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October 17, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

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

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals that were recently approved by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively the "banking agencies").

DNB Financial Corporation is a bank holding company whose bank subsidiary, DNB First, National Association (DNB), is a community bank headquartered in Downingtown, Pennsylvania with 13 locations in Chester and Delaware counties. Founded in 1860, DNB is the oldest National Bank in the Philadelphia region. In addition to providing a broad array of consumer and business banking products, DNB offers brokerage and insurance services through DNB Investments & Insurance, and investment management services through DNB Investment Management & Trust. As the leading independent community bank in the region, DNB strives to be a financially sound institution on which our shareholders, customers, employees, and

communities can rely to help meet their financial goals. We accomplish this by delivering quality financial products and practicing sound financial management.

We are in support of ensuring that the banks in this country have adequate capital to support the risks that they take and to enable them to navigate through rough waters. We have always striven to be a well capitalized institution and indeed have consistently reported ratios that exceed the levels deemed to be "well capitalized" for regulatory purposes. However, like most other community banks in this country we are highly concerned about the effects Basel III will have on our ability to remain well capitalized and to continue funding the economic opportunities in our community.

The following items are the areas of the proposal for which we have concerns:

- **The requirement that unrealized gains and losses on the available for sale (AFS) securities be included in regulatory capital**
  Our bank has a very conservative investment portfolio consisting mainly of agencies and low risk corporate and municipal securities. While the risk of loss is low and the overall duration is short (less than three years) these securities are still subject to interest rate risk. Given the historically low interest rate environment, our AFS portfolio currently has a significant net gain, which would serve to increase regulatory capital in the short term. This inflated capital will reverse and move in the other direction when interest rates rise. Even though we may still be above the minimum regulatory requirements to be adequately capitalized, we would be headed in the wrong direction and could be subject to further regulatory scrutiny and reduced lending. This volatility will also impact our legal lending limit, which could be significantly reduced in a rising rate environment leaving us vulnerable to competition from larger institutions and reducing our ability to generate income and increase capital through retained earnings.

- **The elimination of Trust Preferred Securities as Tier 1 capital**
  Our bank has $9.3 million in Trust Preferred Securities with approximately $5.1 million maturing in 2031 and $4.2 million maturing in 2034. These securities have served as a very cost effective source of capital and has allowed us to grow our bank and better serve our community. Eliminating this vital source of capital could reduce our ability to grow by as much as $90.0 million and significantly reduce our lending capacity. We encourage the banking agencies to remain consistent with the intent of the Collins Amendment under Dodd-Frank and allow the grandfathering of existing trust preferred instruments for institutions under $15.0 billion.

- **Increased risk weighting for residential mortgage loans**
  The proposal would require assigning risk weightings to individual loans based on two broad categories defined by collateral values, loan structure, LTVs underwriting standards and past due status. It also significantly changes the risk weighting ranges from 50 to 100% to 35 to 200%. While we are not a large originator of residential

mortgages we do purchase mortgages to supplement loan demand and to provide a stable source of liquidity for commercial loans and other funding needs. Additionally we also originate first and second lien home equity loans (HE) and lines of credit (HELOC). The punitive risk weights of up to 200% will preclude us from originating and purchasing certain types of loans and only serves as a capital redundancy given that the additional risk would be captured in the allowance for loan and lease losses (ALLL) analysis. Additionally the risk weighting of individual loans on a continual basis will create an administrative burden that will make it cost prohibitive to continue this line of business without increasing the cost to the consumer. At least a full time staff person would have to be assigned to this task and an undetermined amount of systems development to facilitate tracking.

- **Increased risk weightings on high volatility commercial real estate and delinquent loans**
  Increasing the risk weightings on "high volatility commercial real estate", (HVCRE), and delinquent loans is a redundant means of raising capital. In both cases the risk associated with these types of loans is assessed in the allowance for loan and lease losses (ALLL) analysis and any increased required reserves provides the necessary capital buffer for the risk inherent in these loans. Community banks are already highly regulated in this area and are severely criticized if reserves are found to be inadequate. Creating a capital redundancy such as this is both restrictive and unnecessary.

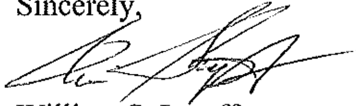
- **Exclusion of certain Deferred Tax Assets (DTAs) and increased risk weightings**
  DTAs arising from carryovers of net operating losses and tax credits are required to be fully deducted from capital. DTAs arising from temporary differences, which cannot be realized through carry-back to prior years, are subject to strict limits: DTAs of this type cannot exceed 10% of CET1 capital. The exclusion of certain tax assets and the increased risk weightings on temporary differences increases our capital requirements on assets who's creation is largely driven by the Internal Revenue Service and Generally Accepted Accounting Principles. The requirement adds yet another restriction on lending, reducing our ability to compete with larger institutions. Further it adds an element of complexity to an already complex tax calculation that will increase our administrative burden and cost. We strongly recommend that DTAs not be excluded from capital and that risk weightings be set at no more than 100%.

In conclusion, we are concerned about the overall complexity required to interpret and implement the proposed rules. The added restrictions imposed by these rules would seriously impede DNB's ability to lend and service it's customers. It would put downward pressure on return on capital and create a level of uncertainty that would reduce an investor's willingness to invest and reduce the bank's ability to raise capital. It is widely speculated by proponents of the proposal, that the impact for most community banks would be minimal, we do not believe they have fully explored and analyzed the impact. While it is true that many community banks will meet the new capital ratio levels, the fact is capital ratios will be significantly reduced. This reduction will impede our ability to grow at a time when growth is paramount if we are to

stimulate the economy and accelerate it's recovery. We strongly agree that foreign banks and very large institutions need to be better capitalized and stronger capital requirements will ensure a more stable and secure banking industry over all, but we do not believe this should be accomplished at the expense of our communities. We strongly urge you to consider an exemption for community banks from the proposed rules.

Thank you for your consideration.

Sincerely,



William S. Latoff
Chairman and Chief Executive Officer

cc: Senator Robert Casey
Congressman James Gerlach
Congressman Patrick Meehan
Congressman Joseph Pitts
Senator Patrick Toomey