

NOMURA J-TIPS Index Index Rulebook

CROSS-ASSET

Key features of NOMURA J-TIPS Index

- NOMURA J-TIPS Index is an investment return index developed to reflect the performance of the entire secondary market of J-TIPS, Inflation-Indexed JGBs (JGBi) which have a different return and risk profile than nominal bonds.
- The index value calculation method and inclusion criteria of NOMURA J-TIPS Index are based upon the NOMURA-BPI.
- NOMURA J-TIPS Index includes JGBi with principal guaranteed (i.e., deflation floored), the issuance of which started in October 2013.
- Bonds included in the NOMURA J-TIPS Index are reviewed monthly.

Global Markets Research

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1. Introduction

First released in 2004, the NOMURA J-TIPS Index is a bond performance index developed to reflect the performance of the entire secondary market for JGBi, which have a different return and risk profile than nominal bonds. The index value calculation method and inclusion criteria of NOMURA J-TIPS Index are based upon the NOMURA-BPI¹.

Nomura Securities' Index Operations Dept. (IOD) is the Administrator of the NOMURA J-TIPS Index, and Nomura Research Institute (NRI) serves as the Calculation Agent.

The IOD assumes the primary responsibility for the daily calculation of the bond performance indices, its production and operation. Specifically, the IOD, in its role as operations manager:

- Maintains and records the index weightings of all constituents;
- Reviews the index portfolios according to the inclusion/exclusion criteria, and replaces securities in these portfolios as necessary, reflecting these changes in the performance and other indicators; reviews the index portfolio inclusion criteria.
- Announces changes in the securities included in the index portfolios, which are determined as a result of daily operations management and scheduled reviews; and
- Distributes the index portfolio performances, either through NRI's data delivery service or on its own.

The NOMURA J-TIPS Index is meant to be used as;

- A tool for determining investment policies (asset allocation strategies);
- A tool for determining investment manager structure;
- An investment management benchmark;
- A tool for portfolio management;
- An investment performance indicator; and
- A risk management tool.

¹ NOMURA-BPI[®] is a registered trademark of Nomura Securities Co., Ltd. (Registered Number: 4991073)

2. Sector classification

Beginning in October 2013, the principals of JGBi are guaranteed at maturity (i.e., deflation floored), and these bonds are also included in the NOMURA J-TIPS Index. In the NOMURA J-TIPS Index, the two types of JGBi are grouped differently, as follows:

- NOMURA J-TIPS Index – deflation floored
- NOMURA J-TIPS Index – non-floored

3. Scheduled portfolio reconstitution

Nomura Securities' IOD reviews and reconstitutes NOMURA J-TIPS Index portfolios every month. Next month's portfolios are determined on the portfolio determination day of each month.

3.1 Scheduled reconstitution date

NOMURA J-TIPS Index portfolios are reconstituted on the first business day of the month (scheduled reconstitution date), with inclusion/exclusion implemented after the bond market closes on the business day before the scheduled reconstitution date.

3.2 Portfolio determination date

In principle, next month's portfolio determination date is the last business day of the month.

3.3 Scheduled reconstitution base date

Next month's portfolio base is determined on the portfolio determination date. The new portfolio structure is determined in principle on the portfolio determination date based on disclosed information available as of the scheduled reconstitution base date.

3.4 Portfolio reconstitution announcement

Information about the scheduled portfolio reconstitution of the NOMURA J-TIPS Index is announced the same day as the NOMURA-BPI.

3.4.1 Unscheduled changes after the portfolio reconstitution announcement

Unscheduled portfolio inclusions/exclusions implemented after the portfolio reconstitution announcement will be notified in advance, except in cases where definite information on new portfolios is unavailable due to unexpected circumstances.

4. Portfolio inclusion/exclusion criteria

4.1 Portfolio inclusion criteria for next month

The NOMURA J-TIPS Index incorporates all securities that meet the inclusion criteria as of the scheduled portfolio reconstitution base date into the index portfolios for the following month.

