



# SHORE BANCSHARES, INC.

*Banking. Insurance. Investments.*

March 5, 2009

Special Inspector General – TARP  
1500 Pennsylvania Avenue, NW  
Suite 1064  
Washington, DC 20220

Dear Mr. Barofsky:

This is in response to your February 6, 2009, correspondence.

Shore Bancshares, Inc. (SHBI) is a financial holding company registered with the Board of Governors of the Federal Reserve System. It is the parent company of three banks: The Talbot Bank of Easton, Maryland, a Maryland chartered bank regulated by the FDIC and the State of Maryland; The Centreville National Bank of Maryland, a national bank headquartered in Maryland and regulated by the OCC; and The Felton Bank, a Delaware chartered bank regulated by FDIC and the State of Delaware.

SHBI closed on the U.S. Treasury Department's Capital Purchase Program (CCP) January 9, 2009, and received \$25,000,000 in TARP funds. At that time, SHBI, through the three banks, had a total of \$891.6 million in loans. Since that time, SHBI has been able to increase loan funding by \$10.3 million to \$901.9 million. The TARP funds have allowed us to continue to meet loan demand in our community. It is anticipated remaining TARP funds will support continued loan demand in our community. The funds were maintained by SHBI in a separate interest bearing account at The Talbot Bank of Easton, Maryland. An additional \$8 million in Federal Home Loan Bank advances were repaid through the increased liquidity at The Talbot Bank of Easton, Maryland.

At the time of CPP closing, the five most highly compensated employees signed a waiver acknowledging that compensation, bonus, incentive and other benefit plans may require modification as a result of their employer's participation with the TARP Program. We continue to monitor Treasury guidelines on executive pay, and will implement required changes as a result of our TARP participation. Given the executive compensation requirements have changed significantly since participation, and apply retroactively, we are unable to provide specific detail on how we plan to comply until we receive more specific guidance from the Treasury.<sup>1</sup> SHBI did pay bonus and incentive compensation to its five most highly paid employees on January 8, 2009. At that time, this was not prohibited. The bonus and incentive pay was a result of a Management Incentive Program (MIP) in place to award senior executives when corporate and individual performance meet or exceed predetermined goals. The Compensation Committee of SHBI oversees the MIP and executive compensation matters. Each member of the Compensation Committee is a non-employee director, and has not served as an officer of SHBI or its subsidiaries. Further, as required, the Compensation Committee has reviewed incentive compensation arrangements to identify any factors that could lead senior executive officers to take unnecessary risks that could threaten the value of the financial institution. It has reviewed same with senior risk officers to ensure senior executive officers are not encouraged to take such risks.

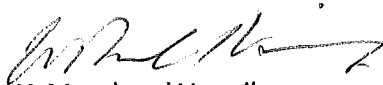
<sup>1</sup> *Treasurer must review bonuses, incentive pay and other compensation paid prior to February 17, 2009, to determine whether any such payments were inconsistent with EESA, as amended.*

RE: TARP Program  
March 5, 2009  
Page Two

Lastly, as a result of increasing negative association with participation in the TARP program, and significant changes to the rules governing TARP recipients, consideration is being given to withdrawing from the TARP program.

Pursuant to, and for the purposes only of, Title 18, United States Code, Section 1001, the undersigned certifies to the accuracy, in all material aspects, of all statements, representations, and supporting information set forth herein.

Sincerely,



W. Moorhead Vermilye  
President & CEO

**(b) (6)**

Attachments

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Shore Bancshares, Inc.  
2009 Loan Growth

	Balances January 9, 2009	Balances March 3, 2009	2009 Growth
The Talbot Bank	551,189,919	564,064,228	12,874,309
The Centreville National Bank	256,596,737	252,917,232	(3,679,505)
The Felton Bank	83,815,146	84,902,091	1,086,945
Total Loans	891,601,802	901,883,551	10,281,749

## **Shore Bancshares, Inc. Completes Sale of \$25 Million in Preferred Stock Under the Treasury's Capital Purchase Program**

