AMENDED THIS 05-DEC-2024 PURSUANT TO
MODIFIÉ CONFORMÉMENT À

☐ RULE/LA RÈGLE 26.02 (________)

☑ THE ORDER OF JUSTICE GLUSTEIN
L'ORDONNANCE DU
DATED/FAIT LE 4-DEC-2024

C. RAHMAN Digitally signed by C. RAHMAN Date: 2024.12.11 15:10:02 -05'00'

REGISTRAR GREFFIER
SUPERIOR COURT OF JUSTICE COUR SUPÉRIEURE DE JUSTICE

Court File No. CV-18-00597284-00CP

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

GRAHAM WRIGHT

Plaintiff

and

GLOBAL X INVESTMENTS CANADA INC. (FORMERLY HORIZONS ETFS MANAGEMENT (CANADA) INC.)

Defendant

Proceeding under the *Class Proceedings Act, 1992*

FRESH AS AMENDED STATEMENT OF CLAIM

TO THE DEFENDANT(S):

A LEGAL PROCEEDING HAS BEEN COMMENCED AGAINST YOU by the Plaintiff. The Claim made against you is set out in the following pages.

IF YOU WISH TO DEFEND THIS PROCEEDING, you or an Ontario lawyer acting for you must prepare a Statement of Defence in Form 18A prescribed by the *Rules of Civil Procedure*, serve it on the Plaintiff's lawyer or, where the Plaintiff does not have a lawyer, serve it on the Plaintiff, and file it, with proof of service, in this court office, WITHIN TWENTY DAYS after this Statement of Claim is served on you, if you are served in Ontario.

If you are served in another province or territory of Canada or in the United States of America, the period for serving and filing your Statement of Defence is forty days. If you are served outside Canada and the United States of America, the period is sixty days.

Instead of serving and filing a Statement of Defence, you may serve and file a Notice of Intent to Defend in Form 18B prescribed by the *Rules of Civil Procedure*. This will entitle you to ten more days within which to serve and file your Statement of Defence.

IF YOU FAIL TO DEFEND THIS PROCEEDING, JUDGMENT MAY BE GIVEN AGAINST YOU IN YOUR ABSENCE AND WITHOUT FURTHER NOTICE TO YOU. IF YOU WISH TO DEFEND THIS PROCEEDING BUT ARE UNABLE TO PAY LEGAL FEES,

LEGAL AID MAY BE AVAILABLE TO YOU BY CONTACTING A LOCAL LEGAL AID OFFICE.

IF YOU PAY THE PLAINTIFF'S CLAIM, and $0 for costs, within the time for serving and filing your Statement of Defence, you may move to have this proceeding dismissed by the Court. If you believe the amount claimed for costs is excessive, you may pay the Plaintiff's claim and $0 for costs and have the costs assessed by the Court.

TAKE NOTICE: THIS ACTION WILL AUTOMATICALLY BE DISMISSED if it has not been set down for trial or terminated by any means within five years after the action was commenced unless otherwise ordered by the court.

Date May 4, 2018

Issued by "Registrar"
Local Registrar

Address of
court office: 393 University Avenue, 10th Floor
Toronto, Ontario
M5G 1E6

TO: GLOBAL X INVESTMENTS CANADA INC.
(formerly Horizons ETFs Management (Canada) Inc.)
55 University Avenue, Suite 800
Toronto, ON M5J 2H7

CLAIM

1. The Plaintiff claims on behalf of himself and on behalf of each of the Class Members (capitalized terms are defined in the definitions/glossary at Schedule "A"):

a) a declaration that the Defendant was negligent:

   i. by developing, promoting and selling to the public an improvident investment fund (HVI) that was unsuitable for its customers;

   ii. by failing to make disclosure of the material facts concerning HVI, including its risks and rewards; and

   iii. in failing to diligently perform its duties as manager of HVI;

b) general damages in the amount of $45,000,000 or such other sum as this Honourable Court may find appropriate;

c) damages for loss of investment opportunity in an amount to be determined;

d) punitive, aggravated and exemplary damages in the amount of $5,000,000;

e) an accounting of all fees or commissions paid to or received by the Defendant in relation to HVI;

f) disgorgement of all fees or commissions paid to or received by the Defendant in relation to HVI;

g) an interim and permanent Order prohibiting the Defendant from seeking or obtaining indemnity or reimbursement from the assets of HVI in respect of monetary relief paid or payable to the Plaintiff and the other Class Members in this action or its costs and expenses of this action;

h) prejudgment interest in accordance with section 128 of the *CJA*;

i) postjudgment interest in accordance with section 129 of the *CJA*;

j) an Order directing a reference or such other directions as may be necessary to determine issues not determined at the trial of the common issues;

k) costs of this proceeding on a substantial indemnity basis plus, pursuant to section 26(9) of the *CPA*, the costs of notice and of administering the plan of distribution of the recovery in this action plus all applicable taxes; and

l) such further and other Relief as to this Honourable Court may seem just.

Nature of the Action

2. This claim is brought by the representative Plaintiff, Graham Wright, a retail investor. Wright and the other Class Members suffered substantial losses by trading in an improvident investment product offered by Horizons, a registered investment fund manager and a significant participant in the Canadian exchange traded funds business. The investment fund in question was BetaPro S&P 500 VIX Short-Term Futures Daily Inverse ETF (HVI), which traded on the TSX.

3. HVI was marketed as an investment product that would provide inverse exposure to stock market volatility as measured by the VIX Index published by the CBOE Options Exchange.

4. An inverse volatility ETF represents a short-volatility trading strategy, by which the ETF collects the so-called “volatility premium” that is characteristic of the term structure of VIX futures contracts, by selling (shorting) VIX futures contracts in accordance with the ratio in the Underlying Index.

5. The trading strategies built around shorting VIX futures contracts carry with them extreme risks. Like selling insurance, the collection of premiums is profitable until the insured event occurs, in which case the payout can be very costly.

6. Until recently the VIX futures market was the exclusive domain of sophisticated hedge fund managers and the trading desks of large financial institutions with the expertise and resources to manage the risk. However, a small number of North American ETF providers began offering access to the VIX futures market to retail investors through leveraged and inverse ETFs.

7. In 2018 when HVI collapsed, Horizons was the only ETF issuer in the Canadian market that offered leveraged and inverse ETFs. This form of product "innovation" is far removed from traditional ETFs that provide investors with low-cost access to broad based equity or bond indexes. The introduction of leveraged and inverse ETFs to the Canadian market was a cause of some alarm amongst investor advocacy groups and certain regulators. In both Canada and the U.S., market leaders in the ETF industry opted *not* to offer leveraged and inverse ETFs to their customers due to their complexity and unusual risk/return characteristics.

8. HVI was part of Horizons' BetaPro catalogue of next generation leveraged and inverse ETFs. Until 2015, the BetaPro ETFs were managed by ProShares, a U.S. ETF manufacturer who acted as a portfolio manager for Horizons. Horizons made a business decision to offer a "suite" of volatility ETFs to its Canadian customers: a 1*x* volatility ETF (HUV), a 2*x* volatility ETF (HVU) and a 1*x* inverse volatility ETF (HVI).

9. For HVI, Horizons simply invested its customers' funds in shares of the ProShares inverse volatility ETF, SVXY. It used a forward agreement structure with its preferred counterparty, National Bank, pursuant to which it disclosed the forward agreement but not the underlying portfolio holdings. It also created a Reference Index based on the price of SVXY at 4:00 p.m., which it posted on Bloomberg at the end of the day. Horizons never disclosed what its index was based on. In its marketing materials it referred to it as a custom index.

10. Horizons' target market for HVI was self-directed retail investors. This was partly out of necessity as Canadian investment dealers introduced restrictions on their advisors trading leveraged and inverse ETFs for their clients. Horizons marketed HVI to its customers through social media with links to content on its website.

11. Horizons had no prior experience with the volatility trading strategies that it was promoting. Horizons cultivated the image of being an industry innovator with the expertise to develop and manage complex inverse volatility ETFs and with the trading experience to advise as to their use as "investment tools". However, Horizons relied entirely on ProShares to have conducted proper product due diligence before launching SVXY and to manage SVXY in accordance with its investment objective. Horizons only learned about the idiosyncrasies of its volatility ETFs at the same time as its customers.

12. In fact, HVI was a flawed product. The inherent and unreasonable risks of shorting volatility were exacerbated in an ETF structure, which required mechanical daily rebalancing of SVXY's short exposure to the Underlying Index at 4:15 p.m., necessitating late day trading in VIX

futures contracts, and crystallizing any daily gains or losses. Horizons did not fully understand all the risks that it was unnecessarily exposing its customers to.

13. Horizons promoted HVI in late 2017, following an unprecedented period of low market volatility, as Canada's best performing ETF. Horizons knew (or should have known) that not only was the low volatility environment unlikely to last, but additional risks had developed in the volatility market due to the massive influx of assets into short volatility funds all chasing the same volatility premium. A sudden reversal in fortune for short volatility funds was probable.