Fig. 1: NOMURA J-TIPS Index inclusion criteria

Inclusion candidate	Inflation-linked bonds issued by the Japanese government.
Issuance process	Publicly-offered bonds issued in Japan
Currency denomination	JPY
Coupon	Fixed
Issue date	Issues until the last day of the month prior to the scheduled reconstitution date.
Face value amount for inclusion	Amount equivalent to the issue amount publicly offered in the market
Outstanding face value	JPY1 billion or more which is unadjusted for inflation as of the last day of the month the portfolio reconstitution is implemented.
Term to maturity	1 year or more

Source: NSC

4.1.1 Issuance process

The NOMURA J-TIPS Index incorporates publicly-offered bonds issued in Japan. JGBi not publicly offered in the market (i.e., JGBs tailored for retail investors and sold New OTC sales system, those issued for BOJ Rollover) are excluded.

4.1.2 Term to maturity

The NOMURA J-TIPS Index only includes bonds that are dated one year (365 days) or longer until maturity as of the last day of the month following the scheduled portfolio reconstitution base date.

4.2 Portfolio exclusion criteria for next month

Any JGBi that fall short of the inclusion criteria (Figure 1) as of the scheduled reconstitution base date will be excluded from the index portfolio in the following month.

4.2.1 Outstanding face value

JGBi for which the outstanding face value amount will decrease to levels below JPY1 billion, unadjusted for inflation, on the last business day of the month following the scheduled reconstitution base date will be excluded from the index portfolio.

4.2.2 Term to maturity

The NOMURA J-TIPS Index excludes bonds that are dated less than one year (365 days) until maturity as of the last business day of the month following the scheduled reconstitution base date².

² In accordance with business practice, bonds with less than one year remaining to maturity consider leap days, while bonds with more than one year to maturity do not count occurrences of 29 February in the interval.

5. Unscheduled portfolio reconstitution

In principle, NOMURA J-TIPS Index portfolios, as determined on the portfolio determination date, will remain unchanged until the last business day of the month following the portfolio determination date. However, these portfolios may be subject to an unscheduled reconstitution, which will be implemented on a predetermined date, if the material event occurs in terms of any of the JGBi included.

5.1 Announcement of unscheduled portfolio reconstitution

Information about unscheduled portfolio reconstitution is announced from Nomura Securities, except in cases where definite information on such a change is unavailable until that actually takes place due to unexpected circumstances.

6. Definition of NOMURA J-TIPS Index indicators

6.1 Definition of issue-specific return-risk indicators

In NOMURA J-TIPS Index, the issue-specific return-risk indicators are defined as described below.

Note that variables whose name beginning with “A” represent inflation-adjusted numbers in each of the following equations. Otherwise, the variables are not adjusted for inflation.

- Face value unadjusted for inflation

Outstanding face value amount unadjusted for inflation. This should be equal to the issue amount unless the bond is not partially redeemed.

- Face value adjusted for inflation

Calculated by multiplying the inflation-unadjusted face value by the index ratio, as indicated below:

$$AA = A \times IR$$

<i>AA</i>	:	Face value adjusted for inflation
<i>A</i>	:	Face value unadjusted for inflation
<i>IR</i>	:	Index ratio

- Bond price adjusted for inflation

Bond price with the face value of JPY100 calculated from the inflation-unadjusted face value amount.

