Pegasus
BANK

August 31, 2012

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Sir:

Pegasus Bank is a six year old $250 million, single location, community bank in Dallas, Texas. The bank became profitable in its second year of operation and has experienced no non-performing loans; the bank's total charge offs since inception have been less than $12,000.00. The purpose of this letter is to comment on the proposed regulatory capital rules.

A recurrent theme of the proposed rules is that required capital ratios will depend on the risk appetite of each bank: a bank that chooses to take more risk will be required to maintain a higher capital ratio, and those banks that choose to take less risk should hold less capital; <u>I whole heartily agree with this idea</u>.

This idea of risk sensitive capital ratios clearly manifests itself in the calculation methodology for risk weighted assets; lower LTV loans get recognized with lower capital assignments. The following are comments on some of the specific components of the proposal:

- While I applaud the use of the LTV ratio to determine risk based capital treatment, I would like to suggest increasing the Residential Mortgage loan LTV ratio categories from four to five to include a *"greater than 60% to less than 70%"* category.
- Regarding balloon notes: I think there should be a distinction between types of balloon notes. It appears that the definition of balloon notes would include "bridge loans" or short term loans (6 months to 2 years) that are made to allow home buyers to purchase a new home before the sale and/or closing of their existing homes. Bridge loans allow the borrower to sell and close an existing property so that the borrower would have the funds to further reduce the principle of the bridge loan on the new house before entering into a long term mortgage. There are legitimate needs for these bridge loans which can be prudent investments and should be distinguished from a mortgage ARM (i.e., 3/25 or

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5/1/30 ARM). If regulatory changes create barriers to making bridge loans, I would think the residential mortgage industry would suffer significantly, and some home buyers, trying to move to larger homes, will suffer financially due to additional moving expenses, rental costs, etc. I have made a significant number of bridge loans over the last 35 plus years and have never had a single problem, and bridge loans have greatly facilitated home buyers in every price category. While technically a balloon loan, the source of repayment of the bridge loan is from a combination of two sources: (1) equity in existing home, which, once realized, goes to reduce the principle of the bridge loan, and (2) a new mortgage loan that better reflects the customers' desired and expected mortgage needs.

- The theory and the expectation of the proposed rules are for higher capital levels for all institutions. I think it is important that regulators recognize that banks compete for capital not just among other bank franchises but in the bigger investment arena; that is, bank capital competes with oil and gas investments, real estate investments, private equity investments, etc. Investors have return (ROI and ROE) expectations that are not rationalized because of regulatory oversight. The requirement of additional equity in banks will not enhance the financial performance (the net income) of banks but will systemically lower ROE. Lower ROE's will have an immediate and permanent impact on investor interest in bank stocks, and, if the investor market determines the returns in the financial industry are structurally impaired, the investor will choose to invest elsewhere and this is a consequence that is not favorable to the industry, the regulators, the communities, and the country.
- As an endorser that safe and sound banks create a fair and equal competitive environment, I am concerned with the consequences of the previous point. If higher equity levels drive ROE's down, it is *a priori* that many banks will attempt to cure the ROE deficiency by taking more risk in the form of riskier assets, aggressive LTD ratios, etc. I hope this paradox has received appropriate consideration.
- An issue that is only tangently attached to the proposed capital rules is the increasing costs of risk management and compliance. At Pegasus we routinely review our three to five year plans, including financial forecasts, staffing plans, and technology needs. Our most recent planning exercise exhibited that over the next five years our bank could grow assets to $500 million. To achieve this growth the plan calls for a staff increase from sixteen to thirty one; the interesting thing about this staff increase is that 50% of the proposed staff is in compliance and risk management, not customer contact or relationship employees. Such consequences will further impact net income and ROE which in turn will impact shareholders' appetite to invest in banks.
- A solution that I have heard from several other community banks for reigning in costs is the reduction of sponsorships and charitable contributions. My initial reaction to this cacophonous noise was that it is an exaggeration. However, upon further research I think that this concern is real. When a well run community bank finds it necessary to increase net income from expense reductions, the areas of discretion are extremely limited since

over 80% of a typical community bank's operating expenses are in the four categories of salary, occupancy, FDIC premiums, and data processing.

- I have no concerns or issues with enhancing the quality of capital or with the components and tiers of the proposed capital measurements- common equity, additional Tier 1 and Tier 2.
- I have no concerns or issues with the Capital Conservation Buffer.

Thank you for this opportunity to comment.

Sincerely yours,

Joe R. Goyne
President and Chairman

Distribution:
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