



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

Before the Commissioner (Securities Market Division)

**In the matter of Show Cause Notice dated 07.07.2005 issued to
Alfalah Securities (Pvt.) Limited**

Date of Hearing:

25 July 2005

Present at the hearing:

Representing Alfalah Securities (Pvt.) Ltd.:

- (i) Mr. Ijaz Ahmed
- (ii) Mr. Mohammad Shoib Memon

Legal Counsel
Chief Executive

Assisting the Commissioner (SM):

- (i) Mr. Imran Inayat Butt
- (ii) Mr. S. M. Aly Osman

Director (SM)
Joint Director (SE)

ORDER

1. The present matter arises out of a Show Cause Notice No. SMD/SE/2(45)02 dated 07 July 2005 issued by the Securities and Exchange Commission of Pakistan ("the Commission") to Alfalah Securities (Pvt.) Limited ("the Brokerage Company").
2. Brief facts of this case are that the Brokerage Company, in its "Morning Note" dated 11 January 2005 published the following statement under the heading "News Highlights":

“PTCL revenues to get inflated by potential reversal in APC revenues provisioning in 1QFY05 (Our Sources)

(Positive)

According to our sources in the company, PTCL’s revenues are likely to be inflated by about PKR 2 bn (PKR 0.39 per share) in its 2QFY05 results. This is due to (I) an addition of about PKR 800mn of the revenues related to Interconnect, which were not incorporated in 1QFY05 due to non-finalization of Interconnect draft rules. The Ministry of Telecom and IT has recently released rules for Access Promotion Contribution Fund (APC), which are acceptable from January 01, 2005. Therefore, any provisions, which were made by PTCL in this regard during 1QFY05, would be reversed. (II) PTCL is likely to book about PKR 1.2bn revenues under APC account during 2QFY05. Provisions for APC revenue and cost will be applicable from 2HFY05 while the Ministry still has to release the Service Fund rules for which it is still in search of an adviser. Therefore, we do not expect these rules to be applicable on PTCL during FY05. PTCL booked a net profit of PKR 6.282 mn (EPS:1.23) in 1QFY05. However, we are still in the process of revising our earning estimates. We believe that PTCL is likely to book profit after tax (PAT) within the range of PKR 8.16 – 8.6 bn....”

3. It was evident from a bare reading of the text of the said Morning Note that the Brokerage Company had obtained the information contained therein from a source placed inside PTCL.
4. It is further evident that the information was such as to materially affect the price of the shares of PTCL: on 11 January 2005 (the date on which the Morning Note was published) the price of shares of PTCL closed at the upper circuit breaker price of Rs. 53.30 per share reflecting an increase of Rs.3.79 (7.45%) per share from its closing price of Rs. 49.60 per share on the preceding day.

5. In order to ascertain the details of the trading activity of the Brokerage Company in the month of January 2005, the Commission sought the relevant data from the Karachi Stock Exchange (KSE). The information provided by the KSE is detailed as under:

	Purchase		Sale	
Date	Quantity	Rate (in Rs.)	Quantity	Rate (in Rs.)
04.01.05	-	-	750,000	45.18
10.01.05	-	-	130,000	48.38
11.01.05	240,500	52.60	240,500	52.90
14.01.05	100,000	52.10	110,000	51.71
17.01.05	-	-	210,000	53.04
18.01.05	-	-	200,000	52.71

6. This information clearly showed that during the period of 10th to 14th January 2005 (i.e. immediately prior to and after the publication of the Morning Note) the Brokerage Company had both bought and sold substantial shares of PTCL.
7. Accordingly the Commission issued a Show Cause Notice to the Brokerage Company on 07 July 2005 detailing the aforesaid facts and asking it as to why action should not be initiated against it under Sub-Section (3) and (4) of Section 15 B of the Securities & Exchange Ordinance 1969 (“the Ordinance”), Sub-Section (1) (d) of Section 7 of the Ordinance, Sub-Section (1) (c) of Section 22 of the Ordinance, Rule 8(ii) read with Rule 8(a) of the Brokers and Agents Registration Rules 2001, Rule 8(iv) read with Rule 8(a) of the Brokers and Agents Registration Rules 2001. The date of hearing was fixed for 18 July 2005.
8. At the request of the Legal Counsel of the Brokerage Company (“the Legal Counsel”) the date of hearing was extended to 25 July 2005. On that date the

