

# Canada

## Real Return Bonds

Government of Canada Real Return Bonds (the "Bonds") constitute direct, unsecured, unconditional obligations of Her Majesty in right of Canada. The Bonds may be issued from time to time in different series, with the coupon rate and maturity date ("Maturity") varying for each series. The Bonds of a series may not be called for redemption by the Government of Canada prior to Maturity for that series. Each Bond has a nominal principal amount of \$1,000 ("Principal").

The Bonds bear interest adjusted in relation to the Consumer Price Index for Canada (the "CPI"). Interest on the Bonds consists of both an inflation compensation component ("Inflation Compensation") calculated based on Principal and payable at Maturity and a cash entitlement ("Coupon Interest") calculated based on Principal and accrued Inflation Compensation, which Coupon Interest is payable in semi-annual installments on the dates specified for each series of Bonds (the "Coupon Payment Dates") in each year. Coupon Interest is calculated by multiplying one-half of the specified annual coupon rate for the relevant series of Bonds by the sum of the Principal and the Inflation Compensation accrued from the date the first Bond of such series was issued (the "Original Issue Date") to the relevant Coupon Payment Date. At Maturity, in addition to Coupon Interest payable on such date, a final payment (the "Final Payment") equal to the sum of Inflation Compensation accrued from the Original Issue Date to Maturity (whether positive or negative) and Principal will be made. See "Description of the Real Return Bonds".

Global certificates ("Global Certificates") for the full amount of the Bonds of each series offered from time to time are issued in fully registered form in the name of "CDS & CO.", a nominee of The Canadian Depository for Securities Limited ("CDS"). Individual certificates evidencing the Bonds are not available to beneficial owners of the Bonds ("Bondowners"). The Bonds must be purchased, transferred or sold directly or indirectly through a participant in the CDS book-entry systems and only in denominations of \$1,000 and integral multiples thereof. No Bondowner is shown on the records maintained by CDS other than a Bondowner who is a CDS participant.

November 25, 1994

## DESCRIPTION OF THE REAL RETURN BONDS

### General

The Bonds bear interest adjusted in relation to the CPI (which for the purposes of the calculation of interest on the Bonds includes any substitute index published by the Government of Canada as described under "Description of the Real Return Bonds - Commitment to Publish CPI"). Principal and interest on the Bonds will be payable in lawful money of Canada.

### Conventional Bonds versus Real Return Bonds

While the nominal yield to maturity and nominal cash flows are known in advance with conventional bonds (for example an 8% per annum Government of Canada bond purchased at par has a nominal yield of 8% per annum), the real yield (i.e. the yield after considering the effect of inflation on the purchasing power of money) depends on inflation throughout the term of the bonds. Even though the nominal amount due on maturity is known in advance, the purchasing power of that amount at such time is uncertain and may be more or less than the purchasing power of the original principal.

In the case of the Bonds, the real yield to maturity and real cash flows are known in advance; however, the nominal yield depends on inflation throughout the term of the Bonds. In addition, while the purchasing power of the amount due on maturity is known in advance, the actual nominal amount due on maturity is uncertain and may be more or less than the nominal amount of the original principal.

### Rank

The Bonds constitute direct, unsecured, unconditional obligations of Her Majesty in right of Canada. Principal and interest on the Bonds (interest consisting of Coupon Interest and Inflation Compensation) are direct charges on, and payable out of, the Consolidated Revenue Fund of Canada. The Consolidated Revenue Fund is the aggregate of all public monies such as tax revenues which are on deposit at the credit of the Receiver General for Canada, the public officer who receives or collects public monies for and on behalf of Canada. The Bonds rank *pari passu* and are payable ratably, without any preference or priority, with other obligations in respect of borrowed money payable from the Consolidated Revenue Fund.

