

July 27, 2009

Chairman Gary Gensler  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Dear Mr. Gensler

**Re    *Written Testimony Submission for CFTC Hearings on the “Application of Position Limits and Exemptions from Position Limits in Energy Markets” (Day 2, Panel 2 - July 29, 2009)***

1.    Mr. Chairman, and fellow Commissioners, my name is Adam Felesky, Chief Executive Officer of BetaPro Management Inc. (“BetaPro”), the trustee and manager of the Horizons BetaPro ETFs, which are listed on the Toronto Stock Exchange (the “TSX”) and are the fastest growing family of exchange traded funds (“ETFs”) in Canada. Several of our commodity-based ETFs have been or are the most actively traded securities on the TSX and currently account for over 37 million units traded each day<sup>1</sup>.
2.    I would first like to thank the Commission for this opportunity as a product manufacturer and specialist in the energy markets to share our views as relates to the Commission’s current review of the application of position limits and exemptions in this market place<sup>2</sup>.

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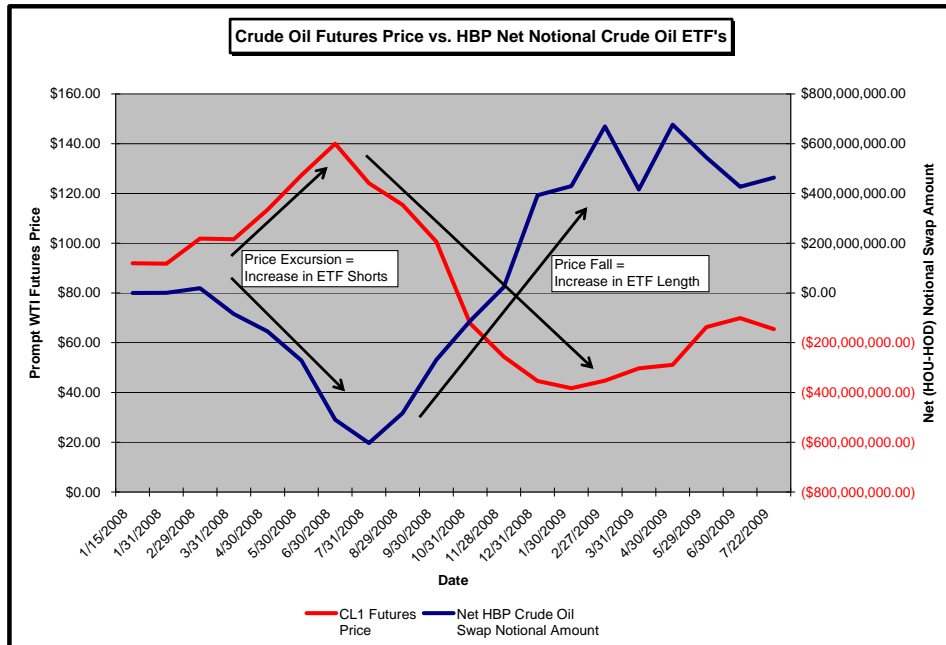
<sup>1</sup> Based on the 30 day daily trading volume average across the Horizons BetaPro NYMEX<sup>®</sup> Crude Oil and Natural Gas Bull Plus and Bear Plus ETFs as at July 24, 2009.

<sup>2</sup> A copy of our comment letter to the Commission is attached as Schedule A (Note: Point 6 on page 3 and Appendix E have been revised).

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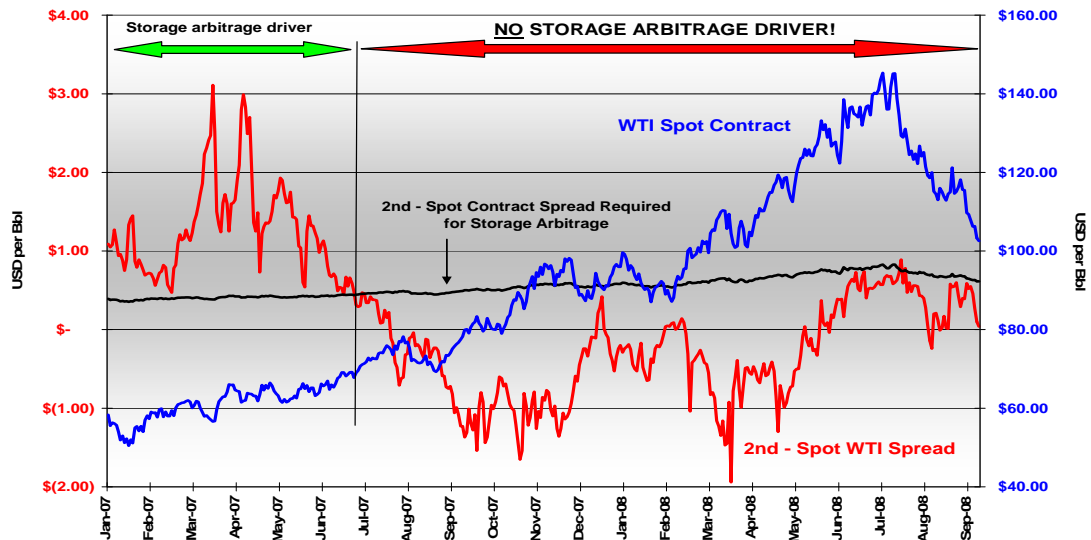
3. The Horizons BetaPro ETFs currently have assets in excess of Cdn. \$2.5 billion among 38 passively managed ETFs, 14 of which are commodity-based and six (6) of which have crude oil or natural gas as their underlying benchmarks. BetaPro specializes in offering currency hedged leveraged exposure both long and short – and was the first manager to offer such products for commodities in North America – where an investor can earn a return on a daily basis that is a multiple of that ETF's underlying index (e.g., +200% or -200%). All of our ETFs are rebalanced daily, which limits an investor's risk to their invested capital.
4. Currently we manage the second largest natural gas ETF in North America with notional long exposure of approximately Cdn. \$1.0 billion. Our ETFs are used by a vast cross section of investors, including mutual funds, pensions, insurance companies, dealer liability desks, hedge funds, financial advisors and retail clients. Many of our investors use the Horizons BetaPro ETFs exclusively to manage the risk within their portfolios.
5. Initially, I would like to speak to the role our commodity-based ETFs played during the 2008 price appreciation of crude oil to its July 11 high of U.S. \$147 per barrel as this event, I believe, is one of the primary reasons why we are gathered here today. While much of the public discourse would suggest that commodity-based ETFs were a factor in the rise in the price of oil, the data clearly does not support this conclusion.
6. We launched the first leveraged long and short crude oil ETFs in North America, on January 16, 2008. On that date, the price of crude oil was U.S. \$90.84 per barrel. On July 11, 2008 when crude oil peaked at U.S. \$147 per barrel - only six (6) months after our launch - our Horizons BetaPro NYMEX<sup>®</sup> Crude Oil Bull Plus ETF held less than Cdn. \$100.0 million in notional long exposure (or long 450 contracts) while our Horizons BetaPro NYMEX<sup>®</sup> Crude Oil Bear Plus ETF had soared to approximately Cdn. \$600.0 million in notional short exposure (or short 3,850 contracts). Clearly our investors saw a significant opportunity to capitalize from a price decline after such a dramatic price appreciation.

