



MEMORANDUM

To: The Investment Subcommittee (ISC) & Banking Subcommittee of the Cash Management Policy Board (Board)
From: Fiah M. Kwessey, Director of Operation and Funds Management
CC: Colleen C. Davis, State Treasurer, Brennon Fountain, Deputy State Treasurer, Khairat Makanjuola, Chief Operating Officer, Antonia Kramer, Cash Manager & Jason Staib, Deputy Attorney General
Date: Tuesday, July 15, 2025
RE: **Review of the Board Investment Guidelines Related to Recent Credit Rating Downgrades**

The Office of the State Treasurer ("OST") has received an inquiry from the Federal Home Loan Bank (FHLB) of Pittsburgh seeking clarification as to whether letters of credit issued by the FHLB of Pittsburgh are eligible to serve as collateral under Section 5.2.1 of the Investment Guidelines, which addresses the collateralization requirements for demand deposit accounts. Currently, OST has three FHLB letters of credit (LOCs) in place:

- A letter of credit issued by the FHLB of Pittsburgh in the amount of \$15 million, which serves as collateral for uninsured deposits held by TD Bank, N.A.
- A letter of credit issued by the FHLB of Cincinnati in the amount of \$375 million, which serves as collateral for uninsured deposits held by JPMC.
- A letter of credit issued by the FHLB of New York in the amount of \$128.5 million, which serves as collateral for uninsured deposits held by M&T Bank.

The inquiry was prompted by Moody's recent downgrade of the credit rating of the Federal Home Loan Bank (FHLB) System and the FHLBs to Aa1/Stable Outlook. This action appears to be a direct result of Moody's downgrading of U.S. debt (to Aa1) due to the failure of successive US administrations to reverse ballooning deficits and interest costs. Moody's actions mirrored earlier downgrades by the other two major rating agencies, Standard & Poor's in 2011 and Fitch in 2023.

Section 5.2.1(b) of the Investment Guidelines requires that letters of credit, to be eligible to serve as collateral for State funds on deposit with an approved banking partner, be "issued by a Federal Home Loan Bank or financial institution rated in the highest rating category by at least one Nationally Recognized Statistical Rating Organization approved by OST ("NRSRO")." OST historically has only relied on ratings issued by the "big three" NRSROs (Moody's, S&P and Fitch).

Consequently, the FHLBs of Pittsburgh, Cincinnati and New York are no longer rated in the highest rating category by an NRSRO approved by OST, meaning that the three FHLB letters or credit technically are not eligible to serve as collateral for uninsured State funds.

OST believes that the three FHLBs are and remain acceptable credit risks, notwithstanding the downgrades, and would propose that the Board revise the Investment Guidelines to accommodate FHLB letters of credit. This could be accomplished by requiring that FHLBs have credit ratings "at least as high as U.S. debt," while retaining the "highest credit rating" for letters of credit issued by other financial institutions. This change will ensure continued compliance and flexibility and will also minimize risk. OST would also recommend that the Board approve OST's continued use of the FHLB letters of credit pending formal amendment of the Investment Guidelines.