# REPORT OF HOLDING COMPANY INSPECTION

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|---|---|---|---|
| HC Name: | SVB Financial Group | Inspection Commenced: | December 31, 2018 |
| Location: | Santa Clara, California | Inspection Concluded: | January 17, 2019 |
| RSSD Number: | 1031449 | Financial Data as of: | September 30, 2018 |

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April 11, 2019

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

Dear Members of the Board:

The Federal Reserve Bank of San Francisco (FRBSF) conducted a full-scope inspection of SVB Financial Group (SVBFG or Company). Using a September 30, 2018 starting date, the inspection commenced on December 31, 2018, and concluded on January 17, 2019. A meeting was held with management[1] on February 12, 2019 to discuss findings and recommendations. This Report of Inspection (ROI) concludes the 2018 supervisory cycle.

**OVERALL CONCLUSIONS**

SVBFG's overall condition and supervisory assessment remain satisfactory. The organization has designed a broad risk-management framework, though design and build-out of credible second lines of defense for defined risk areas has been slow. Risk monitoring and reporting remain fair; Silicon Valley Bank (SVB) continues to operate under an enforcement action for compliance with Bank Secrecy Act/Anti Money Laundering (BSA/AML) and Office of Foreign Assets Control (OFAC). The company's consolidated financial condition remains satisfactory, with noted strength in liquidity. Prior regulatory findings have been or are being addressed in an acceptable manner and the parent company and nonbanking activities do not pose a material financial risk to SVB.

**SCOPE**

The Company was inspected under the authority of section 5(c) of the Bank Holding Company Act of 1956, as amended. The objective of this inspection was to assess the overall risk management and consolidated financial condition of the organization. Also, the inspection included a review of the parent company's ability to act as a source of strength to SVB, its sole subsidiary depository institution. Intercompany transactions were reviewed to determine their conformity with laws and regulations. In addition, examiners reviewed and assessed the organization's response to any outstanding supervisory findings and issues. As SVB accounted for 98.5 percent of SVBFG's consolidated assets, conclusions reached in the SVB Report of Examination (ROE) issued on March 6, 2019 were heavily leveraged. Inspection results also considered continuous monitoring activities conducted during the 2018 supervisory cycle.

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[1] SVBFG meeting attendees included: Dan Beck, Chief Financial Officer; Laura Izurieta, Chief Risk Officer; Michael Kruse, Treasurer; Kamran Husain, Chief Accounting Officer; Redacted ; Bob Neitz, Chief Compliance Officer; Redacted ; and Redacted . FRBSF Examiner in Charge presented findings, and was accompanied by Redacted , Central Point of Contact. By invitation, California Department of Business Oversight (CDBO) Examiner in Charge, Redacted attended.

## RATINGS

SVBFG remains in satisfactory condition and is rated a composite "2" according to the Federal Reserve System's Uniform Bank Holding Company rating system. Ratings are assigned on a scale from 1 to 5 in ascending order of supervisory concern.

> **Rating 2 (Satisfactory).** Holding companies in this group are fundamentally sound but may have modest weaknesses in risk management practices or financial condition. The weaknesses could develop into conditions of greater concern but are believed correctable in the normal course of business. As such, the supervisory response is limited. Cash flow is adequate to service obligations, and the nondepository entities are unlikely to have a significant negative impact on the subsidiary depository institution(s).

The table below lists the composite, component, and subcomponent RFI/C (D) ratings assigned to the Company at this inspection, as well as the ratings assigned at the two prior inspections.

| SVB Financial Group | Current Inspection 12/31/18 | Prior Inspection 12/04/17 | Prior Inspection 12/27/16 |
|---|---|---|---|
| | | | |
| **R – Risk Management** | **2** | **2** | **2** |
| *Components:* | | | |
| Board and Senior Management Oversight | 2 | 2 | 2 |
| Policies, Procedures, and Limits | 2 | 2 | 2 |
| Risk Monitoring and MIS | 3 | 3 | 3 |
| Internal Controls | 2 | 2 | 2 |
| **F – Financial Condition** | **2** | **2** | **2** |
| *Components:* | | | |
| Capital | 2 | 2 | 2 |
| Asset Quality | 2 | 2 | 2 |
| Earnings | 2 | 2 | 2 |
| Liquidity | 1 | 1 | 1 |
| **I – Impact of Parent and Non-Depository Subsidiaries on Depository Institution** | **2** | **2** | **2** |
| | | | |
| **C – Composite Rating** | **2** | **2** | **2** |
| | | | |
| **(D) – Depository Institution** | **2** | **2** | **2** |

