



Right-Sized Resilience: A Framework for Optimizing FHLB Des Moines Dry Powder

MEMBER STRATEGIES

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Federal Home Loan Bank of Des Moines membership provides a powerful liquidity backstop for member institutions. The protection it offers comes from your ability to draw advances and letters of credit rapidly when stress hits, not from the size of the unused collateral you have pledged. That access is already built into your membership. The question is whether you are leaving more of it idle than your situation requires.

Industry evidence suggests that many FHLB Des Moines members maintain significantly more unused pledged collateral than their actual risk profiles require. For institutions with diversified, insured-heavy deposit bases, the worst-case scenarios embedded in many contingency funding plans are not well calibrated to the institution's true vulnerability. The result is structural over-reservation that imposes a real cost: foregone net interest income, constrained loan growth and ALM strategies less agile than they could be.

This paper makes two core arguments:

- Most FHLB Des Moines members face a depositor risk profile fundamentally different from the concentrated, interconnected bases that have driven the most severe recent stress events
- Right-sized capacity, deployed productively, allows members to make money and reduce risk simultaneously

At the heart of this paper is a four-dimension framework executive teams can use to evaluate whether their institution's contingent liquidity capacity ("dry powder") is appropriately calibrated and to identify the balance sheet levers available if it is not.

THE LIQUIDITY PARADOX: SAFETY AND OPPORTUNITY COST ARE NOT OPPOSITES

Every financial institution navigates a fundamental tension: holding more liquidity reduces the risk of a funding shortfall but imposes a direct cost on earnings and balance sheet efficiency. Federal Reserve supervisory guidance has acknowledged this tradeoff for decades. SR Letter 10-6, the industry's primary framework for liquidity risk management, calls on institutions to maintain sufficient liquid assets relative to their risk profile, and equally, to understand the cost of that buffer. The question has never been whether to hold contingent liquidity. It has always been how much.

Institutions holding more unused FHLB Des Moines capacity than their stress scenarios require are not, in fact, safer than institutions that have calibrated their buffer more precisely. Institutions holding more unused FHLB Des Moines capacity than necessary are carrying a cost without a corresponding benefit. The basis points foregone by holding excess idle collateral capacity are real and compounding.

Understanding that excess, and what it costs, requires a clear-eyed analysis of the stress scenarios used to justify the buffer. That analysis begins with evidence on how liquidity stress actually unfolds.



WHAT THE EVIDENCE TELLS US ABOUT REAL LIQUIDITY STRESS

The most severe deposit run episodes in recent U.S. banking history share a specific set of structural characteristics. Federal Reserve System analysis documents that catastrophic runs, those involving the loss of 20 percent or more of deposits within 48 hours, have been concentrated at institutions with three compounding vulnerabilities:

- An exceptionally high share of uninsured deposits, often exceeding 85 percent of total funding
- A homogeneous depositor base drawn from a single industry or ecosystem, connected through common backers, shared payment networks, or mutual business interdependencies
- A liability structure in which large institutional depositors could move enormous sums in a coordinated fashion

This profile does not describe the typical FHLB Des Moines member. The overwhelming majority of member institutions hold deposit bases that are structurally far more resilient: retail depositors dominate, insured deposits account for a large majority of funding, and the depositor base is diversified across businesses, households, and geographies with no destabilizing concentration. FDIC data confirms this directly. Counter to what one might expect, institutions with less than \$10 billion in assets, the group that encompasses the vast majority of FHLB Des Moines members, experienced slight deposit growth through the peak of the 2023 stress period.

Sophisticated stress calibration goes a step further. It accounts for the possibility that collateral haircuts may tighten during stress, that concurrent demand from many members may affect the timing of advance availability, and that diversifying contingent liquidity across multiple channels may be appropriate for some institutions. Acknowledging these factors does not weaken the core conclusion. It refines what genuine stress needs look like for each individual member.

