CITY NATIONAL CORP
Form 10-Q
November 08, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-10521

CITY NATIONAL CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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

City National Plaza

555 South Flower Street, Los Angeles, California, 90071

(Address of principal executive offices)(Zip Code)

(213) 673-7700

(Registrant s telephone number, including area code)

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

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

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

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

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

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

As of October 29, 2010, there were 52,118,347 shares of Common Stock outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CITY NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts)	September 30, 2010 (Unaudited)	December 31, 2009	September 30, 2009 (Unaudited)
Assets			
Cash and due from banks	$ 224,363	$ 364,483	$ 348,958
Due from banks - interest-bearing	506,081	443,443	767,362
Federal funds sold	395,010	5,000	240,000
Securities available-for-sale - cost $5,275,623, $4,319,420, and $3,480,659 at September 30, 2010, December 31, 2009 and September 30, 2009, respectively:			
Securities pledged as collateral		226,985	226,497
Held in portfolio	5,397,870	4,079,773	3,285,575
Trading securities	170,750	154,302	188,904
Loans and leases, excluding covered loans	11,418,625	12,146,908	12,168,490
Less: Allowance for loan and lease losses	274,167	288,493	265,005
Loans and leases, excluding covered loans, net	11,144,458	11,858,415	11,903,485
Covered loans, net of allowance for loan losses	1,910,133	1,851,821	
Net loans and leases	13,054,591	13,710,236	11,903,485
Premises and equipment, net	123,427	124,309	126,097
Deferred tax asset	86,948	164,038	173,752
Goodwill	479,982	479,982	491,501
Customer-relationship intangibles, net	42,610	45,601	41,866
Bank-owned life insurance	78,897	76,834	76,155
Affordable housing investments	98,667	93,429	92,170
Customers acceptance liability	2,970	2,951	3,476
Other real estate owned ($110,391 and $60,558 covered by FDIC loss share at September 30, 2010 and December 31, 2009, respectively)	168,853	113,866	43,969
FDIC indemnification asset	324,240	380,743	
Other assets	668,357	612,782	390,837
Total assets	$ 21,823,616	$ 21,078,757	$ 18,400,604
Liabilities			
Demand deposits	$ 8,455,164	$ 7,753,936	$ 7,441,898
Interest checking deposits	1,513,924	2,278,586	1,776,643
Money market deposits	6,711,758	4,546,532	4,220,737
Savings deposits	288,417	393,177	276,087
Time deposits-under $100,000	373,276	756,616	210,344
Time deposits-$100,000 and over	1,071,067	1,650,601	1,182,734
Total deposits	18,413,606	17,379,448	15,108,443
Federal funds purchased and securities sold under repurchase agreements		626,779	231,903
Other short-term borrowings	710	690	720
Current portion of subordinated debt	155,649		
Subordinated debt	179,384	340,137	341,587
Long-term debt	771,408	471,029	233,536

Reserve for off-balance sheet credit commitments	20,401	17,340	19,576
Acceptances outstanding	2,970	2,951	3,476
Other liabilities	255,358	176,238	192,974
Total liabilities	19,799,486	19,014,612	16,132,215
Redeemable noncontrolling interest	46,967	51,381	49,897
Commitments and contingencies			
Equity			
Preferred stock; 5,000,000 shares authorized; 200,000 and 400,000 shares issued and aggregate liquidation preference of $200,000 and $400,000 at December 31, 2009 and September 30, 2009, respectively		196,048	391,593
Common stock, par value $1.00 per share; 75,000,000 shares authorized; 53,885,886 shares issued at September 30, 2010, December 31, 2009 and September 30, 2009	53,886	53,886	53,886
Additional paid-in capital	487,919	513,550	514,904
Accumulated other comprehensive income (loss)	73,369	(3,049)	24,329
Retained earnings	1,447,569	1,377,639	1,363,176
Treasury shares, at cost - 1,771,740, 2,349,430 and 2,386,899 shares at September 30, 2010, December 31, 2009 and September 30, 2009, respectively	(110,769)	(151,751)	(154,245)
Total common shareholders equity	1,951,974	1,790,275	1,802,050
Total shareholders equity	1,951,974	1,986,323	2,193,643
Noncontrolling interest	25,189	26,441	24,849
Total equity	1,977,163	2,012,764	2,218,492
Total liabilities and equity	$ 21,823,616	$ 21,078,757	$ 18,400,604

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(in thousands, except per share amounts)	For the three months ended September 30, 2010	2009	For the nine months ended September 30, 2010	2009
Interest Income				
Loans and leases	$ 177,526	$ 145,756	$ 521,430	$ 433,636
Securities available-for-sale	35,716	34,243	100,783	90,835
Trading securities	34	31	6	465
Due from banks - interest-bearing	546	259	1,315	705
Federal funds sold and securities purchased under resale agreements	239	130	396	145
Total interest income	214,061	180,419	623,930	525,786
Interest Expense				
Deposits	12,417	12,854	38,165	48,483
Federal funds purchased and securities sold under repurchase agreements	1,652	2,016	5,291	6,279
Subordinated debt	4,697	3,220	14,001	5,294
Other long-term debt	7,579	988	21,245	3,803
Other short-term borrowings			9	113
Total interest expense	26,345	19,078	78,711	63,972
Net interest income	187,716	161,341	545,219	461,814
Provision for credit losses on loans and leases, excluding covered loans	13,000	85,000	100,000	205,000
Provision for losses on covered loans	8,233		54,749	
Net interest income after provision	166,483	76,341	390,470	256,814
Noninterest Income				
Trust and investment fees	32,695	32,289	100,180	83,342
Brokerage and mutual fund fees	6,494	6,041	17,236	22,443
Cash management and deposit transaction charges	11,620	13,142	36,204	39,143
International services	7,905	7,895	22,787	22,416
Bank-owned life insurance	727	639	2,063	2,373
FDIC loss sharing (expense) income, net	(377)		37,048	
Gain (loss) on disposal of assets	2,603	(173)	1,180	(130)
Gain on sale of securities	451	3,445	2,940	3,795
Gain on acquisition	2,111		27,339	
Other	2,721	6,345	20,991	21,366
Impairment loss on securities:				
Total other-than-temporary impairment loss on securities	(11,739)	(20,588)	(13,248)	(34,161)
Less: Portion of loss recognized in other comprehensive income	11,587	19,810	11,587	19,810
Net impairment loss recognized in earnings	(152)	(778)	(1,661)	(14,351)
Total noninterest income	66,798	68,845	266,307	180,397
Noninterest Expense				
Salaries and employee benefits	103,397	80,776	297,966	234,690
Net occupancy of premises	14,463	12,613	40,715	37,433
Legal and professional fees	10,633	8,706	33,570	24,347
Information services	7,940	7,342	22,994	20,814
Depreciation and amortization	6,351	6,472	19,061	18,417

Marketing and advertising		4,954		4,615		16,000		14,034
Office services and equipment		4,035		3,610		12,105		11,136
Amortization of intangibles		2,228		1,726		6,803		5,237
Other real estate owned		12,642		2,231		46,731		4,481
FDIC assessments		7,561		5,308		21,744		22,237
Other operating		10,477		10,366		29,613		28,058
Total noninterest expense		184,681		143,765		547,302		420,884
Income before income taxes		48,600		1,421		109,475		16,327
Income taxes		13,461		(6,966)		15,020		(6,320)
Net income	$	35,139	$	8,387	$	94,455	$	22,647
Less: Net income attributable to noncontrolling interest		721		348		3,021		375
Net income attributable to City National Corporation	$	34,418	$	8,039	$	91,434	$	22,272
Less: Dividends and accretion on preferred stock				5,502		5,702		16,504
Net income available to common shareholders	$	34,418	$	2,537	$	85,732	$	5,768
Net income per share, basic	$	0.65	$	0.05	$	1.63	$	0.11
Net income per share, diluted	$	0.65	$	0.05	$	1.62	$	0.11
Shares used to compute income per share, basic		52,105		51,482		51,937		49,855
Shares used to compute income per share, diluted		52,498		51,660		52,391		49,987
Dividends per share	$	0.10	$	0.10	$	0.30	$	0.45

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)	**For the nine months ended September 30, 2010**	**2009**
Cash Flows From Operating Activities		
Net income	$ 94,455	$ 22,647
Adjustments to net income:		
Provision for credit losses on loans and leases, excluding covered loans	100,000	205,000
Provision for losses on covered loans	54,749	
Amortization of intangibles	6,803	5,237
Depreciation and amortization	19,061	18,417
Amortization of cost and discount on long-term debt	614	436
Share-based employee compensation expense	12,425	10,786
(Gain) loss on disposal of assets	(1,180)	130
Gain on sale of securities	(2,940)	(3,795)
Gain on acquisition	(27,339)	
Impairment loss on securities	1,661	14,351
Other, net	(14,127)	2,085
Net change in:		
Trading securities	(16,448)	113,094
Deferred income tax benefit	18,727	(470)
Other assets and other liabilities, net	247,074	(143,336)
Net cash provided by operating activities	493,535	244,582
Cash Flows From Investing Activities		
Purchases of securities available-for-sale	(2,933,612)	(2,440,987)
Sales of securities available-for-sale	436,894	554,834
Maturities and paydowns of securities available-for-sale	1,535,868	618,141
Loan originations, net of principal collections	751,982	73,617
Net payments for premises and equipment	(18,179)	(10,432)
Net cash acquired (paid) in acquisitions	94,706	(18,328)
Other investing activities, net	39,824	2,779
Net cash used in investing activities	(92,517)	(1,220,376)
Cash Flows From Financing Activities		
Net increase in deposits	492,659	2,456,319
Net decrease in federal funds purchased and securities sold under repurchase agreements	(626,779)	(676,254)
Net decrease in short-term borrowings, net of transfers from long-term debt	(30,519)	(123,780)
Net increase in other borrowings	294,858	170,900
Proceeds from exercise of stock options	18,578	1,150
Tax benefit from exercise of stock options	3,186	141
Redemption of preferred stock	(200,000)	
Issuance of common stock		119,929
Repurchase of common stock warrants	(18,500)	
Cash dividends paid	(18,737)	(36,883)
Other financing activities, net	(3,236)	(3,673)
Net cash (used in) provided by financing activities	(88,490)	1,907,849
Net increase in cash and cash equivalents	312,528	932,055
Cash and cash equivalents at beginning of year	812,926	424,265
Cash and cash equivalents at end of period	$ 1,125,454	$ 1,356,320
Supplemental Disclosures of Cash Flow Information:		

Cash paid during the period for:				
Interest	$	83,921	$	63,804
Income taxes				17,689
Non-cash investing activities:				
Transfer of loans to other real estate owned	$	116,010	$	47,715
Transfer from securities available-for-sale to trading securities				6,400
Assets acquired (liabilities assumed) in acquisitions:				
Securities available-for-sale	$	17,183	$	
Covered loans		330,566		
Covered other real estate owned		15,161		
Deposits		(541,499)		
Other borrowings		(30,539)		

See accompanying Notes to the Unaudited Consolidated Financial Statements.

Table of Contents

CITY NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

AND COMPREHENSIVE INCOME

(Unaudited)

	City National Corporation Shareholders Equity								
(in thousands, except share amounts)	**Common shares issued**	**Preferred stock**	**Common stock**	**Additional paid-in capital**	**Accumulated other comprehensive income (loss)**	**Retained earnings**	**Treasury shares**	**Non-controlling interest**	**Total equity**
Balance, January 1, 2009	50,961,457	$ 390,089	$ 50,961	$ 389,077	$ (48,022)	$ 1,379,624	$ (156,736)	$ 25,441	$ 2,030,434
Net income (1)						22,272		1,625	23,897
Other comprehensive income, net of tax:									
Amortization of prior service cost					119				119
Non-credit related impairment loss on investment securities, net of taxes of $8.3 million					(11,523)				(11,523)
Net unrealized gain on securities available-for-sale, net of taxes of $60.9 million and reclassification of $2.0 million net loss included in net income					84,657				84,657
Net unrealized loss on cash flow hedges, net of taxes of $0.6 million and reclassification of $5.2 million net gain included in net income					(902)				(902)
Total comprehensive income								1,625	96,248
Dividends and distributions to noncontrolling interest								(1,717)	(1,717)
Issuance of common stock	3,220,000		3,220	116,409					119,629
Issuance of shares under share-based compensation plans	(295,571)		(295)	(1,814)			2,491		382
Preferred stock accretion		1,504				(1,504)			
Share-based employee compensation expense				10,693					10,693
Tax expense from share-based compensation plans				(714)					(714)
Cash dividends:									
Preferred						(15,000)			(15,000)
Common						(22,216)			(22,216)
Net change in deferred compensation plans				492					492
Change in redeemable noncontrolling interest				761					761
Other								(500)	(500)
Balance, September 30, 2009	53,885,886	$ 391,593	$ 53,886	$ 514,904	$ 24,329	$ 1,363,176	$ (154,245)	$ 24,849	$ 2,218,492
Balance, January 1, 2010	53,885,886	$ 196,048	$ 53,886	$ 513,550	$ (3,049)	$ 1,377,639	$ (151,751)	$ 26,441	$ 2,012,764
Net income (1)						91,434		1,606	93,040

Other comprehensive income, net of tax:									
Amortization of prior service cost					119				119
Non-credit related impairment loss on investment securities, net of taxes of $4.8 million					(6,740)				(6,740)
Net unrealized gain on securities available-for-sale, net of taxes of $61.3 million and reclassification of $0.6 million net gain included in net income					85,215				85,215
Net unrealized loss on cash flow hedges, net of taxes of $3.1 million and reclassification of $4.3 million net gain included in net income					(2,176)				(2,176)
Total comprehensive income								1,606	169,458
Dividends and distributions to noncontrolling interest								(1,606)	(1,606)
Issuance of shares under share-based compensation plans				(23,671)			40,885		17,214
Preferred stock accretion		3,952				(3,952)			
Redemption of preferred stock		(200,000)							(200,000)
Repurchase of common stock warrants				(18,500)					(18,500)
Share-based employee compensation expense				12,367					12,367
Tax benefit from share-based compensation plans				2,107					2,107
Cash dividends:									
Preferred						(1,750)			(1,750)
Common						(15,802)			(15,802)
Net change in deferred compensation plans				350			97		447
Change in redeemable noncontrolling interest				1,716					1,716
Other								(1,252)	(1,252)
Balance, September 30, 2010	53,885,886	$	$ 53,886	$ 487,919	$ 73,369	$ 1,447,569	$ (110,769)	$ 25,189	$ 1,977,163

(1) Net income excludes net income (loss) attributable to redeemable noncontrolling interest of $1,415 and ($1,250) for the nine-month periods ended September 30, 2010 and 2009, respectively. Redeemable noncontrolling interest is reflected in the mezzanine section of the consolidated balance sheets. See Note 16 of the Notes to the Unaudited Consolidated Financial Statements.

