

# Corporate Class Fund Conversion - FAQ (September 3, 2019)

**In response to our recent press release dated August 23, 2019 please find below some frequently asked questions and our answers.**

## **What is a Corporate Class fund (ETF)?**

Mutual funds in Canada (which includes ETFs) are typically set up using either a trust or corporate structure. First established in 1987, mutual fund corporations are structured similarly to traditional corporations. Under one corporate structure, many different investment fund mandates (series) can exist. In the case of ETFs, the different ETFs are all held within the corporate structure, where each ETF is a separate class or series.

Within a Canadian mutual fund corporation structure, only Canadian capital gains and dividends can be distributed to investors. From a tax perspective, any income and foreign dividends generated within any one series of the corporation can potentially be offset by losses and expenses incurred in other series (from a tax perspective), which generally makes the corporate class structure more tax-efficient than a traditional mutual fund trust.

According to Strategic Insight, more than \$157 billion is invested in corporate class mutual funds in Canada. It is a widely used structure used by advisors and end-investors primarily for taxable accounts.

## **How will the conversion happen?**

Horizons ETFs will merge all of the ETFs it offers that primarily use derivatives-based structures into a new mutual fund corporation; this would include all of the Horizons Total Return Index (TRI) ETFs and all of the BetaPro ETFs. The ETFs will all still be ETFs and have the same investment objectives, same tickers, and same fee structures, as they do currently. The primary difference is that each ETF will be a series within the corporate class structure as opposed to an individual trust, which will allow these ETFs to pool expenses and use realized losses of income and capital to offset realized gains of income and capital across all series.

## **Will the new Horizons ETFs Corporate Class products continue to use their derivative structures?**

Horizons is proposing to add 15 of our TRI ETFs into the corporate structure alongside four single commodity ETFs and 25 leveraged, inverse and inverse leveraged ETFs that make up our BetaPro ETF family. All of these ETFs use a synthetic derivative replication structure and no taxable distributions have ever been paid to end unitholders of these 44 ETFs. The ETFs are expected to maintain their current derivative-based structure and follow the same investment objectives as when they were mutual fund trusts. They are expected to keep the likelihood of a taxable distribution by the new mutual fund corporation extremely low.

## **What makes the TRI ETFs tax efficient?**

The synthetic derivatives structure of these ETFs, which utilize swap-agreements with major Canadian Schedule 1 Banks, are designed to reduce the likelihood of taxable distributions being paid to unitholders. Instead, the value of any income or dividends generated by the underlying index securities are generally reflected in the net-asset-value of the ETF (NAV). Under the new corporate structure, nothing about this arrangement will change. However the TRI ETFs will have the added benefit of being able to aggregate future realized income and capital losses and expenses to offset any potential realized income and capital gains that could result from the settlement or partial settlement of swap contracts.

## **How do these differ from other corporate class funds?**

The major difference between these ETFs and other corporate class funds is that these products will use a synthetic derivatives structure as the portfolio, whereas most other corporate class mandates in Canada utilize a traditional physical strategy, where they own the physical securities of a portfolio.

By using the synthetic derivatives structure, our ETFs will typically only realize income gains and losses from downsizing the derivative contracts and will continue to have additional performance advantages, which include low-tracking error relative to other physically replicated index strategies, as well as similar tax benefits to when they were in a trust structure, since these ETFs are not expected to make regular income distributions.



# Corporate Class Fund Conversion - FAQ

## **Why did Horizons ETFs decide to recommend the change to these ETFs structures?**

The 2019 Federal Budget released by the Department of Finance on March 19, 2019, and updated on July 30, 2019, proposed several changes to the taxation of Canadian mutual fund trusts and in particular the “allocation to redeemers” methodology used by many mutual funds and exchange-traded funds. The TRI and BetaPro ETFs had utilized the “allocation to redeemers” methodology to ensure the tax-efficiency of their strategy.

With the elimination of the “allocation to redeemers” methodology as it relates to income, there was an increased likelihood that the TRI and BetaPro ETFs would have to make distributions after the 2019 tax year. By reorganizing the TRI and BetaPro ETFs into a corporate fund structure, Horizons ETFs will no longer need to use the “allocation to redeemers” methodology or the related Capital Gains Refund Mechanism (CCRM).

In our view, the corporate structure provides ample flexibility to eliminate or significantly reduce the potential for taxable distributions being made in the circumstances where there is a requirement to pre-settle any of the underlying swaps in these ETFs.

There are also significant operational efficiencies that can be achieved through a corporate structure. For example, Horizons ETFs will only need to file one-tax return for the overarching mutual fund corporation. All expenses for the corporation can also be aggregated, alongside all gains and losses, which can create more structural tax efficiency.