The implication for FHLB Des Moines members is direct: institutions should calibrate their unused FHLB Des Moines capacity to their own depositor profile, not to a worst-case scenario drawn from institutions whose vulnerabilities bear little resemblance to their own. Miscalibrated stress scenarios produce excess buffers that carry real costs to FHLB Des Moines members.

THE OPPORTUNITY COST OF EXCESS DRY POWDER

The cost of maintaining excess unused FHLB Des Moines collateral capacity is not theoretical. It shows up in the income statement, the balance sheet, and the ALM profile. For institutions with excess dry powder, the direct opportunity cost takes three forms:

- **Foregone earning asset deployment** - Assets pledged as collateral cannot be redeployed into higher-yielding loans or investments, limiting incremental earning asset growth.
- **Foregone advance carry** - Undrawn FHLB Des Moines capacity represents a missed opportunity to generate spread income through borrowing and reinvestment.
- **Constrained ALM flexibility** - Limited use of advances reduces the institution's ability to actively manage duration, funding costs and interest rate risk.

The ALM dimension deserves particular emphasis. FHLB Des Moines advances offer a breadth of maturity options, from overnight through multi-year terms, that allows institutions to actively manage interest rate risk in ways on-balance-sheet liquidity buffers cannot. Term advances can extend liability duration to reduce exposure to rising rates. Short-term advances bridge timing gaps without stretching deposit pricing. These are not defensive strategies. They are offensive uses of FHLB Des Moines membership that improve risk management and financial performance at the same time.



A FRAMEWORK FOR RIGHT-SIZING DRY POWDER

Determining the appropriate level of unused FHLB Des Moines capacity is not a compliance exercise – it is a strategic discipline. The goal is not to minimize contingent liquidity. The goal is to ensure that the buffer an institution maintains is genuinely calibrated to the risks that institution actually faces. Too often, buffer levels are driven by assumption, inertia, or industry-wide worst-case scenarios that bear little resemblance to the institution’s actual profile.

Dimension	Key Questions	Optimization Signal
1. Depositor Profile	<ul style="list-style-type: none"> • What share of deposits are insured? • Are there concentrations among interconnected depositors? • How diversified is the depositor base across sectors and geographies? 	Highly insured deposit ratios and diversified depositor bases support lower contingent buffer requirements.
2. Stress Scenario Calibration	<ul style="list-style-type: none"> • Do stress scenarios reflect this institution’s actual depositor profile, or do they default to industry worst case assumptions? • Do they account for dynamic factors such as collateral haircut tightening or concurrent advance demand? • When were they last calibrated? 	Scenarios anchored to idiosyncratic risk, not generic industry shocks, often reveal lower required buffers.
3. Capacity Utilization Review	<ul style="list-style-type: none"> • What share of pledged collateral capacity is currently unused? • Is this a deliberate strategic reserve, or a default posture that has never been actively examined? 	Unused capacity above stress scenario requirements represents a potential deployment opportunity.
4. Deployment Readiness and ALM Integration	<ul style="list-style-type: none"> • Is the institution operationally ready to draw advances rapidly? • Are advances and letters of credit integrated into the ALM strategy, not just the contingency funding plan? 	Institutions that use FHLB Des Moines capacity both defensively and offensively capture more value from FHLB Des Moines membership.

APPLYING THE FRAMEWORK

The four dimensions are designed to be evaluated together. An institution with a highly insured, diversified deposit base that conducts rigorous institution-specific stress testing and reviews its capacity utilization actively may find significant room to optimize. An institution with meaningful uninsured deposit concentrations or a more complex liability structure will appropriately maintain a larger buffer, but even those institutions benefit from understanding precisely why, rather than defaulting to excess capacity as a matter of habit.

Dimension 4 deserves particular attention because it is the most frequently overlooked. An institution that has pledged collateral and established its borrowing capacity but has not integrated FHLB Des Moines advances and letters of credit into its active ALM strategy is capturing only a fraction of the membership value available to it. The question is not just whether the institution can draw when needed. It is whether the institution is drawing proactively to improve financial performance, manage interest rate risk and support its lending mission.



