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CREDIT CARDS

7 “Smart” Credit Tips That Aren’t

By Martha C. White | May 06, 2013

There’s a lot of advice floating around out there about how to manage your credit cards and other debts to maximize your credit score. The trouble is, not all this wisdom is created equal, and some tips intended to help your credit can actually have the opposite effect. Here are seven supposedly “smart” tips we’ve heard bandied about recently that generally ought to ignored.

Asking for a lower credit limit

If you can’t control your spending, asking for a lower credit limit may indeed keep you out of trouble by simply capping how much you can borrow. But there’s also a risk to this approach. As MyFICO.com explains, 30% of your credit score is based on how much you owe. The formula looks at how much you owe as a percentage of how much available credit you have, otherwise known as your credit utilization ratio. So if you’re unable to pay off your debts, lowering your credit limit will increase your ratio — and damage your score. The impulse to impose external limits on your spending is understandable, and in some cases wise, but you’re better off focusing your energy on internal restraint.

Paying off an installment account early

Paying off debts early might seem like a good way to improve your credit, but paying off an installment loan like a car loan early can actually ding your score because it raises your utilization ratio. For instance, if you have a $10,000 car loan with a $5,000 balance that you pay off in one fell swoop, your debt load will drop by $5,000, but your available credit will drop by $10,000 once the account is closed.

This isn’t to say you shouldn’t pay off a debt early if you find yourself with a windfall on your hands. An earlier payoff can save you a bundle in interest. But if you’re trying to raise your credit score, paying off a credit card rather than an installment loan is the way to go.

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Opening a bunch of cards at once

Since your utilization ratio is so important, a lot of people think that getting as much available credit as possible — immediately — will do the trick. But it doesn’t work like this, unfortunately. You can’t magically improve your utilization ratio by applying for a slew of cards in rapid succession because numerous inquiries and multiple brand-new cards both can lower your score, says Barry Paperno, credit expert at Credit.com. If you want more credit to improve your score, space out the process and be realistic about your situation; don’t take the hit to your score by

Settling a debt for less than you owe

Negotiating with a lender and then settling the debt for less than you owe can be a smart move. But it can also hurt your credit if you do it the wrong way. You must get the lender or collections company to agree in writing to report the debt as “paid in full;” otherwise, it will be noted “settled for less than the balance.” It sounds like a small distinction, but having a debt — even a paid debt — listed as “settled” on your credit record can hurt your credit score, says Natalie Lohrenz, chief development officer and director of counseling at Consumer Credit Counseling Service of Orange County.

Using prepaid debit cards to rebuild your credit

John Ulzheimer, president of consumer education at SmartCredit.com, says a lot of borrowers have the misconception that prepaid debit cards and credit cards are equally good credit-building tools. They’re not. Prepaid cards “don’t do anything to help build or rebuild your credit and are not a viable long-term plastic solution,” he says. Although some prepaid card issuers say they help build credit, none currently report to the three major credit bureaus.

Instead, Paperno suggests a *secured* credit card, which requires you to put up a cash deposit equal to the amount you can spend. The effect on your cash flow is the same as with a prepaid card, but you’ll be building a credit history. That said, there two caveats to keep in mind. First, although most secured card issuers do report your activity to credit bureaus, check the fine print or call and ask to make sure it reports to at least one of the big three (TransUnion, Equifax or Experian). Second, watch out for fees; in a March ruling that disappointed consumer advocates, the Consumer Financial Protection Bureau reversed a regulation that limited some fees on these cards.

(**MORE:** 5 Ways To Repair A Trashed Credit Score)

Never using your credit cards

Some people approach credit like a poker game, with the mentality that you can’t lose money if you don’t play your cards. Although it’s always advisable to pay off your bill in full every month to avoid interest charges, not using credit cards at all can actually backfire when it comes to your credit score. If an issuer looks at your account and sees that there hasn’t been any activity for a while (how long varies, but more than a year is a good rule of thumb), they might close it. Losing that credit line hurts your utilization ratio, which can hurt your credit score. Lohrenz suggests charging a small amount regularly — maybe a recurring bill like a gym membership or Netflix subscription — and paying it off every month. Some issuers will let you set up automatic payments from your checking account, so you won’t forget to make those payments.

Checking your credit daily

Checking your credit score every day won’t hurt your score (when you request your score, it’s called a “soft pull,” which is different from the “hard pull” lenders conduct that does affect your score). But trying to parse why you gained or lost two points here or there will just give you heartburn and won’t give you any greater insight into how your score is calculated. Lenders generally report to credit bureaus every 30 days, so checking your score every day takes the focus off what really matters: how your longer-term financial habits affect your credit file.