7. Our data shows that our commodity-based ETFs have attracted sellers when commodity prices are rising and buyers when commodity prices are falling. Instead of being a source of volatility, our commodity-based ETFs have been a source of price stability. Similar results have been experienced by our largest competitor in the United States as evidenced in their securities filings and further supported by the Commission’s September 2008 Staff Report on Commodity Swap Dealers and Index Traders.
  
8. The inverse relationship between the net notional exposure of our long and short commodity-based ETFs and the price of crude oil continues to persist today:



9. In addition, interest in our commodity-based ETFs coupled with other index activity (such as rebalances) is one factor which explains why the crude oil futures curve fell into steeper backwardation in early 2008:

**Storage Arbitrage versus Prompt WTI**



10. It should also be stressed that our commodity-based ETFs do not hold spot month futures to delivery. All of our long commodity-based ETFs roll out of the current nearby future to the next by selling the spot month which is the most relevant for the end user/consumer. As a result, if there is any direct price impact emanating from our long commodity-based ETF activity on the prompt month contract it is to exert a downward effect on price, which tends to moderate any upward price pressures attributable to other market factors.
11. Our long commodity-based ETFs are the aggregate investment of thousands of investors acting independently and to our knowledge no one investor has indirectly obtained a position in any of our commodity-based ETFs in excess of the speculative limit that would otherwise be imposed directly on such an individual. As of July 24, 2009 our energy long ETFs held, on average, less than 0.51 contracts per investor<sup>3</sup>.

<sup>3</sup> Our long natural gas and crude oil ETFs had approximately 40,000 and 30,000 investors, respectively, as at July 24, 2009. (Source: Broadridge)  
 Average number of contracts per investor - calculated by dividing the notional assets under management multiplied for each ETF by the underlying futures contract value of that ETF, and then further dividing the result by the number of investors in that ETF; the result was then averaged between our long oil and gas ETFs as at July 24, 2009.

12. In addition, our ETFs use a customized passive swap which tracks the applicable ETFs underlying index, which allows the underlying commodity returns to be hedged back to the Canadian dollar and rebalanced on a daily basis. This exposure is not attainable in the futures market on a same margin basis.
  13. While, we would support any regulatory reforms to improve transparency and disclosure of individual investors as relates to their individual limits (see our proposal under the heading “Possible Response” on page 3 of our comment letter to the Commission, a copy of which is attached as Schedule “A”), we feel strongly that treating a single ETF as one investor for the purposes of any position limit calculations would not only be discriminatory relative to an over-the-counter (“OTC”) or future position, it would encourage investors to assume a riskier, less transparent (in the case of an OTC alternative) and less collateralized investment - all of which seem incongruent with the Commission’s objectives.
  14. Similarly if the bona fide hedge exemption for swap dealers is eliminated and replaced by a new limited risk management exemption which does not adequately provide for the trading activity of passive commodity-based ETFs such as ours, we see five (5) negative consequences that will likely occur immediately, in addition to the more obvious concerns of reduced liquidity and increased volatility:
    - (a) Each of our commodity-based ETFs may conceivably dissolve into a series of smaller commodity-based ETFs to ensure each ETF is below the Commission’s speculative position limit. This would result in a larger number of ETFs to monitor, greater costs to the investor, and arguably, an increased risk that an individual could aggregate his or her position in excess of the Commission’s speculative position limit across several ETFs with the same investment objective without triggering a traditional securities disclosure event. For example, based on the current size of
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assets under management by natural gas ETFs and the Commission's existing speculative position limits, this could potentially result in the three current ETFs fractionalizing into approximately 26 ETFs<sup>4</sup>;

