



Transmitted via Secure Email

November 19, 2019

Board of Directors
SVB Financial Group
3003 Tasman Drive
Santa Clara, California 95054

Members of the Board:

The Federal Reserve Bank of San Francisco (FRBSF) conducted a target inspection of SVB Financial Group (SVBFG) Corporate Governance/Global Risk Management activities beginning on July 29th; onsite work began on August 5th, and concluded on August 15th. Preliminary results were presented to Chief Executive Officer Greg Becker, Chief Risk Officer (CRO) Laura Izurieta, Chief Credit Officer (CCO) Marc Cadieux, and Chief Audit Executive John Peters during a September 23rd exit meeting. This letter communicates the inspection's final conclusions and feedback provided to management that may assist in further strengthening risk management practices.

Purpose and Scope

The inspection's objective was to assess SVBFG's compliance with applicable provisions of Regulation YY and assess alignment with SR Letter 95-51 (*Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies*). In doing so, we evaluated the skills, independence, stature, and maturity of the second line of defense (LoD) relative to the size and complexity of the institution. Furthermore, we assessed management's remediation efforts for three Matters Requiring Attention (MRAs)¹ outstanding from the 2017 supervisory cycle.

Summary of Findings

SVBFG's board has established a risk committee and the organization's risk-management program complies with the broad requirements of Regulation YY. Additionally, management continues to develop and implement a risk management framework as the organization grows in size and complexity; however, further enhancements are needed to ensure the effective implementation of an appropriate internal controls and risk oversight structure. While the second LoD has made notable progress and provides sufficient oversight of risk-taking activities, aggregate risks, and concentrations to ensure compliance with the board-approved risk appetite, concerns persist about certain aspects of the

¹ Matters Requiring Attention are matters that are important and the Federal Reserve is expecting a banking organization to address over time.

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structure, independence, and functional expertise within the risk-management framework. The most notable concerns surround the reporting line of the CCO, information technology expertise, and second LoD independence when participating in risk-taking activities. SVBFG has made reasonable progress remediating MRAs within the scope of this inspection; we are closing all three, but recasting two to reflect the remaining work needed to address the underlying supervisory concerns.

Matters Requiring Attention

Enterprise Risk Management (ERM) Controls Monitoring

Issue: While the board and senior management have made significant progress designing and implementing certain aspects of the enterprise risk-management framework over the last couple of years, further enhancements are required to ensure that the second LoD has adequate oversight of the controls performed by the first LoD.

Consequence of Issue: Without adequate insight into the effectiveness of first LoD control activities, the board and senior management may not have a sufficient view/perspective into aggregate residual risk exposures.

Required Action: Management is required to complete the development of a control identification, self-testing, and monitoring program (Program) for implementation in the first LoD that periodically determines and documents the effectiveness of controls performed by the first LoD. In addition, the Program should include processes for the first LoD to manage self-identified issues and action plans, and report control testing and monitoring results to the second LoD. Furthermore, the second LoD is expected to provide effective oversight of the Program, including periodic risk-based monitoring that ensures the first LoD is meeting control-testing requirements.

Model Overlay/Assumption Governance

Issue: Management continues to use a capital stress testing methodology as a key component in assessing capital adequacy and in setting various capital risk limits. Within the stress-testing process, management has a well-defined governance process that remains similar to the previous Dodd-Frank Act Stress Testing (DFAST) process. Through the process followed in 2019, two large model overlay/assumptions were made regarding the Sponsor Led Buyout portfolio in the idiosyncratic stress scenario. These overlays were not appropriately identified in presentation materials provided to senior management committees and examiners. Without appropriate disclosure, the modeled loss results were unintuitive and hard to explain.

Consequence of Issue: Without a transparent and repeatable process for setting capital limits and buffers, the board and senior management may rely on stress testing results that do not accurately reflect the risk appetite.

Required Action: Management is required to ensure that all significant assumptions, model adjustments, and management overlays are clearly identified and discussed when disclosing stress-

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testing results. In the case where stress testing results are unintuitive, the presentation must include a clear narrative explanation.