Legal Counsel and Mr. Mohammad Shoib Memon, Chief Executive (“the Chief Executive”) of the Brokerage Company appeared before me and presented their case. They also submitted a written reply to the Show Cause Notice.

9. The main points raised by the Legal Counsel and the Chief Executive in their written reply and in the course of their presentation, were as follows:
 - (a) PTCL, in its accounts for the first quarter, of the financial year 2005, ended on 30 September 2004, had made a provision of Rs. 895 million. This provision had been necessitated by the telecom deregulation policy which required PTCL to make an Access Promotion Contribution (“APC”) to the Universal Service Fund in respect of all international incoming calls, from July 2004 onwards. The rationale of this provision was also explained in note 10 to the said quarterly accounts.
 - (b) The APC Rules were notified on 31 December 2004 and consequently PTCL did not have to pay APC Contributions to the Universal Service Fund for the first two quarters of the financial year 2005.
 - (c) The analyst of the Brokerage Company had forecasted the profits of PTCL based on the provisions of the APC Rules and the published account of PTCL. Therefore the information contained in the Morning Note was already publicly available.
10. On the basis of the aforesaid, the Legal Counsel requested that the Show Cause Notice may be withdrawn for the following reasons:
 - (a) The information contained in the Morning Note was based on information that was already publicly available. Accordingly the same was excluded from the purview of Section 15-A as is provided in clause (a) of the said Section.

- (b) The Brokerage Company has no relationship with PTCL that allows it access to any unpublished price sensitive information.
- (c) The Brokerage Company neither intended to nor made any gains from trading in PTCL for the reason that it has only undertaken transactions on behalf of its clients. None of the transactions undertaken by the Brokerage Company with other brokers show any gains and accordingly the penal provisions of Section 15-B are not attracted.
- (d) The price appreciation in the shares of PTCL was not as a result of the information contained in the Morning Note. PTCL shares hit the upper lock on January 10, 2005 and January 11, 2005. On both days the increase in price was on account of the news from the government with regard to positive developments for the privatization of PTCL. This has been noticed by a number of brokerage houses and the industry analysts. The Morning Note was issued at around 11:45 a.m by which time PTCL shares had already appreciated by approximately 7.5%.
- (e) The purchase transaction of 240,400 shares of PTCL undertaken by the Brokerage Company on January 11, 2005 was executed at 10:28 am at a rate of Rs. 52.60 per share. These shares were sold at 10:31 a.m at the rate of Rs. 52.90 per share. These transactions were undertaken on the instructions of Bank Alfalah Limited. The price at which the shares were purchased was already fairly close to the upper lock. The Morning Note was issued after these trades and therefore could not have possibly have affected the decision of the Brokerage Company to undertake this transaction. The transaction was also in the usual trade pattern of Bank Alfalah Limited.
- (f) The APC Rules were also posted on the website of the Ministry of Information Technology on January 11, 2005.

