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SRTs in the Resolution of Failed Banks

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Christopher B. Horn
Jed Miller
Daniel Meade
Ivan Loncar
Kathryn Borgeson
Chris van Heerden
Christina Mille

I. Introduction

U.S. banks are increasingly turning to significant risk transfers (SRTs)[1] to manage credit risk and optimize regulatory capital. SRTs are transactions that satisfy the definition and operational criteria for "synthetic securitizations" under the bank regulatory capital rules.[2] In general terms, a synthetic securitization is a transaction in which a bank transfers credit risk on a pool of financial exposures to third parties through credit derivatives or guarantees, with the risk divided into tranches of different seniority.[3] The capital rules impose operational requirements designed to ensure genuine risk transfer, including that the credit protection cannot be terminated or repriced due to credit deterioration.[4]

An SRT typically takes one of two forms:

1. **Credit-linked notes issued directly by the bank (directly-issued CLNs)**: The bank issues notes to investors whose principal is exposed to losses on a specified reference portfolio of financial assets, thereby transferring a defined tranche of credit risk to third parties while the bank retains ownership of the underlying assets.

2. **Credit default swap with a third party (third-party CDS)**: The bank enters into a credit default swap or similar credit derivative with a counterparty that agrees to absorb specified credit losses on a specified reference portfolio of financial assets in exchange for periodic premium payments, again without transferring the underlying assets.[5]

1 SRTs are also commonly referred to as credit risk transfers, or "CRTs".

2 Synthetic securitizations are distinct from "cash" securitizations, in which credit risk is transferred through the sale of assets to a securitization vehicle and the issuance of asset-backed securities. Cash securitizations are beyond the scope of this paper. For a detailed discussion of the various forms of SRTs, *see Credit Risk Transfers (CRTs): A Handbook for U.S. Banks* (Dec. 2024); available at: CRTs_-_A_Handbook_for_U_S__Banks.pdf (the "Handbook").

3 *See* 12 C.F.R. §217.2 (defining "synthetic securitization" as a transaction in which credit risk is transferred through credit derivatives or guarantees, the risk is separated into at least two tranches reflecting different levels of seniority, performance depends on the underlying exposures, and all or substantially all of the underlying exposures are financial exposures).

4 *See* 12 C.F.R. §217.41(b). Among other things, the operational criteria also require that the credit risk mitigant be financial collateral, an eligible guarantee, or an eligible credit derivative, and that any clean-up calls be eligible clean-up calls.

5 Third-party CDS structures may be implemented in various forms. In some transactions, credit protection is provided by a bankruptcy-remote special purpose entity (SPE) that issues credit-linked notes to investors and posts the proceeds as collateral securing its obligations to the bank (a funded SRT). In other transactions, credit protection may be provided on an unfunded basis by an eligible guarantor. *See* the Handbook for further detail.

Recent academic and policy literature has evaluated SRTs through the lens of regulatory capital relief, credit risk management, and potential implications for financial stability.[6] An often overlooked benefit, however, emerges in the resolution of a failed bank. SRTs can preserve loss-absorbing capacity outside the receivership estate and give the Federal Deposit Insurance Corporation (FDIC), as receiver, valuable optionality through its statutory authority to enforce or repudiate the failed bank's contracts.[7]

In effect, the receiver holds an embedded financial option. The value of this option derives from the FDIC's selective enforcement power: the ability to preserve favorable credit protection while repudiating burdensome obligations. As Part IV explains, the value of this option depends on the credit outlook of the reference portfolio and the terms of the SRT, and can materially improve recoveries and narrow the range of loss outcomes in a bank failure. When preserved by the receiver, existing credit protection can function as a tail-risk hedge, potentially improving the marketability of the reference portfolio.

The FDIC's treatment of a failed bank's contracts depends critically on whether each contract constitutes a "qualified financial contract" (QFC) under the Federal Deposit Insurance Act (FDIA).[8] QFCs, which include swap agreements such as credit default swaps, are subject to a safe harbor that preserves counterparty close-out and netting rights after a brief stay period. Contracts that are not QFCs are subject to the FDIC's broader discretionary authority, including a longer stay period, the power to enforce contracts notwithstanding *ipso facto* clauses, and the power to selectively repudiate burdensome contracts. This bifurcated framework creates materially different resolution dynamics for the two principal forms of SRTs: directly issued CLNs typically are not QFCs and are therefore subject to the FDIC's full discretionary powers, while third-party CDS transactions generally are QFCs subject to the safe harbor's constraints.