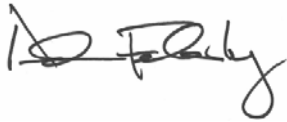
- (b) This fractionalization will also result in a disproportionate reduction in the liquidity of such ETFs and therefore liquidity in the underlying futures market, especially as larger institutional clients would be less inclined to use ETFs and would likely revert back to using OTC positions to satisfy their investment needs;
  - (c) Imposing speculative position limits on commodity-based ETFs as a single investor also has the potential to significantly increase the number of dealers that will engage in commodity-related trading activity and will therefore increase the need for regulatory supervision;
  - (d) Speculative position limits will also impose constraints on the ability of dealers to provide exposure which we expect would increase costs dramatically for all users; and
  - (e) Commodity-based ETFs might attempt to obtain exposure to the markets outside of the Commission's jurisdiction, resulting in reduced market transparency and market oversight.
15. In summary, we strongly believe that our commodity-based ETFs provide a cost effective, less risky, transparent and liquid investment alternative for investors who want to access the commodity markets while playing an integral role in enhancing the underlying liquidity of the commodities markets itself for the benefit of all users. Our commodity-based ETFs are passive, do not take delivery of the underlying commodity and are listed on the TSX. Our commodity-based ETFs should not be a source of concern for the Commission, but rather an essential tool to promote its objectives of:

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<sup>4</sup> Calculated based on the notional value of all North American natural gas ETFs divided by the current limits of the Commission as at July 24, 2009.

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- (a) lowering systemic risks;
  - (b) promoting transparency and efficient markets; and
  - (c) promoting market integrity.
16. To help achieve those objectives, we fully support any effort to increase the transparency of individual investor positions within ETFs (see our proposal under the heading “Possible Response” on page 3 of our comment letter to the Commission, a copy of which is attached as Schedule “A”).
17. Thank you and I look forward to your questions.



## Schedule A

### Initial Submission to the Commission by BetaPro Management Inc.

July 24, 2009

Mr. David Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Dear Mr. Stawick:

Re: Concept Release 74 FR 12282 - *Whether to Eliminate the Bona Fide Hedge Exemption for Certain Swap Dealers and Create A New Limited Risk Management Exemption for Speculative Position Limits* (the "Concept Release")

#### *Introduction*

I am Adam Felesky, Chief Executive Officer of BetaPro Management Inc. ("BPM"), the manager of the Horizons BetaPro ETFs (the "HBP ETFs"), which is a family of exchange traded funds ("ETFs") domiciled in Ontario, Canada and listed on the Toronto Stock Exchange (the "TSX"). I would like to respond to the Concept Release released by the Commodity Futures Trading Commission (the "CFTC") earlier this year with respect to its impact on our investors as well as on our business capabilities.

The HBP ETFs currently have assets in excess of Cdn. \$2.5 billion among 38 ETFs – 14 of which are commodity based. BPM specializes in offering leveraged exposure long and short – and was the first manager to offer such products for commodities in North America. Currently we manage the second largest natural gas ETF in North America. Our ETFs are used by a vast cross section of investors, including mutual funds, hedge funds, pensions, insurance companies, dealer liability desks, financial advisors and retail clients. Many of our investors use the HBP ETFs exclusively to manage the risk within their existing portfolios. Several of the commodity-based HBP ETFs have been or are the most actively traded securities on the TSX.

While the HBP ETFs are not domiciled in the United States, the exposure for many of our ETFs is obtained indirectly through an over-the-counter ("OTC") swap with a Canadian counterparty dealer which, to varying degrees, hedges its position in the underlying futures market.



*Concept Release*

BPM would like to submit the following comments on the Concept Release in advance of the July 2009 scheduled hearings on this matter. We believe that the HBP ETFs should continue to be eligible for an exemption from the proposed specified position limits for the following reasons:

- 1) The HBP ETFs are Exchange Traded Funds that track an underlying index such as a commodity and depending on the investment objective of the HBP ETF deliver a return that is a multiple of the performance of its underlying index (e.g., +200%, -100% or -200%). Although the HBP ETFs use leverage to varying degrees, they are passively managed and are rebalanced daily, which limits the exposure of investors. By virtue of the swap activity currently undertaken by the HBP ETFs, they have been very successful in providing investment results that almost perfectly track their investment objectives. In addition, by being listed on the TSX, the HBP ETFs are transparent and are not a source of market manipulation or speculation.
- 2) Our commodity-based HBP ETFs provide a limited risk, exchange-listed alternative for investors compared to an OTC swap or future position which can involve unlimited risk of their capital.
- 3) Our commodity-based HBP ETFs never hold spot month futures to expiry. Long commodity HBP ETFs roll out of the current nearby future to the next by selling the spot month which is the most relevant for the end user/ consumer. As a result, if there is any direct price impact emanating from the long HBP ETF activity on the prompt month contract it would be to exert a downward effect on price, serving to moderate any upward price pressures attributable to other market factors.
- 4) In the spring and summer of 2008, the crude oil futures curve was in backwardation most of the time, with the second month forward contract (which would absorb the HBP ETF's buying activity) trading at a discount to where physical market players were largely establishing the prompt month contract price. Consequently, as the second month contract was trading at a discount, the HBP ETF buying activity in the second contract month did not force up the prompt contract (see Appendix A).
- 5) Our commodity-based HBP ETFs have attracted sellers when there was significant price appreciation and buyers when there was significant price declines – not vice versa – which arguably promotes price stability, not volatility. This was further established and presented in the CFTC September 2008 Staff Report on Commodity Swap Dealers and Index Traders. In addition, ETFs that provide short exposure, such as the Horizons BetaPro Crude Oil Bear+ ETF, provide a unique means by which investors can take a position against a perceived inflated market, versus simply reducing an existing long position (see Appendix B). Finally it should be noted that the

HBP ETFs that are leveraged long and short oil and gas have holding periods of only 1 to 3 days (see Appendix C). Hence, while these HBP ETFs provide tremendous additional market liquidity (see Appendix D), they do not result in a sustained market position over longer periods.

- 6) The assets in our commodity-based HBP ETFs are the aggregate investment of thousands of investors and to our knowledge no one investor has indirectly obtained a position in a commodity-based HBP ETF in excess of the speculative limit that would otherwise be imposed directly on such an individual. Our commodity-based HBP ETFs only held on average less than 0.20 contracts per unit holder as of December 31, 2008 (see Appendix E).

