

CITY NATIONAL CORP
Form 10-Q
November 14, 2003

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

FORM 10-Q

(Mark One)

**ý QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2003

or

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

For the transition period from to

Commission File Number 1-10521

CITY NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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Delaware

(State or other jurisdiction of
incorporation or organization)

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)

Registrant's telephone number, including area code **(310) 888-6000**

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 such filing requirements for the past 90 days.

YES ☒

NO ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

YES ☒

NO ☐

Number of shares of common stock outstanding at October 31, 2003: 48,953,252

PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION
CONSOLIDATED BALANCE SHEET
(Unaudited)

| Dollars in thousands, except per share amounts | September 30, 2003 | December 31, 2002 | September 30, 2002 |
|---|-----------------------|----------------------|-----------------------|
| Assets | | | |
| Cash and due from banks | \$ 497,392 | \$ 497,273 | \$ 480,884 |
| Federal funds sold | 717,200 | 460,000 | 268,000 |
| Securities available-for-sale - cost \$3,381,676; \$2,169,444 and \$1,925,814 at September 30, 2003, December 31, 2002 and September 30, 2002, respectively | 3,409,374 | 2,226,656 | 1,979,439 |
| Trading account securities | 92,024 | 172,211 | 66,581 |
| Loans | 7,542,147 | 7,999,470 | 7,966,801 |
| Less allowance for credit losses | 166,209 | 164,502 | 159,173 |
| Net loans | 7,375,938 | 7,834,968 | 7,807,628 |
| Premises and equipment, net | 64,403 | 61,208 | 59,990 |
| Deferred tax asset | 68,404 | 36,578 | 25,177 |
| Goodwill | 251,038 | 229,834 | 229,658 |
| Intangibles | 46,233 | 27,007 | 28,983 |
| Bank owned life insurance | 62,324 | 60,119 | 59,583 |
| Affordable housing investments | 65,609 | 68,848 | 53,688 |
| Other assets | 172,672 | 186,766 | 204,896 |
| Customers acceptance liability | 7,917 | 8,924 | 9,260 |
| Total assets | \$ 12,830,528 | \$ 11,870,392 | \$ 11,273,767 |
| Liabilities | | | |
| Demand deposits | \$ 5,365,335 | \$ 4,764,234 | \$ 4,200,997 |
| Interest checking deposits | 729,892 | 692,261 | 627,765 |
| Money market deposits | 3,303,615 | 2,929,501 | 2,757,585 |
| Savings deposits | 212,688 | 198,288 | 219,968 |
| Time deposits-under \$100,000 | 205,625 | 218,447 | 221,601 |
| Time deposits-\$100,000 and over | 968,546 | 1,036,967 | 1,098,806 |
| Total deposits | 10,785,701 | 9,839,698 | 9,126,722 |
| Federal funds purchased and securities sold under repurchase agreements | 103,346 | 266,727 | 231,389 |
| Other short-term borrowings | 15,125 | 125,125 | 294,125 |
| Subordinated debt | 299,898 | 303,795 | 301,917 |
| Long-term debt | 282,159 | 68,682 | 68,897 |

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| | | | |
|---|----------------------|----------------------|----------------------|
| Other liabilities | 126,539 | 126,303 | 102,137 |
| Acceptances outstanding | 7,917 | 8,924 | 9,260 |
| Total liabilities | 11,620,685 | 10,739,254 | 10,134,447 |
| Minority interest in consolidated subsidiaries | 26,044 | 21,179 | 13,465 |
| Commitments and contingencies | | | |
| Shareholders' Equity | | | |
| Preferred Stock authorized - 5,000,000 : none outstanding | | | |
| Common Stock-par value-\$1.00; authorized - 75,000,000; Issued - 50,454,249; 50,282,743 and 50,275,643 shares at September 30, 2003, December 31, 2002 and September 30, 2002, respectively | | | |
| | 50,454 | 50,283 | 50,276 |
| Additional paid-in capital | 401,612 | 400,866 | 400,994 |
| Accumulated other comprehensive income | 21,446 | 40,400 | 39,122 |
| Retained earnings | 783,902 | 675,195 | 640,563 |
| Deferred equity compensation | (7,158) | | |
| Treasury shares, at cost - 1,545,450; 1,299,312; and 112,338 shares at September 30, 2003, December 31, 2002 and September 30, 2002, respectively | (66,457) | (56,785) | (5,100) |
| Total shareholders' equity | 1,183,799 | 1,109,959 | 1,125,855 |
| Total liabilities and shareholders' equity | \$ 12,830,528 | \$ 11,870,392 | \$ 11,273,767 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME

(Unaudited)

| In thousands, except per share amounts | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|------------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Interest Income | | | | |
| Loans | \$ 107,515 | \$ 127,682 | \$ 334,427 | \$ 375,004 |
| Securities available-for-sale | 33,162 | 26,235 | 94,885 | 81,186 |
| Federal funds sold and securities purchased under resale agreements | 1,511 | 540 | 2,693 | 1,751 |
| Trading account | 173 | 159 | 365 | 544 |
| Total interest income | 142,361 | 154,616 | 432,370 | 458,485 |
| Interest Expense | | | | |
| Deposits | 10,045 | 17,766 | 36,067 | 54,877 |
| Subordinated debt | 1,232 | 1,711 | 3,995 | 5,629 |
| Other long-term debt | 1,788 | 807 | 5,482 | 3,037 |
| Federal funds purchased and securities sold under repurchase agreements | 292 | 845 | 1,331 | 2,430 |
| Other short-term borrowings | 343 | 1,963 | 1,493 | 8,719 |
| Total interest expense | 13,700 | 23,092 | 48,368 | 74,692 |
| Net interest income | 128,661 | 131,524 | 384,002 | 383,793 |
| Provision for credit losses | | 20,500 | 29,000 | 49,500 |
| Net interest income after provision for credit losses | 128,661 | 111,024 | 355,002 | 334,293 |
| Noninterest Income | | | | |
| Trust fees and investment fee revenue | 23,412 | 15,287 | 60,397 | 45,297 |
| Cash management and deposit transaction charges | 10,661 | 9,929 | 32,238 | 30,323 |
| International services | 4,845 | 4,747 | 14,192 | 13,257 |
| Bank owned life insurance | 747 | 737 | 2,192 | 2,129 |
| Gain (loss) on sale of loans and assets | 16 | (3,756) | 118 | (757) |
| Gain on sale of securities | 36 | 1,206 | 2,538 | 2,078 |
| Other | 5,551 | 6,028 | 17,621 | 16,532 |
| Total noninterest income | 45,268 | 34,178 | 129,296 | 108,859 |
| Noninterest Expense | | | | |
| Salaries and employee benefits | 55,261 | 49,109 | 161,582 | 146,221 |
| Net occupancy of premises | 8,142 | 6,837 | 22,973 | 19,512 |
| Professional fees | 6,821 | 5,418 | 20,026 | 15,829 |
| Information services | 4,749 | 4,200 | 13,304 | 13,221 |
| Depreciation | 3,315 | 3,268 | 9,453 | 9,996 |
| Marketing and advertising | 3,060 | 3,259 | 9,725 | 9,358 |

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| | | | | |
|---|---------------|---------------|----------------|----------------|
| Office services | 2,504 | 2,231 | 7,472 | 7,060 |
| Amortization of intangibles | 2,365 | 1,976 | 6,568 | 5,547 |
| Equipment | 528 | 599 | 1,832 | 1,870 |
| Other operating | 5,588 | 5,258 | 16,126 | 15,116 |
| Total noninterest expense | 92,333 | 82,155 | 269,061 | 243,730 |
| Minority interest in net income of consolidated subsidiaries | 1,717 | 217 | 3,257 | 374 |
| Income before income taxes | 79,879 | 62,830 | 211,980 | 199,048 |
| Income taxes | 27,376 | 14,145 | 69,741 | 60,367 |
| Net income | 52,503 | 48,685 | 142,239 | 138,681 |
| Other comprehensive income | | | | |
| Unrealized gain (loss) on securities available-for-sale | (29,393) | 22,600 | (31,828) | 50,843 |
| Unrealized gain (loss) on cash flow hedges | (1,191) | 1,593 | (706) | (342) |
| Less reclassification adjustment for gain included in net income | 1,055 | 988 | 169 | 1,413 |
| Income taxes (benefit) | (13,304) | 9,756 | (13,749) | 20,640 |
| Other comprehensive income (loss) | (18,335) | 13,449 | (18,954) | 28,448 |
| Comprehensive income | \$ 34,168 | \$ 62,134 | \$ 123,285 | \$ 167,129 |
| Net income per share, basic | \$ 1.08 | \$ 0.97 | \$ 2.93 | \$ 2.80 |
| Net income per share, diluted | \$ 1.05 | \$ 0.94 | \$ 2.85 | \$ 2.69 |
| Shares used to compute income per share, basic | 48,537 | 50,107 | 48,541 | 49,587 |
| Shares used to compute income per share, diluted | 50,177 | 51,899 | 49,942 | 51,595 |
| Dividends per share | \$ 0.280 | \$ 0.195 | \$ 0.690 | \$ 0.585 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION
CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