This paper examines how the FDIC's receivership powers under the FDIA apply to the two principal forms of SRTs. Part II analyzes the application to directly-issued CLNs. Part III addresses third-party CDS. Part IV discusses the resolution-stage option that SRTs create for the FDIC, and Part V offers concluding thoughts.

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6 *See, e.g.*, Jeremy Brizzi, Jeffrey Gerlach, and John Kelly, *Banking Trends: Synthetic Risk Transfers*, Economic Insights, Third Quarter 2025, Federal Reserve Bank of Philadelphia, available at: https://www.philadelphiafed.org/-/media/FRBP/Assets/Economy/Articles/economic-insights/2025/q3/bt-synthetic-risk-transfers.pdf; Fabio Cortes et al., *Recycling Risk: Synthetic Risk Transfers*, IMF Working Paper WP/25/200 (Oct. 2025), available at: https://www.imf.org/en/publications/wp/issues/2025/10/03/recycling-risk-synthetic-risk-transfers-570914.

7 Note that FDIC receivership generally only applies to insured depository institutions (*i.e.*, banks and savings associations). Receivership under the FDIC's statutory authority does not extend to entities that are not insured depository institutions, such as bank holding companies and non-bank subsidiaries of a holding company. Such entities must seek relief under another insolvency regime, typically the U.S. Bankruptcy Code. Accordingly, if a bank holding company or non-bank subsidiary is party to the SRT, the resolution of that entity and its SRT would likely be governed by the U.S. Bankruptcy Code, rather than the FDIC receivership process.

8 *See* 12 U.S.C. §1811 *et seq.*

II. Application to Directly-Issued CLNs (Non-QFC)

In a directly-issued CLN transaction, the bank issues notes to investors under an indenture that typically designates the bank's insolvency or receivership as an event of default. This gives CLN investors contractual rights to accelerate and exercise other remedies. Directly-issued CLNs, however, typically should not constitute QFCs under the FDIA.[9] Non-QFCs are subject to the FDIC's general receivership powers, including a 90-day stay on counterparty remedies, the authority to enforce contracts notwithstanding *ipso facto* clauses, the discretion to selectively repudiate burdensome contracts, and the power to transfer contracts to a bridge bank or other acquirer without counterparty consent.

A. The 90-Day Stay

Upon the FDIC's appointment as receiver, counterparties to non-QFCs may not terminate, accelerate, or exercise remedies without the FDIC's consent for 90 days.[10] This window gives the FDIC time to evaluate the CLN transaction and the performance of the underlying reference portfolio before deciding whether to enforce, repudiate, or transfer the contract.[11]

B. Enforcement

The FDIC may enforce any contract of the failed bank notwithstanding any provision that permits termination, default, acceleration, or exercise of rights based on the bank's insolvency or receivership, commonly known as an "*ipso facto* clause."[12] This authority extends to clauses that do not explicitly mention insolvency but are triggered by events incidental to it, such as a sale or transfer of the failed bank's assets.[13]

If the reference portfolio has experienced credit deterioration, or if losses are anticipated, the credit protection embedded in the CLN structure may be economically valuable to the

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9 *See* 12 U.S.C. §1821(e)(8)(D)(i) (defining "qualified financial contract" to include securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements). Directly issued CLNs are debt instruments issued by the bank itself and do not fall within these enumerated categories.

10 *See* 12 U.S.C. §1821(e)(13)(C)(i).

11 The 90-day stay under §1821(e)(13)(C)(i) restricts the exercise of contractual remedies. Separately, under §1821(d)(5)(A)(i), the FDIC has 180 days following the filing of a claim to determine whether to allow or disallow such claim. A counterparty whose contract is repudiated on day 90 would file a damages claim and then await the FDIC's determination, which could extend through day 270 from receivership.

12 *See* 12 U.S.C. §1821(e)(13)(A).

