

REGULATORY CIRCULAR NO. 95-87

October 18, 1995

TO: Members and Member Organizations

ATTENTION: Chief Executive Officers/Managing Partners/
Compliance Officers/Senior Registered Options Principals

FROM: Capital Markets Division

SUBJECT: Japan Export Index Put Warrants and/or Japan Export Index Call Warrants.,
Expiring ___*___ 1997

The aforementioned securities are the subject of a preliminary prospectus.

As more fully set forth in Registration Statement (#33-xxxxxx) and related Prospectus Supplement, each Warrant will entitle the holder thereof to receive from PaineWebber Group, Inc. (the "Issuer") upon exercise, (including automatic exercise) an amount in U.S. dollars calculated by reference to changes in the level of the Japan Export Index.

In the case of the **Put Warrants** (trading symbol JXP.WS), such amount (the "Cash Settlement Value") will equal the product of ___*___ multiplied by the quotient (rounded to the nearest cent) of (A) the amount, if any, by which the Index Strike Price exceeds the Index Spot Price for the applicable Valuation Date, divided by (B) a Fixed Japanese Yen/U.S. \$ **exchange** rate of Yen ___*___ per U.S. \$ 1.00. This amount is described in the following formula:

$$\text{Cash Settlement Value} = \text{___*___} \text{ times (Index Strike minus Index Spot) divided by Fixed Yen / U.S. \$ Exchange Rate.}$$

In the case of the **Call Warrants** (trading symbol JXC.WS), such amount (the "Cash Settlement Value") will equal the product of ___*___ multiplied by the quotient (rounded to the nearest cent) of (A) the amount, if any, by which the Index Spot Price **exceeds the Index Strike Price** for the applicable Valuation Date, divided by (B) a fixed Japanese Yen / U.S. \$ exchange **rate** of Yen ___*___ per U.S. \$1.00. This amount is described in the following formula:

$$\text{Cash Settlement Value} = \text{___*___} \text{ times (Index Spot minus Index Strike) divided by Fixed Yen / U.S. \$ Exchange Rate.}$$

The purpose of this circular is to provide basic information to Members and Member Organizations regarding a proposed new issue of Japan Export Index Warrants and to advise of certain compliance responsibilities when handling transactions in the Warrants. This is not a sales document and is not intended to be distributed to customers.

* To be announced at the time of the initial public offering.

JAPAN EXPORT INDEX:

The Japan Export Index (trading symbol JEX) is a new equal-weighted index composed of 40 of the largest export companies traded on the Tokyo Stock Exchange (TSE), as measured by total yen-denominated export revenue. The Index is calculated and disseminated by the CBOE once each business day before the opening of trading in the U.S. under the trading symbol JEX. TSE closing prices are used for the daily calculation of the Index. CBOE will maintain sole discretion over the maintenance of the Index.

The Index was set to equal 100 as of March 31, 1984 and on September 29, 1995 was 200.82. The 40 stocks that make up the Index are from 10 different industry groups: Auto and Auto Parts (25%), Electric Machinery-diversified (22.5%), Consumer Electronics (20.0%), Iron and Steel (7.5%), Precision Instruments (7.5%), Shipbuilding (5.0%), Chemicals (5.0%), Machinery (2.5%), Computers and Semiconductors (2.5%), Services (2.5%). As of September 29, 1995, the total market capitalization of the Index was \$503.85 billion.

OTHER IMPORTANT INFORMATION:

— Calculation of the Cash Settlement Value may be postponed and possibly made under an alternative formula due to an “Extraordinary Event,” as described under “Extraordinary Events and Exercise Limitation Events” in the Prospectus Supplement.

— The Warrants will be immediately exercisable upon issuance and may be exercised until 3:00 p.m Eastern time, on the earlier of (I) the Business Day immediately preceding the Expiration Date or (ii) the last Business Day prior to the effective date of their removal or permanent suspension from trading and failure to list on another national securities exchange. Any in-the-money Warrant not exercised at or before the expiration date or removal date, will be automatically exercised.

— A Warrant holder may exercise no fewer than 500 Warrants at any one time, except in the case of automatic exercise. Warrant holders will also have the right to specify that such Warrants are not to be exercised if there is a change of 15 points or more from the Index level on the Exercise Date.

— As more fully explained in the Prospectus Supplement, the Valuation Date for a Warrant exercised prior to 3:00 p.m. Eastern Time will be the first business day after the related Exercise Date. Warrants exercised after 3:00 p.m. are deemed to be exercised on the following business day.

— Warrant Certificates will be initially issued in registered form. Forty-five calendar days after the closing of the offering, each registered Warrant holder will have the right to convert to book-entry form within forty-five calendar days.

— The Warrants are unsecured contractual obligations of PaineWebber Group, Inc. and will rank on a parity with the Issuer’s other unsecured contractual obligations and unsecured and subordinated debt. The Warrants are solely the Issuer’s obligation and are not standardized options issued or guaranteed by the Options Clearing Corporation.

