

CITY NATIONAL CORP

Form 10-Q

May 04, 2009

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

COMMISSION FILE NUMBER: 1-10521

CITY NATIONAL CORPORATION

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(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware

(State of Incorporation)

95-2568550

(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 NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes NO

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act). (Check one):

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

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

As of April 30, 2009, there were 48,242,669 shares of Common Stock outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION
CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)	March 31, 2009 (Unaudited)	December 31, 2008	March 31, 2008 (Unaudited)
Assets			
Cash and due from banks	\$ 378,289	\$ 279,921	\$ 514,878
Due from banks - interest-bearing	140,484	144,344	77,567
Federal funds sold	12,300		1,000
Securities available-for-sale - cost \$2,969,554, \$2,239,184, and \$2,405,948 at March 31, 2009, December 31, 2008 and March 31, 2008, respectively			
Securities pledged as collateral	237,003	223,506	210,529
Held in portfolio	2,678,880	1,921,364	2,178,930
Trading securities	67,582	295,598	121,152
Loans and leases	12,305,114	12,444,259	11,754,865
Less allowance for loan and lease losses	241,586	224,046	168,278
Net loans and leases	12,063,528	12,220,213	11,586,587
Premises and equipment, net	128,189	131,294	119,243
Deferred tax asset	207,860	226,854	129,793
Goodwill	459,418	459,418	449,595
Customer-relationship intangibles, net	38,776	40,619	65,216
Bank-owned life insurance	75,043	74,575	72,875
Affordable housing investments	97,869	74,577	72,260
Customers' acceptance liability	2,112	1,714	2,752
Other real estate owned	12,639	11,388	3,812
Other assets	333,558	350,130	327,843
Total assets	\$ 16,933,530	\$ 16,455,515	\$ 15,934,032
Liabilities			
Demand deposits	\$ 6,611,752	\$ 6,140,619	\$ 5,680,845
Interest checking deposits	1,184,225	988,313	826,341
Money market deposits	4,025,741	3,699,900	3,709,142
Savings deposits	197,020	146,590	134,825
Time deposits-under \$100,000	233,605	234,669	215,401
Time deposits-\$100,000 and over	1,437,207	1,442,033	1,225,815
Total deposits	13,689,550	12,652,124	11,792,369
Federal funds purchased and securities sold under repurchase agreements	519,687	908,157	1,118,478
Other short-term borrowings	28,405	124,500	720,992
Subordinated debt	164,296	161,595	162,813
Long-term debt	242,122	246,554	243,439
Reserve for off-balance sheet credit commitments	21,545	22,703	24,863
Acceptances outstanding	2,112	1,714	2,752
Other liabilities	176,206	262,923	153,799
Total liabilities	14,843,923	14,380,270	14,219,505

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Redeemable noncontrolling interest	8,975	8,871	9,866
Commitments and contingencies			
Equity			
Preferred Stock; 5,000,000 shares authorized; 400,000 shares issued; aggregate liquidation preference of \$400,000 as of March 31, 2009 and December 31, 2008, respectively	390,590	390,089	
Common Stock, par value \$1.00 per share; 75,000,000 shares authorized; 50,961,457, 50,961,457, and 50,982,387 shares issued at March 31, 2009, December 31, 2008 and March 31, 2008, respectively	50,961	50,961	50,982
Additional paid-in capital	424,376	425,017	415,724
Accumulated other comprehensive loss	(23,093)	(48,022)	(3,431)
Retained earnings	1,369,451	1,379,624	1,390,781
Treasury shares, at cost - 2,427,659, 2,413,039 and 2,607,208 shares at March 31, 2009, December 31, 2008 and March 31, 2008, respectively	(157,094)	(156,736)	(175,048)
Total common shareholders equity	1,664,601	1,650,844	1,679,008
Total shareholders equity	2,055,191	2,040,933	1,679,008
Noncontrolling interest	25,441	25,441	25,653
Total equity	2,080,632	2,066,374	1,704,661
Total liabilities and equity	\$ 16,933,530	\$ 16,455,515	\$ 15,934,032

