

CITY NATIONAL CORP  
Form 10-Q  
August 08, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

**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 June 30, 2006**

**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**  
(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**

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(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 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

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of August 1, 2006, there were 48,089,646 shares of Common Stock outstanding.

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## PART 1 - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**CITY NATIONAL CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

| Dollars in thousands, except per share amounts  | June 30,<br>2006<br>(Unaudited) | December 31,<br>2005 | June 30,<br>2005<br>(Unaudited) |
|---|---------------------------------|----------------------|---------------------------------|
| <b>Assets</b>   |                                 |                      |                                 |
| Cash and due from banks   | \$ 467,076                      | \$ 365,217           | \$ 406,709                      |
| Due from banks - interest-bearing   | 50,416                          | 40,803               | 34,676                          |
| Federal funds sold  | 1,900                           | 157,000              | 400,000                         |
| Securities available-for-sale - cost \$3,348,607; \$4,076,984 and \$4,075,374 at June 30, 2006, December 31, 2005 and June 30, 2005, respectively | 3,211,590                       | 3,999,261            | 4,057,267                       |
| Trading account securities  | 123,418                         | 59,344               | 22,337                          |
| Loans   | 9,821,755                       | 9,265,602            | 8,869,675                       |
| Less allowance for loan and lease losses  | 157,580                         | 153,983              | 147,930                         |
| Net loans   | 9,664,175                       | 9,111,619            | 8,721,745                       |
| Premises and equipment, net   | 84,802                          | 82,868               | 73,169                          |
| Deferred tax asset  | 150,625                         | 125,175              | 110,443                         |
| Goodwill  | 253,286                         | 247,708              | 251,494                         |
| Intangibles   | 44,718                          | 36,416               | 38,181                          |
| Bank-owned life insurance   | 68,772                          | 67,774               | 66,509                          |
| Affordable housing investments  | 66,468                          | 67,508               | 67,235                          |
| Customers acceptance liability  | 4,582                           | 3,232                | 2,870                           |
| Other assets  | 285,239                         | 217,935              | 222,963                         |
| Total assets  | \$ 14,477,067                   | \$ 14,581,860        | \$ 14,475,598                   |
| <b>Liabilities</b>  |                                 |                      |                                 |
| Demand deposits   | \$ 5,880,630                    | \$ 6,562,038         | \$ 6,468,339                    |
| Interest checking deposits  | 711,368                         | 867,509              | 791,183                         |
| Money market deposits   | 3,214,296                       | 3,296,260            | 3,508,793                       |
| Savings deposits  | 168,526                         | 177,874              | 191,959                         |
| Time deposits-under \$100,000   | 177,392                         | 177,230              | 180,819                         |
| Time deposits-\$100,000 and over  | 1,826,618                       | 1,057,561            | 1,011,115                       |
| Total deposits  | 11,978,830                      | 12,138,472           | 12,152,208                      |
| Federal funds purchased and securities sold under repurchase agreements   | 234,995                         | 190,190              | 204,052                         |
| Other short-term borrowings   | 143,724                         | 100,000              | 27,678                          |
| Subordinated debt   | 266,675                         | 275,682              | 285,771                         |
| Long-term debt  | 209,864                         | 219,445              | 233,290                         |
| Reserve for off-balance sheet credit commitments  | 15,206                          | 15,596               | 13,811                          |
| Other liabilities   | 187,141                         | 156,884              | 129,630                         |
| Acceptances outstanding   | 4,582                           | 3,232                | 2,870                           |
| Total liabilities   | 13,041,017                      | 13,099,501           | 13,049,310                      |
| Minority interest in consolidated subsidiaries  | 27,985                          | 24,351               | 25,400                          |
| <b>Commitments and contingencies</b>  |                                 |                      |                                 |
| <b>Shareholders Equity</b>  |                                 |                      |                                 |
| Preferred Stock authorized - 5,000,000; none outstanding  |                                 |                      |                                 |
| Common Stock-par value-\$1.00; authorized - 75,000,000;   | 50,735                          | 50,601               | 50,640                          |
| Issued - 50,734,861; 50,600,943 and 50,639,861 shares at June 30, 2006,   |                                 |                      |                                 |

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|   |               |               |               |
|---|---------------|---------------|---------------|
| December 31, 2005 and June 30, 2005, respectively   |               |               |               |
| Additional paid-in capital  | 402,476       | 396,659       | 398,981       |
| Accumulated other comprehensive loss  | (86,931)      | (51,551)      | (12,948)      |
| Retained earnings   | 1,196,812     | 1,121,474     | 1,035,589     |
| Treasury shares, at cost - 2,214,875; 887,304; and 1,117,367 shares at June 30, 2006, December 31, 2005 and June 30, 2005, respectively |               |               |               |
|   | (155,027)     | (59,175)      | (71,374)      |
| Total shareholders' equity  | 1,408,065     | 1,458,008     | 1,400,888     |
| Total liabilities and shareholders' equity  | \$ 14,477,067 | \$ 14,581,860 | \$ 14,475,598 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

| In thousands, except per share amounts                                  | For the three months ended<br>June 30, |                  | For the six months ended<br>June 30, |                   |
|---|--|------------------|--------------------------------------|-------------------|
|   | 2006                                   | 2005             | 2006                                 | 2005              |
| <b>Interest Income</b>  |  |                  |                                      |                   |
| Loans   | \$ 166,377                             | \$ 132,621       | \$ 321,809                           | \$ 257,878        |
| Securities available-for-sale   | 38,121                                 | 40,691           | 79,973                               | 82,441            |
| Trading account   | 833                                    | 292              | 1,389                                | 509               |
| Federal funds sold and securities purchased under resale agreements     | 604                                    | 547              | 744                                  | 758               |
| Due from banks - interest-bearing                                       | 269                                    | 114              | 481                                  | 329               |
| <b>Total interest income</b>  | <b>206,204</b>                         | <b>174,265</b>   | <b>404,396</b>                       | <b>341,915</b>    |
| <b>Interest Expense</b>   |  |                  |                                      |                   |
| Deposits  | 36,527                                 | 17,382           | 63,980                               | 32,625            |
| Federal funds purchased and securities sold under repurchase agreements | 6,716                                  | 2,265            | 15,649                               | 3,721             |
| Subordinated debt   | 3,706                                  | 2,444            | 7,197                                | 4,652             |
| Other long-term debt  | 3,196                                  | 2,427            | 6,528                                | 4,740             |
| Other short-term borrowings   | 2,061                                  | 101              | 4,638                                | 105               |
| <b>Total interest expense</b>   | <b>52,206</b>                          | <b>24,619</b>    | <b>97,992</b>                        | <b>45,843</b>     |
| <b>Net interest income</b>  | <b>153,998</b>                         | <b>149,646</b>   | <b>306,404</b>                       | <b>296,072</b>    |
| Provision for credit losses   | (610)                                  |                  | (610)                                |                   |
| <b>Net interest income after provision for credit losses</b>            | <b>154,608</b>                         | <b>149,646</b>   | <b>307,014</b>                       | <b>296,072</b>    |
| <b>Noninterest Income</b>   |  |                  |                                      |                   |
| Trust and investment fees   | 24,909                                 | 20,119           | 46,683                               | 39,963            |
| Brokerage and mutual fund fees  | 12,269                                 | 9,931            | 23,953                               | 19,807            |
| Cash management and deposit transaction charges                         | 7,691                                  | 8,874            | 15,755                               | 17,884            |
| International services  | 6,870                                  | 5,908            | 12,859                               | 10,796            |
| Bank-owned life insurance   | 677                                    | 652              | 1,611                                | 1,516             |
| Gain on sale of loans and other assets                                  |  | 162              |                                      | 185               |
| (Loss) gain on sale of securities                                       | (716)                                  | 844              | (8)                                  | 1,099             |
| Other   | 6,888                                  | 4,869            | 12,665                               | 10,467            |
| <b>Total noninterest income</b>   | <b>58,588</b>                          | <b>51,359</b>    | <b>113,518</b>                       | <b>101,717</b>    |
| <b>Noninterest Expense</b>  |  |                  |                                      |                   |
| Salaries and employee benefits  | 73,718                                 | 63,839           | 145,334                              | 130,471           |
| Net occupancy of premises   | 9,460                                  | 8,727            | 18,472                               | 16,343            |
| Depreciation  | 4,662                                  | 4,535            | 9,322                                | 9,105             |
| Legal and professional fees   | 9,169                                  | 10,791           | 18,586                               | 19,505            |
| Information services  | 4,571                                  | 4,015            | 9,027                                | 8,226             |
| Marketing and advertising   | 4,990                                  | 3,943            | 9,006                                | 7,517             |
| Office services   | 2,549                                  | 2,688            | 5,240                                | 5,177             |
| Amortization of intangibles   | 1,974                                  | 1,441            | 3,865                                | 2,882             |
| Equipment   | 623                                    | 646              | 1,255                                | 1,195             |
| Other operating   | 6,243                                  | 6,796            | 11,947                               | 13,504            |
| <b>Total noninterest expense</b>  | <b>117,959</b>                         | <b>107,421</b>   | <b>232,054</b>                       | <b>213,925</b>    |
| <b>Minority interest expense</b>  | <b>1,213</b>                           | <b>1,532</b>     | <b>2,441</b>                         | <b>3,343</b>      |
| <b>Income before income taxes</b>                                       | <b>94,024</b>                          | <b>92,052</b>    | <b>186,037</b>                       | <b>180,521</b>    |
| Income taxes  | 35,283                                 | 34,345           | 70,063                               | 67,353            |
| <b>Net income</b>   | <b>\$ 58,741</b>                       | <b>\$ 57,707</b> | <b>\$ 115,974</b>                    | <b>\$ 113,168</b> |
| Net income per share, basic   | \$ 1.20                                | \$ 1.18          | \$ 2.36                              | \$ 2.30           |

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|  |    |        |    |        |    |        |    |        |
|--|----|--------|----|--------|----|--------|----|--------|
| Net income per share, diluted                    | \$ | 1.16   | \$ | 1.13   | \$ | 2.28   | \$ | 2.22   |
| Shares used to compute income per share, basic   |    | 48,957 |    | 49,090 |    | 49,220 |    | 49,101 |
| Shares used to compute income per share, diluted |    | 50,654 |    | 51,043 |    | 50,977 |    | 51,037 |
| Dividends per share                              | \$ | 0.41   | \$ | 0.36   | \$ | 0.82   | \$ | 0.72   |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

| Dollars in thousands   | For the six months ended<br>June 30, |                   |
|--|--------------------------------------|-------------------|
|  | 2006                                 | 2005              |
| <b>Cash Flows From Operating Activities</b>  |                                      |                   |
| Net income   | \$ 115,974                           | \$ 113,168        |
| Adjustments to net income  |                                      |                   |
| Provision for credit losses  | (610)                                |                   |
| Amortization of restricted stock grants  | 2,558                                | 1,969             |
| Amortization/writedown of intangibles  | 3,865                                | 2,882             |
| Depreciation and software amortization   | 9,322                                | 9,105             |
| Amortization of cost and discount on long-term debt  | 353                                  | 353               |
| Stock-based employee compensation expense  | 3,468                                |                   |
| Deferred income tax benefit  | (25,450)                             | (8,247)           |
| Loss (gain) on sales of securities   | 8                                    | (1,099)           |
| Net change in other assets and other liabilities   | (49,298)                             | (8,364)           |
| Other, net   | 75,504                               | 5,993             |
| <b>Net cash provided by operating activities</b>   | <b>135,694</b>                       | <b>115,760</b>    |
| <b>Cash Flows From Investing Activities</b>  |                                      |                   |
| Purchase of securities available-for-sale  | (79,156)                             | (406,157)         |
| Sales of securities available-for-sale   | 401,099                              | 74,321            |
| Maturities and paydowns of securities  | 294,464                              | 423,416           |
| Loan originations, net of principal collections  | (556,153)                            | (392,079)         |
| Purchase of premises and equipment   | (11,256)                             | (13,650)          |
| Other investing activities   | (20,497)                             | (5,104)           |
| <b>Net cash provided (used) by investing activities</b>  | <b>28,501</b>                        | <b>(319,253)</b>  |
| <b>Cash Flows From Financing Activities</b>  |                                      |                   |
| Net (decrease) increase in deposits  | (159,642)                            | 165,293           |
| Net increase (decrease) in federal funds purchased and securities sold under repurchase agreements | 44,805                               | (602)             |
| Net increase in short-term borrowings, net of transfers from long-term debt                        | 43,724                               | 27,553            |
| Net decrease in notes  | (147)                                | (32)              |
| Proceeds from exercise of stock options  | 8,812                                | 14,150            |
| Tax benefit from exercise of stock options   | 3,263                                | 4,683             |
| Stock repurchases  | (108,002)                            | (34,455)          |
| Cash dividends paid  | (40,636)                             | (35,566)          |
| <b>Net cash provided (used) by financing activities</b>  | <b>(207,823)</b>                     | <b>141,024</b>    |
| Net decrease in cash and cash equivalents  | (43,628)                             | (62,469)          |
| Cash and cash equivalents at beginning of year   | 563,020                              | 903,854           |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 519,392</b>                    | <b>\$ 841,385</b> |

