Will bankruptcy ruin my credit?

Because I'm a California bankruptcy lawyer, **people often ask me if filing for bankruptcy will ruin their credit**. You may already know that the fact of your bankruptcy may stay on your credit report for ten years, and isn't that really bad? Let's take a look at that question.

If you're behind in your bills or behind in making credit card payments, and especially if you also have high credit card balances, **your credit is already bad and will get worse** if you don't do something to bring your accounts up to date. If you're not behind in making payments, you probably soon will be if you're considering filing bankruptcy (if you're reading this, I assume you're considering it) and your credit will move to "bad". And, again, **your credit will only get worse until you "fix" it some way**.

Now, let's see what happens to your credit report after a bankruptcy.

- **Late payments are removed.**
- **Unpaid debts are removed.**
- **High balances are removed.**

That means **your credit report is mostly "wiped clean"**. Instead of those items listed above, your accounts included in bankruptcy will be noted as **"Included in Chapter 7 Bankruptcy" or "Included in Chapter 13 Wage Earner Plan"**, depending on which type of bankruptcy you filed (that's for another discussion and not important here). **That "bankruptcy" note is probably not as harmful to your credit rating as those things that were removed.**

Another important factor is that after you eliminate your debt in the bankruptcy, your debt-to-income ratio is greatly reduced and your credit score will increase as a result.

But one of the largest differences in this bankruptcy-or-not credit-rating comparison is that **without bankruptcy your credit rating will probably continue to get worse, and after bankruptcy (only 3 to 3 1/2 months with Chapter 7) you can actively start to improve your credit rating**. Here's the way it usually goes.

Credit card companies know that after you complete bankruptcy, **you can't do that again for six or eight years** (again, depending on the type of bankruptcy). Guess what that means to them? That you are a good prospect for a credit card! After bankruptcy, you will probably receive one or more offers for a credit card. Any credit card offer will probably be for a card with a very low limit, for example $300, and a high interest rate for balances, but THAT DOESN'T MATTER. Here's what you should do to start to improve your credit rating:

- Get that offered credit card.
- Use it ONLY for the purpose of rebuilding your credit, not (for example) to "carry" you to the next payday.
- Those "bad old days" are over and you must have a new relationship with your credit card. The purpose of your new credit card is not to help you finance your life, but instead ONLY to rebuild your credit.
- Use it at least once a month and then QUICKLY pay the balance IN FULL.
- Do not charge more than about one-fourth of the card's limit. One of the factors in a "credit score" is how close to the limit you are on a credit card, so don't get close. Keep it one-half-limit or lower, and one-fourth is better.

- Do not even get close to the time due for a payment before you pay off the balance in full, so there is no chance of being late.

Your regular use of the credit card, regular low balance, and never-late-for-a-payment history will result in an increasing credit rating. For example, it's common for people who couldn't get a car loan because of bad credit to be able to get one within one-to-two years after bankruptcy.

There's another important point here. **Using the credit card only as described above will prevent you from falling victim to any number of "bad practices" of credit card companies**. Raise your interest rate? No problem; you never incur any interest charges. Very high late charges? No problem; you're never close to being late. Add a large "over limit" fee because an interest charge puts you over the limit? Again, no problem because you (1) never have interest charges and (2) are never close to your card's limit.

I think you get the idea. Whether you should file for bankruptcy is quite another question, and one you should discuss with a bankruptcy attorney, but you probably shouldn't be afraid of its effect on your credit. It might actually be the best thing you could do for your credit.

CAUTION: After bankruptcy, read very carefully any offers you receive for credit cards or other offers of credit. Be careful to avoid offers from companies that say they own or represent someone who owns a debt that was discharged in your bankruptcy. This "offer" may be a reaffirmaton agreement in disguise, an attempt to get you to reaffirm or reinstate a discharged debt in return for receiving credit. Or it could be an attempt to get you to add some or all of a discharged debt to this new credit account.

12/4/2011 – There are recent reports of credit cards being offered to people after bankruptcy that have very high multiple fees, for example "set up fee," "statement fee," "annual fee," etc. So choose your credit card carefully. A reasonable annual fee is probably the price of admission, but cards with the other fees should be avoided. Cards from Orchard Bank seem to fall into the "reasonable" category.

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