STRATEGIC IMPLICATIONS: FROM ANALYSIS TO ACTION

Right-sizing dry powder is an ongoing governance discipline, one that connects liquidity management to strategic financial performance. The institutions that will derive the greatest value from FHLB Des Moines membership are those that approach the relationship between these two things strategically, integrating the framework above into board-level discussions of balance sheet efficiency, ALM strategy and growth planning.

The case for active engagement is supported by rigorous research. A 2025 Urban Institute study analyzing Federal Home Loan Bank (FHLBank) membership across commercial and savings bank members over more than two decades found that a one-percent increase in FHLBank advances is associated with a statistically significant 19-point improvement in bank z-scores. The z-score is a widely used measure of bank solvency risk: it captures how much of an earnings shock an institution could absorb before its capital buffer is exhausted. A higher z-score means a larger cushion against insolvency, and a 19-point improvement represents a substantial increase in that cushion. The significance of that finding is that the protection comes from the act of borrowing, not from the act of holding unused capacity.

ADVANCES MAKE MONEY AND REDUCE RISK SIMULTANEOUSLY

FHLB Des Moines advances are unusual among funding sources in that they serve both offensive and defensive purposes at the same time. Members can use advances to:

- Fund loan growth and balance sheet expansion, particularly in housing and community lending
- Manage interest rate risk through term advances that match-fund fixed-rate assets and reduce duration mismatch
- Bridge cyclical funding gaps without stretching deposit pricing or relying on more volatile wholesale alternatives
- Improve liquidity ratios. For institutions subject to the Liquidity Coverage Ratio, FHLB Des Moines advances receive favorable regulatory treatment under 12 CFR Part 249

There is also a meaningful pricing advantage that often goes unappreciated. Because FHLB Des Moines members earn dividends on activity-based capital stock, the all-in cost of a dividend-adjusted FHLB Des Moines advance is frequently lower than that of brokered deposits or other wholesale funding alternatives. For members, this translates directly into lower funding costs, wider net interest margins, and more competitive loan pricing for borrowers in their communities.

LETTERS OF CREDIT: AN UNDERUTILIZED RESOURCE

Letters of Credit are a second important product available to FHLB Des Moines members that many institutions have not fully utilized. FHLB Des Moines letters of credit allow members to satisfy collateral requirements for government and municipal depositors without tying up liquid balance sheet assets.

The optimization is direct. By using illiquid loan collateral, such as residential or commercial mortgages, to back letters of credit, members free up the Treasury securities, agency securities, and cash that would otherwise be encumbered as public deposit collateral. The benefit is twofold. First, those liquid assets become available for reinvestment at current yields or for funding new loans. Second, because pledged securities cannot be counted toward liquid asset measures, replacing them with letters of credit immediately strengthens the institution's liquidity ratios, including the High Quality Liquid Asset measure for the largest members subject to LCR requirements, and similar internal liquidity metrics for institutions of all sizes.



DEFENSIVE AND OFFENSIVE APPLICATIONS

Beyond specific products, executive teams should think about FHLB Des Moines membership along two dimensions simultaneously: defensive uses that preserve resilience during stress and offensive uses that actively improve financial performance.

On the defensive side, the fundamental tasks are:

- Ensuring the advance infrastructure is operationally ready and tested
- Keeping collateral positions current and accurately valued
- Maintaining a contingency funding plan with scenario assumptions calibrated to the institution's actual depositor profile

On the offensive side, the orientation shifts from contingency to active deployment:

- Treating FHLB Des Moines advances and letters of credit as primary funding and balance sheet tools, not just contingent reserves
- Integrating FHLB Des Moines capacity into the institution's ALM strategy on an ongoing basis
- Engaging with the FHLB Des Moines on advance structuring, capacity planning and balance sheet strategy throughout the cycle

GOVERNANCE AND THE ROLE OF THE BOARD

For this optimization discipline to take hold, it must be embedded in governance, not left to the treasury function alone. The board of directors bears ultimate responsibility for the institution's risk appetite and liquidity framework, and the board's oversight of liquidity should extend beyond reviewing compliance ratios to actively engaging with the question of whether the institution's contingent capacity is appropriately sized. Liquidity optimization should be a standing element of the board's annual strategic planning discussion, connected explicitly to the institution's NIM targets, loan growth objectives, and capital deployment priorities.

