the Bank s Wealth Management Services division, all non-bank subsidiaries, including the asset management affiliates, and the portion of corporate departments, including the Treasury Department and the Asset Liability Funding Center, that have not been allocated to Commercial and Private Banking.

Business segment earnings are the primary measure of the segment s performance as evaluated by management. Business segment earnings include direct revenue and expenses of the segment as well as corporate and inter-unit allocations. Allocations of corporate expenses, such as data processing and human resources, are calculated based on estimated activity levels for the fiscal year. Inter-unit support groups, such as Operational Services, are allocated based on actual expenses incurred. Capital is allocated using a methodology similar to that used for federal regulatory risk-based capital purposes. If applicable, any provision for credit losses is allocated based on various credit factors, including but not limited to, credit risk ratings, ratings migration, charge-offs and recoveries and loan growth. Income taxes are charged on unit income at the Company s statutory tax rate of 42 percent.

Exposure to market risk is managed in the Treasury department. In order to allocate interest rate risk to the units comprising the Commercial and Private Banking segment, a fund transfer pricing (FTP) model is used. The FTP model records a cost of funds or credit for funds using a combination of matched maturity funding for most assets and liabilities and a blended rate based on various maturities for the remaining assets and liabilities.

The Bank s investment portfolio and unallocated equity are included in the Other segment. Core deposit intangible amortization is charged to the affected operating segments.

Operating results for the Commercial and Private Banking reportable segment are discussed in the Segment Results section of Management s Discussion and Analysis. Selected financial information for each segment is presented in the following tables.

CITY NATIONAL CORPORATION

Segment Results

(Dollars in thousands) Three months ended March 31,	**Commercial & Private Banking 2007**	**Commercial & Private Banking 2006**	**Other 2007**	**Other 2006**	**Consolidated Company 2007**	**Consolidated Company 2006**
Earnings Summary:						
Net interest income	$ 147,262	$ 146,949	$ 30	$ 5,457	$ 147,292	$ 152,406
Provision for credit losses						
Noninterest income	16,000	15,593	49,975	39,337	65,975	54,930
Depreciation and amortization	1,560	1,428	3,440	3,232	5,000	4,660
Noninterest expense and minority interest	91,300	88,872	27,539	21,791	118,839	110,663
Income before income taxes	70,402	72,242	19,026	19,771	89,428	92,013
Income taxes	25,124	27,186	7,759	7,595	32,883	34,781
Net income	$ 45,278	$ 45,056	$ 11,267	$ 12,176	$ 56,545	$ 57,232
Selected Average Balances:						
Loans	$ 10,457,105	$ 9,520,055	$ 97,839	$ 104,961	$ 10,554,944	$ 9,625,016
Total Assets	10,882,554	9,943,628	3,953,868	4,882,887	14,836,422	14,826,515
Deposits	10,713,925	10,595,529	1,202,389	992,109	11,916,314	11,587,638
Performance measures:						
Return on average assets	1.7 %	1.8 %	1.2 %	1.0 %	1.5 %	1.6 %

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CITY NATIONAL CORPORATION

FINANCIAL HIGHLIGHTS

Dollars in thousands, except per share amounts	At or for the three months ended March 31, 2007 (Unaudited)	December 31, 2006	March 31, 2006 (Unaudited)	Percent change March 31, 2007 from December 31, 2006	March 31, 2006
For The Quarter					
Net income	$ 56,545	$ 58,556	$ 57,232	(3)%	(1)%
Net income per common share, basic	1.18	1.23	1.16	(4)	2
Net income per common share, diluted	1.15	1.19	1.12	(3)	3
Dividends per common share	0.46	0.41	0.41	12	12
At Quarter End					
Assets	$ 15,264,047	$ 14,884,381	$ 14,738,246	3	4
Securities	2,939,527	3,102,279	3,907,526	(5)	(25)
Loans	10,649,598	10,386,005	9,567,403	3	11
Deposits	12,606,381	12,172,816	11,908,529	4	6
Shareholders equity	1,590,538	1,490,915	1,469,390	7	8
Book value per common share	32.73	31.39	29.66	4	10
Average Balances					
Assets	$14,836,422	$ 14,711,880	$ 14,826,515	1	0
Securities	2,971,386	3,171,429	3,970,440	(6)	(25)
Loans	10,554,944	10,244,914	9,625,016	3	10
Deposits	11,916,314	12,050,585	11,587,638	(1)	3
Shareholders equity	1,518,744	1,473,110	1,480,527	3	3
Selected Ratios					
Return on average assets (annualized)	1.55 %	1.58 %	1.57 %	(2)	(1)
Return on average shareholders equity (annualized)	15.10	15.77	15.68	(4)	(4)
Corporation s tier 1 leverage	8.59	8.81	8.85	(3)	(3)
Corporation s tier 1 risk-based capital	10.62	11.09	12.26	(5)	(13)
Corporation s total risk-based capital	13.12	13.60	15.41	(4)	(15)
Period-end shareholders equity to period-end assets	10.42	10.02	9.97	4	5
Dividend payout ratio, per share	39.11	33.55	35.65	17	10
Net interest margin	4.49	4.51	4.62	0	(3)
Efficiency ratio (1)	57.18	58.21	54.80	(2)	4
Asset Quality Ratios					
Nonaccrual loans to total loans	0.22 %	0.20 %	0.15 %	10	47
Nonaccrual loans and OREO to total loans and OREO	0.22	0.20	0.15	10	47
Allowance for loan and lease losses to total loans	1.51	1.50	1.64	1	(8)
Allowance for loan and lease losses to nonaccrual loans	687.55	743.88	1,075.11	(8)	(36)
Net recoveries/(charge-offs) to average loans (annualized)	0.05	(0.11)	0.11	(145)	(55)
At Quarter End					
Assets under management (2)	$ 27,290,505	$ 27,859,729	$ 19,246,286	(2)	42
Assets under management or administration (2)	48,648,658	48,684,237	40,435,813	0	20

(1) The efficiency ratio is defined as noninterest expense excluding OREO expense divided by total revenue (net interest income on a fully taxable-equivalent basis and noninterest income).