- Clean price adjusted for inflation

$$ACP = CP \times IR$$

<i>ACP</i>	:	Clean price adjusted for inflation
<i>CP</i>	:	Clean price unadjusted for inflation
<i>IR</i>	:	Index ratio

- Dirty price unadjusted for inflation

$$DP = CP + ac$$

<i>DP</i>	:	Dirty price unadjusted for inflation
<i>CP</i>	:	Clean price unadjusted for inflation
<i>ac</i>	:	Accrued interest unadjusted for inflation

- Dirty price adjusted for inflation

$$ADP = CP \times IR + Aac$$

<i>ADP</i>	:	Dirty price adjusted for inflation
<i>CP</i>	:	Clean price unadjusted for inflation
<i>IR</i>	:	Index ratio
<i>Aac</i>	:	Accrued interest adjusted for inflation

- Market value adjusted for inflation

$$AMV = \frac{CP \times IR \times A}{100}$$

<i>AMV</i>	:	Market value adjusted for inflation
<i>CP</i>	:	Clean price unadjusted for inflation
<i>IR</i>	:	Index ratio
<i>A</i>	:	Face value unadjusted for inflation

- Accrued interest adjusted for inflation

$$ACC = \frac{ac \times IR \times A}{100}$$

<i>ACC</i>	:	Accrued interest adjusted for inflation
<i>ac</i>	:	Accrued interest unadjusted for inflation
<i>IR</i>	:	Index ratio
<i>A</i>	:	Face value amount unadjusted for inflation

- Coupon rate

Coupon rate of the JGBi.

- Break-even inflation rate π

Assuming the rate of inflation will remain unchanged at a certain level (π) until the bond's maturity, the nominal interest payments and redemption amount are determined. The present value of inflation-unadjusted dirty price equal to the total nominal interest payments and redemption amount multiplied by the nominal discount factor.

Given this, the break-even inflation rate π is defined as follows:

(For floored issues)

$$DP = \sum_i CF_i(1 + \pi)^{t_i} DF(t_i) + \max \left\{ 100 \times (1 + \pi)^T, \frac{100}{IR_{(today)}} \right\} DF(T)$$

(For non-floored issues)

$$DP = \sum_i CF_i(1 + \pi)^{t_i} DF(t_i) + 100 \times (1 + \pi)^T DF(T)$$

DP	:	Dirty price unadjusted for inflation
π	:	Break-even inflation rate
t_i	:	Number of years until CF_i occurs
T	:	Number of years until redemption cash flow occurs
CF_i	:	Real cash flow for i th period
$DF(t_i)$:	Discount factor (nominal) for period t_i
$IR_{(today)}$:	Index ratio, as of today

- Nominal compound yield n

Based on the break-even inflation rate π , the nominal compound yield n is calculated in the following equation:

(For floored issues)

$$DP = \sum_i CF_i(1 + \pi)^{t_i} \left(1 + \frac{n}{2}\right)^{-2t_i} + \max \left\{ 100 \times (1 + \pi)^T, \frac{100}{IR_{(today)}} \right\} \left(1 + \frac{n}{2}\right)^{-2T}$$

(For non-floored issues)

$$DP = \sum_i CF_i(1 + \pi)^{t_i} \left(1 + \frac{n}{2}\right)^{-2t_i} + 100 \times (1 + \pi)^T \left(1 + \frac{n}{2}\right)^{-2T}$$

DP	:	Dirty price unadjusted for inflation
π	:	Break-even inflation rate
t_i	:	Number of years until CF_i occurs
T	:	Number of years until redemption cash flow occurs
CF_i	:	Real cash flow for i th period
n	:	Nominal compound yield (semi-annual)
$IR_{(today)}$:	Index ratio, as of today

- Real compound yield r

The real compound yield r is defined as follows:

$$DP = \sum \frac{Ct_i}{\left(1 + \frac{r}{2}\right)^{2t_i}}$$

DP	:	Dirty price unadjusted for inflation
r	:	Real compound yield
t_i	:	Number of years until Ct_i occurs
Ct_i	:	Real cash flow for i th period

- Duration:

$$D = \frac{1}{DP} \sum \frac{Ct_i \times t_i}{\left(1 + \frac{r}{2}\right)^{2t_i}}$$

D	:	Duration
r	:	Real compound yield
DP	:	Dirty price unadjusted for inflation
t_i	:	Number of years until Ct_i occurs
Ct_i	:	Real cash flow for i th period

- Modified duration:

$$mD = \frac{D}{1 + \frac{r}{2}} \left(= -\frac{1}{DP} \frac{d}{dr} DP \right)$$

mD	:	Modified duration
D	:	Duration
r	:	Real compound yield
DP	:	Dirty price unadjusted for inflation

6.2 Definition of portfolio indicators

Portfolio indicators are calculated using the issue-specific indicators of all issues in the index portfolio. Basically, the inflation-adjusted weighted average is used in the calculation. Note, however, that the inflation-adjusted clean/dirty price is calculated using the weighted-average inflation-unadjusted face value amount.