14. Only a few months later HVI was effectively eliminated in a single day on February 5, 2018. Volatility surged after a 4.1% decline in the S&P 500 following a positive jobs report in the U.S., which fuelled fears of inflation and higher interest rates. This was hardly a catastrophic event to trigger market panic, but the fickleness of volatility combined with the fact that the VIX Index had been languishing at historic lows was such that short-volatility funds like HVI were vulnerable to a catastrophic loss.

15. HVI unitholders were shocked and confused by the performance of HVI on February 5, 2018. Amongst various confounding factors, the majority of HVI's losses were realized after the TSX closed on February 5, 2018. The market price of HVI on the TSX declined by approximately 29% notwithstanding that the VIX had increased by 115%. Anyone who bought on February 5, 2018, believing that HVI had priced in the movement in the VIX was gravely mistaken. When HVI opened at 1:45 p.m. (after a trading halt) on February 6, 2018, it was down 88% since its close on February 2, 2018.

16. Horizons customers did not understand how HVI could lose value after the TSX was closed and its NAV had been struck, during which time they had no opportunity to mitigate their losses.

17. HVI's losses on February 5, 2018, were crystallized through SVXY's rebalancing of its portfolio holdings. The magnitude of the losses was such that it was mathematically impossible for HVI to recover, even as the VIX Index receded from the levels it reached on February 5, 2018, and VIX futures prices stabilized.

18. On April 10, 2018, Horizons announced that it was terminating HVI. Horizons claimed that since February of that year the pricing of VIX Futures Contracts had been "*very irrational and erratic*", which in its view "*significantly changed the profile of [HVI] to be far too high for Canadian investors*". Horizons stated that after "reassessing" the performance of HVI during the first week of February, it had concluded that they did not offer an "*acceptable risk/reward trade-off*" for investors.

19. Unfortunately for its customers, Horizons recognition of the risks came too late. Horizons fell well short of meeting its duty of care to Class Members in offering and promoting HVI and its negligence caused them to lose approximately $45 million in a single day.

The Parties

20. The Plaintiff is an individual residing in Toronto, Ontario. He is a retail investor who, until he lost the majority of his investing capital on February 5, 2018, actively bought and sold investments through a self-directed brokerage account.

21. The Plaintiff is the representative of the Class, who owned Units of HVI at the close of the markets on February 5, 2018. The Plaintiff owned 17,500 Units at the close of the markets on February 5, 2018. He bought those Units at an average price of $15.72 for a total price of $275,125. Wright purchased the majority of his Units between 2:30 p.m. and 3:00 p.m. on February 5, 2018. Wright experienced net losses on February 5, 2018 of approximately $225,000.

22. Horizons is a company incorporated under the laws of Canada. On May 1, 2024, Horizons changed its name to Global X Investments Inc. Horizons is the manager, investment manager, promoter and trustee of HVI. Horizons describes itself and its subsidiaries as an innovative financial services organization distributing the Horizons family of leveraged, inverse and actively managed ETFs. Horizons is a subsidiary of Mirae Asset Global Investments Co., Ltd., which is part of the Mirae Asset Financial Group, which the Prospectus describes as one of the world's largest investment managers in emerging market equities.

23. As the registered investment fund manager of HVI, Horizons had the responsibility and authority to manage and direct the business and affairs of HVI, including making all decisions regarding the business and affairs of HVI.

24. As the registered investment manager and portfolio manager of HVI, Horizons was required to provide investment advisory and portfolio management services to HVI.

25. As promoter of HVI, Horizons founded and organized HVI on or about April 3, 2012.

26. Horizons is also the trustee of HVI pursuant to the Trust Declaration.

Background to Volatility ETFs

27. HVI was an open-ended mutual fund trust established under the laws of Ontario. It was subject to *National Instrument 81-102 – Investment Funds*. It was also a commodity pool subject to *National Instrument 81-104 – Commodity Pools*.

28. HVI was an ETF and its Units traded on the TSX under the ticker symbol HVI. Securities of HVI were made available by Horizons to one Designated Broker: National Bank Financial Inc. (NBF), and three Dealers: NBF, CIBC World Markets Inc. and Société Générale Capital Canada Inc. The Designated Broker and the Dealers were the only entities that could purchase units of HVI directly from Horizons. Individual investors could only purchase units of HVI on the TSX through a brokerage account with a registered securities dealer. They could not purchase units of HVI from Horizons directly.

29. According to the Prospectus, HVI was designed to provide daily investment results that corresponded to the single inverse (opposite) of the daily performance of the S&P 500 VIX Short-Term Futures Index. Understanding the investment objective of HVI required significant specialised knowledge about stock market volatility, the S&P 500 index, the VIX Index, VIX Futures Contracts, the VIX Short-Term Futures Index, and concept of index shorting.

30. Since 1993 the CBOE has calculated and published the VIX Index, a proprietary measurement of implied expected volatility over a 30-day period of the S&P 500, a weighted index of 500 large-cap U.S. operating companies and real estate investment trusts selected by the U.S. Index Committee.

31. The VIX Index is based on the calculated implied volatility given the prices of 30-day near-term options on the S&P 500. The VIX Index is often referred to in the investment industry as the "fear gauge" of the U.S. equities market. The implied level of volatility of the S&P 500 typically increases during periods of market instability as buyers of options are prepared to pay a premium to offset rising risk and sellers require extra compensation for selling risk mitigation exposure, increasing the level of the VIX Index. While the VIX was considered a useful measure of market volatility, it was not originally created as an "asset class" to be traded.

32. To understand the risk/return characteristics of HVI required an understanding of the VIX futures market. This is an institutional market. There are significant barriers to entry for retail investors, including margin requirements, the cost of the contracts, which are traded in bundles with theoretical unlimited liability, and regulatory and industry restrictions for investor protection aimed at protecting the capital of the dealers executing the trades.

33. Even amongst institutional investors, volatility trading strategies are rare. Horizons' portfolio managers had no experience with volatility trading strategies. In turn, Horizons knew that its customers would have no experience with volatility contingent strategies or trading VIX Futures Contracts.

34. Indices were developed by index manufacturers which tracked VIX Futures Contracts over different time periods. In December 2008 S&P Dow Jones Indices LLC developed the S&P 500 VIX Short-Term Futures Index, the Underlying Index for HVI, with the Bloomberg ticker SPVXSP, which tracks the performance of the two nearest months VIX Futures Contracts i.e.

contracts with the earliest expiration dates, calculated on a rolling basis to maintain an average 30-day forward exposure.

35. Horizons also claimed to have created a custom index to track a one times inverse exposure to SPVXSP: the "Horizons Short VIX Short-Term Futures Index", which was supposedly the Reference Index for HVI. Horizons caused this to be published by Bloomberg at the close of each trading day under the ticker CMDYVXER. Through its disclosure and marketing material, Horizons represented that it provided inverse exposure to SPVXSP by shorting the two near-term VIX Futures Contracts in the same proportion as the Underlying Index. Horizons even included the "HVI Roll Calendar" on its website and in other disclosure, so that its customers could track the two VIX Futures Contracts and calculate their value.

HVI was an investment in another ETF

36. Horizons never caused HVI to short VIX Futures Contracts. Instead, it agreed with its preferred counterparty – National Bank – to provide the exposure for HVI through a forward agreement by purchasing shares of SVXY, a U.S. ETF offered by ProShares with the same investment objective. HVI's custom index was in fact the daily price of SVXY at approximately 4 p.m., when the stock markets closed. This was not an index at all, but the price of a single ETF stock. It was misleading to call it the "Horizons Short VIX Short-Term Futures Index".

37. Horizons relied entirely on ProShares to meet its stated investment objective for SVXY. Horizons simply passed on the returns of SVXY, minus fees and costs, to the unitholders of HVI. In 2015, Horizons took over as portfolio manager from ProShares. Horizons had no oversight of

ProShares whatsoever beyond what it disclosed publicly. It did not have access to the SVXY valuation methodology or the daily iNAV calculations that ProShares gave to its market makers.

38. HVI was simply an investor in SVXY. It abdicated the portfolio manager function of HVI, a legal requirement for an ETF, to a third-party manager with whom it had no agreement during the material time. HVI charged higher fees than SVXY, which were charged to HVI investors. National Bank was not prepared to provide inverse exposure to the SPVXSP index by shorting VIX Futures Contracts directly due to the high risk involved.

39. Ultimately HVI received the returns National Bank received from a portfolio of SVXY shares, which SVXY generated by shorting VIX Futures Contracts in accordance with the proportions of the S&P 500 VIX Short-Term Futures Inverse Daily Index (unlike HVI, SVXY disclosed its portfolio holdings).

40. Horizons never disclosed that HVI was simply an investment in a ProShares ETF. While Horizons disclosed that it would endeavour to meet the investment objective for HVI using forward contracts, it never disclosed the underlying portfolio holdings or “hedge” utilized by National Bank: shares of SVXY. Instead, Horizons reported the portfolio holding for HVI as comprising Forward Contracts with a “net notional exposure”.