See accompanying Notes to the Unaudited Consolidated Financial Statements.

CITY NATIONAL CORPORATION

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Organization

City National Corporation (the Corporation) is the holding company for City National Bank (the Bank). The Bank delivers banking, trust and investment services through 74 offices in Southern California, the San Francisco Bay area, Nevada and New York City. The Corporation has seven consolidated investment advisory affiliates and a noncontrolling interest in two other firms. The Corporation also has two unconsolidated subsidiaries, Business Bancorp Capital Trust I and City National Capital Trust I. 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 approved as a financial holding company pursuant to the Gramm-Leach-Bliley Act of 1999.

Consolidation

The consolidated financial statements of the Company include the accounts of the Corporation, its non-bank subsidiaries, the Bank and the Bank s wholly owned subsidiaries, after the elimination of all material intercompany transactions. The Company has both redeemable and non-redeemable noncontrolling interest. A noncontrolling interest is the portion of equity in a subsidiary not attributable to a parent. Preferred stock of consolidated bank affiliates that is owned by third parties is reflected as Noncontrolling interest in the equity section of the consolidated balance sheets. Redeemable noncontrolling interest includes noncontrolling ownership interests that are redeemable at the option of the holder or outside the control of the issuer. The redeemable equity ownership interests of third parties in the Corporation s investment advisory affiliates are not considered to be permanent equity and are reflected as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated balance sheets. Noncontrolling interests share of subsidiary earnings is reflected as Net income attributable to noncontrolling interest in the consolidated statements of income.

The Company s investment management and wealth advisory affiliates are organized as limited liability companies. The Corporation generally owns a majority position in each affiliate and certain management members of each affiliate own the remaining shares. The Corporation has contractual arrangements with its affiliates whereby a percentage of revenue is allocable to fund affiliate operating expenses (operating share) while the remaining portion of revenue (distributable revenue) is allocable to the Corporation and the noncontrolling owners. All majority-owned affiliates that meet the prescribed criteria for consolidation are consolidated. In November 2009, the Company deconsolidated one of its affiliates, but retained a noncontrolling interest in that affiliate. The Corporation s interests in two investment management affiliates in which it holds a noncontrolling share are accounted for using the equity method. Additionally, the Company has various interests in variable interest entities (VIEs) that are not required to be consolidated. See Note 15 for a more detailed discussion on VIEs.

Use of Estimates

The Company s accounting and reporting policies conform to generally accepted accounting principles (GAAP) and practices in the financial services industry. To prepare the financial statements in conformity with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and income and expenses during the reporting period. Circumstances and events that differ significantly from those underlying the Company s estimates and assumptions could cause actual financial results to differ from those estimates. The material estimates included in the financial statements relate to the allowance for loan and lease losses, the reserve for off-balance sheet credit commitments, valuation of stock options and restricted stock, income taxes, goodwill and intangible asset impairment, securities available-for-sale impairment, private equity and alternative investment impairment, valuation of assets and liabilities acquired in business combinations, subsequent valuations of covered loans, valuation of noncontrolling interest and the valuation of financial assets and liabilities reported at fair value.

The Company has applied its critical accounting policies and estimation methods consistently in all periods presented in these financial statements.

Table of Contents

Note 1. Summary of Significant Accounting Policies (Continued)

Basis of Presentation

The Company is on the accrual basis of accounting for income and expenses. The results of operations reflect any adjustments, all of which are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q, and which, in the opinion of management, are necessary for a fair presentation of the results for the periods presented. In accordance with the usual practice of banks, assets and liabilities of individual trust, agency and fiduciary funds have not been included in the financial statements. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

The results for the 2010 interim period are not necessarily indicative of the results expected for the full year. The Company has not made any significant changes in its critical accounting policies or in its estimates and assumptions from those disclosed in its 2009 Annual Report other than the adoption of new accounting pronouncements and other authoritative guidance that became effective for the Company on or after January 1, 2010. Refer to *Accounting Pronouncements* for discussion of accounting pronouncements adopted in 2010.

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

Accounting Pronouncements

During the nine months ended September 30, 2010, the following accounting pronouncements applicable to the Company were issued or became effective:

- In December 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-16, which codifies FASB Statement No. 166, *Accounting for Transfers of Financial Assets* into Accounting Standards Codification (ASC) Topic 860. ASU 2009-16 represents a revision to former FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. ASU 2009-16 expands required disclosures about transfers of financial assets and the risks associated with a transferor s continuing involvement with transferred assets. It also removes the concept of qualifying special-purpose entity from U.S. GAAP. The new guidance became effective for the Company on January 1, 2010. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements.

- In December 2009, the FASB issued ASU 2009-17, which codifies FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*, into ASC Topic 810, *Consolidations* (ASC 810). ASU 2009-17 revises former FASB Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities.* The revised guidance requires, among other things, that an entity perform both a quantitative and qualitative analysis to determine if it is the primary beneficiary of a VIE and therefore required to consolidate the VIE. The qualitative analysis includes determining whether an entity has the power to direct the most significant activities of the VIE. The amended guidance also requires consideration of related party relationships in the determination of the primary beneficiary of a VIE and enhanced disclosures about an enterprise s involvement with a VIE. The new guidance became effective for the Company on January 1, 2010. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements.

- In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements (Topic 820), Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 enhances disclosure requirements under ASC Topic 820, *Fair Value Measurements and Disclosures* (ASC 820), to include disclosure of transfers in and out of Level 1 and 2, and detail of activity in Level 3 fair value measurements. The ASU also provides clarification of existing disclosure requirements pertaining to the level of disaggregation used in fair value measurements, and disclosures about inputs and valuation techniques used for both recurring and nonrecurring fair value measurements. The new guidance, except for the requirement to provide the Level 3 activity on a gross basis, became effective for the Company on January 1, 2010. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements. The expanded disclosure requirements pertaining to Level 3 activity will be effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

Table of Contents

Note 1. Summary of Significant Accounting Policies (Continued)

• In February 2010, the FASB issued ASU 2010-09, *Subsequent Events* (*Topic 855), Amendments to Certain Recognition and Disclosure Requirements* (ASU 2010-09). ASU 2010-09 addresses the interaction of the requirements of Subtopic 855-10 with the SEC s reporting requirements. The amendments in the ASU provide that an entity that is an SEC filer is required to evaluate subsequent events through the date that the financial statements are issued. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. The ASU also refines the scope of disclosure requirements pertaining to revised financial statements. The new guidance became effective for the Company upon issuance. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements.

• In February 2010, the FASB issued ASU 2010-10, *Consolidation (Topic 810), Amendments for Certain Investment Funds* (ASU 2010-10). ASU 2010-10 defers the effective date of the consolidation provisions contained in ASU 2009-17 for a reporting entity s interest in an entity: (1) that has attributes of an investment company; or (2) for which it is industry practice to apply measurement principles for financial reporting purposes that are consistent with those followed by investment companies. The ASU also clarifies how a related party s interests in an entity should be considered when evaluating the criteria for determining whether a decision maker or service provider fee represents a variable interest. In addition, the ASU clarifies that a quantitative calculation should not be the sole basis for evaluating whether a decision maker s or service provider s fee is a variable interest. The new guidance became effective for the Company on January 1, 2010. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements.

• In April 2010, the FASB issued ASU 2010-18, *Receivables (Topic 310), Effect of a Loan Modification When the Loan is Part of a Pool That is Accounted for as a Single Asset* (ASU 2010-18). ASU 2010-18 applies to loans that are currently accounted for under ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30), as part of a pool of loans that, when acquired, had deteriorated in credit quality. Under the guidance, modification of a loan that is part of a pool accounted for under ASC 310-30 should not result in removal of the loan from the pool. Such modifications would include those that would otherwise qualify as a troubled debt restructuring had the loan not been part of a pool. ASU 2010-18 is effective for any modifications of a loan accounted for within a pool in the first interim reporting period ending after July 15, 2010, and will be applied prospectively. Early application is permitted as long as an entity has not issued financial statements in that fiscal year. The Company elected to early adopt ASU 2010-18 effective with March 31, 2010 reporting. Adoption of the new guidance did not have a material effect on the Company s consolidated financial statements.

• In July 2010, the FASB issued ASU 2010-20, *Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses* (ASU 2010-20) which requires new and enhanced disclosures about the credit quality of an entity s financing receivables and its allowance for credit losses. The new and amended disclosure requirements focus on such areas as nonaccrual and past due financing receivables, allowance for credit losses related to financing receivables, impaired loans, credit quality information and modifications. The ASU requires an entity to disaggregate new and existing disclosures based on how it develops its allowance for credit losses and how it manages credit exposures. The expanded disclosures as of the end of the reporting period are effective for interim or annual reporting periods ending after December 15, 2010. These period-end disclosure requirements will become effective for the Company with its 2010 Form 10-K. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The ASU encourages, but does not require, comparative disclosures for earlier reporting periods that ended before initial adoption. The Company is evaluating the impact of adoption of ASU 2010-20 on its disclosures in the consolidated financial statements.

Table of Contents

Note 2. Business Combinations

1st Pacific Bank of California and Sun West Bank

On May 7, 2010, the Bank acquired the banking operations of 1st Pacific Bank of California (FPB) in a purchase and assumption agreement with the Federal Deposit Insurance Corporation (FDIC). Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately $318.6 million in assets and assumed $264.2 million in liabilities. The Bank acquired most of FPB s assets, including loans with a fair value of $202.8 million and assumed deposits with a fair value of $237.2 million. The Bank paid $12.3 million in cash to the FDIC. The acquisition of FPB added five new bank branches in California.

On May 28, 2010, the Bank acquired the banking operations of Sun West Bank (SWB) in Las Vegas, Nevada in a purchase and assumption agreement with the FDIC. Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately $340.0 million in assets and assumed $310.1 million in liabilities. The Bank acquired most of SWB s assets, including loans and other real estate owned (OREO) with a fair value of $127.6 million and $12.1 million, respectively, and assumed deposits with a fair value of $304.3 million. The Bank received approximately $29.2 million in cash from the FDIC. The acquisition of SWB added three new bank branches in Nevada.

In connection with the acquisitions of FPB and SWB, the Bank entered into loss-sharing agreements with the FDIC under which the FDIC will reimburse the Bank for 80 percent of eligible losses with respect to covered assets. Covered assets include acquired loans (covered loans) and OREO (covered OREO) that are covered under the loss-sharing agreement with the FDIC. Under the FPB loss-sharing agreement, the Company has a first loss tranche that is not reimbursable by the FDIC. At acquisition date, the first loss tranche was determined by the FDIC to be $22.3 million but was later amended by the FDIC to $19.8 million in September 2010. The Company will recognize losses of up to $19.8 million, and all subsequent losses above that threshold will then be subject to FDIC reimbursement of 80 percent. There is no first loss tranche under the SWB loss-sharing agreement. The term of the loss share agreements is ten years for single family residential loans and five years for all other loans. The expected reimbursements under the loss-sharing agreements were recorded as indemnification assets at their estimated fair value of $36.5 million for FPB and $104.6 million for SWB. The difference between the fair value of the FDIC indemnification asset and the undiscounted cash flows that the Bank expects to collect from the FDIC is accreted into noninterest income.

The Bank recognized a $3.8 million liability in the acquisition of FPB relating to a requirement that the Bank reimburse the FDIC if actual cumulative losses are lower than the cumulative losses originally estimated by the FDIC prior to the acquired bank s failure. There was no similar liability recognized in the acquisition of SWB.

During the second quarter of 2010, the Bank recognized a gain of $0.5 million and $24.7 million on the acquisitions of FPB and SWB, respectively. The gain represents the amount by which the fair value of the assets acquired and consideration received from or paid to the FDIC exceeds the liabilities assumed. During the third quarter of 2010, the Bank recognized an additional gain of $2.1 million when the first loss tranche under the FPB loss-sharing agreement was revised from $22.3 million to $19.8 million. Acquisition gains are reported in Gain on acquisition in the consolidated statements of income.

Imperial Capital Bank

On December 18, 2009, the Bank acquired the banking operations of Imperial Capital Bank (ICB) in a purchase and assumption agreement with the FDIC. Excluding the effects of acquisition accounting adjustments, the Bank acquired approximately $3.25 billion in assets and assumed $3.09 billion in liabilities. The Bank acquired most of ICB s assets, including loans and OREO with a fair value of $1.86 billion and $58.8 million, respectively, and assumed deposits of $2.08 billion. The Bank received approximately $70.8 million in cash from the FDIC and recorded a receivable for an additional $5.3 million expected in 2010. A gain of $38.2 million was recognized on the acquisition in 2009. The acquisition of ICB added three new bank branches in California.

Table of Contents

Note 2. Business Combinations (Continued)

In connection with the acquisition, the Bank entered into a loss-sharing agreement with the FDIC under which the FDIC will reimburse the Bank for 80 percent of eligible losses up to $649 million and 95 percent of eligible losses in excess of $649 million. The term of the loss share agreement is ten years for single family residential loans and seven years for all other loans. The expected reimbursements under the loss-sharing agreement were recorded as an indemnification asset at their estimated fair value of $380.0 million at the acquisition date. The difference between the fair value of the FDIC indemnification asset and the undiscounted cash flow the Bank expects to collect from the FDIC is accreted into noninterest income.

