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Don't Transfer Balances the Wrong Way!, Part 1

What about transferring high-interest rate credit card balances? Will that improve your credit score? Usually it will not – although it can save you money in finance charges in the long run. If you ever want to transfer balances from one credit card to another, keep these five tips in mind.

Do not close out those old accounts! This is the most important rule. Think back to the five different components that go into calculating your FICO credit score. The experts at Fair Isaac say that it is a misconception among consumers that closing an old account will raise their credit score. The truth is that it won't. What's worse is that in many cases, closing out an old account can actually have the opposite intended effect, and can lower your FICO credit score. The reason is that, even if you transfer a balance to a card under a 0 percent balance transfer deal, if you close out your original account, you will be purging your credit history and decreasing the average age of your accounts. That account you close may have been one with considerable longevity. You might have had it for three, five, seven years, or more. But now, just because you transferred a balance to a lower rate card (one with a low rate for a temporary period, I might add), you've made the classic mistake of wiping out your seven-year track record of paying another credit card on time.

Don't reopen an account after you've closed it. Some people, upon learning of the mistake they've made in closing out an old account, will ask me whether they should reopen the account. My answer is no, do not try to reopen it because, again, you could be shooting yourself in the foot, and hurting your credit score. Getting the account reopened means you'll have another inquiry on your credit file, and you'll have to apply for a new line of credit. It's better to simply learn the lesson and not make this mistake again in the future.

Don't ruin your credit utilization rate. Another classic mistake people make in initiating balance transfers is that they ruin their credit utilization rate, once again hurting their FICO credit score. Here's an example of how this is commonly done.

Let's say you have two credit cards – a MasterCard and a Visa, and each has a \$10,000 credit limit. Let's further assume that you've charged \$5,000 on each card. Therefore, your credit utilization rate is 50 percent. In other words, you've charged a total of \$10,000 and you have a total of \$20,000 in credit at your disposal.

Now let's say you get a wonderful credit card offer in the mail from Discover. Since your Visa and MasterCard carry interest rates of 14.9 percent and 17.9 percent, respectively, and Discover is offering you a 4.9 percent balance transfer deal, you jump at this offer in a bid to save money on finance charges.

continued on back



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The problem arises, however, when Discover tells you that you've been approved for a \$10,000 credit line. But the company is willing to let you transfer balances from both your Visa and MasterCard up to the full \$10,000 limit on your Discover—even with no over-the-limit charges—in order to help you save money.

Naturally, you take Discover up on its offer, and those \$10,000 worth of charges that were sitting on your Visa and MasterCard bill get transferred over to your new Discover card. Moreover, you close out your old accounts with Visa and MasterCard. You're thinking, "Ha! I've beat the system. I'll be saving lots of money as a result of these smart balance transfers!" But take a look at what happens next in the credit scoring world.

Previously, you had a 50 percent credit utilization rate, because you'd charged \$10,000 and had \$20,000 worth of credit available to you. Now, your credit utilization rate jumps to 100 percent. You haven't charged a single additional dime. But because you have \$10,000 worth of debt on a single card with a \$10,000 limit, statistically, the FICO credit scoring model looks at you as a person who is maxed out on your cards. Not so smart, is it?

Adding further insult to injury, you've also lowered your credit score by closing those old accounts and decreasing the average age of your accounts. All you have now is a brand-spanking new Discover card with a one-month history; previously you had a MasterCard with a five year, or 60-month history, and a Visa with a seven year, or 84-month history.

Do you see how people can easily get tripped up if they make some common mistakes with credit and debt? One potential solution is to request a higher limit from Discover. A \$20,000 limit would preserve your 50 percent credit utilization rate if you closed out the Visa and MasterCard accounts. Of course, a better strategy is to also refrain from closing out those old accounts.