Shorting Volatility – Don’t Try this at Home

41. The concept of shorting volatility has been employed by the derivatives trading desks of sophisticated and well capitalized financial institutions in the form of “selling index volatility” or “index shorting”. These are income strategies, known as “risk-premium harvesting”, and are

analogous to selling insurance. Income is generated by selling exposure to the Underlying Index in exchange for an (unknown) rate of return. Historically, the yield curve for the VIX Futures Contracts in the Underlying Index had been in a condition of contango (i.e. an upward sloping curve) most of the time, with the more distant contracts trading at higher prices than the nearer term contracts.

42. When the VIX futures yield curve was in contango, SVXY would generate “roll yield” as the fund rebalanced daily and SVXY sold the more distant term VIX Futures Contracts at a price higher than the nearer term VIX Futures Contracts that it was buying. A significant difference between SVXY compared to institutional trading desks is that SVXY shorted volatility mechanically by rebalancing its VIX futures exposure every day at approximately 4:15 p.m.

43. While SVXY collected “roll yield”, its exposure from shorting VIX Futures Contracts created theoretical unlimited risk, which could manifest itself rapidly in the event of an unexpected market shock. The risks of “index shorting” applied to volatility have increased significantly due to the rapid growth of algorithmic trading, which exacerbates the market’s reaction to news events. Consequently, only the most sophisticated hedge funds, which constantly monitor market news and stock market behaviour, have sufficient expertise and financial capital to dynamically manage the underlying risk of this strategy on a continuous intra-day basis.

44. Retail investors are unequipped to fully appreciate, let alone manage, the almost instantaneous catastrophic risk exposures associated with “index shorting” expressed through HVI.

HVI was a Flawed Product

45. The replication of an index shorting volatility strategy in an ETF structure added additional layers of complexity and created unique problems and risks that would not be faced by institutional traders trading VIX Futures Contracts directly.

a) Daily Rebalancing

46. A defining feature that HVI shared with other leveraged and inverse ETFs, by virtue of its investment in SVXY, was the daily mechanical rebalancing of its exposure. This resulted in gains or losses being crystallized daily. Due to the compounding of returns, rebalancing ETFs cannot be assured of meeting their stated investment objective if held for longer than a single day (hence the inclusion of "Daily" in the names of HVU and HVI). The effect of compounding on ETFs that rebalance daily is highly complex. The Prospectus and other prescribed Horizons disclosures are replete with warnings, in bold, that "**HVI does not seek to achieve its stated investment objective over a period of time greater than one day**".

47. The ETF Facts for HVI stated, in bold, that it is "**intended for use in daily or short-term trading strategies by sophisticated investors**".

48. When leveraged and inverse ETFs were introduced into Canada by Horizons, the Canadian Foundation for Investor Rights ("**FAIR**") expressed concerns about inverse ETFs (offered by Horizons) delivering the opposite expected returns due to compounding of daily returns from rebalancing.

49. Similarly, since 2009, the Canadian Investment Regulatory Organization ("**CIRO**") and its predecessors expressed concerns about the suitability of leveraged and inverse ETFs, suggesting that such products should not be permitted to be traded by investment dealers on behalf of their clients at all, or should be limited to a specific sub-class of clients. Most investment dealers took these warnings seriously and imposed internal restrictions on clients trading these products.

50. Market leaders in ETFs eschewed offering leveraged and inverse ETFs altogether.

51. Horizons eventually became aware that its customers were confused by the strange behaviour of its volatility ETFs and acknowledged that the implications of the daily reset could be very confusing.

b) Shorting Volatility is Not a Daily or Short-Term Strategy

52. HVI was designed to only perform reliably in relation to its investment objective for a single day, yet a short volatility trading strategy was inherently a longer-term strategy. While a Horizons customers *could* trade HVI intraday, the potential daily gains were very small compared to the downside risk.

c) Crystallization of Losses

53. While small daily losses (or gains) would result in HVI not tracking the inverse of the SPVXSP very well due to the compounding of returns, in the case of a significant daily loss, the rebalancing impairs the ability of the fund to recover the loss. In that scenario the ETF has a smaller asset base from which to generate the expected "roll-yield" (assuming the VIX futures market is in contango), resulting in lower absolute returns. However, this nuance is lost on most retail

investors, whose experience with conventional ETFs is that they track their underlying index, so if the index declines and then recovers, so does the ETF. That does not happen with leveraged and inverse ETFs.

54. As discussed further below, the losses incurred by HVI on February 5, 2018, could not be recovered, even though the VIX receded and VIX futures prices dropped from their February 5, 2018 highs. This meant that in one day, HVI was effectively eliminated.

d) Vulnerability to the VIX futures market

55. An additional problem for HVI is that trading of the two near-term VIX futures that comprise the SPVXSP does not always correlate well with trading over North American stock exchanges, a problem exacerbated by the earlier close of the stock markets at 4:00 p.m. At the relevant time, the daily market for VIX futures closed at 4:15 p.m., and the SPVXSP price was set based on the settlement of the VIX futures at 4:15 p.m.

56. Due to a lack of active arbitrage between the spot price of the VIX and VIX futures, it is difficult to predict if or when changes in the VIX Index will be reflected in the price of VIX futures. However, it had become apparent before February 2018 that there could be a lag between movement in the VIX and price movement in VIX futures. Also, a significant volume of two near-term VIX futures were traded in the last five minutes before 4:15 p.m. This was caused in part by the growth in volatility ETFs and ETNs, which all needed to rebalance their VIX futures exposure to match their NAV as close as possible to 4:15 p.m. This created the potential for significant changes in the valuation of the underlying VIX Futures Contracts and the price of the SPVXSP index after the stock exchange had closed.

57. Hedge funds and institutional trading desks engaged in VIX Futures Contract trading knew that volatility ETFs and other structured products with rebalancing requirements were going to rebalance at 4:15 p.m. They could calculate the demand for the specific VIX Futures Contracts and front-run the anticipated end of day trading to their advantage and the disadvantage of the ETFs. Because they were not exposed to VIX futures through an ETF, they were not constrained by the closing of the stock market at 4:00 p.m.

58. However, any HVI investors that held their position at the close of the TSX were fully exposed to any price changes in the daily rebalancing and settlement of VIX Futures Contracts. Because volatility spikes rapidly and recedes gradually, significant price increases in the last few minutes of VIX futures trading before 4:15 p.m. were possible. This meant that on a day of market volatility, there was a risk that short volatility funds such as HVI would experience a sharp decrease in their NAV between 4:00 p.m., when the TSX had closed, and 4:15 p.m. when the final VIX futures rebalancing occurred. Retail customers could not assess the potential for significant price movement in the applicable VIX Futures Contracts after the close of the stock exchange.

59. This was a serious flaw in the design of SVXY which was adopted by Horizons – without any analysis – for HVI.

60. This characteristic of the VIX futures market also undermined the effectiveness of the arbitrage pricing mechanism for HVI over the stock exchange, which relies on the Designated Broker and Dealers to keep a “tight spread” around the NAV of the ETF as it trades throughout the day. The effectiveness of the pricing mechanism depends on the Dealers having sufficient insight into the VIX futures market to bring about proper pricing. However, as the Dealers only

sought to keep a tight spread around the value of the SPVXSP index or, in the case of HVI, the price of SVXY, it failed to respond to the potential for changes in the pricing of the two near-term VIX Futures Contracts after the stock markets closed at 4:00 p.m.

61. On a day of increased market volatility, mechanically tracking the pricing of the VIX Futures Contracts through the day up to 4:00 p.m. inevitably resulted in a discord between the likely end of day NAV for the ETF at 4:15 p.m. and the prices at which it was trading over the stock exchange. For sophisticated institutional market participants, not only could they take advantage of the rebalancing demand of SVXY and similar funds by waiting until the end of the trading day to drive up the prices of VIX futures during peak demand, but they could also short SVXY and HVI knowing that they had not recognized the inevitable impairment of their NAV when they rebalanced. This resulted in a wealth transfer from retail investors to sophisticated institutional market participants.

62. This made holding SVXY overnight highly risky and unpredictable as the ETF was vulnerable to the behaviour of VIX futures traders. This shortcoming flowed to HVI.

e) Dangerous Changes in the Volatility Market

63. As addressed further below, the growth in inverse and leveraged volatility ETFs and ETNs significantly increased the demand for the two near-term VIX Futures Contracts. The rebalancing needs of these funds created an imbalance in the market when volatility increased because 1) in the case of inverse funds, they would have to buy a greater number of VIX futures to reduce their short exposure to align with their reduced NAV, and 2) the leveraged funds would also have to buy a greater number of the same VIX futures to increase their long exposure to align with their

increased NAV. This imbalance was potentially dangerous if there was a spike in the VIX of sufficient size.

64. This development was noted by market analysts in 2017, including Horizons' options analyst, who warned Hawkins, Horizons' President and Chief Executive Officer that the shorting volatility trade was becoming dangerous.

65. This weakness was fully exposed on February 5, 2018, discussed further below. However, it should have been apparent to Horizons before then.

66. In summary, attempting to replicate a short volatility trading strategy within an ETF structure exposed Horizons' HVI customers to unnecessary and (predictably) unpredictable risk flowing from the daily rebalancing and exposure to the idiosyncrasies of the VIX futures market. It was foreseeable that on a day of increased market volatility the pricing of HVI over the stock exchange would not correlate with the closing value of the SPVXSP index, and HVI customers would suffer unreasonably high losses while the TSX was closed.