In the last three quarters of the seventh year of the agreement, the Bank has the right, without FDIC consent, to sell up to $400 million of the remaining covered loans, provided the properties securing those loans have a current independent appraisal that supports a loan-to-value ratio of 75 percent or more of the covered loans book value.

Note 3. Fair Value Measurements

ASC 820 defines fair value for financial reporting purposes as the price that would be received to sell an asset or paid to transfer a liability in an orderly market transaction between market participants at the measurement date (reporting date). Fair value is based on an exit price in the principal market or most advantageous market in which the reporting entity could transact.

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

Fair Value Hierarchy

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

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

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

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

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

The Company records securities available-for-sale, trading securities and derivative contracts at fair value on a recurring basis. Certain other assets such as impaired loans, OREO, goodwill, customer-relationship intangibles and private equity investments are recorded at fair value on a nonrecurring basis. Nonrecurring fair value measurements typically involve assets that are periodically evaluated for impairment and for which any impairment is recorded in the period in which the remeasurement is performed.

Table of Contents

Note 3. Fair Value Measurements (Continued)

The following tables summarize assets and liabilities measured at fair value as of September 30, 2010, December 31, 2009 and September 30, 2009 by level in the fair value hierarchy:

		Fair Value Measurements at Reporting Date Using		
(in thousands)	Balance as of September 30, 2010	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Measured on a Recurring Basis				
Assets				
Securities available-for-sale				
U.S. Treasury	$ 19,117	$ 19,117	$	$
Federal agency - Debt	1,311,936		1,311,936	
Federal agency - MBS	508,508		508,508	
CMOs - Federal agency	2,923,601		2,923,601	
CMOs - Non-agency	205,320		205,320	
State and municipal	360,471		360,471	
Other debt securities	58,890		38,594	20,296
Equity securities and mutual funds	10,027	10,027		
Trading securities	170,750	154,309	16,441	
Mark-to-market derivatives (1)	66,191	3,547	62,644	
Total assets at fair value	$ 5,634,811	$ 187,000	$ 5,427,515	$ 20,296
Liabilities				
Mark-to-market derivatives (2)	$ 38,798	$ 1,391	$ 37,407	$
Total liabilities at fair value	$ 38,798	$ 1,391	$ 37,407	$
Measured on a Nonrecurring Basis				
Assets				
Collateral dependent impaired loans (3)				
Commercial	$ 1,869	$	$ 1,869	$
Commercial real estate mortgages	31,733		20,134	11,599
Residential mortgages	9,319		9,319	
Real estate construction	130,744		125,712	5,032
Equity lines of credit	3,485		3,485	
Collateral dependent impaired covered loans (3)				
Commercial	2,633			2,633
Other real estate owned (4)	71,297		59,592	11,705
Private equity investments	8,580			8,580
Total assets at fair value	$ 259,660	$	$ 220,111	$ 39,549

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

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

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

(4) OREO balance of $168.9 million in the consolidated balance sheets includes $110.4 million of covered OREO and is net of estimated disposal costs.

Table of Contents

Note 3. Fair Value Measurements (Continued)

(in thousands)	Balance as of December 31, 2009	Fair Value Measurements at Reporting Date Using: Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Measured on a Recurring Basis				
Assets				
Securities available-for-sale:				
U.S. Treasury	$ 73,597	$ 73,597	$	$
Federal agency - Debt	656,721		656,721	
Federal agency - MBS	555,157		555,157	
CMOs - Federal agency	2,306,111		2,306,111	
CMOs - Non-agency	241,329		241,329	
State and municipal	378,639		378,639	
Other debt securities	76,506		49,727	26,779
Equity securities and mutual funds	18,698	18,698		
Trading securities	154,302	154,302		
Mark-to-market derivatives (1)	52,309	5,335	46,974	
Total assets at fair value	$ 4,513,369	$ 251,932	$ 4,234,658	$ 26,779
Liabilities				
Mark-to-market derivatives (2)	$ 14,577	$ 1,080	$ 13,497	$
Total liabilities at fair value	$ 14,577	$ 1,080	$ 13,497	$
Measured on a Nonrecurring Basis				
Assets				
Collateral dependent impaired loans (3)				
Commercial	$ 450	$	$ 450	$
Commercial real estate mortgages	54,212		34,302	19,910
Residential mortgages	8,112		7,726	386
Real estate construction	176,202		98,387	77,815
Equity lines of credit	912		912	
Other real estate owned (4)	48,920		30,866	18,054
Private equity investments	4,374			4,374
Total assets at fair value	$ 293,182	$	$ 172,643	$ 120,539

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

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

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

(4) OREO balance of $113.9 million in the consolidated balance sheets includes $60.6 million of covered OREO and is net of estimated disposal costs.

Table of Contents

Note 3. Fair Value Measurements (Continued)

(in thousands)	Balance as of September 30, 2009	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Measured on a Recurring Basis				
Assets				
Securities available-for-sale				
U.S. Treasury	$ 13,554	$ 13,554	$	$
Federal agency - Debt	360,284		360,284	
Federal agency - MBS	581,974		581,974	
CMOs - Federal agency	1,781,666		1,781,666	
CMOs - Non-agency	280,856		280,856	
State and municipal	403,264		403,264	
Other debt securities	69,749		42,776	26,973
Equity securities and mutual funds	20,725	20,725		
Trading securities	188,904	175,035	13,040	829
Mark-to-market derivatives (1)	64,414	5,337	59,077	
Total assets at fair value	$ 3,765,390	$ 214,651	$ 3,522,937	$ 27,802
Liabilities				
Mark-to-market derivatives (2)	$ 19,315	$ 624	$ 18,691	$
Total liabilities at fair value	$ 19,315	$ 624	$ 18,691	$
Measured on a Nonrecurring Basis				
Assets				
Collateral dependent impaired loans (3)				
Commercial	$ 414	$	$ 414	$
Commercial real estate mortgages	40,193		40,193	
Residential mortgages	2,472		2,472	
Real estate construction	180,118		180,118	
Equity lines of credit	1,487		1,487	
Other real estate owned (4)	32,758		32,758	
Private equity investments	4,954			4,954
Total assets at fair value	$ 262,396	$	$ 257,442	$ 4,954

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

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

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

(4) Other real estate owned balance of $44.0 million in the consolidated balance sheets is net of estimated disposal costs.

Table of Contents

Note 3. Fair Value Measurements (Continued)

At September 30, 2010, $5.63 billion, or approximately 26 percent, of the Company s total assets were recorded at fair value on a recurring basis, compared with $4.51 billion or 21 percent at December 31, 2009, and $3.77 billion or 20 percent at September 30, 2009. The majority of these financial assets were valued using Level 1 or Level 2 inputs. Less than a quarter of 1 percent of total assets was measured using Level 3 inputs. Approximately $38.8 million, $14.6 million and $19.3 million of the Company s total liabilities at September 30, 2010, December 31, 2009 and September 30, 2009, respectively, were recorded at fair value on a recurring basis using Level 1 or Level 2 inputs. At September 30, 2010, $259.7 million, or approximately 1 percent of the Company s total assets, were recorded at fair value on a nonrecurring basis, compared with $293.2 million or 1 percent at December 31, 2009, and $262.4 million or 1 percent at September 30, 2009. These assets were measured using Level 2 and Level 3 inputs. There were no transfers of assets or liabilities between Level 1 and Level 2 of the fair value hierarchy during the nine months ended September 30, 2010.

For assets measured at fair value on a nonrecurring basis, the following table presents the total losses (gains), which include charge-offs, specific reserves, valuation write-downs, and net losses on sales of other real estate owned, recognized in the three and nine months ended September 30, 2010 and 2009:

(in thousands)	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Collateral dependent impaired loans				
Commercial	$ 829	$ 368	$ 7,725	$ 5,203
Commercial real estate mortgages	5,288	11,481	22,736	14,737
Residential mortgages	507	573	1,713	1,444
Real estate construction	(5,210)	39,161	4,910	84,613
Equity lines of credit	487	177	538	519
Collateral dependent impaired covered loans				
Commercial	414		414	
Other real estate owned	5,794	4,199	28,410	9,537
Private equity investments	487	1,396	915	1,799
Total losses recognized	$ 8,596	$ 57,355	$ 67,361	$ 117,852

Level 3 assets measured at fair value on a recurring basis include CDO senior notes in the current and prior year periods, and CDO income notes in the first quarter of 2009 only, for which the market is inactive. The fair value of these securities is determined using an internal cash flow model that incorporates management s assumptions about risk-adjusted discount rates, prepayment expectations, projected cash flows and collateral performance. These assumptions are not directly observable in the market. Unrealized gains and losses on securities available-for-sale are reported as a component of Accumulated other comprehensive income (AOCI) in the consolidated balance sheets. Activity in Level 3 assets measured on a recurring basis for the nine months ended September 30, 2010 and 2009 is summarized in the following table:

Level 3 Assets Measured on a Recurring Basis

(in thousands)	September 30, 2010 Securities Available-for-Sale	September 30, 2009 Securities Available-for-Sale	September 30, 2009 Trading Securities	Total Level 3 Assets

Balance, beginning of period	$ 26,779	$ 32,419	$	$ 32,419
Total realized/unrealized gains (losses):				
Included in earnings		(9,281)	(1,618)	(10,899)
Included in other comprehensive income	(4,952)	7,068		7,068
Purchases, sales, issuances and settlements, net	(1,531)	(786)		(786)
Transfers between categories		(2,447)	2,447	
Balance, end of period	$ 20,296	$ 26,973	$ 829	$ 27,802

Table of Contents

Note 3. Fair Value Measurements (Continued)

Level 3 assets measured at fair value on a nonrecurring basis include certain collateral dependent impaired loans, OREO for which fair value is not solely based on market observable inputs, and certain private equity and alternative investments. Non-observable inputs related to valuing loans and OREO may include adjustments to external appraised values based on an internally generated discounted cash flow analysis or management s assumptions about market trends or other factors that are not directly observable. Private equity and alternative investments do not have readily determinable fair values. These investments are carried at cost and evaluated for impairment on a quarterly basis. Due to the lack of readily determinable fair values for these investments, the impairment assessment is based primarily on a review of investment performance and the likelihood that the capital invested would be recovered.

Fair Value of Financial Instruments

A financial instrument is broadly defined as cash, evidence of an ownership interest in another entity, or a contract that imposes a contractual obligation on one entity and conveys a corresponding right to a second entity to require delivery or exchange of a financial instrument. The table below summarizes the estimated fair values for the Company s financial instruments as of September 30, 2010 and September 30, 2009. The disclosure does not include estimated fair value amounts for assets and liabilities which are not defined as financial instruments but which have significant value. These assets and liabilities include the value of customer-relationship intangibles, goodwill, and affordable housing investments carried at cost, other assets, deferred taxes and other liabilities. Accordingly, the total of the fair values presented does not represent the underlying value of the Company.

Following is a description of the methods and assumptions used in estimating the fair values for each class of financial instrument:

Cash and due from banks, Due from banks interest bearing and Federal funds sold For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Securities available-for-sale and Trading securities For securities held as available-for-sale, the fair value is determined by quoted market prices, where available, or on observable market inputs appropriate for the type of security. If quoted market prices or observable market inputs are not available, discounted cash flows may be used to determine an appropriate fair value. Fair value for trading securities is generally based on quoted market prices or dealer quotes. The fair value of trading securities for which quoted prices are not available is based on observable market inputs. The fair value of CDO income notes was determined using a discounted cash flow model.

Loans and leases Loans are not recorded at fair value on a recurring basis. Nonrecurring fair value adjustments are periodically recorded on impaired loans that are measured for impairment based on the fair value of collateral. Due to the lack of activity in the secondary market for the types of loans in the Company s portfolio, a model-based approach is used for determining the fair value of loans for purposes of the disclosures in the table below. The fair value of loans is estimated by discounting future cash flows using discount rates that incorporate the Company s assumptions concerning current market yields, credit risk and liquidity premiums. Loan cash flow projections are based on contractual loan terms adjusted for the impact of current interest rate levels on borrower behavior, including prepayments. Loan prepayment assumptions are based on industry standards for the type of loans being valued. Projected cash flows are discounted using yield curves based on current market conditions. Yield curves are constructed by product type using the Bank s loan pricing model for like-quality credits. The discount rates used in the Company s model represent the rates the Bank would offer to current borrowers for like-quality credits. These rates could be different from what other financial institutions could offer for these loans.

Covered loans The fair value of covered loans is based on estimates of future loan cash flows and appropriate discount rates, which incorporate the Company s assumptions about market funding cost and liquidity premium. The estimates of future loan cash flows are determined using the Company s assumptions concerning the amount and timing of principal and interest payments, prepayments and credit losses.

FDIC indemnification asset The fair value of the FDIC indemnification asset is estimated by discounting estimated future cash flows based on estimated current market rates.

Investment in FRB and FHLB stock Investments in government agency stock are recorded at cost. Ownership of these securities is restricted to member banks and the securities do not have a readily determinable market value. Purchases and sales of these securities are at par value with the issuer. The fair value of investments in FRB and FHLB stock is equal to the carrying amount.

Table of Contents

Note 3. Fair Value Measurements (Continued)

Derivative contracts The fair value of non-exchange traded (over-the-counter) derivatives is obtained from third party market sources. The Company provides client data to the third party source for purposes of calculating the credit valuation component of the fair value measurement of client derivative contracts. The fair values of interest rate contracts include interest receivable and payable and cash collateral, if any.

Deposits The fair value of demand and interest checking deposits, savings deposits, and certain money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is determined by discounting expected future cash flows using the rates offered by the Bank for deposits of similar type and remaining maturity at the measurement date. This value is compared to the termination value of each CD given the bank s standard early withdrawal penalties. The fair value reported is the higher of the discounted present value of each CD and the termination value after the recovery of prepayment penalties. The Bank reviews pricing for its CD products weekly. This review gives consideration to market pricing for products of similar type and maturity offered by other financial institutions.