**Supplemental Disclosures of Cash Flow Information:**

Cash paid during the period for:

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|              |    |        |    |        |
|--------------|----|--------|----|--------|
| Interest     | \$ | 89,106 | \$ | 44,734 |
| Income taxes |    | 63,143 |    | 48,439 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.



**CITY NATIONAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**AND COMPREHENSIVE INCOME**

(Unaudited)

| Dollars in thousands   | Shares<br>issued | Common<br>stock | Additional<br>paid-in<br>capital | Accumulated<br>other<br>comprehensive<br>income | Retained<br>Earnings | Treasury<br>stock | Total<br>shareholders<br>equity |
|--|------------------|-----------------|----------------------------------|---|----------------------|-------------------|---------------------------------|
| Balance, December 31, 2004   | 50,589,408       | \$ 50,589       | \$ 397,954                       | \$ (1,352)                                      | \$ 957,987           | \$ (56,643)       | \$ 1,348,535                    |
| Net income   |                  |                 |                                  |   | 113,168              |                   | 113,168                         |
| Other comprehensive loss net of tax  |                  |                 |                                  |   |                      |                   |                                 |
| Net unrealized loss on securities<br>available-for-sale, net of reclassification<br>adjustment of \$4.0 million for net loss<br>included in net income |                  |                 |                                  | (10,306)  |                      |                   | (10,306)                        |
| Net unrealized loss on cash flow hedges,<br>net of reclassification of \$0.9 million of net<br>gains included in net income                            |                  |                 |                                  | (1,290)   |                      |                   | (1,290)                         |
| Total other comprehensive loss   |                  |                 |                                  | (11,596)  |                      |                   | (11,596)                        |
| Issuance of shares for stock options   |                  |                 | (3,868)                          |   |                      | 17,733            | 13,865                          |
| Restricted stock grant/vesting   | 50,453           | 51              | (1,757)                          |   |                      | 1,991             | 285                             |
| Stock-based employee compensation<br>expense   |                  |                 | 1,969                            |   |                      |                   | 1,969                           |
| Tax benefit from stock options   |                  |                 | 4,683                            |   |                      |                   | 4,683                           |
| Cash dividends   |                  |                 |                                  |   | (35,566)             |                   | (35,566)                        |
| Repurchased shares, net  |                  |                 |                                  |   |                      | (34,455)          | (34,455)                        |
| Balance, June 30, 2005   | 50,639,861       | \$ 50,640       | \$ 398,981                       | \$ (12,948)                                     | \$ 1,035,589         | \$ (71,374)       | \$ 1,400,888                    |
| Balance, December 31, 2005   | 50,600,943       | \$ 50,601       | \$ 396,659                       | \$ (51,551)                                     | \$ 1,121,474         | \$ (59,175)       | \$ 1,458,008                    |
| Net income   |                  |                 |                                  |   | 115,974              |                   | 115,974                         |
| Other comprehensive loss net of tax  |                  |                 |                                  |   |                      |                   |                                 |
| Net unrealized loss on securities<br>available-for-sale, net of reclassification<br>adjustment of \$2.9 million for net loss<br>included in net income |                  |                 |                                  | (34,363)  |                      |                   | (34,363)                        |
| Net unrealized loss on cash flow hedges,<br>net of reclassification of \$2.8 million of net<br>loss included in net income                             |                  |                 |                                  | (771)   |                      |                   | (771)                           |
| Other net unrealized loss  |                  |                 |                                  | (246)   |                      |                   | (246)                           |
| Total other comprehensive loss   |                  |                 |                                  | (35,380)  |                      |                   | (35,380)                        |
| Issuance of shares for stock options   | 68,246           | 68              | (3,406)                          |   |                      | 12,150            | 8,812                           |
| Restricted stock grant/vesting   | 65,672           | 66              | (66)                             |   |                      |                   |                                 |
| Tax benefit from stock options   |                  |                 | 3,263                            |   |                      |                   | 3,263                           |
| Stock-based employee compensation<br>expense   |                  |                 | 6,026                            |   |                      |                   | 6,026                           |
| Cash dividends   |                  |                 |                                  |   | (40,636)             |                   | (40,636)                        |
| Repurchased shares, net  |                  |                 |                                  |   |                      | (108,002)         | (108,002)                       |
| Balance, June 30, 2006   | 50,734,861       | \$ 50,735       | \$ 402,476                       | \$ (86,931)                                     | \$ 1,196,812         | \$ (155,027)      | \$ 1,408,065                    |

See accompanying Notes to Unaudited Consolidated Financial Statements.



**CITY NATIONAL CORPORATION**

**NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

1. City National Corporation (the Corporation) is the holding company for City National Bank (the Bank). City National Bank delivers banking, trust and investment services through 55 offices in Southern California, the San Francisco Bay area and New York City. The Corporation has a majority ownership interest in nine asset management affiliates and minority interests in two others. Because the Bank comprises substantially all of the business of the Corporation, references to the Company mean the Corporation and the Bank together. The Corporation is also approved as a financial holding company pursuant to the Gramm-Leach-Bliley Act of 1999.

2. Our accounting and reporting policies conform with 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. 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, 2005. The results for the 2006 interim periods are not necessarily indicative of the results expected for the full year.

During the six months ended June 30, 2006, the following accounting pronouncements were issued:

FASB Staff Position ( FSP ) 115-1 became effective on January 1, 2006. The Company has evaluated the applicability of FSP 115-1, and determined that there was no impact on its financial statements as of June 30, 2006.

The FASB issued Interpretation No 48, Accounting for Uncertainty in Income Taxes (FIN 48), on July 13, 2006. FIN 48 provides a single model for addressing uncertainty in tax positions and requires expanded annual disclosures about tax positions. It becomes effective for the Company as of January 1, 2007. The Company will evaluate its tax positions to determine if any changes in the measurement or recognition of tax benefits are needed.

3. All securities other than trading securities and stock in the Federal Reserve Bank and Federal Home Loan Bank are classified as available-for-sale and are stated 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 the declines are considered other than temporary and a new cost basis is established for the securities. The estimated

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. Investment fee revenue consists of fees, commissions, and markups on securities transactions with clients and money market mutual fund fees.

4. Certain prior periods data have been reclassified to conform to current period presentation.

5. 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 June 30, 2006:

| <b>Period</b>       | <b>Total Number of Shares (or Units) Purchased</b> | <b>Average Price Paid per Share (or Unit)</b> | <b>Total number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs</b> | <b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</b> |
|---------------------|--|---|--|---|
| 04/01/06 - 04/30/06 | 150,000  | \$ 70.53                                      | 150,000  | 1,687,800   |
| 05/01/06 - 05/31/06 | 880,600  | 73.18   | 880,600  | 807,200   |
| 06/01/06 - 06/30/06 | 461,000  | 64.82   | 461,000  | 346,200   |
|                     | 1,491,600(1)                                       | \$ 70.33                                      | 1,491,600  | 346,200(2)  |

(1) During the second quarter of 2006, we repurchased an aggregate of 337,800 shares of our common stock pursuant to a repurchase program that we publicly announced on May 24, 2004 (the Program ) and there are no shares remaining to be purchased. We received no shares in payment for the exercise price of stock options.

(2) On April 26, 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. During the second quarter of 2006, we repurchased an aggregate of 1,153,800 shares of our common stock pursuant to this repurchase program. 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.

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 June 30, 2006, there were 511,497 antidilutive options compared to no antidilutive options at June 30, 2005.

6. The Company has adopted Statement of Financial Accounting Standards No. 123 (revised) Share Based Payment , (SFAS 123R) effective January 1, 2006. The Company previously applied APB Opinion No. 25 Accounting for Stock Issued to Employees in accounting for stock option plans and accordingly, no compensation cost had been recognized for these plans in the prior period financial statements. The Company has applied the Modified Prospective Application (MPA) in its implementation of the new accounting standards. As such, the Company has recognized stock based compensation expense for these plans in the current period. Prior period amounts have not been restated. As a result of adopting Statement 123(R) on January 1, 2006, the Company's income before income taxes and net income for the six-month period ended June 30, 2006, are \$3.5 million and \$2.0 million lower, respectively, than if it had continued to account for stock-based compensation under APB Opinion 25. Basic and diluted earnings per share for the six-month period ended June 30, 2006 are both \$0.04 lower than if the Company had continued to account for stock-based compensation under APB Opinion 25.

On June 30, 2006, 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 June 30, 2006, and \$6.1 million for the six months ended June 30, 2006, compared to \$1.1 million and \$2.0 million for the three and six-month periods ending June 30, 2005, respectively. The total income tax benefit recognized in the income statement for stock-based compensation arrangements was \$1.4 million, for the three months ended June 30, 2006, and \$2.6 million for the six months ended June 30, 2006, compared to \$0.5 million, and \$0.8 million for the three and six month periods ending June 30, 2005, respectively. Prior year amounts include expense for restricted stock, but do not include stock-based compensation from stock option plans issued at market value. See the table below for comparative purposes of prior year amounts.

| Dollars in thousands, except for per share amounts  | For the three months ended |           | For the six months ended |            |
|---|----------------------------|-----------|--------------------------|------------|
|   | June 30,                   |           | June 30,                 |            |
|   | 2006                       | 2005      | 2006                     | 2005       |
| Net income, as reported   | \$ 58,741                  | \$ 57,707 | \$ 115,974               | \$ 113,168 |
| Add: Stock-based compensation included in reported net income, net of tax   | 1,962                      | 650       | 3,535                    | 1,171      |
| Less: Stock-based employee compensation expense determined under the fair-value method for all awards, net of tax | (1,962)                    | (1,890)   | (3,535)                  | (3,944)    |
| Pro forma net income  | 58,741                     | 56,467    | 115,974                  | 110,395    |

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|  |      |      |      |      |
|--|------|------|------|------|
| Net income per share, basic, as reported   | 1.20 | 1.18 | 2.36 | 2.30 |
| Pro forma net income per share, basic      | N/A  | 1.15 | N/A  | 2.25 |
| Net income per share, diluted, as reported | 1.16 | 1.13 | 2.28 | 2.22 |
| Pro forma net income per share, diluted    | N/A  | 1.11 | N/A  | 2.16 |

### 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. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant. These awards vest in 4 years and have 10-year contractual terms. Restricted stock awards generally vest over 5 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 stock issued prior to January 31, 2006.

