Collateral Management

Collateral is a property or an asset that a borrower offers as a way for a lender to secure the loan. Collateral arrangement is a risk reduction tool that mitigates risk by reducing credit exposure.

Collateral doesn't turn a bad counterparty into a good one and doesn't eliminate credit risk. Instead, it just reduces the loss at the time of default. Collateral arrangement is an essential element in the plumbing of the financial system.

In the derivatives world, collateral posting is a risk reduction tool that mitigates risk by reducing credit exposure. It allows financial institutions to reduce economic capital and credit risk, free up lines of credit, and expand the range of counterparties. All of these factors contribute to the growth of financial markets. The benefits are broadly acknowledged and affect dealers and end users, as well as the financial system generally.

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Bankruptcy code generally prevents creditors from seizing assets of a firm in bankruptcy. This provision is called the "automatic stay". The code affords special treatment to financial derivative contracts, which exempts these contracts from the "automatic stay".

The special treatment is also called a safe harbor. The safe harbor allows counterparties to terminate derivative contracts with a debtor in bankruptcy and seize the underlying collaterals.

Reference:

https://finpricing.com/lib/EqWarrant.html