Federal funds purchased, Securities sold under repurchase agreements and Other short-term borrowings The carrying amount is a reasonable estimate of fair value.

Structured securities sold under repurchase agreements The fair value of structured repurchase agreements is based on market pricing for synthetic instruments with the same term and structure. These values are validated against dealer quotes for similar instruments.

Subordinated and long-term debt The fair value of subordinated and long-term debt is obtained through third-party pricing sources.

FDIC clawback liability The FDIC clawback liability represents an estimated payment by the Company to the FDIC if actual cumulative losses on acquired covered assets are lower than the cumulative losses originally estimated by the FDIC at the time of acquisition. The fair value of the FDIC clawback liability is estimated by discounting estimated future cash flows based on estimated current market rates.

Commitments to extend credit The fair value of these commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The Company does not make fixed-rate loan commitments. The fair value of commitments to extend credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

Commitments to private equity and affordable housing funds The fair value of commitments to invest in private equity and affordable housing funds is based on the estimated cost to terminate them or otherwise settle the obligation.

17

Table of Contents

Note 3. Fair Value Measurements (Continued)

The carrying amounts and fair values of the Company s financial instruments as of September 30, 2010 and September 30, 2009 were as follows:

	September 30, 2010		September 30, 2009	
(in millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial Assets:				
Cash and due from banks	$ 224.4	$ 224.4	$ 349.0	$ 349.0
Due from banks - interest bearing	506.1	506.1	767.4	767.4
Federal funds sold	395.0	395.0	240.0	240.0
Securities available-for-sale	5,397.9	5,397.9	3,512.1	3,512.1
Trading securities	170.8	170.8	188.9	188.9
Loans and leases, net of allowance	11,144.5	11,517.3	11,903.5	12,058.1
Covered loans, net of allowance	1,910.1	1,921.7		
FDIC indemnification asset	324.2	321.6		
Investment in FRB and FHLB stock	124.4	124.4	54.2	54.2
Derivative contracts	66.2	66.2	64.4	64.4
Financial Liabilities:				
Deposits	$ 18,413.6	$ 18,418.8	$ 15,108.4	$ 15,112.5
Federal funds purchased and securities sold under repurchase agreements			31.9	31.9
Structured securities sold under repurchase agreements			200.0	210.1
Other short-term borrowings	0.7	0.7	0.7	0.7
Subordinated and long-term debt	1,106.4	1,140.4	575.1	571.8
Derivative contracts	38.8	38.8	19.3	19.3
FDIC clawback liability	3.6	3.6		
Commitments to extend credit	5.7	21.1		13.7
Commitments to private equity and affordable housing funds	20.8	37.3		36.1

Table of Contents

Note 4. Investment Securities

The following is a summary of amortized cost and estimated fair value for the major categories of securities available-for-sale at September 30, 2010, December 31, 2009 and September 30, 2009:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2010				
U.S. Treasury	$ 19,058	$ 59	$	$ 19,117
Federal agency - Debt	1,304,219	7,717		1,311,936
Federal agency - MBS	486,208	22,300		508,508
CMOs - Federal agency	2,834,258	89,437	(94)	2,923,601
CMOs - Non-agency	217,169	2,663	(14,512)	205,320
State and municipal	343,008	17,486	(23)	360,471
Other debt securities	65,321	3,660	(10,091)	58,890
Total debt securities	5,269,241	143,322	(24,720)	5,387,843
Equity securities and mutual funds	6,382	3,645		10,027
Total securities	$ 5,275,623	$ 146,967	$ (24,720)	$ 5,397,870
December 31, 2009				
U.S. Treasury	$ 73,597	$ 2	$ (2)	$ 73,597
Federal agency - Debt	659,716	651	(3,646)	656,721
Federal agency - MBS	552,691	6,521	(4,055)	555,157
CMOs - Federal agency	2,294,676	23,641	(12,206)	2,306,111
CMOs - Non-agency	272,262	304	(31,237)	241,329
State and municipal	368,454	10,915	(730)	378,639
Other debt securities	82,163	1,093	(6,750)	76,506
Total debt securities	4,303,559	43,127	(58,626)	4,288,060
Equity securities and mutual funds	15,861	2,837		18,698
Total securities	$ 4,319,420	$ 45,964	$ (58,626)	$ 4,306,758
September 30, 2009				
U.S. Treasury	$ 13,543	$ 11	$	$ 13,554
Federal agency - Debt	358,928	1,464	(108)	360,284
Federal agency - MBS	564,193	17,804	(23)	581,974
CMOs - Federal agency	1,750,790	32,139	(1,263)	1,781,666
CMOs - Non-agency	314,583	88	(33,815)	280,856
State and Municipal	384,999	18,476	(211)	403,264
Other	76,069	873	(7,193)	69,749
Total debt securities	3,463,105	70,855	(42,613)	3,491,347
Equity securities and mutual funds	17,554	3,171		20,725
Total securities	$ 3,480,659	$ 74,026	$ (42,613)	$ 3,512,072

Table of Contents

Note 4. Investment Securities (Continued)

Proceeds from sales of securities were $4.9 million and $436.9 million for the three and nine months ended September 30, 2010, compared with $108.8 million and $554.8 million for the three and nine months ended September 30, 2009, respectively. The following table provides the gross realized gains and losses on the sales of securities available-for-sale:

	For the three months ended September 30,		For the nine months ended September 30,	
(in thousands)	2010	2009	2010	2009
Gross realized gains	$ 453	$ 3,554	$ 5,447	$ 12,218
Gross realized losses	(2)	(109)	(2,507)	(8,423)
Net realized gains (losses)	$ 451	$ 3,445	$ 2,940	$ 3,795

Impairment Assessment

The Company performs a quarterly assessment of the debt and equity securities in its investment portfolio that have an unrealized loss to determine whether the decline in the fair value of these securities below their cost is other-than-temporary. Impairment is considered other-than-temporary when it becomes probable that an investor will be unable to recover the cost of an investment. The Company s impairment assessment takes into consideration factors such as the extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer including events specific to the issuer or industry; defaults or deferrals of scheduled interest, principal or dividend payments; external credit ratings and recent downgrades; and whether the Company intends to sell the security and whether it is more likely than not it will be required to sell the security prior to recovery of its amortized cost basis. If a decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value which then becomes the new cost basis. The new cost basis is not adjusted for subsequent recoveries in fair value.

In accordance with ASC 320-35, *Investments Debt and Equity Securities Subsequent Measurement*, when there are credit losses associated with an impaired debt security and the Company does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, the Company will separate the amount of the impairment into the amount that is credit-related and the amount related to non-credit factors. The credit-related impairment is recognized in Net impairment loss recognized in earnings in the consolidated statements of income. The non-credit-related impairment is recognized in AOCI.

Securities Deemed to be Other-Than-Temporarily Impaired

Through the impairment assessment process, the Company determined that certain investments were other-than-temporarily impaired at September 30, 2010. The Company recorded impairment losses in earnings on securities available-for-sale of $0.2 million and $1.7 million for the three and nine months ended September 30, 2010, respectively. Of the Company s total other-than-temporary impairment losses, $11.6 million related to non-credit-related impairment and was recorded in AOCI. The Company recorded impairment losses in earnings on securities available-for-sale of $0.8 million and $14.4 million for the three and nine months ended September 30, 2009, respectively.

The following table provides total impairment losses recognized in earnings on other-than-temporarily impaired securities:

(in thousands) **Impairment Losses on** **Other-Than-Temporarily Impaired Securities**	**For the three-months ended September 30,** **2010**	**2009**	**For the nine-months ended September 30,** **2010**	**2009**
Non-agency CMOs	$ 152	$ 778	$ 1,368	$ 2,315
Collateralized debt obligation income notes				9,282
Perpetual preferred stock			293	1,124
Mutual funds				1,630
Total	$ 152	$ 778	$ 1,661	$ 14,351

Table of Contents

Note 4. Investment Securities (Continued)

The following table provides a rollforward of credit-related other-than-temporary impairment recognized in earnings for debt securities for the three and nine months ended September 30, 2010 and 2009. Credit-related other-than-temporary impairment that was recognized in earnings during the three and nine months ending September 30, 2010 is reflected as an Initial credit-related impairment if the current period is the first time the security had a credit impairment. A credit related other-than-temporary impairment is reflected as a Subsequent credit-related impairment if the current period is not the first time the security had a credit impairment.

(in thousands)	Three months ended September 30, 2010	Three months ended September 30, 2009	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Balance, beginning of period	$ 18,922	$ 14,835	$ 17,707	$ 8,083
Subsequent credit-related impairment	152	696	1,341	5,215
Initial credit-related impairment		82	26	2,315
Balance, end of period	$ 19,074	$ 15,613	$ 19,074	$ 15,613

Non-Agency CMOs

During the third quarter of 2010, the Company identified certain non-agency collateralized mortgage obligation securities (CMOs) that were considered to be other-than-temporarily impaired because the present value of expected cash flows was less than cost. These CMOs have a fixed interest rate for an initial period after which they become variable-rate instruments with annual rate resets. For purposes of projecting future cash flows, the current fixed coupon was used through the reset date for each security. The prevailing LIBOR/Treasury forward curve as of the measurement date was used to project all future floating-rate cash flows based on the characteristics of each security. Other factors considered in the projection of future cash flows include the current level of subordination from other CMO classes, anticipated prepayment rates, cumulative defaults and loss given default. The Company concluded that the shortfall in expected cash flows represented a credit loss and recognized impairment losses in earnings totaling $0.2 million on its investments in CMOs in the third quarter. The Company has recognized credit losses totaling $1.4 million on its investments in non-agency CMOs year-to-date. The remaining other-than-temporary impairment for these securities was recognized in AOCI. This non-credit portion of other-than-temporary impairment is attributed to external market conditions, primarily the lack of liquidity in these securities and increases in interest rates.

Table of Contents

Note 4. Investment Securities (Continued)

The following tables provide a summary of the gross unrealized losses and fair value of investment securities aggregated by investment category and length of time that the securities have been in a continuous unrealized loss position as of September 30, 2010, December 31, 2009 and September 30, 2009. The tables include investments for which an other-than-temporary impairment has not been recognized in earnings, along with investments that had a non-credit-related impairment recognized in AOCI:

	Less than 12 months		12 months or greater		Total	
(in thousands)	Fair Value	Estimated Unrealized Loss	Fair Value	Estimated Unrealized Loss	Fair Value	Estimated Unrealized Loss
September 30, 2010						
U.S. Treasury	$	$	$	$	$	$
Federal agency - Debt						
CMOs - Federal agency	72,944	94			72,944	94
CMOs - Non-agency	21,746	375	98,581	14,137	120,327	14,512
State and municipal	543	2	729	21	1,272	23
Other debt securities			13,358	10,091	13,358	10,091
Total securities	$ 95,233	$ 471	$ 112,668	$ 24,249	$ 207,901	$ 24,720
December 31, 2009						
U.S. Treasury	$ 59,995	$ 2	$	$	$ 59,995	$ 2
Federal agency - Debt	437,548	3,646			437,548	3,646
Federal agency - MBS	285,328	4,055			285,328	4,055
CMOs - Federal agency	634,732	12,206			634,732	12,206
CMOs - Non-agency	35,192	428	180,699	30,809	215,891	31,237
State and municipal	18,187	340	4,500	390	22,687	730
Other debt securities			36,315	6,750	36,315	6,750
Total securities	$ 1,470,982	$ 20,677	$ 221,514	$ 37,949	$ 1,692,496	$ 58,626
September 30, 2009						
Federal agency - Debt	$ 25,819	$ 108	$	$	$ 25,819	$ 108
Federal agency - MBS	9,937	23			9,937	23
CMOs - Federal agency	129,042	1,263			129,042	1,263
CMOs - Non-agency			257,400	33,815	257,400	33,815
State and municipal	1,611	31	5,865	180	7,476	211
Other debt securities			45,089	7,193	45,089	7,193
Total securities	$ 166,409	$ 1,425	$ 308,354	$ 41,188	$ 474,763	$ 42,613

At September 30, 2010, total securities available-for-sale had a fair value of $5.40 billion, which included $207.9 million of securities available-for-sale in an unrealized loss position as of September 30, 2010. This balance consists of $156.1 million of temporarily impaired securities and $51.8 million of securities that had non-credit related impairment recognized in AOCI. At September 30, 2010, the Company had 24 debt securities in an unrealized loss position. The debt securities in an unrealized loss position include 1 Federal agency MBS, 4 Federal agency CMOs, 16 private label CMOs, 2 state and municipal securities and 1 other debt security.

The largest component of the unrealized loss at September 30, 2010 was $14.5 million related to non-agency collateralized mortgage obligations. The Company monitors the performance of the mortgage pools underlying these bonds. The Company only holds the most senior tranches of each issue which provides protection against defaults. The Company attributes the unrealized loss on CMOs held largely to the current absence of liquidity in this sector of the credit market and to increases in market yields. Other than the $1.4 million year-to-date credit loss discussed in *Non-Agency CMOs* above, the Company expects to receive all contractual principal and interest payments due on its CMO debt securities. Additionally, the Company does not intend to sell the securities, and it is not more likely than not that it will be required to sell the securities before it recovers the cost basis of its investment. The mortgages in these asset pools are relatively large and have been made

Table of Contents

Note 4. Investment Securities (Continued)

to borrowers with strong credit history and significant equity invested in their homes. They are well diversified geographically. Nonetheless, significant further weakening of economic fundamentals coupled with significant increases in unemployment and substantial deterioration in the value of high-end residential properties could extend distress to this borrower population. This could increase default rates and put additional pressure on property values. Should these conditions occur, the value of these securities could decline and trigger the recognition of further other-than-temporary impairment charges.

