



## TECHNOLOGY

# Relationship-based pricing

Solution enables banks to pursue innovative approaches to manage customer relationships

By K Nanda Kumar, President & CEO, SunTec

Islamic banking is not new. In fact, it has been functioning in its modern institutional form for over 50 years. But, now there is an ever growing demand for Islamic financial services.

Debt and profit-and-loss sharing instruments are two common Islamic financial methods, while interest (riba) is forbidden. Globally, the flourishing Islamic banking and finance market is projected to be worth a whopping \$500 billion. In value terms, the Islamic finance sector is currently enjoying an estimated year-on-year growth of 20 per cent.

Hence, it comes as no surprise that almost all the top 10 financial institutions and banks in the world are looking at or have already embarked on Islamic banking in right earnest. Predominantly banks in Muslim majority countries have introduced niche Islamic banking

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to cater to this demand. Today, estimates say that more than 130 banks and financial institutions worldwide, managing close to \$90 billion, are practicing the principles of Islamic banking and finance.

In the absence of interest (riba) based income, fee (ujr) income becomes an important source of acceptable revenue for Islamic banking Institutions. Fee income in the form of transaction charges or ujr is realized from transactions like ATM, DD, SI, Brokerages, tele banking, etc. In addition to these charges other fees can be levied for various transactions or services for other Islamic products designed in conformance to shariah.

In short, the nucleus of Islamic banking is fee-based.

## Fee structures

With fee-based banking comes the inherent challenge of not only



setting up and maintaining shariah-compliant fee structures but making them transparent to the end customer. This is, as usual, easier said than done.

Islamic banking law is interpreted differently in different countries and sometimes, even within a country, depending on their individual shariah advisor and his interpretation of how a banking product can be offered to the consumer. Thus to set up fees, it is important to have a region-wise product definition. The same Islamic banking product could be viewed differently in two countries with a different fee structure associated with it.

A mention of some basic shariah principles of Islamic banking will help us better comprehend Islamic banking, namely, (i) profit and loss sharing, (ii) fees-based, (iii) free services, and (iv) ancillary principles.

In addition to the above, there could be as many as another 14 principles! A case in point is that of Islamic Bank of Bahrain and the Dubai Islamic Bank that have the least number of principles i.e. five. On the other side of the spectrum is

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State Bank of Pakistan, which is the central bank of Pakistan, and has twelve principles.

Islamic banks must abide by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards. It is mandatory to keep the standard accounting entries and booking methods of the transactions and the bank's income and investments according to these AAOIFI standards.

Another key aspect of Islamic deposit/investment transactions is the disbursement of returns to depositors based on the principle of profit and loss sharing. Depositors earn income on their investment based on the performance of their portfolio/s. Sometimes fees of maintaining an investment portfolio can depend on this income and loss. This kind of fee association is quite unique to the Islamic banking world. As the bank can charge service fees based on income/loss accumulation, a fee management platform needs to support this pooling of assets and liabilities.

Finally to add to the challenges, in Islamic Banking, the fee structures are



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also multiple as in a traditional fee banking business, fees are based on mark-up, commission and services.

Since the Islamic banking products are much more dynamic in definition and practiced 'differently' in multiple regions, it is very important to ensure proper recording and charging of transaction data. A solution that is rule-based which takes into consideration region-wise exceptions is the panacea.

### Centralized Relationship-based pricing and billing

A centralized Relationship-based

pricing (RBP) and billing solution in the perspective of Islamic banking is a system capable of identifying transactions from multiple platforms and then charging a fee/ujr based on pre-defined criterion in compliance with the principles of the Holy Koran. It is built on shariah rules and regulations and has embedded in it, the related information capturing features.

Through sophisticated rule-based pricing engines, RBP solutions can emulate the pricing and billing (fees/ujr) functions of any Islamic banking product. Pricing can be based

on multiple parameters. New product bundles and prices can be easily configured and deployed. Cross-selling becomes easier. The key features of RBP are pricing freedom and flexibility.

Relationship-based pricing and billing solution enables banks to pursue innovative approaches to manage customer relationships by providing a 360 degree view of its relationship with customers creating a win-win solution for both the bank and customers which in essence is the heart of Islamic banking. □

