



JAIIB by Ashish Sir LEARNING SESSIONS



BANKER SPECIAL RELATIONSHIP



PPB Module A Chapter 7 By Ashish Sir



RIGHT OF SET-OFF – COMPLETE EXPLANATION

1. What is the Right of Set-Off?

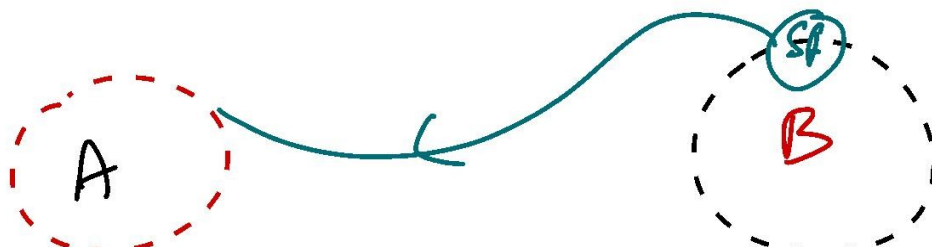
Right of Set-Off allows a bank to **adjust the debit balance** in one account **against** the **credit balance** in another account of the **same customer** .

This applies when the **bank-customer relationship** is that of **creditor-debtor** and **debtor-creditor** .



In simpler terms, the bank **can recover dues from a customer's other accounts** instead of waiting for repayment.

Example: A customer has a **savings account** with ₹50,000 and a **loan account** with ₹40,000 due. The bank can **adjust ₹40,000 from the savings balance** instead of asking the customer to pay separately.



2. Essential Features of Set-Off

~~Statutory & Contractual Right~~

- The **right of set-off** is a **legal right** under banking laws and may also be agreed upon in **contracts**.

Reasonable Notice Required

- Banks must **inform the customer** before exercising the **set-off** unless automatic conditions apply.

No Agreement to Exclude Set-Off

- If a **bank-customer contract** specifically **excludes set-off**, the bank **cannot** apply it.

Mutual Debts Should Exist

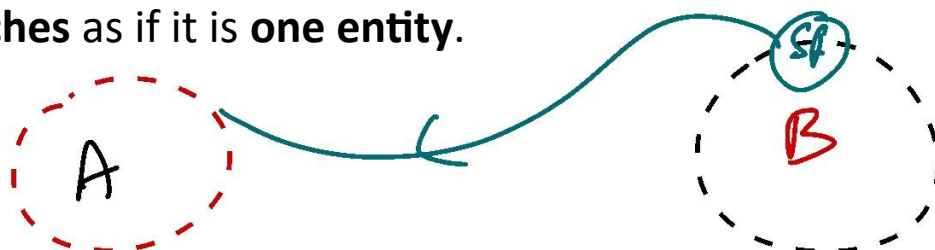
- The customer must owe the bank a **certain amount**, and the bank must hold a **credit balance** of the customer.

~~Only for Certain (Determined) Amounts~~

- Set-off cannot be applied to uncertain, contingent, or undetermined amounts.

All Branches Are Considered as One

- A bank can adjust the **balance of accounts** across its **branches** as if it is **one entity**.



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Only for Due & Recoverable Debts

- The debt must be due; the bank cannot apply set-off for future or contingent liabilities.

Cannot Apply on a Trust Account

- If the customer holds an account under trust, the bank cannot use that balance for set-off.

No Set-Off Between a Deceased's Credit Account & Customer's Debit Account

- The credit balance of a deceased cannot be adjusted against a living customer's loan dues.

Important

Automatic Set-Off Cases

In certain situations, the bank can apply set-off without notice, including:

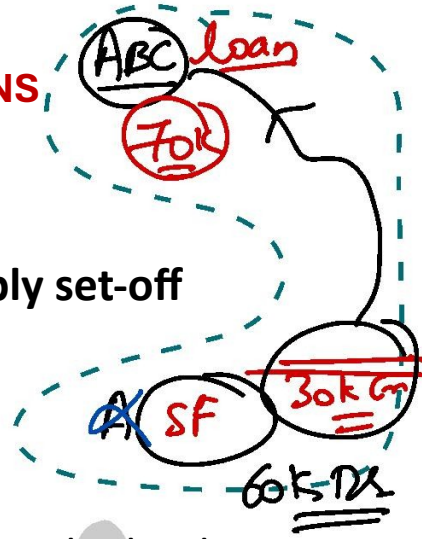
Death, insanity, or insolvency of the customer.

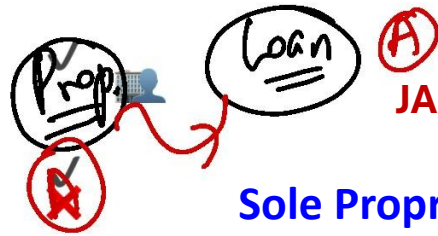
Insolvency of a partner or winding up of a company .

Receipt of a garnishee order (a court order to seize funds).

Notice of assignment of customer's credit balance.

Notice of secured mortgage over bank security.





Sole Proprietor's Business & Personal Accounts Can Be Combined

- If a person has **both a business and a personal account**, the bank can combine them for set-off.