Horizons Learns of HVI's Flaws and Investor Confusion

67. On August 31, 2015, after the VIX had spiked and HVI lost value, Horizons received numerous questions and complaints about HVI's price not reflecting the prices of the two VIX Futures Contracts that it was supposedly tracking. In response, Horizons published a bulletin on its website entitled "*The Mechanics of Horizons BetaPro S&P 500 VIX Short-Term Futures Inverse ETF*". This bulletin acknowledged a number of the problems with tracking the value of HVI, including the potential for price movements of close to 10% between 4:00 p.m. and 4:15 p.m.

after the TSX had closed and HVI had struck its NAV, as well as other idiosyncrasies, such as time lag, that were becoming apparent in the VIX futures market. The bulletin failed to disclose that HVI's return was based off SVXY, which would have helped to resolve investor confusion. Nor did Horizons disclose that its CMDYVXER custom index was the 4:00 p.m. price of SVXY. Instead, it referred Horizons' customers to SVXY and XIV, another U.S. exchange traded inverse product, as proxies for HVI.

68. At this time Horizons was aware that certain of its customers did not understand the mechanics of HVI.

69. Also at this time, Horizons started to inform itself about the VIX futures market by contacting the CBOE VIP Helpdesk to inquire about the risks of after-hours trading and the existence of circuit breakers. Horizons knew or should have known that its customers would not have understood these aspects of the VIX futures market.

70. With the rise in volatility in late August 2015, there were significant new subscriptions for HVI, and it quadrupled in size within two weeks. Horizons would have learned that its customers were trading HVI expecting a short-term gain from the VIX receding. These investors were clearly unaware that the primary way HVI increased in value was from harvesting the roll yield when volatility was low. Attempting to catch a short-term gain in HVI from the VIX receding was highly uncertain and complicated by the behaviour of the VIX futures market described above and the rebalancing of HVI (SVXY). In fact, the value of HVI did not reach the pre VIX spike of August 20, 2015, until early 2017, a year and a half later.

Different Risk/Return Characteristics from the VIX

71. A further flaw in the concept of volatility ETFs, which was shared by HVI, was that the risk/return characteristics of VIX Futures Contracts have proven to be significantly different from the VIX. Most investors would follow the VIX in making trading decisions for volatility ETFs. Horizons points out that the ETFs are (supposedly) invested in VIX Futures Contracts rather than the VIX. However, it advised that there was a high degree of correlation between SPVXSP and the VIX (i.e. they typically move in the same direction). While that is true, what Horizons did not disclose, and did not understand, is that the returns of SPVXSP were significantly different than the returns of the VIX. The reason for this is that the prices of the VIX and SPVXSP are determined by different markets: the VIX is determined by buyers and sellers in the CBOE S&P 500 options markets, and the SPVXSP is determined by buyers and sellers of the nearby VIX Futures Contracts.

72. There is no active arbitrage between the two markets so the price of VIX and SPVXSP have no deterministic relation with each other. This should have raised considerable doubt about the concept of offering a volatility ETF based off a benchmark comprising VIX Futures Contracts. Most investors associate market volatility with stock market volatility as measured by the VIX and most likely traded HVI based on movements in the VIX. However, a decision to trade HVI needed to be made based on the expected behaviour of the VIX futures market for the nearby contracts. When one calculates the return of the VIX from 2012 to 2018 it is -12% a year, compared to -62% for SPVXSP.

Horizons did not Disclose HVI's Flaws

73. Even if the Prospectus clearly explained the risks HVI customers would face if they bought HVI, and it does not, Horizons offered and promoted an ETF that had unreasonable risk/return characteristics and flaws in its design. Horizons belatedly acknowledged the inappropriateness of HVI as an investment product on April 10, 2018, when it announced the termination of HVI and HVU.

74. The possibility of a significant change in the NAV of HVI occurring between 4:00 p.m. and 4:15 p.m. due to the rebalancing of SVXY's VIX futures exposure could not be addressed through disclosure. The only way to avoid this risk would be to exit the product every day before the close of the TSX. This would mean that HVI's asset base would go to zero each day, which meant that Horizons would not receive a management fee.

75. In any event, as elaborated below, the Prospectus was drafted with the sole objective of Horizons shielding itself with risk disclosure. No attempt was made to inform its customers about the key risk/return characteristics of HVI, how HVI actually worked to generate returns, or to warn them of the product flaws that could harm them. Horizons knew that its customers would not be able to understand the key characteristics of HVI from the Prospectus disclosure.

Prospectus Disclosure was Misleading and Deficient

76. In the opening background section of the "Prospectus Summary" on "Investing in Volatility", Horizons observes that volatility "*is a market condition that is easier to identify than it is to manage*". However, Horizons makes no attempt in the Prospectus to explain *why* its

customers should attempt to manage volatility through its volatility ETFs, or *how* they could profit from doing so. Horizons failed to ask itself these questions before launching HVI.

a) The Purpose of HVI is Misstated

77. On the front page of the Prospectus Horizons states, in bold, "***The ETFs are speculative investment tools, are very different from other Canadian exchange traded funds, and can be used for diversification or as a partial hedge against market conditions.***" This was wrong, particularly with respect to HVI.

78. No explanation is provided as to how each of the ETFs qualified by the Prospectus could be used for diversification or as a partial hedge against market conditions. The ETFs promoted by the Prospectus each had significantly different risk/return characteristics. Whereas HUV and HVU could be traded short-term as a form of portfolio hedge for a decline in the equity markets (albeit an expensive one), HVI behaved in the opposite way. General statements made in the Prospectus that may have been accurate in relation to HUV and HVU were inaccurate and misleading with respect to HVI.

79. The 1*x* and 2*x* volatility funds would consistently lose value when the yield curve for VIX Futures Contracts was in contango. However, they *could* increase in value quickly in the event of an increase in volatility, which often coincided with a decline in the S&P 500. So, if a Horizons customer held HUV or HVU at the right time, they could potentially offset losses in their equity portfolio holdings. In contrast, HVI (through SVXY) would perform well when the futures market was in contango through the accumulation of the risk premium as SVXY shorted 2nd month VIX futures and covered the short VIX Futures Contracts with 1st month contracts on a rolling basis in

accordance with the SPVXSP. However, if the S&P 500 dropped, and volatility rose, HVI would decline rapidly and exacerbate equity portfolio losses. It was therefore inaccurate to suggest that HVI could be used to hedge against "*market conditions*" as it generally performed well when the equities market performed well and *vice versa*. Hawkins represented to Horizons customers that he owned HVI personally as an equity exposure in 2017, contradicting the Prospectus.

80. The Prospectus also created the misleading impression that HVI could increase in value quickly, on page two: "*In considering whether to buy Units of an ETF, the investor should be aware that investing through derivatives can quickly lead to large losses as well as large gains*." This was misleading with respect to HVI, as volatility only spikes up, not down. A Horizons customer would have needed to buy and hold HVI for months or longer to earn a "*large gain*", whereas they could lose their investment in a single day. This disparity is never addressed.

81. Further, the Prospectus repeatedly warns that, "***These ETFs are not suitable for investors seeking a long term investment*** …" (page 25, bolding in the original). This warning, which is repeated in the ETF Facts, misdirected HVI customers from the one way in which a trade in HVI could potentially be profitable, which was to hold it longer term and hope that market volatility remained low. Horizons had to warn against holding HVI for purposes other than daily or short-term trades because of the product structure, which included the daily rebalancing, which could cause it to deviate significantly from its investment objective.

82. It was misleading to refer to HVI as being an "*investment tool*", speculative or otherwise. It would not allow a Horizons customer to achieve "diversification", nor could it serve as a "partial

hedge" against market conditions. It was not suitable for a short-term speculative bet on the direction of market volatility.

b) Futures Market Risk is Mischaracterized

83. The Prospectus fails to address the risks that HVI faced from late day rapid increases in the price of the near term VIX Futures Contracts, except in an incomplete and inadequate way under the heading "HVI Risk" on page 22. Horizons states that the closing valuation time of the Reference Index is 4:00 p.m. while the closing valuation time of the Underlying Index is 4:15 p.m. It correctly notes that the underlying VIX Futures Contracts and therefore the Underlying Index can change significantly in that 15-minute period and that the day over day closing net asset value of HVI may not always "closely correlate" to the inverse performance of the day over day closing value of the Underlying Index.

84. The Prospectus presents this "risk" as akin to a tracking error. However, the key risk for HVI unitholders was not that the Reference Index (which was just the price of SVXY at 4:00 p.m.) would not "closely correlate" with the value of the Underlying Index, it was that the value of their Units could decline significantly after the TSX closed and they were locked into their position. The fact that the closing price of HVI may be misaligned with the Underlying Index at 4:15 p.m. ignores the risk of a significant loss of value while HVI unitholders cannot trade, which is crystallized through daily rebalancing.

85. This disclosure does not warn investors about the scenario that unfolded on February 5, 2018. There is no mention of the significant volume of VIX Futures Contracts that trade in the last five minutes before 4:15 p.m., the vulnerability of the ETF to institutional trading desks front-

running the VIX futures demand, or of the fact that rebalancing can result in the crystallization of potentially unrecoverable HVI losses.

