James J. Sullivan
Senior Managing Director
Head of Fixed Income

Prudential Fixed Income
Two Gateway Center, 3rd Floor, Newark NJ 07102-5096
Tel 973 802-4560 Fax 973 367-8668
james.sullivan@prudential.com

A business of Prudential Financial, Inc.

June 13, 2011

Via E-Mail http://www.regulations.gov/

Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
OCC-2011-0002

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, D.C. 20551
Docket No. R-1411

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments
RIN 3064-AD74

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
File Number S7-14-11

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G St NW, 4th Floor
Washington, DC 20552
RIN 2590-AA43

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
Docket No. FR-5504-P-01

RE: Proposed Rule, Credit Risk Retention
OCC Docket No. 2011-0002; Federal Reserve Docket No. R-1411; FDIC RIN 3064-AD74;
SEC File No. S7-14-11; FHFA RIN 2590-AA43, HUD *Docket No. FR-5504-P-01*

Dear Sir or Madam:

Prudential Investment Management, Inc. (PIM) respectfully submits these comments in response to the proposed rule on risk retention issued by the Office of the Comptroller of the Currency, Treasury (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), U.S. Securities and Exchange Commission (Commission), Federal Housing Finance Agency (FHFA), and Department of Housing and Urban Development (HUD) (collectively, the "Agencies").

Registered Principal, Prudential Investment Management Services LLC, Certain securities products managed by Prudential Fixed Income are distributed by its broker-dealer affiliate, Prudential Investment Management Services LLC, a FINRA member firm.

We sincerely thank the Agencies for thoughtfully addressing the need for meaningful credit risk retention within structured securities. PIM, with $569 billion in assets under management (as of March 31, 2011), ranks among the largest institutional asset managers in the United States, and was one of the earliest institutional investors to embrace structured products in the late 1980s.

Our primary public fixed income asset management business, Prudential Fixed Income, is one of the largest fixed income managers in the United States[1] with $289 billion (as of 31 March 2011) of assets under management. In 1991, Prudential Fixed Income formed a dedicated group of analysts to focus solely on the structured products market, and we continue to maintain this specialized approach today. We have been a lead investor in many structured transactions, with approximately $64 billion (as of 31 March 2011) under management in mortgage-backed and structured securities for both affiliated and third party institutional clients as well as for retail investors. Our structured product holdings contain public and private investments across the capital structure of asset-backed securities (ABS) transactions, including collateralized loan obligations (CLO), commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS), commodity consumer sector (e.g., autos, credit cards, student loans) and small "esoteric" ABS sectors (e.g., containers, franchise, timeshare).

PIM also maintains a dedicated CLO and corporate credit synthetic obligations (CSO) asset management platform, and a PIM affiliate was involved in the issuance of CMBS for many years. Our decades of active involvement with structured securities, as an investor, manager and issuer provides the Agencies with an experienced, balanced and unique perspective that only few institutions can offer.

The implementation of the credit risk retention rules and other regulatory reforms will shape PIM's continued interest in the structured finance market, both as a suitable investment for our clients and a sustainable issuance platform for our business units. For PIM, the primary goal of all the proposed regulatory changes is fostering the long-term stability of the structured market. We fundamentally believe a robust alignment of interests between issuers and investors in the securitization market promotes the availability of affordable credit products for borrowers. We thank the Agencies for considering our comments. Please contact us for any follow-up.

Sincerely,

James J. Sullivan
Senior Managing Director and Head of Prudential Fixed Income
2 Gateway Center, 3rd Floor
Newark, New Jersey 07102
Telephone: 973-802-4560
james.sullivan@prudential.com

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[1] *Source: Institutional Investor, July/August 2010, based on domestic fixed income securities held as of 12/31/09.*

I. OUR KEY GUIDING PRINCIPLES

1. ***Risk retention is an effective method to align the interests of issuers and investors:*** We believe properly implemented risk retention will encourage issuers to emphasize loan underwriting quality over loan origination volumes in the prevailing "originate-to-distribute" environment, as well as strengthen investor confidence in the securitization market.

