

Weird stuff that hurts your credit

What seems smart, like moving a balance to a lower-interest credit card, can ding your credit scores. Here are some of the other hidden threats to your credit and how you can fight back.

By Liz Pulliam Weston

One of the things that drives people nuts about credit scores is how they react when you close an account.

A reader named Mike put it this way in an e-mail:

"You say . . . that canceling a credit card, even one that has been kept in good order, can negatively impact your FICO score. This seems unreasonable, even unfair, almost un-American. Is there some reason that makes it all right for the scorekeepers to do this?"

I'm not sure about "un-American," but it certainly can seem unreasonable or unfair until you understand a bit more about how credit scoring works.

Losing points for voluntarily closing accounts is just one of the unexpected ways you can hurt your credit scores, those three-digit numbers that lenders use to gauge your creditworthiness. You also can get dinged for:

- Opening accounts, both when you apply and for as long as a year afterward.
- Transferring credit card balances.
- Settling debts.
- Using "limitless" cards.
- Incurring library fines, parking tickets or other penalties seemingly unrelated to credit.

Here's what you need to know and what you can do to minimize unintentional damage to your scores.

Among all the bankrupts, you're the best!

The FICO credit-scoring system, which is the most widely used, groups together people with similar histories when rating them. These groups are called score cards.

If you have a bankruptcy on your report, for example, you'll be grouped on a score card with other bankrupts. Your credit habits may look pretty good compared with theirs, but if the bankruptcy were to disappear from your record, you'd be lumped in with people who have stronger histories. Your credit behavior might not look so good compared with this new group. Something similar apparently happened to Carmen Georgescu, who had \$51,000 of credit card debt and a 710 FICO score. After paying off \$17,000 of debt in a few months, her score rose to 726. A few weeks later, though, her score suddenly plunged to 686.

Such abrupt drops can often be traced to a negative item, like a delinquency or a bankruptcy, disappearing from a borrower's credit report. In this case, though, the change was even more subtle.

Here's how Barry Paperno, the manager of customer service for Fair Isaac -- the company that created the FICO -- explains it:

"Carmen had opened a new account (a year previously) which, at that time, put her in a different scoring group consisting of consumers who had newly opened accounts on their credit files. Then when this recently opened account had aged enough to take her out of this scoring group and put her into one with consumers who had not opened any accounts recently, her score dropped."

There's not much you can do about this quirk in the scoring formula, other than brace for the potential effect. The good news: Georgescu's score recovered within a few months, as Paperno had predicted. The key was continuing to pay down debt and holding off on opening any new accounts.

(Keeping your balances low, by the way, has become even more important since Fair Isaac rolled out the latest version of the score, FICO 08.)

Fight the credit bureaus and win

Credit expert John Ulzheimer discusses how to effectively dispute an item on your credit report, with CNBC's Carmen Wong Ulrich.

Don't transfer your problems

Lower interest rates are generally better when you're trying to pay off debt, but taking advantage of a balance-transfer offer can wallop your credit scores in a number of ways.

Just opening a credit card account to take advantage of the offer can ding your scores by 5 points or so. Transferring your balance to a card with a lower limit can hurt your scores, as can consolidating debt.

That's because the FICO model is heavily influenced by your "credit utilization ratio," the portion of your available credit limit you're actually using. The formula likes to see a wide gap between your balances and your limits. Transferring a balance from a high-limit card to a lower-limit card makes it look like you're closer to maxing out that second card, and the scores can react negatively.

To put it simply: The FICO formula typically would rather see \$1,000 balances on five cards than a \$5,000 balance on one card.

You can compound the damage to your scores by closing the card from which you transferred the balance. Closing the old account trims the amount of available credit that's used in the credit-scoring formula.

If you're planning to take advantage of a balance-transfer offer, read the fine print and consider the following:

- **Limit the number of accounts you open.** If you want to improve your credit scores, don't keep bouncing your balances from card to card.
- **Pay down your debt.** Use the lower rate as an opportunity to reduce your debt load. Paying off debt is good for your wallet and good for your credit scores.

