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October 30, 2013

Via Electronic Submission http://www.regulations.gov/

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW.
Suite 3E–218, Mail Stop 9W–11
Washington, DC 20219.
Docket Number OCC–2013–0010

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

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551.
Docket No. R–1411

Alfred M. Pollard
General Counsel,
Attention: Comments/RIN 2590–AA43
Federal Housing Finance Agency
Constitution Center
(OGC) Eighth Floor
400 7th Street SW.
Washington, DC 20024

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

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
RIN 2501–AD53

RE: Proposed Rule, Credit Risk Retention
OCC Docket No. 2013-0010; Federal Reserve Docket No. R-1411; FDIC RIN 3064-AD74;
SEC File No. S7-14-11; FHFA RIN 2590-AA43, HUD RIN FR-2501-AD53

Dear Sir or Madam:

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

We sincerely thank the Agencies for thoughtfully addressing the need for meaningful credit risk retention within structured securities. Prudential Investment Management, with $826 billion in assets under management (as of June 30, 2013), 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 $391 billion (as of June 30, 2013) 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. We have been a lead investor in many structured transactions, with approximately $64 billion (as of June 30, 2013) 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 sectors (e.g., autos, credit cards, student loans) and small "esoteric" ABS sectors (e.g., containers, franchise, timeshare).

Prudential Investment Management also maintains a dedicated CLO asset management platform and an affiliate is involved in the origination of loans for a CMBS platform. 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 Prudential Investment Management'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. The primary goal of all the proposed regulatory changes should foster 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 me for any follow-up.

Sincerely,

Richard B. Rogers

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Head of Structured Product Research
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[1] *Source: US and Global Pension Fund data, Pensions & Investments Top 1000 US Pension Funds, 9.30.12, Pension Funds Online 2012 and IPE Top 1000 Global Institutional Investors.*

EXECUTIVE SUMMARY

A Short Window of Opportunity Exists to Increase the Resiliency of Securitized Product Markets

The financial crisis exposed critical issues with the credit underwriting process for loans distributed to the capital markets through securitized products, particularly in RMBS and CMBS. Consumer and commercial borrowers' access to credit continues to be constrained and nearly five years later, securitized markets still have not fully recovered. Since securitized products are a key element in many credit markets and directly impact the health of the economy, it is vital to apply the lessons learned from the financial crisis to ensure an orderly functioning of these markets throughout the credit cycle. We need to strengthen the resiliency of the structured market today or risk facing a repeat of the last cycle and economic downturn, where lenders and investors contract their activity, leaving consumer and commercial borrowers without access to credit, and further weakening the economy.

Our Key Risk Retention Principals

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 quantity. Improved alignment should serve to moderate underwriting standards, especially during times of economic froth, and will result in more conservative and consistent underwriting throughout the economic cycle. A more muted cycle should increase investor confidence and re-attract and maintain capital that fled from securitized markets at the onset of the crisis.

2. 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. The rules must include meaningful provisions to police issuers and provide for penalties for sponsors that take actions to avoid credit risk retention requirements.

CMBS Underwriting Standards Are Deteriorating Once Again

The delay in mandating risk retention for the CMBS sector is a contributing factor to current deteriorating CMBS underwriting practices. Until risk retention rules are implemented, CMBS issuers may be willing to let credit quality slip further in order to increase loan volume and to maximize profit, leaving the rating agencies and bondholders as the remaining defense against continued deterioration. Unfortunately, both of those parties proved to be ineffective at moderating aggressive issuer underwriting practices in 2006 and 2007.

RMBS Risk Retention Recommendations

1. Defining Qualified Residential Mortgage (QRM) to be equal to Qualified Mortgage (QM) does not provide adequate risk retention. We believe that any workable QRM definition should only include

loans that: (1) meet the core QM criteria, (2) require a minimum 20% down payment and (3) consider the borrower's credit history.