Fig. 2: Portfolio Indicator Calculation Methods

Indicator	Calculation Method
Face value amount unadjusted for inflation Face value amount adjusted for inflation	Sum
Clean price adjusted for inflation Dirty price adjusted for inflation	Weighted average with face value amount unadjusted for inflation
Coupon rate Years until maturity Clean price unadjusted for inflation Dirty price unadjusted for inflation	Weighted average with face value amount adjusted for inflation
Real compound yield Break-even inflation rate	Weighted average with market value amount adjusted for inflation
Duration Modified duration	Weighted average with market value amount (incl. accrued interest) adjusted for inflation

Source: NSC

7. Calculating index value

7.1 Method for calculating index

7.1.1 Total investment return index (total index)

This is the index of total investment return during a given period, including capital and income gains. Assuming that the index portfolio was purchased on the last business day of the previous month at a value including accrued interest, coupon payments and redemptions are added to the market value amount (including accrued interest), which is announced as the index value for the day. All coupon payments and redemptions are assumed to be received in cash without interest on the day they are made, and reinvested at the following portfolio reconstitution. Coupon payments made on weekends and holidays are assumed to be made on the following business days.

$$TI_{(today)} = TI_{(e.l.m)} \times \frac{AMV_{(today)} + AAC_{(today)} + AIC_{(today)} + ARD_{(today)}}{AMV_{(e.l.m)} + AAC_{(e.l.m)}}$$

$TI_{(today)}$:	Total index value for today
$TI_{(e.l.m)}$:	Total index value for the last business day of the previous month
$AMV_{(today)}$:	Market value amount adjusted for inflation for today
$AMV_{(e.l.m)}$:	Market value amount adjusted for inflation for the last business day of the previous month
$AAC_{(today)}$:	Accrued interest adjusted for inflation for today
$AAC_{(e.l.m)}$:	Accrued interest adjusted for inflation for the last business day of the previous month
$AIC_{(today)}$:	Income gains adjusted for inflation between the end of previous month and today
$ARD_{(today)}$:	Redemptions adjusted for inflation between the end of previous month and today

7.1.2 Capital investment return index (Capital index)

This is an index of investment return during a given period in terms of capital gains. Assuming that the index portfolio was purchased on the last business day of the previous month at the dirty price, redemptions that have occurred through the valuation date are added to the market value amount (excluding accrued interest), which is announced as the index value for the day. All redemptions are assumed to be received in cash without interest on the day they are made, and reinvested at the following portfolio reconstitution.

$$CI_{(today)} = CI_{(e.l.m)} \times \left(1 + \frac{AMV_{(today)} - AMV_{(e.l.m)} + ARD_{(today)}}{AMV_{(e.l.m)} + AAC_{(e.l.m)}} \right)$$

$CI_{(today)}$:	Capital index value for today
$CI_{(e.l.m)}$:	Capital index value for the last business day of the previous month
$AMV_{(today)}$:	Market value amount adjusted for inflation for today
$AMV_{(e.l.m)}$:	Market value amount adjusted for inflation for the last business day of the previous month
$AAC_{(e.l.m)}$:	Income gains adjusted for inflation for the last business day of the previous month
$ARD_{(today)}$:	Redemptions adjusted for inflation between the end of previous month and today

7.2 Return

7.2.1 Total return (annualized)

$$RT(m, n) = \left(\frac{TI(n)}{TI(m)} - 1 \right) \times \frac{365}{\Delta t_D}$$

Period m is assumed to precede period n in a given timeline.