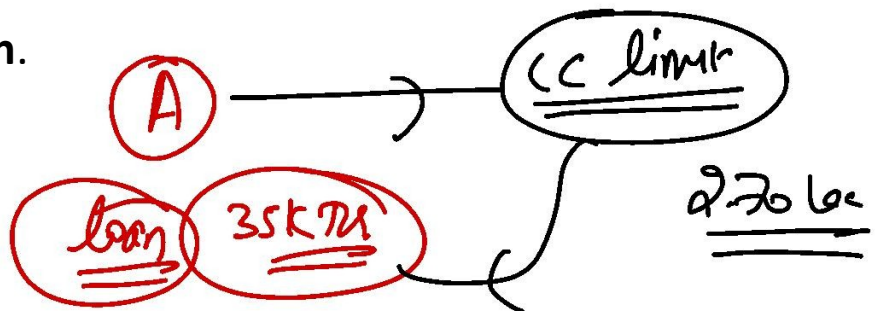
Customers Can't Demand Set-Off Across Bank Branches

- A customer **cannot insist** that their funds in one branch be used to clear overdrafts at another branch.
- **Example Case:** *Mohammed Hussein Saheb vs. Chartered Bank, Madras (1965)*

- The court ruled that a customer **cannot demand set-off** for their **Karachi branch deposit** to cover an overdraft at the **Madras branch**.

Set-Off Applies Only to Credit Balances

- The bank can only use the customer's available credit balance.
- It cannot apply set-off where the account has no funds or is overdrawn.





3. When Can the Right of Set-Off Be Applied?

When a Customer Has Both a Credit & Debit Account

- Example: If a customer has ₹60,000 in FD & ₹50,000 loan dues, the bank can adjust the loan from the FD balance.

For Overdrafts & Loan Defaults

- The bank can adjust a customer's savings balance if they default on an overdraft or loan.

Across Different Accounts of the Same Customer

- Example: If a person has both a savings account & a loan account, the bank can adjust dues automatically.

When the Bank Receives a Garnishee Order

- If the court orders the seizure of funds, the bank can set off balances to comply.

In Case of Customer's Death or Insolvency

- The bank can adjust credit balances against any dues left unpaid before final settlement.

4. When Can the Right of Set-Off NOT Be Applied?

On Undue & Future Debts

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- If a loan installment is due next month, the bank cannot set off funds today.

~~On Trust or Fiduciary Accounts~~

because of different capacity

- If money is held in trust, the bank cannot use it for set-off.

Between a Deceased's Credit Account & Customer's Loan

Account

- A bank cannot adjust funds from a deceased account against a living person's loan.

- The bank cannot adjust funds from Person A's account for Person B's loan (unless they are joint borrowers).

Between Different Branches (Customer's Choice)

- A customer cannot request that funds in one branch be used to pay an overdraft at another branch.

5. Examples of Set-Off in Action

Example 1: A customer has ₹1 lakh FD & ₹80,000 overdraft due. The bank can adjust ₹80,000 from the FD.

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Example 2: A businessman defaults on a loan, and he has a current account balance of ₹50,000. The bank can set off this balance against his loan dues.

Example 3: A sole proprietor has ₹30,000 in a business account & ₹25,000 in a personal account. The bank can combine both and set off any overdues.

Example 4: A customer forgets to pay EMI, but has a credit balance in another account. The bank can recover EMI from the available balance.

6. Right of Set-Off vs. Banker's Lien

Feature	Right of Set-Off	Banker's Lien
Definition	Adjusting credit balance against debit dues	Holding securities until debt is repaid
Legal Basis	Banking Law & Indian Contract Act	Section 171 of Indian Contract Act, 1872
Nature	Balances adjustment between accounts	Possession-based (Bank retains securities)
Right to Sell?	No	Yes, if there is default
Example	Adjusting savings balance against a loan	Holding FD as security for overdraft

7. Summary Table

Key Point	Explanation
Definition X	Adjusting a customer's credit balance against their outstanding dues
Legal Basis	Banking Law, Contracts
When Applicable?	Loans, overdrafts, unpaid EMIs
When Not Applicable?	Trust accounts, contingent debts, deceased accounts
Automatic Set-Off?	Yes, in case of death, insolvency, garnishee order

Limitation *Expire*

Final Takeaway:

Right of Set-Off allows banks to adjust credit balances against dues . It applies only to determined, recoverable debts and requires mutual rights between accounts . However, it cannot be used for trust accounts, future debts, or customer accounts at different branches .

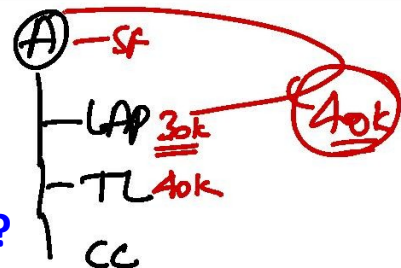
RIGHT OF APPROPRIATION

1. What is the Right of Appropriation?

Right of Appropriation refers to the **application of payments** made by a debtor when they have **multiple accounts or loans** with the bank .