## MATTERS REQUIRING ATTENTION

Examiners did not identify any new matters requiring attention.[2] Outstanding matters and disposition are summarized as follows:

| SUMMARY OF OUTSTANDING FINDINGS | | | | |
|---|---|---|---|---|
| **Matters Requiring Attention (MRA)** | | | | |
| **Issue** | **Main Category** | **Status** | **Comments** | **Timeframe for Completion Date** |
| Model Risk Management | Management - Risk Management | Close | Required actions have been completed. | Closed during current inspection. |
| Rationale & Support of DFAST Framework | Capital - Capital Stress Testing (DFAST) | Open | To be reviewed during the 2019 supervisory cycle. | 12/31/2018 |
| Investment Tracking Framework | Management - Risk Management | Open | To be reviewed during the 2019 supervisory cycle. | 03/31/2019 |

## RISK MANAGEMENT – 2

Risk Management remains satisfactory. Board and senior management oversight, policies, procedures, and limits, and internal controls remain satisfactory. However, risk monitoring and MIS (management information system) remain assessed as fair. Management has not yet established a credible, independent, and complete second line of defense aligned with the Company's risk management framework and commensurate with its growth and risk profile.

<u>Board and Senior Management Oversight – 2</u>

Board and senior management oversight is satisfactory. The board and senior management are reasonably informed of inherent organizational risks and industry conditions that potentially impact the organization's safety and soundness. The board provides adequate oversight of business strategies, significant policies, and risk management practices through regular committee meetings complemented by a layered risk oversight structure. The bank and corporate boards are identical and have remained stable, allowing for an appropriate understanding of SVB, parent, and nonbank subsidiary activities at the top level. Management and the board have demonstrated a willingness and ability to manage the Company in a safe and sound manner and have provided the resources and oversight to address problem areas.

<u>Policies, Procedures, and Limits – 2</u>

Policies, procedures, and limits remain satisfactory. This assessment reflects policies and procedures that cover material risks inherent to SVBFG's significant activities, and that are generally consistent with the Company's goals, objectives, and overall financial condition. Project plans to develop the ERM (Enterprise Risk Management) Policy and Procedure Office and strengthen policy governance extend

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

through 2020. Plans include cataloguing and performing a control assessment of existing procedures, developing monitoring and reporting processes for the ERM activities, selecting a vendor solution, and developing a migration plan to an ERM-managed central repository for improved efficiency and process consistency.

Risk Monitoring and MIS – 3

Risk monitoring and MIS remain fair. While management made progress clarifying the risk management framework and related roles and responsibilities, the global risk management program requires additional time to implement. The firm remains heavily reliant on front-line controls and risk monitoring processes and a challenge process conducted through discussion occurring among executive management. Second line monitoring and testing to ensure an appropriate system of controls and business line compliance with law, supervisory guidance, and internal policies was partially placed on hold as management built out teams and processes. As a result, risk monitoring may not provide adequate information to identify and monitor enterprise risk and control effectiveness, commensurate with the risk profile and growth of the Company. This is partially mitigated by the ERM Program Office, which continues to develop and refine the risk assessment of existing and new products and services.

Internal Controls – 2

Internal controls remain satisfactory. As most risk activities reside at SVB, this assessment is primarily informed by the recently issued SVB ROE. The system of internal controls provides adequate coverage of the firm's major risks and business activities. Finally, as reported in our February 22, 2019 supervisory letter, the internal audit function continues to provide an independent, reliable, and effective review of internal controls, governance, and risk management processes throughout SVBFG.

**FINANCIAL CONDITION – 2**

The consolidated financial condition of the Company remains satisfactory.[3] Capital, asset quality and earnings continue to be rated satisfactory, while liquidity continues to be rated strong.

Capital – 2

Consolidated capital continues to be rated as satisfactory. SVBFG maintains adequate capital to support the volume and risk characteristics of the business lines, provide a cushion to absorb losses, and support growth. Capital ratios are stable and have kept pace with asset growth while continuing to exceed the Company's internally established limits and regulatory well-capitalized minimum expectations. The Company reported common tier one equity capital, tier one capital, total capital, and tier one leverage of 13.28 percent, 13.45 percent, 14.34 percent, and 8.99 percent, respectively.

In 2018, regulatory requirements regarding capital planning and stress testing changed, and the Company is no longer subject to annual DFAST testing regimen guided by supervisory scenario and reporting framework. Therefore, risk management of capital planning will be reviewed by examiners during the 2019 supervisory cycle. Subsequent to the inspection as of date, SVBFG obtained regulatory

[3] Unless otherwise noted, all financial information is as-of September 30, 2018 or for the nine months ended September 30, 2018, as applicable.

approval for a $500.0 million share redemption program. During the fourth quarter 2018, the Company repurchased $140.0 million in common shares.