| Dollars in thousands | For the nine months ended September 30, | |
|--|--|------------|
| | 2003 | 2002 |
| Cash Flows From Operating Activities | | |
| Net income | \$ 142,239 | \$ 138,681 |
| Adjustments to net income: | | |
| Provision for credit losses | 29,000 | 49,500 |
| Amortization of intangibles | 6,568 | 5,547 |
| Depreciation | 9,453 | 9,996 |
| Deferred income tax (benefit) | (18,065) | 31,693 |
| (Gain) loss on sales of loans and assets | (118) | 757 |
| Gain on sales of securities | (2,538) | (2,078) |
| Net decrease (increase) in other assets | 20,554 | (46,128) |
| Net decrease in trading securities | 80,187 | 11,685 |
| Other, net | 1,623 | (5,419) |
| Net cash provided by operating activities | 268,903 | 194,234 |
| Cash Flows From Investing Activities | | |
| Purchase of securities | (2,588,462) | (688,468) |
| Sales of securities available-for-sale | 188,525 | 164,205 |
| Maturities and paydowns of securities | 1,181,395 | 440,974 |
| Sales of loans | 11,744 | 12,531 |
| Loan principal collections (originations), net | 432,375 | (486,057) |
| Purchase of premises and equipment | (14,628) | (6,715) |
| Net cash from (for) acquisitions | (39,907) | 35,633 |
| Other, net | (2) | 4 |
| Net cash used by investing activities | (828,960) | (527,893) |
| Cash Flows From Financing Activities | | |
| Net increase in deposits | 946,003 | 557,057 |
| Net (decrease) increase in federal funds purchased and securities sold under repurchase agreements | (163,381) | 59,858 |
| Net decrease in short-term borrowings, net of transfers from long-term debt | (125,000) | (246,000) |
| Repayment of long-term debt | (6,575) | |
| Net proceeds of issuance of senior debt | 221,749 | |
| Proceeds from exercise of stock options | 23,728 | 24,088 |
| Stock repurchases | (45,616) | (6,629) |
| Cash dividends paid | (33,532) | (28,849) |
| Net cash provided by financing activities | 817,376 | 359,525 |

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| | | |
|--|--------------|------------|
| Net increase in cash and cash equivalents | 257,319 | 25,866 |
| Cash and cash equivalents at beginning of year | 957,273 | 723,018 |
| Cash and cash equivalents at end of period | \$ 1,214,592 | \$ 748,884 |

Supplemental Disclosures of Cash Flow Information:

Cash paid during the period for:

| | | |
|--------------|-----------|-----------|
| Interest | \$ 52,643 | \$ 51,029 |
| Income taxes | 64,000 | 43,500 |

Non-cash investing activities:

| | | |
|---|--------|----------|
| Transfer from loans to foreclosed assets | \$ | \$ 1,664 |
| Transfer from long-term debt to short-term borrowings | 15,000 | 125,000 |

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

| Dollars in thousands | For the nine months ended September 30, | |
|---|--|-----------|
| | 2003 | 2002 |
| Common Stock | | |
| Balance, beginning of period | \$ 50,283 | \$ 48,150 |
| Stock issued for acquisitions | | 1,208 |
| Stock options exercised | | 918 |
| Restricted stock and units issued | 171 | |
| Balance, end of period | 50,454 | 50,276 |
| Additional paid-in capital | | |
| Balance, beginning of period | 400,866 | 301,022 |
| Tax benefit from stock options | 5,465 | 9,552 |
| Stock options exercised | (12,216) | 21,642 |
| Restricted stock and units issued | 7,497 | |
| Excess of market value of shares issued for acquisitions over historical cost | | 68,778 |
| Balance, end of period | 401,612 | 400,994 |
| Accumulated other comprehensive income (loss) | | |
| Balance, beginning of period | 40,400 | 10,674 |
| Other comprehensive income (loss) net of income taxes | (18,954) | 28,448 |
| Balance, end of period | 21,446 | 39,122 |
| Retained earnings | | |
| Balance, beginning of period | 675,195 | 530,731 |
| Net income | 142,239 | 138,681 |
| Dividends paid | (33,532) | (28,849) |
| Balance, end of period | 783,902 | 640,563 |
| Deferred equity compensation | | |
| Balance, beginning of period | | |
| Restricted stock and units issued | (7,668) | |
| Amortization of restricted stock awards | 510 | |
| Balance, end of period | (7,158) | |
| Treasury shares | | |
| Balance, beginning of period | (56,785) | |
| Purchase of shares | (45,616) | (6,629) |
| Issuance of shares for stock options | 35,944 | 1,529 |

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| | | |
|----------------------------|--------------|--------------|
| Balance, end of period | (66,457) | (5,100) |
| Total shareholders' equity | \$ 1,183,799 | \$ 1,125,855 |

See accompanying Notes to the 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). In light of the fact that the Bank comprises substantially all of the business of the Corporation, references to the Company mean the Corporation and the Bank together.
2. The results of operations reflect the 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 period presented. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2002. The results for the 2003 interim periods are not necessarily indicative of the results expected for the full year.
3. Trading account securities are stated at market value. Investments not classified as trading securities are classified as securities available-for-sale and recorded at fair value. Unrealized holding gains or losses for securities available-for-sale, net of taxes are excluded from net income and are reported as other comprehensive income included as a separate component of shareholders' equity.
4. Certain prior periods' data have been reclassified to conform to current period presentation.
5. Reserves established as a purchase price adjustment for the February 29, 2000 acquisition of The Pacific Bank N.A. of \$0.9 million for exit costs relating to surplus space remain as of September 30, 2003. Reserves established as a purchase price adjustment for the February 28, 2002 acquisition of Civic BanCorp of \$0.6 million for exit costs relating to surplus space remain as of September 30, 2003.
6. On February 13, 2003, the Corporation issued \$225 million of 5.125 percent Senior Notes due 2013 in a private placement. A like amount of exchange notes were subsequently registered pursuant to the Securities Act of 1933 in April 2003 and 100 percent of the Senior Notes were exchanged for the registered notes in an exchange offering with the Senior Notes which closed on May 29, 2003.

7. On January 22, 2003, the Board of Directors authorized a 1 million-share stock buyback program. No shares were repurchased during the third quarter of 2003. A total number of 750,100 shares have been repurchased under this program at an average price of \$42.47 per share leaving 249,900 shares available for repurchase. Shares will be repurchased on a selective basis from time to time in open market transactions. The shares purchased under the buyback programs may be reissued for acquisitions, upon the exercise of stock options, or for other general corporate purposes. There were 1,545,450 treasury shares at September 30, 2003.

On July 15, 2003, the Board of Directors authorized the repurchase of 500,000 additional shares of City National Corporation stock, following completion of the Company's current buyback initiative.

Basic earnings per share is based on the weighted average shares of common stock outstanding less unvested restricted shares and units. Diluted earnings per share gives effect to all dilutive potential common shares which consists of stock options and restricted shares and units that were outstanding during the period. At September 30, 2003, 50,950 stock options were antidilutive.

8. The Company applies APB Opinion No. 25 in accounting for stock option plans and, accordingly, no compensation cost has been recognized for its plans in the financial statements. As a practice, the Corporation's stock option grants are such that the exercise price equals the current market price of the common stock. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123 using the Black Scholes option-pricing model, the Company's proforma net income would have been reduced to the proforma amounts indicated below:

| Dollars in thousands, except for per share amounts | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|-----------|--|------------|
| | 2003 | 2002 | 2003 | 2002 |
| Net income, as reported | \$ 52,503 | \$ 48,685 | \$ 142,239 | \$ 138,681 |
| Proforma net income | 50,807 | 46,143 | 137,524 | 131,057 |
| Net income per share, basic, as reported | 1.08 | 0.97 | 2.93 | 2.80 |
| Proforma net income per share, basic | 1.05 | 0.92 | 2.83 | 2.64 |
| Net income per share, diluted, as reported | 1.05 | 0.94 | 2.85 | 2.69 |
| Proforma net income per share, diluted | 1.01 | 0.89 | 2.75 | 2.54 |
| Percentage reduction in net income per share, diluted | 3.81% | 5.32% | 3.51% | 5.58% |

During the latter part of the second quarter of 2003, stock-based compensation performance awards for 2002 were granted to colleagues of the Company. These performance awards for the first time included restricted stock grants with fewer stock options, which reduced the total number of shares awarded but better aligned the interests of shareholders and colleagues. The Company recorded \$381,000 in expense for restricted stock awards in the third quarter of 2003 and \$510,000 for the first nine months of 2003 out of the original \$7,668,000 grant.

9. In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. The recognition and measurement provisions of this Interpretation are effective for newly created VIEs formed after January 31, 2003. On October 9, 2003, the FASB issued FIN 46-6 which delayed the recognition and measurement provisions of FIN 46 for existing VIEs to the first interim or annual reporting period ending after December 15, 2003. The Company adopted the disclosure provisions of FIN 46 effective December 31, 2002. The Company adopted the recognition and measurement provisions of FIN 46 for newly formed VIEs effective February 1, 2003, which did not have a material effect on the Company's financial statements. The Company intends to adopt the recognition and measurement provisions of FIN 46 for existing VIEs on December 31, 2003. The Company does not expect that the adoption of FIN 46 will have a material effect on the Company's financial statements.

10. On April 1, 2003, the Corporation acquired Convergent Capital Management LLC, a privately held Chicago-based company, and substantially all of its asset management holdings, including its majority ownership interests in eight asset management firms and minority interests in two additional firms. Combined, these 10 firms manage assets of approximately \$7.3 billion as of September 30, 2003. The purchase price was \$49.0 million, comprised of cash and the assumption of approximately \$7.5 million of debt. The acquisition preliminarily resulted in \$25.8 million in customer contract intangibles, which is being amortized over 20 years, and \$21.5 million in goodwill.