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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 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 range below results from certain groups of employees exhibiting different behavior. 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 based on the dividend yield of the Company's stock at the time of the grant.

|                             | For the three months ended<br>June 30, |         | For the six months ended<br>June 30, |         |
|-----------------------------|--|---------|--------------------------------------|---------|
|                             | 2006                                   | 2005    | 2006                                 | 2005    |
| Expected volatility         | 23.51%                                 | 25.06%  | 24.82%                               | 24.70%  |
| Weighted-average volatility | 23.51%                                 | 26.17%  | 23.95%                               | 24.61%  |
| Expected dividends          | \$ 2.12                                | \$ 2.16 | \$ 2.14                              | \$ 2.15 |
| Expected term (in years)    | 5.64                                   | 7.00    | 5.91                                 | 7.00    |
| Risk-free rate              | 4.84%                                  | 3.92%   | 4.60%                                | 4.05%   |

A summary of option activity under the Plan as of June 30, 2006 and changes during the period then ended are presented below:

| Options                        | Shares<br>(000) | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value<br>(\$000) |
|--------------------------------|-----------------|---|--|--|
| Outstanding at January 1, 2006 | 4,375           | \$ 45.98                                  | 5.60   | \$ 83,594                                  |
| Granted                        | 436             | 76.59                                     | 9.72   | (5,009)                                    |
| Exercised                      | (247)           | 39.12                                     | 4.11   | (6,419)                                    |
| Forfeited or expired           | (34)            | 59.32                                     | 7.55   | (195)                                      |
| Outstanding at June 30, 2006   | 4,530           | \$ 49.20                                  | 5.83   | \$ 71,971                                  |
| Exercisable at June 30, 2006   | 3,356           | \$ 42.64                                  | 4.81   | \$ 75,344                                  |

The weighted-average grant-date fair value of options granted during the six-month periods ended June 30, 2006 and 2005 was \$19.90 and \$16.86, respectively. The total intrinsic value of options exercised during the six-month periods ended June 30, 2006 and 2005 was \$6.4 million, and \$7.3 million, respectively.

A summary of the status of the Company's unvested shares as of June 30, 2006 and changes during the six-month period ended are presented below:

| Unvested Shares             | Shares (000) | Weighted-Average<br>Grant-Date<br>Fair Value |
|-----------------------------|--------------|--|
| Unvested at January 1, 2006 | 1,332        | \$ 19.23                                     |
| Granted                     | 436          | 19.88  |
| Vested                      | (562)        | 13.45  |
| Forfeited                   | (32)         | 13.84  |

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|                           |       |          |
|---------------------------|-------|----------|
| Unvested at June 30, 2006 | 1,174 | \$ 15.05 |
|---------------------------|-------|----------|

As of June 30, 2006, there was \$18.3 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 2.4 years. The number of shares vested during the six-month period ended June 30, 2006 was 562,318.

7. 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 Statement of Financial Accounting Standards



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No. 133 Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS No. 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 No. 133, the Company documents its hedge relationships, including identification of the hedging instruments and 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 significant undesignated hedges during 2006 or 2005.

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 continued 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 would be 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 continuing 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. The ineffective portion, if any, of the changes in the fair value of these hedges (the differences between changes in the fair value of the interest rate swaps and the hedged items) would be recognized in other noninterest income in the consolidated statement of income.

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 would be reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings.

8. As previously reported, the California Franchise Tax Board has taken the position that certain real estate investment trust ( REIT ) and registered investment company ( RIC ) tax deductions shall be disallowed under California law. As of June 30, 2006, the Company has recorded a \$43.1 million state tax receivable for the years 2000, 2001 and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of \$28.1 million after giving effect to Federal tax benefits. Management is aggressively pursuing its claims for REIT and RIC refunds for the 2000 to 2004 tax years, however, no outcome can be predicted

with certainty and an adverse outcome on the refund claims could result in a loss of all or some portion of the \$28.1 million net state tax receivable.

9. 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. The Company recorded profit sharing contributions expense of \$4.6 million and \$8.6 million for the three-month and six-month periods ended June 30, 2006, compared to \$3.2 million and \$7.8 million for the second quarter of 2005 and the six-month period ending June 30, 2005, respectively.

The Company has a Supplemental Executive Retirement Plan ( SERP ) for one of its executive officers. At June 30, 2006, there was a \$3.0 million unfunded pension liability and a \$0.8 million intangible asset related to the SERP. The total expense for the second quarter of 2006 was \$0.2 million, and \$0.4 million for the six-month period ended June 30, 2006, compared to \$0.1 million and \$0.3 million for the second quarter of 2005 and the six-month period ended June 30, 2005, respectively.

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

## CITY NATIONAL CORPORATION

## FINANCIAL HIGHLIGHTS

(Unaudited)

| Dollars in thousands, except per share amounts (1)         | At or for the three months ended |                   |                  | Percentage change<br>June 30, 2006 from |                  |
|--|----------------------------------|-------------------|------------------|---|------------------|
|  | June 30,<br>2006                 | March 31,<br>2006 | June 30,<br>2005 | March 31,<br>2006                       | June 30,<br>2005 |
| <b>For The Quarter</b>                                     |                                  |                   |                  |   |                  |
| Net income   | \$ 58,741                        | \$ 57,232         | \$ 57,707        | 3%                                      | 2%               |
| Net income per common share, basic                         | 1.20                             | 1.16              | 1.18             | 3                                       | 2                |
| Net income per common share, diluted                       | 1.16                             | 1.12              | 1.13             | 4                                       | 3                |
| Dividends, per common share                                | 0.41                             | 0.41              | 0.36             | 0                                       | 14               |
| <b>At Quarter End</b>                                      |                                  |                   |                  |   |                  |
| Assets   | \$ 14,477,067                    | \$ 14,739,384     | \$ 14,475,598    | (2)                                     | 0                |
| Securities   | 3,335,008                        | 3,907,526         | 4,079,604        | (15)                                    | (18)             |
| Loans  | 9,821,755                        | 9,567,403         | 8,869,675        | 3                                       | 11               |
| Deposits   | 11,978,830                       | 11,908,529        | 12,152,208       | 1                                       | (1)              |
| Shareholders' equity                                       | 1,408,065                        | 1,479,564         | 1,400,888        | (5)                                     | 1                |
| Book value per common share                                | 29.26                            | 29.87             | 28.51            | (2)                                     | 3                |
| <b>Average Balance</b>                                     |                                  |                   |                  |   |                  |
| Assets   | \$ 14,782,469                    | \$ 14,826,515     | \$ 14,040,591    | (0)                                     | 5                |
| Securities   | 3,581,206                        | 3,970,440         | 4,071,516        | (10)                                    | (12)             |
| Loans  | 9,902,893                        | 9,625,016         | 8,747,660        | 3                                       | 13               |
| Deposits   | 11,930,729                       | 11,587,638        | 11,678,544       | 3                                       | 2                |
| Shareholders' equity                                       | 1,454,175                        | 1,480,527         | 1,358,941        | (2)                                     | 7                |
| <b>Selected Ratios</b>                                     |                                  |                   |                  |   |                  |
| Return on average assets (annualized)                      | 1.59%                            | 1.57%             | 1.65%            | 1                                       | (4)              |
| Return on average shareholders' equity (annualized)        | 16.20                            | 15.68             | 17.03            | 3                                       | (5)              |
| Corporation's tier 1 leverage                              | 8.45                             | 8.92              | 8.39             | (5)                                     | 1                |
| Corporation's tier 1 risk-based capital                    | 11.29                            | 12.36             | 11.91            | (9)                                     | (5)              |
| Corporation's total risk-based capital                     | 14.36                            | 15.51             | 15.45            | (7)                                     | (7)              |
| Period-end shareholders' equity to period-end assets       | 9.73                             | 10.04             | 9.68             | (3)                                     | 1                |
| Dividend payout ratio, per share                           | 34.43                            | 35.65             | 30.86            | (3)                                     | 12               |
| Net interest margin  | 4.65                             | 4.62              | 4.73             | 1                                       | (2)              |
| Efficiency ratio (2)                                       | 55.20                            | 54.80             | 53.39            | 1                                       | 3                |
| <b>Asset Quality Ratios</b>                                |                                  |                   |                  |   |                  |
| Nonaccrual loans to total loans                            | 0.15%                            | 0.15%             | 0.25%            | 0                                       | (40)             |
| Nonaccrual loans and OREO to total loans and OREO          | 0.15                             | 0.15              | 0.25             | 0                                       | (40)             |
| Allowance for loan and lease losses to total loans         | 1.60                             | 1.64              | 1.67             | (2)                                     | (4)              |
| Allowance for loan and lease losses to nonaccrual loans    | 1,050.47                         | 1,075.11          | 667.52           | (2)                                     | 57               |
| Net recoveries/(charge-offs) to average loans - annualized | 0.05                             | 0.11              | 0.05             | (55)                                    | 0                |

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**At Quarter End**

|   |    |            |    |            |    |            |    |    |
|---|----|------------|----|------------|----|------------|----|----|
| Assets under management                   | \$ | 26,852,922 | \$ | 19,246,286 | \$ | 17,257,493 | 40 | 56 |
| Assets under management or administration |    | 47,199,024 |    | 40,435,813 |    | 36,972,895 | 17 | 28 |

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(1) Certain prior period balances have been restated to conform to the current period presentation.

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

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND 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 four 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, and stock-based performance plans. 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, 2005.

*Overview*

City National Corporation is the parent company of City National Bank, the second largest independent bank headquartered in California. The Corporation offers a full complement of banking, trust and investment services through 55 offices, including 12 full-service regional centers, in Southern California, the San Francisco Bay Area and New York City. The Corporation has a majority ownership interest in nine asset management affiliates and minority interests in two others.

The Corporation recorded net income of \$58.7 million, or \$1.16 per share, for the second quarter of 2006 compared with \$57.7 million, or \$1.13 per share, for the second quarter of 2005 and \$57.2 million, or \$1.12 per share, for the first quarter of 2006.

*Recent Developments*

On May 31, 2006, the Company completed the acquisition of Independence Investments LLC, a Boston-based firm that manages \$8 billion in assets for corporate, public and Taft-Hartley pension plans, as well as foundations and endowments. This acquisition is expected to become modestly accretive to earnings in the second half of 2006.

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 on April 26, 2006. Shares will be repurchased from time to time in open market transactions and are expected to be used for stock options, future acquisitions, and other general purposes.

On July 17, 2006 the Company announced a joint business alliance with the Bank of East Asia (BEA). Under the terms of the agreement, the Company will refer its clients who need local banking services in China to BEA, as appropriate. Likewise BEA will, as appropriate, refer BEA clients who wish to do business in California and New York to the Company. The Company expects the agreement to benefit its clients who invest or do business in China as well as those seeking Chinese distributors for American-made goods. Incorporated in Hong Kong in 1918, BEA has assets of more than \$30 billion (U.S). It is listed on the Stock Exchange of Hong Kong. BEA delivers comprehensive retail and commercial banking services covering Hong Kong and Greater China, the United States, Canada, the United Kingdom, the British Virgin Islands, and Southeast Asia.

*Highlights*

Revenue of \$212.6 million represented a 6 percent increase from the second quarter of 2005.

Average loans grew to \$9.9 billion, up 13 percent from the second quarter of 2005. This growth was led by increases in commercial loans and residential mortgage loans.



Loan recoveries again exceeded charge-offs and nonaccrual loans amounted to \$15 million, down \$7.2 million, or 32 percent from the second quarter of 2005, but up \$0.4 million from the first quarter of this year.

