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February 22, 1985

Mr. Morton L. Riff
Mr. Ernest W. Kapas
Mr. Wallace M. Wong
California Department of Corporations
600 South Commonwealth Avenue
Los Angeles, California 90005

Re: <u>WestCorp Trust Deed Fund</u>

Gentlemen:

The following outline is provided, at your request, to set forth the grounds upon which it may be established that (a) the sale of Fund Participation Interests in the manner described in the Prospectus is "fair, just and equitable" to investors; and (b) the application of the suitability standards contained in the rules for Real Estate Programs would be inappropriate.

I. The Sale of Participation Interests is Fair, Just and Equitable.

A. All investors are treated alike.

1. <u>Each loan selected by Fund Manager:</u> All investors--those who have invested in the trust deeds listed on Schedule A, and those who have not yet but will invest in the Fund--are cash investors. At the time of their investment, their monies have been or will be promptly invested in a trust deed loan with a principal balance equal to the amount of their investments. Each trust deed loan on Schedule A which may be contributed to the Fund, and each trust deed loan to be acquired in the future by the Fund, will meet the same

underwriting standards and will have been selected by Pension Asset Management, Inc.

2. Loans valued consistently throughout life of Fund: Each investor in the Fund will acquire an undivided interest in all of the Fund trust deed loans. Assigning arbitrarily enhanced or discounted values to Schedule A loans, but not to after-acquired loans, treats the Schedule A purchasers and the Schedule A loans very differently, without reason. A cash investor during the Fund's fourth, fifth or sixth month of existence is in essence exchanging cash for a pool of existing loans, yet there would not be an "appraisal" of the Fund trust deed loans at those times. Therefore, the Fund applies the same method of valuation to all trust deed loans owned by the Fund.

3. Same price for all purchasers: In order to treat likes alike, all investors must receive $1.00 of Participation Interests for each $1.00 of cash invested. This is the manner in which the Fund in fact operates.

B. Participation Interests must be valued by reference to the "active market of substantial depth" which exists for the origination, but not the resale, of small, individual trust deed loans.

1. General rule: Rule 260.140.50 provides that "securities shall be sold at a price which is fair to the issuer and the purchasers."

2. Predominant weight given to reliable market indicators: According to this Rule, predominant weight will be given to the recent market price of such securities, or comparable securities of others, which are publicly traded on an active market of substantial depth. In the absence of any such reliable indicator, the price of the securities is to be evaluated "in the light of market conditions generally."

3. Active primary, but not secondary, market: There is no active public secondary market for small, individual trust deed loans. However, there is an active primary market for such loans; the market (consisting of lenders) prices these loans according to risk and quality by means of varying interest rates.

4. Varying interest rates discount loans for risk: A higher or lower interest rate reflects the borrower's creditworthiness, as well as the value of the underlying security. In certain cases, it may also reflect more or less favorable terms in the note and/or deed of trust. The varying interest rates therefore appropriately discount each of the individual loans, making the principal balance the common denominator by which to objectively rank the relative values of individual loans.

5. Primary market is best evidence of asset values: The value of Participation Interests will be determined according to the only market-related "reliable indicator" of the value of small, individual trust deed loans, which is the interest rates at which the loans are issued. Giving full effect to different interest rates upon the contribution of trust deed loans to the Fund takes into account the differing risk of individual trust deed loans. This same method will be used to determine asset values on a daily basis throughout the life of the Fund.

6. Primary market measure can be consistently applied: Upon formation of the Fund and at all times thereafter, trust deed loans will be individually discounted according to interest rate differentials. Their respective principal balances thus provide the common denominator by which relative value is measured. Absent an active secondary market of substantial depth, relying upon the primary market for trust deed loans is the only fair and reliable pricing method.

C. The valuation method proposed is fair to all concerned.

1. General rule: Rule 260.140.50 requires that securities shall be sold at a price which is "fair to the issuer and the purchasers."