$RT(m, n)$:	Total return from period m through period n
$TI(i)$:	Index value at period i
$\Delta t_D (> 0)$:	Days between period m and period n (not counting in the settlement date)

7.2.2 Capital return (annualized)

$$RC(m, n) = \left(\frac{CI(n)}{CI(m)} - 1 \right) \times \frac{365}{\Delta t_D}$$

Period m is assumed to precede period n in a given timeline.

$RC(m, n)$:	Capital return from period m through period n
$CI(i)$:	Principal investment index return index at period i
$\Delta t_D (> 0)$:	Days between period m and period n (not counting in the settlement date)

7.2.3 Income return (annualized)

$$RI(m, n) = RT(m, n) - RC(m, n)$$

Period m is assumed to precede period n in a given timeframe.

$RI(m, n)$: Income return from period m through period n

$RT(m, n)$: Total return from period m through period n

$RC(m, n)$: Capital return from period m through period n

7.3 Reference for obtaining market data

The NOMURA J-TIPS Index references bond market pricing data for the marked-to-market valuation of the index portfolios (listed in descending order of priority):

- JS Price³
- Nomura Securities final mid-price

These values are provided on a settlement-day basis, and should be converted to trade-day basis for use as reference in calculating portfolio and performance indicators.

7.4 Key indices and data released

Key indices provided in the NOMURA J-TIPS Index and their base dates are as follows (base dates vary depending on the index):

Index	Base date (= Base index value)	Publication start date
NOMURA J-TIPS Index	31 Mar 2004 (=100)	Oct 2004
NOMURA J-TIPS Index - deflation floored	31 Oct 2013 (=100)	Nov 2013

³ Bond market data provided jointly by the Nikkei Inc., Financial Technology Research Institute Inc., Nomura Research Institute, Ltd. and Nomura Securities Co., Ltd. Data are intended primarily for use as reference in marked-to-market valuation of bond portfolios.

Data delivery services

Data on performance indices, such as the total investment return index, and portfolio indicators are available from the following sources:

NOMURA J-TIPS Index data providers

- Nomura Securities' Securities Market Benchmarks' website

<http://qr.nomura.co.jp/jp/jtips/index.html> (Japanese page)

- Nomura Research Institute Integrated Data Services (IDS)

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- Quick

NRIJ001

NOMURA Indices guidance

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NOMURA J-TIPS Index

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Appendix A-1

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Transactions involving convertible bonds are subject to a sales commission of up to 1.08% of the transaction amount (or a commission of ¥4,320 if this would be less than ¥4,320). When convertible bonds are purchased via OTC transactions (including offerings), only the purchase price shall be paid, with no sales commission charged. However, Nomura Securities may charge a separate fee for OTC transactions, as agreed with the customer. Convertible bonds carry the risk of losses owing to factors such as interest rate fluctuations and price fluctuations in the underlying stock. In addition, convertible bonds denominated in foreign currencies also carry the risk of losses owing to factors such as foreign exchange rate fluctuations.

When bonds are purchased via public offerings, secondary distributions, or other OTC transactions with Nomura Securities, only the purchase price shall be paid, with no sales commission charged. Bonds carry the risk of losses, as prices fluctuate in line with changes in market interest rates. Bond prices may also fall below the invested principal as a result of such factors as changes in the management and financial circumstances of the issuer, or changes in third-party valuations of the bond in question. In addition, foreign currency-denominated bonds also carry the risk of losses owing to factors such as foreign exchange rate fluctuations.

