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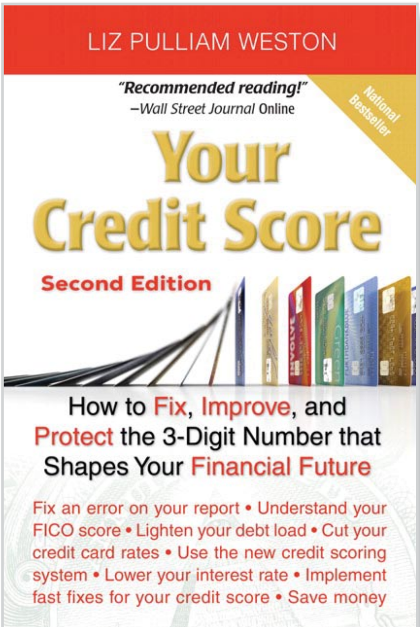
Credit Scoring Myths



Your Credit Score: How to Fix, Improve, and Protect the 3-Digit Number that Shapes Your Financial Future, Second Edition

Liz Pulliam Weston
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For most of credit scoring's history, the vast majority of the people involved in lending decisions pretty much had to guess what hurt or helped a score. Creators of scoring formulas didn't want to reveal much about how the models worked, for fear that competitors would steal their ideas or that consumers would figure out how to beat the system. Fortunately, today we know a lot more about credit scoring—but not everybody has kept up with the latest intelligence. Mortgage brokers, loan officers, credit bureau representatives, credit counselors, and the media, among others, continue to spread outdated and downright false information. Acting on their bad advice can put your score and your finances at significant risk. Here are some of the most common myths.

Myth: Closing Credit Accounts Will Help Your Score

Closing accounts can make your credit history look younger than it is. Your credit score factors in the age of your oldest account and the average age of all your accounts. So closing accounts, particularly older accounts, can ding your score. Additionally, closing accounts reduces the total credit available to you, making your debt utilization ratio soar. Remember that the FICO formula measures the gap between the credit you use and your total credit limits. The wider the gap, the better. If you suddenly lower that limit by shutting down accounts, the gap narrows—and that's a bad thing.

Myth: You Can Boost Your Score By Asking Your Credit Card Company to Lower Your Limits

Narrowing the gap between the credit you use and the credit you have available to you can have a negative effect on your score. It doesn't matter that you asked for the reduction; the FICO formula doesn't distinguish between lower limits that you requested and lower limits imposed by a creditor. All it sees is less space between your balances and your limits, and that's not good.

Myth: You Can Hurt Your Score By Checking Your Own Credit Report

The FICO formula ignores any inquiries generated when you check your own reports and scores. Where you can hurt yourself is if you ask a lender to check your score. When a lender pulls your credit, it generates what's known as "hard" inquiry—and those are counted against your score. As long as you order from a credit bureau or a service affiliated with a bureau, such as MyFico.com, your inquiries won't hurt your score.

Myth: You Don't Have to Get a Good Credit Score

The credit scoring formula is designed to judge how well you handle credit over time; if you have no credit, or you don't at least occasionally use the credit you have, the formula won't have enough information to make an assessment. You don't have to live in debt to get a decent score, but you do need to use credit.

Myth: Bankruptcy Hurts Your Score So Much That It's Impossible to Get Credit

Bankruptcy does deal a devastating blow to your score, but that doesn't mean you can't get credit afterward—or even that you'll have to wait that long. You can get a mortgage in as little as six months after your bankruptcy is discharged (completed). You might get credit card offers before your case has even closed. How quickly you'll re-establish credit and how much you'll pay for it will depend largely on your behavior after you file for bankruptcy. If you start handling credit responsibly—paying your bills on time, not running up big balances, and not applying for a bunch of credit at once—your score will begin to recover.