13 *See Iberiabank v. Beneva* 41-I, LLC, 701 F.3d 916, 920–21 (11th Cir. 2012) (holding that the FDIC's enforcement authority extends to provisions triggered by events incidental to insolvency).

receivership. In that case, the FDIC can elect to enforce the CLN notwithstanding any *ipso facto* clause in the indenture.[14] By doing so, the FDIC preserves the investors' risk-bearing commitment and keeps loss-absorbing capacity outside the receivership estate. So long as the receivership (or a transferee) continues to perform under the indenture, the CLN remains in force and noteholders' contractual rights, including any perfected security interest in pledged collateral, continue according to the terms of the contract.[15]

C. Repudiation

The FDIC may repudiate any contract (other than a QFC, the repudiation of which is discussed below) that it determines, in its discretion, to be burdensome and whose repudiation will promote the orderly administration of the failed bank's affairs.[16] The FDIC must make this determination within a reasonable period following its appointment.[17] Thus, if the CLN transaction is economically unfavorable (for example, if the reference portfolio has performed well and no material losses are expected, while the bank owes significant interest payments to CLN investors), the FDIC may repudiate the indenture.

Upon repudiation, the noteholders' recovery is limited to a claim for actual direct compensatory damages (which excludes punitive damages and lost profits), determined as of the date of the FDIC's appointment as receiver.[18] If the CLN indenture provides for a segregated collateral account in which investors have a first-priority perfected security interest, repudiation does not extinguish that interest.[19] The investors would be secured creditors to the extent of the collateral's value and may realize recoveries up to their allowed damages; any surplus collateral would revert to the receivership. If there is no such collateral arrangement, the investors' claim ranks as a general unsecured claim, behind deposit liabilities and other higher-priority claims under the FDIA's priority scheme.[20]

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14 *See* 12 U.S.C. §1821(e)(13)(A).

15 A receivership claim arises only if the FDIC repudiates the indenture or otherwise breaches the note obligations (*e.g.*, by failing to make interest or principal payments when due). In that event, noteholders are secured to the extent of any pledged collateral and unsecured for any deficiency.

16 *See* 12 U.S.C. §1821(e)(1).

17 *See* 12 U.S.C. §1821(e)(2).

18 *See* 12 U.S.C. §1821(e)(3)(A)-(B). Such claims are paid from funds recovered through liquidation of the failed bank's assets, not immediate cash. The FDIC Resolutions Handbook explains that "[c]laims against the failed insured depository institution are paid from the funds recovered by the FDIC as receiver through its liquidation efforts.... Payments on these claims are known as dividends. After all assets are liquidated, final receivership expenses are paid, a final dividend is made, and the receivership is terminated." FDIC, Resolutions Handbook (2025), at p. 17, available at: https://www.fdic.gov/bank-failures/resolutions-handbook.pdf. The timing and amount of dividend payments are within the receiver's discretion and subject to available funds. *See* 12 U.S.C. §1821(d)(10)(A)–(B). Distributions follow the statutory priority scheme, under which general unsecured creditors rank behind depositors and certain other parties. *See* 12 U.S.C. §1821(d)(11)(A). Claimants' ability to challenge FDIC determinations judicially is constrained by 12 U.S.C. §1821(j), which bars courts from taking "any action ... to restrain or affect the exercise of powers or functions of the [FDIC] as ... receiver," subject to limited exceptions for de novo review of disallowed claims under 12 U.S.C. §1821(d)(6).

19 *See* 12 U.S.C. §1821(e)(12) ("No provision of this subsection shall be construed as permitting the avoidance of any legally enforceable or perfected security interest in any of the assets of any depository institution except where such an interest is taken in contemplation of the institution's insolvency or with the intent to hinder, delay, or defraud the institution or the creditors of such institution.").

20 *See* 12 U.S.C. §1821(d)(11)(A) (establishing priority of claims: (i) administrative expenses, (ii) deposit liabilities, (iii) general or senior liabilities, (iv) subordinated obligations, (v) shareholder claims).

D. Transfer

The FDIC may transfer any asset or liability of the failed bank, including the CLN transaction, together with the underlying reference portfolio, to a bridge bank or other acquirer.[21] Such a transfer is effective without any approval, assignment, or consent[22] and does not trigger contractual termination rights. *Ipso facto* clauses that are unenforceable against the FDIC remain unenforceable against a bridge bank or other transferee.[23]

A transfer may be attractive where the FDIC wishes to preserve the credit protection for purposes of marketing the reference portfolio or the bridge bank's business. The bridge bank succeeds to the failed bank's rights and obligations under the CLN, and the investors remain in substantially the same economic position, albeit with the bridge bank as obligor.