Settling debts

For years, a glitch in the FICO formula often penalized folks for paying old debts that had been charged off and sent to collection agencies. That glitch finally got fixed, as I wrote in "[When paying bills can hurt your credit.](#)"

But you can still do substantial damage to your scores if you settle a current debt for less than you owe. If an account hasn't been charged off and you're dealing with the original creditor, Fair Isaac officials say, a settlement can be worse than leaving the account open and unpaid. Of course, leaving an account unpaid will eventually result in a charge-off and a referral to a collection agency, which isn't good for your scores, either.

There's no easy solution if you haven't got the money to pay your bills. Filing for bankruptcy is an option, although it's likely to have a far more devastating effect on your credit than a settled account or two. You also might investigate a debt-repayment plan through a legitimate credit-counseling agency.

Read "[The consumer's guide to credit counseling](#)" and "[Is there a statute of limitations on debt?](#)" for more information.

The limits on 'limitless' cards

For years, Capital One declined to report its customers' credit limits to the three major credit bureaus. Instead, the bureaus used the highest balance a customer had charged as a proxy for the limit.

As a result, the customers' credit utilization ratios could appear artificially high, potentially depressing their credit scores. That's what happened to accountant John Johnson of Springdale, Ark., who painstakingly rebuilt his credit after some business reversals several years ago.

Making on-time payments to Capital One cards over the years initially helped Johnson rebuild his credit scores, but then the company's policy on credit limits started to hurt him. Capital One's practice makes Johnson appear to be using more than 60% of his credit limit, when in fact he's using less than 40%. He tried disputing the issue with the credit bureaus, to no avail. "I got pretty hostile after a while," Johnson admitted. "I just don't understand why they (Capital One) would do that."

Capital One merely said it was its policy to keep the information secret. Consumer advocates speculated the company was trying to keep competitors from spotting and targeting its most creditworthy customers.

After years of pressure, though, Capital One finally caved and agreed in August 2007 to start reporting limits.

That doesn't solve the issue of missing or incorrect limits, though. You don't need to worry that much if your card actually doesn't have a limit; many American Express cards and some high-end MasterCard and Visas don't. To get and keep these cards, you must have pretty good credit, which means the lack of a limit is unlikely to hurt you as much as someone whose credit is troubled or young.

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But sometimes issuers report an outdated or simply erroneous limit to the credit bureaus. You can, and should, check which number your lenders are using by viewing copies of your credit reports. By federal law, you can get one copy free annually from each bureau; the only free site is AnnualCreditReport.com.

If your limits aren't being reported accurately, you have a few options:

- **Fight.** If your card has a limit, ask your issuer to report it correctly, and follow up with a dispute to the credit bureaus if it fails to act.
- **Reset.** If your lender reports the highest balance charged instead of an actual limit, you can reset the number reported to the bureaus by running up a big balance one month. Just make sure you can pay this hefty number off in full when the bill comes to avoid unnecessary finance charges. And don't do this when you're in the market for a loan, since you could sustain some short-term damage to your credit scores.
- **Switch.** Use cards that properly report your limits to the credit bureaus.

Are you a library and parking scofflaw?

I wrote about this issue a few years ago in "[New threats to your credit score](#)," and the trend has gained momentum since then. Local governments are determined to recoup some of the billions in unpaid debts consumers owe, including unpaid library fines, parking tickets and traffic penalties. So these governments increasingly turn to private collection agencies, which typically report the unpaid amounts to the credit bureaus as part of their efforts to pressure consumers into paying the fines. The collectors may add late fees or other charges that increase the balance.

The bottom line:

- **Pay your fines promptly.** Don't wait for follow-up notices because they can easily go astray. Many libraries allow you to review your library record, including unpaid fines, online, and municipalities typically have a Web site or a phone number allowing you to check for traffic or parking fines.
- **Don't let a dispute fall through the cracks.** If you're disputing a traffic or parking ticket, note the applicable deadlines on your calendar and make sure the issue has been resolved.
- **Don't move away from a problem.** If you plan to move and believe you may have unpaid fines, contact the relevant municipality or library and make sure you've squared your account with them. Don't expect a government agency to spend much energy tracking you down; it's much easier to turn a delinquent account over to a collection agency, and once that's happened, your credit is at risk.