

Brazil and Islamic Finance

By Alvaro Tair Jr. and Felipe A. Bitar

Brazil is the fifth-largest country in the world, with an area equivalent to almost one-half of the entire South American continent. It borders all South American countries except Chile and Ecuador. The country has a population of approximately 188 million and São Paulo is one of the fastest-growing cities in the world.



There is an increasing interest by the regulatory authorities, specifically CVM (the securities and exchange commission of Brazil), in accommodating Islamic finance products in legislation whenever possible.

The Brazilian economy is large by almost any standard and well-diversified. Brazil has gone through privatization of several state-owned companies in various strategic sectors, such as transport and telecommunication.

Entering the 21st century, Brazil participates actively as a regional and emerging global player, establishing several alliances, including being part of BRICs (fast-growing developing economies of Brazil, Russia, India and China) and a leader in Mercosul (trading zone among South American countries), with the objective of strengthening its political position and its economy.

With historic inflation under control, and benefiting from reduced interest rates and country risk, the Brazilian GDP was starting to show consistent growth rates prior to the current financial crisis and credit crunch.

Crisis and Opportunity

It is common sense that one of the main causes of the current crisis is the lack of confidence by investors and the general public in financial institutions, especially after the crash of sub-prime credit in the U.S., which ended up affecting all financial sectors around the world, causing the credit crunch and bankruptcy of American and European institutions.

We understand that the effect of the crisis for Islamic finance is expected to be more moderate, since its operations were not subject to accommodating local legislation or regulation, but to the Shari'ah, which is universal and inspired by principles that prohibit Riba (interests), Gharar (uncertainty) and Maisir (gambling).

In Brazil, due to rigid control rules and efficient risk management practices, the crisis has not so far affected the solidity of the domestic financial sector. The Brazilian Central Bank reports that Brazilian financial institutions have improved risk management tools and made progress in the two other pillars of sustainability, social and environmental.

If one of the pillars of sustainability of the after-crisis economy is the social aspect, and Islamic finance is based on principles of tolerance and social responsibility, the after-crisis period can provide good opportunities for growth and the possibility to strengthen this sector around the globe, especially in Brazil, where important steps have already been implemented. We expect that interest in Islamic finance products in Brazil could increase in the near future in comparison to that in conventional financial institution investments.

Brazil and the Islamic Market

The Nobel Prize winner in economics, Paul Krugman, has a positive opinion regarding the

current Brazilian economy. According to Krugman, even though the country is growing less than it could due to the crisis, recent economic achievements will place Brazil as a leader of emerging nations in the post-crisis scenario.

"Brazil is in a very interesting position, since it is the biggest emerging country, besides China and India. China and India have their specificities and it is difficult to put any of them both as a leader to the other emerging countries, because, in a certain way, they are too big to be part of the alliances. Then, it is Brazil that is going to be the leader of the developing countries," Krugman said, as reported by Brazilian newspaper Folha de São Paulo.

The consequences of this transformation can be linked to the Islamic market. Despite the fact that the Islamic finance market is new in Brazil, its principles certainly are not. Brazil has become among the big exporters of halal food. In February 2009, Brazil concluded an important partnership with the National Independent Halal Trust (NIHT) of South Africa, sending Brazilian technicians to Africa to demonstrate the Brazilian certification of halal products, which is one of the best in the world and is involved in an estimated market of 2 billion people, with revenues of around US\$150 billion in the food market alone. Since the beginning of the international crisis, which has caused a drop in Brazilian beef exports, Brazilian halal products are being an exception, conquering new markets, mainly in the Middle East. Most Brazilian products exported to the Middle East have consistently increased in volume in recent years.

This commercial trading growth can represent an excellent opportunity for Islamic financial prod-

Alvaro Tair Jr. is the Tax Partner at PricewaterhouseCoopers responsible for financial services industry tax in South America. He is also part of the PwC Global Islamic Finance Group. Tair has extensive experience working with financial institutions and investment managers to develop innovative fund and deal structures for foreign investors in the Brazilian financial market. Alvaro is also a professor of taxation on the financial market in the LLM program of IBMEC.

Felipe A. Bitar is a Tax Manager based in the São Paulo office of PricewaterhouseCoopers. He has over 10 years of experience in audit and tax advisory, specializing in the financial sector. He recently joined PwC's Global Islamic Finance Group in Brazil. His portfolio includes national and international financial institutions, asset managers, brokers and a stock exchange, among others.



The current situation is highly favorable to Islamic finance rising as a sustainable alternative in the global economy, while the Brazilian market appears to be a bright spot among emerging countries.

ucts in Brazil, since the fundamental principles apply and considering the relationship of quality/price and confidence between the countries involved.

Legal, Tax and Accounting Challenges

The increasing social responsibility of Brazilian companies shows that conquering new customers is directly related to business based on socially responsible principles, including providing products and services that do not offend the environment, promoting social inclusion and participating in the development of the community where the company is located.

These aspects are also consistent with Islamic principles in respect to commerce and financial operations, which take into consideration matters of social justice, equity, justice and practice.

As for Brazil, there is an increasing interest by the regulatory authorities, specifically CVM (the securities and exchange commission of Brazil), in accommodating Islamic finance products in legislation whenever possible, since they can represent an important inflow of external capital that is different from most foreign capital, which is usually

speculative and, consequently, more subject to crisis and threats.

Examples of this interest include the presentation of a proposal for Brazilian Sukuk by Vicente Rossetto of CVM at the 19th Asian-Pacific Conference on International Accounting Issues in Kuala Lumpur in 2007 and a conference on Islamic finance held by Bovespa (the Brazilian stock exchange) in December 2008 focusing on how to leverage Islamic finance in Brazil.

In addition to questions related to the regulation of the financial sector, one of the most relevant obstacles to the adoption of some Islamic finance products in Brazil is tax legislation. The rules may result in double taxation on some operations. This problem was stressed by the international PwC representatives at the Bovespa conference. The alterations made in British tax legislation to create a level playing field for Islamic finance is used as a good example of changes that the Brazilian authorities should make in order to leverage Islamic finance.

Some examples of the tax changes that should be implemented refer to the indirect taxes levied when Brazilian financial institutions are buying or selling tangible assets in order to finance them. British rules would understand that Islamic finance trading of a tangible asset should not mean higher taxation than normal financing. Brazil could adopt similar rules in looking for new investors in our market.

The Brazilian Central Bank rules should also be amended to accommodate Islamic finance, for example in reference to the limits imposed on financial institution in acquiring non-financial assets.

From the accounting point of view, the good news is that Brazilian companies are already facing the challenge of moving accountancy standards to a global level. A federal law enacted at the end of 2007 requires Brazilian companies to prepare their financial reports according to the International Financial Reporting Standards (IFRS), after a transition period.

Gaining Momentum

The current situation is highly favorable to Islamic finance rising as a sustainable alternative in the global economy, while the Brazilian market appears to be a bright spot among emerging countries. Since Brazilian tax and accounting systems are entering a transition period, Islamic finance can benefit from this movement.

It is true that certain regulatory changes are needed to fully accommodate Islamic financial instruments, but we are confident about the success of the already initiated synergy between Brazil and the Islamic world.