

# Credit Myths Revealed

by John Ulzheimer for [Credit.com](http://Credit.com)

Everyone knows of and possibly believes in a great myth. Whether it's the Loch Ness Monster, Bigfoot, Alien Crop Circles or the Abominable Snowman we're all hooked to some extent. But unless you seriously have plans to spend time across the pond diving for prehistoric marine mammals then your belief probably won't become a serious threat to your wallet.

There are several myths, however, that are widely accepted as the truth (insert your favorite political one-liner here) and can cost you a bundle if you're not careful. These myths come right out of the world of [credit reporting and credit scoring](#). Believing that the following are factual can cost you plenty.

## **Making a lot of money will help your credit report and your credit scores.**

It's amazing how many people will say "do you know how much I make" when they get decline letters in the mail or don't get the best interest rates or the highest credit limits. The assumption is that an impressive salary leads to a great credit report and credit score. The fact of the matter is that your salary has nothing to do with [your credit reports or credit scores](#).

Now that doesn't mean that a great paycheck won't help you qualify for the credit you desire. It will. But not like you may think. Your salary is important to lenders but not important in a [credit worthiness](#) way. It's important for them to know that you have the ability to make the payments that you are going to be saddled with for the next 5, 10 or 30 years. That's called "capacity."

Lenders use your salary as a measurement of your capacity to make the required monthly payments. Your credit reports and credit scores are how lenders determine your credit worthiness. One is as important as the other but you won't be approved for the best interest rates if your credit stinks...regardless of how much money you make.

So, congratulations on that killer W2...but don't think that's all that matters.

## **Paying cash for everything will help your credit rating.**

I call this "credit avoidance" and for some reason people think that it's a good idea. The cash and carry crowd has it wrong here.

You have to have some sort of history of responsible [credit usage](#) in order to establish solid credit histories and credit scores. If you don't establish and maintain various types of credit accounts then your scores won't be as good as someone with a long history of responsible credit use. Surprise surprise!!

The next logical comment is "well, if I don't ever plan on using credit then why would I need a [good credit history](#)?" Come on. Can anyone reading this seriously tell me that they function efficiently without any sort of credit?

That would mean that you paid cash for your house and cars, don't rent movies at the local rental store that requires a [credit card](#) number on file, don't ever buy anything online and carry around gobs of cash when you go on vacation. I don't think so.

Credit use isn't bad. Credit abuse is bad. Please don't think that using cash for everything is somehow better than using credit responsibly. It simply isn't.

## **A great credit score is a result of a credit report WITHOUT any late payments.**

Paying all of your bills on time is a great start. And, you will not have excellent [credit reports and scores](#) without a clean payment history. But, it's not the only thing. In fact, it's only 1/3rd of the equation.

A full 2/3rds of your credit score is derived from things other than how well you pay your bills. That's quite a surprise, especially to someone who is in an incredible amount of debt but somehow struggles to make his or her minimum payments every month.

This person is referred to in the credit world as a "ticking time bomb." It's just a matter of time before it goes off. If you want to have the best scores possible you must perform well in not only making your payments on time but by also staying out of overwhelming debt.

## **A divorce decree will absolve you of your credit responsibilities.**

Going through a divorce is difficult enough without having to worry about dividing credit debts. Unfortunately, it's certainly one of the most important items to focus on as you are proceeding through a divorce.

Generally part of the process is dividing the credit [debts](#). Here the judge will decree that one or the other spouse will be responsible for making payments on car loans, mortgages, credit cards and other credit obligations. That's fine but the judge's decree doesn't override the contract that you signed with your creditors. So, if you and your spouse both signed to take out a mortgage or a car loan and it stops being paid by the newly responsible party then both of you will suffer.

The lender will almost certainly report the late payments on both of your credit reports and if the account goes seriously delinquent or even into the dreaded collection status then your scores will suffer for years despite what the judge said.

### **All three of your credit reports and credit scores will be the same.**

Nope. In fact, the opposite is almost a guarantee. It's a certainty that all three of your [credit reports](#) will be different and, therefore, so will all three of your credit scores.

There are three primary reasons why this is so. They are...

Not all of your accounts will be reported to all three credit -reporting agencies. Since reporting is a voluntary act, not all lenders report to all three.

You will most certainly have a different number of inquiries on your three credit reports. An inquiry is a record of when someone or some company accesses your credit report. Since most lenders just pull one of your three credit reports (except for mortgage lenders) you will have a different number of inquiries on your reports.

Lenders don't always update their accounts on your credit reports at the same time. For example, Dave's Bank might update their accounts at Equifax the first week of the month, Experian the second week and TransUnion the fourth week.

It's because of all of these reasons that your [credit reports and scores](#) will not be the same across the board.

### **If you have poor credit then your credit scores will suffer for seven years.**

Fortunately for those who have had credit problems in the past this isn't exactly true. The way the credit scoring systems are designed allows consumers to start improving their scores very quickly, months later in some cases.