- (g) Another brokerage house had also released a daily on January 12, 2005 containing a similar analysis.
 - (h) All the trades undertaken by the Brokerage Company were on behalf of its Clients which are institutional investors. These transactions were undertaken by them in the ordinary course of their business and can in no manner be termed as having been influenced by the information contained in the Morning Note which in any event was public information.
 - (i) The Brokerage Company has not contravened Section 15-A of the Ordinance or the rules framed thereunder and accordingly no action is warranted under Section 7(1)d, Section 15-B or Section 22(1)(e) of the Ordinance or Rule 8 of the Brokers and Agents Registration Rules, 2001.
8. When asked as to why the Brokerage Company, in its Morning Note had used the phrase “our sources” and “according to our sources in the company”, the Legal Counsel was unable to give a satisfactory answer except for saying that these sentences might have been used by the Brokerage Company to “over emphasize or to make the Morning Note more credible”.
9. I have heard the views and contentions of the Brokerage Company at length and after carefully examining the record I find that the following issues arise out of this matter:
- (a) Was the Brokerage Company directly or indirectly in possession of certain information about PTCL which was not generally available?
 - (b) If yes, was this information of such a nature that had it been available it would have materially affected the price of the shares of PTCL?

- (c) Did the Brokerage Company directly or indirectly deal in the shares of PTCL?
- (d) Did the Brokerage Company cause any other person to deal in the shares of PTCL?
- (e) Has the Brokerage Company violated any provisions of the Ordinance or the Rules made thereunder as specified in the Show Cause Notice?

Each of these issues has been examined seriatim:

- (a) *Was the Brokerage Company directly or indirectly in possession of certain information about PTCL which was not generally available?*
10. The Brokerage Company has argued at length that the information contained in the Morning Note was based upon the published accounts of PTCL and the APC Rules and was therefore readily available to the public.
 11. A scrutiny of the contents of the Morning Note reveals that it refers to two things: one is the APC Rules and the other is reversal of provisioning of APC revenues. As far as the APC Rules are concerned, these had been notified by the Ministry of Information Technology and Telecommunication Division by SRO.1012 (1)/2004 dated 31 December 2004. I therefore tend to agree with the argument of the Legal Counsel that the information with regard to APC Rules as contained in the Morning Note was generally available to the public. The information pertaining to reversal of APC revenues is however a management decision and only the Board of Directors of PTCL can take such a decision. This suggests that the Brokerage Company had access to information that would only be available to an insider at PTCL.

12. This fact is further reinforced by the categorical statement made by the Brokerage Company at the very outset of the Morning Note that the information contained therein is “according to our sources in the company”.
 13. The Legal Counsel has stated that similar information was contained in dailies published by other companies. I have examined these dailies and have observed that while Morning Notes of various other brokerage companies such as KASB, AKD highlighted “privatization play” as the main news pertaining to PTCL, the Brokerage Company emphasized the inflated revenues of PTCL due inter alia to the reversal in the provisioning of APC revenues in addition to the issuance of APC Rules. I have also observed that while the Brokerage Company kept its rating “neutral” on the privatization matter, it rated its report on reversal of revenues provisioning as “Positive”.
 14. I am also not satisfied by the explanation given by the Legal Counsel that the reference by the Brokerage Company to “our sources in the Company” was merely by way of over emphasis or to make its story more credible”.
 15. On this issue therefore, I am of the considered view that in addition to the information about the annual accounts of PTCL and the APC Rules, the Brokerage Company had access to privileged information regarding the reversal of APC revenues which was not otherwise generally available. I am further of the view that the usage of such phrases as “according to our sources in the Company” and by giving a rating of “Positive” on its report about the reversal of revenues provisioning, the Brokerage Company has failed to act with due care, skill and diligence in the conduct of its business and has given misleading (in that it is overly positive) advice and information to its clients.
- (b) *If yes, was this information of such a nature that had it been available it would have materially affected the price of the shares of PTCL?*

16. Any information pertaining to an increase in revenues of any Company is likely to cause an increase in the price of shares of its shares. The Brokerage Company in its Morning Note clearly indicated a rise in the revenues of PTCL and the share price of PTCL increased from the low of Rs. 46.85 on 10 January 2005 to close at Rs. 49.60 on 10 January 2005 and Rs. 53.30 on 11 January 2005 i.e. an increase of Rs. 6.45 or 13.76%.
17. The fact that the price of shares of PTCL in fact rose on the very day that the Morning Note appeared clearly indicates that the additional information contained in the said Morning Note which was not already in the public domain (i.e. information pertaining to the reversal of revenues) was capable of and did materially affect the price of shares of PTCL.

