Section 1: 10-K (10-K)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Year Ended December 31, 2019

Commission File No. 0-22345

SHORE BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Maryland	52-1974638
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
28969 Information Lane, Easton, Maryland	21601
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (410) 763-7800

Securities Registered pursuant to Section 12(b) of the Act:

Title of Each Class:	Trading Symbol(s)	Name of Each Exchange on Which Registered:
Common stock, par value $.01 per share	SHBI	Nasdaq Global Select Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☑ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 16(d) of the Act. ☐ Yes ☑ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit files). Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☑
Non-accelerated filer	☐	Smaller reporting company	☑
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ☐ No ☑

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $ 205,187,524.

The number of shares outstanding of the registrant's common stock as of the latest practicable date: 12,519,624 as of February 29, 2020.

Documents Incorporated by Reference

Certain information required by Part III of this annual report is incorporated therein by reference to the definitive proxy statement for the 2020 Annual Meeting of Stockholders.

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Cautionary note regarding forward-looking statements

This Annual Report on Form 10-K of Shore Bancshares, Inc. (the "Company" and "we," "our" or "us" on a consolidated basis) contains forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. These forward looking statements represent plans, estimates, objectives, goals, guidelines, expectations, intentions, projections and statements of our beliefs concerning future events, business plans, expected operating results and the assumptions upon which those statements are based. In some cases, you can identify these forward-looking statements by words like "may," "will," "should," "expect," "plan," "anticipate," "intend," "believe," "estimate," "predict," "potential," or "continue" or the negative of those words and other comparable terminology, although not all forward-looking statements contain these words. Forward-looking statements are not a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. We caution that the forward-looking statements are based largely on our expectations and information available at the time the statements are made and are subject to a number of known and unknown risks and uncertainties that are subject to change based on factors which are in many instances, beyond our control. Actual results, performance or achievements could differ materially from those contemplated, expressed, or implied by the forward-looking statements. You should bear this in mind when reading this annual report and not place undue reliance on these forward-looking statements. The following factors, among others, could cause our financial performance to differ materially from that expressed in such forward-looking statements:

- general economic conditions, whether national or regional, and conditions in the lending markets in which we participate that may have an adverse effect on the demand for our loans and other products, our credit quality and related levels of nonperforming assets and loan losses, and the value and salability of the real estate that we own or that is the collateral for our loans;

- results of examinations of us by our regulators, including the possibility that our regulators may, among other things, require us to increase our reserve for loan losses or to write-down assets;

- our ability to prudently manage our growth and execute our strategy;

- impairment of our goodwill and intangible assets;

- changing bank regulatory conditions, policies or programs, whether arising as new legislation or regulatory initiatives, that could lead to restrictions on activities of banks generally, or our subsidiary bank in particular, more restrictive regulatory capital requirements, increased costs, including deposit insurance premiums, regulation or prohibition of certain income producing activities or changes in the secondary market for loans and other products;

- changes in market rates and prices may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet;

- our liquidity requirements could be adversely affected by changes in our assets and liabilities;

- the effect of legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;

- competitive factors among financial services organizations, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;

- the growth and profitability of non-interest or fee income being less than expected;

- the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board, the Securities and Exchange Commission (the "SEC"), the Public Company Accounting Oversight Board and other regulatory agencies; and

- the effect of fiscal and governmental policies of the United States federal government.

You should also consider carefully the Risk Factors contained in Item 1A of Part I of this annual report, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. The risks discussed in this annual report are factors that, individually or in the aggregate, management believes could cause our actual results to differ materially from expected and historical results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider such disclosures to be a complete discussion of all potential risks or uncertainties.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

PART I

Item 1. Business.

BUSINESS

General

The Company was incorporated under the laws of Maryland on March 15, 1996 and is a financial holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). The Company is the largest independent financial holding company located on the Eastern Shore of Maryland. The Company, through its subsidiary, provides commercial banking products and services, including trust, wealth management and financial planning services. The Company and Shore United Bank (the "Bank") are Affirmative Action/Equal Opportunity Employers.