Other debt securities include the Company s investments in highly rated corporate debt and collateralized bond obligations backed by trust preferred securities (CDOs) issued by a geographically diverse pool of small- and medium-sized financial institutions. Liquidity pressures in 2008 and in 2009 caused a general decline in the value of corporate debt. The CDOs held in securities available-for-sale at September 30, 2010 are the most senior tranches of each issue. The market for CDOs has been inactive since 2008, therefore, the fair values of these securities were determined using an internal pricing model that incorporates assumptions about discount rates in an illiquid market, projected cash flows and collateral performance. The CDOs had a $9.7 million net unrealized loss at September 30, 2010 which the Company attributes to the illiquid credit markets and to the increase in market yields on these securities resulting from lower credit ratings. The two issues held have collateral that exceeds the outstanding debt by approximately 24 percent and 28 percent, respectively, at September 30, 2010. Security valuations reflect the current and prospective performance of the issuers whose debt is contained in these asset pools. The Company expects to receive all contractual principal and interest payments due on its CDOs. Additionally, the Company does not intend to sell the securities, and it is not more likely than not that it will be required to sell the securities before it recovers the cost basis of its investment.

The Company does not consider the debt securities in the table above to be other than temporarily impaired at September 30, 2010.

At December 31, 2009, total securities available-for-sale had a fair value of $4.31 billion, which included $1.69 billion of securities available-for-sale in an unrealized loss position as of December 31, 2009. This balance consisted of $1.65 billion of temporarily impaired securities and $43.5 million of securities that had non-credit related impairment recognized in AOCI. At December 31, 2009, the Company had 155 debt securities in an unrealized loss position. The debt securities in an unrealized loss position included 1 U.S. Treasury bill, 15 Federal agency debt securities, 30 Federal agency MBS, 44 Federal agency CMOs, 29 private label CMOs, 32 state and municipal securities and 4 other debt securities.

At September 30, 2009, total securities available-for-sale had a fair value of $3.51 billion, which included $474.8 million of securities available-for-sale in an unrealized loss position as of September 30, 2009. This balance consisted of $429.5 million of temporarily impaired securities and $45.3 million of securities that had non-credit related impairment recognized in AOCI. At September 30, 2009, the Company had 55 debt securities in an unrealized loss position. The debt securities in an unrealized loss position included 2 Federal agency securities, 1 Federal agency MBS, 7 Federal agency CMOs, 29 private label CMOs, 10 state and municipal securities and 6 other debt securities.

Table of Contents

Note 4. Investment Securities (Continued)

The following table provides the expected remaining maturities of debt securities included in the securities portfolio as of September 30, 2010, except for mortgage-backed securities which are allocated according to the average life of expected cash flows. Average expected maturities will differ from contractual maturities because mortgage debt issuers may have the right to repay obligations prior to contractual maturity.

Debt Securities Available-for-Sale

(in thousands)	One year or less	Over 1 year through 5 years	Over 5 years through 10 years	Over 10 years	Total
U.S. Treasury	$ 14,036	$ 5,081	$	$	$ 19,117
Federal agency - Debt	1,089,855	222,081			1,311,936
Federal agency - MBS	73	256,020	225,191	27,224	508,508
CMOs - Federal agency	368,661	2,346,567	195,268	13,105	2,923,601
CMOs - Non-agency	21,005	157,277	27,038		205,320
State and municipal	36,753	157,707	116,029	49,982	360,471
Other	6,938	10,099	41,853		58,890
Total debt securities	$ 1,537,321	$ 3,154,832	$ 605,379	$ 90,311	$ 5,387,843
Amortized cost	$ 1,527,245	$ 3,063,647	$ 590,726	$ 87,623	$ 5,269,241

Note 5. Other Investments

Federal Home Loan Bank and Federal Reserve Bank Stock

The Company s investment in stock issued by the Federal Home Loan Bank of San Francisco (FHLB) and Federal Reserve (FRB) totaled $124.4 million at September 30, 2010 compared to $123.2 million at December 31, 2009, and $54.2 million at September 30, 2009. Ownership of government agency securities is restricted to member banks, and the securities do not have readily determinable market values. The Company records investments in FHLB and FRB stock at cost in Other assets of the consolidated balance sheets and evaluates these investments for impairment.

At September 30, 2010, the Company held $93.6 million of FHLB stock. FHLB banks are cooperatives that provide products and services to member banks. The FHLB provides significant liquidity to the U.S. banking system through advances to its member banks in exchange for collateral. The purchase of stock is required in order to receive advances and other services. FHLB stock is not publicly traded and is purchased and sold by member banks at its par value. The Company completed an assessment of its investment in FHLB stock for impairment at September 30, 2010. Since 2009, the FHLB has experienced higher levels of other-than-temporary impairment in its investments in private label mortgage-backed securities due to continued weakness in the housing market. The FHLB took steps to preserve capital and increase the balance of restricted retained earnings available to protect members paid-in-capital from the effects of adverse credit events. As a result of these actions and a decline in member advances, the FHLB s capital-to-assets ratio remained well above regulatory requirements at September 30, 2010.

Additionally, the FHLB resumed payment of regular quarterly dividends and repurchases of excess capital stock from members in 2010. The Company expects to recover the full amount invested in FHLB stock and does not consider its investment to be impaired at September 30, 2010.

Table of Contents

Note 5. Other Investments (Continued)

Private Equity and Alternative Investments

The Company has ownership interests in a limited number of private equity, venture capital, real estate and hedge funds that are not publicly traded and do not have readily determinable fair values. These investments are carried at cost in the Other assets section of the consolidated balance sheets and are net of impairment write downs, if applicable. The Company s investments in these funds totaled $36.7 million at September 30, 2010, $37.4 million at December 31, 2009 and $37.9 million at September 30, 2009. A summary of investments by fund type is provided below:

(in thousands) **Fund Type**		**September 30,** **2010**		**December 31,** **2009**		**September 30,** **2009**
Private equity and venture capital	$	21,031	$	21,617	$	21,351
Real estate		9,649		9,061		9,854
Hedge		2,953		2,700		2,700
Other		3,111		4,038		3,948
Total	$	36,744	$	37,416	$	37,853

Management reviews these investments quarterly for impairment. The impairment assessment includes a review of the most recent financial statements and investment reports for each fund and discussions with fund management. An impairment loss is recognized if it is deemed probable that the Company will not recover the cost of an investment. The impairment loss is recognized in Other noninterest income in the consolidated income statements. The new cost basis of the investment is not adjusted for subsequent recoveries in value. The Company recognized impairment totaling $0.5 million and $0.9 million on its investments during the three and nine months ended September 30, 2010, respectively. The Company recognized $1.4 million and $1.8 million of impairment on private equity and hedge fund investments for the same periods in 2009. The table below provides information as of September 30, 2010 on private equity and alternative investments that have had a nonrecurring measurement due to the recognition of impairment:

Alternative Investments With Nonrecurring Measurements

(in thousands) **Fund Type**		**Fair** **Value**		**Unfunded** **Commitments**	**Redemption** **Frequency**	**Redemption** **Notice Period**
Private equity and venture capital (2)	$	760	$	27	None (1)	N/A
Real estate (3)		7,367		1,568	None (1)	N/A
Hedge (4)		453			(4)	
Total	$	8,580	$	1,595		

(1) Fund makes periodic distributions of income but does not permit redemptions prior to the end of the investment term.

(2) Fund invests in securities and other instruments of public and private companies, including corporations, partnerships, limited liability companies and joint ventures.

(3) Fund invests in commercial, industrial and retail projects and select multi-family housing opportunities which are part of mixed use projects in low and moderate income neighborhoods.

(4) Fund invests in other hedge funds. Fund is being liquidated and capital returned to investors as the underlying investments are sold or redeemed.

Table of Contents

Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments

The following is a summary of the major categories of loans:

Loans and Leases

(in thousands)	September 30, 2010	December 31, 2009	September 30, 2009
Commercial	$ 4,015,113	$ 4,335,052	$ 4,219,141
Commercial real estate mortgages	1,967,959	2,161,451	2,164,398
Residential mortgages	3,586,858	3,533,453	3,541,534
Real estate construction	575,060	835,589	999,045
Equity lines of credit	757,210	734,182	694,660
Installment	167,395	172,566	174,170
Lease financing	349,030	374,615	375,542
Loans and leases, excluding covered loans	11,418,625	12,146,908	12,168,490
Less: Allowance for loan and lease losses	(274,167)	(288,493)	(265,005)
Loans and leases, excluding covered loans, net	11,144,458	11,858,415	11,903,485
Covered loans	1,960,190	1,851,821	
Less: Allowance for loan losses	(50,057)		
Covered loans, net	1,910,133	1,851,821	
Total loans and leases	$ 13,378,815	$ 13,998,729	$ 12,168,490
Total loans and leases, net	$ 13,054,591	$ 13,710,236	$ 11,903,485

Concentrations of credit risk arise when a number of clients are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. The Company s lending activities are predominantly in California, and to a lesser extent, New York and Nevada. Excluding covered loans, at September 30, 2010, California represented 87 percent of total loans outstanding and Nevada and New York represented 2 percent and 5 percent, respectively. The remaining 6 percent of total loans outstanding represented other states. Although the Company has a diversified loan portfolio, a substantial portion of the loan portfolio and credit performance depends on the economic stability of Southern California. Credit performance also depends, to a lesser extent, on economic conditions in the San Francisco Bay area, New York and Nevada. Within the Company s covered loan portfolio at September 30, 2010, the five states with the largest concentration were California (41 percent), Texas (12 percent), Nevada (7 percent), New York (5 percent) and Arizona (4 percent). The remaining 31 percent of total covered loans outstanding represented other states.

Covered Loans

Covered loans represent loans acquired from the FDIC that are subject to loss-sharing agreements and were $1.96 billion at September 30, 2010 and $1.85 billion as of December 31, 2009. Covered loans, net of allowance for loan losses, were $1.91 billion as of September 30, 2010. There was no allowance for loan losses on covered loans as of December 31, 2009. The increase in covered loans from December 31, 2009 was due to loans acquired in the FDIC-assisted acquisitions of FPB and SWB in the second quarter of 2010, offset by a decrease in loans acquired from

ICB.

The Company evaluated the acquired loans from ICB, FPB and SWB and concluded that all loans, with the exception of a small population of acquired loans, would be accounted for under ASC 310-30. Loans are accounted for under ASC 310-30 when there is evidence of credit deterioration since origination and for which it is probable, at acquisition, that the Company would be unable to collect all contractually required payments.

Table of Contents

Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)

As of the respective acquisition dates, the preliminary estimates of the contractually required payments receivable for all acquired impaired loans of FPB and SWB were $643.3 million, the cash flows expected to be collected were $378.9 million, and the fair value of the loans was $330.6 million. These amounts were determined based on the estimated remaining life of the underlying loans, which included the effects of estimated prepayments. Fair value of the acquired loans include estimated credit losses, therefore, an allowance for loan losses was not recorded on the acquisition date. Interest income is recognized on all acquired impaired loans through accretion of the difference between the carrying amount of the loans and their expected cash flows.

Changes in the accretable yield for acquired impaired loans were as follows for the period from January 1, 2010 through September 30, 2010:

(in thousands)		**Accretable Yield**
Balance at January 1, 2010	$	687,126
Additions		48,644
Accretion		(88,325)
Reclassifications to nonaccretable yield		(120,315)
Disposals and other		(16,543)
Balance at September 30, 2010	$	510,587

Because of the short time period between the closing of the ICB acquisition and year-end 2009, certain 2009 amounts related to the acquired impaired ICB loans were preliminary estimates. In finalizing its analysis of these loans, the Company recorded adjustments to 2009 amounts that are reflected in the Disposals and other line of the above table.

At acquisition date, the Company recorded an FDIC indemnification asset for its FDIC-assisted acquisitions of ICB in December 2009 and FPB and SWB in May 2010. The FDIC indemnification asset represents the present value of the expected reimbursement from the FDIC related to expected losses on acquired loans and OREO. The FDIC indemnification asset from all three acquisitions was $324.2 million at September 30, 2010 and $380.7 million at December 31, 2009. See Note 2, *Business Combinations*, for further discussion of the FDIC indemnification asset.

Table of Contents

Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)

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

The following is a summary of activity in the allowance for loan and lease losses on non-covered loans and reserve for off-balance sheet credit commitments:

(in thousands)	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
Allowance for loan and lease losses				
Balance, beginning of period	$ 290,492	$ 256,018	$ 288,493	$ 224,046
Provision for credit losses	13,000	85,000	100,000	205,000
Transfers (to) from reserve for off-balance sheet credit commitments	(1,091)	846	(3,061)	3,127
Charge-offs	(34,587)	(80,324)	(121,176)	(172,628)
Recoveries	6,353	3,465	9,911	5,460
Net loans charged-off	(28,234)	(76,859)	(111,265)	(167,168)
Balance, end of period	$ 274,167	$ 265,005	$ 274,167	$ 265,005
Reserve for off-balance sheet credit commitments				
Balance, beginning of period	$ 19,310	$ 20,422	$ 17,340	$ 22,703
Provision for credit losses/transfers	1,091	(846)	3,061	(3,127)
Balance, end of period	$ 20,401	$ 19,576	$ 20,401	$ 19,576

Nonaccrual loans, excluding covered loans, were $239.1 million at September 30, 2010, $388.7 million at December 31, 2009 and $408.3 million at September 30, 2009. Total impaired loans, excluding covered loans, were $240.3 million at September 30, 2010, $375.7 million at December 31, 2009 and $394.8 million at September 30, 2009. Impaired loans at September 30, 2010 include $10.9 million of restructured loans that have been returned to accrual status, but will continue to be reported as impaired until they have a demonstrated period of performance under their restructured terms. At September 30, 2010, impaired loans with an allocated allowance totaled $102.4 million and impaired loans without an allocated allowance totaled $137.9 million. At September 30, 2010, there were $229.4 million of impaired loans included in nonaccrual loans, with an allowance allocation of $20.3 million. The remaining $9.7 million of nonaccrual loans at September 30, 2010 are loans under $500,000 that are not individually evaluated for impairment. 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. At December 31, 2009, there were $375.7 million of impaired loans which had an allowance of $55.8 million allocated to them. At December 31, 2009, impaired loans with an allocated allowance totaled $274.7 million and impaired loans without an allocated allowance totaled $101.0 million. At September 30, 2009, there were $394.8 million of impaired loans which had an allowance of $61.1 million allocated to them. At September 30, 2009, impaired loans with an allocated allowance totaled $316.2 million and impaired loans without an allocated allowance totaled $78.6 million. The average balance of impaired loans was $251.1 million and $299.2 million for the three and nine months ended September 30, 2010, respectively. With the exception of restructured loans that have been returned to accrual status, interest income is not recognized on impaired loans until the principal balances of these loans are paid off.