That said, BPM supports any regulatory efforts to ensure that there is adequate transparency and is willing to immediately enter into discussions with the Ontario Securities Commission, the HBP ETF's principal regulator, to achieve that result.

- 7) The HBP ETFs, which are not actively managed, require a customized passive swap which tracks its customized underlying index, which allows the underlying commodity returns to be hedged back to the Canadian dollar. This exposure would not be attainable in the futures market on a same margin basis.
- 8) If the bona fide hedge exemption is eliminated and if no exemption was allowed by the CFTC for the HBP ETF's related swap activity, each HBP ETF could conceivably dissolve into a series of ETFs to ensure it was below the CFTC speculative limit. This could result in a larger number of ETFs to monitor, greater costs to the investor (i.e., due to reduced economies of scale), and arguably, increased risk that an individual could aggregate a position in excess of the CFTC speculative limit across several ETFs with the same investment objective without triggering a traditional securities disclosure event.
- 9) If the bona fide hedge exemption is eliminated and if no exemption was allowed by the CFTC for the HBP ETF's related swap activity, there would also be an attraction for dealers that are currently not involved in commodity-related trading activity to enter the market, as the scarcity value of speculative limits for non-commercial clients would be significant. We believe in time the market structure and price dynamics would be unchanged but the CFTC may have significantly more dealers to monitor and the costs to investors may be substantially higher.

#### *Possible Response*

Our perception is the CFTC is most concerned about market transparency and potentially imposing speculative limits to avoid market manipulation and to mitigate excessive speculation, while at the same time ensuring that non-commercial activity is

sufficiently robust in order to support commercial hedging needs. To achieve these goals while still exempting commodity-based ETFs, like our commodity-based HBP ETFs, from the proposed speculative limits, the CFTC might want to consider:

- a) Requiring disclosure to the CFTC by such ETFs of any investors who indirectly hold investments in such ETFs with a value that is more than a specified level (e.g., 33%) of the speculative limit on a monthly basis;
- b) Mandating any investor in such ETFs to notify the manager of such ETFs if their investment in such ETFs at any time exceeds 100% of the speculative limit; and
- c) Requiring the managers of such ETFs to have the ability to force an investor in such ETFs to redeem a portion or all of their investment in such ETFs such that the investor does not exceed any stipulated guidelines adopted by the CFTC.

The foregoing would help assist the CFTC in monitoring an individual investor's position in such ETFs and potentially in such ETFs in the same fund complex. As you can appreciate, implementing such a solution will require the coordination of all applicable regulatory authorities (i.e., the Securities and Exchange Commission and the Canadian securities administrators in the case of the HBP ETFs). However, as the number of investors that will likely be impacted is probably quite small, the cost of imposing these requirements may be appropriate.

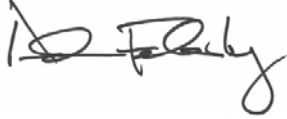
### *Conclusion*

In summary, we strongly believe that commodity-based ETFs, like our commodity based HBP ETFs, play an integral role in enhancing the underlying liquidity of the commodities market through a structure which is cost effective, transparent and liquid (i.e., as they are usually listed on an exchange). Furthermore, our data with respect to our commodity-based HBP ETFs and other competitors indicate that the recent price appreciation in crude oil in June 2008 was curtailed by crude oil ETFs, rather than being exaggerated. In addition, the inability of such ETFs to limit the price move in crude oil in 2008 further illustrates that the physical market continues to be substantially larger and of greater influence.

The possible elimination of the bona fide hedge exemption could also result in an immediate fractionalization of ETFs and potentially increase the number of dealers that would begin acting as counterparties, which would increase the need for regulatory oversight and potentially the cost for investors. Commodity-based ETFs, such as our commodity-based HBP ETFs, which passively track an index, are listed on a public exchange, are subject to regulatory oversight and do not take delivery of the commodity, are transparent and are important investment vehicles for many investors. They should not be viewed negatively and should not be restricted from providing benefits to investors, particularly when they are not a source of market manipulation or speculation.

Thank you for considering my remarks. Please do not hesitate to contact me at 416 933 5739 if I can be of any other assistance.