86. The section "HVI Risk" fails to mention any of the key risks associated with buying HVI.

c) Rebalancing Risk

87. Nowhere in the Prospectus is the rebalancing risk addressed except as the reason why HVI's "*returns over periods longer than one day will likely be different in amount and possibly direction from the performance of the Underlying Index*". Another attribute of rebalancing is that any loss from SVXY's short position in VIX futures was crystallized daily and the net asset value of the ETF decreased accordingly. This happened even if the price of underlying futures contracts recovered (fell) the next day. If the loss was large enough, it could take a very long time or be impossible for the ETF to recover the loss because it had a reduced asset base from which to resume accumulating risk premium from rolling the short position in VIX Futures Contracts.

88. Although there are some references in the Prospectus to the possibility of HVI suffering "*substantial losses*" when the Underlying Index experiences "*significant one day increases on days when equity markets have large negative returns*" (page 25), nowhere is it explained that such losses may be unrecoverable due to the daily rebalancing. Horizons knew or should have known that retail investors might understand that risky ETFs can lose value on a given trading day, but that they would not be familiar with ETFs where the losses are crystallized daily, meaning that the ETF does not recover along with the underlying index.

89. In contrast, the SVXY prospectus explains these risks. No similar explicit description of the risk of holding HVI was contained in the Horizons' Prospectus, notwithstanding that HVI's only portfolio holding was shares of SVXY.

d) Misleading Disclosure: Portfolio Holdings and Reference Index

90. Finally, as referenced above, the Prospectus omits mention of the fact that, (a) the inverse exposure to SPVXSP is obtained by National Bank purchasing shares of SVXY, or (b) that the Inverse or Reference Index that Horizons reported each day was the 4:00 p.m. price of SVXY shares. The Prospectus states that "*HVI invests in financial instruments that have similar return characteristics as one times (100%) the inverse (opposite) of the performance of the Underlying Index. In order to achieve this objective, HVI obtains exposure to an Inverse Index that substantially corresponds to a one times inverse (opposite) multiple of the Underlying Index. The value of the current Inverse Index is published by Bloomberg L.L.P. (ticker symbol: CMDYVXER)…*" (page 13). This description is inconsistent with what Horizons was doing.

91. The Forward Contracts with National Bank were not "financial instruments" with "return characteristics". Horizons invested in *one instrument* (the forward agreement) and had an agreement with National Bank that it would buy and sell shares of SVXY and flow the returns through to HVI. Horizons' disclosure made investors believe that HVI was an investment in VIX Futures Contracts when it was not.

92. Nor was there an "*Inverse Index*", and to say that "*HVI obtains exposure to an Inverse Index*" was also misleading and obscured what Horizons was really doing. In ordinary parlance,

an index means a plurality of things, and in the finance context a group or basket of securities or assets. It was misleading to refer the Horizons' tracking of SVXY as an "*Inverse Index*".

93. Further, the Prospectus includes a lengthy section on "Futures Contracts and Related Options" (pages 16-17), in which reference is made to the ETFs purchasing or selling "*stock index futures contracts and options*", engaging in "*closing or offsetting transactions before final settlement wherein a second identical futures contract is sold to offset a long position (or bought to offset a short position)*", and so on. This section of the Prospectus suggests that Horizons was trading VIX futures contracts to obtain the exposure for HVI.

94. In totality, Horizons' Prospectus disclosure was misleading with respect to how Horizons had structured HVI and deficient in explaining the rationale for HVI, its risk/return characteristics or the unusual risks that it faced through its exposure to the VIX futures market and its daily rebalancing. Horizons customers were not provided the material facts necessary for them to make an informed decision about whether to trade HVI. This fell short of the standard of full, true, and plain disclosure.

e) Prospectus Disclosure and Continuing Disclosure Were Deficient Under Ontario Securities Law

95. Horizons' Prospectus failed to make the disclosure required by *National Instrument 81-101 – Mutual Funds Prospectus Disclosure*[1] and the associated *Form 81-101F1 – Contents of Simplified Prospectus*. In particular, the Prospectus was deficient for not disclosing, *inter alia*:

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[1] All references to National Instruments are to the version in force as at February 5, 2018.

a) Item 6: Fundamental Investment Objectives – Horizons was required to "*State the type or types of securities, such as money market instruments, bonds, equity securities or securities of another mutual fund, in which the mutual fund will primarily invest under normal market conditions*". Horizons failed to disclose that the underlying investment of HVI was in SVXY;

b) Item 7: Investment Strategies – Horizons was required to describe *"the principal investment strategies that [HVI] intends to use in achieving its investment objectives*". Horizons failed to disclose that the underlying investment of HVI was in SVXY, flowed through the Forward Contract; and

c) *Item 8: Fees and Expenses* – HVI indirectly held the securities of SVXY (per s. 2.5 of *National Instrument 81-102 – Investment Funds*). Horizons was required to disclose that there were fees and expenses payable to SVXY in addition to those associated with an investment in HVI.

96. Further, Horizons' continuing disclosure for HVI breached its disclosure obligations under securities law and was generally inadequate.

a) Pursuant to National Instrument 81-106 - *Investment Fund Continuous Disclosure*, Horizons had the obligation to disclose:

    i. The underlying interest in the Forward Contract (Section 3.5 – Statement of Investment Portfolio); and

    ii. The top 25 positions held by HVI, each expressed as a percentage of net asset value. Because HVI invested "*substantially all of its assets directly or indirectly (through the use of derivatives) in securities of [SVXY]", it was required to disclose* "*the 25* *largest holdings of [SVXY] by percentage of net asset value*" (*Form 81-106F1*, Item 5 – Summary of Investment Portfolio).

Horizons did not do so.

b) Pursuant to *Form NI 81-101F3* – Contents of Fund Facts Document, Item 3: Investments of the Fund:

   i. Horizons was required to "*Briefly set out under the heading "What does the fund invest in?" a description of the fundamental nature of the mutual fund, or the fundamental features of the mutual fund that distinguish it from other mutual funds*". Horizons' Fund Facts documents did not accurately describe the fundamental nature of HVI;

   ii. Horizons was required to "*briefly describe the nature of [the Reference Index]*". Horizons' Fund Facts documents did not accurately describe the fundamental nature of the Reference Index; and

   iii. As a mutual fund that "*invests substantially all of its assets directly or indirectly (through the use of derivatives) in securities of another fund*", Horizons was required to "*list the 10 largest holdings of the other mutual fund and show the percentage of the other mutual fund's net asset value represented by the top 10 positions*". It did not list the holdings of SVXY in the prescribed manner. It did not refer to SVXY at all.

97. Horizons did not make the disclosure required above and its disclosure was inadequate and misleading. It did not disclose that its primary holding – through the forward contract – was SVXY

and did not disclose that the Reference Index was simply the market price of SVXY at 4:00 p.m. daily.

Promotion of HVI

98. Horizons knew that none of its customers would trade HVI based on the disclosure in the Prospectus, so it published promotional or investor education materials on its website. One such early publication, entitled "*Profit from declining volatility*", included guidance to investors that was overly simplistic and misleading. It implies that trading volatility is as simple as investors switching between long and inverse volatility ETFs and that buying HVI when the VIX has spiked is a viable strategy to profit from declining volatility. No reference is made to the term structure of the VIX futures market, which was critical to understanding HVI and the concept of shorting volatility. Instead, Horizons customers were told that the SPVXSP correlates to the VIX, and to trade based on their expectations concerning the level of the VIX. As addressed above, this was a misdirection. The advice from Horizons does not address why a Horizons customer should buy an expensive and highly risky ETF such as HVI to profit from a recovering market when that could be achieved inexpensively with low risk by buying an ETF benchmarked to the S&P 500 Index, which would never result in a total loss in a single day barring a total collapse of all markets globally.

Horizons Promotes HVI During a Time of Heightened Risk

99. A sustained period of low volatility in the market during 2016 and 2017 caused short-volatility funds like HVI (through SVXY) to be very profitable as they collected volatility risk-premium without significant interruption. Predictably, a large amount of investor money flowed

into these products during 2017 and January of 2018. However, their inherent riskiness had become more pronounced due to the historically low level of the VIX Index. The long-term average (since 1990) for the VIX is 19.7 (as of December 2016), whereas the VIX had dropped below 10 in January 2018 and was subsequently languishing in the low teens.

100. This left the VIX susceptible to a large and rapid increase in percentage terms. Market analysts were expressing concerns that a one-day decline in equities of 3% or 4% could cause a significant spike in the VIX (in percentage terms) and trigger catastrophic losses for volatility-contingent strategies. Some analysts were of the view that the unwinding and rebalancing of volatility strategies could become self-propelling due to limited liquidity, especially during periods of market stress, which would rapidly drive up the price of VIX Futures Contracts.

101. Rather than reassess the ETF in response to these ominous signals about the state of the market, Horizons sought to profit off the exceptional run of recent past success for HVI and started to promote HVI to its customers through a webinar that it produced in August 2017.