| Summary of Outstanding MRAs within the Inspection Scope | | |
|---|---|--|
| Issue | Status (Date Opened) | Comments |
| Risk Management- Compliance and Independent Oversight | Close (October 2017 Silicon Valley Bank Roll-Up) | Management has taken significant action to address concerns about the Corporate Compliance and ERM functions by completing 18 of the 19 agreed upon action plans; therefore, this MRA is being closed. However, further enhancements are required to ensure the first LoD implements effective internal controls and the second LoD provides adequate oversight of the control environment. (See above MRA titled Enterprise Risk Management Controls Monitoring.) |
| Rationale & Support of DFAST Framework | Close (October 2017 DFAST) | DFAST is no longer a requirement for firms of SVBFG's size due to the passage of The Economic Growth, Regulatory Relief and Consumer Protection Act. As such, this MRA is being closed. Nevertheless, given that stress-testing results are key to setting capital limits, safety and soundness concerns dictate that expectations for a sound and transparent process remain. (See above MRA titled Model Overlay/Assumption Governance.) |
| Internal Capital Adequacy Assessment | Close (October 2017 Silicon Valley Bank Roll-Up) | Management has revised the capital planning and stress testing process in the absence of the DFAST requirement to focus on two scenarios. The capital stack now specifically allocates capital buffers to the risk categories of credit, interest rate risk, and operational risk. While specificity in risk attribution could be further improved, management has addressed the MRA's key requirements. |

Regulation YY

SVBFG complies with the specific risk-management requirements of section 252.33 of Regulation YY, subpart D. The Risk Committee (RC), a chartered independent committee of the board, approves and periodically reviews the risk-management policies and oversees the operation of the global risk-management framework. The firm's ERM framework is commensurate with its current structure, risk profile, complexity, activities, and size. SVBFG has adopted a three lines of defense model, and appropriately delineated roles and responsibilities in the ERM Policy, ERM Framework, and the ERM

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Program 2019 Annual Program Document. CRO Izurieta has experience in identifying, assessing, and managing risk exposures of large, complex financial institutions; she is responsible for overseeing the ERM program and reporting risk-management deficiencies and emerging risks to the RC. Nevertheless, as the firm continues to build-out the corporate and risk governance framework with respect to management committees, SVBFG may want to consider developing a principles-based approach to promote consistency in defining what constitutes a management committee and how second LoD independence is appropriately maintained when participating in/voting on risk-taking decisions. In addition, the board and senior management may benefit in documenting their understanding of the potential conflicts/independence concerns inherent in the second LoD's roles and responsibilities within management committees.

Risk Management Framework

SVBFG's risk-management framework continues to mature on pace with its size and complexity. The framework defines key elements including roles and responsibilities across the three lines of defense; risk appetite metric identification, measurement, and monitoring processes; risk and control self-assessment, and risk event reporting processes. The RC has adopted a formal risk appetite statement, and related metrics for credit, operational, market, and liquidity risks are approved annually by the board. Risk issues, including metric breaches, are escalated to the board and senior management through the Quarterly Risk Report. Nevertheless, when addressing the ERM Controls Monitoring MRA noted above, the ERM function may want to ensure risk-metric owners have appropriate controls and testing in place to ensure data accuracy. Additionally, in continuing to drive first LoD accountability in its risk culture, SVBFG may benefit by further defining ERM's roles and responsibilities in the issues management process to include a risk-based approach for validating management action plans to address issues identified through risk appetite breaches, risk and control self-assessments, and operational risk events.

The second LoD has adequate stature and provides sufficient management oversight of risk-taking activities, aggregate risks, and concentrations to ensure compliance with the risk appetite. In addition, appropriate action plans have been developed to more closely align SVBFG's risk-management framework with the company's risk profile. However, concerns remain about certain aspects of the structure, independence, and functional expertise within the risk-management framework.

The current structure of the credit risk-management framework does not fully align with the ERM framework description of the three lines of defense model, as the first LoD remains the owner of the credit policies. In addition, there is no discernable challenge from the second LoD; however, the CCO and credit administration, while in the first LoD, have provided credible challenge to the business line risk-takers. Nevertheless, the board's Credit Committee recently approved a plan transitioning the CCO into the second LoD. As the details of this plan are further developed, the board and senior management may want to consider evaluating potential independence concerns related to loan approvers reporting to the CCO and the CCO's approval authority in, as of yet, undefined escalation situations.

While the Risk Leadership Team reporting to CRO Izurieta is generally qualified to oversee the ERM program, personnel within the second LoD lack sufficient technical expertise to provide effective

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oversight of systems/technology and business disruption risks; this situation resulted in an MRA at the 2019 Information Technology examination.² In addition, given that, the complexity and risk profile of SVBFG continues to increase and the second LoD is not fully mature, the second LoD may want to consider conducting periodic skills and staffing assessments to ensure it possesses sufficient resources to provide effective review and challenge of front-line assessments.

A response to this letter³ is requested. Please provide SVBFG's issue remediation and audit validation plans by December 20th. We welcome the opportunity to discuss any aspect of this letter or our supervisory process with members of the board or management. Please direct any such requests to Central Point of Contact **Redacted** at **Redacted** .

Sincerely,

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Examiner in Charge
Federal Reserve Bank of San Francisco

² Results of the target examination were provided by letter and Report of Examination transmitted on June 6th.

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