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9 Myths About Credit Scores

People think they know what causes a credit score to rise or fall. They're often wrong.

By Demetria Gallegos

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Everybody wants to have the highest credit score possible. But most people have little idea how to go about getting it.

In fact, the opposite is often true: The things that many people believe will help or hurt their score don't actually help or hurt them at all.

Telling fact from myth, though, is crucial, as consumers strive to do what they can to improve their credit score. A higher score can mean better terms on credit cards, lower rates on mortgages and less expensive premiums on auto and homeowners insurance. It can make it more likely to win approval for an apartment, and get deposits waived when setting up services like electricity and cable in a new home. It can even mean a better chance at nabbing a job offer.

In other words, a credit score has come to signal much more than the likelihood of defaulting on debt. It is a key to a better standard of living entirely.

With that in mind, here's a look at some misconceptions that hamstring many people—and best practices that will help make your score one that lenders will fight over.

MYTH: Checking my credit score hurts my credit score

Many consumers are confused about the difference between a hard inquiry, in which a financial firm is considering making a loan to you, and a soft inquiry in which, say, an employer is conducting a background check or a utility company is setting up a new account for you.

If you're trying to refinance your mortgage or sign up for a store credit card—that is, if credit might be extended—those hard inquiries could each drop your score by a few points. True, there are gray areas that could contribute to the confusion. For example, some home-rental

applications are hard inquiries, others are not. You can usually open a bank account with no impact, but signing up for overdraft protection might mean a hard query.

Still, there is no confusion when it comes to seeking information about your own score. That is always a soft inquiry, and won't cost you points.

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In fact, doing a self-check on your score can empower you to take charge of your credit reputation. Both of the leading scoring models, FICO and VantageScore, are available free. Most mortgage lenders use FICO scores, which everyone can get through Discover's Credit Scorecard. Credit Karma and Mint can provide your VantageScore 3.0., which is relied on especially by the credit-card and auto sectors.

Merely knowing your score can improve it, according to a paper published in July by the National Bureau of Economic Research. Over 400,000 student-loan borrowers were sent a quarterly email reminder about the availability of their FICO scores. On average, their scores increased about eight points over a year compared with borrowers who weren't getting the alerts. They were also 4% less likely to miss a monthly payment.

MYTH: If I pay my bills on time, that's all I need to worry about

For many consumers, the assumption is that on-time bill payment is all that matters when it comes to a good credit score. But that assumption forgets about the importance of credit utilization, which is the percentage of debt you owe compared with the total available credit that's been granted to you.

Utilization is one of the most important components of your score. If your credit cards are maxed out, your score won't look good even if you're paying promptly. A rule of thumb is to use less than 30% of your available credit each month and ideally less than 10%.

Another key strategy to consider is calling your card issuer to ask for a higher credit limit. If successful (and 85% of the time it is, according to CreditCards.com, a credit-card comparison site), the request would instantly lower your utilization.

"This is one of the fastest, easiest, no-cost ways that anyone can help their score," says industry analyst Ted Rossman of CreditCards.com.

MYTH: Carrying a balance helps boost my credit score

One persistent misconception is that to build a strong credit score people should demonstrate activity by keeping a charge on their credit cards at all times; that is, they should carry debt over from month to month.

In fact, 22% of consumers who said they had carried a balance did so mistakenly believing that it would help their credit score, according to a 2018 survey by CreditCards.com. But they are wrong: Keeping a balance on your cards doesn't help and could set back your financial goals, which are better served by consistently paying off credit-card debt in full.

“It surprises us that people really do think that carrying a balance is good, but it hurts their credit and you just rack up interest charges,” says Dana Marineau, vice president at Credit Karma.

MYTH: Closing an old credit card with a high interest rate will help my score

Sometimes the first credit cards we get—when our credit profiles aren’t well established—have higher interest rates than the more competitive cards we can qualify for as our credit usage matures. And people, especially those with low scores, often assume that shedding some credit cards will help boost a credit score. So they close the cards with the higher interest rate and keep the ones with the lower rates.

But the truth is that closing an older credit card won’t help your score—and it might actually hurt you.

FICO and VantageScore differ on how they factor for a closed credit-card account. FICO ignores the closed account status and continues averaging its age with your active accounts. Depending on the type of account and your credit profile, VantageScore may drop the closed account, shortening your overall age of credit. With both models, if you had a positive payment history on the closed account, that will continue to count in your favor but you’ve lowered your total amount of available credit, which could raise your utilization and hurt your score.