Troubled debt restructured loans were $42.8 million, before specific reserves of $1.7 million, at September 30, 2010. Troubled debt restructured loans were $11.2 million, before specific reserves of $1.0 million, at December 31, 2009. At September 30, 2009, the Company had no troubled debt restructured loans. Commitments to lend additional funds on restructured loans totaled $0.8 million at September 30, 2010.

Table of Contents

Note 6. Loans, Allowance for Loan and Lease Losses, and Reserve for Off-Balance Sheet Credit Commitments (Continued)

The following is a summary of activity in the allowance for loan losses on covered loans:

(in thousands)	For the three months ended September 30, 2010		For the three months ended September 30, 2009	For the nine months ended September 30, 2010		For the nine months ended September 30, 2009
Balance, beginning of period	$	46,255	$	$		$
Provision for losses		8,233			54,749	
Charge-offs		(414)			(414)	
Reduction in allowance due to loan removals		(4,017)			(4,278)	
Balance, end of period	$	50,057	$	$	50,057	$

The allowance for loan losses on covered loans was $50.1 million as of September 30, 2010. The Company recorded provision expense of $8.2 million and $54.7 million on covered loans for the three and nine months ended September 30, 2010, respectively. Approximately $0.4 million of the provision on covered loans related to acquired loans that are outside the scope of ASC 310-30. The loss on covered loans is mainly the result of lower projected interest cash flows due to the Company s revised default forecasts, though credit losses remain in line with previous expectations. The revisions of the default forecasts were based on the results of management s review of the credit quality of the covered loans and the analysis of the loan performance data since the acquisition of covered loans. The Company will continue updating the cash flow projections on a quarterly basis. The allowance for loan losses on covered loans is reduced for any loan removals. A loan is removed when it has been fully paid-off, fully charged off, or transferred to OREO.

Covered loans accounted for under ASC 310-30 are generally considered accruing and performing loans as the loans accrete interest income over the estimated life of the loan when cash flows are reasonably estimable. Accordingly, acquired impaired loans that are contractually past due are still considered to be accruing and performing loans. If the timing and amount of future cash flows is not reasonably estimable, the loans may be classified as nonaccrual loans and interest income is not recognized until the timing and amount of future cash flows can be reasonably estimated. At September 30, 2010, there were no acquired impaired covered loans accounted for under ASC 310-30 that were on nonaccrual status. Of the population of covered loans that are accounted for outside the scope of ASC 310-30, the Company had $2.6 million of acquired covered loans that were on nonaccrual status and were considered to be impaired.

Note 7. Other Real Estate Owned

At September 30, 2010, OREO was $168.9 million and included $110.4 million of covered OREO. Covered OREO represents OREO covered by FDIC loss-sharing agreements in the acquisitions of ICB, FPB and SWB. At December 31, 2009, OREO was $113.9 million and included $60.6 million of covered OREO. At September 30, 2009, OREO was $44.0 million. Excluding covered OREO, the Company recognized additions of $19.6 million, sales of $14.1 million, and valuation write-downs of $1.5 million in the three months ended September 30, 2010. For the nine months ended September 30, 2010, the Company recognized additions of $46.8 million, sales of $21.7 million, and valuation write-downs of $19.9 million.

For the three months ended September 30, 2010, the Company recognized additions of $26.4 million, sales of $7.4 million, and valuation write-downs of $7.4 million for covered OREO. For the nine months ended September 30, 2010, there were additions of $84.4 million (including $15.2 million acquired from FPB and SWB at acquisition date), sales of $18.2 million, and valuation write-downs of $16.4 million for covered OREO.

Covered OREO expenses and valuation write-downs are recorded in the noninterest expense section of the consolidated statements of income. Under the loss-sharing agreements, 80 percent of covered OREO expenses and valuation write-downs are reimbursable to the Company from the FDIC. The portion of these expenses that are reimbursable is recorded in FDIC loss sharing income, net in the noninterest income section of the consolidated statements of income.

Table of Contents

Note 8. Shareholders Equity

There were no purchases by the Company of equity securities that are registered by the Company pursuant to Section 12 of the Securities and Exchange Act of 1934 during the nine-month period ended September 30, 2010.

At September 30, 2010, the Corporation had 1.5 million shares of common stock reserved for issuance and 0.7 million shares of unvested restricted stock granted to employees and directors under share-based compensation programs.

On November 21, 2008, the Corporation received aggregate proceeds of $400 million from the United States Department of the Treasury (Treasury) under the TARP Capital Purchase Program in exchange for 400,000 shares of cumulative perpetual preferred stock and a 10-year warrant to purchase up to 1,128,668 shares of the Company s common stock at an exercise price of $53.16 per share. The preferred stock and warrant were recorded in equity on a relative fair value basis at the time of issuance. The preferred stock was valued by calculating the present value of expected cash flows and the warrant was valued using an option valuation model. The allocated values of the preferred stock and warrant were approximately $389.9 million and $10.1 million, respectively. Cumulative dividends on the preferred stock were payable quarterly at the rate of 5 percent for the first five years and increasing to 9 percent thereafter. The warrant had a 10-year term and is immediately exercisable upon its issuance, with an exercise price, subject to anti-dilution adjustments, equal to $53.16 per share of the common stock.

In December 2009, the Corporation repurchased $200 million, or 200,000 shares, of the TARP preferred stock that it had sold to the Treasury. On March 3, 2010, the Corporation repurchased the remaining $200 million, or 200,000 shares, of TARP preferred stock. The repurchase on March 3, 2010 resulted in a one-time, after-tax, non-cash charge of $3.8 million.

On April 8, 2010, the Corporation repurchased its outstanding common stock warrant issued to the Treasury during the Corporation s participation in the TARP Capital Purchase Program. The repurchase price of $18.5 million was recorded as a charge to additional paid-in capital.

Note 9. Earnings per Common Share

The Company applies the two-class method of computing basic and diluted EPS. Under the two-class method, EPS is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. The Company grants restricted shares under a share-based compensation plan that qualify as participating securities.

Table of Contents

Note 9. Earnings per Common Share (Continued)

The computation of basic and diluted EPS is presented in the following table:

(in thousands, except per share amounts)	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
Basic EPS:				
Net income attributable to City National Corporation	$ 34,418	$ 8,039	$ 91,434	$ 22,272
Less: Dividends on preferred stock		5,502	5,702	16,504
Net income available to common shareholders	$ 34,418	$ 2,537	$ 85,732	$ 5,768
Less: Earnings allocated to participating securities	447	56	1,078	199
Earning allocated to common shareholders	$ 33,971	$ 2,481	$ 84,654	$ 5,569
Weighted average common shares outstanding	52,105	51,482	51,937	49,855
Basic earnings per common share	$ 0.65	$ 0.05	$ 1.63	$ 0.11
Diluted EPS:				
Earnings allocated to common shareholders (1)	$ 33,974	$ 2,481	$ 84,661	$ 5,569
Weighted average common shares outstanding	52,105	51,482	51,937	49,855
Dilutive effect of equity awards	393	178	454	132
Weighted average diluted common shares outstanding	52,498	51,660	52,391	49,987
Diluted earnings per common share	$ 0.65	$ 0.05	$ 1.62	$ 0.11

(1) Earnings allocated to common shareholders for basic and diluted EPS may differ under the two-class method as a result of adding common stock equivalents for options and warrants to dilutive shares outstanding, which alters the ratio used to allocate earnings to common shareholders and participating securities for the purposes of calculating diluted EPS.

The average price of the Company s common stock for the period is used to determine the dilutive effect of outstanding stock options and common stock warrant. Antidilutive stock options and common stock warrant are not included in the calculation of basic or diluted EPS. There were 2.0 million average outstanding stock options that were antidilutive for the three months ended September 30, 2010 compared to 3.3 million outstanding stock options and a 1.1 million common stock warrant that were antidilutive for the same period in 2009. On April 8, 2010, the Company repurchased the common stock warrant. There were 2.1 million average outstanding stock options and an average 0.4 million common stock warrant that were antidilutive for the nine month period ended September 30, 2010 compared to 3.5 million outstanding stock options and a 1.1 million common stock warrant that were antidilutive for the same period in 2009.

Note 10. Share-Based Compensation

On September 30, 2010, the Company had one share-based compensation plan, the City National Corporation 2008 Omnibus Plan (the Plan), which was approved by the Company s shareholders on April 23, 2008. No new awards will be granted under predecessor plans. A description of the Plan is provided below. The compensation cost that has been recognized for all share-based awards was $4.3 million and $12.4 million for the three and nine months ended September 30, 2010, respectively, and $3.6 million and $10.8 million for the three and nine months ended September 30, 2009, respectively. The Company received $18.6 million and $1.2 million in cash for the exercise of stock options during the nine months ended September 30, 2010 and 2009, respectively. The tax benefit recognized for share-based compensation arrangements in equity was $2.1 million for the nine months ended September 30, 2010, compared with tax expense of $0.7 million for the nine months ended September 30, 2009.

Table of Contents

Note 10. Share-Based Compensation (Continued)

Plan Description

The Plan permits the grant of stock options, restricted stock, restricted stock units, performance shares, performance share units, performance units and stock appreciation rights, or any combination thereof, to the Company s eligible employees and non-employee directors. No grants of performance shares, performance share units, performance units or stock appreciation rights had been made as of September 30, 2010. The purpose of the Plan is to promote the success of the Company by providing an additional means to attract, motivate, retain and reward key employees of the Company with awards and incentives for high levels of individual performance and improved financial performance of the Company, and to link non-employee director compensation to shareholder interests through equity grants. Stock option awards are granted with an exercise price equal to the market price of the Company s stock at the date of grant. These awards vest in four years and have 10-year contractual terms. Restricted stock awards granted under the Plan vest over a period of at least three years, as determined by the Compensation, Nominating and Governance Committee (Committee). The participant is entitled to dividends and voting rights for all shares issued even though they are not vested. Restricted stock awards issued under predecessor plans vest over five years. The Plan provides for acceleration of vesting if there is a change in control (as defined in the Plan) or a termination of service, which may include disability or death. Unvested options are forfeited upon termination of employment, except for those instances noted above, and the case of the retirement of a retirement-age employee for options granted prior to January 31, 2006. The Company generally issues treasury shares upon share option exercises. All unexercised options expire 10 years from the grant date. At September 30, 2010, there were approximately 1.5 million shares available for future grants.

Fair Value

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation methodology 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 a 20-year look back period to calculate the volatility factor. The length of the look back period reduces the impact of the recent disruptions in the capital markets, and provides values that management believes are more representative of expected future volatility. The Company uses historical data to predict option exercise and employee termination behavior. The expected term of options granted is derived from historical exercise activity and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield is equal to the dividend yield of the Company s stock at the time of the grant.

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
Weighted-average volatility	31.43%	31.36%	31.42%	31.42%
Dividend yield	0.76%	1.08%	0.73%	3.36%
Expected term (in years)	6.29	6.32	6.10	6.12
Risk-free interest rate	2.14%	3.26%	2.91%	2.84%

Using the Black-Scholes methodology, the weighted-average grant-date fair values of options granted during the nine months ended September 30, 2010 and 2009 were $16.82 and $6.83, respectively. The total intrinsic values of options exercised during the nine months ended September 30, 2010 and 2009 were $9.4 million and $0.6 million, respectively.

Table of Contents

Note 10. Share-Based Compensation (Continued)

A summary of option activity and related information under the Plan for the nine months ended September 30, 2010 is presented below:

Options	Number of Shares (in thousands)		Weighted Average Exercise Price (per share)		Aggregate Intrinsic Value (in thousands) (1)	Weighted Average Remaining Contractual Term
Outstanding at January 1, 2010	4,862	$	49.64			
Granted	588		50.32			
Exercised	(515)		36.04			
Forfeited or expired	(146)		52.11			
Outstanding at September 30, 2010	4,789	$	51.11	$	35,636	5.72
Exercisable at September 30, 2010	3,015	$	56.42	$	13,241	4.10

(1) Includes in-the-money options only.

A summary of changes in unvested options and related information for the nine months ended September 30, 2010 is presented below:

Unvested Options	Number of Shares (in thousands)		Weighted Average Grant Date Fair Value (per share)
Unvested at January 1, 2010	1,861	$	10.14
Granted	588		16.82
Vested	(582)		12.23
Forfeited	(93)		11.23
Unvested at September 30, 2010	1,774	$	11.61

The number of options vested during the nine months ended September 30, 2010 and 2009 were 581,789 and 440,827, respectively. The total fair value of options vested during the nine months ended September 30, 2010 and 2009 was $7.1 million. As of September 30, 2010, there was $15.0 million of unrecognized compensation cost related to unvested stock options granted under the Company s plans. That cost is expected to be recognized over a weighted-average period of 2.5 years.