Recent Transactions

On December 31, 2018, the Company sold the assets and activities of its insurance business, The Avon-Dixon Agency, LLC ("Avon"), a Maryland limited liability company, with two specialty lines, trading as Elliot Wilson Insurance (Trucking) and Jack Martin & Associates (Marine). The Company received net proceeds from the sale of $25.2 million. In addition, the Company discontinued operations of its insurance premium finance business, Mubell, LLC ("Mubell"), a Maryland limited liability company. Additional details related to the sale of Avon and the discontinuing operations of Mubell can be located in Note 2 to the Company's Consolidated Financial Statements included in Item 8 of Part II of this annual report.

Banking Products and Services

The Bank is a Maryland chartered commercial bank with trust powers that can trace its origin to 1876. The Bank currently operates 21 full service branches, 23 ATMs, 2 loan production offices, and provides a full range of commercial and consumer banking products and services to individuals, businesses, and other organizations in Baltimore City, Baltimore County, Howard County, Kent County, Queen Anne's County, Caroline County, Talbot County, Dorchester County and Worcester County in Maryland, Kent County, Delaware and in Accomack County, Virginia. The Bank's deposits are insured up to applicable legal limits by the Federal Deposit Insurance Corporation (the "FDIC").

The Bank is an independent community bank that serves businesses and individuals in their respective market areas. Services offered are essentially the same as those offered by larger regional institutions that compete with the Bank. Services provided to businesses include commercial checking, savings, certificates of deposit and overnight investment sweep accounts. The Bank offers all forms of commercial lending, including secured and unsecured loans, working capital loans, lines of credit, term loans, accounts receivable financing, real estate acquisition and development, construction loans and letters of credit. Merchant credit card clearing services are available as well as direct deposit of payroll, internet banking and telephone banking services.

Services to individuals include checking accounts, various savings programs, mortgage loans, home improvement loans, installment and other personal loans, credit cards, personal lines of credit, automobile and other consumer financing, safe deposit boxes, debit cards, 24-hour telephone banking, internet banking, mobile banking, and 24-hour automatic teller machine services. The Bank also offers nondeposit products, such as mutual funds and annuities, and discount brokerage services to their customers. Additionally, the Bank has Saturday hours and extended hours on certain evenings during the week for added customer convenience.

Lending Activities

The Bank originates secured and unsecured loans for business purposes. Commercial loans are typically secured by real estate, accounts receivable, inventory, equipment and/or other assets of the business. Commercial loans generally involve a greater degree of credit risk than one to four family residential mortgage loans. Repayment is often dependent upon the successful operation of the business and may be affected by adverse conditions in the local economy or real estate market. The financial condition and cash flow of commercial borrowers is therefore carefully analyzed during the loan approval process, and continues to be monitored by obtaining business financial statements, personal financial statements and income tax returns. The frequency of this ongoing analysis depends upon the size and complexity of the credit and collateral that secures the loan. It is also the Bank's general policy to obtain personal guarantees from the principals of the commercial loan borrowers.

The Bank's commercial real estate loans are primarily secured by land for residential and commercial development, agricultural purpose properties, service industry buildings such as restaurants and motels, retail buildings and general purpose business space. The Bank attempts to mitigate the risks associated with these loans through thorough financial analyses, conservative underwriting procedures, including loan to value ratio standards, obtaining additional collateral, closely monitoring construction projects to control disbursement of funds on loans, and management's knowledge of the local economy in which the Bank lends.

The Bank provides residential real estate construction loans to builders and individuals for single family dwellings. Residential construction loans are usually granted based upon "as completed" appraisals and are secured by the property under construction. Additional collateral may be taken if loan to value ratios exceed 80%. Site inspections are performed to determine pre-specified stages of completion before loan proceeds are disbursed. These loans typically have maturities of six to 12 months and may have fixed or variable rate features. Permanent financing options for individuals include fixed and variable rate loans with three- and five-year balloon features and one-, three- and five-year adjustable rate mortgage loans. The risk of loss associated with real estate construction lending is controlled through conservative underwriting procedures such as loan to value ratios of 80% or less at origination, obtaining additional collateral when prudent, and closely monitoring construction projects to control disbursement of funds on loans.

