

For U.S., Ripple Effects Of Russia-Ukraine Are More Concerning Than Direct Exposure

March 18, 2022

This report does not constitute a rating action.

Key Takeaways



Economy. S&P Global Economics' preliminary estimate in response to developments related to the crisis is that the effects will shave 70 basis points (bps) from U.S. GDP growth this year, with the economy now set to expand 3.2%. The prospects of steadily rising interest rates and persistent inflation are the main drivers of this assessment, with an expected recession in Russia playing only a small part.



Corporates. The conflict has had minimal direct impact on U.S. and Canadian corporate entities we rate. Only a handful of issuers had any notable direct sales exposure to Russia—and suspended business operations due to sanctions, and discretionary exits due to security concerns or public pressure, have had a limited effect on credit quality. But the ripples in commodities markets and the broader economy are already having a pronounced effect on many.



Financial Services. The conflict has roiled financial markets and created new risk dynamics across the globe. Although the direct impact for U.S. financial institutions is limited, the situation has created an air of uncertainty. Risks that have arisen for U.S. financial institutions due to the conflict include: cyber risk; operational risk to avoid breaching sanctions; trading losses resulting from higher market volatility; elevated counterparty risk amid higher margin requirements.



Structured Finance. All told, we expect the Russia-Ukraine conflict to have limited direct credit effects on the structured finance transactions we rate globally. U.S. aircraft asset-backed securitization (ABS) is an exception because 48% of the transactions we rate (12 of 25) in the sector have direct exposure to Russia and/or Ukrainian airlines.



U.S. Public Finance. While the diverse sectors that represent U.S. public finance are geographically distant from the Russia-Ukraine military conflict, the geopolitical situation will clearly weigh on macroeconomic and credit conditions. Inflation has been a headwind for all sectors for months, and labor costs, funding services, and capital construction outlays will likely pressure state and local budgets.



Insurance. For the vast majority of insurers and reinsurers headquartered outside Russia that have exposure to the country, their exposure is small enough and their capital strong enough for them to avoid a deterioration in credit quality. The same is true for insurers and reinsurers with no direct exposure to Russia, but we continue to assess the impact of macroeconomic and financial market volatility on balance sheets.

As the Russia-Ukraine military conflict rages on, and the West's sanctions continue to hammer the Russian economy, the reverberations are being felt around the world. And while the U.S. is comparatively isolated from the effects (certainly relative to the pain many European countries are feeling), the ramifications of the conflict are measurable—both for the world's biggest economy and the businesses and borrowers that operate in it.

S&P Global Economics' preliminary estimate in response to developments related to the crisis is that the effects will shave 70 basis points (bps) from U.S. GDP growth this year, with the economy now set to expand 3.2%. The prospects of steadily rising interest rates and persistent inflation are the main drivers of this assessment, with an expected recession in Russia playing only a small part.

With the demand-driven component of inflation all but requiring a monetary-policy response, the Federal Reserve has kicked off a cycle of rate hikes, with a 25-bps move at its March meeting. We expect the Fed to raise its target interest rate six times this year with a steady set of 25-bps moves, followed by five more hikes in 2023-2024. This comes as soaring energy prices underpin supply-side inflation, and we expect extreme price pressures to persist for at least the next two quarters. This would continue a run of historic inflation readings, with the Consumer Price Index jumping an annualized 7.9% in February—the most in 40 years. And that reading came before the full effects of the surge in gas prices could be felt. Inflation will likely move even higher, given that prices at the pump have soared to record levels, to well above \$4 per gallon on average nationally.

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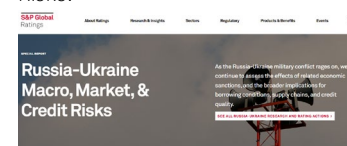
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Links

S&P Global Ratings Special Reports on Russia-Ukraine Macro, Market, & Credit Risks:



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We see the risks to our baseline forecast as firmly on the downside—mainly related to an escalation of the conflict beyond what is included in our baseline numbers. But we still see the chance of a U.S. recession as moderate, especially after growth surprised on the upside in the fourth quarter as the damage from the coronavirus omicron variant was less pronounced than we expected. If the public health situation in the U.S. keeps improving, the 2022 economic outlook would likely remain largely solid, even as the Russia-Ukraine conflict clouds the outlook.