Regardless of scoring model, a better move, according to Ms. Marineau of Credit Karma, is to pay off any higher-interest credit cards and then keep them open—either with an occasional charge you promptly repay in full, or by putting a small monthly subscription, such as Netflix, onto it, and auto-paying it so that you don’t have to think about it. That way, it helps with longevity but can no longer hurt you.

Mr. Rossman points out that you should be sure such a semiretired credit card is not costing you each year. “If there is an annual fee, do a product change and ask the issuer to switch you to a different card in their portfolio that does not have a fee.” He says you can usually keep the same account number and the positive payment history, and the unused credit limit will continue to make a favorable impact on your utilization rate.

MYTH: Opening a new retail credit card is good for your score

Retailers constantly tempt us to open a new store card by offering a purchase discount or a promotional 0% interest period. And some consumers believe that doing so can help their credit if they pay off the balance within the promotional period. But every time we open a new credit card—or take out a loan or qualify for a mortgage, for that matter—the overall average age of our credit takes a hit, and the hard inquiry subtracts more points from our credit score.

“Do the math,” says Ethan Dornhelm, vice president of FICO Scores and Predictive Analysis for Fair Issac Corp., the creator of the FICO scoring model. “If it’s 10% off of a new washer/dryer, that

may be more material, but if it's a couple of free shirts, there should be that calculation or understanding that you may be trading off a few dollars on that retail item for a few points on your FICO score."

An exception might be for a young person just starting out. If they've made it through school without student loans and have been reliant on debit cards, they've essentially been invisible to the credit industry. So getting that first credit card is important to building a thicker credit file, and retail cards are often among the easiest to qualify for. For those people, the myth may be accurate after all.

MYTH: It hurts my credit score to comparison shop for a mortgage, auto or student loan

People looking for a lender sometimes opt for the first deal or interest rate they are offered, fearing that the credit queries from too many lenders will lower their scores. But, the reality is that the scoring models assume you're going through a shopping process. If they see different lenders pulling your credit score around the same time, they bundle multiple requests as a single query.

But you have to do that shopping fairly quickly. I learned that lesson when I recently bought a home. I had checked with two different lenders over the summer, which meant two hard inquiries that cost me points. When I spotted the credit-score damage from both prequalification applications I stopped shopping around because I wanted to keep my score high enough to get the best interest rate.

VantageScore's shopping period is 14 days. FICO has various scoring models that lenders might look at, with shopping periods ranging from 14 to 45 days during which multiple inquiries count as one.

Jeff Richardson, vice president at VantageScore Solutions, recommends waiting until after closing to take on new obligations like furniture and appliances, to prevent those inquiries from hurting your score at the last minute and affecting your mortgage rate.

MYTH: The older my unpaid debt, the more it hurts me

It's true that late payments, collections, foreclosures and chapter 13 bankruptcies hurt your credit score for seven years. A chapter 7 bankruptcy will hurt it for 10 years. But, with the exception of the bankruptcies, the impact of the other problems diminishes as the information ages.

After about two years, says Mr. Rossman, the lender has probably charged off the debt and given up. It's the newer delinquencies that will be more aggressively collected, he says.

So if you're in arrears, your priority should be on any new or recent problems. As an unpaid bill moves from 30 to 60 to 90 days late, and then finally to collections, that's when a bad problem is on the verge of becoming much worse, and intervention can be much more beneficial.

MYTH: Selecting 'credit' while using your debit card for a purchase is good for your credit score

When you choose to make a credit-type purchase with your debit card, your credit score doesn't benefit—or suffer—from any of those transactions. Still, a survey of 1,051 adults by Credit Card Insider found that 42% of respondents thought using their debit card or selecting the credit option on a debit-card purchase would help their score.

"If you put a credit card next to a debit card the optics are very similar," says Bruce McClary, vice president of communications for the National Foundation for Credit Counseling. "You have the name of the bank, you have the Visa or Mastercard logo on each, so it's easy to understand that someone might be confused."

Your bank typically won't report any debit-card activity to the credit-reporting companies. The main difference is that choosing the credit option on your debit-card purchase means the funds could take up to three days to post, whereas the debit option means immediate withdrawal.

Mr. McClary says that for someone worried about getting in over their heads with credit cards, the better choice is to choose a "secured" card in which a user makes an advance deposit against which card purchases are subtracted. Paying that bill essentially restores the full deposit. He recommends double-checking that the card issuer will report that activity to the credit-reporting companies, which then does count as part of your credit-score building efforts.

MYTH: Credit reports are accurate

Most consumers are unaware of what's being said about them between their lenders and the credit-reporting companies. And too many people wrongly assume that what ends up on their credit report—and the resulting credit score—must be correct.