2. ***Issuers should not be permitted to realize any profit at the time of securitization:*** In order to effectively implement a "skin in the game" requirement, an issuer should earn profits from a securitization over time and only if the underlying collateral is performing as expected. A securitization market that permits profiting upon issuance could potentially encourage loan origination volume over loan quality for securitization. Securitization proceeds should be capped based on our proposed "Net Borrower Proceeds" and "Origination & Hedging Expense" definitions. The cap must consider all sources and uses of cash, including cash inflows from issuance (total securitization proceeds) and net cash outlays in originating the collateral (loan proceeds, expenses, borrower fees, hedges until securitization).

3. ***Risk retention should be 5% of the net proceeds lent to the underlying borrowers:*** The net proceeds lent by an issuer to its borrowers is known with certainty prior to issuing a securitization, and therefore the application of risk retention can be applied consistently across all potential forms of risk retention (horizontal, L-shaped, vertical or B-piece).

4. ***After an appropriate period of time, risk retention may be sold or hedged:*** After an appropriate period of seasoning, much of the future performance of a collateral pool is predicated on the then current economic conditions and is less related to underwriting standards when the loan was originated. As such, transferring or hedging of risk retention may be appropriate and would not lessen alignment of interests.

5. ***An independent servicer / advisor is necessary to address conflicts of interest where horizontal risk retention is chosen:*** From an investor's perspective, a primary weakness in first loss horizontal risk retention is that the servicer could administer the collateral in a fashion to maximize value for the risk retention holders at the expense of other investors.

6. ***Exceptions should be narrow with rules strongly enforced:*** Credit risk retention is meant to protect the financial system and address the excesses that were factors in the most recent recession. Any carve out to the risk retention requirements, or the designation of "qualified assets" to be exempt from risk retention, should be extraordinarily narrow in scope. The rules must include meaningful policing of issuers and penalties for sponsors that take actions to avoid credit risk retention.

II. PIM'S RECOMMENDATIONS ON PROPERLY IMPLEMENTED CREDIT RISK RETENTION

PIM believes properly implemented risk retention should possess the following characteristics:

As we present our proposal, we contrast PIM's proposed approach with the Credit Risk Retention Proposed Rules (CRR) published on April 29, 2011 in the Federal Register.

1. Issuers Should Not Be Permitted To Realize Any Profit At The Time Of Securitization

PIM believes permitting sponsors to "cash out" at the time of issuance rewards originators who maximize loan volume over loan underwriting quality and potentially materially offsets the intended benefits of risk retention. In order to further strengthen an issuer's "skin in the game," an issuer should only earn profits from a securitization, post issuance, over time and only if the underlying collateral is performing as expected.

Difference vs. CRR: While the proposed rule, through the creation of a Premium Capture Cash Reserve (PCCR) Account, would discourage a securitization issuance exceeding 100% of the par amount, an issuer could still realize immediate profitability if the "Net Borrower Proceeds," defined below, are less than the loan face amount (see point 3 below for more detail).

2. Risk Retention Should Be 5% Of The Net Proceeds Lent To The Underlying Borrowers

In order to encourage issuers to emphasize loan underwriting quality over loan origination volume, we believe an issuer, or the B-piece investor in CMBS, should be required to retain a minimum risk retention interest of at least 5% of the "Net Borrower Proceeds," defined below. Since the net proceeds lent by an issuer to its borrowers is known with certainty prior to issuing a securitization, application of the requirement could be implemented consistently across all potential forms (horizontal, L-shaped, vertical or B-piece). We believe the risk retention holding may be divided between multiple parties, but retained interests financed with non-recourse debt should be prohibited (e.g. structured vehicles, like CDOs, should not be eligible holders).