Asset Quality – 2

Consolidated asset quality remains satisfactory. Problem assets remain low and manageable. On a consolidated basis, the total classified asset ratio is 20.3 percent and the weighted classified ratio is 4.5 percent; both ratios slightly decreased since the prior inspection. All loans are originated at SVB, and examiners concluded that credit quality metrics were stable, reflecting a manageable level of problem assets, effective credit risk management, and appropriate board oversight. Also, examiners concluded that the ALLL methodology was acceptable and supported by a policy that is comprehensive, prescriptive, and articulates the requirements for maintaining appropriate reserves for various loan pools. Finally, the quality of the investment portfolio remains acceptable; 93.7 percent of the portfolio was securities issued or guaranteed by the U.S. Treasury, government agencies, and sponsored agencies.

Earnings – 2

Earnings remains assessed as satisfactory. Core earnings remains adequate to augment capital and provide for asset growth when due consideration is given to asset quality. The Company earned $707.6 million through the third quarter of 2018, which resulted in an annualized return on average assets (ROAA) of 1.73 percent. The ROAA was significantly above the 1.05 percent reported the same period prior year; the improvement is attributable to increased net interest income and a lower tax rate resulting from the Tax Cuts and Jobs Act (TCJ Act). While the earnings are significantly better than the averages for peer group banks, examiners concluded that at this time it is premature to determine how sustainable the high level of earnings will be, precluding a higher rating.

The yield on loans increased to 5.23 percent during the nine months ending September 30, 2018, as compared to 4.80 percent the equivalent period a year earlier. The majority of loans are tied to variable rate indices benefiting from a rising rate environment, while interest expense remained low and stable. Thus, the Company's net interest margin improved to 3.50 percent compared to 2.97 percent a year earlier. Meanwhile, the TCJ Act lowered the Federal corporate tax rate to 21.0 percent, from the prior maximum rate of 35.0 percent, effective for tax years including or commencing January 1, 2018. Thus, the Company's income tax expense rate was 25.1 percent for the nine months ended September 30, 2018, compared to 35.8 percent for the comparable 2017 period.

Liquidity – 1

Liquidity continues to be assessed as strong. The Company maintains strong liquidity levels and satisfactory funds management practices. The parent company and subsidiaries have reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs. Consolidated liquidity included a portfolio of investment securities totaling $25.0 billion, of which 84.0 percent was unpledged, and $2.1 billion due from Federal Reserve Banks. Secondary liquidity included availability under secured lines of $2.04 billion at the Federal Home Loan Bank and $719.0 million at the FRBSF. Core deposits continued to represent the majority of all liabilities: at $44.5 billion, core deposits represented 83.8 percent of total liabilities.

Liquidity risk management is appropriate for the low liquidity risk profile. Liquidity risk tolerances and oversight appear reasonable. Policy compliance, including liquidity limits, is documented in the Asset-

Liability Committee (ALCO) reports monthly and reported to the Finance Committee of the board quarterly. Policy exceptions are documented and escalated appropriately. Finally, liquidity strategy and planning is discussed at length at the monthly ALCO and board meetings.

**IMPACT – 2**

The parent company and non-depository subsidiaries present a limited likelihood of a significant negative impact on SVB. Risk management of parent and nonbank activities is sufficient to mitigate the impact to the bank, and the parent continues to provide financial and managerial resources to support SVB as needed. Furthermore, the parent company's financial condition remains acceptable. Finally, the parent company remains in compliance with all laws and applicable regulations, including Regulation W.

<u>Parent Company Financial Analysis</u>

The parent company remains in acceptable financial condition. Parent liquidity remains sufficient to meet ongoing capital and funding needs. Parent company cash and marketable securities of $973.1 million, is more than sufficient to meet obligations over the next 24 months. Over the first three quarters of 2018, the parent reported $36.0 million in cash flow from operating activities. Moreover, parent leverage is manageable with a ratio of debt-to-equity at 14.14 percent, compared with 17.25 percent reported one year ago. The parent company's long-term debt decreased in December 2017 when management completed the redemption of $51.5 million in trust preferred securities.

SVB paid dividend to the parent totaling $95.0 million, or 14.4 percent of the bank's net income, during the nine months ended September 30, 2018. On a forward looking basis, management continues to anticipate a bank-to-company dividend of $30 million to $40 million per quarter. The parent does not pay shareholder dividends.

