SVB Financial Group Q2 2020 CEO Letter

July 23, 2020

To our Stakeholders:

In the second quarter, our clients and our markets demonstrated notable resilience, even as the broader economy continued to weaken.

Against this backdrop, we delivered strong Q2 performance with **Earnings per Share of $4.42, Net Income of $229M and Return on Equity of 13.36 percent.** Our results reflected robust balance sheet growth, exceptional client liquidity, resilient net interest income, low credit losses, record investment banking revenues, and healthy market-related gains during the quarter.

While uncertainty over the impact of COVID-19 on the economy and business activity makes it challenging to provide a complete outlook for 2020, we are providing a 2H 2020 outlook for select business drivers.

We remain well-positioned to support our clients and navigate market conditions

We are operating effectively through challenging and changing markets.

1. We are operating seamlessly in a remote work environment and continue to support our clients, employees and communities through a variety of programs and financial commitments.
2. Our strong capital and significant liquidity enable us to support growth, help our clients and manage shifting economic conditions while continuing to invest in our business.
3. Our growing balance sheet reflects long-term growth fueled by high-quality assets and strong client liquidity from public and private fundraising activity.
4. The combination of deferral programs, PPP loans, slowing cash burn and new investor commitments is extending our clients' runway; loan losses remain muted, with higher – but still low – levels of nonperforming loans, and we continue to actively monitor our portfolio and engage with clients.
5. Our experienced, proven leadership and strong global team have successfully navigated past crises and economic cycles.
6. Our business model is resilient, and we are well-positioned for long-term growth.

Operating seamlessly in a remote work environment with continued support for our employees, clients and communities

Like every company, we continue to grapple with the impacts of the global pandemic and recession, and we have remained focused on supporting our employees, clients and communities through this challenging time.

Our smooth transition to remote work in the Spring was enabled in part by the investments we've made in technology and infrastructure. Likewise, the many benefits we've introduced to provide SVBers with work-, life- and health-related support have further helped this transition, as have the resilience and flexibility of our employees.

The systematic and efficient payment deferral programs we created in March gave many of our clients additional time and flexibility to adapt to shifting market conditions, improving the prospects for positive outcomes, while freeing us to focus on clients needing more customized support.

We have originated $1.8 billion of loans under the SBA's Paycheck Protection Program and recently became an accredited lender for similar programs in the UK: the Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Large Business Interruption Loan Scheme (CLBILS).

While the pandemic has disrupted in-person events, it has not affected our commitment to client engagement or our ability to bring our clients together in high-value-add events. By actively embracing virtual events, we have increased the number of bespoke client events we delivered in the first six months of the year by six times over the same period last year and have gotten tremendous positive feedback from clients on the value of these events.

We are delivering on our commitment to our communities of $5.5 million for COVID-19 relief initiatives. More recently, we have put more focus and resources toward our commitment to Inclusion and Diversity at SVB and to championing causes that impact access to and diversity in the Innovation Economy

Well-capitalized with significant liquidity

We are well positioned to support our clients in this market. We have a highly liquid, high-quality balance sheet – the strongest in our history – and our healthy capital levels enable us to meet our clients' needs and invest in our business, while providing flexibility and reserves during uncertain economic times. Our risk-based capital ratios remain well above regulatory minimums for well-capitalized banks. While exceptional deposit growth from increasing client liquidity in the second quarter pushed our bank Tier 1 leverage ratio slightly below our target range of 7% to 8%, we have significant capital at the holding company that can be down-streamed to the Bank to support capital ratios if asset growth continues at this pace. We also expect roll-offs of PPP-related loans in the second half of the year to ease pressure on our bank Tier 1 Leverage ratio.

Approximately 53% of our assets – $46 billion – are held in cash and marketable securities. We have ample liquidity to support our business and we further bolstered liquidity in the second quarter by issuing $500 million of 3.125% Senior Notes at the holding company. We also have access to additional liquidity, through diverse borrowing channels, secured primarily by agency-backed mortgage securities and U.S. Treasuries.

Our ongoing efforts to enhance our liquidity management offerings give us significant flexibility to meet our clients' needs while targeting an optimal balance sheet mix. To further preserve our flexibility in the uncertain economic and rate environment, we expect to moderate our securities purchases and limit duration extension as we grow our balance sheet.