102. Horizons' own options analyst was also aware of the developing market risk and pointed it out to Hawkins as he helped him prepare for the webinar, noting that there were so many people and strategies that were short volatility that such positions would get hurt in a non-linear way, that it would not take much to create a panic, and that the situation was dangerous.

103. Despite this warning, Horizons promoted its webinar on "*Trading Volatility*", headlining HVI as "*Canada's Best-Performing ETF*", with an annual return for the one-year period ending

July 31, 2017 of 169%. Horizons sought to encourage its customers to trade HVI based on these past results which were achieved in highly unusual market conditions.

104. In the webinar Hawkins explained that investors could trade HVI over the long term and expect to profit from long-term negative volatility. Hawkins also represented that he owned HVI personally as a long-term investment and as an equity market exposure. This contradicted the Prospectus disclosure which warned that HVI was not suitable as a long-term investment.

105. He also offered that spikes in volatility produced opportunities for someone to short volatility, because it increased rapidly to a high level then receded. He suggested that a good way to profit from this scenario was to invest in an inverse volatility ETF. Lots of Horizons customers did this on February 5, 2018, and lost almost all their money.

106. The webinar was intended to encourage Horizons customers to trade HVI. The tone and content of the presentation contradicts the Prospectus disclosure.

107. Hawkins' statements about how to trade HVI were inconsistent with Horizons written disclosure about HVI being a daily investment product that only endeavoured to meet its investment objective for a single day. Although the presentation included occasional references to risk, or the need for fortitude, the message was that there were substantial profits to be made from shorting volatility through owning HVI through the short and long term. This was untrue, as there were no high rewards to be gained from HVI over the short term.

108. The presentation ignored the risks identified by the Horizons options analyst.

109. The only direct warnings provided by Hawkins were to not trade HVI in the first or last 15 minutes of the trading day to avoid volatility in trading at those time, and to use stop loss orders to "*know where to draw the line*" with losses because the price of HVI could drop quickly. These warnings gave the misleading impression that HVI customers could protect themselves from price volatility at peak trading times and limit their losses. They could potentially do this if they traded HVI intraday, but if they held HVI for any longer they were fully exposed to trading in VIX futures between 4:00 p.m. and 4:15 p.m. and they could not limit their losses from write-downs in the NAV of HVI overnight caused by price changes to the VIX futures underlying SVXY after 4:00 p.m.

110. Hawkins' statements above gave the erroneous impression that HVI customers could protect themselves from price volatility and could limit their losses, when they could not protect themselves at all after the TSX closed.

111. Throughout the presentation Horizons also represented, inaccurately, that its volatility ETFs held VIX Futures Contracts and rolled those contracts on a daily basis.

The Collapse of HVI

112. The value of HVI continued a generally upward trajectory through late 2017 (the average daily increase was 0.27% in the six months ending February 1, 2018), during which time the VIX stayed at historically low levels.

113. The number of units in HVI grew by 1,675,000 (approximately 147%) between January 1 and February 5, 2018, as the Designated Broker and the Dealers subscribed for additional units during this period of elevated risk.

114. On February 1, 2018, HVI closed at a value of $21.64. The VIX rose by 28% on Friday, February 2, 2018, and HVI declined in price to $18.76 by the close of business, a decline of 13.3%. By this time the VIX futures market was in backwardation (i.e. a downward sloping curve) and VIX futures traders would have anticipated increased prices for the near term contracts the next day.

115. On Monday, February 5, 2018, the S&P 500 declined by 4.1%, causing a spike in volatility. The VIX increased by approximately 67% by 2:45 p.m. and 106% by 3:00 p.m. By 4:00 p.m., when the TSX closed, the VIX had increased by 115.60%. Large volumes of HVI Units traded over the TSX on February 5, 2018 – there were 12,987 trades with a trade value of $37.25 million. HVI traded at prices that did not reflect the massive increase in implied expected volatility in the market reflected in the VIX. HVI opened at $17.79 on February 5, 2018, and closed at $13.40, a decline of only 29%. By 4:01 p.m. on February 5, 2018, after the market closed, retail customers were no longer able to trade HVI and could not exit their positions.

116. Horizons did not post the NAV for HVI until 10:26 p.m., at $12.68. However, at that time, Horizons did not know what HVI was worth, as it depended on the value of SVXY which had not posted its NAV. Horizons should have known that the NAV was going to be much lower, based on the prices of the VIX Futures Contracts traded by SVXY.

117. If Horizons had been monitoring the VIX futures market in January 2018, which it wasn't, it would have been aware of the massive imbalance of demand for the two near term VIX futures contracts compared to the size of the market. As at the close on February 2, 2018, there was open interest in the two near term VIX Futures Contracts of $7 billion. The precise amount of rebalancing demand would vary depending on the daily trading results; however, any significant increase in the VIX would be destabilising.

118. With the increase in the VIX, by the end of the day on February 5, 2018, there was rebalancing demand of $7.4 billion from inverse and leveraged funds alone. This represented 74% of the open interest of the front month contract, and 134% of the second month to expiry contract.

119. As the rebalancing had to occur in the last few minutes of the futures market before 4:15 p.m., with the spike in the VIX during the afternoon on February 5, 2018, it became apparent that inverse volatility funds such as SVXY, as well as leveraged volatility funds, would have to buy an increased number of the same near term VIX Futures Contracts to affect their required daily rebalance (inverse funds needed to reduce their short exposure in accordance with their reduced NAV and leveraged funds had to increase their exposure in accordance with their increased NAV). It was inevitable that the price of the two near term VIX Futures Contracts was going to increase dramatically. While retail customers had no concept of this, institutional traders would have been aware and positioned themselves to take advantage of demand.

120. In fact, HVI did suffer additional, dramatic losses in the aftermarket as the prices of the near term VIX Futures Contracts continued to rise significantly after 4:00 p.m. When HVI started

trading again the next day at 1:45 p.m., after a trading halt, it was $2.32 – a decline of 82.69% from the previous night's close and nearly 87% less from its price at the close on February 2, 2018.

121. The price of HVI could not recover from a loss of that magnitude.

122. An unprecedented volume of 4,481,010 HVI Units traded over the TSX on February 5, 2018, indicating that a significant number of Horizons customers thought, consistent with what Horizons had represented, that a spike in volatility was a good time to trade a short volatility ETF. However, this advice was wrong.

123. Retail customers were unaware that the market price of HVI over the TSX did not reflect the expected dramatic increase in the price of the two near term VIX futures when trades settled at the end of the day before 4:15 p.m. The price of the two VIX Futures Contracts sold short by SVXY lagged the spike in the VIX. When SVXY rebalanced its VIX futures exposure, the losses were crystallised. There was no profitable trade to be made in HVI from the VIX declining after it had spiked on February 5, 2018. This was due to the structural limitations of the ETF, which made timing a trade to profit from a short-term decline in the VIX impossible. Horizons and its retail customers were not aware of the nuances of HVI and how it was affected by the VIX futures market.

124. Subscriptions and redemptions of HVI were suspended on February 6, 2018, and when they resumed on February 7, 2018, NBF subscribed for 3,725,000 units, which increased the number of the Fund's outstanding units on that day by 132%. While part of this subscription was to cover NBF's short position from prior days trading (from which it profited), it also reflected

increased demand for units of HVI on February 6 and 7, 2018. This further demonstrated a complete lack of understanding in the market about how HVI worked. Due to the rebalancing of SVXY's exposure, HVI was not going to "bounce back" once the VIX receded.

125. Horizons' management was in a state of confusion during the evening of February 5, 2018. Because it relied on ProShares and SVXY, Horizons had no control over the rebalancing of the VIX Futures Contracts. If it had, it could potentially have deferred the rebalance until the market for the VIX futures stabilized. Horizons recognized internally that its theoretical rebalancing was going to be hard to explain to its customers. It was also unable to reconcile the price of HVI in relation to the underlying futures prices that its customers believed HVI was invested in, because it didn't have the index methodology used by SVXY to calculate its NAV.

The Aftermath

126. Horizons scrambled to be able to explain what had happened to its customers. In the process of attempting to reconcile the price of HVI it learned that the HVI roll calendar on the Horizons website was wrong – it was off by a day. As Horizons was not shorting VIX Futures Contracts in the same proportions as the SPVXSP, this error was not identified earlier.

127. Horizons failed to be candid with investors that asked pointed questions to it about what happened to HVI, and avoided disclosing that HVI was simply taking the price of SVXY for its CMDYVXER index in response to those questions.

128. Horizons published its own explanation for the catastrophic losses incurred by HVI on February 5, 2018. Horizons suggested that HVI had a very specific purpose for investors who

chose to trade HVI to seek a potential short term trading gain, and also repeated this reframing of the trading strategy for HVI in other public statements. Horizons also maintained the inaccurate impression that it was managing an inverse volatility ETF, with reference to closing out its current futures exposure and buying its new exposure as part of its reset. It referenced its "*perfect 1.0 correlation to CMDYVXER*", its Reference Index, but failed to disclose that the Reference Index was based on the price of the underlying portfolio of SVXY shares.