2. A minimum 2.5% risk retention should be required for any pool that blends qualified and non-qualified assets.

3. Representative Sample should not be allowed as a permitted form of risk retention.

CMBS Risk Retention Recommendations

1. We agree that the first loss horizontal risk retention position may be shared by two unaffiliated investors on a pari passu basis. However, we oppose any recommendation from market participants that the first loss position be split into senior and subordinate positions.

2. The voting threshold for the replacement of the special servicer should be marginally increased from the suggested 5% quorum. An increase to 15%-20% would help to avoid a situation where a conflicted investor and/or operating advisor attempted to circumvent the system by replacing a special servicer that was otherwise adhering to the servicing standard.

3. We do not object to the suggested marginal loosening of the qualified commercial real estate (QCRE) definition; however, we oppose any further weakening of the definition from what was re-proposed.

SUMMARY BACKGROUND

RMBS SECTOR

1. QRM DEFINITION

We believe the recommended approach for RMBS, which would define QRM to be equal to the Truth in Lending Act's QM definition, is inadequate and essentially promotes practices that are arguably at the heart of what led the markets into the financial crisis. Oddly, the non-agency RMBS sector is the only sector in the re-proposal to avoid meaningful risk retention by exempting the significant majority of loans through the application of a very broad QRM definition. Investors may demand higher returns or avoid future private label RMBS transactions entirely in the absence of a more narrow QRM definition. We believe that any workable QRM definition should only include loans that: (1) meet the core QM criteria, (2) require a minimum 20% down payment and (3) consider the borrower's credit history.

With the impact of the financial crisis ongoing, we cannot support a solution for such a critical sector of the economy that would not have been effective at addressing the previous crisis. As highlighted in the re-proposal, "of loans originated from 2005 to 2008, 23 percent of those that met the QM criteria experienced a spell of 90-day or more delinquency or a foreclosure by the end of 2012".[2]

We are sympathetic to the Agencies' concern that a more restrictive definition of QRM may limit access to credit. We believe, however, that the direct costs incurred by a sponsor for funding the retained portion would be relatively small. The cost to the sponsor is further reduced given that the re-proposal has eliminated premium re-capture and allows for risk retention to be satisfied by retaining only a vertical slice. Credit access for creditworthy borrowers is best served over the long run by a commitment to market stability which requires that issuer and investor interests are properly aligned. Consumer access to credit would benefit from risk retention as a stable securitization market would lead to broader investor participation and tighter financing spreads.

A broad exemption to risk retention in the RMBS sector may encourage lenders to return to their pre-crisis aggressive underwriting "standards" that could contribute to another housing bubble and subsequent financial crisis. We remain hopeful that the Agencies will reconsider its decision to equate QRM to QM and will adopt the advice of SEC Commissioner Gallagher in his dissenting statement: "In order for a risk retention rule to have any meaning, however, any exemptions from the application of such a rule would have to be made on a limited basis to only the highest-quality loans, that is, those that simply don't need the protections the rule is designed to offer."[3]

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[2] Credit Risk Retention, FEDERAL RESERVE SYSTEM, 12 CFR Part 244, Docket No. R-1411, RIN 7100-AD70, page 257

[3] Commissioner Daniel M. Gallagher, Dissenting Statement of Commissioner Daniel M. Gallagher Concerning Re-Proposal of Rules Implementing the Credit Risk Retention Provisions of the Dodd-Frank Act, August 28, 2013

2. BLENDED POOLS

We agree with the Agencies' concern that providing unlimited flexibility with respect to mixing qualifying and non-qualifying collateral pools could create opportunities for practices that would be inconsistent with the principals of risk retention. Therefore, to the extent that blended pools are permitted to proportionally lower required risk retention, we believe that there should be a 2.5% risk retention minimum. This minimum would provide investors some protection against scenarios where sponsors "barbell" low quality non-QRM assets with high quality qualified assets.