III. Application to Third-Party CDS (QFC)

In a third-party CDS transaction, the bank obtains credit protection through a credit default swap with a counterparty that agrees to absorb specified credit losses on a reference portfolio in exchange for periodic premium payments. The counterparty may be an eligible guarantor providing unfunded protection, or a bankruptcy-remote special purpose entity (SPE) that issues credit-linked notes to investors and posts the proceeds as collateral securing its obligations to the bank.[24] In either case, the credit default swap generally constitutes a QFC under the FDIA.[25] The transaction is therefore subject to the QFC safe harbor, which constrains the FDIC's authority and preserves certain counterparty rights.

21 *See* 12 U.S.C. §1821(d)(2)(G)(i)(II) (transfer authority); 12 U.S.C. §1821(n)(1)–(3) (bridge bank authority).

22 *See* 12 U.S.C. §1821(n)(3)(A)(iv) ("The transfer of any assets or liabilities... of an insured depository institution in default transferred to a bridge depository institution shall be effective without any further approval under Federal or State law, assignment, or consent with respect thereto.").

23 *See* Iberiabank v. Beneva 41-I, LLC, 701 F.3d 916, 922 (11th Cir. 2012).

24 *See* the Handbook for a detailed discussion of funded and unfunded third-party CDS structures.

25 *See* 12 U.S.C. §1821(e)(8)(D)(i), (vi) (defining "qualified financial contract" to include "swap agreements," which encompasses credit default swaps).

A. The One-Business-Day Stay

Upon the FDIC's appointment as receiver, the CDS counterparty may not immediately exercise contractual termination rights solely by reason of the receivership. The QFC safe harbor imposes a stay until 5:00 p.m. (Eastern time) on the business day following the receiver's appointment, during which *ipso facto* close-out rights are suspended.[26] This window, though short, gives the FDIC time to evaluate the CDS and determine whether to transfer it.

Unlike the 90-day stay applicable to non-QFC contracts, the QFC stay does not prevent the counterparty from exercising termination rights based on other defaults. If, for example, the failed bank was in payment default under the CDS prior to receivership (and any applicable cure period has expired), the counterparty may exercise close-out rights immediately.[27]

B. The Transfer Decision

The FDIC's principal choice with respect to a third-party CDS is whether to transfer the contract or allow it to terminate. Unlike non-QFC contracts, the FDIC cannot selectively repudiate individual QFCs; it must repudiate all or none of the QFCs with a given counterparty and its affiliates.[28] Moreover, even if the FDIC repudiates, the counterparty retains its close-out rights once the stay expires.[29] Therefore, as a practical matter, the FDIC's meaningful choice is whether to transfer the CDS (preserving the contract), or allow it to terminate upon expiration of the stay.

If the FDIC elects to transfer, it must transfer all QFCs between the failed bank and the counterparty (and its affiliates) to a single eligible transferee, such as a bridge bank.[30] If the FDIC provides notice of transfer by the statutory deadline, the counterparty may not exercise *ipso facto* termination rights, and the CDS continues with the transferee on its original terms.[31]

Where the CDS provides economically valuable credit protection (for example, if the reference portfolio has experienced credit deterioration or losses are anticipated), the FDIC can preserve that protection by transferring the CDS to a bridge bank or other acquirer. The successor institution continues to make premium payments and, in return, retains the right to receive credit protection payments if losses materialize.

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26 *See* 12 U.S.C. §1821(e)(10)(B)(i)(I).

27 *See* 12 U.S.C. §1821(e)(10)(B)(i) (providing that the stay applies only to termination rights exercised "solely by reason of or incidental to the appointment of a receiver").

28 *See* 12 U.S.C. §1821(e)(11).

29 *See* 12 U.S.C. §1821(e)(8)(A) (preserving counterparty rights to "cause the termination, liquidation, or acceleration of any qualified financial contract" after the stay period expires).