Average deposits of \$11.9 billion were 2 percent higher than the second quarter of 2005 and 3 percent higher from the first quarter of this year.

Noninterest income grew to \$58.6 million, up 14 percent from the second quarter of 2005, and 7 percent higher than the first quarter of this year. The increase was led by the growth of City National's wealth management and international services fee revenue.

*Outlook*



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As disclosed in the Company's press release on second-quarter earnings, management expects earnings per share this year to grow at a rate of between 1 percent and 4 percent as compared with 2005.

### *Net Interest Income*

Fully taxable-equivalent net interest income reached \$157.3 million in the second quarter of 2006, up 3 percent from \$152.7 million for the same period last year. Fully taxable-equivalent net interest income in the first quarter of 2006 was \$155.5 million. Net interest income increases were primarily attributable to increases in average commercial and residential mortgage loans, while noninterest income grew as a result of increases in wealth management assets under management or administration and higher demand for international services.

The bank's prime rate was 8.25 percent on June 30, 2006, up from 7.75 percent at March 31, 2006, and 6.25 percent on June 30, 2005.

| Dollars in millions                                     | For the three months ended<br>June 30, |            |        | %          | For the three<br>months ended |   |
|---|--|------------|--------|------------|-------------------------------|---|
|   | 2006                                   | 2005       | Change |            | March 31, 2006                | % |
| <i>Average Loans</i>                                    | \$ 9,902.9                             | \$ 8,747.7 | 13     | \$ 9,625.0 | 3                             |   |
| <i>Average Securities</i>                               | 3,581.2                                | 4,071.5    | (12)   | 3,970.4    | (10)                          |   |
| <i>Average Earning Assets</i>                           | 13,581.2                               | 12,935.6   | 5      | 13,652.2   | (1)                           |   |
| <i>Average Deposits</i>                                 | 11,930.8                               | 11,678.5   | 2      | 11,587.6   | 3                             |   |
| <i>Average Core Deposits</i>                            | 10,278.7                               | 10,781.6   | (5)    | 10,334.0   | (1)                           |   |
| <i>Fully Taxable-Equivalent Net Interest<br/>Income</i> | 157.3                                  | 152.7      | 3      | 155.5      | 1                             |   |
| <i>Net Interest Margin</i>                              | 4.65%                                  | 4.73%      | (2)    | 4.62%      | 1                             |   |

Second-quarter average loan balances reached \$9.9 billion, up 13 percent over the same period last year and 3 percent from the first quarter of 2006. The commercial lending portfolio grew 23 percent over the second quarter of 2005 and 4 percent from the first quarter of 2006. Residential mortgage loans grew 12 percent from the second quarter of last year and 3 percent from the first quarter of 2006. Commercial real estate mortgage loans were 3 and 2 percent higher than the second quarter of 2005 and first quarter of 2006, respectively. Real estate construction loans increased 2 percent from the same period a year ago, but were unchanged from the first quarter of 2006.

The Company's average deposits reached \$11.9 billion in the second quarter of 2006, 2 percent higher than the second quarter of 2005 and 3 percent higher from the first quarter of 2006. The growth was primarily in certificates of deposits.

As part of its long-standing asset-liability management strategy, the Company uses plain vanilla interest rate swaps to hedge loans, deposits, and borrowings. The notional value of these swaps was \$1.5 billion at June 30, 2006, up \$0.2 billion from the second quarter of 2005, and slightly lower than the first quarter of this year. The swaps reduced net interest income by \$2.2 million in the second quarter of 2006, compared with a \$1.2 million reduction to net interest income in the first quarter of 2006, and \$3.3 million addition to net interest income in the second quarter of 2005. These amounts included income of \$0.4 million, \$0.9 million, and, \$2.9 million respectively, for interest rate swaps qualifying as fair value hedges. The income/(expense) from swaps qualifying as cash flow hedges was (\$2.7 million) for the second quarter of 2006, compared with (\$2.1 million) for the first quarter of 2006, and \$0.4 million for the second quarter of 2005. The expense from existing swaps of loans qualifying as cash-flow hedges expected to be recorded in net interest income within the next 12 months is (\$9.6 million). Both the expense for the quarter and the projected expense for the next 12 months should be viewed in context with the benefit the Company has and will receive from the rise in interest rates.



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Net interest income is the difference between interest income (including yield-related loan fees) and interest expense. Net interest income on a fully taxable-equivalent basis expressed as a percentage of average total earning assets is referred to as the net interest margin, which represents the average net effective yield on earning assets. The following table presents the components of net interest income on a fully taxable-equivalent basis for the three and six months ended June 30, 2006 and 2005.

| Dollars in thousands  | Net Interest Income Summary |   |                       |                 |   |                       |
|---|-----------------------------|---|-----------------------|-----------------|---|-----------------------|
|   | Average Balance             | For the three months ended June 30, 2006<br>Interest income/expense (2) | Average interest rate | Average Balance | For the three months ended June 30, 2005<br>Interest income/expense (2) | Average interest rate |
| <b>Assets</b>   |                             |   |                       |                 |   |                       |
| Interest-earning assets   |                             |   |                       |                 |   |                       |
| Loans   |                             |   |                       |                 |   |                       |
| Commercial  | \$ 3,966,875                | \$ 67,687   | 6.84%                 | \$ 3,215,700    | \$ 48,194   | 6.01%                 |
| Commercial real estate mortgages                                    | 1,908,673                   | 36,160  | 7.60                  | 1,856,031       | 32,455  | 7.01                  |
| Residential mortgages   | 2,737,272                   | 36,343  | 5.31                  | 2,444,178       | 31,725  | 5.19                  |
| Real estate construction  | 743,094                     | 16,940  | 9.14                  | 727,799         | 13,380  | 7.37                  |
| Equity lines of credit  | 352,296                     | 6,703   | 7.63                  | 296,852         | 4,219   | 5.70                  |
| Installment   | 194,683                     | 3,748   | 7.72                  | 207,100         | 3,715   | 7.12                  |
| Total loans (1)   | 9,902,893                   | 167,581   | 6.79                  | 8,747,660       | 133,688   | 6.13                  |
| Due from banks - interest bearing                                   | 46,453                      | 269   | 2.31                  | 36,951          | 114   | 1.24                  |
| Federal funds sold and securities purchased under resale agreements | 50,682                      | 604   | 4.77                  | 79,459          | 547   | 2.76                  |
| Securities available-for-sale                                       | 3,529,259                   | 40,184  | 4.55                  | 4,034,412       | 42,699  | 4.25                  |
| Trading account securities  | 51,947                      | 857   | 6.61                  | 37,104          | 301   | 3.25                  |
| Total interest-earning assets                                       | 13,581,234                  | 209,491   | 6.19                  | 12,935,586      | 177,349   | 5.50                  |
| Allowance for loan losses   | (156,776)                   |   |                       | (147,587)       |   |                       |
| Cash and due from banks   | 442,624                     |   |                       | 442,591         |   |                       |
| Other non-earning assets  | 915,387                     |   |                       | 810,001         |   |                       |
| Total assets  | \$ 14,782,469               |   |                       | \$ 14,040,591   |   |                       |
| <b>Liabilities and Shareholders Equity</b>                          |                             |   |                       |                 |   |                       |
| Interest-bearing deposits   |                             |   |                       |                 |   |                       |
| Interest checking accounts  | \$ 757,305                  | \$ 512  | 0.27                  | \$ 848,997      | \$ 177  | 0.08                  |
| Money market accounts   | 3,351,884                   | 17,778  | 2.13                  | 3,567,195       | 10,271  | 1.15                  |
| Savings deposits  | 173,982                     | 162   | 0.37                  | 199,087         | 139   | 0.28                  |

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|   |               |            |       |               |            |       |
|---|---------------|------------|-------|---------------|------------|-------|
| Time deposits -<br>under \$100,000  | 175,589       | 1,311      | 3.00  | 181,355       | 443        | 0.98  |
| Time deposits -<br>\$100,000 and over   | 1,652,113     | 16,764     | 4.07  | 896,943       | 6,352      | 2.84  |
| Total interest -<br>bearing deposits  | 6,110,873     | 36,527     | 2.40  | 5,693,577     | 17,382     | 1.22  |
| Federal funds<br>purchased and<br>securities sold<br>under repurchase<br>agreements | 546,108       | 6,716      | 4.93  | 315,261       | 2,265      | 2.88  |
| Other borrowings  | 652,137       | 8,963      | 5.51  | 518,319       | 4,972      | 3.85  |
| Total interest -<br>bearing liabilities   | 7,309,118     | 52,206     | 2.86  | 6,527,157     | 24,619     | 1.51  |
| Noninterest -<br>bearing deposits   | 5,819,856     |            |       | 5,984,967     |            |       |
| Other liabilities   | 199,320       |            |       | 169,526       |            |       |
| Shareholders<br>equity  | 1,454,175     |            |       | 1,358,941     |            |       |
| Total liabilities and<br>shareholders equity  | \$ 14,782,469 |            |       | \$ 14,040,591 |            |       |
| Net interest spread   |               |            | 3.33% |               |            | 3.99% |
| Fully<br>taxable-equivalent<br>net interest income                                  |               | \$ 157,285 |       |               | \$ 152,730 |       |
| Net interest margin   |               |            | 4.65% |               |            | 4.73% |

- 
- (1) Includes average nonaccrual loans of \$13,927 and \$25,123 for 2006 and 2005, respectively.
- (2) Loan income includes loan fees of \$4,649 and \$5,804 for 2006 and 2005, respectively.

| Dollars in thousands  | Net Interest Income Summary |   |                             |                 |   |                             |
|---|-----------------------------|---|-----------------------------|-----------------|---|-----------------------------|
|   | Average Balance             | For the six months ended<br>June 30, 2006<br>Interest<br>income/<br>expense (2) | Average<br>interest<br>rate | Average Balance | For the six months ended<br>June 30, 2005<br>Interest<br>income/<br>expense (2) | Average<br>interest<br>rate |
| <b>Assets</b>   |                             |   |                             |                 |   |                             |
| Interest-earning assets   |                             |   |                             |                 |   |                             |
| Loans   |                             |   |                             |                 |   |                             |
| Commercial  | \$ 3,890,428                | \$ 129,918  | 6.74%                       | \$ 3,163,957    | \$ 92,306   | 5.88%                       |
| Commercial real estate mortgages                                    | 1,891,407                   | 70,106  | 7.47                        | 1,837,324       | 63,893  | 7.01                        |
| Residential mortgages   | 2,700,845                   | 71,453  | 5.29                        | 2,399,502       | 62,220  | 5.19                        |
| Real estate construction  | 742,952                     | 32,652  | 8.86                        | 772,049         | 26,949  | 7.04                        |
| Equity lines of credit  | 343,212                     | 12,608  | 7.41                        | 281,221         | 7,769   | 5.57                        |
| Installment   | 195,877                     | 7,349   | 7.57                        | 206,412         | 6,902   | 6.74                        |
| Total loans (1)   | 9,764,721                   | 324,086   | 6.69                        | 8,660,465       | 260,039   | 6.05                        |
| Due from banks - interest bearing                                   | 45,025                      | 481   | 2.15                        | 50,857          | 329   | 1.30                        |
| Federal funds sold and securities purchased under resale agreements | 32,020                      | 744   | 4.68                        | 56,360          | 758   | 2.71                        |
| Securities available-for-sale                                       | 3,726,619                   | 84,069  | 4.51                        | 4,056,044       | 86,783  | 4.31                        |
| Trading account securities  | 48,128                      | 1,426   | 5.97                        | 37,285          | 523   | 2.83                        |
| Total interest-earning assets                                       | 13,616,513                  | 410,806   | 6.08                        | 12,861,011      | 348,432   | 5.46                        |
| Allowance for loan losses   | (155,951)                   |   |                             | (148,236)       |   |                             |
| Cash and due from banks   | 440,672                     |   |                             | 441,617         |   |                             |
| Other non-earning assets  | 903,018                     |   |                             | 803,061         |   |                             |
| Total assets  | \$ 14,804,252               |   |                             | \$ 13,957,453   |   |                             |
| <b>Liabilities and Shareholders Equity</b>                          |                             |   |                             |                 |   |                             |
| Interest-bearing deposits   |                             |   |                             |                 |   |                             |
| Interest checking accounts  | \$ 782,759                  | \$ 963  | 0.25                        | \$ 853,617      | \$ 359  | 0.08                        |
| Money market accounts   | 3,369,773                   | 32,885  | 1.97                        | 3,628,192       | 19,364  | 1.08                        |
| Savings deposits  | 176,268                     | 325   | 0.37                        | 202,083         | 261   | 0.26                        |