CITY NATIONAL CORPORATION

FINANCIAL HIGHLIGHTS

(Unaudited)

| Dollars in thousands, except per share amounts | At or for the three months ended | | | Percentage change | |
|---|----------------------------------|---------------|--------------------|---------------------------------------|--|
| | September 30, 2003 | June 30, 2003 | September 30, 2002 | September 30, 2003 from June 30, 2003 | September 30, 2003 from September 30, 2002 |
| For The Quarter | | | | | |
| Net income | \$ 52,503 | \$ 46,081 | \$ 48,685 | 14% | 8% |
| Net income per common share, basic | 1.08 | 0.95 | 0.97 | 14 | 11 |
| Net income per common share, diluted | 1.05 | 0.93 | 0.94 | 13 | 12 |
| Dividends, per common share | 0.280 | 0.205 | 0.195 | 37 | 44 |
| At Quarter End | | | | | |
| Assets | \$ 12,830,528 | \$ 12,354,833 | \$ 11,273,767 | 4 | 14 |
| Deposits | 10,785,701 | 10,166,806 | 9,126,722 | 6 | 18 |
| Loans | 7,542,147 | 7,590,226 | 7,966,801 | (1) | (5) |
| Securities | 3,501,398 | 3,080,721 | 2,046,020 | 14 | 71 |
| Shareholders' equity | 1,183,799 | 1,144,690 | 1,125,855 | 3 | 5 |
| Book value per share | 24.29 | 23.77 | 22.44 | 2 | 8 |
| Average Balances | | | | | |
| Assets | \$ 12,418,660 | \$ 11,914,869 | \$ 10,964,142 | 4 | 13 |
| Deposits | 10,320,828 | 9,774,905 | 8,772,826 | 6 | 18 |
| Loans | 7,558,799 | 7,793,863 | 7,958,258 | (3) | (5) |
| Securities | 3,247,019 | 2,900,785 | 1,936,582 | 12 | 68 |
| Shareholders' equity | 1,139,440 | 1,131,682 | 1,094,381 | 1 | 4 |
| Selected Ratios | | | | | |
| Return on average assets | 1.68% | 1.55% | 1.76% | 8 | (5) |
| Return on average shareholders' equity | 18.28 | 16.33 | 17.65 | 12 | 4 |
| Corporation's tier 1 leverage | 7.37 | 7.17 | 7.88 | 3 | (6) |
| Corporation's tier 1 risk-based capital | 10.76 | 10.21 | 10.16 | 5 | 6 |
| Corporation's total risk-based capital | 14.94 | 14.45 | 14.61 | 3 | 2 |
| Dividend payout ratio, per share | 25.94 | 21.51 | 20.03 | 21 | 30 |
| Net interest margin | 4.61 | 4.79 | 5.35 | (4) | (14) |
| Efficiency ratio * | 52.92 | 52.53 | 48.65 | 1 | 9 |
| Asset Quality Ratios | | | | | |
| Nonaccrual loans to total loans | 0.72% | 0.91% | 0.63% | (21) | 14 |
| Nonaccrual loans and ORE to total loans and ORE | 0.72 | 0.92 | 0.64 | (22) | 13 |

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|--|--------|--------|--------|------|------|
| Allowance for credit losses to total loans | 2.20 | 2.25 | 2.00 | (2) | 10 |
| Allowance for credit losses to non accrual loans | 304.08 | 246.37 | 317.25 | 23 | (4) |
| Net charge-offs to average loans - annualized | (0.25) | (0.52) | (0.95) | (52) | (74) |

* The efficiency ratio is defined as noninterest expense excluding ORE expense divided by total revenue (net interest income on a 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 would be reported under different conditions or using different assumptions. These policies relate to the accounting for securities, the allowance for credit losses, derivatives and hedging activities and stock based performance plans. The Company, in consultation with the Audit 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) to Financial Statements in the Company's 2002 Form 10-K.

Overview

The Corporation recorded net income of \$52.5 million, or \$1.05 per common share, for the third quarter of 2003, compared with net income of \$48.7 million, or \$0.94 per share, for the third quarter of 2002 on fewer common shares outstanding this year.

For the first nine months of 2003, City National Corporation recorded net income of \$142.2 million, or \$2.85 per share, compared with net income of \$138.7 million, or \$2.69 per share, reported for the first nine months of 2002.

HIGHLIGHTS

In light of improved credit quality, no provision for credit losses was recorded in the third quarter of 2003 compared with \$20.5 million in the prior year as nonaccrual loans declined 21 percent; selected higher-risk credits were paid, charged off or sold; charge-offs were lower and recoveries were higher than expected; and loans declined by 1 percent from the end of the prior quarter. The year-to-date provision for credit losses was \$29.0 million compared with \$49.5 million for the first nine months of 2002. The allowance for credit losses to total loans was 2.20 percent at September 30, 2003.

Average core deposits for the first nine months were up 23 percent from the same period last year. Third-quarter average core deposits were up 23 percent from a year ago and 6 percent from the prior quarter.

Average securities for the first nine months were up 46 percent from the same period last year due to significantly higher deposit balances and modest loan demand. The average duration of total available-for-sale securities at September 30, 2003 was 3.2 years. Average loans for the first nine months were essentially unchanged from the same period last year and period-end loan balances were down \$48.1 million from the last quarter.

Net interest income for the first nine months of 2003 increased slightly over the first nine months of 2002, but was 2 percent lower in the third quarter compared with the same period last year. This decline is consistent with the

18-basis-point compression in the net interest margin to 4.61 percent during the third quarter of 2003.

Noninterest income excluding gains on sale of loans, assets and securities rose 18 percent for the first nine months over the same period last year. This continued increase was primarily due to the acquisition of Convergent Capital Management (CCM) on April 1, 2003. Third-quarter noninterest income, excluding gains on the sale of loans, assets and securities, was 23 percent higher than the third quarter of 2002 and 3 percent higher than the second quarter of 2003.

Exposure to syndicated non-relationship commercial and purchased media and telecommunication loans declined 40 percent from June 30, 2003 to \$31.2 million at September 30, 2003 out of a total loan portfolio of \$7.5 billion.

| Dollars in millions, except per share | For the three months ended September 30, | | | % Change | For the three months ended June 30, 2003 | For the nine months ended September 30, | | | % Change |
|--|---|----------|-----|-------------|--|--|----------|-----|-------------|
| | 2003 | 2002 | | | | 2003 | 2002 | | |
| Earnings Per Share | \$ 1.05 | \$ 0.94 | 12 | | \$ 0.93 | \$ 2.85 | \$ 2.69 | 6 | |
| Net Income | 52.5 | 48.7 | 8 | | 46.1 | 142.2 | 138.7 | 3 | |
| Average Assets | 12,418.7 | 10,964.1 | 13 | | 11,914.9 | 11,941.5 | 10,749.8 | 11 | |
| Return on Average Assets | 1.68% | 1.76% | (5) | | 1.55% | 1.59% | 1.72% | (8) | |
| Return on Average Equity | 18.28 | 17.65 | 4 | | 16.33 | 16.83 | 18.01 | (7) | |

Return on average assets for the third quarter and the first nine months of 2003 declined compared with the same periods last year due to an increase in average assets, primarily lower-yielding securities. The lower return on average shareholders' equity for the first nine months was due primarily to a higher level of shareholders' equity from retained net income and from the exercise of stock options, net of treasury share repurchases.

Outlook

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Consistent with its October 15, 2003 third quarter earnings release, management currently expects net income per diluted common share for 2003 to be approximately 8 to 10 percent higher than net income per diluted common share for 2002 based on the business indicators below:

| | |
|-----------------------------|------------------------------|
| Average loan growth | flat to 2 percent |
| Average deposit growth | 13 to 16 percent |
| Net interest margin | 4.75 to 4.85 percent |
| Provision for credit losses | \$29 million to \$35 million |
| Noninterest income growth | 18 to 21 percent |
| Noninterest expense growth | 9 to 12 percent |
| Effective tax rate | 32 to 34 percent |

Revenues

Revenues (net interest income plus noninterest income) for the first nine months of 2003, increased 4 percent to \$513.3 million compared with \$492.7 million for the first nine months of 2002, primarily due to the acquisition of CCM. Third-quarter revenues increased 5 percent to \$173.9 million from \$165.7 million in the third quarter of 2002. Revenues increased 1 percent from the second quarter of 2003.

Net Interest Income

Fully taxable-equivalent net interest income for the first nine months of 2003 was \$395.0 million compared with \$394.9 million for the first nine months of 2002. Net interest income for the third quarter of 2003 was \$132.4 million on a fully taxable-equivalent basis, a 2 percent decrease from \$135.2 million in the third quarter of 2002 due to lower interest rates and lower commercial loan demand.

| Dollars in millions | For the three months ended September 30, | | | For the three months ended June 30, 2003 | For the nine months ended September 30, | | |
|---|---|------------|-------------|--|--|------------|-------------|
| | 2003 | 2002 | % Change | | 2003 | 2002 | % Change |
| Average Loans | \$ 7,558.8 | \$ 7,958.3 | (5) | \$ 7,793.9 | \$ 7,770.8 | \$ 7,772.7 | 0 |
| Average Securities | 3,247.0 | 1,936.6 | 68 | 2,900.8 | 2,866.2 | 1,963.7 | 46 |
| Average Deposits | 10,320.8 | 8,772.8 | 18 | 9,774.9 | 9,826.7 | 8,422.3 | 17 |
| Average Core Deposits | 9,323.5 | 7,565.7 | 23 | 8,763.1 | 8,808.0 | 7,138.6 | 23 |
| Fully Taxable-Equivalent Net Interest Income | 132.4 | 135.2 | (2) | 130.8 | 395.0 | 394.9 | 0 |
| Net Interest Margin | 4.61% | 5.35% | (14) | 4.79% | 4.82% | 5.35% | (10) |

Average loans for the first nine months of 2003 were just slightly lower than the same period last year. However, average loans for the third quarter of 2003 declined 5 percent compared with the same period last year and 3 percent from the prior quarter, due to continued modest loan demand. Compared with the first nine months of 2002 averages, commercial loans decreased 5 percent, residential first mortgage loans rose 3 percent, real estate mortgage loans rose 5 percent, and real estate construction loans rose 5 percent. Compared with the prior-year third-quarter averages, commercial loans declined 11 percent, residential first mortgage loans rose 1 percent, real estate mortgage loans declined 1 percent, and real estate construction loans declined 3 percent due to payoffs on completed construction projects. Compared with the prior quarter, average residential first mortgage loans and installment loans increased while all other loan categories decreased.

