Mastering Client Debt Repayment:
Ideal Repayment Plans for Clients and Advisors

Nick Lorenzo

In view of client needs, business demands, and practicality, this paper aims to help advisors evaluate repayment plans specifically in the context of an advisor-client relationship.

Debt repayment is a key consideration in comprehensive financial recommendations. To help financial professionals find the right fit between client, financial practice, and repayment plan, we propose three goals that an ideal repayment plan should achieve. These goals ensure that the plan best serves both client and advisor, and that the plan is correctly implemented by the client. After defining each goal using several straightforward criteria, we evaluate two classes of repayment plans against these requirements.

Introduction

Client Benefits

Sound debt repayment advice benefits both the client and the advisor.

With 80% of Americans [1] and over 60% of American small businesses [2] carrying some form of debt, it's clear that financial advice is rarely complete without a thoughtfully formed debt repayment plan. And because many borrowers find the topic of repayment to be confusing [3], financial advisors who dispense sound repayment advice provide a much-needed service to their clients.

Advisor Benefits

"When advisors... surmise that they have only a share of a client's investable assets, they should endeavor to increase their share, since doing so improves the prospect of retaining that client." [4]

Of course, such advice is also likely to benefit the advisor's financial practice: deeper client relationships are a strong indicator of an increased likelihood of client retention [4]. Advisors also report that referrals (presumably from satisfied clients) are a major contributor of client acquisition [5], and that the single largest source of asset growth is from existing clients [6]. The message is clear: relationships with existing clients are an enormous source of potential growth for financial practices.

An exceptional repayment plan can help tap this potential by strengthening client relationships (which may prompt additional referrals) and generating more revenue from additional services and client growth.

Types of Debts Discussed in this Paper

In this paper, we use the terms **debt** and **loan** interchangeably.

We assume that each debt under consideration is **analyzable**. Essentially,† this means that (**i**) the debt's properties (such as interest rates and remaining principal) are known in advance for each debt individually, and that (**ii**) borrowers can direct specific payment values toward each debt individually.

For our discussion ahead, we consider two types of analyzable debts.

1. A **traditional** debt has a fixed interest rate, has no outstanding interest, and is not eligible for forgiveness.
2. A **non-traditional** debt may have any combination of (**i**) an interest rate that varies, (**ii**) outstanding interest (that may or may not capitalize), and (**iii**) forgiveness eligibility.

Repayment Strategies vs. Repayment Plans

A **repayment strategy** is a systematic method of repaying debt. Examples include the AVALANCHE strategy (prioritize high-interest debt) and the SNOWBALL strategy (prioritize low-balance debt).

In this paper, we restrict ourselves to plans whose only parameter is the choice of total monthly payment.

On the other hand, a **repayment plan** is a specific instance of a strategy, paired with deliberately chosen parameters. For example, one might use the AVALANCHE strategy with a total monthly payment of $750; this pairing of the AVALANCHE strategy with a deliberately chosen total monthly payment constitutes a repayment plan.

Components of a Repayment Plan

A repayment plan is therefore comprised of three components:

1. the underlying strategy,
2. the total monthly payment used in executing that strategy, and
3. any analyses leading to that choice of total monthly payment.

A plan's strategy and analyses must be chosen wisely in order to ensure that the recommended total monthly payment is suitable for the client.

In this paper, we address the question of how to choose an appropriate underlying strategy with accompanying analyses. We refer to the strategy-analysis pairing as a plan, with the understanding that the advisor will use his or her financial expertise and knowledge of the client to make a suitable recommendation for the total monthly payment.

We now discuss the three goals achieved by an ideal repayment plan.

† For more details, see [11].

Goals Achieved by an Ideal Repayment Plan

From the financial professional's perspective, an **ideal repayment plan** accomplishes three separate goals.

An ideal repayment plan serves the best interests of the client, is a sensible business choice for the advisor, and maximizes its likelihood of being successfully implemented by the client.

1. **Fiduciary Goal:** the plan serves the client's best interests.
2. **Commercial Goal:** the plan is commercially practical for the advisor.
3. **Executive Goal:** the plan maximizes the likelihood of its being successfully implemented by the client, so its benefits are fully realized.