The ETFs will also be able to streamline their ongoing reporting requirements and how they deal with the management of the swap structures and expenses associated with that process.

In our view these operational efficiencies should result in cost-advantages for the corporation, and by extension, unit holders of the ETFs.

## **Are there any concerns around the Federal Government or the Canadian Revenue Agency making additional changes that could impact this new structure?**

The government can always make legislative changes that impact any investment product structures. In the case of these corporate class ETFs, we believe the government would have to target the mechanics of the corporate class structure as a whole, which would effectively impact all \$157 billion+ of corporate class mutual assets.

The currently proposed legislation changes impact our ETFs ability to use the “allocation to redeemers” methodology, which meant the federal government was concerned with how certain unit holders were deducting the income allocated to them from the TRI and BetaPro ETFs.

This new structure will not use the “allocation to redeemers” methodology, and will provide ample, well-established, corporate tax mechanisms that can be used to continue the benefits of these ETF strategies.

## **Do I need to do anything to ensure my ETF holdings are continued into the new structure?**

If all of the necessary regulatory approvals are received and the reorganization is approved by unitholder vote, there will be an automatic merger of a unitholders’ current trust units into a new series of shares of the corporate structure that would have substantially the same attributes to the ETF trust they previously owned. The proposed corporate class reorganization is not expected to be a taxable event for unitholders of the ETFs, so long as those Canadian resident unitholders who currently own units of the affected ETFs in taxable accounts, subsequent to the reorganization, make a joint election with the proposed mutual fund corporation under Section 85 of the Income Tax Act, as part of the exchange from their existing trust units into shares of a series of the corporation. Horizons ETFs is establishing a process to provide assistance to unitholders and their custodians in taking the necessary steps to file the joint election, which will be free of charge.

## **If I am making a joint election with Horizons ETFs, will Horizons ETFs then have access to some of my personal information?**

Yes. The Canada Revenue Agency form that facilitates a Section 85 rollover, or deferral, of any gains an investor may realize in a taxable account as a result of this corporate action does contain confidential investor information. Since it is a joint election, Horizons ETFs will sign the form along with the investor, and both Horizons ETFs and the investor file their copy with the CRA. If you submit personal information to Horizons ETFs, Horizons ETFs and its service provider will use it solely for the purposes of providing information and services to you regarding this transaction and the tax filing(s). Your personal information will not be used to market any goods or services to you. Please see our Privacy Policy at [www.horizonsetfs.com/Privacy](http://www.horizonsetfs.com/Privacy).

## **Will there be a forced disposition of the units of these ETFs?**

The reorganization of the existing ETF units into a series of shares of the new ETF corporation does, from a tax perspective, constitute a deemed disposition of the units. However, where the units are held in a taxable account, the unitholder can make a joint election with the mutual fund corporation to defer such disposition, as previously indicated.

# Corporate Class Fund Conversion - FAQ

## **Will there be any retro-active taxation of the ETFs?**

We do not expect any tax liability to result from the built-up historical gains of any of the ETFs. The only way for a unitholder to incur a potential tax liability in this process would be to sell their units in the open market through the facilities of a stock exchange thereby realizing a capital gain or loss, or to not file a section 85 rollover documentation if they hold the units in a taxable account at the conversion/reorganization date.

## **Will there be any change in fees or costs to own these ETFs?**

Horizons ETFs does not anticipate changing the fee structure on any of these ETFs related to their reorganization, nor do we expect any additional costs for unitholders to own units of these ETFs. Horizons ETFs is covering all costs of the reorganization.

## **In what circumstances would these ETFs be expected to pay a distribution?**

While we don't expect these ETFs to pay any distributions, there is always the possibility that distributions could be required to be paid. However, we would expect their size and frequency to be much smaller than other types of physically replicated strategies. All distributions from a mutual fund corporation are in the form of Canadian capital gains and dividends.

## **Will there be a T-Class structure of these?**

No. There is no plan to create a T-class of these ETFs, since they are not expected to pay any taxable distributions, which negates most of the need to create a T-class structure at this time.

## **When will this change occur?**

If approved at unitholder meetings expected to begin early November, 2019, the conversion of the existing mutual fund trust structure into the proposed corporate structure should occur before the end of the 2019 calendar year.

## **What approvals are required?**

There are regulatory and unitholder approvals required to complete the proposed reorganization. Unitholders will be delivered materials by mail in the coming weeks, which will include how to vote. We fully expect to revive all necessary approvals in due course.