<u>Intercompany Transactions</u>

The majority of inter-company transactions consisted of employee expenses related to work performed on behalf of nonbank subsidiaries and overhead expenses. SVB employees and departments providing services to nonbank affiliates complete a semi-annual Regulation W Cost Allocation Survey. The survey results are used to determine the allocation of personnel and occupancy expenses charged to SVB affiliates. Costs are justified in expense studies performed to allocate the various expenses incurred by the Company, and reimbursements are made monthly. Further, the tax sharing agreement complies with supervisory guidance. The parent company and non-bank subsidiaries remain in compliance with Regulation W.

<u>Parent and SVB Capital Non-marketable Securities and Warrants</u>

Non-marketable securities and warrants held by the parent and SVB Capital add a degree of market risk to the organization, specifically pricing risk, as valuation is largely dependent on factors outside the Company's control. The parent and SVB capital holds $688.7 million in non-marketable securities in the form of venture capital and private equity fund investments and equity warrants, the majority of which are estimated via Level 3 fair value measurement or other valuation techniques. While non-marketable securities and warrants were 1.2 percent of consolidated assets, realized and unrealized gains from non-marketable securities and warrants held by the parent and SVB Capital totaled $167.8 million, or 30.1 percent of consolidated non-interest income. Nonetheless, examiners conclude that risk management of non-marketable securities and warrants held by the parent company and SVB Capital is adequate. Included in the parent company non-marketable securities, were investments in “illiquid” covered funds, as defined by the Volcker Rule, totaling $244.0 million. SVBFG obtained Board of Governors staff approval for an extension until July 21, 2022 to reach compliance with the Volcker Rule.

**DEPOSITORY INSTITUTION – 2**

SVB remains in satisfactory condition, this assessment is based on the March 6, 2019 ROE issued by the CDBO and FRBSF. Capital, Asset Quality, Management, Earnings, and Sensitivity continued to rated satisfactory. Liquidity continued to be rated strong. The SVB examination reported only two new MRA (model risk management and liquidity risk management), with six existing MRA carried-forward and five MRA were closed.

In addition, the most recent FRBSF and Consumer Financial Protection Bureau (CFPB) compliance examinations have resulted in satisfactory ratings. The October 26, 2016 CFPB report identified violations related to loan originator compensation and Home Mortgage Disclosure Act reporting, and cited MRAs to ensure that corrective action was performed to address these violations and the FRBSF concurred with these findings. The October 22, 2018 FRBSF report identified that SVB continues to build out its consumer compliance risk management framework; however, the examination did not identify any violations related to the non-enumerated consumer laws and regulations.

**OTHER MATTERS**

<u>BSA/AML and OFAC Compliance Program</u>

The organization’s BSA/AML and OFAC compliance program is managed at SVB. On January 30, 2017, SVB entered into a Memorandum of Understanding (MOU) to address internal control deficiencies in the BSA/AML and OFAC program. Although the bank continues to make progress towards addressing provisions of the MOU, key improvements remain in progress. Through the December 21, 2018 Supervisory Letter, examiners concluded that the BSA/AML and OFAC compliance programs continue to require improvement.

<u>Information Technology (IT)</u>

IT was reviewed in 2018, and findings were communicated in the May 24, 2018 ROE. Examiners concluded that the overall performance of SVB’s IT function is satisfactory, and the level and quality of oversight and support of IT activities by the board and management was satisfactory.

**CLOSING COMMENTS**

As SVBFG remains in satisfactory condition and no new parent or nonbank supervisory issues are noted, a response to this ROI is not required. However, each director is required to sign the Signature of Directors page, and it is expected that the board’s review of the ROI will be maintained in the company’s corporate records. The contents of this letter are confidential and should not be made public.

We appreciate the availability and cooperation of management and staff throughout the supervisory cycle, and look forward to the opportunity to meet with the board of directors meeting to discuss our supervisory assessment and answer any questions you may have regarding our findings and conclusions.

If you have any immediate questions or comments related to this ROI or any other regulatory matter concerning your institution, please contact Central Point of Contact Redacted at Redacted .

Sincerely,

Redacted

Redacted
Examiner in Charge

## SIGNATURE OF DIRECTORS

We, the undersigned directors of SVB Financial Group, Santa Clara, California have personally reviewed the contents of the report of inspection dated December 31, 2018.

| Signature of Directors | Date |
|---|---|
| Greg W. Becker | |
| Eric A. Benhamou | |
| John S. Clendening | |
| Roger F. Dunbar | |
| Joel P. Friedman | |
| Kimberly A. Jabal | |
| Jeffrey N. Maggioncalda | |
| Mary J. Miller | |
| Kate D. Mitchell | |
| John F. Robinson | |
| Garin K. Staglin | |

NOTE: This form should remain attached to the report of inspection and be retained in the holding company's file for review during subsequent inspections. The signature of committee members will suffice only if the committee includes outside directors and a resolution has been passed by the full board delegating the review to such committee.