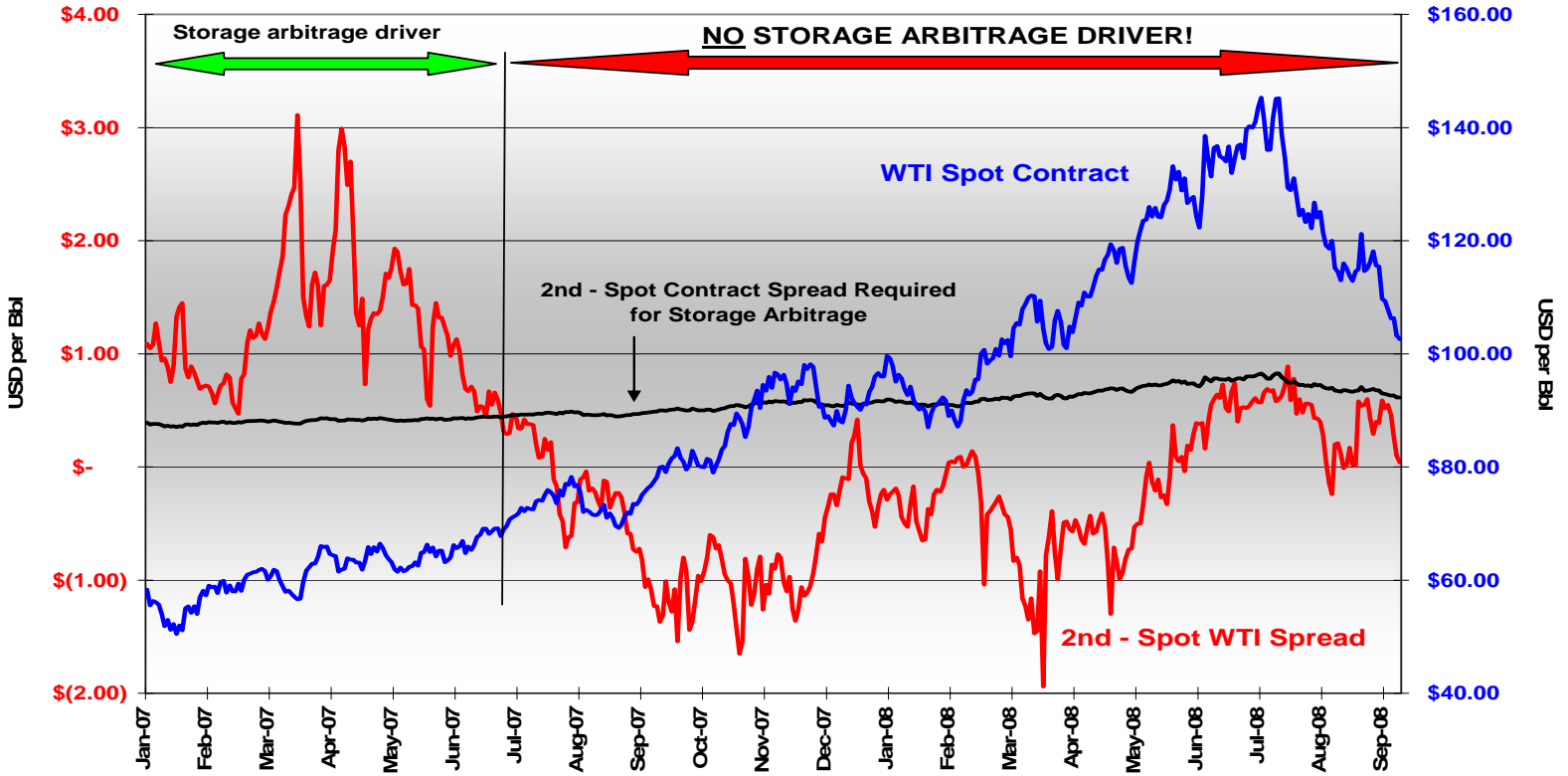
Sincerely,

A handwritten signature in black ink, appearing to read "Adam Felesky". The signature is written in a cursive style with a prominent initial "A".

Adam Felesky  
Chief Executive Officer,  
BetaPro Management Inc.

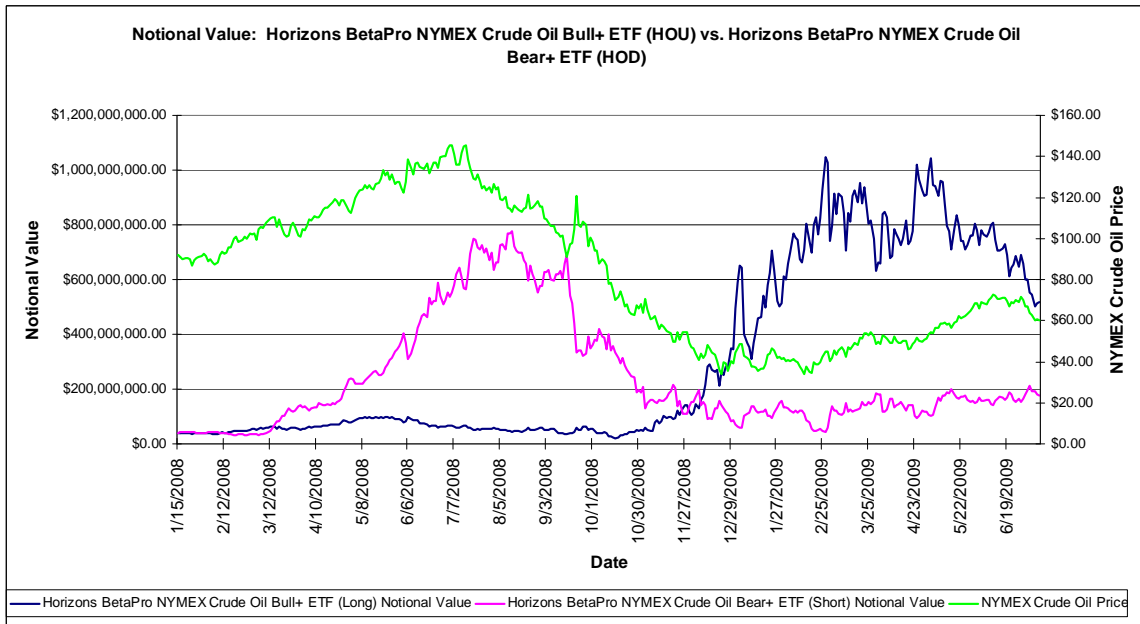
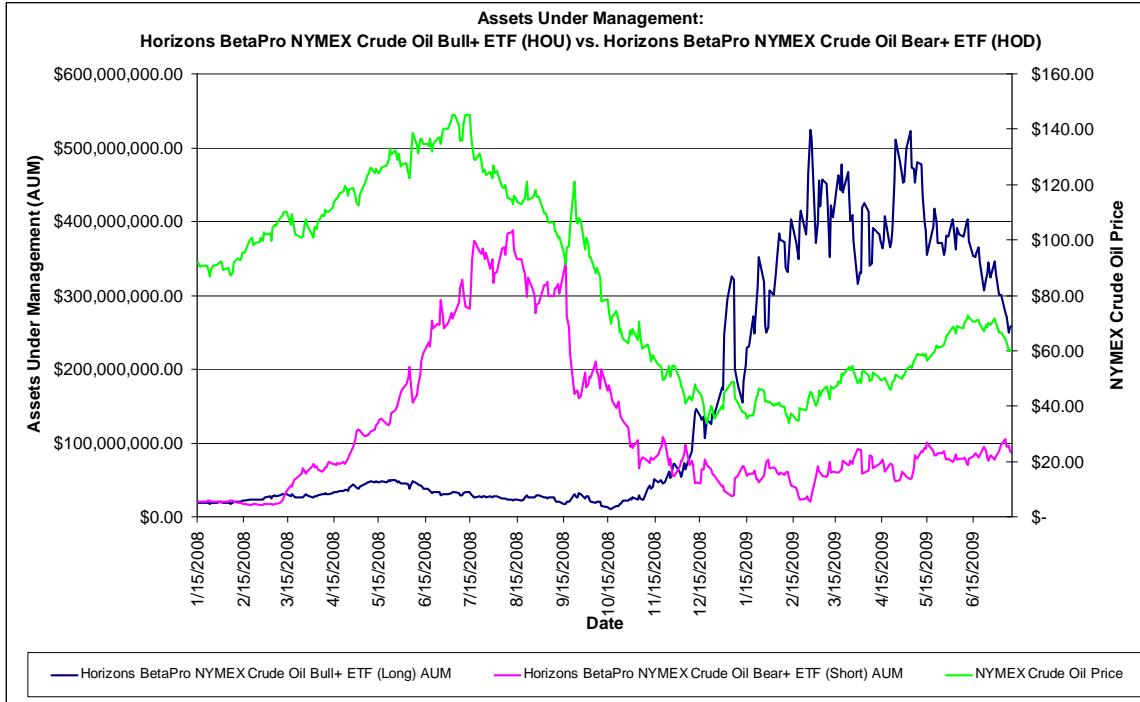
Appendix A – Crude Bull Market Review: 2007 – 2008