Financial markets have reflected this uncertainty. While secondary-market spreads on corporate debt remain historically narrow—even for borrowers at the lower end of the credit scale—they are widening steadily. The risk is rising that investors will begin to demand an “uncertainty premium” of higher returns. Higher benchmark rates, combined with a normalization (widening) of spreads, will likely end the historic run of favorable financing conditions—if this hasn’t already happened. While there’s not a lot of debt due this year, and a relatively small amount maturing next year, a large portion of speculative-grade debt outstanding carries floating interest rates and would therefore become more expensive to repay. Either way, a rapid and volatile market repricing—affecting debt-servicing costs and funding access—would hurt lower-rated borrowers, in particular.

Corporates

Given that the Russian economy accounts for less than 3% of global GDP, the conflict in Ukraine has had minimal direct impact on U.S. and Canadian corporate entities we rate. Only a handful of issuers had any notable direct sales exposure to Russia, and in those cases, it was below 15%. Suspended business operations due to sanctions, and discretionary exits due to security concerns or public pressure, have had a limited effect on credit quality.

This contrasts with the ripples in commodities markets and the broader economy that are already having a pronounced effect on many U.S. and Canadian issuers. Russia is the world's third-largest oil producer and supplies close to 40% of Europe's natural gas imports. The anticipation of interrupted supply sent energy prices soaring. Food prices have risen as well given the amounts of wheat, barley, corn, and fertilizer exported from the region. We now expect inflation to climb even higher in the short term, prompted by the rising food and energy prices. We also expect companies to face rising input costs as air-traffic interruptions and limited access to the Black Sea exacerbate supply bottlenecks.

Depending on how much these headwinds weigh on economic growth and consumer sentiment, we expect top lines to be pressured—especially for industrial companies or those for which demand is driven chiefly by economic growth. As expected, the uncertainty is causing investors to rethink their preferred asset classes and is tightening access to capital for lower-rated borrowers or those in the more vulnerable sectors of the economy.

Russia was under sanctions before the conflict began, and therefore it is reasonable to expect that it would remain under some level of trade restrictions even after a ceasefire. Additionally, permanent exits from the region and various efforts to diversify suppliers and reduce energy dependence on the region suggest that economic activity will take a different form and size even when it returns.

Table 1

Impact Of Russia-Ukraine Conflict On Credit Quality Of North American Corporates By Sector

Sector	Impact	Likelihood	Rated debt (bil. US\$)
Aerospace and defense	Neutral	Medium	329
Autos	Negative	High	476
Capital goods	Negative	Medium	561
Chemicals, packaging, and environmental services	Neutral	Medium	560
Consumer products	Negative	Medium	1,320
Forest products and building materials	Negative	Medium	225
Health care	Neutral	High	1,368
High technology	Neutral	Medium	1,419
Homebuilders/real estate	Negative	Low	430
Media and entertainment	Neutral	Medium	1,482
Metals, mining, and steel	Positive	High	178
Oil and gas	Positive	High	560
Retail/restaurants	Negative	Medium	850
Telecommunications	Neutral	Medium	1,374
Transportation	Negative	High	429
Utilities	Neutral	Medium	1,917

Note: Impact—The type of rating pressure we anticipate as a result of direct and indirect consequences from the Russia-Ukraine conflict. For each sector we incorporate our outlook as well as how well issuers are positioned to sustain ongoing macroeconomic and operational challenges. Likelihood—Our general confidence level that the impacts we expect will materialize with the magnitude or duration we anticipate. Rated debt data is as of March 15, 2022.

Source: S&P Global Ratings.

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See appendix for full list of corporate analytical contacts.

Oil and gas

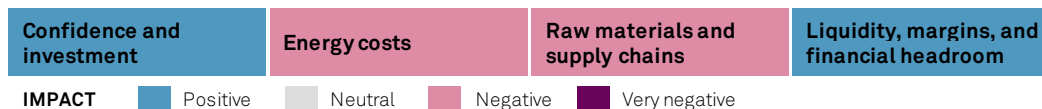


According to the Energy Information Administration (EIA), Russia was the world's third-largest producer of oil and the second-largest producer of natural gas in 2020, giving it an outsized influence on global energy markets. As public pressure has grown to broaden sanctions, so too have the prospects of energy-supply shortfalls. The effects are wide-ranging as oil is connected to all transportation systems, from planes to automobiles, that facilitate the delivery of goods and services. Natural gas also has a broad influence as an input to electricity generation and with its role as a raw material in fertilizer production.