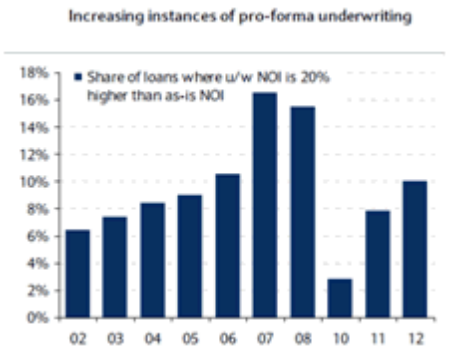
3. REPRESENTATIVE SAMPLE

We agree with the re-proposal's elimination of representative sample as a permitted form of risk retention for RMBS and all sectors of the structured securities market. We support the SEC's position 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."[4]

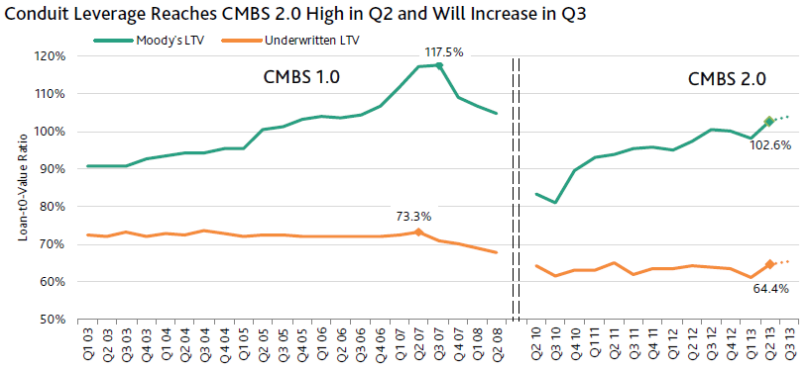
CMBS SECTOR

1. OVERVIEW OF CURRENT CREDIT QUALITY

The delay in mandating risk retention in the CMBS sector is already having a negative effect. We believe the lack of risk retention is a contributing factor to the current cycle of deteriorating CMBS underwriting practices as evidenced by the number of recent loans that are sized according to projected, or "pro forma", net operating income rather than actual property-level income[5] and by a negative trend in rating agency "stressed LTV" metrics.[6] Until issuers retain risk alongside securitized product investors, loan volume may continue to supersede loan quality in the quest to maximize profit, and credit quality may deteriorate accordingly.



Source: Barclays Securitization Research



Source: Moody's Investor Service

[4] Federal Register / Vol.75, No.84 / Monday, May 3, 2010 / Prospectus Rules – Page 23339
[5] Barclays Securitization Research, "Stressing Credit Risk on CMBS 2.0/3.0", September 27, 2012
[6] Moody's Investor Service, "US CMBS Q2 Review: Ten-Year Loans, Five-Year Memories", July 18, 2013

2. RECOMMENDATIONS

Multiple B-piece Buyers

We agree with the recommendation that up to two B-piece buyers can share, on a pari passu basis, the first loss horizontal risk retention. However, we are opposed to a recommendation from some industry participants that two, or perhaps more, B-piece buyers could split the single first loss position into separate senior and subordinate positions for the following reasons:

(1) A senior/subordinate split of the first loss position would further dilute risk retention:

The effectiveness of risk retention in CMBS has already been diluted by allowing a third party B-piece buyer to retain risk in lieu of the issuer. CMBS is the only asset class that has the benefit of this exception, and lenders may exploit the loophole by simply underwriting loans to the standards of the most aggressive B-piece buyer rather than the prudent standards of a long-term holder. Risk retention, and the corresponding alignment it is intended to create, would be further weakened if the B-piece buyer was permitted to sell half of its exposure to another, perhaps less sophisticated, third party investor that is even further removed from the original underwriting.

(2) The subordinate holder of risk retention in a senior/subordinate structure would not be aligned with any other investors in the transaction:

Under current practice, a B-piece buyer purchases a first loss tranche equal to approximately 5% of the total transaction par amount (bonds rated double-B plus through Not Rated). In return, the B-piece buyer receives detailed loan information weeks in advance of the securitization, re-underwrites the entire pool of loans, and is granted the right to "kick-out" loans from the pool it deems too risky. The B-piece purchase price is often made at a very deep discount, perhaps less than 50 cents on the dollar. As a result, the B-piece buyer holds the equivalent of an interest-only (IO) security that behaves very differently than the principal bonds (priced near par) that all other investors purchase.

