CALIFORNIA DEPARTMENT OF
FINANCIAL PROTECTION AND INNOVATION

FEDERAL RESERVE BANK OF
SAN FRANCISCO

DFPI DEPARTMENT OF FINANCIAL PROTECTION & INNOVATION

2101 ARENA BOULEVARD
SACRAMENTO, CALIFORNIA 95834
(916) 576-4941

101 MARKET STREET
SAN FRANCISCO, CALIFORNIA 94108
(415) 974-2000

Federal Reserve Bank of San Francisco

November 15, 2022

Mr. Greg Becker
Chief Executive Officer
C/O Ben Jones, Head of Regulatory Affairs
SVB Financial Group
Silicon Valley Bank
3003 Tasman Drive
Santa Clara, California 95054

Subject: 2022 CAMELS Exam

Dear Mr. Becker:

The Federal Reserve Bank of San Francisco (FRBSF) and the California Department of Financial Protection and Innovation (CDFPI) jointly completed the 2022 annual CAMELS examination at Silicon Valley Bank (SVB or the Firm). The 2022 CAMELS ratings will be formally conveyed in concert with the 2022 Large Financial Institutions (LFI) ratings in 1Q 2023. Going forward, the timing of CAMELS and LFI rollups will be aligned to reduce redundancy. This letter serves to communicate the change in timing of rating issuance and to formalize the supervisory findings discussed with management on November 14, 2022.

Executive Summary

<u>Sensitivity to Market Risk</u>
The Firm's interest rate risk (IRR) simulations are not reliable and require improvements. SVB's balance sheet had been modeled and reported as asset sensitive. While data from the first 3 quarters of 2022 confirmed asset sensitivity and the firm benefiting from rising rates, management is forecasting meaningful Net Interest Margin (NIM) compression, Net Interest Income (NII) decline and significant adverse earnings impact starting in 4Q and into 2023. Changes in NIM, NII and earnings are directionally inconsistent with internal projections and IRR simulations, calling into question the reliability of IRR modeling and the effectiveness of risk management practices. Unreliable IRR modeling directly impairs management and the board's ability to make sound asset liability management decisions. As such, a Matters

Requiring Attention[1] (MRA) is identified to address this concern and is further detailed in the Appendix.

Asset Quality

As part of the exam scope, the examination team assessed the effectiveness of the internal loan review (ILR) function. ILR practices are consistent with supervisory expectations, with adequate support for concluded risk ratings and timely identification of policy exceptions. Examiners reviewed 93 relationships and 233 loans, with a focus on credits reviewed by ILR, as well as loans from the Investor Dependent portfolio, SVB Private Bank and Boston Private. Out of the 93 relationships reviewed, examiners considered one ILR conclusion incorrect.

Additionally, the exam team assessed the Firm's remediation for two outstanding credit related MRAs. These MRAs are considered closed as follows:

Outstanding MRAs	Status
FLOD/SLOD separation of duties MRA	Closed
Internal Loan Review MRA	Closed

Next Steps

After reviewing this supervisory letter[2], and within 45 calendar days of its receipt, management is required to submit a written response to the MRA contained herein. We appreciate the assistance received from your management team and staff throughout the year. As a reminder, this letter contains confidential material and should be treated

[1] **Matters Requiring Immediate Attention** (MRIAs) arising from an examination, inspection, or any other supervisory activity are matters of significant importance and urgency that the FR requires organizations to address immediately and include: (1) matters that have the potential to pose significant risk to the organization's safety and soundness; (2) matters that represent significant noncompliance with applicable laws and regulations; (3) repeat criticisms that have escalated in importance due to insufficient attention or inaction by the organization; and (4) in the case of consumer compliance examinations, matters that have the potential to cause significant consumer harm.