Understandably, consumers of Russia's oil and gas are accelerating their efforts to diversify—Europe has proposed cutting its natural gas dependency by two-thirds in the next year. As net producers of these commodities, American and Canadian companies are positioned to benefit from rising prices, and we are already seeing examples of widening margins (see **"S&P Global Ratings Raises Near-Term Oil And Gas Price Assumptions Following Russian Invasion Of Ukraine,"** published Feb. 28).

Although these markets are global, logistics barriers can limit how much volumes can move and prices equalized across regions. As an example, natural gas prices in recent months have risen significantly higher in Europe than North America. Furthermore, it is unlikely that these efforts can completely offset the vast volumes that were exported from Russia any time soon.

Metals and mining



Russia is a large producer of aluminum, nickel, and, most notably, palladium. As expected, we have seen sharp increases in prices for these metals, and rising demand for others, such as gold, which is viewed as an inflation hedge (see **"Metal Price Assumptions: Shortages Worsen And Prices Spike As Conflict Roils Metals Trading,"** published March 17). Typically, this should result in supply responses, particularly in the various high-fixed-cost areas of metals and mining, where increases in revenue drop more completely to the bottom line. However, in our view, there are many factors that can hinder supply increases in certain cases. As an example, palladium reserves are relatively rare and scarce, and alternative sources simply aren't available in the abundance required to completely offset Russian exports in a manner that wouldn't be cost-prohibitive. Secondly, in many cases palladium is a byproduct of another primary metal that is being mined. This makes it difficult to scale up its production without destabilizing operations for what would typically be mining for a primary industrial metal. Finally, energy is a key input in the mining and processing of metals, and in cases such as aluminum it can be the highest cost component.

Volatile energy and metals prices, as well as the costs and lead time required to scale up in the metals and mining industry, all contribute to slowing the supply responses. However, many prices had already been high for some time, strengthening credit quality in the sector, and in the interim we are seeing margins continue to widen, even though the picture could quickly change.

Regulated utilities



The regulated utilities outlook has been negative since early 2020 and remains so for 2022. Credit quality for the investor-owned North America regulated utility industry weakened during 2020 and

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increasingly expensive natural gas. This could put U.S.-based nitrogen-fertilizer producers, such as The Mosaic Co. and CF Industries Holdings, at an advantage due to their access to relatively lower-cost natural gas.

Airlines



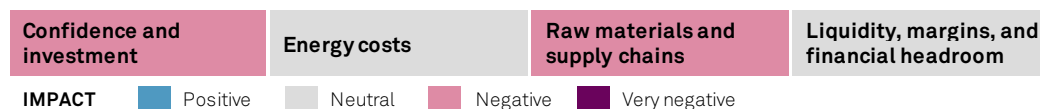
The military conflict and financial sanctions on Russia will directly affect the aircraft lessors we rate. The sanctions prohibit providing aircraft and aircraft parts to Russia, and this also applies to aircraft leases. This prohibition takes effect March 28 (see **“Aircraft Lessors Hit By Western Sanctions On Russia,”** published March 1).

Several lessors have disclosed their exposure to Russia: AerCap Holdings, the world’s largest aircraft-leasing company, stated that about 5% of its aircraft (measured by book value) are on lease to Russian airlines. We expect that the exposure of most other rated aircraft lessors will also be in the single-digit percent area. The highest exposure disclosed thus far is SMBC Aviation Capital, at 10%, but the aircraft are mostly new-technology narrowbody planes—the easiest to place with new airline lessees.

Many aircraft leases have provisions that allow a leasing company to terminate a lease if forced to do so by government actions. The actual repossession of the hundreds of aircraft affected will be a major logistical undertaking, but our understanding is that prohibitions on Russian planes entering the air space of certain other countries either wouldn’t apply to repossession flights or could be circumvented by flying to other destinations outside Russia.

More broadly, the run-up in oil (and thus jet fuel) prices will hurt airlines throughout the world, including those outside Russia.