When Japanese government bonds (JGBs) for individual investors are purchased via public offerings, only the purchase price shall be paid, with no sales commission charged. As a rule, JGBs for individual investors may not be sold in the first 12 months after issuance. When JGBs for individual investors are sold before maturity, an amount calculated via the following formula will be subtracted from the par value of the bond plus accrued interest: (1) for 10-year variable rate bonds, an amount equal to the two preceding coupon payments (before tax) x 0.79685 will be used, (2) for 5-year and 3-year fixed rate bonds, an amount equal to the two preceding coupon payments (before tax) x 0.79685 will be used. When inflation-indexed JGBs are purchased via public offerings, secondary distributions (uridashi deals), or other OTC transactions with Nomura Securities, only the purchase price shall be paid, with no sales commission charged. Inflation-indexed JGBs carry the risk of losses, as prices fluctuate in line with changes in market interest rates and fluctuations in the nationwide consumer price index. The notional principal of inflation-indexed JGBs changes in line with the rate of change in nationwide CPI inflation from the time of its issuance. The amount of the coupon payment is calculated by multiplying the coupon rate by the notional principal at the time of payment. The maturity value is the amount of the notional principal when the issue becomes due. For JI17 and subsequent issues, the maturity value shall not undercut the face amount. Purchases of investment trusts (and sales of some investment trusts) are subject to a purchase or sales fee of up to 5.4% of the transaction amount. Also, a direct cost that may be incurred when selling investment trusts is a fee of up to 2.0% of the unit price at the time of redemption. Indirect costs that may be incurred during the course of holding investment trusts include, for domestic investment trusts, an asset management fee (trust fee) of up to 5.4% (annualized basis) of the net assets in trust, as well as fees based on investment performance. Other indirect costs may also be incurred. For foreign investment trusts, indirect fees may be incurred during the course of holding such as investment company compensation.

Investment trusts invest mainly in securities such as Japanese and foreign equities and bonds, whose prices fluctuate. Investment trust unit prices fluctuate owing to price fluctuations in the underlying assets and to foreign exchange rate fluctuations. As such, investment trusts carry the risk of losses. Fees and risks vary by investment trust. Maximum applicable fees are subject to change; please thoroughly read the written materials provided, such as prospectuses or documents delivered before making a contract.

In interest rate swap transactions and USD/JPY basis swap transactions ("interest rate swap transactions, etc."), only the agreed transaction payments shall be made on the settlement dates. Some interest rate swap transactions, etc. may require pledging of margin collateral. In some of these cases, transaction payments may exceed the amount of collateral. There shall be no advance notification of required collateral value or collateral ratios as they vary depending on the transaction. Interest rate swap transactions, etc. carry the risk of losses owing to fluctuations in market prices in the interest rate, currency and other markets, as well as reference indices. Losses incurred as such may exceed the value of margin collateral, in which case margin calls may be triggered. In the event that both parties agree to enter a replacement (or termination) transaction, the interest rates received (paid) under the new arrangement may differ from those in the original arrangement, even if terms other than the interest rates are identical to those in the original transaction. Risks vary by transaction. Please thoroughly read the written materials provided, such as documents delivered before making a contract and disclosure statements.

In OTC transactions of credit default swaps (CDS), no sales commission will be charged. When entering into CDS transactions, the protection buyer will be required to pledge or entrust an agreed amount of margin collateral. In some of these cases, the transaction payments may exceed the amount of margin collateral. There shall be no advance notification of required collateral value or collateral ratios as they vary depending on the financial position of the protection buyer. CDS transactions carry the risk of losses owing to changes in the credit position of some or all of the referenced entities, and/or fluctuations of the interest rate market. The amount the protection buyer receives in the event that the CDS is triggered by a credit event may undercut the total amount of premiums that he/she has paid in the course of the transaction. Similarly, the amount the protection seller pays in the event of a credit event may exceed the total amount of premiums that he/she has received in the transaction. All other conditions being equal, the amount of premiums that the protection buyer pays and that received by the protection seller shall differ. In principle, CDS transactions will be limited to financial instruments business operators and qualified institutional investors. No account fee will be charged for marketable securities or monies deposited. Transfers of equities to another securities company via the Japan Securities Depository Center are subject to a transfer fee of up to ¥10,800 per issue transferred depending on volume.

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