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|   |               |            |       |               |            |       |
|---|---------------|------------|-------|---------------|------------|-------|
| Time deposits - under \$100,000   | 177,830       | 2,462      | 2.79  | 181,386       | 1,037      | 1.15  |
| Time deposits - \$100,000 and over                                      | 1,453,964     | 27,345     | 3.79  | 920,398       | 11,604     | 2.54  |
| Total interest - bearing deposits                                       | 5,960,594     | 63,980     | 2.16  | 5,785,676     | 32,625     | 1.14  |
| Federal funds purchased and securities sold under repurchase agreements | 676,729       | 15,649     | 4.66  | 284,676       | 3,721      | 2.64  |
| Other borrowings  | 700,275       | 18,363     | 5.29  | 518,909       | 9,497      | 3.69  |
| Total interest - bearing liabilities                                    | 7,337,598     | 97,992     | 2.69  | 6,589,261     | 45,843     | 1.40  |
| Noninterest - bearing deposits  | 5,799,588     |            |       | 5,840,090     |            |       |
| Other liabilities   | 199,788       |            |       | 172,378       |            |       |
| Shareholders equity   | 1,467,278     |            |       | 1,355,724     |            |       |
| Total liabilities and shareholders equity                               | \$ 14,804,252 |            |       | \$ 13,957,453 |            |       |
| Net interest spread   |               |            | 3.39% |               |            | 4.06% |
| Fully taxable-equivalent net interest income                            |               | \$ 312,814 |       |               | \$ 302,589 |       |
| Net interest margin   |               |            | 4.63% |               |            | 4.74% |

- 
- (1) Includes average nonaccrual loans of \$13,852 and \$28,442 for 2006 and 2005, respectively.
- (2) Loan income includes loan fees of \$9,269 and \$11,824 for 2006 and 2005, respectively.



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Net interest income is impacted by the volume (changes in volume multiplied by prior rate), rate (changes in rate multiplied by prior volume), and mix of interest-earning assets and interest-bearing liabilities. The following table shows changes in net interest income on a fully taxable-equivalent basis between the second quarter and first six months of 2006 and the second quarter and first six months of 2005, as well as between the second quarter and first six months of 2005 and the second quarter and first six months of 2004.

**Changes In Net Interest Income**

| Dollars in thousands  | For the three months ended June 30,<br>2006 vs 2005 |           |                               | For the three months ended June 30,<br>2005 vs 2004 |           |                               |
|---|---|-----------|-------------------------------|---|-----------|-------------------------------|
|   | Increase (decrease)<br>due to                       |           | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                       |           | Net<br>increase<br>(decrease) |
|   | Volume  | Rate      |                               | Volume  | Rate      |                               |
| <b>Interest earned on:</b>  |   |           |                               |   |           |                               |
| Loans   | \$ 18,671   | \$ 15,222 | \$ 33,893                     | \$ 9,770  | \$ 16,294 | \$ 26,064                     |
| Due from banks - interest-bearing                                   | 35  | 118       | 153                           | (14)  | 36        | 22                            |
| Securities available-for-sale                                       | (5,468)   | 2,953     | (2,515)                       | 5,037   | (2,009)   | 3,028                         |
| Federal funds sold and securities purchased under resale agreements | (246)   | 301       | 55                            | (1,420)   | 851       | (569)                         |
| Trading account securities  | 155   | 401       | 556                           | 7   | 256       | 263                           |
| Total interest-earning assets                                       | 13,147  | 18,995    | 32,142                        | 13,380  | 15,428    | 28,808                        |
| <b>Interest paid on:</b>  |   |           |                               |   |           |                               |
| Interest checking deposits  | (20)  | 355       | 335                           | 3   |           | 3                             |
| Money market deposits   | (656)   | 8,164     | 7,508                         | (140)   | 4,248     | 4,108                         |
| Savings deposits  | (19)  | 41        | 22                            | (9)   | 5         | (4)                           |
| Time deposits   | 6,202   | 5,079     | 11,281                        | 264   | 3,173     | 3,437                         |
| Other borrowings  | 3,903   | 4,538     | 8,441                         | 605   | 3,567     | 4,172                         |
| Total interest-bearing liabilities                                  | 9,410   | 18,177    | 27,587                        | 723   | 10,993    | 11,716                        |
|   | \$ 3,737  | \$ 818    | \$ 4,555                      | \$ 12,657   | \$ 4,435  | \$ 17,092                     |

| Dollars in thousands  | For the six months ended June 30,<br>2006 vs 2005 |           |                               | For the six months ended June 30,<br>2005 vs 2004 |           |                               |
|---|---|-----------|-------------------------------|---|-----------|-------------------------------|
|   | Increase (decrease)<br>due to                     |           | Net<br>increase<br>(decrease) | Increase (decrease)<br>due to                     |           | Net<br>increase<br>(decrease) |
|   | Volume  | Rate      |                               | Volume  | Rate      |                               |
| <b>Interest earned on:</b>  |   |           |                               |   |           |                               |
| Loans   | \$ 35,005   | \$ 29,042 | \$ 64,047                     | \$ 19,521   | \$ 25,734 | \$ 45,255                     |
| Due from banks - interest-bearing                                   | (41)  | 193       | 152                           | (43)  | 140       | 97                            |
| Securities  | (6,848)   | 4,133     | (2,715)                       | 12,593  | (4,871)   | 7,722                         |
| Federal funds sold and securities purchased under resale agreements | (415)   | 401       | (14)                          | (1,963)   | 1,173     | (790)                         |
| Trading account securities  | 188   | 715       | 903                           | 18  | 428       | 446                           |
| Total interest-earning assets                                       | 27,889  | 34,484    | 62,373                        | 30,126  | 22,604    | 52,730                        |
| <b>Interest paid on:</b>  |   |           |                               |   |           |                               |
| Interest checking deposits  | (32)  | 635       | 603                           | 6   | 16        | 22                            |
| Money market deposits   | (1,472)   | 14,993    | 13,521                        | 366   | 7,016     | 7,382                         |
| Savings deposits  | (36)  | 100       | 64                            | (18)  |           | (18)                          |

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|                                    |          |        |           |           |          |           |
|------------------------------------|----------|--------|-----------|-----------|----------|-----------|
| Time deposits                      | 7,688    | 9,479  | 17,167    | 317       | 5,332    | 5,649     |
| Other borrowings                   | 12,227   | 8,567  | 20,794    | 1,030     | 6,050    | 7,080     |
| Total interest-bearing liabilities | 18,375   | 33,774 | 52,149    | 1,701     | 18,414   | 20,115    |
|                                    | \$ 9,514 | \$ 710 | \$ 10,224 | \$ 28,425 | \$ 4,190 | \$ 32,615 |

The impact of interest rate swaps, which affect interest income on loans, and interest expense on deposits and borrowings, is included in rate changes.

*Provision for Credit Losses*

The Company accounts for the credit risk associated with lending activities through its allowance for loan and lease losses and provision for credit losses. The provision is the expense recognized in the income statement to adjust the allowance and the reserve for off-balance sheet credit commitments to the levels deemed appropriate by management, as determined through application of the Company's allowance methodology procedures. (See Critical Accounting Policies on page 26 of the Company's Form 10-K for the year ended December 31, 2005.)

The provision for credit losses primarily reflects management's ongoing assessment of the credit quality and growth of the loan and commitment portfolios as well as the levels of net loan charge-offs/recoveries, nonaccrual loans, and changes in the economic environment during the period. For the three months ended June 30, 2006, December 31, 2005, and June 30, 2005, net recoveries totaled \$1.2 million, \$2.1 million, and \$1.2 million, respectively. For these periods, nonaccrual loans at period end totaled \$15.0 million, \$14.4 million, and \$22.2 million, respectively.

In June 2006, the Company recorded \$0.6 million in income through its provision for credit losses, based on the Bank's well-established loan-loss allowance methodology, which takes into account several factors, including asset quality, credit risk, loan growth and economic conditions. The key indicators of the strong asset quality of the loan portfolio during the period were a continued low level of nonaccrual loans and loan recoveries that exceeded charge-offs.

*Noninterest Income*

Second-quarter 2006 noninterest income of \$58.6 million was 14 percent higher than the second quarter of 2005 due primarily to continuing growth of the Company's wealth management and international services revenue. Noninterest income was 28 percent of total revenue in the second quarter of 2006, compared to 26 percent for both the second quarter of 2005 and the first quarter of 2006.

*Wealth Management*

Trust and investment fees increased 24 percent over the second quarter of 2005, primarily due to an increase in assets under management or administration. Assets under direct management grew 56 percent from the same period last year, largely as the result of the acquisition of Independence Investments, new business, a strong relative investment performance and higher market values. Increases in market values are reflected in fee income primarily on a trailing-quarter basis. Not including the acquisition of Independence, the Company's trust and investment fee income in the second quarter of 2006 grew 13 percent from the same period last year. Second-quarter noninterest income grew 10 percent from last year, excluding the acquisition of Independence.

| Dollars in millions                     | At or for the<br>three months ended<br>June 30, |         |  | %      | At or for the<br>three months<br>ended<br>March 31, 2006 |  | %      |
|---|---|---------|--|--------|--|--|--------|
|   | 2006  | 2005    |  | Change | 2006   |  | Change |
| <i>Trust and Investment Fee Revenue</i> | \$ 24.9   | \$ 20.1 |  | 24     | \$ 21.8  |  | 14     |
| <i>Brokerage and Mutual Fund Fees</i>   | 12.3  | 9.9     |  | 24     | 11.7   |  | 5      |

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|  |          |          |    |          |    |
|--|----------|----------|----|----------|----|
| <i>Assets Under Management (1)</i>                         | 26,852.9 | 17,257.5 | 56 | 19,246.3 | 40 |
| <i>Total Assets Under Management or Administration (1)</i> | 47,199.0 | 36,972.9 | 28 | 40,435.6 | 17 |

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(1) Excludes \$9.3 billion, \$5.5 billion, and \$9.4 billion of assets under management for the investment affiliates in which the Company held minority ownership interests as of June 30, 2006, June 30, 2005, and March 31, 2006, respectively

Other Noninterest Income

Second-quarter cash management and deposit transaction fees fell 13 percent from the same period last year and 5 percent from the first quarter of 2006, primarily due to a higher earnings credit rate.

International service fees for the second quarter of 2006 grew 16 percent from the same period last year and 15 percent from the first quarter of this year, largely because of an increase in foreign exchange transaction revenue. International services income includes foreign exchange fees, fees on commercial letters of credit and standby letters of credit, foreign collection and other fee income.

Other noninterest income for the second quarter of 2006 amounted to \$6.9 million, up \$2 million from the same period one year ago. The increase was due largely to a \$0.9 million gain on the exercise of warrants obtained as the result of a credit restructuring agreement negotiated several years ago.