Technology



For tech companies, the conflict adds to existing supply disruption and inflationary commodities pricing but is incremental and the effects will likely be modest. There’s limited direct revenue exposure to Russia (3% for global PC, 2%-3% for global smartphones, low-single-digits for the Apple food chain). We also see the indirect impact due to supply dynamics for critical semiconductor materials to be low. Even with 70%-plus of the neon supply coming from Ukraine, the current situation seems manageable, with most vendors having 3-6 months of inventory on hand—but a bottleneck could occur if the conflict continues.

Financial Institutions

The armed conflict in Ukraine has roiled financial markets and created new risk dynamics across the globe. Although the direct impact for U.S. financial institutions is limited, the situation has created an air of uncertainty with many secondary effects from the conflict looming—notably, our lower U.S. GDP growth forecast.

Risks that have arisen for U.S. financial institutions due to the conflict include:

- Cyber risk
- Operational risk to avoid breaching sanctions
- Possible trading losses resulting from higher market volatility
- Elevated counterparty risk amid higher margin requirements and profit margin pressure
- Funding risk along with margin pressure as credit spreads widen
- The hit to the U.S. economy, accompanied by higher interest rates and muted loan growth
- Higher credit risk, particularly for credit given to lower-income consumers
- Higher inflationary expectations
- A flatter yield curve
- Market volatility that could hit revenues and profitability for asset managers

Banks

U.S. banks' direct exposure to Russia and Ukraine is limited. For example, according to the Bank for International Settlements (BIS), U.S. claims on an immediate counterparty basis to Russia total \$14.7 billion, with \$7 billion in local currency. No U.S. bank has exposure to either of these countries exceeding 0.75% of assets of greater than 15% of capital, according to data from the Federal Financial Institutions Examination Council.

We believe Citigroup has the largest absolute exposure to Russia of any bank in North America, and the conflict could complicate its plans to exit consumer banking in the country. Still, the \$8.2 billion exposure it has reported equated to only about 0.3% of its assets and about 5% of its S&P Global Ratings total adjusted capital. Its exposure includes corporate and consumer loans, local government securities, and deposits with the Russian central bank and other financial institutions. On top of that, it said it had \$1.6 billion of exposure to Russian counterparties not held at its Russian subsidiary. The company has estimated that under a severe stress scenario related to the conflict, its losses would equate to less than half of those exposures, or around 2%-3% of its S&P Global Ratings total adjusted capital.

Only two of the other seven global systemically important banks in the U.S.—Goldman Sachs and Bank of New York Mellon—disclosed exposure to Russia in their 2021 annual reports. Both showed minimal exposure. None of the others, including JPMorgan Chase, the most global of the U.S. banks after Citi, listed Russia or Ukraine among their largest country exposures (usually the 20 largest).

Still, we believe that U.S. banks could suffer some indirect effects from heightened geopolitical risk. Specifically, we identify the potential for elevated counterparty risk to institutions with more direct exposure to these countries. Volatility in financial markets could generate trading losses, as well, and counterparty risk can develop, particularly for counterparties trading in commodities given the recent volatility. Higher energy and commodities prices, combined with protracted supply constraints, could exacerbate already high inflation. This, in turn, could weigh on credit costs for U.S. banks, particularly lenders exposed to lower-income consumers. Other risks include more complex operational procedures amid a complex array of sanctions. In addition, we believe banks and possibly the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system itself, could be subject to cyber attacks.

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Securities firms

U.S. securities firms we rate also have limited direct exposure to Russia. But, again, they're exposed to secondary effects, particularly declining financial market values and increased volatility. For retail firms, declining securities values could weigh on asset-based fee revenue, but this wouldn't likely be a material ratings issue for any firm. Institutional firms that hold securities inventory are more exposed to potential write-downs from declining market prices, as well as increased trading book value at risk from increased volatility, which could lower their risk-adjusted capitalization. There is also potential for counterparty exposure to other institutions that are more directly exposed. Given firms' capitalization we don't expect this to be material unless market stress is more severe or prolonged than we expect.

For firms that self-clear, higher market volatility also increases counterparty risk on trades, and the amount of margin they must post to their trading counterparties, including clearinghouses, to cover settlement risk on their and their clients' trades.