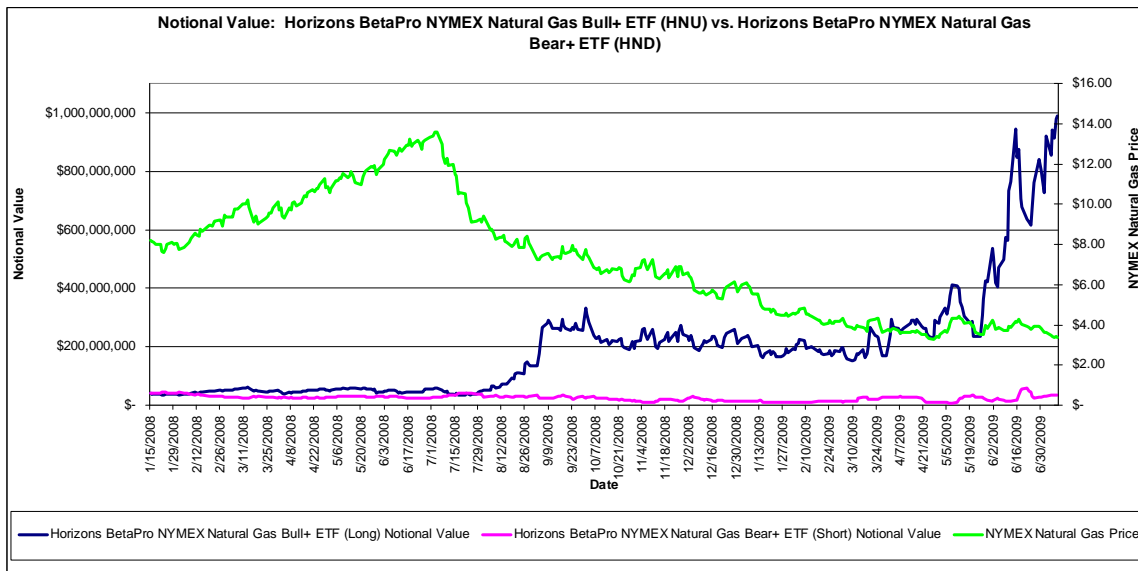
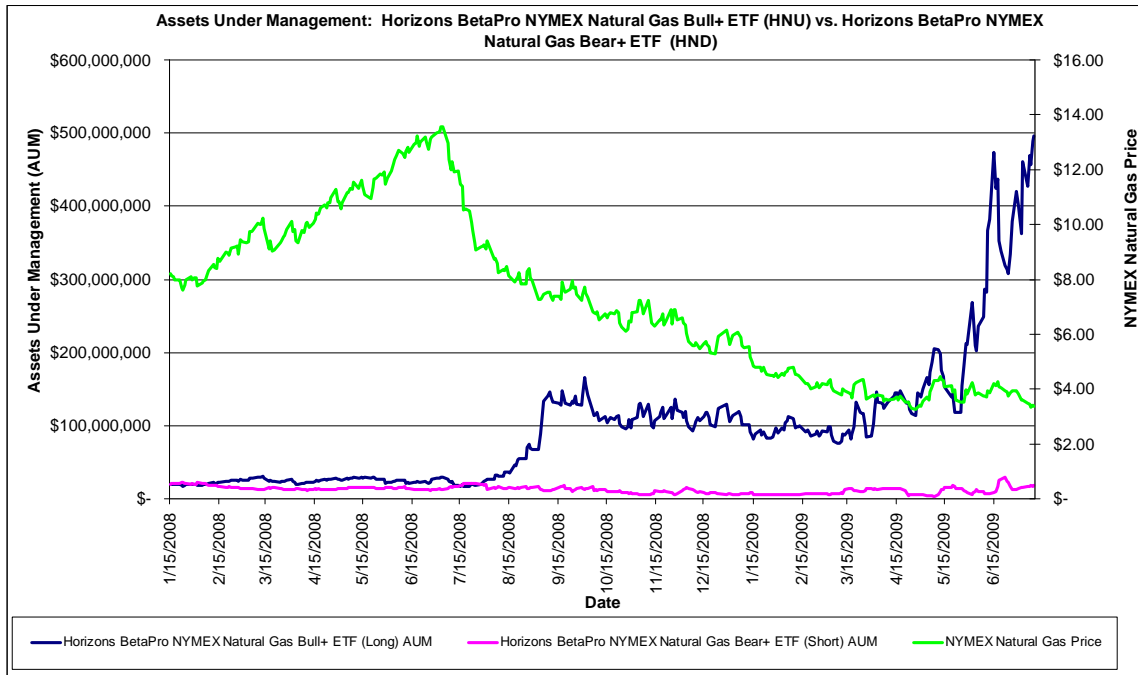
Storage Arbitrage versus Prompt WTI



