

# HOW MANY DAYS ARE ACTUALLY IN A YEAR IN ILLINOIS?

## HAVE YOU READ YOUR LOAN CHECKLIST DOCUMENTATION LATELY?

*“Use of the Actual/360 accrual method has been claimed to be an Unfair and Deceptive Trade Practice. Due to the unstable legal environment surrounding the use of the Actual/360 accrual method, we recommend that you do not use this accrual method. Lenders that choose the Actual/360 accrual method assume any liability resulting from the use of this accrual method.”* **ARTA Lending from BankersSystems – Advisory Warning**

*“A 365/360 interest calculation method has been selected for this loan. This calculation method results in a higher effective interest rate than the numeric interest rate stated in the loan documents. Before committing to this interest calculation method, you should consult your legal counsel of compliance officer.”* **Laser Pro Lending from Harland Financial – Advisory Warning**

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By: Louis Dunham  
CEO CAMELSolutions

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Have you read these advisory warnings? If not and your bank is charging commercial clients interest based on the 365/360 day interest method, you may be at risk of being sued. As early as 2006, warning alerts issued by these widely accepted industry documentation specialists have contained this admonition.

### **What’s in a Warning?**

There is presently at least one lawsuit in Illinois, “Kitson vs. the Bank of Edwardsville” dealing with this question. In the lawsuit, Kitson argued that the Bank violated the Illinois Interest Act because the effective Interest Rate on their loan was greater than the stated interest rate on the loan. The Bank of Edwardsville, a \$1.4 billion community bank, saw this case converted into a class action lawsuit and has a settlement pending for *\$3.5 million*.

With the ever increasing number of foreclosures in today’s markets, bank client attorneys are looking for creative ways to delay or stall foreclosure proceedings on behalf of their clients and your borrowers. In the Bank of

Edwardsville and other cases, lawyers have challenged loan documents and allege “unfair and deceptive practices” in the calculation of interest on commercial loans.

### **We Have Always Done It Like This...**

For years, banks nationwide have used two primary methods of calculating interest on commercial loans. The first method, the 365/365 method (or Stated Rate Method), utilizes a 365-day year, while the second method, the 365/360 method (or Bank Method) utilizes a 360-day year and charges interest for the actual number of days the loan is outstanding. Although it is common practice across the nation, the Bank Method calculation results in a slightly higher effective interest rate than the Stated Rate on loan documents. The legal community is now challenging this calculation method.

The result is a potential contractual issue between the bank and its commercial borrowers. Hopefully your bank procedures include the issuance of an acceptance letter to the borrower that states the interest accrual method the bank will utilize. In addition, all banks

should have legal counsel review the interest computation method used to ensure state and Federal legal compliance, and at the very least require the borrowers to either initial the 365/360 computation method disclosed on the promissory note or develop additional disclosures to protect the bank from a potential suit. Borrowers can very easily claim they were deceived and were unaware they were being charged an effective rate higher than the stated rate if this is not done. The advisory warnings printed for each loan by commercial loan documentation packages may very well support a borrower's argument.

### **Should My Bank Be Worried?**

The bank's commercial loan portfolio could be at risk of a class action suit. Banks have been warned by the major loan documentation providers that a potential problem exists. Every loan your bank has booked has contained that warning for at least the past three years. It is long past time to make the argument that the bank is performing its due diligence to correct the problem either through additional disclosures or loan modification of the accrual method. The argument that banks charge on a 365/360 because 'we have always done it that way' will not suffice in a court of law.

Attorneys are now recognizing the issue and filing class action lawsuits on behalf of their clients. The result is a halt on any foreclosure proceedings on the subject property and a major cost to the bank to defend the lawsuit. Banks with attorney-prepared documents using the Bank Method face similar issues with the added expense that the bank attorney can be named as a co-defendant in the suit and the bank will need to hire additional legal counsel to defend this problem.

### **What Should I Do?**

In Illinois, the Illinois Interest Act and the Illinois Consumer and Deceptive Practices Act have been cited in the lawsuits. Penalties contained in these regulations require your bank to review its

commercial lending practices. All banks should carefully and quickly review their respective state's laws that impact the bank's ability to use the Bank Method of interest accrual. If it is utilizing this method, the bank should have additional disclosure language and the loan acceptance documentation should clearly state the computational method, and written borrower acceptance should be obtained.

Your state's law might allow this interest calculation method (which is what many IL banks thought) but if you have not been reviewing your warnings in the lender checklist and have not done additional due diligence you might have an expensive lawsuit you will have to defend. It is vital that your bank review every Loan Checklist Warning before closing on a loan. In addition, you should be fully reviewing all product release notes and product bulletins from your loan documentation vendor.

The loan documentation companies want to limit their liability to banks on this issue. However, in this writer's opinion, they have not done enough to fully notify client banks of the problem. An objective review by CAMELSolutions, LLC can provide you with the assurance that you have no exposure - or offer guidance to correct your origination procedures and address issues with existing loans.

Unfortunately, this issue will not go away easily or inexpensively. Be proactive and read the documentation and have your attorney validate that you comply with the law. Ask your Loan Department head if he/she is aware of these warnings ... you might be surprised at the answer.

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*Lou Dunham is the CEO and Managing Principal of CAMELSolutions LLC. He can be reached at [lou.dunham@CAMELSolutions.com](mailto:lou.dunham@CAMELSolutions.com) or by phone at (847) 687-7353.*

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