

# **The 365/360 Method of Calculating Interest: Lenders and Borrowers Square Off**

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Recently, financial institutions in Illinois have encountered a new defense to mortgage foreclosure suits and a new wave of class action lawsuits, all arising out of the 365/360 method of calculating interest. With the exception of a few cases in downstate Illinois, courts facing these new claims and defenses have ruled in favor of the financial institutions. That being said, it is likely that the showdown will continue in the appellate courts and, ultimately, the Illinois legislature.

## **Understanding the Issue**

Promissory notes frequently contain language providing that interest will be computed by multiplying the stated interest rate by 365 and dividing that number by 360. As a result, the interest rate that actually accrues in a calendar year is slightly higher than what is stated in the promissory note. The reasoning behind this method goes to the bank's attempts to standardize interest rates on a 30-day month, while taking into account the 365-day calendar year. The 365/360 method has been recognized for quite some time by the Illinois Department of Financial & Professional Regulation, as well as courts throughout Illinois, as an appropriate means of calculating interest.

In raising defenses to mortgage foreclosure cases and in plaintiff's class action cases, however, borrowers are claiming that the 365/360 method violates the Illinois Interest Act because certain promissory notes refer to interest being calculated either "per annum" or "annually." In some cases, these parties are maintaining that the method also violates the Illinois Consumer Fraud Act and provides evidence of fraud. Furthermore, borrowers are contending that the Illinois Interest Act requires lenders to use a calendar year to compute interest whenever the word "year" (or a comparable term) is used in a loan document. With respect to damages, some borrowers have also argued that the Illinois Interest Act allows them to recover twice the amount of the unauthorized interest that was charged.

## **Mixed Results in the Courts**

So far, this legal strategy has met with mixed results. While some courts in downstate Illinois have sided with the borrowers, most judges in Cook County have rejected the argument and ruled in favor of the lenders, reasoning that the Illinois Interest Act does not apply when a promissory note clearly states a specific basis for interest computation (e.g., the 365/360 method).

Given the increase in the number of cases addressing these new claims and defenses, the Illinois legislature is poised to pass legislation that validates the legality of the 365/360 method. While the final resolution remains uncertain, it is clear that these latest court battles are the byproduct of an economic environment that has left lenders scrambling to protect and collect on their loans, while borrowers attempt to preserve their options until the economy recovers.

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