Period-end September 30, 2003 loans declined \$48.1 million from June 30, 2003, representing a slowing in the decline in the total loan portfolio and the modest growth seen in certain areas, compared with the \$242.6 million decline between June 30, 2003 and March 31, 2003.

Average securities, principally with low current yields and short maturities, for the first nine months and third quarter of 2003 increased 46 percent and 68 percent over the same periods last year due to higher deposit balances and modest loan demand. As of September 30, 2003, unrealized gains on securities available-for-sale were \$27.7 million. In addition, the average duration of total available-for-sale securities at September 30, 2003 was 3.2 years compared to 2.3 years at June 30, 2003, consistent with our expectations given the change in interest rates from June to September.

Average deposits continued to increase over the prior-year periods as well as from the prior quarter. Average core deposits represented 90 percent of the total average deposit base for the third quarter of 2003, compared with 86 percent for the third quarter of 2002 and 90 percent for the second quarter of 2003. New clients and higher client balances maintained as deposits to pay for services contributed to the continued growth of deposits.

The net interest margin narrowed due to prepayment and refinancing activity and low interest rates.

As part of the Company's long-standing asset liability management strategy, its plain vanilla interest rate swaps hedging loans, deposits and borrowings, with a notional value of \$1,051.4 million, added \$8.1 million to net interest income in the third quarter of 2003. That compared with \$8.2 million in the third quarter of 2002 and \$7.5 million for the second quarter of 2003. These net interest income amounts included \$5.8 million, \$3.7 million and \$5.2 million, respectively, for interest swaps qualifying as fair-value hedges. Income from swaps qualifying as cash-flow hedges was \$2.3 million for the third quarter of 2003, compared with \$4.5 million for the third quarter of 2002 and \$2.3 million for the second quarter of 2003. For the first nine months of 2003, interest rate swaps added \$23.1 million to net interest income, compared with

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\$24.6 million for the first nine months of 2002. These amounts included \$15.5 million and \$10.6 million, respectively, for interest swaps qualifying as fair value hedges. Income from existing swaps qualifying as cash flow hedges of loans expected to be recorded in net interest income within the next 12 months is \$7.8 million.

Interest recovered on nonaccrual and charged-off loans included in net interest income for the first nine months of 2003 was \$2.3 million compared with \$1.4 million for the first nine months of 2002. Interest income

recovered was \$1.3 million for the third quarter of 2003, compared with \$0.4 million for the third quarter of 2002 and \$0.4 million for the second quarter of 2003, respectively.

The Bank's prime rate was 4.00 percent as of September 30, 2003, compared with 4.75 percent a year earlier.

The following tables present the components of net interest income on a fully taxable-equivalent basis for the three and nine months ended September 30, 2003 and 2002. 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.

Net Interest Income Summary

| Dollars in thousands | For the three months ended September 30, 2003 | | | For the three months ended September 30, 2002 | | |
|---|--|------------------------------------|-----------------------------|--|------------------------------------|-----------------------------|
| | Average Balance | Interest income/ expense (2) | Average interest rate | Average Balance | Interest income/ expense (2) | Average interest rate |
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| Loans | | | | | | |
| Commercial | \$ 3,191,405 | \$ 42,658 | 5.30% | \$ 3,598,795 | \$ 54,422 | 6.00% |
| Real estate mortgages | 1,890,996 | 30,582 | 6.42 | 1,900,612 | 34,481 | 7.20 |
| Residential first mortgages | 1,754,877 | 26,383 | 5.96 | 1,733,693 | 29,454 | 6.74 |
| Real estate construction | 634,300 | 7,925 | 4.96 | 651,174 | 9,254 | 5.64 |
| Installment | 87,221 | 1,579 | 7.18 | 73,984 | 1,602 | 8.59 |
| Total loans (1) | 7,558,799 | 109,127 | 5.73 | 7,958,258 | 129,213 | 6.44 |
| Securities available-for-sale | 3,146,971 | 35,268 | 4.45 | 1,882,231 | 28,350 | 5.98 |
| Federal funds sold and securities purchased under resale agreements | 584,552 | 1,511 | 1.03 | 120,279 | 540 | 1.78 |
| Trading account securities | 100,048 | 175 | 0.69 | 54,351 | 163 | 1.19 |
| Total interest-earning assets | 11,390,370 | 146,081 | 5.09 | 10,015,119 | 158,266 | 6.27 |
| Allowance for credit losses | (173,822) | | | (160,026) | | |
| Cash and due from banks | 438,968 | | | 440,226 | | |
| Other nonearning assets | 763,144 | | | 668,823 | | |
| Total assets | \$ 12,418,660 | | | \$ 10,964,142 | | |
| Liabilities and Shareholders Equity | | | | | | |
| Interest-bearing deposits | | | | | | |
| Interest checking accounts | \$ 750,513 | 292 | 0.15 | \$ 626,469 | 408 | 0.26 |
| Money market accounts | 3,289,234 | 5,541 | 0.67 | 2,680,730 | 9,128 | 1.35 |
| Savings deposits | 211,623 | 71 | 0.13 | 221,227 | 441 | 0.79 |
| Time deposits - under \$100,000 | 207,362 | 819 | 1.57 | 223,853 | 1,277 | 2.26 |
| Time deposits - \$100,000 and over | 997,287 | 3,322 | 1.32 | 1,207,127 | 6,512 | 2.14 |
| Total interest - bearing deposits | 5,456,019 | 10,045 | 0.73 | 4,959,406 | 17,766 | 1.42 |
| Federal funds purchased and securities sold under repurchase agreements | | | | | | |
| Other borrowings | 132,731 | 292 | 0.87 | 211,321 | 845 | 1.59 |
| Other borrowings | 660,830 | 3,363 | 2.02 | 750,319 | 4,481 | 2.37 |
| Total interest - bearing liabilities | 6,249,580 | 13,700 | 0.87 | 5,921,046 | 23,092 | 1.55 |
| Noninterest - bearing deposits | 4,864,809 | | | 3,813,420 | | |
| Other liabilities | 164,831 | | | 135,295 | | |
| Shareholders equity | 1,139,440 | | | 1,094,381 | | |

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| | | | | |
|--|----|------------|-------|------------|
| Total liabilities and shareholders' equity | \$ | 12,418,660 | \$ | 10,964,142 |
| Net interest spread | | | 4.22% | 4.72% |
| Fully taxable-equivalent net interest income | \$ | 132,381 | \$ | 135,174 |
| Net interest margin | | | 4.61% | 5.35% |

(1) Includes average nonaccrual loans of \$59,319 and \$57,025 for 2003 and 2002, respectively.

(2) Loan income includes loan fees of \$5,899 and \$6,486 for 2003 and 2002, respectively.

Net Interest Income Summary

| Dollars in thousands | For the nine months ended September 30, 2003 | | | For the nine months ended September 30, 2002 | | |
|---|---|------------------------------------|-----------------------------|---|------------------------------------|-----------------------------|
| | Average Balance | Interest income/ expense (2) | Average interest rate | Average Balance | Interest income/ expense (2) | Average interest rate |
| Assets | | | | | | |
| Interest-earning assets | | | | | | |
| Loans | | | | | | |
| Commercial | \$ 3,383,367 | \$ 134,157 | 5.30% | \$ 3,573,657 | \$ 163,287 | 6.11% |
| Real estate mortgages | 1,902,117 | 93,531 | 6.57 | 1,803,924 | 98,029 | 7.27 |
| Residential first mortgages | 1,748,237 | 81,284 | 6.22 | 1,695,501 | 87,201 | 6.88 |
| Real estate construction | 659,157 | 25,668 | 5.21 | 628,239 | 26,428 | 5.62 |
| Installment | 77,970 | 4,488 | 7.70 | 71,382 | 4,767 | 8.93 |
| Total loans (1) | 7,770,848 | 339,128 | 5.83 | 7,772,703 | 379,712 | 6.53 |
| Securities available-for-sale | 2,794,975 | 101,168 | 4.84 | 1,908,674 | 87,583 | 6.14 |
| Federal funds sold and securities purchased under resale agreements | 323,021 | 2,693 | 1.11 | 133,042 | 1,751 | 1.76 |
| Trading account securities | 71,175 | 373 | 0.70 | 54,992 | 555 | 1.35 |
| Total interest-earning assets | 10,960,019 | 443,362 | 5.41 | 9,869,411 | 469,601 | 6.36 |
| Allowance for credit losses | (172,522) | | | (157,022) | | |
| Cash and due from banks | 436,605 | | | 426,203 | | |
| Other nonearning assets | 717,387 | | | 611,190 | | |
| Total assets | \$ 11,941,489 | | | \$ 10,749,782 | | |
| Liabilities and Shareholders Equity | | | | | | |
| Interest-bearing deposits | | | | | | |
| Interest checking accounts | \$ 712,588 | 933 | 0.18 | \$ 606,326 | 1,166 | 0.26 |
| Money market accounts | 3,126,353 | 20,371 | 0.87 | 2,403,092 | 25,387 | 1.41 |
| Savings deposits | 205,147 | 572 | 0.37 | 231,216 | 1,672 | 0.97 |
| Time deposits - under \$100,000 | 211,673 | 2,760 | 1.74 | 228,059 | 4,214 | 2.47 |
| Time deposits - \$100,000 and over | 1,018,647 | 11,431 | 1.50 | 1,283,647 | 22,438 | 2.34 |
| Total interest - bearing deposits | 5,274,408 | 36,067 | 0.91 | 4,752,340 | 54,877 | 1.54 |
| Federal funds purchased and securities sold under repurchase agreements | | | | | | |
| | 165,765 | 1,331 | 1.07 | 204,712 | 2,430 | 1.59 |
| Other borrowings | 662,054 | 10,970 | 2.22 | 974,785 | 17,385 | 2.38 |
| Total interest - bearing liabilities | 6,102,227 | 48,368 | 1.06 | 5,931,837 | 74,692 | 1.68 |
| Noninterest - bearing deposits | 4,552,251 | | | 3,669,914 | | |
| Other liabilities | 157,366 | | | 118,420 | | |
| Shareholders equity | 1,129,645 | | | 1,029,611 | | |