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(in thousands, except per share amounts)	For the three months ended March 31,	
	2009	2008
Interest Income		
Loans and leases	\$ 144,176	\$ 179,311
Securities available-for-sale	25,100	27,276
Trading securities	54	579
Due from banks - interest-bearing	155	523
Federal funds sold and securities purchased under resale agreements	6	63
Total interest income	169,491	207,752
Interest Expense		
Deposits	19,561	38,831
Federal funds purchased and securities sold under repurchase agreements	2,179	9,630
Subordinated debt	1,200	2,227
Other long-term debt	1,594	3,053
Other short-term borrowings	60	5,846
Total interest expense	24,594	59,587
Net interest income	144,897	148,165
Provision for credit losses	50,000	17,000
Net interest income after provision for credit losses	94,897	131,165
Noninterest Income		
Trust and investment fees	25,869	36,349
Brokerage and mutual fund fees	9,757	17,422
Cash management and deposit transaction charges	13,223	11,124
International services	6,525	7,687
Bank-owned life insurance	863	655
(Loss) gain on sale of securities	(2,931)	969
Impairment loss on securities	(12,036)	
Other	6,025	5,610
Total noninterest income	47,295	79,816
Noninterest Expense		
Salaries and employee benefits	78,252	90,179
Net occupancy of premises	12,261	11,512
Legal and professional fees	7,733	8,560
Information services	6,480	6,206
Depreciation and amortization	5,992	5,502
Marketing and advertising	4,676	5,595
Office services	3,015	2,986
Amortization of intangibles	1,843	2,431
Equipment	589	913
Other real estate owned	94	
Other operating	12,050	7,203
Total noninterest expense	132,985	141,087
Income before income taxes	9,207	69,894
Income taxes	1,632	22,601
Net income	\$ 7,575	\$ 47,293

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Less: Net income attributable to noncontrolling interest		115		3,306
Net income attributable to City National Corporation	\$	7,460	\$	43,987
Less: Dividends on preferred stock		5,501		
Net income available to common shareholders	\$	1,959	\$	43,987
Net income per common share, basic	\$	0.04	\$	0.91
Net income per common share, diluted	\$	0.04	\$	0.91
Shares used to compute net income per common share, basic		48,046		47,829
Shares used to compute net income per common share, diluted		48,130		48,185
Dividends per common share	\$	0.25	\$	0.48

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	For the three months ended March 31,	
	2009	2008
Cash Flows From Operating Activities		
Net income attributable to City National Corporation	\$ 7,460	\$ 43,987
Adjustments to net income:		
Provision for credit losses	50,000	17,000
Amortization of intangibles	1,843	2,431
Depreciation and amortization	5,992	5,502
Amortization of cost and discount on long-term debt	150	132
Share-based employee compensation expense	3,493	3,512
Loss (gain) on sales of securities	2,931	(969)
Impairment loss on securities	12,036	
Other, net	(1,263)	608
Net change in:		
Trading securities	231,969	172,203
Deferred income tax benefit	(219)	(4,686)
Other assets and other liabilities, net	(90,325)	(53,237)
Net cash provided by operating activities	224,067	186,483
Cash Flows From Investing Activities		
Purchase of securities available-for-sale	(1,181,219)	(106,898)
Sales of securities available-for-sale	278,139	84,509
Maturities and paydowns of securities	152,345	101,062
Loan originations, net of principal collections	104,910	(138,743)
Net payments for premises and equipment	(2,887)	(6,678)
Other investing activities, net	(1,303)	(3,503)
Net cash used in investing activities	(650,015)	(70,251)
Cash Flows From Financing Activities		
Net increase (decrease) in deposits	1,037,426	(30,136)
Net decrease in federal funds purchased and securities sold under repurchase agreements	(388,470)	(425,933)
Net (decrease) increase in short-term borrowings, net of transfers from long-term debt	(96,095)	620,992
Net decrease in other borrowings	(3,440)	(115,107)
Proceeds from exercise of stock options	88	5,792
Tax benefit from exercise of stock options	46	1,827
Stock repurchases		(11,086)
Cash dividends paid	(16,799)	(23,205)
Net cash provided by financing activities	532,756	23,144
Net increase in cash and cash equivalents	106,808	139,376
Cash and cash equivalents at beginning of year	424,265	454,069
Cash and cash equivalents at end of period	\$ 531,073	\$ 593,445
Supplemental Disclosures of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 30,233	\$ 76,121
Income taxes	2,615	37,139
Non-cash investing activities:		
Transfer of loans to other real estate owned	1,251	3,812

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Transfer from securities available for sale to trading securities	3,953
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See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
AND COMPREHENSIVE INCOME
(Unaudited)