The Federal Trade Commission says 21% of consumers studied in 2012 found errors that resulted in modifications by the credit-reporting firms. In 5% of the total number of consumers studied, the error was so serious as to affect the terms of any credit they might be granted.

Errors come from many sources. Sometimes, it's a mixed file in which activity from someone with your same name has been conflated with yours. Your ex-spouse's debts could still be showing up in your file. It could be a clerical error because your handwriting was misread. Sometimes, a creditor mistakenly reports a late payment. In some more serious cases, it's identity theft or fraud, which might show up on your report as a credit card or other account you never applied for.

The best way to deal with mistakes is to catch them early by regularly looking at your credit report. You are entitled to a free copy of your credit report annually from each of the credit-reporting companies (TransUnion, Experian and Equifax). You can request them at AnnualCreditReport.com or by calling 1-877-322-8228. Experts suggest you stagger the requests every four months between the three companies in order to keep an eye on your credit record all year long.

Edmund Garcia of Rosharon, Texas, says he didn't find out someone had stolen his identity until he tried to buy a house. The 37-year-old disabled veteran had been working on his credit for two years after some youthful missteps before filing the mortgage application which—when rejected—revealed the fraud. “I was so embarrassed and hurt. I had no idea that someone had taken out credit accounts on me,” he says.

Mr. Garcia says he has had some financial setbacks, particularly with medical bills, but has purposefully brought his score back from 480 to the mid-650s. He joined several financially oriented Facebook groups and signed up with credit-repair services. One strategy he has employed with success is “pay for deletion,” in which he offered his creditors settlements in exchange for them resolving or removing derogatory remarks or judgments on his file.

People need to learn all they can about their credit scores, Mr. Garcia says. “Once you fall behind, it's like trying to climb out of a 60-foot pit.”

Corrections & Amplifications

VantageScore continues to factor positive payment history from closed accounts into your credit score. An earlier version of this article incorrectly stated that such positive payment history is erased. (Oct. 22, 2019)

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THREE PROGRAMS TO BOOST YOUR CREDIT

There are a few existing and coming programs that aim to help consumers demonstrate responsible financial behavior in areas not previously visible to the credit-reporting companies.

Rental reporting

Paying your rent on time can now help your credit score. Such reporting is handled either by big landlords and property-management companies or by individuals who go through a company that verifies and reports the payments.

RentTrack works with housing companies that control many units and reports rent payments to all three credit-reporting companies. Either the property company or the renters pay a fee, about \$2.95 per month in the latter case. If renters want to submit their own payment history, they can do so through RentTrack's CreditPop division. Renters sign up free, but pay \$6.95 a month for their payments to be reported to Equifax and TransUnion. Users allow CreditPop access to bank-account activity so that their rent payments can be verified.

Rental Karma, which reports payments to TransUnion, works similarly to CreditPop. Renters pay a \$25 enrollment fee and then \$6.95 a month. Maitri Johnson, a vice president at TransUnion, which created a program called ResidentCredit, says that they have "found that subprime renters—on the lower scale of the credit scores—when they make timely payments, they can improve their score by 18 points over six months."

Phone and utility bills

Experian Boost, a free program launched last December by credit-reporting company Experian, factors household payments for services like telephone, cable and utilities into a person's FICO score. Consumers connect Experian Boost to the bank account they use for paying these bills. The program then pulls the relevant payment history and immediately recalculates their FICO score.

Experian says more than two million consumers have enrolled in the free service, with an average score boost of 10 points. The company says bank-account numbers or online access information aren't shared.

"The argument for getting rental and utility payment into the files is that you get the positive impact of making those payments on a regular basis," says Jeff Richardson, vice president at VantageScore Solutions, which created the VantageScore model. "Because if those accounts go to collection you would get the negative, but you wouldn't have gotten any credit."

One caveat: Since the program is offered through Experian, only Experian's credit report will reflect a boost in the FICO score based on those payments.

Bank accounts

In a program expected to launch to consumers next year, FICO will begin taking into account consumers' banking habits. Under the free program, called UltraFICO, consumers sign up to allow the program to link to their checking, savings or money-market accounts. Consumers are then rated on factors including the account balances they maintain, how long the accounts have been open and avoiding overdrafts. FICO says the service won't have access to a customer's private bank information.

Ted Rossman, industry analyst at CreditCards.com, says all these programs gather "consumer-permissioned" data that might give lenders more insight into behavior and potential risk.

"For example, you may have a 620 credit score but a lot of cash in the bank," he says. "You can imagine that person might be more creditworthy than a person with the same score with not much in the bank."

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What mistakes or misconceptions have led you to damage your credit score? Join the conversation below.

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