Our loan portfolio is stronger and more diversified than ever. Loans to early-stage, venture-backed companies – the segment of our clients typically most vulnerable to negative economic shifts – represent only five percent of loans, less than half our exposure in 2009. Most of our current loan portfolio (59%) consists of capital call lines of credit and private bank mortgages, which have a history of exceptionally low losses.

We have little to no direct lending exposure to most of the hardest hit economic sectors and most of our portfolio continues to perform well at present

Continued strong client growth and robust VC fundamentals

Despite the impact of COVID-19, Venture Capital (VC) remained active[i] in the second quarter providing support for our clients and our growth.

US VC investment was healthy and on par with Q1, at nearly $35B during the quarter, primarily focused on late-stage deals, consistent with trends of the past few years. Most investments were follow-ons; first-time financings continued to decline, likely exacerbated by the impact of quarantine measures on in-person diligence meetings. Nevertheless, opportunity and high levels of dry powder motivated an increasing (though still small) number of VCs to make new investments without in-person meetings.

VC fundraising also remained strong, at approximately $22B billion in the quarter, reflecting continued LP appetite. Fundraising in 2020 appears on pace to exceed 2019, although the trend of fewer funds raising most of the dollars continues, dominated by mega-rounds. As with VC investing, most of the funding success is being driven by more established funds, rather than first-time managers.

Despite healthy VC investment and fundraising, US VC-backed exits appear to be on track for their worst year since 2011. There were 16 IPOs during the quarter, all but one in healthcare. Year to date, 92 percent of all US venture-backed IPOs have been healthcare companies and 75% of these were SVB clients.

US Private Equity (PE) fundraising remained strong in the second quarter, although investing and exits were down markedly over prior periods, as deal numbers and valuations declined and many in-progress deals were cancelled due to deteriorating business conditions for some companies. Fundraising was driven by larger firms with well-established LP bases that transitioned relatively easily to virtual fundraising processes. Against this backdrop, we continued to see healthy activity among our clients.

We added more than 1,500 new clients in the second quarter, our strongest quarter ever for core commercial client acquisition. This healthy pace of new client wins reflects our continued focus on operational excellence and product innovation, with particularly strong results from our startup banking team. Over time, this focus and our emphasis on building long-term relationships with clients have enabled us to cement our reputation as the partner of choice for entrepreneurs and investors, while maintaining 50 percent market share of all US VC-backed technology and life science companies.

Proven leadership and strong global team that have successfully navigated past economic cycles

While the current economic situation is unprecedented and its effects may be long-lasting, we are confident in our ability to navigate it successfully. Our management team has a long history of strong execution and effective management throughout major economic cycles. Our outstanding global team of professionals has significant experience in responding to the needs and challenges of our unique clients and a reputation for supporting them through difficult times.

Our long expertise in working with high-growth companies and their investors, and our proven ability to execute through crises have enabled us to grow during challenging times through continued investment in our business, new client engagement and focus on the innovation economy, all underpinned by effective credit management.

Low Q2 charge-offs with somewhat higher non-performing loans; actively monitoring our loan portfolio and engaging with clients

We have a long history of strong, resilient credit quality built on a foundation of high-quality underwriting and portfolio management, and consistency over the long term.

Our second quarter provision was driven by our continued reserve build based on modestly deteriorating market conditions, and higher non-performing loans.

Loan losses have remained muted to date, due to our successful payment deferral programs, government stimulus, efforts by our clients to cut expenses and continued investor support for companies. We continue to engage actively with our clients to provide support and effect the best possible outcomes.

In past down cycles, we have seen elevated losses in our early-stage portfolio, and episodic losses in other parts of the portfolio. These have been followed by a rapid return to more normal credit patterns as our resilient client base resumes business activities.

The length and depth of the current downturn will ultimately determine how quickly business conditions return to normal, but we believe the quality of our loan portfolio, strong underwriting and proactive credit management have positioned us to perform well overall, as we have in past downturns.

Resilient business model and solid positioning for long-term growth

Our long-term approach to maintaining high quality growth, capital and investments has established a base of strength and stability that we believe will enable us to support our clients over the long term.