Source: National Bank Financial

## Appendix B – HBP ETF Assets under Management and Corresponding Notional Values Relative to Underlying Futures Contract Prices





Source: Bloomberg

\*Data from ETF inception (January 15, 2008) to June 30, 2009

Appendix C – Average Hold Periods for Horizons BetaPro ETFs

**Horizons BetaPro ETFs – Average Hold Period (June 1, 2009 – June 30, 2009)**

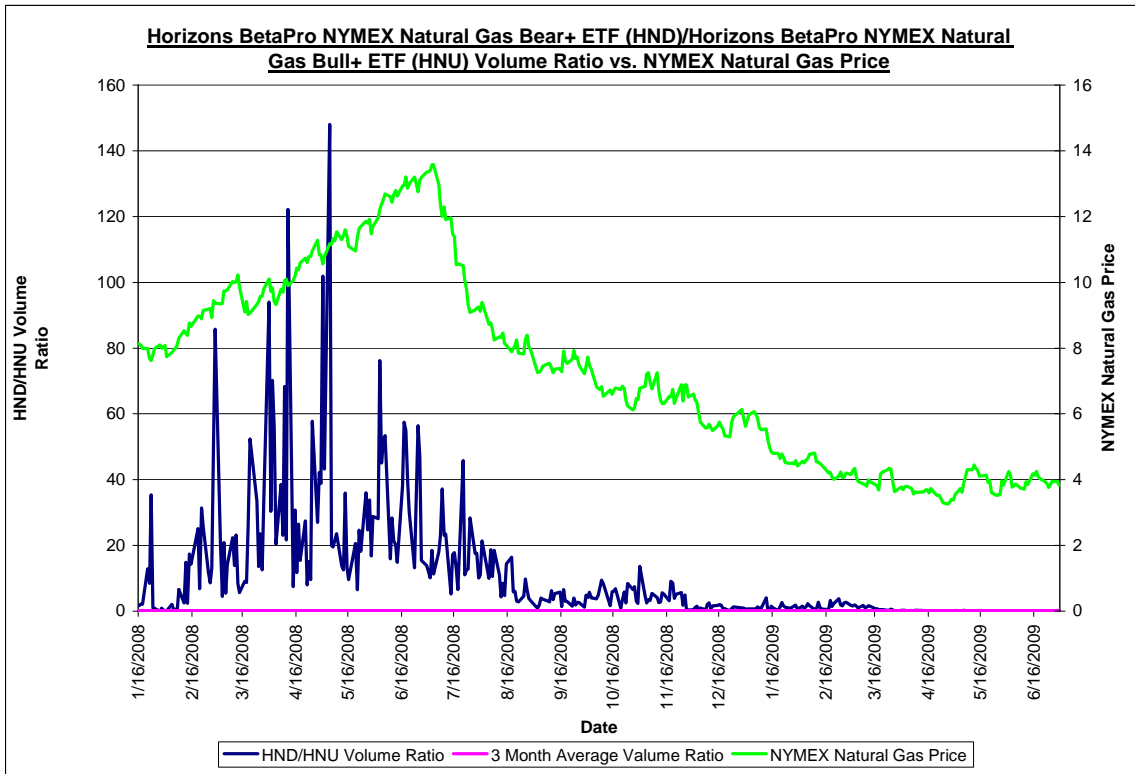
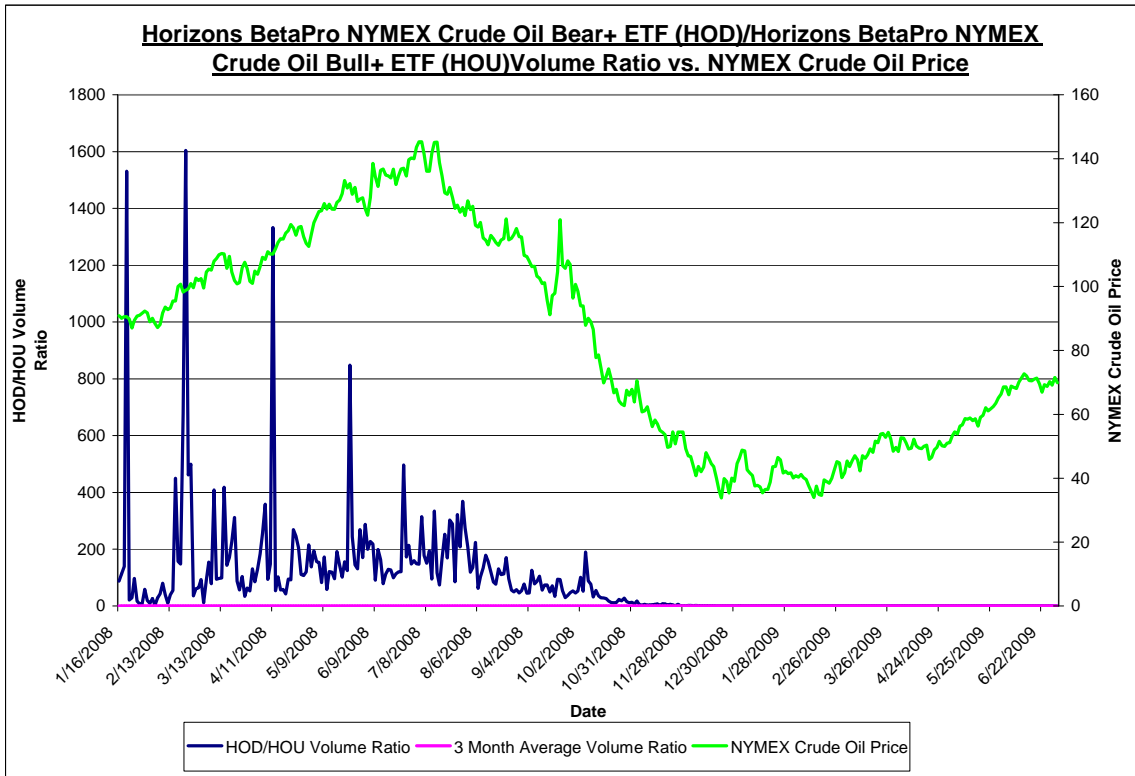
<b><u>ETF</u></b>	<b><u>Average Hold* (Days)</u></b>
Horizons BetaPro NYMEX® Crude Oil Bull+ ETF	3
Horizons BetaPro NYMEX® Crude Oil Bear+ ETF	3
Horizons BetaPro NYMEX® Natural Gas Bull+ ETF	2
Horizons BetaPro NYMEX® Natural Gas Bear+ ETF	1