#### *Noninterest Expense*

Second-quarter 2006 noninterest expense amounted to \$119.2 million, up 9 percent from the same period last year and 3 percent from the first quarter of 2006. Excluding both the acquisition of Independence Investments and the expensing of stock options, noninterest expense grew 6 percent from the second quarter of last year.

Staffing expenses amounted to \$73.7 million, up 15 percent from one year ago largely due to the acquisition of Independence Investments and stock option expense of \$1.9 million.

Legal and professional fees fell 15 percent from the second quarter of 2005, and 3 percent from the first quarter of 2006 as the initiatives to strengthen compliance with the Bank Secrecy Act and the USA Patriot Act were substantially completed in the fourth quarter of 2005.

The Company's second-quarter efficiency ratio was 55.20 percent compared with 53.39 percent for the second quarter of 2005, and 54.80 percent for the first quarter of 2006.

#### *Stock-Based Compensation Expense*

The Company adopted Statement of Financial Accounting Standards No. 123 (revised) *Share Based Payment*, (SFAS 123R) effective January 1, 2006. The Company previously applied APB Opinion No. 25 *Accounting for Stock Issued to Employees* in accounting for stock option plans, and accordingly, no compensation cost had been recognized for these plans in the prior period financial statements. The Company has applied the Modified Prospective Application (MPA) in its implementation of the new accounting standard. As such, the Company has recognized stock-based compensation expense for stock options, restricted stock and restricted unit dividends in the current year only. Prior period amounts have not been restated. The compensation cost for all stock-based compensation awards for the three and six-month periods ended June 30, 2006 was \$3.4 million and \$6.1 million, respectively. If the Company had accounted for stock option expense under SFAS 123R during the prior year, the expense recognized in income would have been \$3.3 million and \$6.8 million for the three and six-month periods ended June 30, 2005, respectively. The total income tax benefit recognized in the income statement related to stock-based compensation was \$1.4 million and \$2.6 million for the three and six-month periods ended June 30, 2006, respectively. The total income tax benefit for stock-based compensation arrangements that would have been recognized in the income statement, for the three and six-month periods ended June 30, 2005 had the Company accounted for stock option expense under SFAS 123R would have been \$1.4 and \$2.9 million, respectively. See the footnote disclosures for a presentation of prior year amounts with the stock option expense that would have been recognized had the Company adopted the new standard in these periods.

The Company did not make any modifications to outstanding stock options prior to the adoption of Statement 123R.

As of June 30, 2006 there was \$18.3 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 2.4 years. The total number of shares vested during the six months ended June 30, 2006 was 562,318.

*Minority Interest*

Minority interest consists of preferred stock dividends on the Bank's real estate investment trust subsidiaries as well as the minority ownership share of earnings of the Corporation's majority-owned asset management firms.

*Income Taxes*





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The second-quarter 2006 effective tax rate was 37.5 percent, compared with 37.3 percent in the second quarter of last year. The effective tax rates differ from the applicable statutory federal and state tax rates due to various factors, including tax-exempt income, interest on bank-owned life insurance, and affordable housing investments.

The Company's tax returns are being audited by the Internal Revenue Service for the years 2002-2003, and by the California Franchise Tax Board for the years 1998-2004. From time to time, there may be differences in opinions with respect to the tax treatment accorded transactions. If a tax position which was previously recognized on the financial statements is no longer more likely than not to be sustained upon a challenge from the taxing authorities, the tax benefit from the tax position will be derecognized. As of June 30, 2006, the Company does not have any tax positions which dropped below a more likely than not threshold.

As previously reported the California Franchise Tax Board has taken the position that certain real estate investment trust ( REIT ) and registered investment company ( RIC ) tax deductions should be disallowed under California law. While management continues to believe that the tax benefits realized in previous years 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 from 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. As of June 30, 2006, the Company had a \$43.1 million state tax receivable for the years 2000, 2001 and 2002 after giving effect to reserves for loss contingencies on the refund claims, or an equivalent of \$28.1 million after giving effect to Federal tax benefits. Although management is aggressively pursuing its claims for REIT and RIC refunds for the 2000 to 2004 tax years, no outcome can be predicted with certainty and an adverse outcome on the refund claims could result in a loss of all or a portion of the net \$28.1 million state tax receivable.

### BALANCE SHEET ANALYSIS

Total assets were \$14.5 billion at both June 30, 2006 and June 30, 2005, and decreased slightly from \$14.7 billion at March 31, 2006. Average assets for the second quarter of 2006 were 5 percent higher than the second quarter of 2005, primarily due to an increase in average loans.

Total average interest-earning assets for the second quarter of 2006 were \$13.6 billion, an increase of 5 percent over average interest-earning assets for the second quarter of 2005 of \$12.9 billion and a decrease of 1 percent from average interest-earning assets for the first quarter of 2006 of \$13.7 billion.

#### *Securities*

Comparative period-end security portfolio balances are presented below:

#### Securities Available-for-Sale

| Dollars in thousands | June 30,<br>2006 |            | December 31,<br>2005 |            | June 30,<br>2005 |            |
|----------------------|------------------|------------|----------------------|------------|------------------|------------|
|                      | Cost             | Fair Value | Cost                 | Fair Value | Cost             | Fair Value |
| U.S. Treasury        | \$ 35,750        | \$ 35,478  | \$ 92,127            | \$ 91,147  | \$ 92,663        | \$ 91,556  |

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|                       |              |              |              |              |              |              |
|-----------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Federal Agency        | 390,545      | 379,213      | 724,728      | 710,178      | 713,483      | 706,171      |
| CMOs                  | 1,421,194    | 1,360,563    | 1,578,948    | 1,543,068    | 1,460,094    | 1,448,089    |
| Mortgage-backed       | 1,105,178    | 1,044,544    | 1,258,433    | 1,224,400    | 1,368,432    | 1,357,215    |
| State and Municipal   | 341,318      | 337,132      | 325,630      | 327,882      | 321,656      | 330,763      |
| Total debt securities | 3,293,985    | 3,156,930    | 3,979,866    | 3,896,675    | 3,956,328    | 3,933,794    |
| Equity securities     | 54,622       | 54,660       | 97,118       | 102,586      | 119,046      | 123,473      |
| Total securities      | \$ 3,348,607 | \$ 3,211,590 | \$ 4,076,984 | \$ 3,999,261 | \$ 4,075,374 | \$ 4,057,267 |

At June 30, 2006, securities available-for-sale totaled \$3.2 billion, a decrease of \$0.8 billion compared with holdings at June 30, 2005. At June 30, 2006, the portfolio had a net unrealized loss of \$137.0 million compared with net unrealized losses of \$77.7 million at December 31, 2005 and \$18.1 million at June 30, 2005. The average duration of total available-for-sale securities at June 30, 2006 was 3.5 years. This duration compares with 3.0 years at December 31, 2005 and 3.1 at June 30, 2005. Duration provides a measure of fair value sensitivity to changes in interest rates. The average duration is within the investment guidelines set by the Company's Asset/Liability Committee and the interest-rate risk guidelines set by the Board of Directors. See "Asset/Liability Management" for a discussion of the Company's interest rate position.

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The following table provides the expected remaining maturities and yields (taxable-equivalent basis) of debt securities included in the securities portfolio as of June 30, 2006, except for mortgage-backed securities which are allocated according to final maturities. Final maturities will differ from contractual maturities because mortgage debt issuers may have the right to repay obligations prior to contractual maturity. To compare the tax-exempt asset yields to taxable yields, amounts are adjusted to pre-tax equivalents based on the marginal corporate federal tax rate of 35 percent.

**Debt Securities Available-for-Sale**

| Dollars in thousands  | One year or less |           | Over 1 year thru 5 years |           | Over 5 years thru 10 years |           | Over 10 years |           | Total        |           |
|-----------------------|------------------|-----------|--------------------------|-----------|----------------------------|-----------|---------------|-----------|--------------|-----------|
|                       | Amount           | Yield (%) | Amount                   | Yield (%) | Amount                     | Yield (%) | Amount        | Yield (%) | Amount       | Yield (%) |
| U.S. Treasury         | \$ 35,477        | 3.27      | \$                       |           | \$                         |           | \$            |           | \$ 35,477    | 3.27      |
| Federal Agency        | 71,436           | 3.09      | 300,779                  | 3.62      | 6,999                      | 2.90      |               |           | 379,214      | 3.50      |
| Mortgage-backed       | 149,946          | 4.15      | 68,462                   | 4.19      | 244,628                    | 4.26      | 1,942,071     | 4.51      | 2,405,107    | 4.45      |
| State and Municipal   | 21,689           | 4.18      | 93,361                   | 4.19      | 136,937                    | 3.85      | 85,145        | 3.94      | 337,132      | 3.99      |
| Total debt securities | \$ 278,548       | 3.77      | \$ 462,602               | 3.83      | \$ 388,564                 | 4.09      | \$ 2,027,216  | 4.49      | \$ 3,156,930 | 4.27      |
| Amortized cost        | \$ 285,226       |           | \$ 475,605               |           | \$ 402,696                 |           | \$ 2,130,458  |           | \$ 3,293,985 |           |

Dividend income included in interest income on securities in the Unaudited Consolidated Statements of Income for the second quarter of 2006 and 2005 was \$1.3 million and \$1.2 million, respectively.

*Loan Portfolio*

A comparative period-end loan table is presented below:

| Dollars in thousands                     | June 30 2006 | Loans December 31, 2005 | June 30 2005 |
|--|--------------|-------------------------|--------------|
| Commercial                               | \$ 3,647,693 | \$ 3,544,504            | \$ 3,311,059 |
| Commercial real estate mortgages         | 2,123,366    | 1,821,334               | 1,826,379    |
| Residential mortgages                    | 2,769,340    | 2,644,030               | 2,485,177    |
| Real estate construction                 | 723,570      | 721,890                 | 724,895      |
| Equity lines of credit                   | 364,312      | 333,548                 | 310,101      |
| Installment                              | 193,474      | 200,296                 | 212,064      |
| Total loans, gross                       | 9,821,755    | 9,265,602               | 8,869,675    |
| Less allowance for loan and lease losses | (157,580)    | (153,983)               | (147,930)    |
| Total loans, net                         | \$ 9,664,175 | \$ 9,111,619            | \$ 8,721,745 |

Total gross loans at June 30, 2006 were 6 percent and 11 percent higher than at December 31, 2005 and June 30, 2005, respectively.



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The following table presents information concerning nonaccrual loans, OREO, loans which are contractually past due 90 days or more as to interest or principal payments and still accruing, and restructured loans. Company policy requires that a loan be placed on nonaccrual status if (1) either principal or interest payments are 90 days past due, unless the loan is both well secured and in process of collection, (2) full collection of interest or principal becomes uncertain, regardless of the time period involved or (3) regulators' ratings of credits suggest that the loan be placed on nonaccrual.