### Indexing Process

An index ratio (the "Index Ratio") is applied to calculate both Coupon Interest and Inflation Compensation. As illustrated below, the Index Ratio for any date ("Date") is defined as the ratio of the reference CPI applicable to such Date ("Ref CPI<sub>Date</sub>") divided by the reference CPI applicable to the Original Issue Date for a particular series of Bonds ("Ref CPI<sub>Base</sub>").

$$\text{Index Ratio}_{\text{Date}} = \frac{\text{Ref CPI}_{\text{Date}}}{\text{Ref CPI}_{\text{Base}}}$$

The reference CPI for the first day of any calendar month is the CPI for the third preceding calendar month. For example, the reference CPI for December 1 in any year will be the CPI for September in that year (which will be published in October of that year). The reference CPI for any other day in a month is calculated by linear interpolation between the reference CPI applicable to the first day of the month in which such day falls and the reference CPI applicable to the first day of the month immediately following. For the purpose of interpolating Ref CPI<sub>Date</sub>, calculations will be carried to six decimal places and rounded, such that Ref CPI<sub>Date</sub> will be expressed to five decimal places (with numbers of 5 or more rounded up). Similarly, calculations of the Index Ratio will be carried to six decimal places and rounded (on the same basis), such that the Index Ratio will be expressed to five decimal places.

Consequently, the formula used to calculate Ref CPI<sub>Date</sub> can be expressed as follows:

$$\text{Ref CPI}_{\text{Date}} = \text{Ref CPI}_M + \frac{t-1}{D} [\text{Ref CPI}_{M+1} - \text{Ref CPI}_M]$$

where,

D = the number of days in the calendar month in which the Date falls;

t = the calendar day corresponding to the Date;

Ref CPI<sub>M</sub> = reference CPI for the first day of the calendar month in which the Date falls;

and

Ref CPI<sub>M+1</sub> = reference CPI for the first day of the calendar month immediately following the Date.

For example, the reference CPI for October 20, 1994 is calculated as follows:

$$\text{Ref CPI}_{\text{October20, 1994}} = \text{Ref CPI}_{\text{October1, 1994}} + \frac{19}{31} [\text{Ref CPI}_{\text{November1, 1994}} - \text{Ref CPI}_{\text{October1, 1994}}]$$

or

$$\text{Ref CPI}_{\text{October20, 1994}} = \text{CPI}_{\text{July1994}} + \frac{19}{31} [\text{CPI}_{\text{August1994}} - \text{CPI}_{\text{July1994}}]$$

where, D = 31 and t = 20.

The Ref CPI<sub>Base</sub> for a series of Bonds is the Ref CPI<sub>Date</sub> applicable to the Original Issue Date for such series. The Ref CPI<sub>Base</sub> remains constant throughout the term of each series of Bonds other than when the Official Time Base (described under "Description of the Consumer Price Index") is changed. Whenever the Official Time Base is changed, the Government of Canada will publish the conversion factor (which is calculated to three decimal places) used to rebase the CPI series to the new Official Time Base. For the purposes of a series of Bonds, such conversion factor will be used to rebase relevant prior CPI data (including CPI data relevant to the calculation of Ref CPI<sub>Base</sub>), when the first CPI published under the new Official Time Base is applicable to the calculation of Ref CPI<sub>Date</sub> for such series, with calculations carried to six decimal places and rounded to five decimal places (in the manner described above) or, in any event, to a minimum of five significant digits. Accordingly, a change in the Official Time Base will not have any impact on the entitlement of a Bondowner to Coupon Interest or Inflation Compensation, except for a possible insignificant impact which might result from rounding calculations.

If the CPI is not published for any month which is relevant for the purposes of the Bonds, the Government of Canada will publish forthwith a substitute index figure for the month that will apply even if the relevant CPI is subsequently published. Should a published CPI be revised for any reason, the originally published figure will apply for the purposes of the Bonds.

### **Interest and Final Payment**

Interest on each series of Bonds consists of both a cash entitlement (i.e. Coupon Interest) payable in semi-annual installments on the Coupon Payment Dates for such series in each year and Inflation Compensation (as described in the next paragraph) payable at Maturity for such series. Interest will accrue daily in such manner as will give rise to the Coupon Interest and Inflation Compensation entitlements set forth below.