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| | | | |
|---|---------------|---------------|-------|
| Total liabilities and shareholders' equity | \$ 11,941,489 | \$ 10,749,782 | |
| Net interest spread | | 4.35% | 4.68% |
| Fully taxable-equivalent net interest income | \$ 394,994 | \$ 394,909 | |
| Net interest margin | | 4.82% | 5.35% |

-
- (1) Includes average nonaccrual loans of \$74,058 and \$52,942 for 2003 and 2002, respectively.
- (2) Loan income includes loan fees of \$16,985 and \$18,377 for 2003 and 2002, respectively.

Net interest income is impacted by the volume, mix and rate 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 third quarter and the first nine months of 2003 and the third quarter and the first nine months of 2002, as well as between the third quarter and the first nine months of 2002 and the third quarter and the first nine months of 2001.

Changes In Net Interest Income

| Dollars in thousands | For the three months ended September 30, 2003 vs 2002 | | | For the three months ended September 30, 2002 vs 2001 | | |
|---|--|-------------|-------------------------------|--|-------------|-------------------------------|
| | Increase (decrease) due to | | Net increase (decrease) | Increase (decrease) due to | | Net increase (decrease) |
| | Volume | Rate | | Volume | Rate | |
| Interest earned on: | \$ (6,284) | \$ (13,802) | \$ (20,086) | \$ 21,193 | \$ (22,323) | \$ (1,130) |
| Securities available-for-sale | 15,524 | (8,606) | 6,918 | 2,315 | (2,746) | (431) |
| Federal funds sold and securities purchased under resale agreements | 1,285 | (314) | 971 | 266 | (280) | (14) |
| Trading account securities | 99 | (87) | 12 | 52 | (267) | (215) |
| Total interest-earning assets | 10,624 | (22,809) | (12,185) | 23,826 | (25,616) | (1,790) |
| Interest paid on: | | | | | | |
| Interest checking deposits | 74 | (190) | (116) | 87 | (209) | (122) |
| Money market deposits | 1,741 | (5,328) | (3,587) | 5,538 | (7,485) | (1,947) |
| Savings deposits | (18) | (352) | (370) | (163) | (1,008) | (1,171) |
| Other time deposits | (1,092) | (2,556) | (3,648) | (1,828) | (7,491) | (9,319) |
| Other borrowings | (851) | (820) | (1,671) | (4,448) | (5,288) | (9,736) |
| Total interest-bearing liabilities | (146) | (9,246) | (9,392) | (814) | (21,481) | (22,295) |
| | \$ 10,770 | \$ (13,563) | \$ (2,793) | \$ 24,640 | \$ (4,135) | \$ 20,505 |

| Dollars in thousands | For the nine months ended September 30, 2003 vs 2002 | | | For the nine months ended September 30, 2002 vs 2001 | | |
|---|---|-------------|-------------------------------|---|-------------|-------------------------------|
| | Increase (decrease) due to | | Net increase (decrease) | Increase (decrease) due to | | Net increase (decrease) |
| | Volume | Rate | | Volume | Rate | |
| Interest earned on: | | | | | | |
| Loans | \$ (91) | \$ (40,493) | \$ (40,584) | \$ 64,420 | \$ (86,266) | \$ (21,846) |
| Securities | 34,824 | (21,239) | 13,585 | 13,859 | (8,234) | 5,625 |
| Federal funds sold and securities purchased under resale agreements | 1,776 | (834) | 942 | 1,356 | (1,630) | (274) |
| Trading account securities | 133 | (315) | (182) | (160) | (1,058) | (1,218) |
| Total interest-earning assets | 36,642 | (62,881) | (26,239) | 79,475 | (97,188) | (17,713) |

Interest paid on:

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| | | | | | | |
|------------------------------------|-----------|-------------|----------|-----------|-------------|-----------|
| Interest checking deposits | 179 | (412) | (233) | 138 | (684) | (546) |
| Money market deposits | 6,335 | (11,351) | (5,016) | 15,798 | (25,414) | (9,616) |
| Savings deposits | (169) | (931) | (1,100) | (352) | (3,739) | (4,091) |
| Other time deposits | (4,347) | (8,114) | (12,461) | (7,937) | (31,832) | (39,769) |
| Other borrowings | (5,415) | (2,099) | (7,514) | (4,965) | (22,424) | (27,389) |
| Total interest-bearing liabilities | (3,417) | (22,907) | (26,324) | 2,682 | (84,093) | (81,411) |
| | \$ 40,059 | \$ (39,974) | \$ 85 | \$ 76,793 | \$ (13,095) | \$ 63,698 |

The impact of interest rate swaps, which increases loan interest income and reduces deposit and borrowing interest expense, is included in rate changes.

Provision for Credit Losses

The Company's decision to make no provision for credit losses in the third quarter of 2003 was attributable to the improving credit quality of the portfolio; nonaccrual loan levels declining by 21%; selected higher risk credits being paid, charged off or sold; a lower level of charge-offs; higher-than-expected recoveries; loans declining by 1 percent from the prior quarter end; management's ongoing assessment of the credit quality of the portfolio and a more stable economic environment. Management believes the allowance for credit losses is adequate to cover risks in the portfolio at September 30, 2003. See Allowance for Credit Losses.

Noninterest Income

The Company continues to emphasize growth in noninterest income through both the development of its existing business and acquisitions. For the first nine months of 2003, noninterest income including gains on the sale of loans, assets and securities increased 19 percent to \$129.3 million, up from \$108.9 million for the first nine months of 2002 primarily as a result of the acquisition of CCM. Noninterest income increased 32 percent to \$45.3 million for the third quarter of 2003, up from \$34.2 million for the third quarter of 2002. Noninterest income increased slightly over the second quarter of 2003.

Noninterest income as a percentage of total revenues for the first nine months and third quarter of 2003 was 25 percent and 26 percent, respectively, compared with 22 percent and 21 percent for the first nine months and third quarter of 2002 and 26 percent for the second quarter of 2003.

Trust and Investment Fee Revenue

| Dollars in millions | At or for the three months ended September 30, | | | % | At or for the three months ended | | | % |
|----------------------------------|--|----------|--------|----|-------------------------------------|---|---------|--------|
| | 2003 | 2002 | Change | | June 30, 2003 | For the nine months ended September 30, | 2002 | Change |
| Trust and Investment Fee Revenue | \$ 23.4 | \$ 15.3 | 53 | \$ | 21.5 | \$ 60.4 | \$ 45.3 | 33 |
| Assets Under Administration | 27,485.8 | 19,067.2 | 44 | | 26,237.3 | | | |
| Assets Under Management (1)(2) | 12,653.0 | 7,022.0 | 80 | | 12,531.3 | | | |

(1) Included above in assets under administration

(2) Excludes \$2,115 and \$1,896 million of assets under management for the CCM minority owned asset managers as of September 30, 2003 and June 30, 2003, respectively

Assets under management at September 30, 2003 increased primarily due to the CCM acquisition in April of 2003. New business, aided by strong relative investment performance and higher market values, also contributed to the increase. The revenue increases for both the first nine months and third quarter of 2003 were driven by higher balances under management or administration. Increases in market values are reflected in fee income primarily on a trailing-quarter basis.

Other Noninterest Income

Cash management and deposit transaction fees for the first nine months and third quarter of 2003 increased 6 percent and 7 percent over the same periods last year, respectively. Strong growth in deposits and higher sales of cash management products contributed to this growth. Cash management and deposit transaction fees for the third quarter of 2003 were essentially unchanged from the previous quarter.

For the first nine months of 2003, international services fees were 7 percent higher than the first nine months of 2002. International services fees for the third quarter 2003 were up 2 percent over the same period last year and decreased 3 percent from the second quarter of 2003. Higher foreign exchange income fueled the year-over-year revenue growth while trade-finance revenue was down from 2002.

