DNB FINANCIAL CORPORATION
DNB FINANCIAL CORPORATION
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March 3, 2009

Neil M. Barofsky
Special Inspector General – TARP
1500 Pennsylvania Avenue
NW; Suite 1064
Washington, D.C. 20220

Dear Mr. Barofsky,

In response to your request for information regarding the use of funds and compliance with executive compensation requirements, I offer you the following responses:

1. Anticipated Use of Funds
(a) When DNB Financial Corporation, (DNB) originally applied for the CPP funds on November 11, 2008 , the intent for using these funds was to enhance its strong capital position, and in doing so, aid local communities by increasing our lending capacity. While these funds gave DNB added financial strength, it should be noted that its capital position already exceeded the regulatory levels for well capitalized. At September 30, 2008 and December 31, 2008, DNB's leverage ratio was 7.42% and 7.46% respectively, and its total risked based capital ratio was 11.70% and 12.05% respectively.

DNB will use the CPP funds to grow loans in 2009 and beyond. Loan growth will be largely in the commercial sector from increased originations and strategic purchases. The added CPP funds have significantly increased DNB's capacity and flexibility in achieving this goal. The added funds increase not only the capacity for volume, but the size of individual loans through an increased legal lending limit. In an article in the Sunday edition of the Daily Local News of Chester County, PA, dated February 8, 2009 (Attachment A), I was quoted as follows: "It (CPP funding) should help our local communities because we'll be able to make more loans. We believe it is important to be part of the government's efforts to stimulate the economy by making credit more available." Additionally in our recent earnings announcement (Attachment B), filed with the SEC on February 13, 2009, there was the following comment on the use of the CPP funds: "This additional capital will enhance DNB's current solid capital position and will aid local communities by increasing DNB's lending capacity. DNB believes it is important to be part of the government's efforts to stimulate the economy by making credit more available."

(b) On January 30, DNB received $11,750,000, for 11,750 shares of DNB preferred shares and associated warrants to purchase up to 186,311 shares of DNB common stock. The proceeds were added to general funds used to fund the assets of the company. The majority of the assets of DNB are investment securities, which made up approximately 23.3% of total assets at December 31, 2008 and loans, which made up approximately 63.2%. Investment securities are used primarily to manage liquidity and interest rate risk and DNB adheres to strict internal policies that limit investments to securities that offer low risk and provide adequate cash flows.

(c) The CPP proceeds have been invested in U.S. agency issued mortgage-backed securities. The cash flows from these securities will be used to grow loans.

(d) We do not anticipate having these funds univested. As previously mentioned DNB has invested these funds in U.S. agency issued mortgage backed securities that offer good cash flows, which will be used to grow loans.

2. Executive Compensation

In connection with the closing of the transaction, William S. Latoff, William J. Hieb, Gerald F. Sopp, Albert J. Melfi, Jr. and Bruce E. Moroney, the company's senior executive officers as defined in the Securities Purchase Agreement, executed a waiver voluntarily waiving any claim against the U.S. Treasury or the company for any changes to compensation or benefits arrangements that are required to comply with the regulation issued by the U.S. Treasury under the Treasury's program and acknowledging that the regulation may require modification of the compensation, bonus, incentive, and other benefit plans, arrangements, and policies and agreements.

The Benefits and Compensation Committee as well as the Nominating and Corporate Governance Committee of the Board of Directors are responsible for executive's compensation oversight. The Committees in their oversight capacity do not and never have permitted arrangements that encourage SEOs to take unnecessary and excessive risks, which threaten the value of the institution. Historically these Committees have met periodically to review, among other things, overall bank as well as executive management performance and related compensation. The Committees have relied on third party compensation consultants to develop compensation ranges for executive level positions. Asset size and performance measures compared to bank peers are taken into account in establishing these ranges.

In accordance with the requirements related to the Corporation's participation in the United States Department of Treasury's Troubled Asset Relief Program, it is the intention of the Committees and the overall Board to continue to review bank and peer performance measurements and to ensure that the Corporation is in compliance with required compensation guidelines.

I hereby certify, subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001, that all statements, representations and supporting information provided in this response are accurate in all material respects to the best of my knowledge.

DNB FINANCIAL CORPORATION

By: ______________________

Name: Gerald F. Sopp

Title: EVP, CFO and Secretary

ATTACHMENT A

DAILY LOCAL NEWS

Serving Chester County



Business

# CA$HING IN

Sunday, February 8, 2009 6:07 AM EST

By BRIAN McCULLOUGH, Staff Writer

When the retired Al Boscov came out of retirement in December to rescue the department store chain that bears his name, he was assisted by National Penn Bank, which was able to provide him with a bridge loan.