(2) Excludes $9.3 billion, $9.1 billion, and $9.4 billion of assets under management for an asset manager in which City National held minority ownership interests as of March 31, 2007, December 31, 2006, and March 31, 2006, respectively.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONAND RESULTS OF OPERATIONS

See Cautionary Statement for Purposes of the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995, below relating to forward-looking statements included in this report.

RESULTS OF OPERATIONS

Critical Accounting Policies

The Company s accounting policies are fundamental to understanding management s discussion and analysis of results of operations and financial condition. The Company has identified five policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These policies relate to the accounting for securities, allowance for loan and lease losses and reserve for off-balance sheet credit commitments, derivatives and hedging activities, stock-based compensation plans and income taxes. The Company, with the concurrence of the Audit & Risk Committee and the Compensation, Nominating and Governance Committee, has reviewed and approved these critical accounting policies, which are further described in Management s Discussion and Analysis and Note 1 (Summary of Significant Accounting Policies) of the Notes to The Consolidated Financial Statements in the Company s Form 10-K as of December 31, 2006.

Overview

City National Corporation is the parent company of City National Bank and Business Bank of Nevada. The Corporation offers a full complement of banking, trust and investment services through 61 offices, including 15 full-service regional centers, in Southern California, the San Francisco Bay Area, Nevada and New York City. As of March 31, 2007, the Corporation had a majority ownership interest in eight investment advisor subsidiaries and minority interests in one asset management firm. The Company also has an unconsolidated subsidiary, Business Bancorp Capital Trust I.

The Corporation recorded net income of $56.5 million, or $1.15 per share, for the first quarter of 2007 compared with $57.2 million or $1.12 per share, for the first quarter of 2006, and $58.6 million, or $1.19 per share, for the fourth quarter of 2006.

Recent Developments

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. BBNV operated as a wholly-owned subsidiary of City National Corporation until its merger into City National Bank after the close of business on April 30, 2007. This acquisition is expected to be neutral to earnings per share in 2007, and modestly accretive to earnings per share in 2008. The Company s first-quarter 2007 financial results reflect its February 28, 2007 acquisition of Business Bank of Nevada.

On May 1, 2007, the Company completed the acquisition of Lydian Wealth Management, an investment advisory firm headquartered in Rockville, Maryland, that manages or advises on clients assets of approximately $7.3 billion. Lydian Wealth Management changed its name to Convergent Wealth Advisors and became an affiliate of Convergent Capital Management, LLC which the Company acquired in 2003. As of May 1, 2007, the Company had a majority ownership interest in nine investment advisory subsidiaries and a minority interest in one other firm.

Highlights

- Revenue of $213.3 million represented a 3 percent increase from the first quarter of 2006.

- Average loans grew to $10.6 billion, up 10 percent from the first quarter of 2006. Lending rose in all major categories, and average loan balances reached $10.6 billion for the first time primarily due to organic growth but also to the acquisition of Business Bank of Nevada.

- Loan recoveries again exceeded charge-offs. Nonaccrual loans amounted to $23.4 million or 0.22 percent of total loans.

- Average deposits of $11.9 billion were up 3 percent from the first quarter of 2006, but down 1 percent from the fourth quarter of 2006 due to seasonal variations.

- Noninterest income totaled $66.0 million, up 20 percent from the first quarter of last year due to fee revenue generated by wealth management, international banking and cash management services as well as the May 31, 2006 acquisition of Independence Investments. At March 31, 2007, noninterest income accounted for 31 percent of City National s total revenue.

- Assets under direct management amounted to $27.3 billion, a 42 percent increase from the first quarter of 2006. Assets under management or administration grew 20 percent to $48.6 billion.

- Credit quality remained strong in the first quarter of 2007. The company required no provision for credit losses and remained adequately reserved at 1.51 percent of total loans.

- City National s first-quarter return on average equity was 15.10 percent and its return on average assets was 1.55 percent.

Outlook

As disclosed in the Company s press release on first-quarter earnings, management expects earnings per share to grow at a rate of between 3 percent and 5 percent in 2007.

Net Interest Income

Fully taxable-equivalent net interest income totaled $151.3 million in the first quarter of 2007, compared to $156.1 million for the same period last year and $154.6 million in the fourth quarter of 2006. Interest income increases, primarily attributable to increases in average commercial and residential mortgage loans, were offset by higher funding costs in the first quarter of 2007.

Dollars in millions	**For the three months ended March 31, 2007**	**2006**	**% Change**	**For the three months ended December 31, 2006**	**% Change**
Average Loans	*$ 10,554.9*	*$ 9,625.0*	*10*	*$ 10,244.9*	