DNB National Bank

October 22, 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[1] that were recently issued for public comment by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

We strongly believe that community banks (DNB National Bank) should be allowed to continue using the current Basel I framework for computing capital requirements. We believe Basel III was intended to apply to the largest Banks as the small community based institutions had no role in depleting the capital levels of the largest banks that caused most of our economic challenges today. DNB has always been a relationship based institution that serves our customers over long timeframes; we are not a high volume transactional business who cares more about profits than relationships and corporate responsibility.

AOCI

The inclusion of accumulated other comprehensive income (AOCI) in capital is captured entirely by unrealized gains and losses on our investment securities being held available-for-sale. Because these securities are held at fair value, any gains or losses due to changes in interest rates are captured in the valuation. As interest rates rise, fair values will fall causing the balance of AOCI to decline and become further negative.

This decline will have a direct and immediate impact on common equity, tier 1, and total capital as the unrealized losses will reduce our capital balances. At my bank, for instance, if interest rates were immediately increased by 300 basis points, my bank's bond portfolio would show a paper loss of $2,742,000. This would mean that my bank's tier one ratio would drop by nearly 45% due to interest rate changes alone (not credit or expected losses). Given this level of risk, it may cause institutions such as ours to significantly curtail lending, limit growth and expansion and restructure our investment portfolio so to assure future levels of capital remain sound. While all of these solutions are possible, it will significantly delay any recovery while at the same time cause earnings to suffer significantly more. Whereas, given the low interest rate environment we are currently experiencing, it is very likely this inclusion of AOCI will cause most community banks to modify their investment strategy to further reduce risk. In communities such as ours, it is very difficult to fully deploy assets in loans as much of our Bank's

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

assets are in the investment portfolio. We strongly believe small institutions should be able to continue to exclude AOCI from capital measures so to not limit growth and indirectly cause increased volatility in our own marketplace. We are very concerned that if this is implemented, most all asset categories market values will decline as most community bankers will have to restructure and sell many of the investments they rely on today for their earnings. This will cause even a further decline in the Bank's ability to generate profits and accrete capital.

Capital Conservation Buffer
Implementation of the capital conservation buffers for DNB National is attainable. However, we have a large surplus of capital while other community banks may not. It may be very difficult for those institutions to satisfy these requirements under the proposal and therefore should not be implemented. The primary way community banks increase capital is through positive net income or shrinking the size of the bank. Given the current ultra low interest rate environment, profitability is already stressed and limits our ability to grow capital. At the very least, more time should be allotted for institutions to satisfy this requirement.

Risk Weightings
We're also concerned that the proposed risk weight framework under Basel III will be a regulatory burden that may jeopardize the housing recovery. Increasing the risk weights for residential balloon loans, interest-only loans, and second liens will penalize banks like us that offer these products to our customers. Additionally, higher risk weights for balloon loans will further penalize community banks for mitigating interest rate risk in our asset-liability management. Ultimately, we will be forced to originate only 15 or 30 year mortgages with durations that will make our balance sheets more sensitive to changes in long-term interest rates (or simply sell 100% of the conforming loans to the secondary market and risk not being able to finance other less qualified borrowers). Community banks should be allowed to remain within the current Basel I risk weight framework for residential loans.

As you can see, we are very concerned. DNB National Bank was charted in 1926 and over the years has experienced difficult years. Given what these proposals seek to implement, we're concerned the worst may be ahead of us due to the unintended consequences to community banks as a result of governing bodies trying to reign-in the large banks. The added regulatory costs and burdens as proposed will simply (and indirectly) play into the hands of the biggest banks by forcing the smaller community bankers to either sell or merge while they will continue to allow the biggest banks to get bigger, more powerful and less likely to fail...

As for DNB National Bank, we're committed to remaining a community bank. Our founders recognized the value of community and relationships back then as their heirs continue with that tradition more so today. Our presence in this community will remain for generations to come. We fill a void in this community that the large banks don't want. In fact, Wells Fargo moved out of our community as we didn't "fit their model" anymore, yet we continue to survive and prosper by improving a model that really works- Community Banking.

Again, I want to thank you for allowing us the opportunity to share our concerns. Feel free to contact me directly with any question or clarification item. I can be reached at 605-874-8382.

Sincerely,

Dan Sievers

Dan Sievers
Executive Vice President
DNB National Bank