That loan and another made to a Berks County outpatient medical facility would not have been possible had the bank not taken part in the federal government's Capital Purchase Program, according to a bank executive.

"Normally, they would not have hit the relationship curve that we require to make such deals," said Gary Rhoads, executive vice president and Chief Financial Officer of National Penn, which received $150 million from the program, which goes by the acronym of CPP. "We felt these are the kinds of things we need to be doing in this environment. It is an opportunity to generate some new loans that previously we would not have considered."

Such words would be music to the ears of legislators who enacted the program to give a jolt the foundering economy.

Under the CPP, the U.S. Department of Treasury is purchasing up to $250 billion of senior preferred shares from healthy U.S. financial institutions. Banks participating in the CPP will pay the Treasury

a 5 percent dividend on senior preferred shares for the first five years following the investment and a rate of 9 percent per year thereafter.

It is part of the government's Troubled Asset Relief Program, or TARP, which is falling under increasing criticism as its size grows.

Some question whether government intervention will be able to turn around the lagging economy -- even some of the local bankers taking part aren't sure.

"Nobody knows whether it will work or not," said John A. Featherman III, chairman of First Chester County Corp., parent company of First National Bank of Chester County.

"Looking out the next five, 10 or 15 years, we anticipate a lot of opportunities and challenges," Featherman said. "I have some concerns about the stimulus package, about whether the people making the changes understand the consequences of their actions."

Featherman said his bank has no specific plans for the $25 million it expects to receive through the CPP program within 30 days.

In January, First Chester County Corp. completed the acquisition of American Home Bank, a Mountville, Lancaster County, a bank with a large mortgage operation.

"One of the goals is to make more credit available to potential borrowers, and this does that," Featherman noted. "We think the housing industry will come back fairly strong."

For now, however, the state of the economy is making it hard to find deals that are worthy of credit.

"There's a very real slowdown in the economy of Chester County right now and I think it's going to continue to deteriorate," Featherman said. "It means we have to be very careful because if the business you're lending to, if their business slows down ...

"All banks' loan-loss reserves are going up."

Featherman's concerns about the economy and the national stimulus package appear to be shared by his contemporaries nationwide.

In a survey conducted by Phoenix Management, only 3 percent of lenders said they think the TARP program will have a "meaningful" impact on their lending practices.

Fifty-five percent of respondents said that TARP would have a "modest impact" while 36 percent said it will have "minimal impact." The remaining 6 percent of respondents said TARP will have "no impact" on their lending.

"It is not having its intended impact," said Michael Jacoby, managing director and shareholder of Phoenix Management Services, from the company's Chadds Ford offices.

While major banks took government assistance "with no accountability and no tracking," healthy regional and community banks have a different set of concerns, said Jacoby, whose company assists distressed firms.

"They are really still hunkering down, scrutinizing loans," Jacoby said. "There's a lot more to lose in this economy by making a bad loan than by not making a loan at all. They are way, way, way more cautious."

That is not to say that small banks aren't glad to have the additional capital with which to work.

For DNB Financial Corp. in Downingtown, which is receiving $11.75 million in CPP funding, the money is inexpensive capital, Chief Financial Officer Gerald Sopp said.

"It should help our local communities because we'll be able to make more loans," Sopp said. "We believe it is important to be part of the government's efforts to stimulate the economy by making credit more available."

Likewise, for West Chester-based Stonebridge Bank, the $10.97 million it's receiving through CPP "is a nice cushion to have in today's environment," said president and CEO Joseph C. Spada. "We're still making loans but we're realistic about our environment."

Stonebridge started out 10 years ago as Internet-based but is evolving into a more traditional bank. Spada takes issue with those who criticize the government's attempts to stem the economic downturn.

"I disagree with all the second-guessers out there," he said. "I think the program was necessary It averted a financial meltdown. We have to pay that money back. I think it's going to be one of the more profitable things (in stimulus spending) that the government does."

To contact business editor Brian McCullough, send an e-mail to business@dailylocal.com.

## Comments

The following are comments from the readers. In no way do they represent the view of dailylocal.com.