129. On February 27, 2018, Horizons announced that it would not be accepting any new subscriptions for Units of HVI, and discouraged investors from purchasing Units on the TSX. A press release of that date stated the suspension was "*[d]ue to a change in business, operations and affairs of HVI*" and indicated that Horizons was "*assessing various courses of action with respect to HVI*". The press release also indicated that after the close of trading on February 28, 2018, Horizons "*expected*" that the performance of HVI would only correspond to approximately one-half times the inverse of the daily performance of the Underlying Index, and that Horizons intended to call a meeting of Unitholders "*in order to amend HVI's investment objectives*".

130. There was no change in the business, operations, or affairs of HVI. Rather, SVXY had changed its investment objective to one half times the inverse of the Underlying Index.

131. On March 13, 2018, Horizons announced that it would resume accepting new subscriptions for HVI on March 14, 2018, and indicated that it expected that the performance of HVI would correspond to approximately one-half times the inverse of the daily performance of the Underlying Index.

132. On April 10, 2018, Horizons announced that it would be terminating HVI and HVU effective as of June 11, 2018, and that effective immediately no further direct subscriptions for Units of the ETFs would be accepted. An April 10, 2018, press release stated that Horizons had reassessed the viability of HVI and concluded that *"[i]n the specific case of leveraged and inverse exposure to volatility futures, we now feel the potential risk of loss simply exceeds the potential reward*". It also indicated that:

> *"After reassessing the performance of HVU and HVI, particularly their respective performance following the first week of February, when volatility futures contracts spiked by more than 100% during one 24-hour trading period, **we have come to the conclusion that these ETFs no longer offer an acceptable risk/reward trade-off for investors**," said Steve Hawkins, President and Co-CEO of Horizons ETFs. "…Ultimately, **we do not want to be offering investment products that have the potential to lose the majority of an investor's capital in such a short period of time**." [italics in original; emphasis added]*

133. Horizons' statements applied with equal force to the period before February 5, 2018. The potential for loss was always greater than the potential reward, particularly over a short time frame. HVI could be expected to generate an incremental positive return on a daily basis (the average daily increase was 0.27% in the six months ending February 1, 2018, during a period of sustained low volatility). However, the fund faced a real yet unpredictable risk at any time of losing all or a substantial part of its net asset value over that same period (HVI lost 88% over two trading days from February 2 to 6, 2018). The radical disparity in the risk/reward ratio of owning HVI over a short time frame was completely unreasonable for retail investors. The risk/reward trade-off was always skewed for HVI.

134. Once SVXY changed its investment objective, HVI could no longer meet its investment objective. National Bank was not prepared to provide one times inverse exposure to SPVXSP and

required much higher fees than it had previously charged to provide even one-half times inverse exposure through conventional means.

Horizons' Breaches of The Duty of Care

135. Pursuant to section 9.7 of the Trust Declaration, section 116 of the *OSA*, OSC Rule 31-505 – *Conditions of Registration,* and the common law, at all material times Horizons owed the following duties to HVI and to the Unitholders, including the Class Members:

a) A duty to exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of HVI and its Unitholders;

b) A duty to act fairly, honestly and in good faith with its clients, which included the Unitholders; and

c) A duty to exercise the degree of care, diligence and skill that a reasonably prudent trustee, investment fund manager and investment manager would exercise in comparable circumstances.

136. These duties required Horizons to exercise due care and consider the best interests of its customers when deciding whether to offer and promote an ETF. It was incumbent on Horizons to establish a proper process with qualified personnel to assess whether HVI was an appropriate product. The following factors needed to have been considered by Horizons:

a) Who was the target market for HVI?

b) Would they understand the key features of HVI, including the daily rebalancing and its implications?

c) Were the risk/return characteristics of HVI reasonable for the target market?

d) Were there any unusual risks associated with HVI that could be harmful to its customers?

e) Would offering HVI be in the best interests of its target customers, including, what purpose would it serve and were they more likely to make money than lose money?

f) Assuming there was a purpose for HVI, were there less risky and costly alternatives?

g) Was there a risk that Horizons customers who were not equipped to trade HVI would do so and suffer losses, and if so, was there a reasonable way to manage that risk?

h) If HVI satisfied the above criteria, was there a need for enhanced disclosure to assist its customers in understanding HVI and making reasonable trading decisions?

i) What resources would its customers require to be able to trade HVI?

137. The above factors should have been reassessed every year when Horizons decided whether to renew the Prospectus for HVI. That was particularly important for a number of reasons: (a) exchange traded products shorting volatility based off indices had only been in existence since 2009; (b) the novelty of this strategy for the retail market; and (c) the rapid expansion of the market with an influx of assets into new ETFs and ETNs all trading a finite number of VIX Futures Contracts, which could change the behaviour of the VIX futures market.

138. Also, once HVI was launched, Horizons received feedback from its sales team indicating that its customers were confused by the product. When Horizons learned that it had customers who didn’t understand HVI but were nevertheless trading it, it should have reassessed the appropriateness of the offering.

139. Even if Horizons had concluded that HVI was a viable ETF to launch based on the above analysis, it had a duty to thoroughly test the product before offering it, to ascertain whether there

were anomalies in relation to its expected behaviour or performance. This should have included, at a minimum:

a) The comparative returns of the VIX and SPVXSP over different time frames, including intra-day;

b) SVXY's returns compared to SPVXSP;

c) HVI's returns compared to SVXY;

d) HVI's returns compared to SPVXSP; and

e) Changes in the value of SPVXSP after the 4:00 p.m. close of the TSX.

140. Horizons had a duty to update the testing of HVI at least annually, particularly considering the idiosyncrasies of the VIX futures market and changes to the market with the influx of new volatility products.

141. In addition, considering Horizons' own lack of experience with trading in the VIX futures market, it had a duty to engage experts with that experience to evaluate the proposed ETF, how its customers would fare trading HVI, and whether there may be any risks that Horizons had not considered when developing the product idea.

142. Horizons failed to even attempt to do any of the above.

143. Instead, it prioritized its short-term commercial interests to the interests of its customers by opportunistically offering and promoting a repackaged ProShares ETF, which it represented to be a Horizons ETF, without any care as to whether it would benefit or harm its customers.

144. Offering an inverse volatility ETF based on the two nearest term and most volatile VIX Futures Contracts was a product idea that should have been rejected. Even if offering such an ETF could be justified, the way Horizons did so was below the standard expected of an investment fund manager. Horizons had to use SVXY to provide the inverse exposure to SPVXSP. Shorting the underlying VIX Futures Contracts was either too costly, too risky or both for Horizons to do so itself (or through National Bank). Horizons knew or should have known that there were additional risks to trading VIX Futures Contracts and to being short volatility.

145. Instead, Horizons invested in SVXY and perpetuated the inaccurate impression that it was trading VIX Futures Contracts. By only trading in shares of SVXY, Horizons never had to learn about the VIX futures market.

146. Notwithstanding its own lack of experience with the VIX futures market, Horizons portrayed itself to its customers as having expertise in volatility trading strategies and it relied on this erroneous perception to promote and market HVI to is customers.

147. In failing to meet its duties to Class Members outlined in paragraphs 161 to 167 above, Horizons breached its duty of care and was negligent. Specifically, it offered and promoted HVI notwithstanding the following problems with the product:

a) HVI had unreasonable risk/return characteristics. In simplistic terms, the risk (total loss) was too great in relation to the potential rewards (incremental growth), particularly over the short term. On a given trading day, an HVI customer could lose their entire investment, whereas they stood to gain only pennies on the dollar.

b) This risk/return profile was highly unusual and at a minimum needed to be clearly explained to potential HVI customers. It was not.

c) Because of the daily rebalancing by SVXY, HVI was not a buy and hold investment. It was designed to be traded intra-day.

d) There was a fundamental mismatch in the design of HVI, as an intra-day trading product, and the concept of shorting volatility, which was to accumulate the risk premium from the rolling short position in VIX Futures Contracts, which was inherently a longer-term strategy.

e) Horizons never reconciled the mismatch in product design and trading strategy and instead gave inconsistent and confusing advice to its customers.

f) HVI was portrayed as an investment or "trading tool" to manage or profit from changes in market volatility as measured by the VIX. However, the ETF was based on the price of VIX Futures Contracts (through SVXY), which was a different market than the market for S&P 500 issuer options from which the VIX is calculated. Due to the lack of active arbitrage between the VIX spot market and the VIX futures market, this made predicting the pricing of VIX futures contracts in relation to the VIX quite uncertain in terms of both quantum and timing.

g) HVI was vulnerable to incurring significant losses between 4:00 p.m. and 4:15 p.m. when the daily VIX futures market settled trades and VIX Exchange Traded Products (e.g. ETFs and ETNs) rebalanced their exposure. During this time HVI customers were unable to trade HVI.

h) Understanding HVI required understanding the VIX futures market. It was unrealistic for Horizons to expect that its target market of self-directed retail customers understood the VIX futures market. Horizons' own portfolio managers lacked experience with the VIX futures market.

i) Horizons customers were unlikely to understand the implications of daily rebalancing by SVXY. In addition to the problem of compounding returns making the ETF unsuitable for anything other than intra-day trading, losses were crystallized through SVXY's rebalancing. Losses in NAV could take months or years to recover or be unrecoverable. This characteristic was guaranteed to be confusing to retail customers who were used to traditional ETFs.

j) Horizons should not have offered and promoted an ETF that its customers would not understand.

k) Nor should Horizons have offered and promoted an ETF that was not in the best interests of its customers.

l) Horizons should not have offered an ETF based on shorting VIX futures contracts when it could not manage such a portfolio itself, whether due to lack of expertise, excessive risk or the high cost of doing so.

m) Risk disclosure in the Prospectus was deficient, and did not compensate for the flaws and unusual characteristics of HVI. It was highly foreseeable that HVI customers would be harmed if they traded HVI.