Our focus on the innovation ecosystem, and the networks and deep relationships we've cultivated globally over decades, allow us to make meaningful connections for our clients and provide value beyond the capabilities of a typical bank. The unparalleled access, connections and insights we can offer because of our unique place at the center of the global innovation ecosystem differentiate us and make us the partner of choice for innovators.

Our markets are resilient because innovation is a primary driver of the global economy, and we believe the pace of innovation and investment in it will continue to grow and accelerate over time. Venture Capital and Private Equity are both sitting on significant levels of uninvested capital and we expect those investors will continue to look for ways to put that capital to work as soon as they can gain better visibility into the markets. We think this cycle will contribute to continued new company formation and funding that, in turn, will ensure our clients' liquidity remains strong.

We believe the investments we've made, and are making, in enhancing the digital client experience, geographic expansion, and diversification of our business, as well as in people and systems, will provide the foundation for continued profitable growth and operating leverage. These investments enhance our ability to compete globally and we believe they will continue to differentiate us with clients.

The long-term effects of the current economic crisis are uncertain, but our long experience with innovators and investors gives us confidence in the continued resilience of our business to withstand the challenges ahead.

New 2H 2020 outlook for select business drivers

We are issuing a new outlook for select business drivers for the second half of 2020 and are expecting a stable to growing balance sheet, even as the broader economic environment remains challenging. While much about the economic outlook and progression of COVID-19 remains uncertain and circumstances could change rapidly, based on where we are today, we believe we have reasonable visibility into the remainder of the year. The specific business drivers for which we are providing a 2H'20 outlook are average loan and deposit balances, net interest income and NIM, core fee income, expenses and tax rate.

In any economy, we generally look to several key variables to gauge our future performance. These variables, which are helpful in understanding our business opportunities and challenges, include but are not limited to VC and PE fundraising and investment, exit and capital markets activity, the shape of the yield curve, the health of the broader economy and competition. In addition, PPP forgiveness timing, the potential for future waves of COVID-19 infection and the results of the November Presidential election are expected to impact our results.

Average loans

We expect 2H'20 average loan balances to be flat to slightly down from the Q2 average of $36.5B.

This assumes elevated repayments of private equity loans tied to lower levels of investment and deal activity, lower utilization as a result of client moves to bolster liquidity levels and reduce cash burn, and forgiveness of approximately 75% of PPP loans. We expect a partial offset to this activity from strong private bank mortgage origination and generally stronger deal activity in the fourth quarter.

Average deposits

We expect 2H'20 average deposit balances to be between $71B and $74B, versus 1H average balances of $64.8B.

Expected upside deposit drivers include clients continuing to conserve cash and the continuation of the healthy public and private market activity we've seen to date. A notable slowdown in VC or PE activity among our clients could drive deposits to the downside. In general, we expect client liquidity to remain very strong, affecting both on and off-balance sheet funds growth.

NII and NIM

We expect 2H'20 net interest income to remain resilient at between $1.05B and $1.09B, generally in line with NII in the first half of the year. This expectation stems from continued low deposit costs due to lower rates, potentially widening spreads on loans, and a continued mix shift to higher yield Technology, Life Science & Healthcare lending.

NII will also be helped by a variety of protections we've put in place, including $10.6B of active loan floors and $211M of locked-in gains from interest-rate swaps (each as of June 30, 2020). We will continue to monitor the rate environment to determine whether additional measures are needed to protect our earnings.

We expect 2H 20 net interest margin to be between 2.70% and 2. 80%, due to lower interest rates on loans (including $1.8 billion of SBA PPP loans), declining yields in our investment securities portfolio, and elevated (though lower than Q2) cash levels. This compares to NIM of 2.95% for the first half of 2020.

Core Fee Income

We expect 2H'20 core fee income to be between $255M and $275M, a decline from the first half of the year ($301M), driven by expectations of lower client investment fee income due to lower rates, and lower card and FX income due to lower levels of client activity, potentially offset somewhat by higher client investment fund balances and our ongoing efforts to deepen our client engagement..

Expenses

We expect 2H'20 expenses to be between $900M and $930M (compared to $879M in 1H'20), due to higher FTE, higher professional services and project costs related to our strategic investments, donation of PPP fees, and higher incentive compensation related to SVB Leerink outperformance. The final range will depend in large part on the timing of our PPP donation and SVB Leerink performance for the remainder of 2020.