Inflation Compensation accrued to any Date ("Inflation Compensation<sub>Date</sub>") for a series of Bonds is defined as the product of the Principal and the Index Ratio for that Date ("Index Ratio<sub>Date</sub>") for such series minus the Principal as depicted below:

$$\text{Inflation Compensation}_{\text{Date}} = \{ [\text{Principal} \times \text{Index Ratio}_{\text{Date}}] - \text{Principal} \}$$

or

$$\text{Inflation Compensation}_{\text{Date}} = \left\{ \left[ \text{Principal} \times \frac{\text{Ref CPI}_{\text{Date}}}{\text{Ref CPI}_{\text{Base}}} \right] - \text{Principal} \right\}$$

Coupon Interest will be calculated by multiplying one-half of the specified annual coupon rate for a series of Bonds by the sum of the Principal and the Inflation Compensation accrued from the Original Issue Date to the relevant Coupon Payment Date for such series. The following formula illustrates the Coupon Interest calculation for a series of Bonds with an annual coupon rate of 4.25% and a Coupon Payment Date of December 1, 1994:

$$\text{Coupon Interest}_{\text{December 1, 1994}} = \left[ \frac{4.25\%}{2} \right] \times [\text{Principal} + \text{Inflation Compensation}_{\text{December 1, 1994}}]$$

At Maturity, in addition to Coupon Interest, a final payment (the "Final Payment") equal to the sum of Inflation Compensation accrued from the Original Issue Date to Maturity (whether positive or negative) and Principal will be made, which sum will be paid in full satisfaction of the Principal and Inflation Compensation. The calculation of the Final Payment is depicted below:

$$\text{Final Payment} = \text{Principal} + \text{Inflation Compensation}$$

or

$$\text{Final Payment} = \text{Principal} + \left\{ \left[ \text{Principal} \times \frac{\text{Ref CPI}_{\text{Maturity}}}{\text{Ref CPI}_{\text{Base}}} \right] - \text{Principal} \right\}$$

### **Commitment to Publish CPI**

The Government of Canada will continue to publish the CPI (CPI to be determined as described under "Description of the Consumer Price Index") at least until the Index Ratio relevant to Maturity for each series of Bonds outstanding has been determined (as described under "Description of the Real Return Bonds - Interest and Final Payment"), except that, if the Government of Canada determines not to publish the CPI, it will publish a substitute index that is designed to reflect pure price movement in the Canadian economy and is equivalent in all material respects to the CPI. Such substitute index will, therefore, also be an "all-items" index designed to reflect pure price movements affecting typical Canadian household expenditures. Such substitute index will be effective for the purposes of the Bonds only from the date of announcement that such substitute index will be used and will not be utilized to adjust any interest entitlement (whether Coupon Interest or Inflation Compensation) which has accrued prior thereto. In addition, the Government of Canada will publish changes in the formula or the method of calculation of the CPI (including any substitute index) which has, or could reasonably be expected to have, a significant impact on the Bonds.

### **Registration and Denomination**

Global Certificates for the full amount of the Bonds of each series offered from time to time are issued in fully registered form in the name of "CDS & CO.", a nominee of The Canadian Depository for Securities Limited ("CDS"). Coupon Interest and the Final Payment will be paid in lawful money of Canada to CDS only, or to such other depository as the Minister of Finance may from time to time select on notice to the Bondowners of the series of Bonds affected by such change. The Bonds must be purchased, transferred or sold directly or indirectly through a participant in the CDS book-entry systems and only in denominations of \$1,000 and integral multiples thereof. No Bondowner will be shown on the records maintained by CDS other than a Bondowner who is a CDS participant.

If at any time, the Minister of Finance determines that it is no longer practicable or appropriate to use CDS or any other depository for the purpose of registration and settlement of a series of Bonds, the Minister of Finance may direct that individual certificates be made available to Bondowners of such series in fully registered form and in integral multiples of \$1,000.

## **Amendment of the Bonds**

The terms of a series of Bonds may be amended only if the amendment is proposed by the Minister of Finance and approved by an extraordinary resolution of Bondowners of such series at a duly convened meeting of such Bondowners at which a quorum is present. An extraordinary resolution of Bondowners of a series of Bonds is a resolution passed by the favourable votes of such Bondowners (excluding Her Majesty in right of Canada, agents thereof, federal Crown corporations and other entities owned or controlled by any of the foregoing) owning not less than two-thirds of the principal amount of the series of Bonds represented at the meeting and voted on a poll upon such resolution. On a poll, each Bondowner present in person or represented by a proxy duly appointed by instrument in writing will be entitled to one vote in respect of each \$1,000 principal amount of Bonds of which such Bondowner is the owner.