30 *See* 12 U.S.C. §1821(e)(9)(A). A bridge bank is treated as an eligible transferee. *See* 12 U.S.C. §1821(e)(10)(C)(i) (providing that a bridge depository institution is not considered "subject of a bankruptcy or insolvency proceeding" for QFC transfer purposes).

31 *See* 12 U.S.C. §1821(e)(10)(A), (B)(i)(II).

Where the CDS is economically unfavorable (for example, if the reference portfolio has performed well and no material losses are expected, while the bank owes significant ongoing premium payments), the FDIC may decline to transfer the contract. In that case, upon expiration of the one-business-day stay, the counterparty may exercise its contractual close-out, netting, and collateral rights.[32]

C. Collateral and Netting

If the CDS terminates (whether because the FDIC declines to transfer or because the counterparty exercises close-out rights for a non-*ipso facto* default), the QFC safe harbor expressly preserves each party's contractual netting rights and rights to enforce security interests in collateral.[33] Valid, perfected security interests are not extinguished by termination or repudiation. The FDIC may not avoid such interests except where taken in contemplation of insolvency or with intent to hinder, delay, or defraud.[34]

In a funded third-party CDS structure, the SPE posts collateral (funded by the proceeds of the credit-linked notes it issued to investors), securing its protection obligations to the bank. This collateral is held for the bank's benefit but remains an asset of the SPE. The FDIC, as receiver of the bank, would not have a direct claim against the SPE's assets. Rather, the bank (or receivership) holds contractual rights under the CDS to receive protection payments as credit losses materialize, and the SPE's cash collateral secures those obligations.

If the CDS terminates, the receivership may apply the posted collateral to satisfy any unpaid protection amounts owed by the SPE, with any surplus returning to the SPE for distribution to CLN investors.[35] If the FDIC instead transfers the CDS to a bridge bank, the collateral arrangement transfers as well, continuing to secure the SPE's performance obligations to the successor institution.

IV. The Resolution Option

The preceding analysis demonstrates that SRTs create meaningful optionality for the FDIC in bank resolution. This Part elaborates on that optionality, compares the option profiles of directly-issued CLNs and third-party CDS, and considers the implications for resolution policy.

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32 *See* 12 U.S.C. §1821(e)(8)(A) (preserving the counterparty's rights to cause termination, liquidation, or acceleration and to exercise rights under security agreements and netting arrangements).

33 *See* 12 U.S.C. §1821(e)(8)(A)(ii)-(iii).

34 *See* 12 U.S.C. §1821(e)(12).

35 The calculation of close-out amounts follows the contract's mechanics and applicable market conventions. Any net amount owed by the receivership after netting and collateral enforcement would be subject to the FDIC's administrative claims process. *See* 12 U.S.C. §1821(d)(5)(A)(i).

A. The Option Framework

The FDIC's authority to enforce economically favorable contracts while repudiating (or declining to transfer) unfavorable ones can be understood as a financial option held by the receiver. The option arises from the asymmetry between the FDIC's ability to preserve beneficial arrangements and its ability to limit exposure to burdensome ones.

To illustrate, suppose a bank has entered into an SRT providing credit protection on a reference portfolio. At the time of receivership, the FDIC must evaluate whether to maintain or exit the arrangement. This decision depends on comparing expected net recoveries under two scenarios:

1. **Continuation**: The receivership (or a bridge bank transferee) continues to perform under the SRT, making ongoing premium or interest payments and, in return, receiving credit protection payments as losses on the reference portfolio materialize.

2. **Exit**: The FDIC repudiates the contract (for non-QFCs) or declines to transfer it (for QFCs), limiting the receivership's exposure to capped damages or close-out amounts.

The FDIC will rationally choose continuation when the expected value of the credit protection exceeds the cost of ongoing performance, and exit when it does not.[36] The FDIC captures the upside of valuable credit protection while limiting downside exposure through repudiation or non-transfer.