Company Release - 01/12/2009 16:05

EASTON, Md., Jan. 12 /PRNewswire-FirstCall/ -- (Nasdaq: SHBI) Shore Bancshares, Inc. announces that it completed the sale of 25,000 shares of Series A Preferred Stock under the U.S. Department of the Treasury's TARP Capital Purchase Plan for \$25 million on January 9, 2009. The investment represents 22.3% of total risk-based capital as of September 30, 2008. The Preferred Stock carries a 5.0% annual dividend yield for five years and 9.0% thereafter. In addition, the U.S. Treasury received a warrant to purchase up to 172,970 shares of Shore Bancshares, Inc. common stock at an exercise price of \$21.68 per share.

As of September 30, 2008, Shore Bancshares' capital position was "well capitalized" by all regulatory standards. With the Treasury's investment, the Company's leverage capital ratio would increase to approximately 12.42% and the total risk-based capital ratio would increase to approximately 15.41%.

About Shore Bancshares, Inc.:

Shore Bancshares, Inc. is a financial holding company headquartered in Easton, Maryland and is the largest independent bank holding company located on Maryland's Eastern Shore. It is the parent company of three banks, The Talbot Bank of Easton, Maryland, The Centreville National Bank of Maryland, and The Felton Bank; three insurance producer firms, The Avon-Dixon Agency, LLC, Elliott Wilson Insurance, LLC and Jack Martin and Associates, Inc; a wholesale insurance company, TSGIA, Inc; two insurance premium finance companies, Mubell Finance, LLC and ESFS, Inc; a registered investment adviser firm, Wye Financial Services, LLC; and a mortgage broker subsidiary, Wye Mortgage Group, LLC.

The foregoing material contains forward-looking statements concerning the financial condition, results of operations and business of the Company. We caution that such statements are subject to a number of uncertainties and actual results could differ materially, and, therefore, readers should not place undue reliance on any forward-looking statements. The Company does not undertake, and specifically disclaims, any obligation to publicly release the results of any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

SOURCE Shore Bancshares, Inc.

Contact: W. Moorhead Vermilye, President and CEO of Shore Bancshares, Inc.: +1-410-822-1400

## **Shore Bancshares Receives Preliminary Approval for \$25 Million under the Treasury's Capital Purchase Program**

Company Release - 12/17/2008 16:54

EASTON, Md., Dec. 17 /PRNewswire-FirstCall/ -- Shore Bancshares, Inc. (Nasdaq: SHBI) has received preliminary approval to participate in the U.S. Treasury Department's Capital Purchase Program as part of the Emergency Economic Stabilization Act of 2008.

"We are pleased to have been selected to participate in this voluntary program which has been designed to stabilize our economy and financial markets by providing additional resources to banks to expand their lending activities," said W. Moorhead Vermilye, president and chief executive officer. "This investment by the Treasury provides an attractive and lower cost source of funds to enhance our capital position, further support our lending and the expansion of services into our communities, and provide flexibility to evaluate future opportunities that may develop."

The Treasury intends to invest \$25 million in senior preferred stock of Shore Bancshares with a 5% annual dividend yield for the first five years, and 9% thereafter. In addition, the Treasury will receive a warrant to purchase \$3.75 million of SHBI common stock at a price to be determined at closing. The closing of the transactions is subject to execution of standard documents available for review on Treasury's website and is expected to occur in January 2009.

As of September 30, 2008, Shore Bancshares' capital position was "well capitalized" by all regulatory standards. With the Treasury's investment, the Company's leverage capital ratio would increase to approximately 12.42% and the total risk-based capital ratio would increase to approximately 15.41%.