A repayment plan must satisfy all three of these goals in order to be ideal. This concept is illustrated in Figure 1 below.

Most repayment plans fall outside the intersection of these three goals. Later in this paper, we discuss some of the ways in which this can happen.

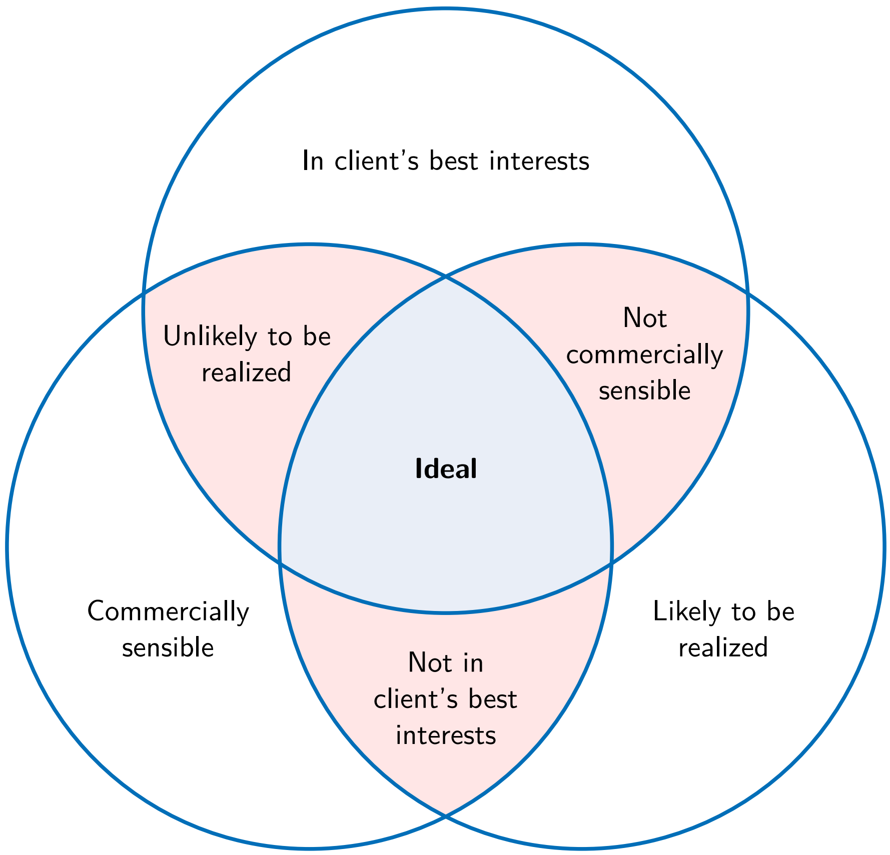

Figure 1: Some repayment plan trait combinations.

In the following sections, we develop the criteria involved in accomplishing each of these goals.

Fiduciary Criteria

Fiduciary criteria are non-negotiable standards that every recommended repayment plan should meet.

Financial professionals have a fiduciary duty to act in the best interests of their clients. Certain professional standards must therefore be met by any suitable repayment plan.

Optimality

The plan's underlying strategy best serves the client by distributing his or her money in a way that minimizes lifetime costs.

Accountability

The plan's analyses and underlying strategy preserve professional accountability by relying only on subject matter experts.

Confidentiality

The plan maintains client confidentiality by using only secure communication with any third party; any such third party must also be committed to confidentiality.

Comparability

An advisor can make sound recommendations in the client's best interests only if the available options can be properly compared.

The plan is readily compared to other investment opportunities, fitting into a comprehensive financial recommendation.