(in thousands, except share amounts)	City National Corporation Shareholders' Equity								
	Shares issued	Preferred stock	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury stock	Non- controlling interest	Total equity
Balance, January 1, 2008	50,824,178	\$	\$ 50,824	\$ 416,063	\$ (9,349)	\$ 1,369,999	\$ (176,035)	\$ 25,583	\$ 1,677,085
Net income						43,987		612	44,599
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 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 gain included in net income					2,582				2,582
Total comprehensive income					5,918	43,987		612	50,517
Dividends and distributions to noncontrolling interest								(542)	(542)
Issuance of shares under share-based compensation plans				(6,281)			12,073		5,792
Restricted stock grants, net of cancellations	158,209		158	(158)					
Share-based employee compensation expense				3,488					3,488
Tax benefit from share-based compensation plans				1,827					1,827
Cash dividends paid						(23,205)			(23,205)
Repurchased shares, net							(11,086)		(11,086)
Change in redeemable noncontrolling interest				785					785
Balance, March 31, 2008	50,982,387	\$	\$ 50,982	\$ 415,724	\$ (3,431)	\$ 1,390,781	\$ (175,048)	\$ 25,653	\$ 1,704,661
Balance, January 1, 2009	50,961,457	\$	\$ 390,089	\$ 50,961	\$ 425,017	\$ (48,022)	\$ 1,379,624	\$ (156,736)	\$ 2,066,374
Net income						7,460		542	8,002
Other comprehensive income, net of tax:									
Amortization of prior service cost					40				40

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Net unrealized gain on securities available-for-sale, net of taxes of \$17.0 million and reclassification of \$1.7 million net loss included in net income					23,642						23,642						
Net unrealized gain on cash flow hedges, net of taxes of \$0.9 million and reclassification of \$1.7 million net gain included in net income					1,247						1,247						
Total comprehensive income					24,929	7,460		542			32,931						
Dividends and distributions to noncontrolling interest								(542)			(542)						
Issuance of shares under share-based compensation plans					(126)			(358)			(484)						
Preferred stock accretion	501					(501)											
Share-based employee compensation expense					3,475						3,475						
Tax benefit from share-based compensation plans					(1,185)						(1,185)						
Cash dividends:																	
Preferred								(5,000)			(5,000)						
Common								(12,132)			(12,132)						
Net change in deferred compensation plans					41						41						
Change in redeemable noncontrolling interest					(2,846)						(2,846)						
Balance, March 31, 2009	50,961,457	\$	390,590	\$	50,961	\$	424,376	\$	(23,093)	\$	1,369,451	\$	(157,094)	\$	25,441	\$	2,080,632

See accompanying Notes to the Unaudited Consolidated Financial Statements.

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CITY NATIONAL CORPORATION

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Organization

City National Corporation (the Corporation) is the holding company for City National Bank (the Bank). The Bank delivers banking, trust and investment services through 63 offices in Southern California, the San Francisco Bay area, Nevada and New York City. Additionally, the Corporation delivers investment and wealth advisory services through its wealth advisory affiliates. 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.

Consolidation

The consolidated 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 and equity ownership of others are reflected as Noncontrolling interests in the consolidated balance sheets. The related minority share of earnings is shown as Net income attributable to noncontrolling interest in the consolidated statements 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. Additionally, the Company has various interests in variable interest entities that are not required to be consolidated. See Note 11 for a more detailed discussion on variable interest entities.

Use of Estimates

The Company's 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 the Company's estimates and assumptions could cause actual financial results to differ from those 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 and restricted stock, income taxes, goodwill and intangible asset impairment, available-for-sale securities impairment and the 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. 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. The Company's estimates and assumptions are expected to change as changes in market conditions and the Company's portfolio occur in subsequent periods.

Basis of Presentation

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, 2008.

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Note 1. Summary of Significant Accounting Policies (continued)

The results for the 2009 interim period are not necessarily indicative of the results expected for the full year. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2008 Annual Report other than the adoption of new accounting pronouncements and other authoritative guidance that became effective for the Company on January 1, 2009. Refer to *Accounting Pronouncements* below for discussion of accounting pronouncements adopted in 2009.

Certain prior period amounts have been reclassified or restated to conform to the current period presentation.

Goodwill and Customer-Relationship Intangible Assets

The Company has not made any acquisitions since the change to the acquisition method of accounting. Prior acquisitions were accounted for under the purchase method. Under the purchase method, assets acquired and liabilities assumed are recorded at their estimated fair values at the date of acquisition. Management utilizes valuation techniques based on discounted cash flow analysis to determine these fair values. Any excess of the purchase price over amounts allocated to acquired assets, including identifiable intangible assets, and liabilities assumed is recorded as goodwill. Intangible assets include core deposit intangibles and client advisory contract intangibles (combined, customer-relationship intangibles) originating from acquisitions of financial services firms. Core deposit intangibles are amortized over a range of four to eight years and client advisory contract intangibles are amortized over various periods ranging from 12 to 20 years. The weighted-average amortization period for the contract intangibles is 18.6 years.