Difference vs. Credit Risk Retention Proposed Rules (CRR): The proposed rule defines risk retention as 5% of par amount of the issued securities, however, the calculation of par amount is not explicitly defined in the proposed rule. If the par amount of issued securities is meant to equal the face amount of the underlying collateral, then 5% horizontal or L-shaped retention may not be the most effective basis to align issuer and investors' interests. First loss securities could be sold at deep discounts, reducing the dollar amount of capital contributed by the issuer. While the issuer may hold 5% of the par amount of the issued securities, the low market value of the risk retention can result in first loss securities behaving like interest-only bonds. These first loss securities function very differently than senior and mezzanine debt securities, thereby weakening the intended alignment of interests.

If instead, the par amount of issued securities is meant to be greater than the face amount of the underlying collateral, the amount of risk retention could approach our recommendation of 5% of "Net Borrower Proceeds", defined below. However, unlike our recommendation, this interpretation of par amount would permit the issuer to profit at the time of securitization if the par amount of issued securities is sufficiently in excess of the face amount of the underlying collateral. Additionally, issuance of a par amount of securities in excess of collateral face amount results in an under-collateralized structure which poses greater credit risk to investors.

3. Risk Retention Amount Should Consider All Sources And Uses Of Cash

In order to accomplish the objective of ensuring that issuers do not profit at time of securitization, it is important to consider all cash inflows from issuance (total securitization proceeds), as well as net cash outlays in originating the collateral (loan proceeds, expenses, borrower fees, and hedges until securitization).

Any risk retention model must account for hedging gains and losses that may be realized by the issuer during the warehouse period (the period when the underlying collateral is aggregated for a securitization). Managing interest rate and spread risk is a prudent element of any origination strategy and is a risk mitigation activity that should be encouraged. If issuers are not permitted to adjust issuance proceeds by the net realized hedging gains/losses, loan originators might either increase the cost of financing to the borrower to offset potential interest rate/spread volatility or exit the lending business.

Additionally, the model should permit an issuer to recoup a portion of its "Loan Origination Expense" (defined below), since it is required to contribute new capital to fund its risk retention obligation.

Finally, the model should also adjust for any value extracted from the collateral by the issuer outside of the securitization process. An issuer could generate immediate profitability through the lending process by simply lowering the coupon to the borrower, taking points upfront, and contributing these lower coupon loans to the securitization at a price equal to par. This immediate profitability could be sufficient to undo the intended benefits of risk retention and shift the focus of origination back to loan volume rather than loan quality.

As stated earlier, we support credit risk retention based on 5% of the "Net Borrower Proceeds" as defined below:

- ***Required Credit Risk Retention*** = *5% x Net Borrower Proceeds*

- ***Net Borrower Proceeds*** = *Gross Loan Proceeds – Discount Points – all Borrower Expenses/Fees paid to the loan originator*

An issuer should always be able to recoup 100% of the incurred "Origination & Hedging Expense," as defined below, through the issuance of a securitization:

- ***Origination & Hedging Expense*** = *Loan Origination Expenses + (Hedge Losses-Hedge Gains)*

- ***Loan Origination Expense*** = *0.5% of the loan par amount*

To the extent an issuer chooses to monetize excess spread and realizes proceeds from the securitization that are greater than the Net Borrower Proceeds, we recommend that such excess proceeds shall only be applied towards an eligible horizontal risk retention sleeve. Under this proposal, the issuer cannot receive gross proceeds from the issuance of securitization interests to unaffiliated third-party parties in excess of:

i. ***If the issuer adopts horizontal risk retention or, for CMBS, if a B-piece buyer rather than the issuer retains risk:*** 100.0% of the Net Borrower Proceeds + 100.0% of the Origination & Hedging Expense; or

ii. ***If the issuer adopts L-shaped risk retention***[1]***:*** 97.5% of the Net Borrower Proceeds + 100.0% of the Origination & Hedging Expense; or

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[1] 97.5% Assumes 2.5% vertical risk retention in the L-shaped risk retention.

iii. ***If the issuer adopts vertical risk retention:*** 95.0% of the Net Borrower Proceeds + 100.0% of the Origination & Hedging Expense.

