



Real Return Bond Index – Methodology

October 26, 2006

Introduction

PC-Bond* has been publishing indices to measure the performance of the Canadian fixed income market since 1947. Our indices are the most widely used fixed income performance benchmarks in Canada. The best known of these indices is the Universe Bond Index, which tracks the broad Canadian bond market. In addition to the Universe, we publish a variety of sub-indices for different term and credit sectors, as well as indices for tracking other segments of the market, including High Yield, Euro, and Yankee Bonds, inflation-indexed Real Return Bonds, Strip Bonds, 20+ Bonds, Maple Bonds, T-Bills, and residential and commercial Mortgage-Backed Securities.

Eligibility Rules – Real Return Bond Index

Minimum issue size	100 Million (before inflation compensation)
Minimum number buyers	10 institutional buyers
Minimum sector size (i.e. Federal, Provincial, Corporate, Municipal)	1.5 Billion
Minimum Credit Rating	BBB(low)
Remaining Term	The remaining term to maturity must be greater than one year
Coupon	The real coupon must be fixed rate. Step-up coupon structures are eligible, provided that the coupon increases in a predetermined way.
Currency	Canadian dollars
Country of issuance	Canada
Country of issuing entity	Canada
Security Structures Specifically Excluded	Floating rate securities, securities targeted to the retail market, convertible bonds, mortgage-backed securities, other prepayable asset-backed securities, or securities that are not legally considered to be debt obligations of the issuing company or government.



Weighting

As with all Scotia Capital bond indices, the RRB indices are capitalization-weighted. That is, each bond contributes to the return on the index in proportion to its relative market value.

The total amount outstanding of each issue is adjusted so that Bank of Canada holdings and stripped securities are excluded, and reconstituted securities are included.

Coupon Reinvestment

Coupon income is reinvested across all bonds in the index in proportion to their market value. Coupon income is recognized each day as coupon income accrues, as well as when an actual coupon payment is made.

Index Re-Balancing

New issues enter the index on the day they are issued, or as soon thereafter once it is confirmed that they meet all eligibility criteria. Eligibility criteria must be established by 3:00 pm EST for a security to enter the index on that day.

A security is removed from the index on the day that its remaining term to maturity falls to one calendar year, whether that year has 365 or 366 days.

A security that is downgraded below BBB(low) is removed from the index 3-months after the date of the downgrade.

Split Credit Ratings

The categorization of bonds into the index credit ratings categories of AAA/AA, A, and BBB is based on information from Dominion Bond Rating Service, Standard and Poor's, and Moody's Investors Service.

In cases where the agencies do not agree on the credit rating, the bond will be classified according to the following rules:

- If two agencies rate a security, use the lower of the two ratings;
- If three agencies rate a security, use the most common rating;
- In the rare event that all three agencies disagree, use the middle rating

Unsolicited ratings (i.e. ratings only based on public information) will not be used when determining index rating categories



Pricing

Securities are priced at their mid-market levels as of 4:00 pm each day. This is the same policy as the Scotia Capital Universe Bond Index.

Settlement Conventions

Prices and risk measures are calculated assuming same-day settlement.

Revision of Index Rules Over Time

The rules and practices for constructing the RRB and other fixed income indices necessarily change over time in order to reflect developments in the market. We will endeavor to provide reasonable advance notice of any such changes, as well as an assessment of the expected impact on the index.

Return Calculation

The securities in the index are all valued daily. The rate of return from day t to day t+1 is calculated as the change in the market value of the securities in the index on day t, plus any cash flows received on these securities on day t+1. It can be calculated using the following formula, where P and AI denote market price and accrued interest, respectively, Q denotes the adjusted amount outstanding, IR denotes the index ratio, and CPN denotes the total coupon cash flow:

$$r_t = \frac{\sum_i Q_{i,t-1} \cdot (P_{i,t} + AI_{i,t}) / 100 \times IR_{i,t} + \sum_{i^*} CPN_{i,t}}{\sum_i Q_{i,t-1} \cdot (P_{i,t-1} + AI_{i,t-1}) / 100 \times IR_{i,t-1}} - 1$$

Given the index value for day t, the index value for day t+1 is therefore:

$$Index_t = Index_{t-1} \times (1 + r_t)$$

Returns for periods longer than 1 day are linked together geometrically:

$$Index_t = Index_{t-k} \times (1 + r_{t-k+1}) \times \dots \times (1 + r_{t-1}) \times (1 + r_t)$$

The return calculations are thus identical to the return calculations on the Scotia Capital Universe Bond Index. The only difference is that, with inflation-linked bonds, accrued income and coupon payments will typically include both real income and inflation income components.



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PC-Bond* calculates and publishes the Scotia Capital Real Return Bond Index and other Scotia Capital fixed income indices at its own expense as an information service to financial market participants. The indices are published on a best-efforts basis, and do not constitute a recommendation to trade any particular security.

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