Meetings of Bondowners of a series of Bonds will be convened on not less than 21 clear days' notice to Bondowners of such series given in the manner provided under "Description of the Real Return Bonds - Notice to Bondowners". Such notice will state the time when and place where the meeting will be held and briefly the general nature of the business to be transacted. A quorum for meetings of Bondowners of a series of Bonds will consist of at least two Bondowners of such series present in person or represented by proxy and owning in the aggregate at least 25% in principal amount of such series of Bonds.

A Bondowner of a series of Bonds, as at the close of business on such record date as the Minister of Finance may select which is not more than 21 and not less than 10 days prior to the meeting date, may vote at any meeting of Bondowners of such series by instructing the relevant CDS participant as to how such Bondowner wishes to vote or by obtaining a form of proxy from such CDS participant appointing the Bondowner, or such individual as the Bondowner may designate, as proxy. Every extraordinary resolution passed as provided above will be binding on all Bondowners of the relevant series of Bonds, whether present at or absent from the meeting.

Clerical, typographical and other inconsequential amendments may be made to a series of Bonds only where the Minister of Finance (or such other Minister as the Minister of Finance may designate in writing), acting reasonably, determines that the amendment would not materially adversely affect the interest of the Bondowners of such series and where the Minister of Finance has received an opinion of counsel (on which such Bondowners may properly rely) to the effect that such amendment preserves and does not impair any of the rights and powers of such Bondowners. Immediately after any such amendment is effected, notice thereof shall be given to such Bondowners in the manner provided under "Description of the Real Return Bonds - Notice to Bondowners".

## **Notice to Bondowners**

All notices to Bondowners regarding the Bonds will be validly given if published in the Toronto and national editions of *The Globe & Mail*, in *The Financial Post* and in *La Presse* or, if any such newspaper is not then being published, in another major Canadian newspaper with national circulation selected by the Minister of Finance.

## **DESCRIPTION OF THE CONSUMER PRICE INDEX**

CPI for purposes of the Bonds is defined as the All-items Consumer Price Index for Canada, not seasonally adjusted, as published by Statistics Canada (or its successor government department or agency). Statistics Canada is a bureau operated under the Statistics Act (Canada) and is responsible for collecting and reporting statistical information concerning commercial, industrial, financial, social, economic and general activities of the people of Canada. Statistics Canada has the specific authority and responsibility to collect and publish statistics on prices and the cost of living in Canada.

The CPI is a general measure of price movements obtained by comparing, through time, the cost of a basket of goods and services, specified according to purchases made by Canadian households in a certain reference period. Since the basket contains commodities of unchanging or equivalent quantity and quality, the index reflects only pure price movement.

The goods and services in the basket are organized into commodity groups, such as food, shelter and transportation, with weights attributed to each. The weights are derived from Family Expenditure Survey data. This survey consists of interviews with a randomly selected sample of households. Notwithstanding the fixed-basket concept, the CPI basket is updated periodically to take into account changes in consumer expenditure patterns. In recent years, the basket has been updated every four to six years. The series based on a new basket are linked to series based on the previous basket to ensure continuity whenever the basket is changed.

The calculation of the monthly CPI begins with the measurement of the price change of a particular good or service in a given region. Because price collection takes place at varying times during the month, the index represents the month as a whole. While prices for many commodities are collected monthly, those with a relatively low degree of price volatility are collected less frequently. Indices are computed for each commodity group, then are combined using the household expenditure weights to determine the monthly All-items CPI for Canada.

The CPI, like all indices, is expressed in relative terms and thus is expressed in relation to a time base reference period for which the level is set at 100. From time to time, the CPI is rebased. For example, the official time base reference period (the "Official Time Base") for the CPI was changed from 1981 = 100 to 1986 = 100 starting from the CPI for June 1990. When the Official Time Base is changed, 100 represents an average for the entire year of the new base year. The Official Time Base is determined independently of the basket reference year.

The CPI for a month is released and published in approximately the third week of the following month.

## CANADIAN FEDERAL INCOME TAX CONSIDERATIONS

The following general summary fairly describes the principal Canadian federal income tax considerations generally applicable to purchasers of Bonds, pursuant to an offering of Bonds by the Government of Canada, who are residents of Canada for the purposes of the Income Tax Act (Canada) (the "Act"), to whom the Bonds constitute capital property for the purposes of the Act and who are subject to tax under Part I of the Act and also describes the Canadian federal withholding tax consequences for purchasers of Bonds, pursuant to an offering of Bonds by the Government of Canada, who are non-residents of Canada for purposes of the Act.