Limiting the amount of gross proceeds an issuer may raise at issuance would result in collateral value in excess of the limit being retained within the securitization structure as enhancement, primarily in the form of excess spread. To the extent the "excess collateral value" is not needed to make required payments that are higher in priority, excess spread will be available to the issuer at the bottom of the waterfall on each payment date.

A cap based upon the Net Borrower Proceeds is objective, is known in advance of a securitization, and is straightforward to understand. This approach encourages horizontal risk retention, our preferred method of risk retention, and L-shaped risk retention, relative to the vertical retention option by allowing the issuer to fund at least a portion of its risk retention amount via monetized excess spread.

For CMBS, the issuer should have the option of satisfying its first loss horizontal, or first loss portion of its L-shaped, risk retention through a combination of holding the bottom tranches in the securitization and holding B-notes sized to 5% of Net Borrower Proceeds on individual loans.

Difference vs. CRR: The proposed rule does not account for hedging gains/losses and does not adjust for net borrower proceeds. Furthermore, it establishes a somewhat complicated PCCR Account as an indirect way to cap proceeds at 100% of the par amount of the issued securities. As described in the proposed rules, the PCCR was constructed with the intention that it never be used. However, this approach does not seem to be well understood, since many market participants may assume that the PCCR account must always be funded.

4. PIM Does Not Support Representative Sample / Random Selection As An Eligible Form Of Risk Retention

PIM agrees with the U.S. Securities and Exchange Commission's position in their Regulation AB proposal: that in retaining risk through the retention of randomly selected exposures, "it would be both difficult and potentially costly for investors and regulators to verify that exposures were indeed selected randomly, rather than in a manner that favored the sponsor."[2]

5. After An Appropriate Period Of Time, Risk Retention May Be Sold Or Hedged

While section 941 (b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the promulgated regulations to prohibit a securitizer from hedging or otherwise transferring the credit risk it is required to retain, section 941 (b) also requires the promulgated regulations to specify a minimum duration of the required risk retention. PIM recommends that the retained risk, whether held by the issuer or a B-piece investor, can be sold, transferred or hedged after a specified period of time, based upon the asset class and securitization specific performance triggers. For CMBS and RMBS we propose the time period should be at least five years. Asset classes with a shorter average life span, such as auto loans, should adopt a shorter time period to better correspond to the shorter average life of the collateral. After an appropriate period of seasoning, much of the future performance of a collateral pool is predicated on real-time economic conditions and is less correlated to underwriting standards from when the loan was originated. Therefore, transferring or hedging of risk retention may be acceptable and would not meaningfully lessen

[2] **Federal Register** / Vol. 75, No. 84 / Monday, May 3, 2010 / Proposed Rules – Page 23339

alignment of interests. The original holder of the risk retention and any subsequent risk retention holder should be prohibited from financing their risk retention holding with non-recourse debt (e.g. structured vehicles, like CDOs, should not be eligible holders).

Difference vs. CRR: The proposed rule would direct an issuer or B-piece investor in CMBS to hold the retained bonds until final maturity. While this approach certainly cements the "skin in the game" concept, a 10-plus year mandatory holding period seems onerous for the party retaining risk. While some level of compromise seems appropriate, it is important to ensure the holding period is sufficiently long to avoid the almost instantaneous laying-off of risk that was prevalent at the height of the financial bubble.

6. An Independent Servicer / Advisor Is Necessary To Address Conflicts Of Interest Where Horizontal Risk Retention Is Chosen

From an investor's perspective, a primary weakness in first-loss horizontal risk retention is the potential that a servicer could administer the collateral to maximize value to the risk retention holder while putting other investors at greater risk.