Matters Requiring Attention (MRAs) constitute matters that are important, and that the FR is expecting an organization to address over a reasonable period of time, but when the timing need not be "immediate" as the threat to safety and soundness is less immediate than with issues giving rise to MRIAs. An MRA typically will remain an open issue until resolution and confirmation by examiners that the banking organization has taken corrective action. If a banking organization does not adequately address an MRA in a timely manner, examiners may elevate an MRA to an MRIA. Similarly, a change in circumstances, environment, or strategy can also lead to an MRA becoming an MRIA.

[2] Any institution about which the Federal Reserve makes a written material supervisory determination is eligible to utilize the appeals process as described in the Appeals Process and Board Ombudsman (Ombuds) Policy Statement (See also 85 *Fed. Reg. 15,175 (March 17, 2020)*). The Ombuds can provide assistance regarding questions related to the appeals process and claims of retaliation as well as assist in facilitating the informal resolution of a supervised institution's concerns prior to the filing of a formal appeal. For more information about the Ombuds, please visit the Federal Reserve Board's public website.

accordingly by your organization.[3] As such, the contents of this letter are subject to the rules of the Board of Governors of the Federal Reserve System regarding disclosure of confidential supervisory information as well as CA Financial Code 452. We welcome the opportunity to further discuss any aspect of this letter or our supervisory process with members of the board or management. Should you have any comments or questions regarding this letter, please directly contact Redacted at Redacted or Redacted, or Redacted with CDFPI at Redacted or Redacted.

Sincerely,

Redacted

Redacted
Redacted
Department of Financial Protection and Innovation

Redacted
Redacted,
LFBO Dedicated Supervisory Team Lead
Federal Reserve Bank of San Francisco

By: Redacted

Redacted
Redacted

cc: Board of Directors
Dan Beck, Chief Financial Officer
John Peters, Chief Auditor
Redacted, FDIC

[3] THIS DOCUMENT IS STRICTLY CONFIDENTIAL: This document has been prepared by an examiner selected or approved by the Board of Governors of the Federal Reserve System. The document is the property of the Board of Governors and is furnished to directors and management for their confidential use. The document is strictly privileged and confidential under applicable law, and the Board of Governors has forbidden its disclosure in any manner without its permission, except in limited circumstances specified in the law (12 U.S.C 1817(a) and 1831m) and in the regulations of the Board of Governors (12 C.F.R. 261.20). Under no circumstances should the directors, officers, employees, trustees or independent auditors disclose or make public this document or any portion thereof except in accordance with applicable law and the regulations of the Board of Governors. Any unauthorized disclosure of the document may subject the person or persons disclosing or receiving such information to the penalties of Section 641 of the U.S. Criminal Code (18 U.S.C. 641). Each director or trustee, in keeping with his or her responsibilities, should become fully informed regarding the contents of this document. In making this review, it should be noted that this document is not an audit and should not be considered as such.

Appendix I: New Matters Requiring Attention (MRA)

MRA: IRR Simulation and Modeling

Issue: SVB's IRR simulations are unreliable. The firm's latest forecasts for 4Q 2022 and 2023 show notable contractions in the net interest margin and net interest income as a result of current interest rate levels and other market conditions, leading to significant adverse impacts on earnings. Importantly, the forecasted changes are directionally inconsistent with dynamic IRR simulations and projections, which modeled and reported the balance sheet as asset sensitive. These inconsistencies call into question the reliability of the firm's IRR modeling and the effectiveness of risk management practices.

Impact: Unreliable IRR modeling outputs impair management and the board's ability to make important asset liability management decisions. In the firm's case, simulation results gave a false sense of safety in a rising rate environment and masked the need to take actions earlier in the rate cycle.

Required Action: By June 30, 2023, the board and senior management is required to:

- Backtest IRR simulations against actual results and compare against latest forecasts to determine driver(s) of inconsistency and reasonableness of assumptions
- Correct deficiencies identified through the backtest
- Perform an analysis of deposit mix shifts and run-offs across different rate and VC funding scenarios
- Incorporate deposit mix shifts and run-offs into IRR simulations, either directly or as part of sensitivity analysis