The Bank originates fixed and variable rate residential mortgage loans. As with any consumer loan, repayment is dependent upon the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy, among other factors. Underwriting standards recommend loan to value ratios not to exceed 80% at origination based on appraisals performed by approved appraisers. The Bank relies on title insurance to protect their lien priorities and protect the property securing the loans by requiring fire and casualty insurance.

A variety of consumer loans are offered to customers, including home equity loans, credit cards and other secured and unsecured lines of credit and term loans. Careful analysis of an applicant's creditworthiness is performed before granting credit, and ongoing monitoring of loans outstanding is performed in an effort to minimize risk of loss by identifying problem loans early.

Deposit Activities

The Bank offers a full array of deposit products including checking, savings and money market accounts, and regular and IRA certificates of deposit. The Bank also offers the CDARS program, providing up to $50 million of FDIC insurance to our customers. Another program offered by the Bank is the ICS program, which is an insured cash sweep program allowing customers the ability to insure deposits over $250 thousand among other Banks that participate in the ICS network while providing competitive rates and easy access to funds. In addition, we offer our commercial customers packages which include cash management services and various checking opportunities and other cash sweep products.

Trust Services

The Bank has a trust department through which it offers trust, asset management and financial planning services to customers within our market areas using the trade name Wye Financial & Trust.

Seasonality

Management does not believe that our business activities are seasonal in nature.

Employees

At February 29, 2020, we employed 294 persons, of which 284 were employed on a full-time basis. None of our employees are represented by any collective bargaining unit or are a party to a collective bargaining agreement. Management of the Company considers its employee relations to be excellent.

COMPETITION

Shore Bancshares, Inc. and the Bank operate in a highly competitive environment. Our competitors include community banks, commercial banks, credit unions, thrifts, mortgage banking companies, credit card issuers, investment advisory firms, brokerage firms, mutual fund companies and e-commerce and other internet-based companies. We compete on a local and regional basis for banking and investment products and services.

The primary factors when competing in the financial service market include personalized services, the quality and range of products and services, interest rates on loans and deposits, lending services, price, customer convenience, and our ability to attract and retain experienced employees.

To compete in our market areas, we utilize multiple media channels including print, online, social media, television, radio, direct mail, e-mail and digital signage. Our employees also play a significant role in maintaining existing relationships with customers while establishing new relationships to grow all areas of our businesses.

SUPERVISION AND REGULATION

The following is a summary of the material regulations and policies applicable to us and is not intended to be a comprehensive discussion. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by reference to the text of applicable statutory and regulatory provisions. Proposals to change the laws and regulations governing the banking industry are frequently raised at both the state and federal levels. The likelihood and timing of any changes in these laws and regulations, and the impact such changes may have on us, are difficult to ascertain. In addition to laws and regulations, bank regulatory agencies may issue policy statements, interpretive letters and similar written guidance applicable to the Company or the Bank. A change in applicable laws, regulations or regulatory guidance, or in the manner such laws, regulations or regulatory guidance are interpreted by regulatory agencies or courts, may have a material effect on our business, operations, and earnings.

General

The Company is a financial holding company registered with the Board of Governors of the Federal Reserve System (the “FRB”) under the BHC Act and, as such, is subject to the supervision, examination and reporting requirements of the BHC Act and the regulations of the FRB.

The Bank is a Maryland chartered commercial bank subject to the banking laws of Maryland and to regulation by the Commissioner of Financial Regulation of Maryland, who is required by statute to make at least one examination in each calendar year (or at 18-month intervals if the Commissioner determines that an examination is unnecessary in a particular calendar year). The primary federal regulator of the Bank is the FRB. The deposits of the Bank are insured by the FDIC, so certain laws and regulations administered by the FDIC also govern its deposit taking operations. In addition to the foregoing, the Bank is subject to numerous state and federal statutes and regulations that affect the business of banking generally.

Nonbank affiliates of the Company are subject to examination by the FRB, and, as affiliates of the Bank, may be subject to examination by the Bank’s regulators from time to time.