B. Factors Affecting Option Value

Several factors influence the value of this resolution option at the time of the FDIC's appointment, including:

- **Credit outlook of the reference portfolio.** If the reference portfolio has experienced credit deterioration, or if economic conditions suggest that losses are likely, the credit protection has positive expected value and the option is in-the-money. The FDIC will elect to enforce or transfer. Conversely, if the portfolio has performed well and no material losses are expected, the protection has little expected value and the option is out-of-the-money. The FDIC may repudiate or decline to transfer, avoiding the burden of continued premium payments for protection unlikely to be needed.[37]

36 In practice, because the FDIC's objective is generally to maximize sales proceeds and time constraints may limit its ability to assess the credit quality of (and outlook for expected losses on) the reference portfolio, it may defer to potential buyers' assessments of the economic value of the attached credit protection in deciding between continuation and exit.

37 The "moneyness" of the option is determined at the time of the FDIC's decision. Because the FDIC has a period to evaluate (90 days for non-QFCs, one business day for QFCs), conditions may evolve between receivership and decision. This evaluation period is itself valuable, particularly in volatile markets.

- **Remaining term, timing of expected losses, and premium obligations.** The value of credit protection depends on the remaining term of the SRT, as well as the expected timing of losses within that term. Expected losses that are closer in time increase the present value of in-place protection. The FDIC's analysis must therefore weigh the present value of expected protection payments against the remaining premium obligations.

- **Collateral arrangements.** In a funded SRT structure where the credit protection is collateralized, the presence of collateral affects both the value of continuation (the protection is more certain to pay) and the consequences of exit (collateral may be available to satisfy close-out amounts or damages).

C. Comparing CLN and CDS Optionality

The QFC/non-QFC distinction creates materially different option profiles for the two principal forms of SRTs. The following table summarizes the key differences:

	Directly-Issued CLN	Third-Party CDS
Stay period	90 days	One business day
FDIC's choice	Enforce or repudiate	Transfer or allow termination
Selective choice	Yes (contract by contract)	No (all-or-nothing with counterparty and its affiliates)
Counterparty close-out rights	No (absent FDIC breach (*e.g.*, nonpayment))	Yes (upon stay expiration)
Damages cap on exit	Yes (actual direct compensatory)	Limited (close-out per contract terms)

The difference in optionality between CLNs and CDS may be relevant to banks structuring SRTs and to regulators evaluating their systemic implications. From a pure resolution-optionality perspective, directly-issued CLNs offer the FDIC greater flexibility. However, the choice of structure depends on many factors beyond resolution treatment, including regulatory capital requirements, investor preferences, accounting treatment, legal considerations, and market conventions.[38]

38 *See* the Handbook for a detailed discussion of structuring considerations.

D. Implications for Resolution Policy

The resolution option embedded in SRTs has two important implications for policymakers.

1. **Preservation of loss-absorbing capacity.** SRTs can preserve third-party loss-absorbing capacity that remains available to the receivership even after the bank has failed. Unlike common equity tier 1 capital and subordinated debt, the credit protection provided by SRT investors or counterparties sits outside the estate and can be called upon as losses materialize. This external loss-absorbing capacity can reduce the FDIC's costs and protect the Deposit Insurance Fund.[39]

2. **Facilitation of orderly resolution.** By reducing uncertainty about credit losses on the reference portfolio, SRTs can make a failed bank's assets more attractive to potential acquirers. A bridge bank holding a loan portfolio together with attached credit protection may command a higher price than one holding the same portfolio without protection. The optionality also allows the FDIC to defer resolution decisions while it evaluates conditions, which is particularly valuable during periods of market stress.[40]

V. Conclusion

SRTs can preserve third-party loss-absorbing capacity outside a receivership estate and give the FDIC valuable discretion to enforce, transfer, or exit credit protection arrangements depending on their economic value at the time of a bank's failure. This resolution-stage optionality is an underappreciated feature of these instruments. As policymakers evaluate the growth of synthetic risk transfer markets, consideration of how SRTs operate in bank receivership may inform a more complete assessment of their role in financial stability.

39 The FDIC's statutory mandate includes minimizing losses to the Deposit Insurance Fund. *See* 12 U.S.C. §1823(c)(4). SRTs that preserve external loss-absorbing capacity can advance this objective by shifting credit losses to private investors or counterparties.

40 The 2023 bank failures illustrated the value of rapid resolution tools. In those cases, the FDIC transferred substantially all assets and liabilities to acquiring institutions within days of receivership. SRTs that travel with the transferred assets preserve credit protection for the acquirer and thus can facilitate such transactions.