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Choosing a Payoff Strategy for Credit Card Debt

There are proven and practical debt-reduction techniques that can assist you in paying off your credit card debt. You should choose the method that's right for you based on your financial management style and the amount of debt you have.

For mathematical and analytical individuals who are looking for the most efficient way to approach their debt, the **avalanche method** might work best.

Individuals who are not as mathematical and prefer psychological victories should consider the **snowball method**.

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The Avalanche Method

The avalanche method refers to paying off debt with the highest interest rate first. This method requires a lot of will and discipline, but it is the most financially efficient way to pay down your debt.

You will save the most on interest and will pay off your debt quickly by using this method. To use the avalanche method, follow the steps below:

1. List all of your credit cards in order of the highest to lowest interest rates.
2. Focus on paying as much as you can on the card with the highest interest rate, regardless of the balance.
3. Pay minimum payments on all the other cards. The key here is to pay more than the minimum payment on the debt you are working to pay off first.
4. When you have completely paid off the first card, use the money that you earmarked for its payments toward paying off the card with the second highest interest rate. (This is in addition to the minimum payments you were already making.)
5. As you pay off more debt, you add more money to your monthly payments on the remaining cards.
6. Continue this method until all debt is paid off.

Consider the following example:

Starting Payment Plan

- **Credit Card A**
 - Balance: \$3,000
 - Interest rate: 21%
 - Minimum Payment (2%): \$60
 - Payment: \$200 (minimum + additional payments)
- **Credit Card B**
 - Balance: \$2,000
 - Interest Rate: 16%
 - Minimum Payment (2%): \$40
 - Payment: \$40
- **Credit Card C**
 - Balance: \$4,000
 - Interest Rate: 12%
 - Minimum Payment (2%): \$80
 - Payment: \$80

Payment Plan after Paying Off Card with Highest Interest Rate

- **Credit Card A**
 - Balance: \$0

- o Interest rate: 21%
- o Minimum Payment (2%): \$60
- o Payment: PAID
- **Credit Card B**
 - o Balance: \$3,000
 - o Interest Rate: 16%
 - o Minimum Payment (2%): \$40
 - o Payment: \$240 (minimum + additional payments)
- **Credit Card C**
 - o Balance: \$4,000
 - o Interest Rate: 12%
 - o Minimum Payment (2%): \$80
 - o Payment: \$80

The Snowball Method

The snowball method refers to paying the smallest balance first. This method helps build confidence with small victories. To use the snowball method, follow the steps below:

1. List all of your credit card debt in order of balance: smallest to largest.
2. Start by paying off the smallest balance first while making the minimum payments on all other credit card debts.
3. Once you pay off the debt with the smallest balance, move on to the next.
4. Roll the payment you earmarked for the first debt and apply it to the second debt's payment. This creates the snowball.
5. As you pay off more debt, you add more money to your monthly payment of the next debt.

Paying off a debt is a great psychological relief and helps you build confidence. These accomplishments make it easier to approach and attack your debt-reduction plan.

Consider the example below:

Starting Payment Plan

- **Credit Card A**
 - o Balance: \$3,000
 - o Interest Rate: 16%
 - o Minimum Payment (2%): \$40
 - o Payment: \$40
- **Credit Card B (Smallest Balance)**
 - o Balance: \$2,000
 - o Interest Rate: 21%
 - o Minimum Payment (2%): \$60
 - o Payment: \$200 (minimum + additional payment)
- **Credit Card C**
 - o Balance: \$4,000
 - o Interest Rate: 12%
 - o Minimum Payment (2%): \$80
 - o Payment: \$80

Payment Plan after Paying Off Card with Smallest Balance

- **Credit Card A (Next Smallest Balance)**
 - o Balance: \$3,000
 - o Interest Rate: 16%
 - o Minimum Payment (2%): \$40
 - o Payment: \$240 (minimum + additional payments)
- **Credit Card B (PAID)**
 - o Balance: \$0
 - o Interest Rate: 21%
 - o Minimum Payment (2%): \$60
 - o Payment: PAID
- **Credit Card C**
 - o Balance: \$4,000

- o Interest Rate: 12%
- o Minimum Payment (2%): \$80
- o Payment: \$80

Additional Tips for Reducing Debt

Here are some additional tips to help you reduce your debt, no matter which payoff strategy you choose.

- **Stop using your credit cards, but do not close them.** Closing the credit cards will reduce your credit limit and can negatively affect your credit score.
- **Track all of your expenses.** Make sure you know where your money is going and identify any cash leakages.
- **Think about every dollar you spend.** Getting out of debt requires a lot of discipline. Make sure your priorities are set.
- **Try a cash budget.** Psychologically, it is much harder to part with cash versus swiping a card to make a purchase.
- **Eliminate unnecessary expenses.** Remind yourself that this will not be forever, but just until your debt is under control. Cable, restaurants and gym memberships are examples of expenses that can strain your budget. These can be cut until the debt is paid off.
- **Consider getting rid of assets that require payments every month**, such as a car, luxury items and other items that can be forgone until your financial situation improves.

Resources

- Consumer Financial Protection Bureau: www.consumerfinance.gov/ask-cfpb/category-credit-cards/
- Federal Trade Commission: www.consumer.ftc.gov/articles/0150-coping-debt
- USA.gov: www.usa.gov/debt
- MyMoney.gov: www.mymoney.gov

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