- BP as of December 31, 1994, were approximately \$12 million. The AAP seeks to provide a high total return with low volatility by allocating investments among equity securities, long- and midterm debt securities and money market instruments. The AAP pays its investment adviser an annual fee of .75% of average daily net assets as compensation for its services. The total assets of the AAP as of December 31, 1994, were approximately \$23.3 million.
- 4. On July 20, 1995, the Board of Trustees of the Trust ("Board") approved both changing the name and the investment policies of the AAP. The changes will cause the AAP to operate more as a balanced fund in that it would invest in a combination of equity securities, investment grade debt obligations and money market instruments. The AAP name will be changed to the "Balanced Portfolio."
- 5. Also on July 20, 1995, the Board determined that it was in the best interest of the shareholders of the BP to terminate the sale of shares of that Portfolio, effective July 21, 1995. The Board based its decision on (a) the minimal assets of BP after almost three years of operations; (b) disproportionately high expenses; (c) the investment adviser's indication that the small size of the Portfolio, partially the result of the Portfolio being offered to only one separate account, makes it difficult to make appropriate investment decisions and comply with the diversification requirements applicable to variable insurance products under section 817(h) of the Internal Revenue Code ("Code"); and (d) PaineWebber Life's assertion that because the investment objectives and policies of the BP and the AAP, as recently changed by the Board, are substantially similar, the two Portfolios basically compete for the same investment goals of Contract purchasers. PaineWebber Life was notified of the Board's determination and discontinued accepting premium payments in the Balanced Division.
- 6. PaineWebber Life proposes that shares of the AAP be substituted for the shares of the BP now held by the Account's Balanced Division. The substitution would be effected at net asset value so that the dollar value of the amount invested in shares of the BP would be the same as the amount invested in shares of the AAP after the substitution. Contract owners will be able to direct their interests in the BP among the remaining eight Portfolios of the Trust ("Remaining Portfolios") if they do not want to move their interests to the AAP.

- 7. On the date of the substitution, the per share values of each of the Portfolios will be determined in the normal course of business. The shares underlying the contract values in the BP will be redeemed by PaineWebber Life and the net asset values applied to purchase shares of the AAP at net asset value. The investment securities held by the BP will be disposed of and any expense incurred in disposing of the investment securities and effecting substitution will be shared by PaineWebber Life and Mitchell Hutchins. There will be no change in the amount of the Contract owner's cash value as a result of the substitution.
- 8. The Contracts reserve to PaineWebber Life the right to replace the shares of the Trust held by the Separate Account with shares of another series or another registered investment company, subject to Commission approval. Contract owners were notified that shares of the BP were no longer available as an investment option for purchase or transfer under the Contracts and that PaineWebber Life intended to file this application with the SEC seeking an Order permitting it to effectuate the proposed substitution. Contract owners with allocation instructions on file with PaineWebber Life that currently direct net premiums to the BP have been notified of the discontinuance of the BP as an investment option.
- 9. Upon receipt of SEC approval of the proposed substitution, Contract owners with Contract values in the BP will be provided a form with which they can elect to transfer their Contract values to one or more of the Remaining Portfolios. Contract owners will be advised that the AAP has an investment objective most similar to the BP in which the Contract owner has values invested. If no instructions are received within 30 days after notice of the request to elect, Contract values in the BP will be transferred automatically to the AAP.
- 10. The Contracts provide Contract owners the right to transfer part or all of the Contract value from one allocation option to one or more of the remaining options. The Contracts also provide that each transfer in excess of 12 in a calendar year is subject to a \$10 charge, which has been waived by PaineWebber Life until further notice. The substitution of the shares of one or more of the Remaining Portfolios for shares of the BP will not be considered a "transfer" for the purpose of the above limitation. Contract owners will not be subject to any charges or costs for the substitution.

Applicants' Legal Analysis

1. Section 26(b) of the 1940 Act prohibits the depositor or trustee of a registered unit investment trust holding the security of a single issuer from substituting another security for such security unless the Commission has approved the substitution. Section 26(b) provides that the Commission will approve a substitution if it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the 1940 Act.

2. Contract owners will not be subject to any additional fees or charges as a result of the substitution. The substitution will not affect any benefits, rights or Contract values under the Contracts nor will it affect the purchase payment dates under the Contracts used in determining the early withdrawal charge. Contract owners will be given notice of the substitution and an opportunity to allocate existing Contract values among the eight Remaining Portfolios as they wish.

Since the Account can no longer purchase shares of the BP, with normal redemptions the BP is expected to shrink rapidly. Applicants state that because of the relatively minor amount of total net assets in the BP, the fact that only one separate account had been investing in the BP when the sale of shares was terminated, and the resulting expense level and investment limitations, PaineWebber Life believes investment in the BP is no longer appropriate. Applicants contend that combining the assets of the BP and AAP, and the investment in the Portfolio by three separate accounts, should enhance its asset growth abilities.

Applicants state that the diminishing amount of assets in the BP makes it difficult for the investment adviser to make appropriate investments for the Portfolio that will meet the Code's requirement for diversification. Failure to meet the diversification requirement could result in the entire Contract being currently taxable, not just that portion of the Contract that is invested in the non-complying Portfolio. Applicants state that it was determined that it was more important to the interests and the benefit of Contract owners to preserve the tax status enjoyed by Contract owners than to maintain the Portfolio which is no longer available for additional purchase. Applicants also contend that the minimal amount of total net assets available for investment and the termination of the sale of shares diminishes investment opportunities and handicaps Mitchell Hutchins in its