Arrive Financial Guide 2

Credit and Credit Scores in Canada: What You Should Know

When coming to any new country, newcomers are met with a whole new set of rules, products and ways of doing things. In Canada, most newcomers will be taken by surprise when asked about credit and credit scores and the important role they play in Canadian life – even for something as basic as renting accommodation. One newcomer recounted her story of being asked for a year's rent in advance because she didn't have a credit score. Her response was, like most newcomers, "What's a credit score?". Before we talk about scores. Let's look at credit in Canada.

What is Credit in Canada?

Credit is the privilege of borrowing money from a financial institution (or lender) based on the understanding that you (the borrower or debtor) will repay the money at an agreed upon date and rate of interest. You may also utilize credit to make a purchase now with the agreement that you will pay later.

Types of Credit in Canada

Credit Card (Revolving Credit) The bank allows you to access money up to a predetermined credit limit. Each time you purchase something on credit you get closer to your limit. When you pay off your balance owing (or part thereof), that amount is added back to your available credit. Interest rates vary from card to card.

Charge Card This card comes with no interest but you are required to pay your monthly balance owing in full upon receipt of your billing statement.

Line of Credit (secured or unsecured). A line of credit (LOC) is a preset amount of money that you can draw from when you need it – up to the maximum amount. You pay interest only on the amount you use.

Installment Loan Repaid over a specific period of time, this loan requires a set number of scheduled payments.

Residential Mortgage. A mortgage is a home loan that can include payment terms of up to 25 years. A mortgage is typically renewed every few years, at which time the terms usually change.

What is a Credit Score?

In Canada, a credit score is essentially a numeric rating that banks (lenders) use to qualify you for a loan. The scores range from 300 (just getting started), 650 (the magic middle number) which will likely qualify you for a standard loan, all the way up to 900 points (the highests score). The higher your score, the lower the risk to the bank. A score under 650 will likely make it more difficult to acquire first time credit. The lower your score on the scale, the higher a risk you are: You will pay higher interest rates while having lower credit limit.

Credit Scores: Part of life in Canada

We have discussed the obvious association between credit scores and one's ability to acquire a loan, but in Canada credit scores appear more often than you might expect.

New Job: Potential employers may check your credit file. Your credit behaviour or score may influence their decision on whether to hire you or not.

Renting a Vehicle: A vehicle rental company can check your credit history to assess the risk may be to them when they loan you that car or van.

Renting an apartment: The landlord may factor in your credit rating and score when assessing tenants' worthiness and their risk.

Insurance companies, Utility companies and others also assess your credit behaviour and credit scores. That's why it's important to set up your bank account and get the ball rolling toward your credit score.

How to Start Building a Good Credit History

Note: this will take time, so start now, be patient and think in the long term.

Open a bank account now. This will be necessary for most of the following tips – and you can do it from home.

Apply for a credit card from a major bank. Using and paying regularly will demonstrate reliability and good payment practice).

Apply for a small loan – Using Your Savings Account as Collateral. Paying back the loan on time according to your credit agreement will show you are low risk.

Pay your bills on time. This speaks for itself.

Establish a steady work record. It's what every newcomer aims to do. It also shows you have a steady income to cover payments.

Understanding Credit in Canada: A Closer Look

In our recent article *Credit and Credit Scores in Canada: What You Need to Know*, we talked briefly about credit (borrowing money from a financial institution) but spent most of our time discussing credit scores and their role in Canadian life. (link to blog). So, let's take a closer look at credit in Canada.

To recap, credit is the privilege of borrowing money from a financial institution (or lender) based on the understanding that you (the borrower or debtor) will repay the money at an agreed upon date and rate of interest. You may also utilize credit to make a purchase now with the agreement that you will pay later. This can come in the form of credit cards, retail credit and personal loans.

The most significant kind of personal credit is a mortgage. Very few people can afford to buy a property outright, and so they must borrow a significant portion of the dollar value from their bank. In Canada, new home buyers are required to have a down payment of 20%, so the mortgage loan must cover the rest of the price of the home. Buying a home is a daunting task in and of itself – getting approved for a mortgage can be very stressful.

Banks take a number of factors into consideration before deciding on a borrower's credit worthiness and approving a loan. Although demonstrating you have the ability to repay the loan is crucial, your credit is measured using the five C's of credit.

The 5 Cs of Credit in Canada: Character, Capital, Capacity, Collateral and Credit

Character describes (in the eyes of the lender) the kind of person you are when it comes to finances. Factors ranging from your credit history, length of employment, your propensity to save and whether you utilize credit responsibly all inform your character and trustworthiness to repay loans.

Here are a few questions a lender may ask to determine if you are a reliable borrower.

1. How long have you been at your present job?
2. How long have you lived at your present address?
3. Do you pay your bills on time?
4. Have you used credit before?
5. Do you have a good credit report?
6. Can you provide character references?

Capital refers to those things you own (assets), such as a home, an automobile, or savings and investments. The lender is interested in these as ways to or secure the loan (repay the debt you owe) in the event that you fail to make your payments.

Capacity is your ability to repay loans. Arguably the most important of the C's, your capacity to pay back is calculated based on your job and annual income as well as payment history.

You may be asked these questions by a lender:

1. Are you employed with a steady job?
2. What is your salary?
3. How many dependents do you have?
4. What are your current expenses?
5. Do you have other loan payments?
6. If so, how may?
7. What are your current debts?

Collateral adds up to additional security for the bank. The value of the house or condominium you are borrowing money to purchase, based on its value, location and characteristics is considered collateral. Collateral can also include outside parties who are willing to guarantee the loan.

Credit in this context, refers to your repayment history. This is the one clear way a lender can predict the likelihood of you reliably making future payments. The primary measurement used is the credit score – also known as credit history, credit report, credit rating.

Even if you're not ready to buy a house, it is important to understand the canadian financial landscape and how to prepare, budget and plan, especially when it comes to Credit.

5 tips on how to maintain a good credit rating:

1. Pay your bills on time. Contact your creditors if you are unable to make a payment.
2. Pay off debt quickly, and when you can, pay more than the minimum amount.
3. Understand the total cost of the things you purchase, including interest charges.
4. Never sign a contract until you have read it and understand it fully.
5. Only deal with established, reputable financial companies.

At Arrive, we are dedicated to helping newcomers achieve career, life and *financial success* in Canada. As part of our focus on the financial side of your journey, we are sharing financial tips and information in our weekly blogs, providing handy online tools and hosting highly-informative webinars and workshops.

An important part of establishing your financial life in Canada is finding the right partner to invest in your financial success. RBC is the largest bank in Canada* and here to be your partner in all of your financial needs.

RBC supports Arrive, and with a 150 year commitment to newcomer success in Canada, RBC goes the extra mile in support and funding to ensure that the Arrive newcomer platform is FREE to all.

Working with RBC, Arrive can help you get your financial life in Canada started – right now.

Speak to an RBC Banking Specialist today to get your financial footing in Canada now.

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