This summary is based upon the current provisions of the Act and the regulations thereunder (the "Regulations") in force as of the date hereof, the current published administrative and assessing policies of Revenue Canada and upon all proposals (the "Draft Amendments") to amend the Act and the Regulations released by the Minister of Finance (Canada) prior to the date hereof. **This summary assumes that the Draft Amendments will be enacted in a form consistent with the following summary; however, no assurance can be given that the Draft Amendments will be enacted in such form.** This summary is not exhaustive of all possible Canadian federal income tax consequences and, moreover, does not take into account or anticipate any provincial, territorial or foreign income tax considerations, which considerations may differ significantly from those discussed herein. Tax legislation in certain of the provinces may require amendment so that Bondowners will be afforded similar provincial tax treatment to that described in this summary.

**This summary is of a general nature only and it is not intended to be, nor should it be construed to be, legal or tax advice to any prospective purchaser of Bonds and no representation with respect to the Canadian federal income tax consequences to any such purchaser is made herein. Prospective purchasers of Bonds should consult their own advisers with respect to their individual circumstances. This summary does not apply to persons acquiring Bonds otherwise than pursuant to an offering of the Bonds made by the Government of Canada.**

### Taxation of Coupon Interest

The normal rules which require certain taxpayers to include interest in income on an accrual basis will not apply to Coupon Interest. Rather, a Bondowner will be required to include in income for each taxation year in which the Bondowner owned a Bond any Coupon Interest which has been received or become receivable in that taxation year, depending upon the method regularly followed by the Bondowner.

A Bondowner will be required to include in income the full amount of Coupon Interest paid on a Coupon Payment Date, being the interest which has accrued since the immediately preceding Coupon Payment Date for the relevant series of Bonds; however, to the extent that Coupon Interest has accrued prior to the date of issuance of Bonds, a deduction will be available to the Bondowner. Any amount which is so deductible must be deducted in computing the adjusted cost base of the Bond to the Bondowner.

### **Taxation of Inflation Compensation**

The Act and the Draft Amendments provide that a Bondowner is required to include in computing income for a taxation year, as interest, the amount by which Inflation Compensation has increased for any inflation adjustment period that ends in such taxation year and during which the Bondowner owned the Bond. The amount of any such increase required to be included in a Bondowner's income at any time shall be added to the adjusted cost base of the Bond to the Bondowner.

The Act and the Draft Amendments further provide that the amount by which accrued Inflation Compensation has decreased for any inflation adjustment period that ends in a taxation year of a Bondowner and during which such Bondowner owned the Bond shall be deductible in computing the income of the Bondowner for such year. The amount of any such decrease permitted to be deducted in computing the income of a Bondowner at any time shall be deducted from the adjusted cost base of the Bond to the Bondowner.

For these purposes, the first inflation adjustment period for a series of Bonds acquired in an offering by the Government of Canada will be the period commencing on the date of issuance of such Bonds. Each subsequent inflation adjustment period will commence on a Coupon Payment Date for such series. An inflation adjustment period will end on the earlier of the next Coupon Payment Date for such series and the date of disposition of the Bond.

### **Disposition of a Bond**

On the disposition or a deemed disposition of a Bond, the Bondowner will realize a capital gain (or capital loss) to the extent that the proceeds of disposition (net of any costs of disposition) exceed (or are exceeded by) the adjusted cost base of the Bond to the Bondowner. The tax treatment of changes in the Inflation Compensation for inflation adjustment periods ending in the taxation year of disposition is described above under the heading "Taxation of Inflation Compensation".

Pursuant to the provisions of the Act, any accrued Coupon Interest on a Bond to the date of disposition of such Bond must be included in the income of the Bondowner. To the extent that the amount received on the disposition of a Bond by the Bondowner in respect of the Coupon Interest is less than the accrued Coupon Interest on such Bond, the Bondowner may be entitled to a deduction.

### **Non-Resident Withholding Tax**

Where a Bondowner is a non-resident of Canada for purposes of the Act, Coupon Interest and Inflation Compensation will not be subject to Canadian withholding tax.