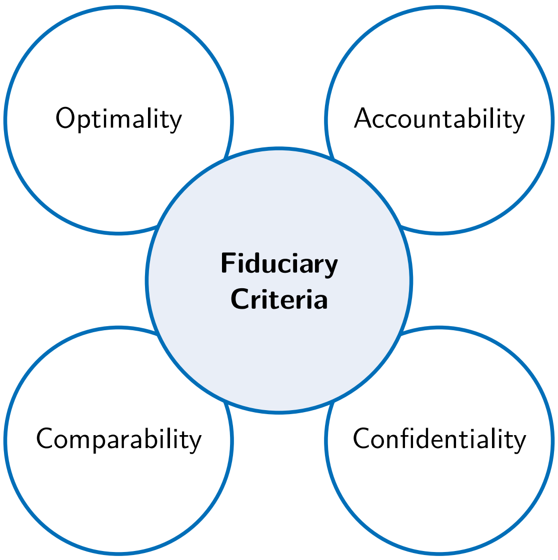

Figure 2: The four fiduciary criteria.

These criteria are consistent with the financial profession's highest standards.

Each of these criteria is essential in carrying out the advisor's fiduciary duty. These criteria are also consistent with the highest professional standards, such as those put forth in the Fiduciary Oath and Code of Ethics of the National Association of Personal Financial Advisors [7].

Commercial Criteria

Financial advisors have a duty not only to their clients, but also to their own financial practices. In order to be commercially useful, any regularly recommended repayment plan must meet certain criteria.

Convenience

Convenience ensures that, like any good tool, the plan saves the advisor time and money.

The plan's analyses are readily available in a turnkey package, allowing the advisor to focus on the available information and to make the holistic recommendation that best suits the client.

Applicability

The plan is broadly applicable to different client types (individuals, couples, families, small businesses, corporations, etc.) having different debt types (credit card debt, student debt, auto loans, mortgages, small business loans, corporate debt, etc.).

Reliability

Predictable costs help advisors continue to use their fee-only or fee-based business models.

The plan generates trustworthy results at a predictable cost. This allows the advisor to depend on the plan as a cost- and time-saving tool for future business needs.

A plan meeting these criteria can be used efficiently in a wide range of contexts.

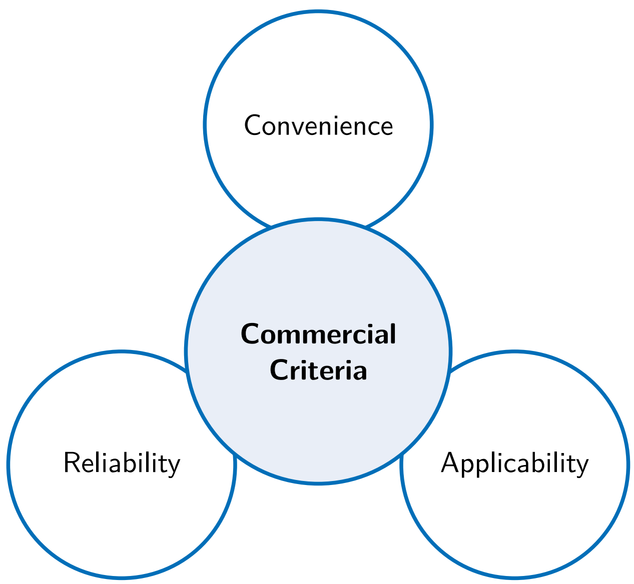

Figure 3: The three commercial criteria.

A plan meeting these criteria is convenient and useful enough to become part of the usual course of business. Reliability not only ensures consistent results, but also affords the use of a fee-based recommendation to accompany the plan (which may help increase client retention [4]).

Executive Criteria

Finally, no plan is worthwhile if it is not successfully implemented by the client: an ideal plan must minimize or eliminate barriers to successful implementation. This is achieved by meeting three requirements.

Simplicity

The plan's strategy is easy to explain to the client, easy to set up, and requires no ongoing effort from the advisor or from the client.

Simplicity is a key element in ensuring that the client successfully executes the advisor's recommendations.

Justifiability

The plan – and the advisor's accompanying recommendations – are easy to justify to the client.

Compatibility

The plan can be used with any payment method the client prefers.

Simplicity and compatibility eliminate the client's procedural barriers to implementation, while justifiability helps the advisor to remove the client's mental barriers.