Given the IO nature of its investment, the B-piece investor can earn targeted returns well before the typical ten-year loan reaches its maturity date and therefore may focus the re-underwriting process more on the likelihood of a loan making its scheduled payments for the first portion of its life rather than on the probability of that loan refinancing successfully. On the other hand, the remaining 95% of bondholders are entirely focused on the likelihood of each loan successfully refinancing in order to ensure the full return of their principal investment. Given these very different return profiles, the B-piece buyer is simply not aligned with other bondholders in the transaction and, since it owes no fiduciary responsibility to the CMBS trust, the B-piece buyer has not acted as an effective loan re-underwriter.

The re-proposal addresses this lack of alignment by requiring the B-piece buyer to purchase 5% of issuance proceeds (rather than par amount) of the structure. This change, given current market structure, would require the B-piece buyer to purchase up to, and including, triple-B rated bonds that are typically bought at prices closer to par. While this arrangement would not provide perfect alignment between the B-piece buyer and more senior bondholders, the alignment would be improved. Since the B-piece buyer would now hold triple-B rated bonds, the returns from which are

highly dependent upon the underlying loans refinancing at maturity, the B-piece buyer should place greater emphasis on a conservative loan structure during its re-underwriting process to ensure a high likelihood of refinancing.

If, contrary to our recommendation, the first loss position was permitted to be divided into senior (priced near par) and subordinate (priced at a deep discount) tranches, the improved alignment created under the re-proposal would be eliminated and the misalignment that plagues the current market structure would continue unabated. Under a senior/subordinate construct, we would not expect the subordinate holder (B-piece buyer) to protect the entire capital structure's interests when exercising its rights to reject poorly underwritten loans. We would expect a continuation of current practice where the B-piece buyer, rather than "kicking out" an otherwise unacceptable loan, may instead chose to keep the loan in the pool, lower the dollar price it pays for the IO, and subject the remaining investors to that imprudently underwritten loan.

(3) A senior holder of risk retention (a "typical" triple-B investor) may not be appropriately compensated for employing sufficient resources to re-underwrite a CMBS transaction and, further, may not even have access to such resources:

A split of the 5% risk retention into senior (triple-B) and subordinate (BB+ through NR) positions would, at least in theory, require both investors to perform similar intensive re-underwriting on the 50-100 loans in a typical CMBS transaction. We estimate that a loan originator spends approximately 30-40 hours underwriting a loan, not including legal review, portfolio manager oversight, and structuring. The typical CMBS deal consists of an average of 70 loans, equating to nearly 2,500 underwriter hours (300+ workdays).

Since a triple-B bond investor currently earns a sub-7% yield as compared to the B-piece buyers' 15+% IRR, the triple-B investor may not utilize sufficient resources (and may not even have access to such resources) to perform similar due diligence since the cost of doing so may be prohibitive given a sub-7% return. Additionally, it would seem nearly impossible for the triple-B buyer to perform a similar thorough review considering that it typically has five days or less from the time the deal is announced to make an investment decision. A triple-B buyer that didn't/couldn't perform the detailed level of independent due diligence would be highly ineffective at policing lenders' loan underwriting practices.

A split of the first loss risk retention into senior and subordinate positions would leave the market unchanged from the structure that exists today with the exception of a minimum holding period. The subordinate holder (B-piece buyer) would continue to hold an IO and would re-underwrite with a parochial view while the senior holder (triple-B buyer) would continue to purchase 2.5% of the structure without likely committing the necessary resources to effectively re-underwrite the pool. Maintaining the current market structure implies that this model is effective even though we witnessed its dramatic failure leading up to the financial crisis.