For the first nine months of 2003, \$2.7 million in gains on the sale of loans and other assets and gains on the sale of securities were realized compared with \$1.3 million in gains for the first nine months of 2002. There were essentially no gains for the third quarter of 2003 compared with a loss of \$2.6 million for the third quarter of 2002 and a gain of \$1.3 million for the second quarter of 2003.

Noninterest Expense

Noninterest expense for the first nine months of 2003 increased 10 percent to \$269.1 million, up from \$243.7 million for the first nine months of 2002. Noninterest expense was \$92.3 million in the third quarter of 2003, up 12 percent from \$82.2 million for the third quarter of 2002 and up 1 percent from \$91.3 million for the second quarter of 2003. Expenses grew primarily because of the addition of CCM, the issuance of restricted stock awards in the second quarter of 2003 and to a lesser extent the Company's expansion, principally into New York. Excluding the expenses of CCM and the New York office, expenses were up less than 5 percent for the first nine months of 2003 over 2002.

For the first nine months of 2003, the Company's efficiency ratio was 51.93 percent compared with the more favorable 48.49 percent for the same period last year. The efficiency ratio for the third quarter of 2003 was 52.92 percent, compared with 48.65 percent for the third quarter of 2002 and 52.53 percent for the second quarter of 2003. The increase in the efficiency ratio is primarily attributable to the acquisition of CCM.

Minority Interest

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

Income Taxes

The effective tax rate for the first nine months of 2003 was 32.9 percent, compared with 30.1 percent for all of 2002. The higher effective tax rate for this year reflects the absence of certain tax benefits recognized in 2002. The third quarter of 2002 included \$4.6 million of such benefits that contributed to an effective tax rate of 22.5 percent for that quarter.

The effective tax rates differ from the applicable statutory federal tax rate due to various factors, including state taxes and the impact of the Company's real estate investment trust subsidiaries on state taxes, tax-exempt income including interest on bank-owned life insurance, and affordable housing investments.

The Company's tax returns are being audited by the Internal Revenue Service back to 1998 and by the Franchise Tax Board of the State of California back to 1996. From time to time, there may be differences in opinions with the respect to tax treatment accorded transactions. When, and if, such differences occur and become probable and estimable, such amounts will be recognized.

BALANCE SHEET ANALYSIS

Average assets for the first nine months of 2003, were \$11.9 billion, 11 percent higher than the \$10.7 billion in average assets for the first nine months of 2002. For the third quarter 2003, average assets reached \$12.4 billion, an increase of 13 percent over the \$11.0 billion in average assets for the third quarter of 2002 and 4 percent over the \$11.9 billion in average assets for the second quarter of 2003. Total assets at September 30, 2003 increased 14 percent to \$12.8 billion from \$11.3 billion at September 30, 2002. Total assets at December 31, 2002 were \$11.9 billion.

Total average interest-earning assets for the first nine months of 2003 were \$11.0 billion, an increase of 11 percent over the \$9.9 billion in total average interest-earning assets for the first nine months of 2002. For the third quarter of 2003, total average interest-earning assets were \$11.4 billion, an increase of 14 percent over the \$10.0 billion in average interest-earning assets for the third quarter of 2002 and 4 percent higher than the \$10.9 billion in average interest-earning assets for the second quarter of 2003.

Securities

Comparative period-end security portfolio balances are presented below:

Securities Available-for-Sale

| Dollars in thousands | September 30, 2003 | | December 31, 2002 | | September 30, 2002 | |
|------------------------------------|-----------------------|--------------|----------------------|--------------|-----------------------|--------------|
| | Cost | Fair Value | Cost | Fair Value | Cost | Fair Value |
| U.S. Government and federal agency | \$ 350,161 | \$ 354,534 | \$ 317,183 | \$ 324,223 | \$ 255,078 | \$ 262,308 |
| Mortgage-backed | 2,594,976 | 2,606,317 | 1,448,673 | 1,491,489 | 1,227,969 | 1,264,548 |
| State and Municipal | 256,541 | 269,651 | 224,013 | 236,591 | 218,627 | 232,611 |
| Other | 109,019 | 109,296 | 5,451 | 4,600 | 31,887 | 32,429 |
| Total debt securities | 3,310,697 | 3,339,798 | 1,995,320 | 2,056,903 | 1,733,561 | 1,791,896 |
| Marketable equity securities | 70,979 | 69,576 | 174,124 | 169,753 | 192,253 | 187,543 |
| Total securities | \$ 3,381,676 | \$ 3,409,374 | \$ 2,169,444 | \$ 2,226,656 | \$ 1,925,814 | \$ 1,979,439 |

Average securities available-for-sale continued to increase primarily due to strong deposit growth. At September 30, 2003, securities available-for-sale totaled \$3.4 billion, an increase of \$1.4 billion compared with holdings at September 30, 2002 and an increase of \$1.2 billion from December 31, 2002. At September 30, 2003 the portfolio had an unrealized net gain of \$27.7 million compared with \$57.2 million and \$53.6 million at December 31, 2002 and September 30, 2002, respectively. The average duration of total available-for-sale securities at September 30, 2003 was an expected 3.2 years. Duration provides a measure of fair value sensitivity to changes in interest rates. The 3.2 expected duration compares with 2.1 at December 31, 2002 and 2.2 at September 30, 2002. This 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.

The following table provides the contractual remaining maturities and yields (taxable-equivalent basis) of debt securities within the securities portfolio as of September 30, 2003. Contractual maturities of mortgage-backed securities are substantially longer than their expected maturities due to scheduled and unscheduled principal payments. 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. Government and federal agency | \$ 623 | 5.86 | \$ 327,959 | 3.23 | \$ 25,952 | 3.69 | \$ | | \$ 354,534 | 3.27 |

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| | | | | | | | | | | |
|-----------------------|-----------|------|------------|------|------------|------|--------------|------|--------------|------|
| Mortgage-backed | | | | | 222,283 | 4.02 | 2,384,034 | 4.66 | 2,606,317 | 4.61 |
| State and Municipal | 9,225 | 6.94 | 100,345 | 6.59 | 108,052 | 6.48 | 52,029 | 6.15 | 269,651 | 6.47 |
| Other | 26,893 | 3.63 | 82,403 | 5.04 | | | | | 109,296 | 4.69 |
| Total debt securities | \$ 36,741 | 4.50 | \$ 510,707 | 4.18 | \$ 356,287 | 4.74 | \$ 2,436,063 | 4.69 | \$ 3,339,798 | 4.62 |
| Amortized cost | \$ 36,683 | | \$ 499,291 | | \$ 349,001 | | \$ 2,425,722 | | \$ 3,310,697 | |

Dividend income included in interest income on securities in the Unaudited Consolidated Statement of Income and Comprehensive Income for the third quarters of 2003 and 2002 was \$1.9 million and \$2.3 million and \$6.0 million and \$7.4 million for the first nine months of 2003 and 2002, respectively.

Loan Portfolio

A comparative period-end loan table is presented below:

Loans

| Dollars in thousands | September 30, 2003 | December 31, 2002 | September 30, 2002 |
|----------------------------------|-----------------------|----------------------|-----------------------|
| Commercial | \$ 3,143,489 | \$ 3,609,053 | \$ 3,572,267 |
| Residential first mortgages | 1,803,424 | 1,738,909 | 1,746,649 |
| Real estate mortgages | 1,887,423 | 1,934,409 | 1,910,277 |
| Real estate construction | 622,941 | 640,861 | 661,698 |
| Installment | 84,870 | 76,238 | 75,910 |
| Total loans, gross | 7,542,147 | 7,999,470 | 7,966,801 |
| Less allowance for credit losses | 166,209 | 164,502 | 159,173 |
| Total loans, net | \$ 7,375,938 | \$ 7,834,968 | \$ 7,807,628 |

Total loans at September 30, 2003 were 5 percent and 1 percent lower than total loans at September 30, 2002 and June 30, 2003, respectively. At September 30, 2003, the Company's loan portfolio included approximately \$950.0 million of credits to borrowers located in Northern California, including approximately \$500.0 million of loans managed in Northern California offices. In addition, the portfolio included approximately \$150.0 million in outstanding dairy loans and \$31.2 million of syndicated non-relationship commercial and purchased media and telecommunication loans, the latter down from \$52.2 million at June 30, 2003.