CERTAIN RISK FACTORS:

— The Warrants involve a high degree of risk, including risks arising from the fluctuations in the prices of the stocks comprising the Index, risks relating to the Index and general risks applicable to the TSE, such as market disruption events, suspensions and trading halts. Prospective purchasers of the Warrants should recognize that their Warrants may expire worthless and should be prepared to sustain a total loss of their investment.

— The underlying stocks that constitute the Index have been issued by Japanese companies. Investments in securities indexed to the value of Japanese equity securities involve certain risks associated with the Japanese securities markets, including the risks of volatility in such markets, government intervention in such markets, cross-shareholdings in Japanese companies, a lack of public information about Japanese companies and accounting and financial standards that differ from those applicable to certain U.S. companies.

— Securities prices in Japan, and the price of the stocks of Japanese export companies in particular, are subject to political, economic, financial and social factors that apply in Japan as well as the countries that are its principal trading partners. These factors could negatively affect the Japanese securities markets generally and the price of the stocks of Japanese export companies in particular.

— It is not possible to predict how the Warrants will trade in the secondary market or whether such market will be liquid or illiquid. To the extent Warrants are exercised, the number of Warrants outstanding will decrease, resulting in a decrease in the liquidity of the Warrants. In addition, the Issuer or one or more of its affiliates or the Underwriters may from time to time purchase Warrants resulting in a decrease in the liquidity of the Warrants.

— The trading value of a Warrant is expected to be dependent upon the Index Strike Price and also upon a number of complex interrelated factors, including the value of the Index, the volatility of the Index, the time remaining to the expiration of the Warrants, the dividend rate on the stocks underlying the Index, Japan Yen/U.S. dollar exchange rates and the interest rates in Japan and the United States.

— A Warrant holder will not be able to determine, at the time of exercise of a Warrant, the Index Spot Price that will be used in calculating the Cash Settlement Value of such Warrant (and will thus be unable to determine such Cash Settlement Value). In addition, the Valuation Date for exercised Warrants may be postponed upon the occurrence and continuation of an Extraordinary Event or an Exercise Limitation Event.

The foregoing information is excerpted from the Prospectus Supplement, and the Exchange assumes no responsibility for the accuracy or completeness of such information. Members and associated persons of member organizations are advised to read the entire Prospectus and Prospectus Supplement for information relating to the Warrants.

REGULATORY CONSIDERATIONS

The Warrants involve a high degree of risk and are not for everyone. It is important that investors be afforded an explanation of the special characteristics and risks of the Warrants. Transactions in the Warrants may only be effected for customers whose accounts have been approved for options trading pursuant to CBOE Rule 9.7. Attention is also directed to CBOE Rule 9.9 which is applicable to recommendations concerning transactions in the Warrants. Further, the requirements of CBOE Rules 9.10, (“Discretionary Accounts”) and 9.21 (“Communication to Customers”), are applicable to the Warrants.

Member and Member Organizations are reminded that SEC Rule 10a-1 (“Short Sales”) and “front running” prohibitions (RG92-29) apply to trading the Warrants on the Exchange.

MARGINS AND OTHER REGULATORY INFORMATION

The margin requirement for a short Warrant will be 100% of the premium plus 15% of the underlying value, less out-of-the-money dollar amount, if any, to a minimum of 10% of the Index Value. A long Warrant position must be paid for in full. Straddles will be permitted for call and put Warrants covering the same underlying value. Members should be aware that the special characteristics of Warrants (e.g. the necessity of borrowing to make delivery on short sales, the issuer credit risk associated with long warrants, and pricing differences between Warrants and Options) may cause these margin requirements to be insufficient to fully cover the risk of positions in the Warrants in certain circumstances. Members must be prepared to call for additional margin when appropriate.

For capital purposes, the Warrants will be treated as stock index options. Rules for trading of the Warrants are found in Chapter XXX of the Exchange Guide. Members must be approved by application submitted to the Membership Committee pursuant to Exchange Rule 30.2 to participate in the trading on the Exchange of securities subject to the rules of Chapter XXX.

POSITION LIMITS

Pursuant to Exchange Rule 30.35 (a) the applicable position and exercise limit is 15 million warrants on the same side of the market in aggregate of all warrants issued on the Japan Export Index.

REPORTABLE POSITIONS

Pursuant to Exchange Rules 4.13 (a) and 30.35 (d) each member shall file a report with the Department of Market Regulation identifying those customer accounts with an aggregate long or short position in excess of 100,000 Warrants overlying the same stock index. Copies of the reporting form are available in the Department of Market Regulation.

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Questions regarding suitability of customer transactions in these Warrants should be directed to Larry Bresnahan (312) 786-7713 and questions regarding marginability should be directed to Diane Malley (312) 786-7924. General product questions should be directed to Nick Parcharidis of the Capital Markets Division (212) 803-1411.