Source: BetaPro Management Inc., Bloomberg

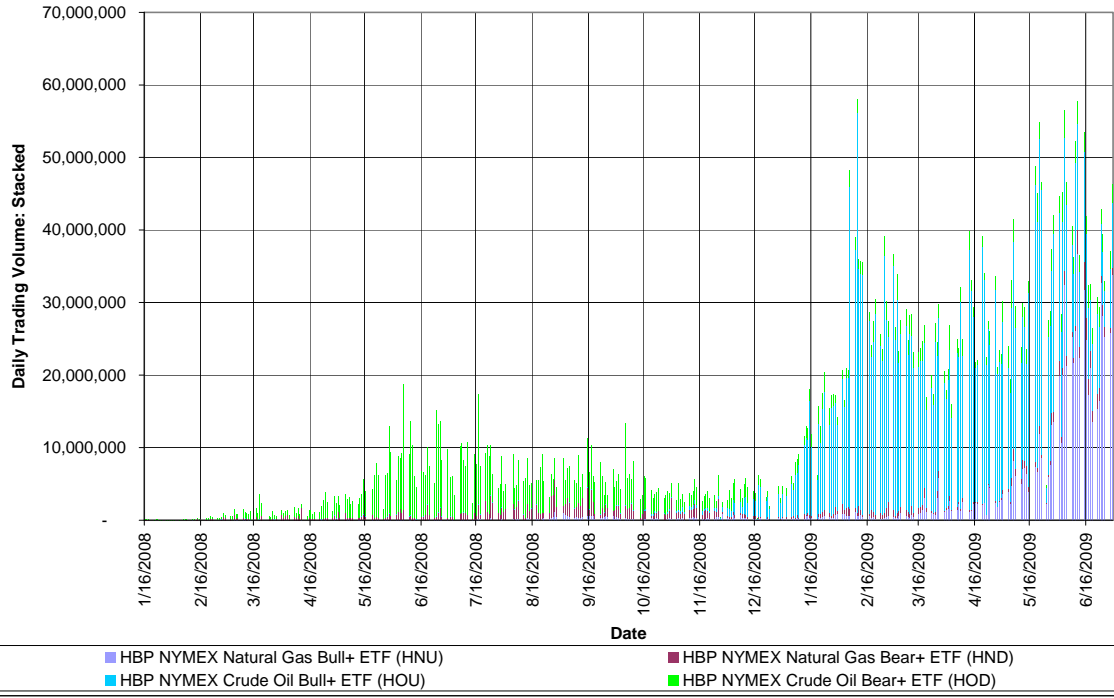
\*Average Hold calculated as: dollar value of ETFs traded per day (Volume\*NAVPU) divided by Assets under Management for each ETF



Appendix D



**HBP NYMEX Natural Gas Bull+ (HNU), Bear+ (HND) and HBP NYMEX Crude Oil Bull+ (HOU), Bear+ (HOD): Stacked Daily Trading Volume Chart**



Appendix E - Number of Underlying Futures Contracts Held per Unit Holder\*

ETF	Number of Contracts per Unit Holder
<b>Horizons BetaPro NYMEX Crude Oil Bull Plus ETF</b>	<b>0.2626</b>
<b>Horizons BetaPro NYMEX Crude Oil Bear Plus ETF</b>	<b>0.3081</b>
<b>Horizons BetaPro NYMEX Natural Gas Bull Plus ETF</b>	<b>0.1953</b>
<b>Horizons BetaPro NYMEX Natural Gas Bear Plus ETF</b>	<b>0.0027</b>

Source: BetaPro Management Inc., Bloomberg

\* Average number of contracts per investor - calculated by dividing the notional assets under management multiplied for each ETF by the underlying futures contract value of that ETF, and then further dividing the result by the number of investors in that ETF; the result was then averaged between our long oil and gas ETFs as at July 24, 2009.

All data as at December 31, 2008 (CAD)