The Plan provides for granting of restricted shares of Company stock to employees. In general, twenty-five percent of the restricted stock vests two years from the date of grant, then twenty-five percent vests on each of the next three consecutive grant anniversary dates. The restricted stock is subject to forfeiture until the restrictions lapse or terminate. A summary of changes in restricted stock and related information for the nine months ended September 30, 2010 is presented below:

Restricted Stock	Number of Shares (in thousands)		Weighted Average Grant Date Fair Value (per share)
Unvested at January 1, 2010	610	$	46.79
Granted	255		50.74
Vested	(112)		66.93
Forfeited	(31)		45.61
Unvested at September 30, 2010	722	$	45.13

Table of Contents

Note 10. Share-Based Compensation (Continued)

Restricted stock is valued at the closing price of the Company s stock on the date of award. The weighted-average grant-date fair values of restricted stock granted during the nine months ended September 30, 2010 and 2009 were $50.74 and $27.64, respectively. The number of restricted shares vested during the nine months ended September 30, 2010 and 2009 were 111,676 and 98,512, respectively. The total fair value of restricted stock vested during the nine months ended September 30, 2010 and 2009 was $7.5 million and $7.0 million, respectively. The compensation expense related to restricted stock for the nine months ended September 30, 2010 and 2009 was $6.2 million and $5.5 million, respectively. As of September 30, 2010, the unrecognized compensation cost related to restricted stock granted under the Company s plans was $21.1 million. That cost is expected to be recognized over a weighted-average period of 3.2 years.

Note 11. Derivative Instruments

The following table summarizes the fair value and balance sheet classification of derivative instruments as of September 30, 2010 and September 30, 2009. The notional amount of the contract is not recorded on the consolidated balance sheets, but is used as the basis for determining the amount of interest payments to be exchanged between the counterparties. If a counterparty fails to perform, the Company s counterparty credit risk is equal to the amount reported as a derivative asset.

Fair Values of Derivative Instruments

(in millions)	September 30, 2010 Notional Amount	September 30, 2010 Derivative Assets (1)	September 30, 2010 Derivative Liabilities (1)	September 30, 2009 Notional Amount	September 30, 2009 Derivative Assets (1)	September 30, 2009 Derivative Liabilities (1)
Derivatives designated as hedging instruments						
Interest rate swaps - fair value:						
Certificates of deposit	$ 10.0	$ 0.5	$	$ 20.0	$ 1.4	$
Long-term and subordinated debt	356.8	27.4		362.4	30.9	
Total fair value contracts	$ 366.8	$ 27.9	$	$ 382.4	$ 32.3	$
Interest rate swaps - cash flow:						
U.S. Dollar LIBOR based loans	$	$	$	$ 200.0	$ 8.6	$
Prime based loans	50.0	0.3		125.0	2.8	
Total cash flow contracts	$ 50.0	$ 0.3	$	$ 325.0	$ 11.4	$
Total derivatives designated as hedging instruments	$ 416.8	$ 28.2	$	$ 707.4	$ 43.7	$
Derivatives not designated as hedging instruments						
Interest rate contracts:						
Swaps	$ 972.5	$ 36.8	$ 37.8	$ 978.6	$ 18.5	$ 18.0
Interest-rate caps, floors and collars	87.4	0.7	0.7	131.2	0.6	0.5
Options purchased	2.0	0.1	0.1	2.0	0.2	0.2

Options written		2.0						2.0				
Total interest-rate contracts	$	1,063.9	$	37.6	$	38.6	$	1,113.8	$	19.3	$	18.7
Equity index futures	$		$		$		$	0.1	$		$	
Foreign exchange contracts:												
Spot and forward contracts	$	217.4	$	4.9	$	4.7	$	263.1	$	3.6	$	2.8
Options purchased		14.5						31.2		0.5		0.5
Options written		14.5		0.3		0.3		31.2		0.1		0.1
Total foreign exchange contracts	$	246.4	$	5.2	$	5.0	$	325.5	$	4.2	$	3.4
Total derivatives not designated as hedging instruments	$	1,310.3	$	42.8	$	43.6	$	1,439.4	$	23.5	$	22.1

(1) Derivative assets include the estimated gain to settle a derivative contract plus net interest receivable. Derivative liabilities include the estimated loss to settle a derivative contract.

Table of Contents

Note 11. Derivative Instruments (Continued)

Derivatives Designated as Hedging Instruments

As of September 30, 2010, the Company had $416.8 million notional amount of interest-rate swaps, of which $366.8 million were designated as fair value hedges and $50.0 million were designated as cash flow hedges. The positive fair value of the fair value hedges of $27.9 million resulted in the recognition of other assets and an increase in hedged deposits and borrowings of $26.0 million. The remaining $1.9 million of fair value represents net interest receivable. The net positive fair value of cash flow hedges of variable-rate loans of $0.3 million resulted in other assets of $0.2 million and other comprehensive income of $0.1 million, after tax, as of September 30, 2010. AOCI also includes a net deferred gain of $2.1 million related to cash flow hedges that were terminated prior to their maturity dates for which the hedged transactions have yet to occur. The remaining $0.1 million of fair value represents net interest receivable.

As of September 30, 2009, the Company had $707.4 million notional amount of interest-rate swaps, of which $382.4 million were designated as fair value hedges and $325.0 million were designated as cash flow hedges. The positive fair value of the fair value hedges of $32.3 million resulted in the recognition of other assets and an increase in hedged deposits and borrowings of $30.3 million. The remaining $2.0 million of fair value represents net interest receivable. The positive fair value of cash flow hedges of variable-rate loans of $11.4 million resulted in the recognition of other assets of $10.4 million and other comprehensive income of $6.0 million, after tax, as of September 30, 2009. AOCI also included a net deferred gain of $0.1 million related to cash flow hedges that were terminated prior to their maturity dates for which the hedged transactions had yet to occur. The remaining $1.0 million of fair value represents net interest receivable.

The Company s swap agreements require the deposit of cash or marketable debt securities as collateral based on certain risk thresholds. These requirements apply individually to the Corporation and to the Bank. Additionally, certain of the Company s swap agreements contain credit-risk-related contingent features. Under these agreements, the collateral requirements are based on the Company s credit rating from the major credit rating agencies. The amount of collateral required varies by counterparty based on a range of credit ratings that correspond with exposure thresholds established in the derivative agreements. If the credit rating on the Company s debt were to fall below the level associated with a particular exposure threshold and the derivatives with a counterparty are in a net liability position that exceeds that threshold, the counterparty could request immediate payment or delivery of collateral for the difference between the net liability amount and the exposure threshold. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a net liability position on September 30, 2010 was $16.7 million. The Company delivered collateral valued at $4.2 million on swap agreements that had credit-risk contingent features and were in a net liability position at September 30, 2010.

The Company s interest-rate swaps had $5.5 million and $9.1 million of credit risk exposure at September 30, 2010 and September 30, 2009, respectively. The credit exposure represents the cost to replace, on a present value basis and at current market rates, all contracts by trading counterparty having an aggregate positive market value, net of margin collateral received. The Company enters into master netting agreements with swap counterparties to mitigate credit risk. Under these agreements, the net amount due from or payable to each counterparty is settled on the contract payment date. Collateral valued at $14.5 million and $16.6 million had been received from swap counterparties at September 30, 2010 and September 30, 2009, respectively. The Company delivered collateral valued at $11.8 million on swap agreements that did not have credit-risk contingent features at September 30, 2010.

The periodic net settlement of interest-rate swaps is recorded as an adjustment to interest income or interest expense. The impact of interest-rate swaps on interest income and interest expense for the three and nine months ended September 30, 2010 and 2009 is provided below:

(in millions) Derivative Instruments Designated as Hedging Instruments	Location in Consolidated Statements of Income	Three Months Ended September 30, 2010	 2009	Nine Months Ended September 30, 2010	 2009
Interest-rate swaps-fair value	Interest expense	$ (4.2)	$ (4.2)	$ (13.0)	$ (11.1)
Interest-rate swaps-cash flow	Interest income	1.9	3.0	7.4	8.9
Total income		$ 6.1	$ 7.2	$ 20.4	$ 20.0

Table of Contents

Note 11. Derivative Instruments (Continued)

Fair value and cash flow interest-rate swaps increased net interest income by $6.1 million and $20.4 million for the three and nine months ended September 30, 2010, respectively, and increased net interest income by $7.2 million and $20.0 million for the same periods in 2009.

Changes in fair value of the effective portion of cash flow hedges are reported in AOCI. When the cash flows associated with the hedged item are realized, the gain or loss included in AOCI is recognized in Interest income on loans and leases, the same location in the consolidated statements of income as the income on the hedged item. The amount of gains on cash flow hedges reclassified from AOCI to interest income for the three and nine months ended September 30, 2010 was $1.9 million and $7.4 million, respectively, and $3.0 million and $8.9 million for the same periods in 2009. Within the next 12 months, $0.1 million of other comprehensive income is expected to be reclassified into interest income. Any ineffective portion of the changes of fair value of cash flow hedges is recognized immediately in Other noninterest income in the consolidated statements of income.

The amount of after-tax loss on the change in fair value of cash flow hedges recognized in AOCI was $4.2 million (net of taxes of $3.1 million) for the nine months ended September 30, 2010, compared with an after-tax loss of $0.6 million (net of taxes of $0.5 million) for the same period of 2009. There was no ineffectiveness on cash flow hedges at September 30, 2010.

Derivatives Not Designated as Hedging Instruments

Derivative contracts not designated as hedges are marked-to-market each reporting period with changes in fair value recorded as a part of Noninterest income in the consolidated statements of income. The table below provides the amount of gains and losses on these derivative contracts for the three and nine months ended September 30, 2010 and 2009:

(in millions) **Derivatives Not Designated as Hedging Instruments**	**Location in Consolidated Statements of Income**	**Three Months Ended September 30,** **2010**	**2009**	**Nine Months Ended September 30,** **2010**	**2009**
Interest-rate contracts	Other noninterest income	$ (0.4)	$ (0.1)	$ (1.3)	$ 1.2
Equity index futures	Other noninterest income		(0.3)	(0.1)	(0.4)
Foreign exchange contracts	International services income	5.2	4.9	15.7	13.7
Total income		$ 4.8	$ 4.5	$ 14.3	$ 14.5

Note 12. Income Taxes

The Company recognized income tax expense of $13.5 million and $15.0 million for the three and nine months ended September 30, 2010, respectively. The Company recognized an income tax benefit of $7.0 million and $6.3 million for the same periods in 2009. Income tax expense for the nine months ended September 30, 2010 included an income tax benefit for a $19 million tax litigation settlement with the California

Franchise Tax Board, which was partially offset by expense of $4.3 million relating to revisions to correct certain deferred tax accounts. In May 2010, the Company and the California Franchise Tax Board closed its audits for the years 1998 through 2004 and settled litigation related to various refund claims and other pending matters under review. Under the terms of the settlement, the Company received $29 million in tax credits, which added approximately $19 million to the Company s net income in the second quarter of 2010. In the second quarter of 2010, the Company also recorded an adjustment to correct certain deferred tax accounts related to revisions of book and tax basis differences established in previous years related to its wealth management affiliates, low income housing investments and fixed assets. The net effect of the adjustment was a reduction of the deferred tax asset and a corresponding tax expense of $4.3 million.

The Company recognizes accrued interest and penalties relating to uncertain tax positions as an income tax provision expense. The Company recognized an interest and penalties benefit of approximately $0.5 million for the nine months ended September 30, 2010 and 2009. A benefit was recognized in 2010 due to a reduction in interest and penalties accrual. The Company had approximately $2.2 million, $5.5 million and $5.8 million of accrued interest and penalties as of September 30, 2010, December 31, 2009 and September 30, 2009, respectively.

Table of Contents

Note 12. Income Taxes (Continued)

The Company and its subsidiaries file a consolidated federal income tax return and also file income tax returns in various state jurisdictions. The Internal Revenue Service (IRS) completed its audits of the Company for the tax year 2008 resulting in no material financial statement impact. The Company is currently being audited by the IRS for 2009. The potential financial statement impact, if any, resulting from completion of these audits is expected to be minimal.

From time to time, there may be differences in opinion with respect to the tax treatment accorded transactions. If a tax position which was previously recognized on the consolidated 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 September 30, 2010, the Company does not have any tax positions which dropped below a more likely than not threshold.

Note 13. Retirement Plans

The Company has a profit-sharing retirement plan with an Internal Revenue Code Section 401(k) feature covering eligible employees. Employer contributions are made annually into a trust fund and are allocated to participants based on their salaries. The profit sharing contribution requirement is based on a percentage of annual operating income subject to a percentage of salary cap. Eligible employees may contribute up to 50 percent of their salary to the 401(k) plan, but not more than the maximum allowed under Internal Revenue Service regulations. The Company matches 50 percent of the first 6 percent of covered compensation. The Company recorded total profit sharing and matching contribution expense of $4.1 million and $8.5 million for the three and nine months ended September 30, 2010 respectively. Profit sharing and matching contribution expense was $1.2 million and $3.2 million for the same periods in 2009, respectively.

The Company has a Supplemental Executive Retirement Plan (SERP) for one of its executive officers. The SERP meets the definition of a pension plan under ASC Topic 960, *Plan Accounting Defined Benefit Pension Plans.* At September 30, 2010, there was a $5.2 million unfunded pension liability related to the SERP. Pension expense for the three and nine months ended September 30, 2010 was $0.2 million and $0.6 million, respectively. Pension expense for the three and nine months ended September 30, 2009 was $0.2 million and $0.5 million, respectively.

There is also a SERP covering three former executives of the Pacific Bank, which the Company acquired in 2000. As of September 30, 2010, there was an unfunded pension liability for this SERP of $2.3 million. Expense for the three months ended September 30, 2010 and 2009 was insignificant. Expense for the nine months ended September 30, 2010 and 2009 was $0.1 million.

The Company does not provide any other post-retirement employee benefits beyond the profit-sharing retirement plan and the SERPs.

Note 14. Contingencies

In connection with the liquidation of an investment acquired in a previous bank merger, the Company has an outstanding long-term indemnity. The maximum liability under the indemnity is $23 million, but the Company does not expect to make any significant payments under the terms of this indemnity.