Goodwill and customer-relationship intangibles are evaluated for impairment at least annually or more frequently if events or circumstances, such as changes in economic or market conditions, indicate that potential impairment exists. Given the volatility in the current economic environment, goodwill and customer-relationship intangibles are evaluated quarterly. Goodwill is tested for impairment at the reporting unit level. A reporting unit is an operating segment or one level below an operating segment for which discrete financial information is available and regularly reviewed by management. Fair values of reporting units are determined using methods consistent with current market practices for valuing similar types of businesses. Valuations are generally based on market multiples of net income or revenue. Management utilizes market information including market comparables and recent merger and acquisition transactions to validate the reasonableness of its valuations. If the fair value of the reporting unit, including goodwill, is determined to be less than the carrying amount of the reporting unit, a further test is required to measure the amount of impairment. If an impairment loss exists, the carrying amount of the goodwill is adjusted to a new cost basis. Subsequent reversal of a previously recognized goodwill impairment loss is prohibited.

Impairment testing of customer-relationship intangibles is performed at the individual asset level. Impairment exists when the carrying amount of an intangible asset is not recoverable and exceeds its fair value. The carrying amount of an intangible asset is not recoverable when the carrying amount of the asset exceeds the sum of undiscounted cash flows (cash inflows less cash outflows) associated with the use and/or disposition of the asset. An impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value. The fair value of core deposit intangibles is determined using market-based core deposit premiums from recent deposit sale transactions. The fair value of client advisory contracts is based on discounted expected future cash flows. Management makes certain estimates and assumptions in determining the expected future cash flows from customer-relationship intangibles including account attrition, expected lives, discount rates, interest rates, servicing costs and other factors. Significant changes in these estimates and assumptions could adversely impact the valuation of these intangible assets. If an impairment loss exists, the carrying amount of the intangible asset is adjusted to a new cost basis. The new cost basis is amortized over the remaining useful life of the asset.

Earnings per Common Share

The Company calculates earnings per common share (EPS) using the two-class method in accordance with FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP 03-6-1), effective January 1, 2009 with retrospective application to all prior-period earnings per share data presented. Refer to *Accounting Pronouncements* below. The two-class method requires the Company to present EPS as if all of the earnings for the period are distributed to common shareholders and any participating securities, regardless of whether any actual dividends or distributions are made. Under FSP 03-6-1, all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities under EITF 03-6. The Company grants restricted shares under a share-based compensation plan that qualify as participating securities. Restricted shares issued under the Company's share-based compensation plan is entitled to dividends at the same rate as common stock.

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Note 1. Summary of Significant Accounting Policies (Continued)

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Basic earnings per common share are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Net income available to common shareholders represents net income reduced by preferred stock dividends. Common shares outstanding include common stock and vested restricted stock awards. Diluted earnings per common share reflects the assumed conversion of all potential dilutive securities. Adoption of FSP 03-6-1 resulted in a 1 cent per share reduction in basic earnings per share for the year-earlier quarter. Diluted earnings per share for the year-earlier quarter was not impacted by the adoption of FSP 03-6-1. Prior-period EPS data presented has been restated retrospectively for comparability.

Accounting Pronouncements

During the three months ended March 31, 2009, the following accounting pronouncements applicable to the Company were issued or became effective:

- The Company adopted Financial Accounting Standards Board (FASB) Statements No. 141(R) (SFAS 141(R)), *Business Combinations* and No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160) effective January 1, 2009. SFAS 141(R) requires the acquiring entity in a business combination to recognize 100 percent of the assets acquired and liabilities assumed in the transaction; establishes acquisition date fair value as the measurement objective for the assets acquired and liabilities assumed; requires recognition of contingent consideration arrangements at their acquisition date fair values; and expands required disclosures regarding the nature and financial effect of the business combination. SFAS 141(R) also requires that acquisition-related costs be expensed when incurred. The provisions of SFAS 141(R) will be applied prospectively for business combination transactions consummated after the date of adoption. SFAS 160 requires that noncontrolling interests in subsidiaries be initially measured at fair value and classified as a separate component of equity in the consolidated financial statements. Following adoption of SFAS 160, the Company reports noncontrolling interests in subsidiaries, with the exception of certain redeemable noncontrolling interests, as a separate component of equity in the consolidated balance sheets, and noncontrolling interests' share of subsidiary earnings is no longer recognized as an expense in the computation of consolidated net income. The presentation and disclosure requirements of SFAS 160 have been applied for the current period and retrospectively for prior periods presented. Redeemable noncontrolling interest continue to be reported in the mezzanine section of the consolidated balance sheets.
- FASB Staff Position (FSP) No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2) became effective for the Company for annual and interim reporting periods beginning January 1, 2009. FSP 157-2 amended 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). The Company's non-financial assets within the scope of SFAS 157, which include goodwill, customer-relationship intangible assets and private equity investments, are reported at fair value on a nonrecurring basis (generally as the result of an impairment assessment) during the period in which the fair value measurement is recorded. The Company currently has no non-financial liabilities required to be reported at fair value.
- FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161) became effective for the Company for annual and interim reporting periods beginning January 1, 2009. The Statement expands disclosure requirements for derivative instruments and hedging activities. The new disclosures address how derivative instruments are used, how derivatives and the related hedged items are accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. In addition, companies are required to disclose the fair values of derivative instruments and their gains and losses in a

tabular format. The disclosure requirements of SFAS 161 have been applied for the current period and retrospectively for prior periods presented.