Finance companies

U.S. finance companies lend mainly to American businesses and consumers, with little or no international exposure in most cases. Nevertheless, ripple effects from the conflict may create headwinds for some. Finance companies rely on wholesale financing, and many took advantage of favorable funding conditions the past two years to push out maturities, but now face more volatile capital markets.

Higher commodities prices and supply disruptions are increasing inflationary pressures, which could hit asset quality for both commercial and consumer finance companies. This will most likely affect consumer finance companies focused on lower-income borrowers, who are likelier to suffer financial stress from elevated inflation. Higher inflation may also weigh on the profitability of those businesses that can't pass on higher costs to customers, which could affect some loans held by commercial finance companies and business development companies (BDCs).

For BDCs, as well as commercial real estate finance companies, higher interest rates may also pressure debt service for their borrowers, however, the effect won't likely be immediate because most of these loans have floating rates and typically have floors that are above current benchmark rates. Positively, if rates rise 100 bps or more, many BDCs and commercial real estate lenders would benefit from higher net interest margins because a portion of their funding is typically at fixed rates.

Asset managers

There is no elevated direct exposure to Russia-Ukraine for the larger asset managers we rate. Therefore, recent losses due to declining Russian/Ukrainian assets don't have an immediate effect. However, we're on the lookout for any second-order effects on valuations, declining levels of assets under management (AUM) due to volatile markets, AUM flows, earnings, and profitability, as well as the ramifications of rising rates and inflation.

Payment companies

Mastercard, Visa, and PayPal have all suspended operations in Russia. While revenue from Russia and Ukraine accounted for only about half a percentage point of PayPal's revenue last year, it made up a more meaningful 6% and 5% for Mastercard and Visa, respectively, in their latest fiscal years. The latter two likely also have some settlement exposure to financial institutions in Russia. Both companies guarantee settlements among their clients for payment volumes they authorize, clear, and settle through their networks. This creates settlement risk due to the difference in timing between the date of a payment transaction and the date of settlement. If a card issuer fails settlement, Mastercard or Visa typically must cover the payment to the merchant.

Structured Finance

Increasing oil (and, thus, gasoline) prices remain a wild card for their potential to lower growth rates and exacerbate inflation. Further, we have seen more caution around new debt offerings, with some issuers hesitant to come to market amid widening spreads and a more uncertain environment, especially with longer-dated assets.

All told, we expect the Russia-Ukraine conflict to have limited direct credit effects on the structured finance transactions we rate globally. U.S. aircraft asset-backed securitization (ABS) is an exception because 48% of the transactions we rate (12 of 25) in the sector have direct exposure to Russia and/or Ukrainian airlines (see **“S&P Global Ratings Reviews Aircraft ABS Exposure To Russian And Ukrainian Airlines,”** published Feb. 28). We recently placed 28 ratings from seven aircraft ABS transactions on CreditWatch with negative implications (see **“28 Ratings From Seven Aircraft ABS Transactions Placed On Watch Negative On The Russia-Ukraine Conflict”** and **“Credit FAQ: Impact Of The Russia-Ukraine Conflict On Aircraft ABS Securitizations,”** both published March 15).

We will continue to monitor other transactions for any indirect impact, such as macroeconomic effects, capital market volatility, and tighter financing conditions. For more, see **“S&P Global Ratings Expects The Russia-Ukraine Conflict To Have Limited Direct Impact On Global Structured Finance,”** published March 3.

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U.S. Public Finance

While the diverse sectors that represent U.S. public finance are geographically distant from the Russia-Ukraine military conflict, the geopolitical situation will clearly weigh on macroeconomic and credit conditions. Here's what we will be watching (see chart 1):

Chart 1

Russia-Ukraine Conflict And U.S. Public Finance: What We're Watching



Source: S&P Global Ratings.

Prospects for slower economic growth. S&P Global Economics' off-cycle global macro forecast in response to market developments related to Russia-Ukraine now sees growth in the world's biggest economy fall 70 bps short of the previous forecast, at 3.2%, due to policy developments and higher energy prices.