Note 15. Variable Interest Entities

The Company holds ownership interests in certain special-purpose entities formed to provide affordable housing. The Company evaluates its interest in these entities to determine whether they meet the definition of a VIE and whether the Company is required to consolidate these entities. The Company is not the primary beneficiary of the affordable housing VIEs in which it holds interests and is therefore not required to consolidate these entities. The investment in these entities is initially recorded at cost, which approximates the maximum exposure to loss as a result of the Company s involvement with these unconsolidated entities. Subsequently, the carrying value is amortized over the stream of available tax credits and benefits. The Company expects to recover its investments over time, primarily through realization of federal low-income housing tax credits. The balance of the investments in these entities was $98.7 million, $93.4 million and $92.2 million at September 30, 2010, December 31, 2009 and September 30, 2009, respectively, and is included in Affordable housing investments in the consolidated balance sheets. Unfunded commitments for affordable housing investments were $20.8

Table of Contents

Note 15. Variable Interest Entities (Continued)

million at September 30, 2010. These unfunded commitments are recorded in Other liabilities in the consolidated balance sheets.

Of the affordable housing investments held as of September 30, 2010, the Company had a significant variable interest in four affordable housing partnerships. These interests were acquired at various times from 1998 to 2001. The Company s maximum exposure to loss as a result of its involvement with these entities is limited to the $6.3 million aggregate carrying value of these investments at September 30, 2010. There were no unfunded commitments for these affordable housing investments at September 30, 2010.

The Company also has ownership interests in several private equity investment funds and alternative investments that are VIEs. The Company is not a primary beneficiary and, therefore, is not required to consolidate these VIEs. The investment in these entities is carried at cost, which approximates the maximum exposure to loss as a result of the Company s involvement with these entities. The Company expects to recover its investments over time, primarily through the allocation of fund income, gains or losses on the sale of fund assets, dividends or interest income. The balance in these entities was $36.7 million, $37.4 million and $37.9 million at September 30, 2010, December 31, 2009 and September 30, 2009, respectively, and is included in Other assets in the consolidated balance sheets. Income associated with these investments is reported in Other noninterest income in the consolidated statements of income.

Note 16. Noncontrolling Interest

In accordance with ASC 810 and EITF Topic D-98, *Classification and Measurement of Redeemable Securities* (Topic D-98), the Company reports noncontrolling interest in its majority-owned affiliates as either a separate component of equity in Noncontrolling interest in the consolidated balance sheets or as Redeemable noncontrolling interest in the mezzanine section between liabilities and equity in the consolidated financial statements. Topic D-98 specifies that securities that are redeemable at the option of the holder or outside the control of the issuer are not considered permanent equity and should be classified in the mezzanine section.

Redeemable Noncontrolling Interest

The Corporation holds a majority ownership interest in seven investment management and wealth advisory affiliates that it consolidates and a noncontrolling interest in two other firms. In general, the management of each majority-owned affiliate has a significant noncontrolling ownership position in their firm and supervises the day-to-day operations of the affiliate. The Corporation is in regular contact with each affiliate regarding their operations and is an active participant in the management of the affiliates through its position on each firm s board.

The Corporation s investment in each affiliate is governed by operating agreements and other arrangements which provide the Corporation certain rights, benefits and obligations. The Corporation determines the appropriate method of accounting based upon these agreements and the factors contained therein. All majority-owned affiliates that have met the criteria for consolidation are included in the consolidated financial statements. All material intercompany balances and transactions are eliminated. The Corporation applies the equity method of accounting to investments where it holds a noncontrolling interest. For equity method investments, the Corporation s portion of income before taxes is included in Trust and investment fees in the consolidated statements of income.

As of September 30, 2010, affiliate noncontrolling owners held equity interests with an estimated fair value of $47.0 million. This estimate reflects the maximum obligation to purchase equity interests in the affiliates. The events which would require the Company to purchase the equity interests may occur in the near term or over a longer period of time. The terms of the put provisions vary by agreement, but the value of the put is intended to equal or approximate the fair market value of the interests. The parent company carries key man life insurance policies to fund a portion of these conditional purchase obligations in the event of the death of an interest holder.

Table of Contents

Note 16. Noncontrolling Interest (Continued)

The following is a reconciliation of redeemable noncontrolling interest for the nine months ended September 30, 2010 and 2009:

(in thousands)	For the nine months ended September 30, 2010	2009
Balance, beginning of period	$ 51,381	$ 44,811
Net income (loss)	1,415	(1,250)
Distributions to redeemable noncontrolling interest	(1,653)	(1,885)
Additions and redemptions, net	(4,721)	9,468
Adjustments to fair value	545	(1,247)
Balance, end of period	$ 46,967	$ 49,897

Note 17. Segment Results

The Company has three reportable segments: Commercial and Private Banking, Wealth Management and Other. The factors considered in determining whether individual operating segments could be aggregated include that the operating segments: (i) offer the same products and services, (ii) offer services to the same types of clients, (iii) provide services in the same manner and (iv) operate in the same regulatory environment. The management accounting process measures the performance of the operating segments based on the Company s management structure and is not necessarily comparable with similar information for other financial services companies. If the management structures and/or the allocation process changes, allocations, transfers and assignments may change.

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

The Wealth Management segment includes the Corporation s investment advisory affiliates and the Bank s Wealth Management Services. The asset management affiliates and the Wealth Management division of the Bank make the following investment advisory and wealth management resources and expertise available to individual and institutional clients: investment management, wealth advisory services, brokerage, estate and financial planning and personal, business, custodial and employee trust services. The Wealth Management segment also advises and makes available mutual funds under the name of CNI Charter Funds. Both the asset management affiliates and the Bank s Wealth Management division provide proprietary and nonproprietary products to offer a full spectrum of investment solutions in all asset classes and investment styles, including fixed-income instruments, mutual funds, domestic and international equities and alternative investments such as hedge funds.

The Other segment includes all other subsidiaries of the Company, the corporate departments, including the Treasury Department and the Asset Liability Funding Center, that have not been allocated to the other segments, and inter-segment eliminations for revenue recognized in multiple segments for management reporting purposes. The Company uses traditional matched-maturity funds transfer pricing methodology. However, both positive and negative variances occur over time when transfer pricing non-maturing balance sheet items such as demand deposits. These variances, offset in the Funding Center, are evaluated annually by management and allocated back to the business segments as deemed necessary.

Business segment earnings are the primary measure of the segment s performance as evaluated by management. Business segment earnings include direct revenue and expenses of the segment as well as corporate and inter-company cost allocations. Allocations of corporate expenses, such as data processing and human resources, are calculated based on estimated activity levels for the fiscal year. Costs associated with intercompany support and services groups, such as Operational Services, are allocated to each business segment based on actual services used. Capital is allocated based on the estimated risk within each business segment. The methodology of allocating capital is based on each business segment s credit, market, and operational risk profile. If applicable, any provision for credit losses is allocated based on various credit factors, including but not limited to, credit risk ratings, credit rating fluctuation, charge-offs and recoveries and loan growth.

Table of Contents

Note 17. Segment Results (Continued)

Income taxes are charged to the business segments at the statutory rate. The Other segment includes an adjustment to reconcile to the Company s overall effective tax rate.

Exposure to market risk is managed in the Company s Treasury department. Interest rate risk is mostly removed from the Commercial and Private Banking segment and transferred to the Funding Center through a fund transfer pricing (FTP) methodology and allocating model. The FTP model records a cost of funds or credit for funds using a combination of matched maturity funding for fixed term assets and liabilities and a blended rate for the remaining assets and liabilities with varying maturities.

The Bank s investment portfolio and unallocated equity are included in the Other segment. Amortization expense associated with customer-relationship intangibles is charged to the affected operating segments.

Selected financial information for each segment is presented in the following tables. Commercial and Private Banking includes all revenue and costs from products and services utilized by clients of Commercial and Private Banking, including both revenue and costs for Wealth Management products and services. The revenues and costs associated with Wealth Management products and services that are allocated to Commercial and Private Banking for management reporting purposes are eliminated in the Other segment. The current period reflects any changes made in the process and methodology for allocations to the reportable segments. Prior period segment results have been revised to conform with current period presentation.

	For the three months ended September 30, 2010			
(in thousands)	**Commercial and Private Banking**	**Wealth Management**	**Other**	**Consolidated Company**
Earnings Summary:				
Net interest income	$ 180,033	$ 473	$ 7,210	$ 187,716
Provision for credit losses on loans and leases, excluding covered loans	13,000			13,000
Provision for losses on covered loans	8,233			8,233
Noninterest income	49,077	39,738	(22,017)	66,798
Depreciation and amortization	3,488	1,440	3,651	8,579
Noninterest expense	155,033	35,430	(14,361)	176,102
Income (loss) before income taxes	49,356	3,341	(4,097)	48,600
Provision (benefit) for income taxes	20,730	1,325	(8,594)	13,461
Net income	28,626	2,016	4,497	35,139
Less: Net income attributable to noncontrolling interest		186	535	721
Net income attributable to City National Corporation	$ 28,626	$ 1,830	$ 3,962	$ 34,418
Selected Average Balances:				
Loans and leases, excluding covered loans	$ 11,364,585	$	$ 50,286	$ 11,414,871
Covered loans	2,015,714			2,015,714
Total assets	14,064,570	567,294	6,982,884	21,614,748

Deposits	17,734,040	44,787	518,391	18,297,218
Goodwill	318,340	161,642		479,982
Customer-relationship intangibles, net	13,771	30,102		43,873

Table of Contents

Note 17. Segment Results (Continued)

(in thousands)	Commercial and Private Banking	Wealth Management	Other	Consolidated Company
	For the three months ended September 30, 2009			
Earnings Summary:				
Net interest income	$ 158,254	$ 316	$ 2,771	$ 161,341
Provision for credit losses	85,000			85,000
Noninterest income	40,653	39,031	(10,839)	68,845
Depreciation and amortization	3,056	1,525	3,617	8,198
Noninterest expense	112,121	36,712	(13,266)	135,567
Income (loss) before income taxes	(1,270)	1,110	1,581	1,421
Provision (benefit) for income taxes	(533)	547	(6,980)	(6,966)
Net income (loss)	(737)	563	8,561	8,387
Less: Net income (loss) attributable to noncontrolling interest		(194)	542	348
Net income (loss) attributable to City National Corporation	$ (737)	$ 757	$ 8,019	$ 8,039
Selected Average Balances:				
Loans and leases	$ 12,303,861	$	$ 35,244	$ 12,339,105
Total assets	12,436,177	548,549	4,953,505	17,938,231
Deposits	13,578,951	52,674	1,145,297	14,776,922
Goodwill	317,801	149,378		467,179
Customer-relationship intangibles, net	8,903	34,432		43,335

(in thousands)	Commercial and Private Banking	Wealth Management	Other	Consolidated Company
	For the nine months ended September 30, 2010			
Earnings Summary:				
Net interest income	$ 521,899	$ 1,174	$ 22,146	$ 545,219
Provision for credit losses on loans and leases, excluding covered loans	100,000			100,000
Provision for losses on covered loans	54,749			54,749
Noninterest income	195,634	119,990	(49,317)	266,307
Depreciation and amortization	10,183	4,947	10,734	25,864
Noninterest expense	457,273	106,668	(42,503)	521,438
Income before income taxes	95,328	9,549	4,598	109,475
Provision (benefit) for income taxes	40,038	3,416	(28,434)	15,020
Net income	55,290	6,133	33,032	94,455
Less: Net income attributable to noncontrolling interest		1,415	1,606	3,021
Net income attributable to City National Corporation	$ 55,290	$ 4,718	$ 31,426	$ 91,434
Selected Average Balances:				
Loans and leases, excluding covered loans	$ 11,603,093	$	$ 42,007	$ 11,645,100
Covered loans	1,951,248			1,951,248
Total assets	14,249,327	556,854	6,092,483	20,898,664
Deposits	16,984,944	46,766	560,763	17,592,473
Goodwill	318,340	161,642		479,982

Customer-relationship intangibles, net	12,624	31,058	43,682

Table of Contents

Note 17. Segment Results (Continued)

	For the nine months ended September 30, 2009			
(in thousands)	Commercial and Private Banking	Wealth Management	Other	Consolidated Company
Earnings Summary:				
Net interest income	$ 462,170	$ 1,572	$ (1,928)	$ 461,814
Provision for credit losses	205,000			205,000
Noninterest income	124,880	107,788	(52,271)	180,397
Depreciation and amortization	9,556	4,140	9,958	23,654
Noninterest expense	335,676	101,400	(39,846)	397,230
Income (loss) before income taxes	36,818	3,820	(24,311)	16,327
Provision (benefit) for income taxes	15,463	2,130	(23,913)	(6,320)
Net income (loss)	21,355	1,690	(398)	22,647
Less: Net income (loss) attributable to noncontrolling interest		(1,250)	1,625	375
Net income attributable to City National Corporation	$ 21,355	$ 2,940	$ (2,023)	$ 22,272
Selected Average Balances:				
Loans and leases	$ 12,324,745	$	$ 37,969	$ 12,362,714
Total assets	12,469,806	546,535	4,228,846	17,245,187
Deposits	12,608,689	66,954	1,211,882	13,887,525
Goodwill	317,801	144,255		462,056
Customer-relationship intangibles, net	9,806	30,589		40,395

Note 18. Subsequent Event

On October 16, 2010, the Company redeemed $250 million of 9.625 percent cumulative trust preferred securities that were issued on December 8, 2009. The Company recognized a $6.8 million charge on the early redemption of these debt securities in its fourth quarter 2010 financial results.

Table of Contents

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

CITY NATIONAL CORPORATION

FINANCIAL HIGHLIGHTS

(in thousands, except per share amounts) (1)	At or for the three months ended September 30, 2010 (Unaudited)	June 30, 2010 (Unaudited)	September 30, 2009 (Unaudited)	Percent change September 30, 2010 from June 30, 2010	September 30, 2009
For The Quarter					
Net income attributable to City National Corporation	$ 34,418	$ 41,318	$ 8,039	(17)%	328%
Net income available to common shareholders	34,418	41,318	2,537	(17)	1,257
Net income per common share, basic	0.65	0.78	0.05		