(c) *Did the Brokerage Company directly or indirectly deal in the shares of PTCL?*

18. It is an admitted fact that the Brokerage Company entered into transactions of PTCL shares on behalf of its parent company (Bank Alfalah Limited) by buying 240,500 on 11 January 2005 at Rs. 52.60 and selling the same at Rs. 52.90 on the same day, thereby causing its parent company to make a profit of Rs. 72,150.00 (at the rate of Rs. 0.30 per share). By dealing in the shares of PTCL on behalf of its parent company, the Brokerage Company directly and indirectly dealt with the shares of PTCL. The fact that the transaction took place a very short while prior in time to the publication of the Morning Note is of no consequence because the information was clearly available with the Brokerage Company at the time the transaction took place.

(d) *Did the Brokerage Company cause any other person to deal in the shares of PTCL?*

19. The Brokerage Company admittedly issued its Morning Note to all its institutional clients on 11 January 2005. The increase in the trading volumes of

shares of PTCL on that date suggests that there may be a direct correlation between the information contained in the Morning Note and the trading volumes. It may therefore be reasonably concluded that the Brokerage Company caused other persons to deal in the shares of PTCL. This matter however requires further investigation and the Commission reserves its right to carry out such investigation at a later stage.

(e) *Has the Brokerage Company violated any provisions of the Ordinance or the Rules made thereunder as specified in the Show Cause Notice?*

20. It is evident from the facts detailed above that the Brokerage Company, acting upon insider, privileged information regarding the shares of PTCL dealt in shares of PTCL for and on behalf of its parent company (Bank Alfalah Limited) due to which the parent company made a profit of Rs. 72,150.00 (at the rate of Rs. 0.30 per share). Such trading on the part of the Brokerage Company is in gross and blatant violation of Section 15(A) of the Ordinance which clearly prohibits a person from directly or indirectly dealing in the shares of a listed company on the basis of information which is not generally available.

21. It may also be noted that the Code of Conduct for brokers as stipulated under the Brokers and Agents Registration Rules, 2001 (“the Rules”) provides inter alia that:

- (i) A broker shall maintain high standards of integrity, promptitude and fairness in the conduct of his business.
- (ii) A broker shall act with due skill, care and diligence in the conduct of all his business.

In dealing in the shares of PTCL on the basis of information which was not generally available and in using terminology in its Morning Note which is more than likely to raise client expectations of the performance of the shares of PTCL, the Brokerage Company has clearly failed to adhere to the prescribed Code of Conduct and has therefore acted in violation of Rule 8(iv) of the Rules.

22. Therefore in exercise of my powers under section 15B of the Ordinance, I hereby impose a fine in the sum of Rs. 72,150.00 which is the gain that has accrued to the parent company, Bank Alfalah Limited, due to the violation of section 15A of the Ordinance by the Brokerage Company.
23. The violation of the Rules as detailed hereinabove is a serious matter which entitles the Commission to suspend the license of the broker, however taking a lenient view of the situation, in exercise of my powers under Rule 8(b) of the Rules, I hereby impose a fine of Rs. 100,000.00 on the Brokerage Company for violation of the Brokers Code of Conduct read with Rule 8(iv) of the Rules.
24. The aggregate sum of Rs. 172,150.00 (Rupees One hundred and Seventy two thousand One hundred and fifty only) should be deposited with the Commission within fifteen (15) days of the date hereof.
25. This Order is issued without prejudice to any other action that the Commission may initiate against the Brokerage Company, its directors, officers or any other person on matters subsequently investigated or otherwise brought to the knowledge of the Commission.

(Shahid Ghaffar)
Commissioner (Securities Market)

Announced:
09 August 2005
Islamabad