Mounting inflation pressures. Inflation has been a headwind for all sectors for months, and the current geopolitical situation will exacerbate this. Inflation in the U.S is also now estimated to be 6% this year due in part to higher energy, food, and metals prices (see "**How Inflation Has Mixed Effects On U.S. State And Local Government Credit Quality**," published Feb. 32, and "**Inflation Could Weigh On U.S. Not-For-Profit Utilities' Credit Ratings**," published Feb. 24). Labor costs, funding services, and capital construction outlays will likely pressure budgets. For consumers, perhaps most noticeable are high gas prices, but inflation is more pervasive, and likely to remain so as supply chain challenges worsen, which could weigh on consumer demand. How much credit quality is pressured will be tied to the duration of the conflict.

Equity market volatility affects revenues and investment returns. Income tax collections are influenced by capital gains, and market volatility can lead to swift and unpredictable revenue deterioration. A sustained equity market decline would likely weaken pension fund investment returns, which can translate to higher public pension funding costs. Higher education endowments will also feel pressure from sustained market volatility.

Acceleration of cyber security threats. We see a heightened risk of cyber attacks given the current geopolitical situation (see "**Cyber Threat Brief: How Worried Should We Be About Cyber Attacks On Ukraine?**" published Feb. 22 and "**ESG Brief: Cyber Risk Management In U.S. Public Finance**," published June 28, 2021). We consider that issuers with weaker cyber governance and risk management are more exposed to rating implications.

We believe U.S. public finance issuers are positioned to weather the downside risks of the current situation as stimulus funds and healthy revenue growth continue to support finance flexibility, but the duration and magnitude of the conflict will bear watching from a credit standpoint.

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For the vast majority of insurers and reinsurers headquartered outside Russia that have exposure to the country, their exposure is small enough and their capital strong enough for them to avoid a deterioration in credit quality. The same is true for insurers and reinsurers with no direct exposure to Russia, but we continue to assess the impact of macroeconomic and financial market volatility on balance sheets. At this stage, we believe these pressures are manageable for most given the strong capital buffers and conservative investment profiles across the sector.

Many global and regional reinsurers have exposure to Russia, as do some industrial line writers. As of now, we believe global reinsurers' exposure is limited, in most cases less than 1% of assets and existing liabilities. Although Russian primary insurers make use of reinsurance from abroad, the overall volume is rather small in a global context. Also, many but not all reinsurance contracts have war and sanctions exclusions. Our base case is that claims will be paid once they arise despite sanctions against many Russian banks. This is because many clients of global reinsurers and industrial line writers in the region are foreign multinational corporates, so we expect sufficient financial-service connections outside of Russia to keep premium and claim payments alive.

We believe lines of business that could be more affected via direct or second-order effects are political risks, terror and war, trade credit, aviation, marine, business interruption, and cyber. We are monitoring, in particular, exposures and terms and conditions with regard to war and sanctions exclusions.

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Related Research

- [Russia-Ukraine Military Conflict: Key Takeaways From Our Articles](#), March 18, 2022
- [Russia-Ukraine Conflict Will Test Agribusiness Supply Chain Efficiencies And Consumers' Appetite For More Food Inflation](#), March 18, 2022
- [Ratings Actions Waypoint: The Russia-Ukraine Conflict As Of March 16, 2022](#), March 17, 2022
- [Metal Price Assumptions: Shortages Worsen And Prices Spike As Conflict Roils Metals Trading](#), March 17, 2022
- [Impact On Tech From Russia-Ukraine Conflict Muted For Now, With Risk Of A Further Macroeconomic Slowdown](#), March 17, 2022
- [U.S. Financial Institutions Ratings See Some Indirect Increased Risk From The Armed Conflict In Ukraine](#), March 17, 2022
- [Credit FAQ: Impact Of The Russia-Ukraine Conflict On Aircraft ABS Securitizations](#), March 15, 2022
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- [Global Macro Update: Preliminary Forecasts Reflecting The Russia-Ukraine Conflict](#), March 8, 2022
- [How Will North American Utilities Cope With Higher Interest Rates, Steeper Commodity Prices, And Inflation?](#), March 8, 2022
- [S&P Global Ratings Expects The Russia-Ukraine Conflict To Have Limited Direct Impact On Global Structured Finance](#), March 3, 2022
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- [Cyber Threat Brief: How Worried Should We Be About Cyber Attacks On Ukraine?](#), Feb. 22, 2022
- [How Inflation Has Mixed Effects On U.S. State And Local Government Credit Quality](#), Feb. 3, 2022
- [ESG Brief: Cyber Risk Management In U.S. Public Finance](#), June 28, 2021

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