### About Shore Bancshares

Shore Bancshares, Inc. is a financial holding company headquartered in Easton, Maryland and is the largest independent bank holding company located on Maryland's Eastern Shore. It is the parent company of three banks, The Talbot Bank of Easton, Maryland, The Centreville National Bank of Maryland, and The Felton Bank; three insurance producer firms, The Avon-Dixon Agency, LLC, Elliott Wilson Insurance, LLC and Jack Martin and Associates, Inc; a wholesale insurance company, TSGIA, Inc; two insurance premium finance companies, Mubell Finance, LLC and ESFS, Inc; a registered investment adviser firm, Wye Financial Services, LLC; and a mortgage broker subsidiary, Wye Mortgage Group, LLC.

SOURCE Shore Bancshares, Inc.

Contact: W. Moorhead Vermilye, President and CEO of Shore Bancshares, Inc., +1-410-822-1400

# Shore Bancshares is strong, according to Vermilye

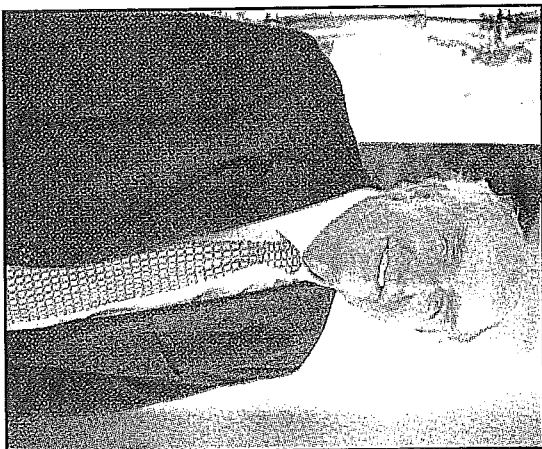
Vermilye: Some have the misconception that the company is in trouble because it received TARP funds

By RICHARD McNEY  
Editor

**EASTON** — Shore Bancshares President and CEO Moorhead Vermilye wants to clear up any possible misconceptions about the \$25 million the financial holding company is receiving from the U.S. Treasury's Troubled Asset Relief Program (TARP). TARP is often referred to as the U.S. Treasury's \$700 billion bailout fund for financial institutions.

Shore Bancshares completed the sale of 25,000 shares of Series A Preferred Stock under TARP's Capital Purchase Plan for \$25 million on Jan. 9.

"The problem that I see with all of the coverage is the headlines and the continued use of the word bailout," Vermilye said. "Obviously that connotes problems. The reason for the TARP was to assist banks that are suffering badly from subprime mortgages and just other asset deteriorations. It is an attempt by the Treasury to ensure that the large financial institutions didn't fail. In doing that they set up a program that could extend to all banks that qualified for the money. The banks that they started with were failing."



**MOORHEAD VERMILYE  
PRESIDENT AND CEO  
SHORE BANCSHARES**

TARP was primarily aimed at national companies such as AIG, Bank of America and Wells Fargo, but smaller banks are also eligible to participate.

"The next level was only given to stronger banks," Vermilye said. "The smaller, weaker banks didn't qualify."

Shore Bancshares applied for the program to improve its liquidity, not because it is in danger from troubled assets, he said.

"Because many of the larger banks have ceased lending or at least cut back on their lending practices we have had an increase in our loan

demand," said Vermilye, adding that the financial holding company's banks' overall loan-deposit ratio is 105 percent. "If we want to continue to support the community and make loans we need the funding to make those loans. Your deposit growth cannot equal the loan demand. (TARP) gives us more liquidity and more opportunity to lend. We have continued to do our loans and this gives us the liquidity with which we can do it."

Headquartered in Easton, Shore Bancshares is the largest independent bank holding company on the Eastern Shore, and is the parent company of Talbot Bank, The Centreville National Bank and The Felton Bank, in addition to a variety of financial service and insurance companies.

Vermilye is concerned that when the public reads about Shore Bancshares participating in TARP and they see the word "bailout" their response will be, "I didn't know they were in trouble."

"We are not in trouble," he said. "Any comparison of Shore Bancshares to its peer group — we are extremely strong. Prior to the \$25 million we were considered a well capitalized bank, far in excess of the required capital position. This only enhances that capital position."