**Nonaccrual Loans and OREO**

| Dollars in thousands  | June 30,<br>2006 | December 31,<br>2005 | June 30,<br>2005 |
|---|------------------|----------------------|------------------|
| <b>Nonaccrual loans:</b>  |                  |                      |                  |
| Commercial  | \$ 6,691         | \$ 5,141             | \$ 17,982        |
| Commercial real estate mortgages  | 3,644            | 923                  | 1,543            |
| Residential mortgages   |                  | 294                  | 1,990            |
| Real estate construction  | 4,617            | 7,650                |                  |
| Equity lines of credit  |                  | 21                   | 22               |
| Installment   | 49               | 371                  | 624              |
| Total   | 15,001           | 14,400               | 22,161           |
| <b>OREO</b>   |                  |                      |                  |
| Total nonaccrual loans and OREO   | \$ 15,001        | \$ 14,400            | \$ 22,161        |
| Total nonaccrual loans as a percentage of total loans                   | 0.15%            | 0.16%                | 0.25%            |
| Total nonaccrual loans and OREO as a percentage of total loans and OREO | 0.15             | 0.16                 | 0.25             |
| Allowance for loan and lease losses to total loans                      | 1.60             | 1.66                 | 1.67             |
| Allowance for loan and lease losses to nonaccrual loans                 | 1,050.47         | 1,069.33             | 667.52           |
| <b>Loans past due 90 days or more on accrual status:</b>                |                  |                      |                  |
| Installment   | \$               | \$                   | \$ 103           |
| Other   | 18               |                      |                  |
| Total   | \$ 18            | \$                   | \$ 103           |

At June 30, 2006, there were \$13.1 million of impaired loans included in nonaccrual loans, with an allowance allocation of \$1.7 million. On a comparable basis, at December 31, 2005, there were \$12.3 million of impaired loans, which had an allowance allocation of \$1.0 million, while at June 30, 2005, impaired loans were \$19.3 million with an allowance allocation of \$6.1 million. The assessment for impairment occurs when and while such loans are on nonaccrual, or the loan has been restructured. When a loan with unique risk characteristics has been identified as being impaired, the amount of impairment will be measured by the Company using discounted cash flows, except when it is determined that the primary (remaining) source of repayment for the loan is the operation or liquidation of the underlying collateral. In such cases, the current fair value of the collateral, reduced by costs to sell, will be used in place of discounted cash flows. As a final alternative, the observable market price of the debt may be used to assess impairment. Additionally, some impaired loans with commitments of less than \$500,000 are aggregated for the purpose of measuring impairment using historical loss factors as a means of measurement.

If the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs and unamortized premium or discount), an impairment allowance is recognized by creating or adjusting an existing allocation of the allowance for loan and lease losses. The Company's policy is to record cash receipts on impaired loans first as reductions in principal and then as interest income.



The following table summarizes the changes in nonaccrual loans for the three and six months ending June 30, 2006 and 2005.

**Changes in Nonaccrual Loans**

| Dollars in thousands                                 | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|--|--|-----------|--------------------------------------|-----------|
|  | 2006                                   | 2005      | 2006                                 | 2005      |
| Balance, beginning of period                         | \$ 14,555                              | \$ 29,918 | \$ 14,400                            | \$ 34,638 |
| Loans placed on nonaccrual                           | 5,750                                  | 2,525     | 9,570                                | 10,984    |
| Charge-offs  | (67)                                   | (1,592)   | (628)                                | (4,418)   |
| Loans returned to accrual status                     | (456)                                  | (2,942)   | (480)                                | (4,178)   |
| Repayments (including interest applied to principal) | (4,781)                                | (5,748)   | (7,861)                              | (14,865)  |
| Balance, end of period                               | \$ 15,001                              | \$ 22,161 | \$ 15,001                            | \$ 22,161 |

In addition to loans in nonaccrual status disclosed above, management has also identified \$15.8 million of credits to sixteen borrowers where the ability to comply with the present loan repayment terms in the future is questionable. However, the inability of the borrowers to comply with repayment terms was not sufficiently probable to place the loans on nonaccrual status at June 30, 2006. This amount was determined based on analysis of information known to management about the borrowers' financial condition and current economic conditions.

Management's classification of credits as nonaccrual or problems does not necessarily indicate that the principal is uncollectible in whole or in part.

*Allowance for Loan and Lease Losses and Reserve for Off-Balance Sheet Credit Commitments*

At June 30, 2006, the allowance for loan and lease losses was \$157.6 million or 1.60 percent of outstanding loans and the reserve for off-balance sheet credit commitments was \$15.2 million. The process used in the determination of the adequacy of the reserve for off-balance sheet credit commitments is consistent with the process for the allowance for loan and lease losses.

The following tables summarize the changes in the allowance for loan and lease losses and the reserve for off-balance sheet credit commitments for the three and six months ended June 30, 2006 and 2005.

### Changes in Allowance for Loan and Lease Losses

| Dollars in thousands   | For the three months ended<br>June 30, |              | For the six months ended<br>June 30, |              |
|--|--|--------------|--------------------------------------|--------------|
|  | 2006                                   | 2005         | 2006                                 | 2005         |
| Loans outstanding  | \$ 9,821,755                           | \$ 8,869,675 | \$ 9,821,755                         | \$ 8,869,675 |
| Average amount of loans outstanding                                    | \$ 9,902,893                           | \$ 8,747,660 | \$ 9,764,721                         | \$ 8,660,465 |
| Balance of allowance for loan and lease losses, beginning of period    | \$ 156,482                             | \$ 147,607   | \$ 153,983                           | \$ 148,568   |
| Loans charged off:   |  |              |                                      |              |
| Commercial   | (774)                                  | (1,795)      | (1,809)                              | (3,367)      |
| Real estate and other  |  | (20)         | (94)                                 | (1,954)      |
| Installment  | (18)                                   |              | (38)                                 |              |
| Total loans charged off  | (792)                                  | (1,815)      | (1,941)                              | (5,321)      |
| Less recoveries of loans previously charged off:                       |  |              |                                      |              |
| Commercial   | 1,897                                  | 2,861        | 4,724                                | 6,550        |
| Real estate and other  | 28                                     | 144          | 981                                  | 193          |
| Installment  | 28                                     |              | 53                                   |              |
| Total recoveries   | 1,953                                  | 3,005        | 5,758                                | 6,743        |
| Net loans recovered / (charged off)                                    | 1,161                                  | 1,190        | 3,817                                | 1,422        |
| Provision for credit losses  | (63)                                   | (867)        | (220)                                | (2,060)      |
| Balance, end of period   | \$ 157,580                             | \$ 147,930   | \$ 157,580                           | \$ 147,930   |
| Total net (charge-offs) recoveries to average loans (annualized)       | 0.05%                                  | 0.05%        | 0.05%                                | 0.02%        |
| Ratio of allowance for loan and lease losses to total period-end loans | 1.60%                                  | 1.67%        | 1.60%                                | 1.67%        |

### Changes in Reserve for Off-balance Sheet Credit Commitments

| Dollars in thousands           | For the three months ended<br>June 30, |           | For the six months ended<br>June 30, |           |
|--------------------------------|--|-----------|--------------------------------------|-----------|
|                                | 2006                                   | 2005      | 2006                                 | 2005      |
| Balance at beginning of period | \$ 15,753                              | \$ 12,944 | \$ 15,596                            | \$ 11,751 |
| Provision for credit losses    | (547)                                  | 867       | (390)                                | 2,060     |
| Balance at end of period       | \$ 15,206                              | \$ 13,811 | \$ 15,206                            | \$ 13,811 |



*Other Assets*

Other assets included the following:

**Other Assets**

| <b>Dollars in thousands</b>            | <b>June 30,<br/>2006</b> | <b>December 31,<br/>2005</b> | <b>June 30,<br/>2005</b> |
|--|--------------------------|------------------------------|--------------------------|
| Accrued interest receivable            | \$ 67,382                | \$ 64,958                    | \$ 57,814                |
| Claim in receivership and other assets | 11,042                   | 11,042                       | 11,887                   |
| Deferred compensation                  | 34,541                   | 28,949                       | 26,685                   |
| Income tax refund                      | 43,133                   | 43,178                       | 36,454                   |
| PML loans                              | 16,300                   | 11,513                       | 16,591                   |
| Other                                  | 112,841                  | 58,295                       | 73,532                   |
| <b>Total other assets</b>              | <b>\$ 285,239</b>        | <b>\$ 217,935</b>            | <b>\$ 222,963</b>        |

See *Income Taxes* for a discussion of income tax refund receivable of \$43.1 million.

*Deposits*

Deposits totaled \$12.0 billion at June 30, 2006, a decrease of 1 percent compared with both the \$12.2 billion at June 30, 2005, and the \$12.1 billion at December 31, 2005.

Core deposits, which continued to provide substantial benefits to the Bank's cost of funds, were 85 percent of total deposits at June 30, 2006, but declined \$0.9 billion since December 31, 2005. Included in core deposits are Specialty Deposits. Average Specialty Deposits, primarily from title and escrow companies, were \$1.3 billion for the three month period ended June 30, 2006, compared with \$1.5 billion for the three months ended December 31, 2005 and \$1.7 billion for the three months ended June 30, 2005. These deposits fluctuate with conditions in the real estate market. These deposits declined more than usual this year because of a general slowdown in transaction volumes for residential housing, but have increased since March 31, 2006. At June 30, 2006 quarterly average Specialty Deposits accounted for 11 percent of total quarterly average deposits.

*Borrowings*

Borrowings of \$0.9 billion at June 30, 2006 reflect an increase of \$104 million from June 30, 2005, and an increase of \$70 million from December 31, 2005 as a result of loans growing faster than deposits. The increase is primarily in Federal Funds Purchased and other short-term borrowings.

*Off Balance Sheet*

In the normal course of business, the Company is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, letters of credit, and financial guarantees. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the consolidated balance sheet. Commitments to extend credit are agreements to lend to a client, as long as there is no violation of certain conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each client's creditworthiness on a case-by-case basis.

The Company had off-balance sheet credit commitments aggregating \$4.8 billion at June 30, 2006, compared with \$4.6 billion at December 31, 2005 and \$4.0 billion at June 30, 2005. In addition, the Company had \$554.0 million outstanding in bankers' acceptances and letters of credit of which \$531.5 million related to standby letters of credit at June 30, 2006. At December 31, 2005, the Company had \$498.7 million in outstanding bankers' acceptances and letters of credit of which \$480.7 million related to standby letters of credit. Substantially all of the Company's loan commitments are on a variable rate basis and are comprised of real estate and commercial loan commitments.

As of June 30, 2006, the Company had private equity fund commitments of \$46.7 million, of which \$13.8 million was funded. As of December 31, 2005 and June 30, 2005, the Company had private equity fund commitments of \$42.7 million and \$18.7 million,

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respectively, of which \$11.1 million and \$9.4 million was funded. In addition, the Company had unfunded Affordable Housing Fund commitments of \$29.9 million, \$36.3 million, and \$34.6 million as of June 30, 2006, December 31, 2005, and June 30, 2005, respectively.

### CAPITAL ADEQUACY REQUIREMENT

The following table presents the regulatory standards for well-capitalized institutions and the capital ratios for the Corporation and the Bank at June 30, 2006, December 31, 2005, and June 30, 2005.

|                                  | Regulatory<br>Well<br>Capitalized<br>Standards | June 30,<br>2006 | December 31,<br>2005 | June 30,<br>2005 |
|----------------------------------|--|------------------|----------------------|------------------|
| <b>City National Corporation</b> |  |                  |                      |                  |
| Tier 1 leverage                  | N/A%   | 8.45%            | 8.82%                | 8.39%            |
| Tier 1 risk-based capital        | 6.00   | 11.29            | 12.33                | 11.91            |
| Total risk-based capital         | 10.00  | 14.36            | 15.53                | 15.45            |
| <b>City National Bank</b>        |  |                  |                      |                  |
| Tier 1 leverage                  | 5.00   | 9.19             | 9.26                 | 8.92             |
| Tier 1 risk-based capital        | 6.00   | 12.27            | 12.86                | 12.62            |
| Total risk-based capital         | 10.00  | 15.34            | 16.05                | 16.15            |

Tier 1 capital ratios include the impact of \$25.4 million of preferred stock issued by real estate investment trust subsidiaries of the Bank, which is included in minority interest in consolidated subsidiaries.

Shareholders' equity to assets as of both June 30, 2006 and June 30, 2005 was 9.7 and was 10.0 percent as of December 31, 2005.

