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Closing Accounts Can Hurt Your Credit

Consider this unfortunate scenario. You have wracked up considerable debt on your credit card accounts. After getting them under control and zeroing out most of your balances, you decide to close those empty accounts in order to prevent yourself from spending more on them. To your dismay, after a month, you find that your credit score has dropped significantly. What happened? You thought you were demonstrating greater credit responsibility by paying off your debts and closing your accounts. What did you do wrong?

Sadly, many people may find themselves in the same situation because they do not understand how a credit score is calculated. One of the essentials in a credit score is your debt-to-available credit. While opening lots of credit accounts can hurt your score, closing down accounts can also decrease it as your total available credit lines decrease as well. So for example, you have reduced your credit debt to about $3,000. You have several credit cards with a combined total credit limit of $15,000. So you are currently using 20 percent of your available credit, a respectable percentage with the credit reporting bureaus. However, if you decide to put that $3,000 on to just one or two cards and close the rest of your accounts, leaving you with say a combined $5,000 credit limit. You are now using 60 percent of your available credit, a much greater percentage and often a red flag to the credit bureaus.

Your credit score may also suffer if you have closed your oldest credit accounts. Part of your credit score is calculated based on the length of your credit history. The credit bureaus like to see a long, consistent history of responsible credit use. Closing the oldest accounts may make your credit history appear shorter than it is, causing your score to drop. And do not be fooled thinking that by closing accounts, you can remove any negative information associated with those accounts from your credit report. That information will remain on file for seven years, even though the account will be listed as “closed.”

Is it always a bad idea to close unused credit accounts? No. Sometimes it can be a very smart thing to do in order avoid to prevent identity theft and to get rid of unnecessary credit card fees and charges. If you do decide you need to close some accounts, be sure that you leave enough open to keep your debt-to-credit-limit ratio low. TransUnion, one of the major credit bureaus, recommends keeping between four and six accounts open at all times. Their website says, “This will keep your credit score and debt balances healthy. Signs of active and responsible credit use are viewed positively by creditors.” And don’t be afraid to close your accounts gradually and one at a time. Credit bureaus will probably view a gradual credit shift as more responsible financial behavior.

Keeping a healthy debt-to-credit-limit ratio also means you should not pile too much debt on to any one card. Try to keep the balance on your credit cards to below 35 percent of your available credit line. And of course, do not close all of your oldest accounts!