

CALIFORNIA DEPARTMENT OF
FINANCIAL PROTECTION AND INNOVATION

FEDERAL RESERVE BANK OF
SAN FRANCISCO



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December 27, 2022

BY SECURE EMAIL

Board of Directors
SVB Financial Group/Silicon Valley Bank
3003 Tasman Drive
Santa Clara, California 95054

Dear Board Members:

The Federal Reserve Bank of San Francisco (FR) and California Department of Financial Protection and Innovation (CDFPI) recently completed a joint target examination of Silicon Valley Bank Financial Group (SVBFG or the Firm) and Silicon Valley Bank's (SVB or the Bank) Internal Audit Program. This examination used the supervisory expectations defined in Supervisory Letter 13-1, Supplementary Policy Statement on the Internal Audit Function and Its Outsourcing and Supervisory Letter 03-5, Interagency Policy Statement on the Internal Audit Function and its Outsourcing, as a basis for our assessment. The review started on October 3, 2022 and concluded on October 28, 2022. This letter serves to formalize the supervisory findings and recommendations discussed with Chief Auditor John Peters on December 19, 2022 and Audit Committee Chair Mary Miller on December 21, 2022.

The scope of the exam covered key elements important to the overall effectiveness of the Internal Audit (IA) Program. These key elements include: the IA risk assessment; the process for defining the audit universe; audit committee reporting and oversight; the independence, professional competence, and quality of the IA function; the quality assurance function; continuous monitoring; audit execution; and issues tracking and validation.

Executive Summary

SVBFG/SVB's Internal Audit (IA) **is not fully effective**. The overall assessment was driven by material weaknesses in the risk assessment process, the process to define the IA audit universe, IA's continuous monitoring, and audit execution. While no new supervisory findings are being cited from this review, the Appendix provides details on the additional matters that the management must address in the Self-assessment and Remediation Plan submitted in response to MRIA #3 issued as part of the Governance and Risk Management Supervisory Letter, dated May 31, 2022.

Summary of Results

Objective	Current examination assessment
1 - Internal audit risk assessment	Below supervisory expectations
2 - Audit universe	Below supervisory expectations
3 - Audit committee reporting and oversight	Partially consistent with supervisory expectations
4 - Independence, professional competence, and quality of the IA function	Partially consistent with supervisory expectations
5 - Quality assurance function	Generally consistent with supervisory expectations
6 - Continuous monitoring	Below supervisory expectations
7 - Audit execution	Below supervisory expectations
8 - Issues tracking and validation	Generally consistent with supervisory expectations

Additional comments are provided below for those areas assessed as “below supervisory expectations:”

Internal Audit Risk Assessment

The IA risk assessment process does not effectively analyze the Firm’s key risks and risk management functions. While there is quantitative methodology that drives the risk assessment, the analysis supporting the numerical scores is limited, lacks transparency, and is often informal. The FR and CDFPI noted several risk indicators that were incorrectly scored with insufficient support and no evidence of effective challenge by IA leadership. For example, market risk, credit risk, and model risk were incorrectly designated as not applicable for SVB Capital without further rationale or challenge.

Audit Universe

IA does not effectively identify all auditable entities within the audit universe. IA’s Audit Manual does not sufficiently address how auditable entities are captured at the department level, the process/activity level or at another aggregated organizational level. IA also has not developed a formal methodology to check the completeness of the Firm’s Audit Universe. Current practices are largely guided by IA leadership; however, without mechanisms to check how the audit universe has been identified, the Firm has the risk of coverage gaps that negatively impact IA’s effectiveness. Examples of possible coverage gaps include:

- IA does not leverage the new product approval process for timely updates to the Audit Universe
- IA does not map/reconcile auditable entities to the General Ledger
- IA’s process to account for vendors, applications, and models within an Audit Universe context is informal and relies heavily on business owners
- IA has not effectively considered the impact of key organizational changes, such as acquisitions, when updating its audit universe

Continuous Monitoring

IA's continuous monitoring processes are ineffective. IA has not established processes for updating the Audit Plan or Staffing as emerging risks or significant organizational changes are occurring. Continuous monitoring processes do not effectively escalate emerging internal controls issues, nor does it adequately cover cross-business line processes or shared services. IA's continuous monitoring processes makes limited use of data analytics – this hinders the timely identification of factors that should prompt updates to the Audit Plan or IA staffing.