2. Fair to issuer: Fairness to the issuer is not a concern.

3. Fairness to purchasers requires horizontal equity: To be fair to the purchasers, the price at which Fund interests are sold must be the same for all purchasers. Throughout the existence of the Fund, Fund assets (trust deed loans) will be valued according to the principal amount of loans outstanding. There is no reason to treat Schedule A loans contributed upon formation of the Fund differently from later-acquired loans. Similarly, the Schedule A cash investors and all other cash investors should be treated exactly alike.

4. Fair to cash investors: Since each cash purchaser will receive a yield equal to the average yield of all loans, valuing the Fund's assets according to the principal amounts of all loans (without adjustment for different interest rates of individual Fund assets) is fair, reasonable and accurate. The sale of $1.00 of Fund assets for $1.00, using the same valuation method for loans throughout the existence of the Fund, is inherently fair to all purchasers.

5. Purchasers are in position to evaluate fairness: It is anticipated that both the Schedule A cash investors and subsequent cash investors will perceive the valuation of trust deed loans according to principal value as the most equitable method. Unlike the sale of common stock, bonds or tax shelter investments, where the purchaser may be required to analyze and understand complicated financial statements and business descriptions, the investor's choice here is

clear. He is exchanging either a trust deed loan with X interest rate, or cash, for a diversified Fund of such loans with an average interest rate of Y.

6. No element of compulsion: A person who chooses to invest in the Fund will have decided that the proposed exchange is a fair one. Unlike certain "roll-ups" or other reorganizations or mergers, there is no element of compulsion here. Each investor is free to choose, and to make the relatively simple decision of whether he prefers interest rate Y yielded by a diversified Fund to other available alternatives.

7. All elements of fairness present: Since the valuation method is reasonable, is based upon the only reliable market indicator of value, treats all purchasers alike, presents an easily understood investment decision, and is offered to investors with no element of compulsion, it is fair, just and equitable to the purchasers.

D. No other method of valuation is as reliable as the one proposed.

1. No objective basis for appraisal: Since there is no active secondary market of substantial depth for small individual trust deed loans, no "appraisal" could be conducted with reference to any such objective market evidence.

2. No expertise available: There are no well-known firms that hold themselves out as expert by training or experience in "appraising" the resale market value of small, individual trust deed loans, inasmuch as no such market exists.

3. Quality of analysis cannot exceed quality of market data: While it would be possible for the Fund to engage a person or firm to purport to "appraise" trust deed loans without refer-

ence to any objective market evidence, such an exercise would create only an illusion of objectivity. Absent reliable objective benchmarks, any "appraisal," no matter how much the Fund might pay for it, would be inherently subjective and unreliable.

4. Imprudent use of investors' funds: Given the subjectivity of any "appraisal" in the absence of an active secondary market of substantial depth, expenditure of Fund assets for such an "appraisal" would unfairly and unreasonably harm the investors' rate of return. By significantly increasing front-end costs, it could also render the organization of the Fund uneconomical, thereby eliminating an opportunity for the Schedule A investors to diversify their investment risk.

5. Best method in light of surrounding circumstances: The standard of "fair, just and equitable" does not require Platonic perfection in determining asset values. Reasonable approaches to the valuation task are permitted, and reasonable judgments may be made, within the realm of economic feasibility. The proposed valuation method is based upon the only objective evidence available. It is administratively practicable, and will yield the highest return to purchasers. It is therefore the most fair method for all concerned.

II. Imposition of Suitability Standards Contained in the Real Estate Program Rules Is Inappropriate.

A. The Fund is not a "real estate program" for which suitability standards should be imposed.

1. Characteristics of real estate programs: Rule 260.140.110.1, and the substance of the rules that follow, make it clear that the rules in Subarticle 10 are designed for programs which own or operate real estate, particularly limited partnerships. Suitability standards, described in Rule

360.140.112.1, are deemed appropriate for such programs "[g]iven the limited transferability, relative lack of liquidity, and the specific tax orientation of many real estate programs."