- FSP No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3) amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). The intent of the FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141, *Business Combinations*, when the underlying arrangement includes renewal or extension terms. FSP 142-3 permits an entity to use its own assumptions, based on its historical experience, about the renewal or extension of an

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Note 1. Summary of Significant Accounting Policies (continued)

arrangement to determine the useful life of an intangible asset. These assumptions are to be adjusted for the entity-specific factors detailed in SFAS 142. FSP 142-3 became effective for the Company on January 1, 2009. Adoption of FSP 142-3 did not have a significant impact on the Company's consolidated financial statements.

- FSP Emerging Issues Task Force (EITF) 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP 03-6-1) became effective for the Company for annual and interim reporting periods beginning January 1, 2009. FSP 03-6-1 states that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends are considered participating securities under EITF 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share* (EITF 03-6). As such, the issuing entity is required to apply the two-class method of computing basic and diluted earnings per share. The Company grants restricted shares under a share-based compensation plan that qualify as participating securities. Adoption of FSP 03-6-1 resulted in a 1 cent per share reduction in basic earnings per share for the year-earlier quarter. Diluted earnings per share for the year-earlier quarter was not impacted by the adoption of FSP 03-6-1. Prior-period EPS and share data presented has been restated retrospectively for comparability.

- EITF No. 07-5, *Determining Whether an Instrument is Indexed to an Entity's Own Stock* (EITF 07-5) became effective for the Company for annual and interim reporting periods beginning January 1, 2009. EITF 07-5 replaces the guidance in EITF Issue 01-6, *The Meaning of Indexed to a Company's Own Stock*. Both Issues 01-6 and 07-5 require an entity to evaluate an instrument's contingency provisions and the factors that affect its ultimate settlement amount (i.e., the payoff to the holder) when determining whether the instrument is indexed to the entity's own stock. Adoption of EITF 07-5 did not have a material impact on the Company's consolidated financial statements.

- On November 13, 2008, the FASB reached a consensus on the issues addressed in EITF Issue 08-6, *Equity Method Accounting Considerations* (EITF 08-6). EITF 08-6 clarifies the accounting for certain transactions and impairment considerations involving equity method investments. The EITF applies to all investments accounted for under the equity method and became effective for the Company, on a prospective basis, for annual and interim reporting period beginning January 1, 2009. Adoption of EITF 08-6 did not have a significant impact on the Company's consolidated financial statements.

- On April 9, 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1). FSP 107-1 amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments in interim financial statements of publicly traded companies as well as in annual financial statements. The FSP also amends APB opinion No. 28, *Interim Financial Reporting*, to require those disclosures in summarized financial information at interim reporting periods. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted

for periods ending after March 15, 2009. In periods after initial adoption, the FSP requires comparative disclosures only for periods ending after initial adoption. Adoption of FSP FAS 107-1 is not expected to have a significant impact on the Company's consolidated financial statements.

- On April 9, 2009, the FASB issued FSP FAS 115-2 and FSP FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2). FSP 115-2 amends the other-than-temporary impairment guidance for debt securities. FSP 115-2 modifies the intent and ability indicator for recognizing other-than-temporary impairment, and changes the trigger used to assess the collectibility of cash flows from probable that the investor will be unable to collect all amounts due to the entity does not expect to recover the entire amortized cost basis of the security. FSP 115-2 changes the total amount recognized in earnings when there are credit losses associated with an impaired debt security and management asserts that it does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis. In those situations, impairment shall be separated into (a) the amount representing a credit loss and (b) the amount related to non-credit factors. The amount of impairment related to credit losses shall be recognized in earnings. The credit loss component of an other-than-temporary impairment, representing an increase in credit risk, shall be determined by the reporting entity using its best estimate of the present value of cash flows expected to be collected from the debt security. The amount of impairment related to non-credit factors shall be recognized in other comprehensive income. The previous cost basis less impairment recognized in earnings becomes the new cost basis of the security and shall not be adjusted for subsequent recoveries in fair value. However, the cost basis shall be adjusted for accretion of the difference between the new cost basis and the present value of cash flows expected to be collected (portion of impairment in other comprehensive income). The total other-than-temporary impairment is presented in the

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Note 1. Summary of Significant Accounting Policies (continued)

consolidated statements of income with a reduction for the amount of the other-than-temporary impairment that is recognized in other comprehensive income, if any.