Following is a breakdown of the syndicated non-relationship commercial loans and purchased media and telecommunication loans as of September 30, 2003:

| Dollars in thousands | Number | Commitments | Outstanding | Percentage |
|-------------------------|--------|-------------|-------------|------------|
| Commercial | 7 | \$ 20,998 | \$ 17,124 | 55% |
| Telecommunications | 3 | 10,323 | 3,689 | 12 |
| Publishing | 2 | 11,850 | 4,426 | 14 |
| Television Broadcasting | 1 | 5,000 | 4,152 | 13 |
| Wireless | 1 | 4,564 | 1,821 | 6 |
| | 14 | \$ 52,735 | \$ 31,212 | 100% |

The following table presents information concerning nonaccrual loans, ORE, and restructured loans. Bank 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, ORE and Restructured Loans

| Dollars in thousands | September 30, 2003 | December 31, 2002 | September 30, 2002 |
|--|-----------------------|----------------------|-----------------------|
| Nonaccrual loans: | | | |
| Commercial | \$ 40,218 | \$ 52,890 | \$ 37,725 |
| Real estate | 14,088 | 17,992 | 10,989 |
| Installment | 353 | 475 | 1,459 |
| Total | 54,659 | 71,357 | 50,173 |
| ORE | | 670 | 460 |
| Total nonaccrual loans and ORE | \$ 54,659 | \$ 72,027 | \$ 50,633 |
| Total non accrual loans as a percentage of total loans | 0.72% | 0.89% | 0.63% |
| Total non accrual loans and ORE as a percentage of total loans and ORE | 0.72 | 0.90 | 0.64 |
| Allowance for credit losses to total loans | 2.20 | 2.06 | 2.00 |
| Allowance for credit losses to nonaccrual loans | 304.08 | 230.53 | 317.25 |
| Loans past due 90 days or more on accrual status: | | | |
| Commercial | \$ 2,582 | \$ 5,854 | \$ 5,905 |
| Real estate | 441 | 104 | 2,858 |
| Installment | | 198 | 143 |
| Total | \$ 3,023 | \$ 6,156 | \$ 8,906 |

Nonaccrual loans fell this quarter primarily due to payoffs. Approximately 27 percent of the nonperforming assets were loans to Northern California clients as of September 30, 2003. Approximately 16 percent were three syndicated non-relationship commercial and purchased media and telecommunication loans totaling \$8.7 million, which compared with four loans totaling \$14.7 million at June 30, 2003 and 4 percent was one dairy relationship for \$2.2 million. The remaining 53 percent were loans to other borrowers with no major industry concentrations.

At September 30, 2003, nonaccrual loans included \$42.8 million of impaired loans which had an allowance for credit losses of \$5.7 million allocated to them. At June 30, 2003, nonaccrual loans included \$68.6 million of impaired loans which had an allowance of \$10.7 million allocated to them. The Company considers a loan to be impaired when it is probable that it will be unable to collect all amounts due according to the contractual terms of the loan agreement. Once a loan is determined to be impaired, the impairment is measured based on the present value of the expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, the impairment is measured by using the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Impairment on loans less than \$500,000 is measured using historical loss factors, which approximates the discounted cash flow method.

When the measurement of the impaired loan is less than the recorded amount of the loan, an impairment is recognized by creating a valuation allowance with a corresponding charge to the allowance for credit losses or by adjusting an existing valuation allowance for the impaired loan.

The Company's policy is to record cash receipts on impaired loans where it is probable that it will be unable to collect all principal amounts, first as reductions in principal and then as interest income.

The following table summarizes the changes in nonaccrual loans for the three and nine months ended September 30, 2003 and 2002.

Changes in Nonaccrual Loans

| Dollars in thousands | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|-----------|--|-----------|
| | 2003 | 2002 | 2003 | 2002 |
| Balance, beginning of period | \$ 69,377 | \$ 64,432 | \$ 71,357 | \$ 38,563 |
| Additions from acquisitions | | | | 3,510 |
| Loans placed on nonaccrual | 17,528 | 17,350 | 89,175 | 70,277 |
| Charge-offs | (4,510) | (20,050) | (27,293) | (39,696) |
| Loans returned to accrual status | (394) | (4,420) | (394) | (5,639) |
| Repayments (including interest applied to principal) and sales | (27,342) | (6,006) | (78,186) | (15,178) |
| Transferred to ORE | | (1,133) | | (1,664) |
| Balance, end of period | \$ 54,659 | \$ 50,173 | \$ 54,659 | \$ 50,173 |

In addition to loans disclosed above as nonaccrual or restructured, management has also identified \$4.7 million of credits to 11 borrowers where the ability to comply with the present loan payment terms in the future is questionable. However, the inability of the borrower to comply with repayment terms was not sufficiently probable to place the loan on nonaccrual status at September 30, 2003. Estimated losses from these potential problem loans have been provided for in determining the adequacy of the allowance for credit losses at September 30, 2003.

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

Allowance for Credit Losses

The allowance for credit losses at September 30, 2003 totaled \$166.2 million, or 2.20 percent of outstanding loans. This compares with an allowance of \$159.2 million, or 2.00 percent at September 30, 2002 and an allowance of \$170.9 million, or 2.25 percent at June 30, 2003. The allowance for credit losses as a percentage of nonaccrual loans was 304 percent at September 30, 2003, compared with 317 percent at September 30, 2002 and 246 percent at June 30, 2003.

For the first nine months of 2003, net charge-offs were \$27.3 million, down from \$42.0 million for the same period last year. Net charge-offs for the third quarter of 2003 were \$4.7 million, including \$4.5 million relating to the Company's syndicated non-relationship commercial and purchased media and telecommunication loan portfolio. This compares with \$19.0 million and \$2.0 million, respectively, for the third quarter of 2002. As an annualized percentage of average loans, net charge-offs were 0.25 percent, 0.95 percent and 0.52 percent for the third quarters of 2003 and 2002 and the second quarter of 2003, respectively.

The allowance for credit losses is maintained at a level that management deems appropriate based on a thorough analysis of numerous factors, including levels of net charge-offs and nonaccrual loans and changes in the loan portfolio. Credit quality will be influenced by underlying trends in the economy, particularly in California, and other factors that may be beyond management's control. No assurances can be given that the

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Company will not sustain credit losses, in any particular period, that are sizable in relation to the allowance for credit losses. Based on known information available to it at the date of this report, management believes the allowance for credit losses is adequate to cover risks inherent in the portfolio at September 30, 2003. Subsequent evaluation of the loan portfolio, in light of factors then prevailing, will dictate the level of provisions required to maintain the adequacy of the allowance for credit losses.

The table below summarizes the changes in the allowance for credit losses for the three and nine months ended September 30, 2003 and 2002.

Changes in Allowance for Credit Losses

| Dollars in thousands | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|--------------|--|--------------|
| | 2003 | 2002 | 2003 | 2002 |
| Loans outstanding | \$ 7,542,147 | \$ 7,966,801 | \$ 7,542,147 | \$ 7,966,801 |
| Average amount of loans outstanding | \$ 7,558,799 | \$ 7,958,258 | \$ 7,770,848 | \$ 7,772,703 |
| Balance of allowance for credit losses, beginning of period | \$ 170,927 | \$ 157,647 | \$ 164,502 | \$ 142,862 |
| Loans charged off: | | | | |
| Commercial | (7,561) | (17,364) | (34,999) | (41,747) |
| Real estate and other | (38) | (2,904) | (1,693) | (5,678) |
| Total loans charged off | (7,599) | (20,268) | (36,692) | (47,425) |
| Less recoveries of loans previously charged off: | | | | |
| Commercial | 2,734 | 658 | 8,752 | 2,694 |
| Real estate and other | 147 | 636 | 647 | 2,755 |
| Total recoveries | 2,881 | 1,294 | 9,399 | 5,449 |
| Net loans charged off | (4,718) | (18,974) | (27,293) | (41,976) |
| Additions to allowance charged to operating expense | | 20,500 | 29,000 | 49,500 |
| Additions to allowance from acquisition | | | | 8,787 |
| Balance, end of period | \$ 166,209 | \$ 159,173 | \$ 166,209 | \$ 159,173 |
| Total net charge-offs to average loans (annualized) | (0.25)% | (0.95)% | (0.47)% | (0.72)% |
| Ratio of allowance for credit losses to total period end loans | | | 2.20% | 2.00% |

Other Assets

Other assets included the following:

Other Assets

| Dollars in thousands | September 30, 2003 | December 31, 2002 | September 30, 2002 |
|----------------------|-----------------------|----------------------|-----------------------|
|----------------------|-----------------------|----------------------|-----------------------|

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| | | | | | | |
|--|----|---------|----|---------|----|---------|
| Interest rate swap mark-to-market | \$ | 52,231 | \$ | 56,690 | \$ | 55,445 |
| Accrued interest receivable | | 43,716 | | 45,124 | | 46,122 |
| Claim in receivership and other assets | | 23,758 | | 23,142 | | 23,067 |
| Loans held-for-sale | | | | 18,155 | | 37,236 |
| Income tax refund | | | | 3,464 | | 810 |
| Other | | 52,967 | | 40,191 | | 42,216 |
| Total other assets | \$ | 172,672 | \$ | 186,766 | \$ | 204,896 |

The claim in receivership and other assets were acquired in the acquisition of Pacific Bank. The claim in receivership, which is approximately half of the balance, is expected to be realized in 2003.

See [Net Interest Income](#) for a discussion of interest rate swaps that result in the swap mark-to-market asset of \$52.2 million.

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 any condition 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 outstanding and unfunded loan commitments aggregating \$3,416.1 million at September 30, 2003. In addition, the Company had \$359.2 million outstanding in bankers' acceptances and letters of credit of which \$304.3 million relate to standby letters of credit at September 30, 2003. Substantially all of the Company's loan commitments are on a variable rate basis and are comprised of real estate and commercial loan commitments.

Deposits

Deposits totaled \$10.8 billion at September 30, 2003, an increase of 18 percent compared with \$9.1 billion at September 30, 2002, and increased 6 percent over the \$10.2 billion at June 30, 2003. New clients, additional trust and escrow deposits and a lower earnings credit on analyzed deposit accounts resulting from lower interest rates, contributed to the growth of deposits.

Demand deposits accounted for 50 percent of total deposits at September 30, 2003. Core deposits, which continued to provide substantial benefits to the Bank's cost of funds, were 91 percent of total deposits at September 30, 2003. See — **Net Interest Income**.

Other Borrowings

Other borrowings have declined by \$63.8 million from December 31, 2002 and \$195.8 million from September 30, 2002 to \$700.5 million at September 30, 2003 as deposits have increased. This is despite the \$225 million of 5.125 percent Senior Notes due 2013 issued by the Corporation in February 2003.