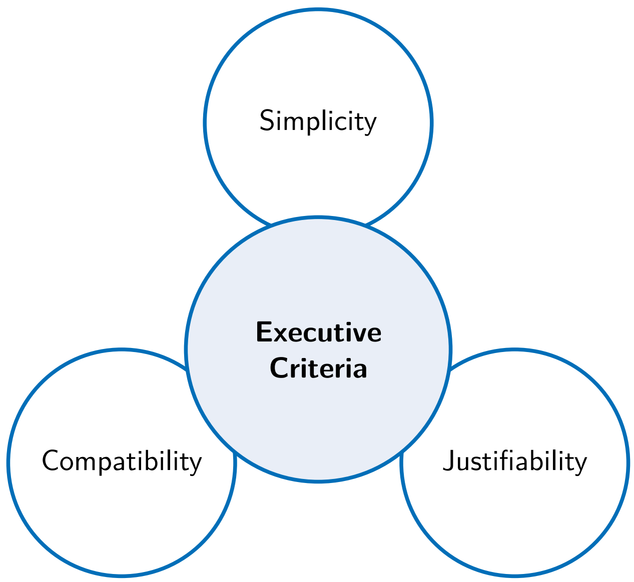

Figure 4: The three executive criteria.

Armed with appropriate comparisons, an advisor arrives at well-reasoned recommendations, which can then be explained directly and clearly.

Justifiability is closely related to comparability: armed with appropriate comparisons, an advisor arrives at well-reasoned recommendations, which can then be explained directly and clearly. Such explanations may improve advisor-client relationships and invite the client to feel more involved in the creation – and implementation – of the plan.

Simplicity and compatibility help to minimize barriers to client compliance [8], [9], ensuring that the plan is easy to understand and convenient to implement.

We now evaluate two classes of repayment plans against the criteria of our three goals.

Sustained Plans

A **sustained** repayment strategy requires the borrower to manually change payment values each time a debt is paid off.

A **sustained strategy** requires ongoing adjustments to payment values as debts are paid off. Examples include the popular AVALANCHE (manually prioritize high-interest debt) and SNOWBALL (manually prioritize low-balance debt) strategies.

A **sustained plan** is a repayment plan based on a sustained strategy. These plans are generally one of three types, depending on how the advisor chooses to obtain the relevant analyses.

Plan (A) The advisor obtains the analyses from a third party.

Plan (B) The advisor performs the analyses oneself.

Plan (C) The advisor does not obtain the analyses.

Plan (C) clearly is undesirable, as it would force the advisor to make uninformed recommendations. This plan should therefore be avoided.

We now evaluate Plans (A) and (B) against our previous criteria.

Fiduciary Criteria

Optimality

The AVALANCHE strategy directs all excess money toward high-interest debt; it is often incorrectly claimed to be optimal.

- ✓ Some sustained strategies can yield low costs for traditional debts.
- ✗ AVALANCHE and other sustained strategies can produce negative savings for non-traditional debts [11].

Accountability

- – Before using Plan (A), the advisor should verify the subject matter expertise of the third party.
- ✓ Plan (B) preserves accountability.

Confidentiality

Plans based on sustained strategies may lack accountability, confidentiality, and comparability.

- – Before using Plan (A), the advisor should verify the confidentiality policy of the third party.
- ✓ Plan (B) preserves confidentiality.

Comparability

- – Plans (A) and (B) may not offer metrics that are comprehensive enough to make useful comparisons.
- ✗ Any such metrics are usually available only for traditional debts.

Commercial Criteria

Convenience

Advisors choosing to perform the calculations involved in these analyses sacrifice both time and money.

- ✓ Plan (A) may offer increased convenience.
- ✗ Plan (B) costs the advisor valuable time that could be spent earning more business. Such solutions may also scale poorly for clients with more than a few debts.

Applicability

- ✗ Plans (A) and (B) are typically useful only for traditional debts; a client having even one non-traditional debt is likely unable to receive the intended benefits.