## **What if unitholders do not approve the transaction(s)?**

If unitholders do not approve the conversion, Horizons ETFs will need to examine a number of product structure alternatives on an ETF by ETF basis, including potentially terminating some of the affected ETFs. However, since the proposed changes are, in our view, clearly in the best interest of the investors, we have no reason to expect that the required approvals would not be forthcoming.

## **Will this be a taxable event for unitholders who are non-residents of Canada?**

This will vary from jurisdiction to jurisdiction, however, generally, the exchange of the existing ETF units for the corresponding series of shares of the ETF corporation will be deemed as a disposition for tax purposes.

Many jurisdictions, like Canada, have elections tax payers can make in order to defer the taxable event until they dispose of the series of shares of the new ETF corporation. Investors should consult the local tax advisor for guidance.

For U.S. residents, we understand that no such deferral is expected to be available..

## **Who should invest in these funds?**

The determination of whether or not an investor should invest in one of these ETFs should be made after careful consideration of the client's risk/return objectives. Investors should also always read the ETF's prospectus before investing. In the case of ETFs from the TRI product line-up, these typically generate optimal results when held in taxable, i.e. non-registered accounts where income and dividend distributions would be taxed as earned. That said, all of these ETFs are eligible for registered accounts, including RRSP, RRIAs and TFSAs.

## **What are the risks of investing in a corporate class fund?**

There are numerous risks associated with investing. Each of the individual ETFs have risk ratings associated with the inherent historical market risk of their respective investment objectives, and their prospectuses detail other risks associated with investing in them as well. However, in terms of risk associated with the corporate structure, we view there to be limited risk relative to traditional mutual fund trusts.

One key risk associated with a corporate structure relative to a traditional mutual fund trust is the fact that any income earned within the corporate structure cannot be distributed to end unitholders and is generally taxed at the corporate rate, which can be higher than an individual investor's marginal tax rate. However, since the new mutual fund corporation is not expected to have net taxable income, we believe this risk is not significant. Since the corporation is not expected to have net taxable income, we do not expect any of the ETFs to have distributions, similar to how they operate now.

# Corporate Class Fund Conversion - FAQ

## How can I invest in these funds?

All of these ETFs are TSX-listed ETFs and can be purchased or sold through an advisor or in your self-directed brokerage account.

ETF Name	Ticker	ETF Name	Ticker
Horizons S&P/TSX 60™ Index ETF	HXT	BetaPro Gold Bullion 2x Daily Bull ETF	HBU
Horizons S&P 500® Index ETF	HXS	BetaPro Gold Bullion -2x Daily Bear ETF	HBD
Horizons S&P 500 CAD Hedged Index ETF	HSB	BetaPro Crude Oil 2x Daily Bull ETF	HOU
Horizons S&P/TSX Capped Energy Index ETF	HXE	BetaPro Crude Oil -2x Daily Bear ETF	HOD
Horizons S&P/TSX Capped Financials Index ETF	HXF	BetaPro Natural Gas 2x Daily Bull ETF	HNU
Horizons Cdn Select Universe Bond ETF	HBB	BetaPro Natural Gas -2x Daily Bear ETF	HND
Horizons NASDAQ-100® Index ETF	HXQ	BetaPro Silver 2x Daily Bull ETF	HZU
Horizons EURO STOXX 50® Index ETF	HXX	BetaPro Silver -2x Daily Bear ETF	HZD
Horizons Cdn High Dividend Index ETF	HXH	BetaPro S&P/TSX 60™ 2x Daily Bull ETF	HXU
Horizons US 7-10 Year Treasury Bond ETF	HTB	BetaPro S&P/TSX 60™ -2x Daily Bear ETF	HXD
Horizons US 7-10 Year Treasury Bond CAD Hedged ETF	HTH	BetaPro S&P/TSX Capped Financials™ 2x Daily Bull ETF	HFU
Horizons Laddered Canadian Preferred Share Index ETF	HLPR	BetaPro S&P/TSX Capped Financials™ -2x Daily Bear ETF	HFD
Horizons Intl Developed Markets Equity Index ETF	HXDM	BetaPro S&P/TSX Capped Energy™ 2x Daily Bull ETF	HEU
Horizons Equal Weight Canada REIT Index ETF	HCRE	BetaPro S&P/TSX Capped Energy™ -2x Daily Bear ETF	HED
Horizons Equal Weight Canada Banks Index ETF	HEWB	BetaPro Canadian Gold Miners 2x Daily Bull ETF	HGU
Horizons Gold ETF	HUG	BetaPro Canadian Gold Miners -2x Daily Bear ETF	HGD
Horizons Silver ETF	HUZ	BetaPro Marijuana Companies 2x Daily Bull ETF	HMJU
Horizons Crude Oil ETF	HUC	BetaPro Marijuana Companies Inverse ETF	HMJI
Horizons Natural Gas ETF	HUN	BetaPro S&P/TSX 60™ Daily Inverse ETF	HIX
BetaPro NASDAQ-100® 2x Daily Bull ETF	HQU	BetaPro S&P 500® Daily Inverse ETF	HIU
BetaPro NASDAQ-100® -2x Daily Bear ETF	HQD	BetaPro S&P 500 VIX Short-Term Futures™ ETF	HUV
BetaPro S&P 500® 2x Daily Bull ETF	HSU		
BetaPro S&P 500® -2x Daily Bear ETF	HSD		