Audit Execution

IA's audit plan execution is not effective. As noted above, IA's Risk Assessment process and approach to identify its Audit Universe lack key elements that have a negative impact on the foundational goal of sufficient audit coverage. Additionally, weaknesses related to audit execution include:

- IA's planning and scoping processes do not provide sufficient oversight. Based on the sample of workpapers reviewed, the FR and CDPFI noted examples where the Risk and Control Matrices were not approved by an IA Director or Manager; end-to-end walkthroughs of the auditable entity were not performed; internal controls maps or process narratives were not developed; and ineffective mechanisms to check the completeness of the audit scope prior to fieldwork.
- IA's testing practices are inconsistent and lacks clarity when relying on other control functions. While the IA Policy allows leveraging off first and second line control testing, there are no defined criteria to determine when to leverage versus when to re-test. Also, the examination noted examples where the testing sample sizes were not aligned with industry standards.

After reviewing this supervisory letter¹, and within 45 calendar days, management is required to submit in writing a revised gap assessment and action plans that detail how the elements above will be fully remediated. The plan should include specific action steps and deliverables, individuals responsible for addressing each action item, and clear deadlines for completing the necessary corrective actions. Please send all supervisory correspondence from your institution in electronic format only, copying our centralized mailbox as a recipient at

Redacted [@sf.frb.org](mailto:Redacted@sf.frb.org).

¹ 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.

Please note that this letter contains confidential material and should be treated accordingly by your organization.² 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. Should you have any comments or questions regarding this letter, please feel free to contact **Redacted** with the FRBSF at **Redacted** and **Redacted** with the CDFPI at **Redacted**.

Sincerely,

Redacted

Redacted

Department of Financial Protection and Innovation

Redacted

LFBO Dedicated Supervisory Team Lead
Federal Reserve Bank of San Francisco

By: **Redacted**

Redacted

Senior Financial Institutions Examiner

cc: Greg Becker, Chief Executive Officer
John Peters, Chief Auditor

Redacted

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CDFPI

FDIC

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APPENDIX:**Assessment of Response and Remediation Plan –
May 2022 Governance Exam MRIA #3 Finding Related to IA Effectiveness**

As part of this target exam, the FR and CDPFI assessed management's response to MRIA #3 on IA Effectiveness from the 2022 Governance and Risk Management supervisory letter issued on May 31, 2022. The MRIA required the Firm to complete a Gap Self-Assessment and Remediation Plan.

We noted that the Firm's Gap Self-Assessment did not sufficiently address the following:

- Audit universe completeness
- Reliance of IA on other control functions
- Individual audit scoping requirements
- Outsourcing oversight

We also noted that the Firm's Remediation Plan needs further development to:

- define clear actions for each gap to be remediated,
- allocate sufficient resources to execute the action steps, and
- set timelines to establish accountability

While no new MRIs or MRAs are proposed at this time, management is required to revise the remediation plans and incorporate the following:

- Interim controls, additional details on resources, and specific time frames required to update legacy risk assessments.
- Criteria to determine a complete audit universe and a sub-processes inventory for each auditable entity, to consider risks indicated by the general ledger, the inventory of vendors, the inventory of models and applications, and the new product approval processes.
- Mechanisms for timely assessment of significant organizational changes such as merger and acquisitions' impacts on the audit universe.
- Specific timeline for integration of SVB Securities into the overall audit universe.
- Enhanced reporting specific to outsourced audits and IA staffing.
- Multi-year staffing analysis of IA's resource and training needs that considers the function's core responsibilities in addition to its future state needs.
- Resourcing strategy, with input from staffing analysis, that considers co-sourcing leverage, skills and competencies, and transformation needs.
- Coverage of all business lines, supporting functions, and legal entities for continuous monitoring purposes.
- Individual audit scoping criteria and requirements, including walkthrough, reviewed and approved risk and controls matrix prior to starting fieldwork and tracking of scoped out sub-processes.

- Formal internal senior management review and approval of the audit scope prior to audit execution.
- Formal criteria and approval requirements as to when testing performed by other control functions may be used in lieu of independent IA testing.