What is a Good Credit Score?

Description

So, what is a good credit score, anyway? In Canada, it's generally anything over 700.

It won't surprise you to hear that it does get more complicated than that. But if your score is above 700, then you're in reasonably good shape. Credit scores in Canada generally range from 300 to 900, and the jump from a "fair" score to a "good" score is right around that 700 mark, depending on company that does the scoring and the bank that's using the score.

Now, let's taking a closer look at how credit scores work and why they're important.

What does a good credit score really mean?

You may have heard people talk about a "credit score" and a "credit report." Sometimes people use these interchangeably, even though they're not exactly the same thing.

Your *credit report* is a listing of all of your credit-related information. Your credit report includes personal information like name, date of birth, social insurance number, current and previous addresses, etc. It also includes a variety of credit-related financial information like credit card information, retail cards, lines of credit, personal loans, bankruptcy or court decisions against you, debts sent to collection agencies, and inquiries from lenders and other financial institutions that have requested your credit report over the past three years.

A credit report is meant to be a resource for lenders who want to see information about your use of credit. In Canada, the major credit bureaus are **Equifax** and TransUnion. These two companies collect the information about consumers' credit and create the credit reports that lenders review.

However, your *credit score* is a score typically between 300 and 900 that's generated based on your credit report and credit history. Credit scoring companies have proprietary algorithms (ahem, a complicated math program) that takes a consumer's credit information and crunches it into a handy score.

So, what a good credit score means is that when the information on your credit report is run through the credit scoring calculations, their program rates you either a good credit risk for a lender or … not so good.

This is why a good credit score is important

A good credit score is important, because it helps you get access to credit. That means qualifying for the best credit cards with the best rewards and perks. Or getting a great interest rate on a mortgage or a car loan.

But it may surprise you to know that your credit score goes beyond getting loans. Your mobile phone company may review your credit, especially if you're using a postpaid plan. If you're a renter, your landlord will almost certainly look at your credit. When applying for insurance, insurers may review your credit. Employers, the government, and even retailers may also want to see your credit report or credit score.

This means that a good credit score isn't just about getting approved for a loan or getting a lower interest rate on an auto loan or mortgage. It may mean lower car insurance rates, getting an apartment rental application approved, or getting a mobile phone contract. It can even make a difference in getting hired for a new job. Yes, it's true: Many employers in Canada use your credit report as part of their hiring process.

Simply put: Your credit history is important for a lot of reasons!

What is a bad credit score?

Equifax tells consumers that *generally* a credit score range of 660 to 724 is "good," 725 to 759 is "very good," and 760 and higher is "excellent."

That leaves scores below 660. If your credit score is between 560 and 660, it's likely considered a "fair" score. That means you may get approved for credit by a lender, but you probably won't get the best terms available.

If your score falls below 560, then you're likely labeled having a "poor" credit score. Lenders generally consider these low scores poor credit risks and are unlikely to approve loans to people with these scores. If your credit score falls below 560, you may have to improve your credit score before trying to get approved for a loan or look for lenders that specialize in working with people with bad credit.

What affects your credit score?

Whether you have a good credit score on its way to very good or excellent, or have a less-than-good score that you'd like to improve, the factors that affect your credit score are generally the same.

Since your credit score depends in part on the credit scoring model used to generate it, how these factors are used can vary. But Equifax offers some useful guidance on what factors are considered and how important they are.

- **Payment history (~35% weighting)**: Your payment history is how consistently you made payments on loans you've taken out — that means credit cards, car loans, mortgages, etc. Making late payments, missing payments, or defaulting on loans will all have a negative effect on this part of your score. How long ago these took place does make a difference, so a loan that was just sent to a collection agency last month will have a big impact, while a single late payment three years ago won't.
- **Used credit versus available credit (~30%)**: Another important factor is how much of your available credit you use, also often called your "credit utilization ratio." This means the amount of your available credit you use. If you have $10,000 in available credit across three credit cards and have $1,000 used, you are viewed as a better credit risk than someone who has used $9,500 of that $10,000 credit limit. This scoring element also considers the total amount of credit available to you (that $10,000 value in the previous example).
- **Credit history (~15%)**: This part of the calculation looks at the age of your credit accounts. Generally speaking, lenders like to see that someone has been able to keep accounts open and in good standing for a long period of time. So, having longer-term accounts on your credit report and not a lot of accounts opened very recently could help your credit score.
- **Public records (~10%)**: If you've had a bankruptcy or a public judgment against you, this can be factored into a credit scoring model. How recent the public record is makes a difference, but these kinds of judgments can have a significant negative impact on your credit score.
- **Inquiries (~10%)**: When you apply for a loan or credit product, an inquiry is made to your credit file. A "hit" to your credit file like this is often referred to as a "hard hit" and is kept track of as part of your credit file. When someone submits a lot of applications for new credit and has a lot of related hard hits in a short period of time, it is often seen as an indicator of financial difficulty and can lower your credit score. Note, though, that inquiries related to pre-approvals for credit — also called "soft hits" — don't affect your credit score in this way.

How to improve your credit score

Improving your credit score — whether that's going from poor credit to good credit or good credit to excellent credit — is one of those things that's simple but not always easy.

It's simple in that generally good credit habits and behaviour will lead to a higher credit score. But it's not always easy, because changing habits can be hard, and if you're facing a challenging financial situation, then making those changes can be especially hard.

But if you're struggling with poor credit, you can get started with small steps and build on those over time. For example, make sure to pay your credit card statement on time, every time. Ideally, you'd be paying more than the minimum monthly payment to work down any balances. But if you're struggling with credit card debt, making sure to make your payments on time can be a step towards improving your credit rating. There are also ways to build your credit without a credit card.

If you have a good credit score, but would like an excellent credit score, then lowering your credit utilization ratio might be a step in that direction. Pay down balances on your credit cards if you have them. Maybe counter-intuitively, you might apply for an additional credit card to increase the overall amount of credit available to you.

Most of all, have patience and be consistent. Good credit habits may not change your credit rating overnight, but done consistently, they will pay off.

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