If the issuer or B-piece investor retains risk in the form of a first-loss horizontal position and controls loan workouts (the special servicer in CMBS), an operating advisor should be required as outlined by the proposed rule. The operating advisor consults with, reviews the actions of, and can remove the CMBS special servicer. This advisor is intended to serve as a check on potential conflicts of interest. An operating advisor's recommendation to remove the CMBS special servicer for violation of the servicing standard (including fraud) should be reviewed and confirmed/rejected through a discovery process (perhaps arbitration).

For RMBS, PIM also believes it is important to appropriately align servicing practices in order to avoid conflicts of interests, and to attract investors back to a sector where there is great uncertainty with regard to servicing practices and concern about the potential conflicts within many servicers. We believe that servicing should be transferred from an originator to an independent third-party after a loan becomes 90 days delinquent. In addition, a special servicer that is independent of the issuer, the servicer, and the related securities should perform all RMBS workouts.

Difference vs. the CRR: The proposed rule only requires an operating advisor if a B-piece investor retains the horizontal first loss position and is silent if the issuer retains the horizontal first loss position. In addition, the proposed rule requires an affirmative vote of a majority of all bondholders to reverse an operating advisor's decision to remove the special servicer, which perhaps places too much power with the operating advisor. Servicing conflicts of interests are not addressed in the proposed rule with regard to RMBS securities.

7. Credit Risk Retention Disclosure / Avoidance Penalties

To provide the greatest transparency to the market, the sponsor and its affiliates should regularly report all of their related holdings, by tranche, of all securitizations by the sponsor (not just their current required risk retention), as we believe that any change in sponsor or affiliate holdings is material and should be disclosed.

Given that the intent of credit risk retention is to protect the financial system and address the excesses that were factors in the financial crisis, we believe there must be meaningful policing and concurrent penalties for sponsors to dissuade them from taking actions that circumvent the letter or spirit of credit risk retention.

As PIM evaluates the suitability of the next generation of structured securities, we will continue to assess how market participants are adapting to the new environment.

8. Credit Risk Retention Should Not Be Diluted

We believe any carve-outs to the risk retention requirements should be extraordinarily narrow in scope, as any exemption will dilute alignment of interests.

III. "QUALIFIED" LOANS

While we acknowledge that the Dodd-Frank regulation requires Agencies to develop a definition of "qualified assets" for a specified list of assets, and exempt these "qualified assets" from the risk retention requirements, it is our view that the "qualified asset" definitions should be very narrow in scope. We are opposed to any incremental structured asset class being designated as a "qualified asset." We also believe that it is difficult to establish underwriting criteria that warrant such exceptions, thus opening the market up for potential manipulation of such exceptions. To the extent boundaries for such exceptions are established, we believe they should be very narrow in scope.

IV. ACCOUNTING CONSIDERATIONS

Consolidation is a primary consideration for issuers, and if the amount or form of credit risk retention would require consolidation, we believe the accounting rules could limit the amount of structured security issuance. The regulators and the Financial Accounting Standards Board (FASB) should develop rules to ensure that consolidation under FASB Statement 167 is never triggered solely by the issuer's risk retention.

Risk retention is important in fostering a long-term, stable structured market, which is a positive for the consumer and the economy. It is important to prevent accounting rules from constraining the benefits of a healthy securitization market.

V. CONCLUSION

PIM is very supportive of risk retention. Although not seen as a "silver bullet," risk retention creates an important alignment of interest that should instill stronger origination and servicing of securitized assets and foster a more stable securitization market. Our recommendations on risk retention are based on a set of core principles that we believe will maximize the effectiveness of the proposed reforms: issuer profitability should be aligned with the performance of the collateral, a retained interest should be held through a reasonable seasoning of the collateral, exceptions to risk retention should be extremely limited, independent parties are required to address conflicts that can undermine the benefits of aligned interests, and enforcement for non-compliance should be meaningful.