As of Sept. 30, Shore Bancshares' capital position was considered "well capitalized" by the FDIC and the \$25 million has increased its capital position — the ratio of liquid assets to indebtedness has increased from 10 to 12.42 percent.

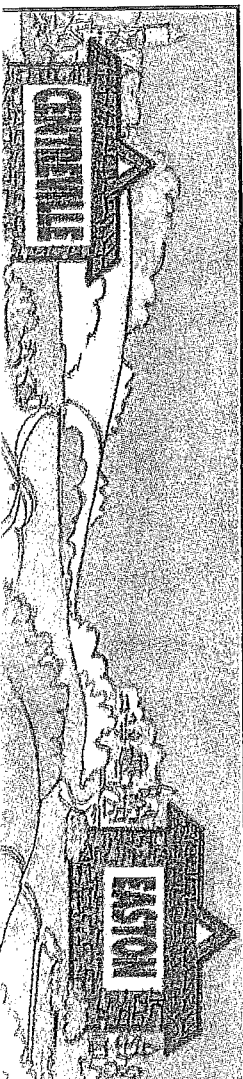
Vermilye added that the company's stock has held up well during these bad times in comparison to other banks.

Shore Bancshares reported its 2008 earnings results on Jan. 28. The company reported net income of \$2.3 million for the fourth quarter of 2008, compared to \$3.1 million for the third quarter of 2008 and \$3.3 million for the fourth quarter of 2007. Net income for 2008 was \$11.5 million compared to \$13.4 million for 2007.

"In spite of the current economy, we produced good net income and, even during this tough operating environment for all banks, we think several of the main measures of our performance are encouraging and will turn out to be above peer averages," said Vermilye in a release with the report. "For instance, our net interest margin has held up well and was 4.24 and 4.23 percent, for the fourth quarter and full year, respectively. Loans grew 14.4 percent and deposits grew 10.4 percent during 2008. Stockholders' equity increased by nearly 6 percent during the year. Noninterest revenue advanced 38.6 percent for 2008 compared to the previous year."

"We believe overall credit quality is fundamentally sound, although there was predictable deterioration. Our ratio of nonperforming assets to total assets was 0.79 percent on Dec. 31, 2008. Although year-to-date annualized net charge-offs as a percentage of average loans amounted to 0.19 percent, we

See **TARP**  
Page 16



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know and know

## TARP

From  
Page 15

maintained our loan-loss reserve coverage at 1.05 percent of period-end loans."

"We believe these statistics are the product of our conservative balance sheet management and a focus on consistent performance. It's also evidence of the determined efforts of our people to further grow our leadership position across the company's Delmarva footprint. Even in this unprecedented banking environment, we think we've done a good job of solidifying our reputation as the bank of choice for area customers and the employer of choice for the top bankers here."

The \$25 million from TARP is not free money. The preferred stock carries a 5

percent annual dividend yield for five years and 9 percent thereafter. In addition, the U.S. Treasury received a warrant to purchase up to 172,970 shares of Share Bancshares Inc. common stock at an exercise price of \$21.68 per share.

"This is an investment by the Treasury, not a handout," Vermilye said. "We are required to pay it back. If we don't pay it back within the five year period the dividend jumps to 9 percent and that becomes expensive money. It would be our intention to pay it back prior to the expiration of the fifth year."

Receiving the TARP funds will have no effect on customers, other than the banks being able to offer more loans,

Vermilye said.

"We will use the money in the same fashion that we use our capital position and that for the most part is lending to consumers," he said. "We are participating in a program that gives us the opportunity to continue to be the leading lender in our market area. The bank couldn't be stronger, will remain strong and this will just enhance our ability to do what we do well."

For the moment, Shore Bancshares is the only local company getting any TARP funds. Queenstown Bank said it turned down the offer, while Easton Bank & Trust is waiting for the Treasury to determine how it will handle Subchapter S Corporations such as itself

*Joy La Prade contributed to this article.*

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