FSP 115-2 requires that the cumulative effect of initial adoption be recorded as an adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. The amortized cost basis of a security for which an other-than-temporary impairment was previously recognized shall be adjusted by the amount of the cumulative effect adjustment before taxes. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted as interest income. FSP 115-2 is effective for reporting periods ending after June 15, 2009. The Company does not expect initial adoption of the FSP to have a significant impact on its financial statements.

- On April 9, 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability have Significantly Decreased and Identifying Transactions that are not Orderly* (FSP 157-4). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for an asset or liability have significantly decreased. FSP 157-4 identifies several factors that a reporting entity should evaluate to determine whether there has been a significant decrease in the volume and level of activity for an asset or liability. If the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity, transactions or quoted prices may not be determinative of fair value (for example, there may be increased instances of transactions that are not orderly), further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with SFAS 157. FSP 157-4 reiterates that even in circumstances where there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. FSP 157-4 is effective for reporting periods ending after June 15, 2009. Adoption of the FSP is not expected to have a significant impact on the consolidated financial statements.

Note 2. Fair Value Measurements

The Company adopted 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.

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.

Table of Contents**Note 2. Fair Value Measurements (continued)**

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.

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, other real estate owned (OREO), goodwill, customer-relationship intangibles and private equity investments are recorded at fair value on a nonrecurring basis. Nonrecurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed.

A distribution of asset and liability fair values according to the fair value hierarchy at March 31, 2009 is provided in the table below:

(in thousands) Asset or Liability Measured at Fair Value	Balance as of March 31, 2009	Fair Value Measurements at Reporting Date Using			
		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	\$ 2,898,851	\$ 36,307	\$ 2,836,268	\$ 26,276	
Other equity securities and mutual funds	17,032	17,032			
Trading securities	67,582	50,802	16,780		
Mark-to-market derivatives (1)	69,762	2,447	67,315		
Total assets at fair value	\$ 3,053,227	\$ 106,588	\$ 2,920,363	\$ 26,276	
Liabilities					
Mark-to-market derivatives (2)	\$ 17,258	\$ 18	\$ 17,240	\$	
Total liabilities at fair value	\$ 17,258	\$ 18	\$ 17,240	\$	
Measured on a Nonrecurring Basis Assets					
Collateral dependent impaired loans (3)	\$ 142,648	\$	\$ 142,648	\$	
Other real estate owned (4)	14,103		14,103		
Total assets at fair value	\$ 156,751	\$	\$ 156,751	\$	

(1) Reported in Other assets in the consolidated balance sheets.

(2) Reported in Other liabilities in the consolidated balance sheets.

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

(4) OREO balance of \$12,639 in the consolidated balance sheets is net of estimated disposal costs.

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Level 3 assets include CDO senior notes and CDO income notes for which the market is inactive. The fair value of these securities is determined using an internal cash flow model that incorporates management's assumptions about risk-adjusted discount rates, prepayment expectations, projected cash flows and collateral performance. These assumptions are not directly observable in the market. Level 3 assets are measured at fair value on a recurring basis. Unrealized gains and losses on Level 3 assets are reported as a component of Other comprehensive income in the consolidated balance sheets.

Table of Contents**Note 2. Fair Value Measurements (continued)**

Activity in Level 3 assets for the three-months ended March 31, 2009 is summarized in the following table:

Level 3 Assets Measured on a Recurring Basis

(in thousands)		Securities Available-for-Sale
Balance of recurring Level 3 assets at January 1, 2009	\$	32,419
Total realized/unrealized gains (losses):		
Included in earnings		(9,282)
Included in other comprehensive income		3,544
Purchases, sales, issuances and settlements, net		(405)
Transfers in and/or out of Level 3		
Balance of recurring Level 3 assets at March 31, 2009	\$	26,276

There were no purchases or sales of Level 3 assets during the period. The \$9.3 million loss included in earnings is an impairment loss recognized on CDO income notes. Refer to Note 3, *Investment Securities*, for further discussion of the impairment.

Note 3. 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, to the extent they are considered temporary, 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 most of the Company's investments, fair values are determined based upon externally verifiable quoted prices or other observable inputs. Realized gains or losses on sales of securities available-for-sale are recorded using the specific identification method.