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***E-mail Address:**

***Year of Birth:**

(children under 13 cannot register)

***First Name:**

***Last Name:**

**Company:**

**Home Phone:**

# DNB Financial Corporation

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FOR IMMEDIATE RELEASE
(DNBF – NasdaqCM)

## DNB Financial Corporation
## Announces Fourth Quarter and Full Year 2008 Earnings

(February 13, 2009 – Downingtown, PA) DNB Financial Corporation ("DNB"), parent of DNB First, National Association, reported net income for the twelve-month period ended December 31, 2008 of $809,000 compared to $1.8 million for the same period in 2007. Diluted earnings per share for the twelve-month period ended December 31, 2008 was $0.31 compared to $0.69 for the same period in 2007. The $993,000 decrease during the most recent twelve-month period was attributable to a $2.0 million increase in the provision for credit losses and a $143,000 increase in non-interest expenses. Net interest income increased year over year by $394,000 and non-interest income increased year over year by $405,000.

For the fourth quarter 2008 DNB reported a net loss of $230,000 or $.09 per diluted share, compared with net income of $415,000 in the fourth quarter of 2007, or $.16 per diluted share. The decrease in earnings was primarily due to a $717,000 increase in the provision for credit losses, coupled with a $153,000 decline in non-interest income and a $196,000 increase in non-interest expense. Net interest income for the quarter increased $241,000 over the fourth quarter of 2007.

William S. Latoff, Chairman and CEO said, "In light of the deteriorating economy, we focused on strengthening our capital and liquidity positions in the fourth quarter. Additionally prudent management required us to increase our provision for credit losses. We increased the provision by $2.0 million for the full year and still remained profitable. While many banks are struggling to survive, we remain adequately reserved for credit losses and our capital exceeds the well capitalized regulatory guidelines."

DNB continues to maintain a strong capital position. At the end of the fourth quarter 2008, DNB's leverage ratio stood at 7.46% and its total risk-based capital ratio stood at 12.05%. On January 6, 2009, DNB was approved to participate in the U. S. Treasury's Capital Purchase Program (CPP) and on January 30, 2009, DNB received $11,750,000 from the U.S. Treasury in exchange for 11,750 shares of DNB Financial Corporation preferred stock and associated warrants, for the purchase of up to 186,311 shares of DNB common stock. DNB's capital ratios mentioned above would have been 9.60% and 15.06% had these proceeds been received on December 31, 2008.

Restating a capital ratio on a pro forma basis as of December 31, 2008 after receipt of the CPP proceeds is a non-GAAP financial measure. The most directly comparable GAAP financial measure is the actual capital ratio as of December 31, 2008. Management believes that presenting DNB's capital ratios before and after the receipt of the CPP proceeds as of December 31, 2008, will give the reader a clearer idea of how the receipt of these funds will impact DNB's capital strength as it starts its 2009 fiscal year. The Summary of Financial Statistics section in this report includes a reconciliation of these non-GAAP pro forma ratios and the corresponding GAAP financial ratios. This additional capital will enhance DNB's current solid capital position and will aid local communities by increasing DNB's lending capacity. DNB believes it is important to be part of the government's efforts to stimulate the economy by making credit more available.

In addition to the CPP program, DNB is participating in the FDIC Transaction Account Guarantee Program, which is part of the FDIC's Temporary Liquidity Guarantee Program (TLGP). Under this program all non-interest bearing deposit transaction accounts, as well as certain types of transaction accounts with interest rates of .50% or less, will be fully guaranteed by the FDIC for the entire amount in the account through December 31, 2009. This is in addition to and separate from the coverage available under the FDIC's general deposit insurance coverage. Additionally the FDIC deposit insurance coverage was increased on October 3, 2008 from \$100,000 to \$250,000 per depositor for all deposits until December 31, 2009.

Mr. Latoff continued, "We have strengthened our balance sheet and have taken the necessary steps to ensure that depositors' funds are safe. We recognize the seriousness of the challenges we face both as a business and as a member of our community and have survived through previous economic downturns by remaining focused and identifying the opportunities that help us grow and prosper. We believe through prudent management we can continue to provide valuable services to our customers and support to our local business community through increased lending. "

Overall assets declined \$13.5 million or 2.48%, when compared to December 31, 2007 and \$18.8 million or 3.41% compared to September 30, 2008. The change, part of management's strategy to strengthen capital, was due to a \$46.8 million decline in the investment portfolio, primarily due to the sale of securities, offset by an increase in loan balances of \$27.1 million when compared to December 31, 2007. Compared to September 30, 2008, the decline in assets was due to a \$50.4 million decline in the investment portfolio, as a result of securities sales, and a \$6.4 million decline in loans, offset by a \$34.9 million increase in cash and cash equivalents.