If a customer deposits money without specifying where it

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should be adjusted, the bank can decide which loan or account to credit first .

Governed by Sections 59 to 61 of the Indian Contract Act,

✓ 1872 .

Example: A borrower has two loans – a personal loan (₹50,000 due) and a home loan (₹1 lakh due). If they deposit ₹30,000 without specifying which loan it should clear, the bank can apply it to either loan.

2. How Appropriation of Payments Works?

1 Appropriation by the Debtor (Customer)

- The debtor (customer) can specify which loan or account the deposit should be applied to .
- If the bank accepts, it must apply the payment accordingly .
- **Example:** A businessman with two loans makes a payment and specifies it for Loan A. The bank must use the amount for Loan A.



2 Appropriation by the Creditor (Bank)

- If the customer does not specify, the bank can decide where to apply the deposit.
- Usually, banks adjust the amount towards the oldest or high-interest loan first.
- Example: If a person deposits money without instructions, the bank can use it to clear an overdue loan first.

3 Appropriation by Law

- If neither the debtor nor the bank specifies where to apply the payment, it is adjusted in the order of time (oldest debt first).
- If multiple loans have the same tenure, the payment is distributed proportionately.

3. Key Legal Provisions Under the ICA, 1872

Section 59 – Appropriation by Debtor

- If a debtor makes a payment and specifies which debt it should be applied to, the bank must follow it.

Section 60 – Appropriation by Creditor



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- If the debtor **does not specify**, the **bank can decide** how to apply the payment .

Section 61 – Appropriation by Law



- If **neither party specifies**, the amount is **adjusted towards the oldest outstanding loan**.



4. Court Ruling on Right of Appropriation

Case: M/s Kharavela Industries Pvt. Ltd. Vs. Orissa State Financial Corporation (AIR 1985 Orissa 153 (A))

Issue:

- Whether a payment made by the debtor should be **adjusted towards principal or interest first** in the **absence of an agreement?**

Judgment:

Court held that **payments are applied to interest first**, then the principal, unless there is an agreement stating otherwise.

Impact:

- This ruling set a **precedent for loan repayments**, ensuring **banks recover interest first before reducing the principal** .

5. How Banks Use Right of Appropriation in Loan

✗ Repayments?

👤 Scenario 1: Customer Gives Instructions

- A customer **deposits ₹20,000** and instructs the bank to apply it to their **personal loan**.
- The **bank must follow the instruction** and cannot apply it elsewhere.

Scenario 2: No Instructions Given

- The bank **can apply the amount** to any **overdue or high-interest loan first**.

Scenario 3: Neither Party Specifies

- The payment is **applied to the oldest outstanding debt first**.

6. Order of Appropriation When No Instructions Are Given

Step 1: Adjust towards **overdue or high-interest loans first**.

Step 2: If multiple debts exist, apply it to **oldest outstanding debt**.

Step 3: If debts are of **equal standing**, distribute proportionately.

Step 4: Apply payments **towards interest first**, then principal.

Example:

- A businessman has **three loans**:
 - Loan A (₹50,000) – **Oldest Loan**
 - Loan B (₹80,000) – **High-interest Loan**
 - Loan C (₹20,000) – **Newest Loan**
- If he deposits **₹30,000 without instructions**, the bank may:

First **adjust it to Loan B (high-interest loan)**.

If no high-interest loan exists, adjust to **Loan A (oldest loan)**.

7. When Can Banks NOT Use the Right of Appropriation?

When the Customer Has Given Clear Instructions

- If the customer specifies **which loan the deposit should be used for**, the bank **must follow it**.

For Deposits Held in Trust

- If a trustee deposits money in an account, the bank cannot use it for personal liabilities.

When an Agreement Specifies Payment Rules

- If the loan agreement mentions a specific order, the bank must follow it.

8. Right of Appropriation vs. Right of Set-Off

Feature	Right of Appropriation	Right of Set-Off
Definition	Deciding which debt to apply a payment to	Adjusting credit balance against a debit balance
Who Decides?	Customer, Bank, or Law	Bank only
Legal Basis	Sections 59-61 of Indian Contract Act, 1872	Banking Law & Contracts
Scope	Multiple debts or accounts of a customer	Credit & debit balances of a customer
Example	Using a deposit to clear Loan A instead of Loan B	Adjusting savings balance against a loan due

9. Summary Table

Key Point	Explanation
Definition	The bank's right to decide how payments are applied to a customer's multiple debts
Legal Basis	Sections 59-61 of the Indian Contract Act, 1872
When Applicable?	Loan repayments, multiple accounts, customer deposits
When Not Applicable?	If the customer has given specific instructions
Order of Application?	Interest first, then principal (As per court ruling)
Court Precedent?	<i>Kharavela Industries Vs. Orissa State Financial Corporation</i> (1985)

Final Takeaway:

Right of Appropriation allows banks to **decide how to apply payments** towards a customer's **multiple loans or accounts** when **no specific instructions** are given . It is **legally governed** by **Sections 59-61** of the Indian Contract Act, **1872** . Courts have ruled that payments **must be adjusted** towards **interest first, then the principal** unless stated otherwise .