## **RISK FACTORS**

Purchasers of Bonds should consider certain risk factors not applicable to conventional debt obligations.

### **Trading in the Secondary Market**

When Bonds of a new series are first issued, there is no assurance that an active secondary market will develop for such series of Bonds. Where a secondary market exists for a series of Bonds, it is not possible to predict how the Bonds will trade in the secondary market. The Bonds have been and may continue to be less liquid than conventional Government of Canada issues. To the extent that the Government of Canada issues additional Real Return Bonds of a series, such additional bonds may enhance the liquidity of such series.

## **Price Variability**

The price of a series of Bonds in the secondary market is subject to changes in real yields and fluctuations in the CPI, which may result in trading gains or losses. Real yields may vary depending on economic developments and the supply and demand for each series of Bonds.

## **Cash Flow Variability**

Coupon Interest on each series of Bonds varies depending upon changes in the relevant Index Ratio, which incorporates CPI data. As a result, the amount of Coupon Interest may rise or fall from one Coupon Payment Date to the next and such variations may be material during periods of significant changes in the CPI.

## **Indexing Lag**

As described in the section entitled "Description of the Real Return Bonds - Indexing Process", the calculation of the Index Ratio incorporates an approximate three-month lag, which may have an impact on the trading price of a series of Bonds, particularly during periods of significant changes in the CPI.

## **Tax Considerations**

Accrued Inflation Compensation for a series of Bonds must be included in a Bondowner's income in the manner described under "Canadian Federal Income Tax Considerations", notwithstanding that payment in respect thereof will not be made until Maturity for such series. Taxable Bondowners should have regard to their respective tax positions, particularly in the event that Coupon Interest received at any relevant time is insufficient to cover the income taxes exigible on all interest required to be included in income in connection with the Bonds.

## **ELIGIBILITY FOR INVESTMENT**

As of the date hereof, the Bonds are eligible investments, without resort to the so-called "basket" provisions or, their purchase is not prohibited, in each case subject to general investment conditions and, in certain cases, subject to prudent investment standards, general investment provisions and quantitative restrictions of such statutes and regulations, and to additional requirements relating to investment or lending policies or goals, under or by the following statutes (and, where applicable, the regulations thereunder):

- Insurance Companies Act (Canada);
- Pension Benefits Standards Act, 1985 (Canada);
- Trust and Loan Companies Act (Canada);
- Insurance Act (Ontario);
- Loan and Trust Corporations Act (Ontario); and
- Pension Benefits Act (Ontario).

As of the date hereof, the Bonds are also qualified investments for registered retirement savings plans, registered retirement income funds and deferred profit sharing plans under the Income Tax Act (Canada) and may be held in such plans subject to the terms of the particular plan. Bonds do not constitute foreign property for purposes of such Act.

## **PLAN OF DISTRIBUTION**

The Bonds are issued from time to time by the Government of Canada and may be issued in different series with differing coupon rates, Coupon Payment Dates and Maturities. The Bonds of a series may be issued on a syndicated basis to a group of investment dealers and/or banks who may acquire the Bonds for resale pursuant to an underwriting agreement with an agreed upon commission. Alternatively, the Bonds may be sold in an auction process, conducted by the Bank of Canada, on behalf of the Department of Finance, available to primary distributors of marketable Government of Canada bonds. Auctions will be conducted according to procedures established by the Minister of Finance from time to time. In any such auction, the Bank of Canada is

eligible to bid, without restriction and the Minister of Finance reserves the right to accept or reject any tender, in whole or in part, including, without limitation, the right to accept less than the total amount specified in a notice of call for tenders. The intention of the Government of Canada to issue Bonds will be pre-announced, from time to time, subject to market conditions, including by announcement in the quarterly auction schedule of the Minister of Finance.

Global Certificates for the full amount of the Bonds offered from time to time are issued in fully registered form to CDS and will be deposited with CDS on the date of issuance of the relevant Bonds. Certificates evidencing the Bonds are not available to Bondowners and registration and transfers of beneficial ownership must be made only through participants in the CDS book-entry systems. (See "Description of the Real Return Bonds - Registration and Denomination").

## **GLOBAL CERTIFICATES**

A specimen of each Global Certificate is available for inspection during normal business hours at the head office of the Bank of Canada in Ottawa.