During the first quarter of 2009, the Corporation liquidated the majority of its investments in individual equity securities and one mutual fund. The majority of equity securities, totaling \$4.0 million, were transferred from available-for-sale to trading securities at March 31, 2009. These securities were transferred to trading at fair value. The gross gains and gross losses included in earnings from the transfer of these securities to trading was \$14 thousand and \$0.6 million, respectively. Trading securities are carried at fair value and unrealized holding gains or losses on trading securities are included in earnings in the consolidated statements of income.

Impairment Assessment

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Impairment exists when the fair value of a security is less than its cost. Cost includes adjustments made to the cost basis of a security for accretion, amortization and previous other-than-temporary impairments recognized in earnings. The Company performs a quarterly assessment of the debt and equity securities in its investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their cost is other-than-temporary. Impairment is considered other-than-temporary when it becomes probable that an investor will be unable to recover the cost of an investment. The Company's impairment assessment takes into consideration factors such as the length of time and the extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer including events specific to the issuer or industry; defaults or deferrals of scheduled interest, principal or dividend payments; external credit ratings and recent downgrades; and the Company's intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value. If a decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The amount of the write down is included in Impairment loss on securities in the consolidated statements of income. The new cost basis is not adjusted for subsequent recoveries in fair value.

Table of Contents**Note 3. Investment Securities (continued)**Securities Deemed to be Other-Than-Temporarily Impaired

Through the impairment assessment process, the Company determined that the investments discussed below were other-than-temporarily impaired at March 31, 2009. The Company recorded an impairment loss on available-for-sale securities of \$12.0 million for the three-months ended March 31, 2009. No impairment was recorded in the three-months ended March 31, 2008.

(in thousands) Impairment Losses on Other-Than-Temporarily Impaired Securities	For the three-months ended March 31,		
		2009	2008
Collateralized debt obligation income notes	\$	9,282	\$
Perpetual preferred stock		1,124	
Mutual funds		1,630	
Total	\$	12,036	\$

Collateralized Debt Obligation Income Notes

The adjusted cost basis of collateralized debt obligation income notes (Income Notes) is \$2.4 million at March 31, 2009. Income Notes are equity interests in a multi-class, cash flow collateralized bond obligation backed by a collection of Trust Preferred securities issued by financial institutions. The equity interests represent ownership of all residual cash flow from the asset pools after all fees have been paid and debt issues have been serviced. Income Notes are collateralized by debt securities with stated maturities and are therefore reported as debt securities in the consolidated balance sheets. Income Notes are classified as Level 3 in the fair value hierarchy. Refer to Note 2, *Fair Value Measurements*, for further discussion of fair value.

Income Notes are evaluated for impairment under EITF 99-20, *Recognition of Interest Income and Impairment of Purchased Beneficial Interests and Beneficial Interests that Continue to be Held by a Transferor in Securitized Financial Assets*, and related interpretations (EITF 99-20). EITF 99-20 provides incremental impairment guidance for certain debt securities within the scope of FAS 115 which are beneficial interests in securitized financial assets not considered to be high credit quality. Under 99-20, other-than-temporary impairment exists when it is probable there has been an adverse change in estimated cash flows for a debt security since the date of acquisition. The market for Income Notes continues to be inactive with no visible trade activity in the past 12 months. The fair value of these securities was determined using an internal cash flow model that incorporates management's assumptions about risk-adjusted discount rates, prepayment expectations, projected cash flows and collateral performance. The Company considered a number of factors in determining the discount rate used in the cash flow valuation model including the implied rate of return at the last date the market for Income Notes and similar securities was active, rates of return that market participants would consider in valuing the securities and indicative quotes from dealers. The Company determined that 25 percent was the appropriate rate to apply in discounting the projected cash flows of its Income Notes. At March 31, 2009, the estimated fair value of the Income Notes was \$2.4 million compared to their cost basis of \$11.7 million, representing an adverse change in cash flows. The Company recognized a \$9.3 million impairment loss in earnings and wrote down the cost basis of its investment in Income Notes to fair value at March 31, 2009.

Perpetual Preferred Stock

The adjusted cost basis of the Company's investment in perpetual preferred stock issued by Freddie Mac and Fannie Mae is \$0.6 million at March 31, 2009. The Company recorded a \$1.1 million impairment loss to adjust the cost basis of its investment to fair value at March 31, 2009. The Company previously recorded other-than-temporary impairment of \$21.9 million on these securities in September 2008 following the action taken by the Federal Housing Finance Agency placing these Government-Sponsored Agencies into conservatorship and eliminating the dividends on their preferred shares.