Demand, money market, NOW and savings deposits, which DNB First considers core to its deposit-gathering strategy, were up in aggregate on a net basis by \$3.7 million or 1.41%, when compared to December 31, 2007. Management considers these types of deposits to be a key indicator of the Bank's ability to generate lower cost funds that are longer in duration and can better support the Bank's liquidity needs. Overall deposits were down \$4.5 million or 1.08% from December 31, 2007 as time deposits, primarily jumbo certificates of deposit, declined \$8.2 million or 5.45%. Deposits at December 31, 2008 were down \$14.0 million or 3.31%, when compared to total deposits at September 30, 2008. Management actively managed deposits during the year to reduce the cost of funds. The Bank's average composite cost of funds for the fourth quarter of 2008 dropped 6 basis points to 2.39% compared to 2.45% for the three months ended September 30, 2008 and 98 basis points compared to 3.37% for the three months ended December 31, 2007.

Interest expense for the fourth quarter of 2008 was \$3.1 million, down 25.83% compared to \$4.2 million for the same period in 2007. The reduction in interest expense was due to lower rates on interest bearing deposits and borrowings. Interest income for the fourth quarter of 2008 was $6.9 million, down 10.76% compared to $7.7 million for the same period in 2007. The decline in interest income was due to lower yields on earning assets as a result of the Federal Reserve's interest rate reductions offset in part by higher average balances. The average balance of earning assets for the three months ended December 31, 2008 was $526.9 million, an increase of $22.0 million or 4.40%. Average loans, which were $343.5 million, increased $29.2 million or 9.30%. The average net interest margin of 2.91% for the fourth quarter of 2008 improved by 5 basis points when compared to the fourth quarter of 2007 but declined 8 basis points compared to the third quarter of 2008.

Non-interest income for the three months ended December 31, 2008 was $919,000 compared to $1.1 million for the same period in 2007. The decline was mainly attributable to a $102,000 decrease in estate and trust fees and a $47,000 decline in gains in the cash surrender value of BOLI policies, offset by an increase of $85,000 in gains on the sale of securities. Non-interest expense for the three month period ended December 31, 2008 was $4.3 million compared to $4.1 million for the same period in 2007. The level of non-interest expense increased $196,000 or 4.79% in the fourth quarter of 2008, when compared to the same period in 2007, mainly as a result of severance costs related to staff reductions, increases in legal, and marketing costs, an increase in charge-offs related to debit card fraud, expenses related to OREO assets and an increase in FDIC insurance. Income taxes for the fourth quarter of 2008 resulted in a credit due to the reported net loss, and were $179,000 lower compared to the same period in 2007.

At December 31, 2008 the allowance for credit losses was $4.6 million. This was an increase of $695,000 or 17.85%, when compared to December 31, 2007. The allowance as a percentage of loans and leases outstanding increased to 1.36%, from 1.26% at December 31, 2007. Non-performing assets, which were $7.7 million at December 31, 2008, decreased $200,000 when compared to September 30, 2008 and increased $5.9 million when compared to December 31, 2007. As noted previously, the increase in non-performing assets is attributed largely to three commercial properties totaling $5.8 million, which are located in market areas DNB is familiar with.

DNB Financial Corporation is a bank holding company whose bank subsidiary, DNB First, National Association, is a $532.3 million community bank headquartered in Downingtown, Pennsylvania. Founded in 1860, DNB First is the oldest independent bank in Chester County, with eleven full service and two limited service offices in Chester and Delaware Counties. In addition to a broad array of consumer banking products, DNB offers commercial and construction lending, commercial leasing, cash management, brokerage and insurance through DNB Financial Services, and trust services through DNB Advisors. DNB Financial Corporation's shares are traded on NasdaqCM under the symbol: DNBF. We invite our customers and shareholders to visit our website at http://www.dnbfirst.com.

This press release contains statements which, to the extent that they are not recitations of historical fact may constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995. Such forward-looking statements may include financial and other projections as well as statements regarding the Corporation's future plans, objectives, performance, revenues, growth, profits, operating expenses or the Corporation's underlying assumptions. The words "may", "would", "could", "will", "likely", "expect," "anticipate," "intend", "estimate", "plan", "forecast", "project" and "believe" or other similar words and phrases may identify forward-looking statements. Persons reading this press release are cautioned that such statements are only predictions, and that the Corporation's actual future results or performance may be materially different.