Reliability

- – The reliability of Plan (A) depends on the third party selected.
- ✓ Plan (B) relies only on the advisor.
- ✗ Both plans may struggle to accommodate non-traditional debts, or may produce unwanted results – such as negative savings – in those cases [11].

Executive Criteria

Simplicity

Sustained plans require diligence and effort throughout the repayment process.

- ✗ When using sustained strategies, clients must manually adjust payment values as a debt is paid off. This tedious and error-prone process is intrinsic to sustained strategies.

Justifiability

- – A plan's justifiability depends on the quality and usefulness of its analyses. Plans (A) and (B) may lack sophistication and detail, and usually are restricted to traditional debts; justifiability is typically sacrificed for clients having even one non-traditional debt.

Compatibility

- ✓ Sustained plans can generally be used with any repayment method the client prefers.

Summary of Sustained Plans

Sustained plans often meet none of the three goals of an ideal repayment plan.

Sustained plans summarily fail to meet the requirement of simplicity. They also can produce sub-optimal (or even negative) savings [11]. In addition, most accompanying analyses – when available at all – are restricted to traditional debts. This immediately jeopardizes comparability, applicability, and justifiability for clients having even one non-traditional debt.

Turnkey Plans

A **turnkey strategy** does not require any additional work after an initial setup – its execution is "set-and-forget."

A **turnkey strategy** uses only fixed payment values, requiring no additional work after the payment values are initially chosen – its execution is "set-and-forget."

A **turnkey plan** is a repayment plan based on a turnkey strategy. Turnkey plans immediately satisfy the requirement of simplicity, as these are the simplest non-trivial plans possible. Examples include MIN PMTS (paying only the minimum toward each debt) and EPSILON (explained below).

The EPSILON Strategy

EPSILON uses optimal, fixed payment values to minimize effort and maximize savings.

EPSILON is a turnkey strategy executed in two steps.

1. Find the fixed payment values that minimize the total lifetime cost of the client's loans.†
2. The client sets payment values to match these optimal values.

After payment values are set to their corresponding optimal values, there is no further action required by the client or the advisor.

We now evaluate EPSILON against our previous criteria.

Fiduciary Criteria

Optimality

By definition, EPSILON uses only optimal payment values.

- ✓ By definition, EPSILON uses only optimal payment values.
- ✓ Perhaps surprisingly, EPSILON can yield lower costs than AVALANCHE, which is typically claimed to be the most frugal strategy.‡
- ✓ Unlike AVALANCHE, EPSILON never produces negative savings.‡

Accountability

- ✓ Optimal EPSILON payment values are found using a proprietary algorithm. To maintain professional accountability, this algorithm employs certification and formal verification in the sense defined in [13], attaining the highest standards in modern algorithm development.

†At the end of this paper, we discuss how to obtain these optimal payment values.
‡See [11] for realistic examples with direct numerical comparisons.

Confidentiality

Security and confidentiality are top priorities.

- ✓ Client information submitted for use with EPSILON is transmitted and stored securely, and adheres to a strict confidentiality policy.

Comparability

- ✓ EPSILON payment values are accompanied by financial metrics such as savings, time savings, return on investment, rate of return, return on cash flow, efficiency measures, and more.
- ✓ Custom financial metrics are available as an enterprise-level solution.

Commercial Criteria

Convenience

Optimal payment values and accompanying analyses are delivered together in a single PDF.

- ✓ EPSILON payment values are obtained using a quick, simple ordering process.
- ✓ Optimal payment values and accompanying analyses are delivered together in a single PDF, ready to review with the client.

Applicability

- ✓ Aribtrary combinations of analyzable debts can be used with EPSILON.
- ✓ Difficult-to-analyze debts – such as those involving introductory interest rates, outstanding interest, subsidized interest, interest capitalization, loan deferment and forbearance, and forgiveness – are handled automatically.
- ✓ EPSILON can be used with virtually any number of debts.

Reliability

Analyses are available in standardized packages with straightforward pricing.

- ✓ Analyses are available in standardized packages with straightforward pricing.
- ✓ Full sample documents are available before ordering, so advisors know exactly what to expect, and at what price point.