Table of Contents**Note 3. Investment Securities (continued)**Mutual Funds

The adjusted cost basis of available-for-sale mutual funds was \$16.4 million at March 31, 2009. The Company determined its investment in one high yield bond fund to be other-than-temporarily impaired based on the magnitude and duration of the decline in its fair value below cost and the likelihood of recovery. The Company recognized a \$1.6 million impairment loss in earnings and wrote down the cost basis of its investment in this fund to fair value at March 31, 2009.

The following table provides a summary of the gross unrealized losses and fair value of investment securities that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position as of March 31, 2009:

(in thousands)	Less than 12 months		12 months or greater		Total	
	Fair Value	Estimated Unrealized Loss	Fair Value	Estimated Unrealized Loss	Fair Value	Estimated Unrealized Loss
Federal agency - Debt	\$ 159,129	\$ 463	\$	\$	\$ 159,129	\$ 463
Federal agency - MBS						
CMOs - Federal agency	80,225	610	6,596	38	86,821	648
CMOs - Non-agency	36,436	6,771	261,617	72,312	298,053	79,083
State and municipal	60,740	1,287	6,702	713	67,442	2,000
Other debt securities	28,432	4,276	31,485	10,249	59,917	14,525
Total debt securities	364,962	13,407	306,400	83,312	671,362	96,719
Equity securities and mutual funds	9,942	42			9,942	42
Total securities	\$ 374,904	\$ 13,449	\$ 306,400	\$ 83,312	\$ 681,304	\$ 96,761

At March 31, 2009, total securities available-for-sale had a fair value of \$2.92 billion, which included the temporarily impaired securities above of \$681.3 million. At March 31, 2009, the Company had 148 debt securities and 1 mutual fund in an unrealized loss position. The debt securities in an unrealized loss position include 6 Federal agency securities, 9 Federal agency CMOs, 33 private label CMOs, 89 state and municipal securities and 11 other debt securities. The largest component of the unrealized loss at March 31, 2009 was \$79.1 million and related to private label collateralized mortgage obligations. The Company monitors the performance of the mortgages underlying these bonds. Although there has been some deterioration in collateral performance, the Company only holds the most senior tranches of each issue which provides protection against defaults. The Company attributes the unrealized loss on CMOs held largely to the current absence of liquidity in the credit markets and not to deterioration in credit quality. These securities remain highly rated by the rating agencies. The Company expects to receive all contractual principal and interest payments due on its debt securities and has the ability and intent to hold these investments until their fair value recovers or until maturity. The mortgages in these asset pools are relatively large and have been made to borrowers with strong credit history and significant equity invested in their homes. They are well diversified geographically. Nonetheless, significant further weakening of economic fundamentals coupled with significant increases in unemployment and substantial deterioration in the value of high-end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline and trigger the recognition of an other-than-temporary impairment charge.

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Other debt securities includes the Company's investments in highly rated corporate debt and collateralized bond obligations backed by Trust Preferred Securities (CDOs) issued by a geographically diverse pool of small- and medium-sized financial institutions. Liquidity pressures in 2008 caused a general decline in the value of corporate debt. Of the CDOs held at March 31, 2009, approximately 91 percent are the most senior tranches of each issue. CDO Income Notes that receive the residual cash flows from the asset pools comprise the remaining 9 percent of holdings. Refer to *Collateralized Debt Obligation Income Notes* above. The market for CDOs was inactive in 2008 and 2009. The fair values of these securities were determined using an internal pricing model that incorporates assumptions about discount rates in an illiquid market, projected cash flows and collateral performance. The Company attributes the \$14.5 million unrealized loss on CDO Senior Notes at March 31, 2009 to the illiquid credit markets. The senior notes have collateral that exceeds the outstanding debt by over 35 percent. Security valuations reflect the current and prospective performance of the issuers whose debt is contained in these asset pools. The

Table of Contents**Note 3. Investment Securities (continued)**

Company expects to receive all contractual principal and interest payments due on its CDO Senior Notes and has the ability and intent to hold these investments until their fair value recovers or until maturity.

The Company does not consider the debt and equity securities in the above table to be other than temporarily impaired at March 31, 2009.

The following table provides a summary of the gross unrealized losses and fair value of investment securities that are not deemed to be other-than-temporarily impaired aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position as of December 31, 2008:

(in thousands)	Less than 12 months		12 months or greater		Total	
	Fair Value	Estimated Unrealized Loss	Fair Value	Estimated Unrealized Loss	Fair Value	Estimated Unrealized Loss
Federal agency - MBS	\$ 63,634	\$ 719	\$ 12,925	\$ 167	\$ 76,559	\$ 886
CMOs - Federal agency	29,133	111	41,041	796	70,174	907
CMOs - Non-agency	172,899	50,631	132,818	36,803		