Replacement of the Special Servicer

While the original proposal granted too much unilateral authority to the operating advisor in its ability to replace the special servicer, the re-proposal strikes a fair balance where the operating advisor, in its own estimate, must first recommend replacement when it believes the special servicer has not abided by the

servicing standard and that recommendation must then be confirmed by a bondholder vote. While we agree that the voting threshold for replacement should be very low, a 5% quorum does raise the potential for "rogue" investors and/or a conflicted operating advisor to manufacture a special servicer replacement to benefit an affiliated party. This potential risk can be alleviated by: (a) marginally raising the threshold to 15% and requiring three unaffiliated investors to vote for replacement or, (b) further increasing the threshold to 20% with no minimum unaffiliated investor-voting requirement. We oppose a more substantive increase in the voting threshold since it could make replacement nearly impossible, thereby cementing the B-piece buyer's ability to control the special servicer and rendering the operating advisor powerless.

The re-proposal should additionally include a provision that would, following a replacement as outlined above, eliminate the ability of the B-piece buyer to replace the special servicer. As currently written, the re-proposal would not prevent the B-piece buyer from overriding a replacement decision by simply removing the new special servicer and hiring an affiliate.

Qualified Commercial Real Estate (QCRE) Loan Definition

While we acknowledge the Dodd-Frank regulation requires the Agencies to develop a definition of "qualified assets" and exempt these "qualified assets" from the risk retention requirements, it is our view that the "qualified asset" definitions should be very narrow, particularly for CMBS.

Each commercial real estate property is unique and has its own set of circumstances that determine its ability to generate future income. We believe it is nearly impossible to assess the riskiness of a loan placed against one of these properties by simply using Debt Service Coverage Ratio (DSCR) and Loan-to-Value (LTV) metrics in isolation. As previously mentioned, an underwriter spends 30-40 hours analyzing each loan, and while DSCR and LTV are important measures of leverage, other property specific attributes cannot be ignored (e.g., property location, property age, stability and diversification of tenancy, quality of tenancy, capital expenditure requirements, construction of new competing properties, submarket average rents and vacancy…etc).

As an example of the danger in using basic statistics to assess the likelihood of default and, correspondingly, whether or not a loan requires risk retention, consider the following two loans, each with a DSCR = 1.5 and LTV = 65:

(a) New York office building with below market rents; diversified and highly rated tenant base; no leases rolling over the term of the loan; recently renovated
(b) "Tertiary Market" warehouse with above market rents; single tenant; lease rolls two years prior to loan maturity; outdated facility surrounded by newly constructed warehouses

While the likelihood of default of each loan appears identical based upon DSCR and LTV metrics, a dramatically different picture emerges once the details are considered. Given a full set of information, it becomes clear that the loan on the New York office building has a low probability of default while the loan on the Tertiary Market warehouse is quite risky and has a high probability of default; yet the re-proposal would exempt both loans from risk retention because it fails to consider each property's unique attributes beyond DSCR and LTV.

The QCRE definition in the original proposal was extremely narrow and, while we don't object to the marginal loosening of the definition specified in the re-proposal, we are also concerned that the closer the QCRE definition migrates towards the characteristics of a "typical" commercial mortgage loan, the greater the likelihood of maneuvering by lenders in order to satisfy the criteria. Given the limitations of using a simplistic definition to assess the risk of loans placed on complex commercial real estate properties, along with the possibility of the maneuvering of those metrics, we are highly opposed to any further loosening of the QCRE definition beyond what was specified in the re-proposal.

CONCLUSION

While risk retention is by no means a "cure all", we believe it will help align incentives between investors and originators and is critical to reestablishing securitized markets as a significant and stable source of capital throughout the economic cycle. We reject the notion that modest risk retention will substantially increase the cost of capital and/or will "shut down the markets." While we acknowledge that risk retention may marginally increase costs at the onset, given proper implementation, it could eventually reduce the cost of capital through a restoration of investor confidence, a resulting influx of long-term capital, and a corresponding tightening in financing spreads.

Even without a subsequent tightening of spreads, the cost of risk retention seems like a small price to pay in an attempt to avoid the vast economic costs of another recession, emergency funding measures (e.g., TALF and PPIP), and taxpayer funded bailouts that could again be required to restart securitized markets.