Executive Criteria

Simplicity

- ✓ As a turnkey plan, EPSILON is easy to explain to the client, easy to set up, and requires no ongoing effort from the advisor or client.

Justifiability

- ✓ Detailed analyses help the advisor to develop straightforward, easily justified, and easily shared recommendations for any client.

Compatibility

EPSILON can be used with any payment method.

✓ EPSILON can be used with any payment method, though it's most convenient when paired with increasingly popular [10] automatic payments. See [12] for some of the benefits of this pairing.

Summary of Turnkey Plans

Turnkey strategies automatically satisfy the requirement of simplicity. EPSILON is a special member of this class that combines turnkey convenience with highly tuned optimality and unmatched comparability.

Overview

Here we tabulate our discussion of the advantages and disadvantages of each repayment plan.

		(A)	(B)	EPSILON
Fiduciary Criteria	Optimality	–	–	✓
	Accountability	–	✓	✓
	Confidentiality	–	✓	✓
	Comparability	–	–	✓
Commercial Criteria	Convenience	✓	✗	✓
	Applicability	–	–	✓
	Reliability	–	–	✓
Executive Criteria	Simplicity	✗	✗	✓
	Justifiability	–	–	✓
	Compatibility	✓	✓	✓

Table 1: Overview of repayment plan characteristics.

Plans based on EPSILON achieve all three goals of an ideal repayment plan.

We see that EPSILON is the only plan meeting all ideal-plan criteria across all three goals. As far as the author is aware, EPSILON-based plans are the only ones satisfying every requirement discussed in this paper.

Detailed conceptual comparisons between EPSILON and the sustained strategies known as AVALANCHE and SNOWBALL can be found in [12].

Summary and Conclusions

With debt so prominent in the United States, sound repayment advice is a boon to both client and advisor. To help advisors evaluate the merits of different repayment plans, we proposed that an ideal plan must meet Fiduciary, Commercial, and Executive goals, each with its own criteria.

Sustained plans fail to meet the basic goals of ideal plans.

We then evaluated sustained plans against these criteria, revealing a general lack of optimality, applicability, and simplicity. Combined with other drawbacks, sustained plans often fail to meet any of the three goals of an ideal plan.

We discovered that EPSILON – with its accompanying analyses – satisfies every requirement of an ideal repayment plan.

Next, we examined turnkey plans, which require no ongoing work. These strategies automatically satisfy the requirement of simplicity, increasing the likelihood that clients will carry out the recommendations provided by their advisors. Finally, we identified EPSILON as an optimal turnkey strategy capable of outperforming popular methods like AVALANCHE, but with the additional convenience of fixed payment values. We discovered that EPSILON – with its accompanying analyses – satisfies every requirement of an ideal repayment plan.

How to Obtain EPSILON Payment Values

We use a proprietary algorithm to find optimal EPSILON payment values. EPSILON is capable of optimizing arbitrary combinations of traditional and non-traditional analyzable debts, including interest rate schedules (such as subsidized loans and introductory interest rates), loan forgiveness, outstanding interest, and interest capitalization.

We offer customized, professional, and informative PDF reports.

Our customized, professional reports include EPSILON payment values and a number of financial metrics and visualizations, such as total savings, payoff times, ROI, ROR, and much more. Everything is packaged into a single, easy-to-read PDF, delivered securely and ready to review with clients.

Readers are encouraged to visit www.epsilonmetrics.com to learn more about the benefits of EPSILON and to see example analyses.

About Strategy Performance

The aim of this paper was to provide a qualitative comparison of sustained and turnkey strategies. Readers interested in direct, real-world comparisons of the savings achieved by examples of these strategies – and the effort required to achieve these savings – are encouraged to read Minimum Effort, Maximum Savings: Comparing Debt Repayment Strategy Performance [11].

About the Author

Nick Lorenzo holds a Ph.D. in Mathematics and an M.S. in Applied Mathematics from Rensselaer Polytechnic Institute and a B.S. in Mathematics and Physics from Case Western Reserve University. He is Epsilon's owner, founder, and lead mathematical researcher.

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