The credit scoring systems are dynamic, meaning that the scores are calculated based on your credit information as of that time. If the information on your credit files changes tomorrow, then so will your scores.

This is good news especially for folks who are about to pay off a large chunk of their [credit card debt](#) or are able to have negative information removed from their credit reports. You should see immediate improvement in your scores. No waiting required.

### **Check Cards can help your credit reports and scores.**

This isn't true. Check cards (also known as Debit Cards) are nothing more than plastic access to your checking account. Since checking accounts aren't recognized as an extension of credit (although I've heard some pretty good arguments that they are) then they don't end up on your credit reports.

The confusion comes in part because of the Visa or MasterCard logos that are on the debit card. They look exactly like credit cards so the assumption is that they count.

The bad news here is that they could hurt you if you aren't careful with how you use and manage them. If you become overdrawn on your checking account because you don't track the use of your check card then it could result in bounced checks. And since there are companies that track and report poor checking account management any abuse could come back to haunt you.

### **Moving your credit card balances around will help you hide your debt from the credit scoring models.**

Credit scoring models are much smarter than people give them credit for. It's impossible to hide your credit card debt.

There's a measurement taken every time your credit score is calculated called "total revolving debt." This is total amount that you currently owe your credit card companies. The problem for folks with a lot of different [credit cards](#) with balances is that this is an aggregate measurement. This means that if you have 10 credit cards each with \$1000 balances OR 5 credit cards each with \$2000 balances then you are still going to have \$10,000 in revolving debt.

And, if you opened a new “no interest for 12 months” credit card and consolidated the \$10,000 onto that one account then guess what...you still have \$10,000 in revolving debt. You simply can't hide it unless, of course, you pay it off.

## **Paying off (or “settling”) late payments, tax liens, collections or judgments will remove them from your credit reports.**

It's not that easy. While it's the responsible and right thing to do, don't expect any miracles to occur just because you pay off some or all of your negative credit related debts.

For some reason people think that by paying these things off they will somehow disappear like they never happened. No, no, no, no. They aren't going anywhere for seven years in most cases. They will be updated on your [credit reports](#) to show “paid collection” or “released tax lien” or “satisfied judgment”, which is much better than the alternative but they will still be there negatively impacting your credit scores.

This myth is commonly abused by collection agencies that offer to have your collections removed from your credit reports if you'll pay them off. It sounds like a good deal but unfortunately in order for them to be completely removed they must be erroneous.

If you ever have the occasion to speak with someone from any of the three credit reporting agencies ask them if they will remove accurate negative information simply because it's paid in full. The answer will always be “no.”

## **Closing credit cards will increase your credit scores.**

This is the granddaddy of all credit myths. It's by far it's the most prevalent piece of advice that consumer's seeking credit guidance are given as a remedy for poor [credit scores](#). It can also cause the most damage.

Here's why...

Another of the measurements taken by the credit scoring models is called “revolving utilization.” This is the percentage of your available credit card limits you are currently using as balances. Here's how it works: if I have 10 [credit cards](#) each with a credit limit of \$10,000 then I have an aggregate credit limit of \$100,000 (\$10,000 times 10 cards). Let's say that five of those cards are completely maxed out with \$10,000 balances. You have an aggregate credit card balance of \$50,000 (\$10,000 times five). Since you are using up half of your credit limits (\$50,000 divided by \$100,000 = .50) you have a revolving utilization of 50%. That's not great but it could be worse. The five unused cards are helping keep that percentage at 50% because of their completely unused credit limit.

So, what if someone tells you to close the other five credit cards that you are not using, and you do it?

What you've just done is eliminated those five cards from the equation. So, now you have to redo the math. Here goes...

Now you have five credit cards each with a limit of \$10,000. That's an aggregate credit limit of \$50,000. Since those five cards are maxed out you are now 100% utilized (\$50,000 divided by \$50,000 = 1.00). Your credit scores just tanked.

Yes, this is an extreme example but even with fewer cards, lower credit limits and lower balances it will almost always lower your scores.

So what should you do now that you've just killed [your credit scores](#)? This is just a math problem. There are several ways to fix the damage, but they all have other negative side effects that you won't be able to avoid.

Re-open the five cards that you closed. It's not that simple. When you go to re-open those five accounts the lender will pull your credit reports, which will result in five new inquiries. These inquiries will probably lower your scores. Also, it's likely that they will report the accounts as being just opened so the fact that you have five brand new accounts on your report will also lower your scores.

Double the credit limits on the five cards that are still open. This is something that you'll request, not demand. Your credit card issuers probably won't agree to do this. And, as with the previous fix, doing this will result in the lender pulling your credit reports, which will again result in five new inquiries.

Pay down your balances by 50%. This will work and it will work without any negative credit scoring side effects. The problem is that how many of us have a spare \$25,000 sitting around in the bank to correct our credit mistakes? And, even if you did have the money and chose to write the checks it would take at least 45 days for the payments to be posted to your credit reports.