Tax Rate

We expect our 2H'20 effective tax rate to remain steady between 27% and 29%.

Credit Commentary

While we are not providing an updated credit outlook for 2020, based on our portfolio analysis and experience, we expect to see the following credit dynamics in each of our portfolios for the remainder of 2020.

- Private Equity/Venture Capital (49% of loans): We expect continued strong credit performance and low credit costs in line with historical performance in our Private Equity/Venture Capital portfolio.
- Private Bank (10% of loans): We expect continued strong credit quality in our mortgage portfolio, although we could see a small number of charge-offs given current economic stress.
- Early stage (5% of loans): We expect the highest losses in our early-stage portfolio, which makes up only 5% of loans but is the most vulnerable even in good economic conditions. That said, we expect loss rates to be below historical peak losses for this portfolio and to be mitigated by lower average loan balances.

- Mid- and later-stage Technology and Life Science & Healthcare (Investor Dependent, Cash Flow and Asset-Based) (27% of loans): We expect elevated, episodic, but manageable, near-term losses among our mid- and later-stage borrowers due to growth in these segments over time. In the technology portfolio, we are especially watching Consumer Internet companies, and those with direct exposure to the most severely affected segments of the economy. In the life science & healthcare portfolio, we are watching companies dependent on clinical trials and elective healthcare services, although many of these services have resumed around the country. Risks in these portfolios are somewhat mitigated by higher asset coverage and enterprise values of these borrowers, relative to early-stage borrowers.
- Wine (3% of loans): Most of our wine loans (75%) are secured by prime vineyard property, primarily in Napa and Sonoma, and our working capital borrowers tend to enjoy high margins on their ultra-premium products. For this reason, we expect relatively low credit losses in our wine portfolio. However, we expect continued bans on in-restaurant dining and tasting-room visits to drive higher non-performing loans in this category.

We are encouraged by the degree to which credit quality has remained healthy. However, based on Q2's higher (although still very low) non-performing loan levels, we expect to see elevated charge-offs in the second half of 2020. We expect these charge-offs to be manageable and believe we have adequately reserved for them.

We believe our reserve modeled on economic scenarios is ample, but if economic forecasts worsen materially in the second half of 2020, we could see a higher provision.

Final Thoughts

While the current environment is challenging and the coming months may be more so, SVB is in the strongest financial position in its history, and we believe we are well-prepared to support our clients and manage effectively through the crisis. We are helping our clients manage their near-term challenges while maintaining our focus on our long-term strategic initiatives to drive growth and scalability in the future. We believe our continued investments in people, digital client experience, geographic expansion and diversification of our business will enable us to remain differentiated over the long term.

None of these achievements would be possible without the hard work of our more than 3,900 employees around the world, who have demonstrated in countless ways in these past few months their commitment to our clients, their passion for our business, and their ingenuity when it comes to solving problems. We are so grateful to them and know their passion comes from their desire to help our clients succeed. We are also grateful to our clients for the trust they have placed in us and for giving us the opportunity to demonstrate what true partnership looks like.

Because of our employees, because of our clients and because of the opportunities we see ahead, we remain optimistic about our long-term prospects supporting innovators and their investors in the most dynamic segment of the global economy. We will continue to focus on being the most valuable partner to our clients and fortifying our position as the bank of the global innovation economy.



Greg Becker

President and CEO

[i] Source for VC and PE data: Q2 2020 Pitchbook-NVCA Venture Monitor and Q2 2020 Pitchbook US PE Breakdown

NOTE: This CEO Letter should be read together with our Q2 2020 Financial Highlights Slides and Q2 2020 Earnings Release, dated July 23, 2020. Additionally, this CEO Letter contains forward-looking statements, which are subject to known and unknown risks and uncertainties, many of which may be beyond our control. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we have based these expectations on our current beliefs as well as our assumptions, and such expectations may not prove to be correct. Actual results could differ. Important factors that could cause our results and financial condition to differ from our expectations are described in our Q2 2020 Earnings Release, dated July 23, 2020, under the section "Forward-Looking Statements" and further discussed in our most recent Annual Report filed on Form 10-K and our latest Quarterly Report filed on Form 10-Q. The forward-looking statements included in this release are made only as of the date of this letter. We do not intend, and undertake no obligation, to update these forward-looking statements.