Secured and unsecured credit

Economics, Money

Credit refers to activities involving the exchange ofmoney, goods or services with a promise to pay in the future. In effect, credit means enjoying something today and paying for it tomorrow. For credit transactions to take place, two parties should be involved: the creditor (the entity or the person who is offering the money, goods, or services on credit), and the debtor (the entity or the person who is availing of the credit accommodation). (Mallor, Barnes, Bowers & Langvardt, 2007)

There are two kinds of credit: the unsecured credit and the secured credit. In an unsecured credit, the creditor turns over his or her money, goods, or services to the debtor with only the latter's promise to pay as a guarantee of collection, relying heavily on the dignity and the capacity to pay of the debtor based on factors like salary and other monies due him/her.

Examples of unsecured credit devices are credit cards and the bills for utilities like water, power, and telephone. (Mallor et al., 2007) Unsecured credit presents a higher risk to creditors because of the absence of security or collateral. For this reason, creditors are resorting to thorough checks of the debtor's credit background to ascertain if he/she is a good credit risk before providing an unsecured credit – meaning that the creditor would want to establish whether the debtor has no past record of defaulting on his/her debts. In addition, the creditor charges a higher interest rate on an unsecured credit. (Baker, 2005)

In a secured credit, the creditor asks the debtor to put up a property like a house or a car to serve as security for the credit transaction. In case of default, or the debtor fails to pay his/her debt, the creditor " can go against

the security." If the security, for instance, is the debtor's house, the creditor has the legal right to demand that the house be sold so that he/she can collect what is due him/her. Because the credit is secured, the creditor has a lesser risk. The interest rate on a secured credit is, therefore, comparatively lower than that charged for an unsecured credit. (Mallor et al., 2007)

In both cases, the law protects the rights of creditors. In case a debtor fails to meet his/her obligation on a secured credit, the creditor has a right to have the security or collateral sold so that the amount owed can be collected. In an unsecured loan, the creditor can file a suit of garnishment so that he/she could collect the debtor's salary or whatever money he/she receives from other sources. (Mallor et al., 2007) As it stands, the law governing secured and unsecured credit appears sufficient to safeguard the rights of creditors. It does not need any amendment at the moment.

References

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