Senior management teams can structure this discussion around a set of governing questions drawn from the four-dimension framework:

- Has the institution's stress testing been updated to reflect the current deposit composition and any changes in depositor concentration?
- Is the current level of unused FHLB Des Moines capacity a deliberate strategic choice or a default posture inherited from a prior environment?
- What specific financial performance improvements would become available if excess capacity were deployed?
- Is the institution's advance and letter of credit usage integrated into the ALM strategy or treated as a purely contingent liquidity resource?

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YOUR FHLBANK AS A STRATEGIC PARTNER

Members who engage with their FHLBank as a strategic partner, rather than a transactional backstop, consistently capture more value from the relationship. That engagement includes deploying advances and letters of credit, utilizing mortgage purchase programs to convert loan into liquidity and participating in housing and community investment initiatives. It also involves close coordination with the FHLBank on balance sheet strategy, including advance structuring, capacity planning and the ongoing calibration of collateral and contingency funding frameworks.



THE RECIPROCAL MISSION: MEMBER USE, STRONGER COMMUNITIES

Every FHLB Des Moines member institution exists to serve its community. Banks, credit unions, and insurance company members support the households, small businesses, farms, and local economies that depend on access to reliable credit and financial protection. Using FHLB Des Moines advances and letters of credit strategically is not separate from that mission. It is one of the most direct ways members fulfill it.

There is also a reciprocal dimension that often goes unmentioned. By statute, each Federal Home Loan Bank contributes a minimum of 10 percent of its annual net income to its Affordable Housing Program. FHLB Des Moines goes beyond this requirement through additional voluntary contributions. When members actively use the FHLB Des Moines through advances, letters of credit, and other products, they support the FHLB Des Moines and that support flows directly back into affordable housing development, community investment grants, and member impact programs across the FHLB Des Moines district.

CONCLUSION: A MORE DISCIPLINED APPROACH TO LIQUIDITY

The evidence is clear. For most FHLB Des Moines member institutions, what protects you in a liquidity event is your ability to draw FHLB Des Moines advances and letters of credit when you need them. What many institutions are also carrying, on top of that protection, is a layer of unused capacity that exceeds what their actual stress scenarios demand. That excess is not safety. It is a cost. And every basis point of pledged collateral capacity above what is genuinely needed to survive a plausible stress event is capacity that can be put to work, supporting loan growth, enhancing net int rest margin, executing ALM strategy, and serving the communities that depend on the institution.

The institutions most vulnerable to severe liquidity events share a specific profile: concentrated, uninsured, interconnected depositor bases. That profile differs fundamentally from those of most FHLB Des Moines members. Stress scenarios calibrated to those worst-case profiles overestimate the risk that typical members face, producing buffers larger than the evidence supports. Right-sizing those buffers is neither reckless nor complicated. It is the application of sound analytical discipline to a question that has, for too long, been answered by default rather than by design.

Independent research supports this more precise view of resilience. The Urban Institute and the Government Accountability Office (GAO) find that when institutions use FHLBank advances to manage liquidity and funding needs, they are better able to sustain lending, absorb stress and reduce the likelihood of financial disruption. That activity strengthens individual institutions while also helping to limit broader systemic risk. The implication is consistent with the analysis above: safety comes from effective use of available liquidity, not from maintaining collateral buffers that exceed realistic needs.

The FHLBank System was built to be used. Members that use advances and letters of credit as active tools rather than as reserves held permanently in waiting are safer and stronger than those that do not. They strengthen their balance sheets, support their lending mission, and enable the FHLBank System to invest more in the communities they serve. The path to right-sized resilience runs through engaged membership, careful stress calibration, and the willingness to deploy capacity productively.

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