The accumulated other comprehensive loss on available-for-sale securities and interest rate swaps at June 30, 2006 was \$86.9 million compared with \$12.9 million at June 30, 2005 and \$51.6 million at December 31, 2005.

The following table provides information about purchases by the Company during the six months ended June 30, 2006 of equity securities that are registered by the Company pursuant of Section 12 of the Exchange Act.

| Period              | Total Number of<br>Shares (or Units)<br>Purchased | Average<br>Price Paid<br>per Share (or<br>Unit) | Total number of Shares<br>(or Units) Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs | Maximum Number of<br>Shares that May Yet<br>Be Purchased Under<br>the Plans or Programs |
|---------------------|---|---|---|---|
| 02/01/06 - 02/28/06 | 41,200  | \$ 73.64  | 41,200  | 337,800   |
| 04/01/06 - 04/30/06 | 150,000   | 70.53   | 150,000   | 1,687,800   |
| 05/01/06 - 05/31/06 | 880,600   | 73.18   | 880,600   | 807,200   |

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|                     |              |       |              |            |
|---------------------|--------------|-------|--------------|------------|
| 06/01/06 - 06/30/06 | 461,000      | 64.82 | 461,000      | 346,200    |
|                     | 1,532,800 \$ | 70.43 | 1,532,800(1) | 346,200(2) |

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(1) No shares were received in payment of the exercise price of stock options.

(2) Remaining shares available for repurchase as of June 2006, pursuant to the program approved on May 24, 2004 by the Company's Board of Directors. 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.

## LIQUIDITY MANAGEMENT

The Company continues to manage its liquidity through the combination of core deposits, federal funds purchased, repurchase agreements, collateralized borrowing lines at the Federal Reserve Bank and the Federal Home Loan Bank of San Francisco and a portfolio of securities available-for-sale. Liquidity is also provided by maturing securities and loans.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### ASSET/LIABILITY MANAGEMENT

Market risk results from the variability of future cash flows and earnings due to changes in the financial markets. These changes may also impact the fair values of loans, securities and borrowings. The values of financial instruments may change because of interest rate changes, foreign currency exchange rate changes or other market changes. The Company's asset/liability management process entails the evaluation, measurement and management of interest rate risk, market risk and liquidity risk. The principal objective of asset/liability management is to optimize net interest income subject to margin volatility and liquidity constraints over the long term. Margin volatility results when the rate reset (or repricing) characteristics of assets are materially different from those of the Company's liabilities. The Board of Directors approves asset/liability policies and sets limits within which the risks must be managed. The Asset/Liability Management Committee (ALCO), which is comprised of senior management and key risk management individuals, sets risk management guidelines within the broader limits approved by the Board, monitors the risks and periodically reports results to the Board.

A quantitative and qualitative discussion about market risk is included on pages 41 to 45 of the Corporation's Form 10-K for the year ended December 31, 2005.

*Net Interest Simulation:* As part of its overall interest rate risk management process, the Company performs stress tests on net interest income projections based on a variety of factors, including interest rate levels, changes in the relationship between the prime rate and short-term interest rates, and the shape of the yield curve. The Company uses a simulation model to estimate the severity of this risk and to develop mitigation strategies, including interest rate hedges. The magnitude of the change is determined from historical volatility analysis. The assumptions used in the model are updated periodically and reviewed and approved by the Asset Liability Management Committee (ALCO). In addition, the Board of Directors has adopted limits within which interest rate exposure must be contained. Within these broader limits, ALCO sets management guidelines to further contain interest rate risk exposure.

The Company has a large portfolio of rate-sensitive commercial loans that are funded in part by rate-stable core deposits. As a result, the net interest margin increases when interest rates increase and decreases when interest rates decrease. The Company mitigates this risk using on and off-balance sheet hedging vehicles. Over time, as interest rates have risen, the Company has moved to a more neutral position. Increased reliance on wholesale funding sources and other changes in the mix of the balance sheet have also moved the Company to a more neutral position. Based on the balance sheet at June 30, 2006, the Company's net interest income simulation model indicates that net interest income would be modestly impacted by changes in interest rates. Assuming a static balance sheet, a gradual 100-basis-point parallel decline in the yield curve over a twelve-month horizon would result in an increase in projected net interest income of approximately 0.6 percent. This compares to decreases in projected net interest income of 0.8 percent and 1.3 percent at December 31, 2005 and June 30, 2005, respectively. The increase in net interest

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income occurs in the short-term due to the Company's greater reliance on wholesale funding which is more rate sensitive than the deposit portfolio. A gradual 100-basis-point parallel increase in the yield curve over the next twelve-month period would result in an increase in projected net interest income of approximately 0.1 percent. This compares to increases in projected net interest income of 0.7 percent at both December 31, 2005 and June 30, 2005.

*Present Value of Equity:* The model indicates that the Present Value of Equity (PVE) is impacted by a sudden and substantial increase in interest rates. As of June 30, 2006, a 200-basis-point increase in interest rates results in a 2.6 percent decline in PVE. This compares to a 3.7 percent decline and a 4.8 percent decline at December 31, 2005 and June 30, 2005, respectively.

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The following table presents the notional amount and fair value of the Company's interest rate swap agreements according to the specific asset or liability hedged:

| Dollars in millions                                       | June 30, 2006   |            |          | December 31, 2005 |            |          | June 30, 2005   |            |          |
|---|-----------------|------------|----------|-------------------|------------|----------|-----------------|------------|----------|
|   | Notional Amount | Fair Value | Duration | Notional Amount   | Fair Value | Duration | Notional Amount | Fair Value | Duration |
| <b>Fair Value Hedge Receive Fixed Interest Rate Swaps</b> |                 |            |          |                   |            |          |                 |            |          |
| Certificates of deposit                                   | \$ 175.0        | \$ (0.6)   | 0.6      | \$ 15.0           | \$         | 0.6      | \$ 15.0         | \$ 0.2     | 0.7      |
| Long-term and subordinated debt                           | 490.9           | (13.1)     | 4.1      | 490.9             | 5.7        | 4.5      | 490.9           | 25.2       | 4.9      |
| Total fair value hedge swaps                              | 665.9           | (13.7)     | 3.2      | 505.9             | 5.7        | 4.4      | 505.9           | 25.4       | 4.8      |
| <b>Cash Flow Hedge Receive Fixed Interest Rate Swaps</b>  |                 |            |          |                   |            |          |                 |            |          |
| <b>US Dollar LIBOR-based</b>                              |                 |            |          |                   |            |          |                 |            |          |
| loans   | 425.0           | (5.8)      | 0.6      | 600.0             | (7.9)      | 0.8      | 700.0           | (5.2)      | 1.1      |
| Prime based loans   | 425.0           | (6.8)      | 1.2      | 425.0             | (3.3)      | 1.7      | 150.0           | 1.0        | 2.2      |
| Total cash flow hedge swaps                               | 850.0           | (12.6)     | 0.9      | 1,025.0           | (11.2)     | 1.2      | 850.0           | (4.2)      | 1.3      |
| <b>Fair Value and Cash Flow</b>                           |                 |            |          |                   |            |          |                 |            |          |
| (1) Interest Rate Swaps                                   | \$ 1,515.9      | \$ (26.3)  | 1.9      | \$ 1,530.9        | \$ (5.5)   | 2.2      | \$ 1,355.9      | \$ 21.2    | 2.6      |

(1) Net fair value is the estimated net gain (loss) to settle derivative contracts. The net fair value is the sum of the mark-to-market liability on swaps of \$26.3 million.

Credit exposure represents the cost to replace, on a present value basis and at current market rates, the net positive value of all contracts for the Company and its subsidiaries with each counterparty that were outstanding at the end of the period, taking into consideration legal right of offset. In the normal course of business, the Company's swap agreements require collateral to mitigate the amount of credit risk if certain market value thresholds are exceeded. At June 30, 2006 the Bank had delivered securities with a market value of \$7.3 million as margin for swaps with a negative replacement value of \$8.2 million. For the same period, the Corporation had delivered securities with market value of \$12.8 million as margin for swaps with a negative replacement value of \$15.0 million.

ITEM 4. CONTROL AND PROCEDURES

**DISCLOSURE CONTROLS AND PROCEDURES**

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities and Exchange Act of 1934 (the Exchange Act)). Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective.

**INTERNAL CONTROL OVER FINANCIAL REPORTING**

There was no change in the Company's internal control over financial reporting that occurred during the registrant's last fiscal quarter to which this report relates that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



**CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

We have made forward-looking statements in this document that are subject to risks and uncertainties. These statements are based on the beliefs and assumptions of our management, and on information currently available to our management. Forward-looking statements include the information concerning our possible or assumed future results of operations, business and earnings outlook and statements preceded by, followed by, or that include the words will, believes, expects, anticipates, intends, plans, estimates, or similar expressions.

Our management believes these forward-looking statements are reasonable. However, you should not place undue reliance on the forward-looking statements, since they are based on current expectations. Actual results may differ materially from those currently expected or anticipated.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties, and assumptions. Our future results and shareholder values may differ materially from those expressed in these forward-looking statements. Many of the factors described below that will determine these results and values are beyond our ability to control or predict. For those statements, we claim the protection of the safe harbor contained in the Private Securities Litigation Reform Act of 1995.

Forward-looking statements speak only as of the date they are made and the Company does not undertake to update forward-looking statements to reflect circumstances or events that occur as of the date the statements are made or to update earnings guidance including the factors that influence earnings.

A number of factors, many of which are beyond the Company's ability to control or predict, could cause future results to differ materially from those contemplated by such forward-looking statements. Factors that could cause this difference include the following - (1) changes in interest rates, (2) significant changes in banking laws or regulations, (3) increased competition in the Company's markets, (4) other than expected credit losses due to real estate cycles or other economic events, (5) earthquake or other natural disasters affecting the condition of real estate collateral, (6) the effect of acquisitions and integration of acquired businesses, and (7) the impact of changes in regulatory or legislative tax treatment of business transactions. Additional factors that may cause future results to differ materially from forward-looking statements are discussed in Part I, Item 1A Risk Factors in the Company's Annual Report on Form 10-K as of December 31, 2005, to which reference is hereby made. There is no assurance that any list of risks and uncertainties or risk factors is complete.

**PART II.**

**Item 1A Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. There are no material changes to the risk factors described under Item 1A of the Company's 2005 Annual Report on Form 10-K.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

(c) Purchase of Equity Securities by the Issuer and Affiliated Purchaser.

The information required by subsection (c) of this item regarding purchases by the Company during the quarter ended June 30, 2006 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act is incorporated by reference from that portion of Part I, Item 1 of the report under Note 5.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The information required by this item was included in the Company's form 10-Q as of March 31, 2006.

**ITEM 6. EXHIBITS**

- No.**
- 10.0 Employment Agreement made as of June 30, 2006, by and between Russell Goldsmith, and the Registrant and City National Bank.
  - 10.1 Form of Stock Option Award Agreement Under the City National Corporation Amended and Restated 2002 Omnibus Plan (2006 and later grants).
  - 10.2 Form of Restricted Stock Award Agreement Under the City National Corporation Amended and Restated 2002 Omnibus Plan (2006 and later grants).
  - 10.3 Form of Restricted Stock Unit Agreement Under the City National Corporation Amended and Restated 2002 Omnibus Plan and Restricted Stock Unit Award Agreement Addendum (2006 and later grants).
  - 31.1 Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002
  - 31.2 Chief Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002
  - 32.0 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

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

**CITY NATIONAL CORPORATION**  
(Registrant)

**DATE:** August 8, 2006

/s/ Christopher J. Carey  
**CHRISTOPHER J. CAREY**  
Executive Vice President and  
Chief Financial Officer  
(Authorized Officer and  
Principal Financial Officer)

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