Causation and Damages

148. But for the negligence of Horizons, described above, the Plaintiff and the other Class Members would not have suffered losses by purchasing HVI.

149. As stated above, the Plaintiff and the Class Members have suffered the following damages and losses:

a) The loss of the capital invested in HVI, totalling approximately $45,000,000, between February 2, 2018 and February 6, 2018; and

b) The loss of the market returns on the capital lost from February 6, 2018, to the date of trial.

150. The Plaintiff and the Class Members are also entitled to recover costs in accordance with the *CPA*, the costs of notice and of administering the plan of distribution of the recovery in this action, plus reasonable legal fees.

151. The Plaintiff and the Class Members are entitled to an accounting of all fees or commissions and other payments made to or received by Horizons in relation to HVI as well as disgorgement of those sums.

152. The conduct of Horizons pleded above demonstrates a calculated disregard of Horizons' duties to the Plaintiff and the Class Members, including its duty to make candid disclosure about the reliance of HVI on SVXY, such that an award of punitive, aggravated and exemplary damages is warranted.

Real and Substantial Connection with Ontario

153. This action has been certified in Ontario under the *CPA*.

154. The Plaintiff pleads and relies on the *CJA*, the *CPA*, the *OSA*, and all relevant amendments thereto.

Place of Trial

155. The Plaintiff requests that this action be tried in the City of Toronto, in the Province of Ontario.

November 25, 2024

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DEFINITIONS/GLOSSARY

1. In this Fresh as Amended Statement of Claim, the following terms have the following meanings:

(a) "**CBOE**" means the Chicago Board Options Exchange;

(b) "***CJA***" means the *Courts of Justice Act*, R.S.O. 1990, c. C.43, as amended;

(c) "**CMDYVXER**" is the ticker symbol for the Reference Index, the Horizons Short VIX Short-Term Futures Index;

(d) "***CPA***" means the *Class Proceedings Act, 1992*, S.O. 1992, c. 6, as amended;

(e) "**Class**" and "**Class Members**" mean any person who owned Units of HVI at the close of the TSX on February 5, 2018;

(f) "**contango**" and "**backwardation**": contango means a situation where the price of the second month's underlying VIX Futures Contracts purchased by HVI were trading higher than the price of the nearer term VIX Futures Contracts. Backwardation is the opposite, where the nearer term VIX Futures Contracts were trading at a higher price than the second month's VIX Futures Contracts;

(g) "**Dealers**" means NBF, CIBC World Markets Inc., and Société Générale Capital Canada Inc. The Dealers acted as designated purchasers and sellers of Units in HVI;

(h) "**Designated Broker**" means National Bank Financial Inc. (NBF), which acted as the principal market maker for Units of HVI;

(i) "**Defendant**" means Horizons ETFs Management (Canada) Inc.;

(j) "**derivative**" means a security that is a contract between two or more parties that is reliant upon or derived from the value of an underlying asset or group of assets;

(k) "**ETF**" means an exchange traded fund, which is an investment fund traded on a stock exchange that tracks an index, commodity, or basket of assets;

(l) "**ETN**" means an exchange traded note, similar to an ETF, which is a type of unsecured debt security that tracks an underlying index of securities that is traded on a stock exchange;

(m) "**ETF Facts**" means the December 22, 2017 Final ETF facts for Units of HUV, HVI and HVU;

(n) "**Forward Contract**" means the forward contracts between Horizons and National Bank through which HVI obtained exposure to the Reference Index;

(o) "**Hawkins**" means Steven Hawkins, Horizons' President and Chief Executive Officer during the material time;

(p) "**Horizons**" means the Defendant Global X Investments Inc. (formerly known as Horizons ETFs Management (Canada) Inc.);

(q) "**HUV**" means BetaPro S&P 500 VIX Short-Term Futures ETF;

(r) "**HVI**" means BetaPro S&P 500 VIX Short-Term Futures Daily Inverse ETF;

(s) "**HVU**" means BetaPro S&P 500 VIX Short-Term Futures 2x Daily Bull ETF;

(t) "**investment fund**" or "**fund**" means HVI;

(u) "**National Bank**" means the National Bank of Canada, Horizons' counterparty on the Forward Contracts;

(v) "**NAV**" means net asset value;

(w) "**NBF**" means National Bank Financial Inc., which acted as the Designated Broker and one of the Dealers for Units of HVI;

(x) "***OSA***" means the *Securities Act*, R.S.O. 1990, c. S.5, as amended;

(y) “**Plaintiff**” means the Plaintiff, Graham Wright;

(z) “**Prospectus**” refers to the December 22, 2017 Final long form prospectus that offered Units of HUV, HVI and HVU, as well as any predecessor prospectus’ in relation to HVI;

(aa) “**ProShares**” is Proshares Advisors LLC (or an affiliate or successor company), being a U.S. based ETF company and sponsor of SVXY;

(bb) “**net asset value**” means the value of the assets of HVI, minus its liabilities. The net asset value per Unit of HVI is the net asset value divided by the number of then-outstanding Units;

(cc) “**Reference Index**” means the Horizons Short VIX Short-Term Futures Index, an index manufactured by Horizons which is intended to be an inverse index to the Underlying Index. The Reference Index was published by Bloomberg L.P. and Reuters at the close of each trading day under the ticker symbol CMDYVXER. The value of the Reference Index throughout the material time was the 4:00 p.m. price of the ProShares Short VIX Short-Term Futures ETF, SVXY;

(dd) “**roll yield**” is income (or loss) derived from the difference in price at which the second month’s VIX Futures Contract is sold and the price at which the first month’s VIX Futures Contract is purchased. The “roll” is the accumulation of income (or loss) over time. HVI generally collected roll yield when markets were in a state of contango;

(ee) “**S&P 500**” means the Standard & Poor’s 500, which is an American stock market index based on the market capitalization of 500 large companies listed on the New York Stock Exchange or NASDAQ. The S&P 500 measures the stock market performance of these large companies, and is widely considered as a proxy for the broader U.S. stock market;

(ff) **"SVXY"** refers to the ProShares Short VIX Short-Term Futures ETF, a United States based inverse volatility ETF that sought to trade the inverse of the Underlying Index;

(gg) "**SPVXSP**" is the ticker symbol for the Underlying Index, the S&P 500 VIX Short-Term Futures Index;

(hh) "**Trust Declaration**" refers to the Amended and Restated Master Declaration of Trust for Horizons BetaPro ETFs, including HVI, dated March 27, 2017;

(ii) "**TSX**" means the Toronto Stock Exchange;

(jj) "**Underlying Index**" means the S&P 500 VIX Short-Term Futures Index, an index developed by S&P Dow Jones Indices LLC and licensed to Horizons to provide exposure to the VIX Index. It is comprised of two near term VIX Futures Contracts – a first month and a second month contract – that are rebalanced daily in order to maintain a continuous one-month maturity. The value of the Underlying Index is determined based on a weighted average of the VIX Futures Contracts;

(kk) "**Units**" means a Class "A" unit of HVI, and "**Unit**" means any one of them;

(ll) "**Unitholders**" means persons who held a Unit or Units and "**Unitholder**" means any one of them;

(mm) "**VIX Index**" or the "**VIX**", means the CBOE Volatility Index, which is a measure of implied and expected volatility of the S&P 500 over a 30 day period. The implied level of volatility of the S&P 500 typically increases in periods of market instability, increasing the level of the VIX Index. The Underlying Index provides exposure to the VIX Index by measuring the excess return from a daily rolling long position in the first and second month VIX Futures Contracts;

(nn) “**VIX Futures Contracts**” are agreements for the payment and receipt of an amount of cash based on the level of the VIX Index on a specified future date, and a “**VIX Futures Contract**” means any one of them;

(oo) “**volatility**” is a statistical measure of the dispersion of returns for a given security or market index. Volatility refers to the amount of uncertainty or risk about the size of changes in the security or index’s value. High volatility means that a price will fluctuate significantly, whereas low volatility means that a price will change more gradually;

(pp) “**Wright**” means the Plaintiff, Graham Wright; and

(qq) **“XIV**” was the VelocityShares Daily Inverse VIX Short Term Exchange-Traded Note, a large US-based inverse ETN that was to provide short exposure to VIX Futures Contracts.

GRAHAM WRIGHT
Plaintiff

-and-

HORIZONS ETFS MANAGEMENT (CANADA) INC.
Defendant

Court File No. CV-18-00597284-00CP

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SUPERIOR COURT OF JUSTICE

PROCEEDING COMMENCED AT
TORONTO

FRESH AS AMENDED STATEMENT OF CLAIM

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