Such forward-looking statements involve known and unknown risks, uncertainties. A number of factors, many of which are beyond the Corporation's control, could cause our actual results, events or developments, or industry results, to be materially different from any future results, events or developments expressed, implied or anticipated by such forward-looking statements, and so our business and financial condition and results of operations could be materially and adversely affected. Such factors include, among others, our need for capital; the impact of economic conditions on our business; changes in banking regulation and the possibility that any banking agency approvals we might require for certain activities will not be obtained in a timely manner or at all or will be conditioned in a manner that would impair our ability to implement our business plans; our ability to attract and retain key personnel; competition in our marketplace; and other factors as described in our securities filings. All forward-looking statements and information made herein are based on our current expectations as of the date hereof and speak only as of the date they are made. The Corporation does not undertake to update forward-looking statements.

For a complete discussion of the assumptions, risks and uncertainties related to our business, you are encouraged to review our filings with the Securities and Exchange Commission, including our most recent annual report on Form 10-K, as well as any changes in risk factors that we may identify in our quarterly or other reports filed with the SEC.

**DNB Financial Corporation**

**Summary of Financial Statistics**

*(Dollars in thousands, except per share data)*

| | Three Months Ended December 31 | | Twelve Months Ended December 31 | |
|---|---|---|---|---|
| | **2008** | **2007** | **2008** | **2007** |
| **EARNINGS:** | | | | |
| Interest income | $6,912 | $7,746 | $28,262 | $30,237 |
| Interest expense | 3,085 | 4,159 | 13,048 | 15,417 |
| Net interest income | 3,827 | 3,587 | 15,214 | 14,820 |
| Provision for credit losses | 777 | 60 | 2,018 | 60 |
| Non-interest income | 918 | 1,071 | 4,408 | 4,003 |
| Non-interest expense | 4,275 | 4,079 | 16,731 | 16,589 |
| Income before income taxes | (307) | 519 | 873 | 2,174 |
| Income tax (benefit) expense | (77) | 104 | 64 | 372 |
| Net income | (230) | 415 | 809 | 1,802 |
| Net income per share, diluted* | ($0.09) | $0.16 | $0.31 | $0.69 |
| **PERFORMANCE RATIOS:** | | | | |
| Interest rate spread | 2.85% | 2.75% | 2.88% | 2.99% |
| Net interest margin | 2.91% | 2.86% | 2.96% | 3.09% |
| Return on average equity | (2.90%) | 5.17% | 2.51% | 5.80% |
| Return on average assets | (0.17%) | 0.31% | 0.15% | 0.35% |

| | December 31 | December 31 |
|---|---|---|
| | **2008** | **2007** |
| **FINANCIAL POSITION:** | | |
| Securities | $ 124,125 | $ 170,909 |
| Loan and leases | 336,454 | 309,342 |
| Allowance for credit losses | 4,586 | 3,891 |
| Total assets | 532,326 | 545,840 |
| Deposits | 408,470 | 412,920 |
| Borrowings | 90,123 | 89,877 |
| Stockholders' equity | 30,058 | 32,635 |
| **EQUITY RATIOS:** | | |
| Tier 1 leverage ratio | 7.46% | 7.77% |
| Risk-based capital ratio | 12.05% | 13.08% |
| Book value per share* | $ 11.53 | $ 12.55 |

* *All per share amounts have been restated to reflect the 5% stock dividend paid in December 2007.*

**DNB Financial Corporation**

**Summary of Financial Statistics**

*(Dollars in thousands, except per share data)*

## COMPARISON OF RISKED BASED CAPITAL RATIOS WITH AND WITHOUT UST CPP FUNDING

| | December 31 2008 | | |
|---|---|---|---|
| | With CPP Funds | | Without CPP Funds |
| Risk-based capital | $ 45,516 | | $ 45,516 |
| CPP funds received 1/30/09 | 11,750 | ** | - |
| Total risk-based capital | 57,266 | | 45,516 |
| Risk-based assets | 380,228 | | 377,878 |
| **EQUITY RATIOS:** | | | |
| Tier 1 leverage ratio | 9.60% | | 7.46% |
| Risk-based capital ratio | 15.06% | | 12.05% |

**$11,750,000 of CPP Funds assigned a @ 20% risk weighting.