# Corporate Class Fund Conversion - FAQ

To learn more, please visit [www.HorizonsETFs.com](http://www.HorizonsETFs.com)



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The Horizons Exchange Traded Products include our BetaPro products (the "BetaPro Products"). The BetaPro Products are alternative mutual funds within the meaning of National Instrument 81-102 Investment Funds, and are permitted to use strategies generally prohibited by conventional mutual funds: the ability to invest more than 10% of their net asset value in securities of a single issuer, to employ leverage, and engage in short selling to a greater extent than is permitted in conventional mutual funds. While these strategies will only be used in accordance with the investment objectives and strategies of the BetaPro Products, during certain market conditions they may accelerate the risk that an investment in units of a BetaPro Product decreases in value. The BetaPro Products consist of our 2x Daily Bull and 2x Daily Bear ETFs ("2x Daily ETFs"), Inverse ETFs ("Inverse ETFs") and our BetaPro S&P 500 VIX Short-Term Futures™ ETF (the "VIX ETF"). Included in the 2x Daily ETFs and the Inverse ETFs are the BetaPro Marijuana Companies 2x Daily Bull ETF ("HMJU") and BetaPro Marijuana Companies Inverse ETF ("HMJI"), which track the North American MOC Marijuana Index (NTR) and North American MOC Marijuana Index (TR), respectively. The 2x Daily ETFs and certain other BetaPro Products use leveraged investment techniques that can magnify gains and losses and may result in greater volatility of returns. These BetaPro Products are subject to leverage risk and may be subject to aggressive investment risk and price volatility risk, among other risks, which are described in their respective prospectuses. Each 2x Daily ETF seeks a return, before fees and expenses, that is either 200% or -200% of the performance of a specified underlying index, commodity futures index or benchmark (the "Target") for a single day. Each Inverse ETF seeks a return that is -100% of the performance of its Target. Due to the compounding of daily returns a 2x Daily ETF's or Inverse ETF's returns over periods other than one day will likely differ in amount and, particularly in the case of the 2x Daily ETFs, possibly direction from the performance of their respective Target(s) for the same period. Hedging costs charged to BetaPro Products reduce the value of the forward price payable to that ETF. Due to the high cost of borrowing the securities of marijuana companies in particular, the hedging costs charged to HMJI are expected to be material and are expected to materially reduce the returns of HMJI to unitholders and materially impair the ability of HMJI to meet its investment objectives. Currently, the manager expects the hedging costs to be charged to HMJI and borne by unitholders will be between 15.00% and 35.00% per annum of the aggregate notional exposure of HMJI's forward documents. The hedging costs may increase above this range. The manager will publish, on its website, the updated monthly fixed hedging cost for HMJI for the upcoming month as negotiated with the counterparty to the forward documents, based on the then current market conditions. The VIX ETF, which is a 1x ETF, as described in the prospectus, is a speculative investment tool that is not a conventional investment. The VIX ETF's Target is highly volatile. As a result, the VIX ETF is not intended as a stand-alone long-term investment. Historically, the VIX ETF's Target has tended to revert to a historical mean. As a result, the performance of the VIX ETF's Target is expected to be negative over the longer term and neither the VIX ETF nor its target is expected to have positive long-term performance. **Investors should monitor their holdings in BetaPro Products and their performance at least as frequently as daily to ensure such investment(s) remain consistent with their investment strategies.**

Certain statements may constitute a forward-looking statement, including those identified by the expression "expect" and similar expressions (including grammatical variations thereof). The forward-looking statements are not historical facts but reflect the author's current expectations regarding future results or events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. These and other factors should be considered carefully and readers should not place undue reliance on such forward looking statements. These forward-looking statements are made as of the date hereof and the authors do not undertake to update any forward-looking statement that is contained herein, whether as a result of new information, future events or otherwise, unless required by applicable law.