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 September 30, 2003, December 31, 2002 and September 30, 2002.

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| | Regulatory Well Capitalized Standards | September 30, 2003 | December 31, 2002 | September 30, 2002 |
|----------------------------------|--|-------------------------------|------------------------------|-------------------------------|
| City National Corporation | | | | |
| Tier 1 leverage | % | 7.37% | 7.55% | 7.88% |
| Tier 1 risk-based capital | 6.00 | 10.76 | 9.87 | 10.16 |
| Total risk-based capital | 10.00 | 14.94 | 14.26 | 14.61 |
| City National Bank | | | | |
| Tier 1 leverage | 5.00 | 7.82 | 7.24 | 7.22 |
| Tier 1 risk-based capital | 6.00 | 11.35 | 9.46 | 9.32 |
| Total risk-based capital | 10.00 | 15.53 | 13.85 | 13.79 |

Tier 1 capital ratios include the impact of \$26.0 million of preferred stock issued by real estate investment trust subsidiaries of the Bank which is included in minority interest in consolidated subsidiaries.

On January 22, 2003, the Board of Directors authorized a 1 million-share stock buyback program. No shares were repurchased during the third quarter of 2003. A total number of 750,100 shares have been repurchased under this program at an average price of \$42.47 per share leaving 249,900 shares available for repurchase. Shares will be repurchased on a selective basis from time to time in open market transactions. The shares purchased under the buyback programs may be reissued for acquisitions, upon the exercise of stock options, or for other general corporate purposes. There were 1,545,450 treasury shares at September 30, 2003.

On July 15, 2003, the Board of Directors authorized the repurchase of 500,000 additional shares of City National Corporation stock, following completion of the Company's current buyback initiative.

On October 22, 2003, the Corporation declared a regular quarterly cash dividend on common stock at a rate of \$0.28 per share to shareholders of record on November 5, 2003, payable on November 17, 2003.

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.

Average core deposits and shareholders' equity comprised 84 percent of total funding of average assets in the third quarter of 2003, compared with 79 percent in the third quarter of 2002. This increase allowed the Company to decrease its use of more costly alternative funding sources. See Net Interest Income.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ASSET/LIABILITY MANAGEMENT

The principal objective of asset/liability management is to maximize net interest income subject to margin volatility and liquidity constraints. Margin volatility results when the rate reset (or repricing) characteristics of assets are materially different from those of the Company's liabilities. Liquidity risk results from the mismatching of asset and liability cash flows. Management chooses asset/liability strategies that promote stable earnings and reliable funding. Interest rate risk and funding positions are kept within limits established by the Board of Directors to ensure that risk taking is managed within prudent interest rate and liquidity guidelines.

A quantitative and qualitative discussion about market risk is included on pages A-16 to A-20 of the Corporation's Form 10-K for the year ended December 31, 2002.

Net Interest Simulation: During the first nine months of 2003, the Company maintained a moderate asset sensitive interest rate position. Based on the balance sheet at September 30, 2003, the Company's net interest income simulation model indicates that net interest income would not be substantially adversely impacted by changes in interest rates.

Assuming a static balance sheet, a gradual 100 basis point decline in interest rates over a twelve-month horizon would result in a decrease in projected net interest income of approximately 3.1 percent. The 3.1 percent at-risk amount is up slightly from the previous two quarters, which were 2.3 percent and 3.0 percent at March 31, 2003, and June 30, 2003 respectively. (Note: The 100 basis point decline could cause some rates to be negative. We assume that discount rates may fall to zero but no further.) A gradual 100 basis point increase in interest rates over the next 12-month period would result in an increase in projected net interest income of approximately 2.3 percent. This is little changed from the March 31, 2003 and June 30, 2003 results which were 2.3 percent and 2.4 percent respectively. Exposure remains within ALCO guidelines. The Company continues to use a variety of other tools to manage its asset sensitivity.

Present Value of Equity: The model indicates that the Present Value of Equity (PVE) is somewhat vulnerable to a sudden and substantial change in interest rates. As of September 30, 2003, a 200 basis point increase in interest rates results in a 6.1 percent decline in PVE. This compares to a 2.6 percent decline at December 31, 2002,

and reflects the Company's fixed income investment portfolio. PVE improves slightly as rates decrease due to their very low starting levels.

As of September 30, 2003, the Company had \$1,051.4 million of notional principal in receive fixed-pay LIBOR interest rate swaps, of which \$866.4 million have maturities greater than one year. The Company's interest-rate risk-management instruments had a fair value and credit exposure risk of \$52.2 million and \$70.2 million at September 30, 2003 and June 30, 2003, respectively taking into consideration legal right of offset. The 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 each counterparty that were outstanding at the end of the period. The Company's swap agreements require collateral to mitigate the amount of credit risk if certain market value exposure thresholds are exceeded. As of September 30, 2003, the Company held securities with a total market value of \$37.1 million to reduce counterparty exposure.

At September 30, 2003 the Company's outstanding foreign exchange contracts for both those purchased as well as sold totaled \$114.1 million, all with maturities less than 1 year. Total outstanding foreign exchange contracts for both those purchased as well as sold were \$123.8 million including \$2.4 million of foreign exchange contracts with maturities over 1 year at June 30, 2003. The Company enters into foreign exchange contracts with its clients and counterparty banks primarily for the purpose of offsetting or hedging for clients' transaction and economic exposures arising out of commercial transactions. The Company's policies also permit limited proprietary currency positioning. The Company actively manages its foreign exchange exposures within prescribed risk limits and controls.

ITEM 4. CONTROL AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Under SEC rules, the Company is required to maintain disclosure controls and procedures designed to ensure that information required by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. As part of the Company's system of disclosure controls and procedures, we have created a disclosure committee which consists of certain members of the Company's senior management. The Company's disclosure controls and procedures are designed to ensure that material information related to the Company, including its consolidated subsidiaries, is made known to management, including the chief executive officer, chief financial officer and other members of the disclosure committee, in a timely manner.

The Company has carried out an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures as of the end of the period covered by this report. The Company's management, including the Company's disclosure committee and its chief executive officer and chief financial officer, supervised and participated in the evaluation. Based on the evaluation, the chief executive officer and the chief financial officer concluded that the Company's disclosure controls and procedures were effective as of the evaluation date.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have not been any changes in the Company's internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are 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, some of which are beyond the Corporation's ability to control or predict, could cause future results to differ materially from those contemplated by such forward-looking statements. These factors include (1) the unknown economic impact caused by the State of California's budget issues, (2) earthquake or other natural disasters impacting the condition of real estate collateral or business operations and (3) the effect of acquisitions and integration of acquired businesses, any of which could hurt our business.

Loan delinquencies may increase;

Problem assets and foreclosures may increase;

Demand for our products and services may decline; and

Collateral for loans made by us, especially real estate, may decline in value, in turn reducing clients' borrowing power, and reducing the value of assets and collateral associated with our existing loans.

Changes in interest rates affect our profitability. We derive our income mainly from the difference or spread between the interest earned on loans, securities, and other interest-earning assets, and interest paid on deposits, borrowings, and other interest-bearing liabilities. In general, the wider the spread, the more we earn. When market rates of interest change, the interest we receive on our assets and the interest we pay on our liabilities fluctuates. This causes changes in our spread and affects our net interest income. In addition, interest rates affect how much money we lend.

Significant changes in the provision or applications of laws or regulations affecting our business could materially affect our business. The banking industry is subject to extensive federal and state regulations, and significant new laws or changes in, or repeals of, existing laws may cause results to differ materially. Also, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects our credit conditions, primarily through open market operations in U.S. government securities, the discount rate for member bank borrowing, and bank reserve requirements. A material change in these conditions would affect our results. Parts of our business are also subject to federal and state securities laws and regulations. Significant changes in these laws and regulations would also affect our business.

We face strong competition from financial service companies and other companies that offer banking services which can hurt our business. Increased competition in our market may result in reduced loans and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer

the banking services that we offer in our service area. These competitors include national, regional, and community banks. We also face competition from many other types of financial institutions, including, without limitation, savings and loans, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks, and other financial intermediaries. Recently passed legislation will make it easier for other types of financial institutions to compete with us.

Our results would be adversely affected if we suffered higher than expected losses on our loans. We assume risk from the possibility that we will suffer losses because borrowers, guarantors, and related parties fail to perform under the terms of their loans. We try to minimize this risk by adopting and implementing what we believe are effective underwriting and credit policies and procedures, including how we establish and review the allowance for credit losses. We assess the likelihood of nonperformance, track loan performance, and diversify our credit portfolio. Those policies and procedures may still not prevent unexpected losses that could adversely affect our results.

Our financial results could be adversely affected by proposed and/or recently adopted changes in regulatory, judicial, or legislative tax matters, including recent changes in California legislative tax treatment of business transactions.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

| | | |
|-----|--------------------|--|
| (a) | Exhibits | |
| | No. | |
| | 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 |
| (b) | Report on Form 8-K | |
| | | On October 15, 2003, the Corporation filed a report on Form 8-K under item 9 (Regulation FD Disclosure) and item 12 (results of Operations and Financial Condition) of Form 8-K regarding the financial results for the quarter and nine months ended September 30, 2003. Included in the report was a press release dated October 15, 2003. |

SIGNATURES

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: November 14, 2003

/s/ Frank P. Pekny

FRANK P. PEKNY
Executive Vice President and
Chief Financial Officer/Treasurer
(Authorized Officer and
Principal Financial Officer)