2. Additional criteria for use of suitability standards: Suitability standards are also appropriate for real estate programs "which involve more than ordinary investor risk," or in which it may not automatically be assumed that a purchaser will "understand the fundamental aspects of the program."

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3. Real estate programs vs. mutual fund: In contrast to real estate programs, which are typified by real estate development tax shelters, the Fund is a mutual fund. Its purpose is neither to own nor to operate real estate. It is neither tax-oriented, illiquid, of more than ordinary investor risk, nor difficult to understand:

(a) No specific tax orientation: The Fund selected the limited partnership form of organization because, in comparison to a Massachusetts Business Trust (the usual form of organization for mutual funds) and other available forms, it best suited the Fund's objectives. However, a number of other forms of organization might have been chosen. Therefore, no special significance should be attached to the fact that the Fund is a limited partnership. Participants in the Fund will for all purposes be in exactly the same position, for tax purposes and otherwise, as if they purchased an interest in any other mutual fund.

(b) Not illiquid: The substantial aggregate income from Fund assets will provide a great deal of liquidity. Investors may elect to have 100% of their income distributed currently. Moreover, up to 3% of Fund assets will be held as a Liquidity Reserve for the discretionary repurchase of Participation Interests. (See Sections 2.14 and 10.20 of the Fund Agreement.)

(c) No unusual risk: Because all the trust deed loans are secured and over-collateralized, there is relatively low risk. The Fund, moreover, will be diversified. Therefore, an investor who owns a single trust deed loan will be acquiring a less risky investment than the one he already owns.

(d) Not a complex investment: Investment in the Fund is straightforward. The Fund is a mutual fund which will own a single kind of fixed-income asset, and such assets will be fully secured. Since the Fund is styled as a mutual fund, it is easy to understand for the average investor.

4. Fund lacks characteristics warranting imposition of suitability standards: Since the Fund has virtually none of the characteristics described in Rule 260.140.112.1, it should not be considered a real estate program for which suitability standards must be imposed.

B. The Fund is designed for the small investor; therefore suitability standards are inappropriate.

1. Purpose to enable small investor to diversify: Mutual funds are designed to permit the small investor to realize the benefits of diversification, which otherwise are available only to large investors.

2. Market for Fund interests: The principal market for sale of Participation Interests will be IRAs and similar plans, which can be expected to invest only a small amount of money. Since the aim is to provide the small investor with diversification by means of a mutual fund, imposition of large-investor suitability standards is inappropriate.

We hope that the foregoing outline will succinctly, and helpfully, set forth the reasons that the terms of the sale of Participation Interests in the Fund as proposed are fair, just and equitable to purchasers.

During our recent telephone meeting, some of you expressed concern that because there is no active secondary market for small, individual trust deed loans, the Fund concept cannot be implemented. That would be unfortunate. Without the opportunity that the Fund will provide, individuals, IRAs and the like will continue to invest in individual trust deed loans. The specific risk inherent in such an investment is absolutely unnecessary. When a single trust deed loan turns sour without warning, an investor might lose everything. Yet the same default on a trust deed loan held by the Fund would have little, if any, impact on the individual investor. The Fund not only will have spread that specific risk over a very large pool of similar loans, but also will have the wherewithal and expertise to realize upon the underlying security.

Investment in a mutual fund of trust deed loans is, quite simply, far superior to investment of the same amount of money in an individual trust deed loan.

We realize that the Fund represents a new idea. The Fund is meant to offer a new opportunity to investors, but the fact that it is new and has not been done is not a reasonable basis for determining that it cannot or should not be done now. It is a good idea. It is not only fair but advantageous to purchasers, and it represents the best method for achieving the objectives of a high rate of return, low fees, and diversification to the small investor.

Sincerely,

Christopher Cox

C. Christopher Cox
of LATHAM & WATKINS