Don't Cancel That Credit Card!

Source: Getty Images

Unless your idea of "streamlined" finances is having eight credit cards in your wallet, you've probably considered canceling some of credit cards you don't use often. At the very least it's a way to save your back from sitting on a Big Mac sized wallet.

However, before you dash off "Dear John" letters to your lenders, first make sure you're not doing more harm than good by parting ways.

The truth about canceling credit cards

Do unused lines of credit hurt your credit score — or help it? Will removing old information about already closed accounts make you look more (or less) attractive to bankers?

Great questions. Let's clear up some common misconceptions:

Closing credit card accounts will not undo anything.

Once a credit card is in play, there's no denying its existence. It's on your permanent record — your credit report

— for at least seven years. Yes, even if you cancel the card the next day. Same goes for any red marks (late payments, charge-offs, overspending) associated with your accounts. Sorry, you simply can't deny your past. But at least it will fade away and, for most negative entries, fall off your report in seven years. However, you might not want some entries to disappear …

Why deny the good?

Removing old closed accounts that have no negative items is a bad idea because you benefit from a long credit history, and those accounts speak to that history. (Good entries can remain on your report forever.) Remember, 15% of your credit score is determined by how long you've been borrowing.

Closing accounts might hurt your FICO score.

Lenders take a hard look at the ratio between the balances on your revolving accounts and your total available credit (your credit utilization ratio). If you do have debt, try to keep it to less than 30% of your available credit. (The *ideal* number here is, of course, 0%.) Go ahead and keep those lines of credit open, but don't be tempted by untouched lines. When you close out open accounts, those credit lines are no longer factored into your ratio. Thus, your debt as a percentage of available credit will increase. *Ouch*.

It's worth noting that if you don't already know your credit score, it's time to fix that. Especially since there are ways to check your credit score for free. And while you're at it, make sure you understand how your credit score is determined.

Tip

You can see The Motley Fool's top credit card picks by visiting our comparison of the best credit cards in Canada.

Why cancel cards at all?

It may sound like the lending industry loves customers who have gobs of plastic, but as with most things, it's best not to binge. According to Fair Isaac, once you acquire more than seven revolving debt accounts, your FICO credit score begins to suffer a little. And while simply closing accounts won't necessarily have an immediate positive effect, over time it could boost your credit score. So let's see if it's time to break up with some of your banks.

Keep the oldies …

As we said above, commitment counts, and lenders see long-held accounts as proof that you are the responsible citizen that we know you are. So, if it's the choice between parting ways with that dashing new sliver of plastic in your wallet or the faded alumni credit card you got when you still had hair, keep the latter.

… and the goodies.

If you get rewards points, miles, cash back, good karma from using a credit card, and — this is important — you actually take advantage of the goodies that come with membership, keep the card in play. It's good to know, however, that credit cards with rewards programs are really common. So if the card carries an annual fee, call and ask if it can be waived. If you don't get back what you pay annually to use it, consider cancelling.

Dump the flighty ones.

Just because your credit boasted a single-digit interest rate when you got it doesn't mean it will do so indefinitely. Nothing's uglier than paying for a new transmission at a 23.9% interest rate. Those credit cards that have ever-shifting rules and rates require an eagle eye be kept on all those leaflets that come in the mail. If you're not the type to keep your eye on the dealer, this card may be a lot more trouble than it's worth to keep in play.

Keep the ones that stood by you in bad times.

If debt was a problem in the past and may become one in the future, keep open those accounts where you have a decent track record — meaning no (or few) bloopers (like late payments or overages) — and a longstanding relationship. If the low-interest offers dry up, your room for negotiating a better deal is best with a lender that has fond long-term memories of your time together.

Hold on to your single days.

If you're married, don't give up your identity entirely. Simply being an authorized user on your sweetheart's credit cards won't help you establish credit or keep your reputation intact. You must keep at least one line of credit from your single days open and active, and in your name only. If you don't occasionally use the card your file will go dormant and become un-scoreable.

In addition to using the nuts and bolts of your credit card program, other factors may play a role in reviewing your lending relationships. Customer service is a biggie for some, and it's usually not an issue until something goes wrong.

The right way to close a credit card account

Simply cutting up the card and calling it quits doesn't count. An unused card is still an active account (until expiration), so while you might not be getting a bill in the mail, the bank still counts you as a customer. If your number gets in the wrong hands, you might not notice until it's too late.

To end your relationship with your lender for real, call the 800 number on your card statement and find your way to a live operator. Specify that you want the account closed — and this is important — "at the cardholder's request." It's a minor point, but it looks better on your credit report if the account was terminated by the user and not the lender.

Know when to hold them, when to fold them

It’s tempting to do a major spring cleaning and dump all the dusty cards from your wallet at one time. However, cutting off too many lines of credit at once can give the wrong impression on your credit score. Again, the level of “acceptable credit” depends on your income. Too high, and you’re a risk. Too low, and your banker may wonder why you don’t qualify for more. Still, with responsible credit usage — paying your bills on time, every time — any short-term blip will be history in no time.

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Date
2025/07/06
Date Created
2012/12/21
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