Regulation of Financial Holding Companies

In November 1999, the Gramm-Leach-Bliley Act (the “GLB Act”) was signed into law. The GLB Act revised the BHC Act and repealed the affiliation provisions of the Glass-Steagall Act of 1933, which, taken together, limited the securities, insurance and other non-banking activities of any company that controls an FDIC insured financial institution. Under the GLB Act, a bank holding company can elect, subject to certain qualifications, to become a “financial holding company.” The GLB Act provides that a financial holding company may engage in a full range of financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities, with new expedited notice procedures. The Company is a financial holding company.

Under FRB policy, the Company is expected to act as a source of strength to the Bank, and the FRB may charge the Company with engaging in unsafe and unsound practices for failure to commit resources to the Bank when required. This support may be required at times when the Company may not have the resources to provide the support. Under the prompt corrective action provisions, if a controlled bank is undercapitalized, then the regulators could require the bank holding company to guarantee the bank’s capital restoration plan. In addition, if the FRB believes that a company’s activities, assets or affiliates represent a significant risk to the financial safety, soundness or stability of a controlled bank, then the FRB could require the bank holding company to terminate the activities, liquidate the assets or divest the affiliates. The regulators may require these and other actions in support of controlled banks even if such actions are not in the best interests of the bank holding company or its stockholders. Because the Company is a bank holding company, it is viewed as a source of financial and managerial strength for any controlled depository institutions, like the Bank.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which made sweeping changes to the financial regulatory landscape that impacts all financial institutions, including the Company and the Bank. The Dodd-Frank Act directs federal bank regulators to require that all companies that directly or indirectly control an insured depository institution serve as sources of financial strength for the institution. The term “source of financial strength” is defined under the Dodd-Frank Act as the ability of a company to provide financial assistance to its insured depository institution subsidiaries in the event of financial distress. The appropriate federal banking agency for such a depository institution may require reports from companies that control the insured depository institution to assess their abilities to serve as sources of strength and to enforce compliance with the source-of-strength requirements. The appropriate federal banking agency may also require a holding company to provide financial assistance to a bank with impaired capital. Under this requirement, the Company could be required to provide financial assistance to the Bank should it experience financial distress.

In addition, under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, depository institutions insured by the FDIC can be held liable for any losses incurred by, or reasonably anticipated to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. Accordingly, in the event that any insured subsidiary of the Company causes a loss to the FDIC, other insured subsidiaries of the Company could be required to compensate the FDIC by reimbursing it for the estimated amount of such loss. Such cross guaranty liabilities generally are superior in priority to obligations of a financial institution to its stockholders and obligations to other affiliates.

Federal Regulation of Banks

Federal and state banking regulators may prohibit the institutions over which they have supervisory authority from engaging in activities or investments that the agencies believe are unsafe or unsound banking practices. These banking regulators have extensive enforcement authority over the institutions they regulate to prohibit or correct activities that violate law, regulation or a regulatory agreement or which are deemed to be unsafe or unsound practices. Enforcement actions may include the appointment of a conservator or receiver, the issuance of a cease and desist order, the termination of deposit insurance, the imposition of civil money penalties on the institution, its directors, officers, employees and institution-affiliated parties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the removal of or restrictions on directors, officers, employees and institution-affiliated parties, and the enforcement of any such mechanisms through restraining orders or other court actions.

The Bank is subject to the provisions of Section 23A and Section 23B of the Federal Reserve Act. Section 23A limits the amount of loans or extensions of credit to, and investments in, the Company and its nonbank affiliates by the Bank. Section 23B requires that transactions between the Bank and the Company and its nonbank affiliates be on terms and under circumstances that are substantially the same as with non-affiliates.

The Bank is also subject to certain restrictions on extensions of credit to executive officers, directors, and principal stockholders or any related interest of such persons, which generally require that such credit extensions be made on substantially the same terms as are available to third parties dealing with the Bank and not involve more than the normal risk of repayment. Other laws tie the maximum amount that may be loaned to any one customer and its related interests to capital levels.

As part of the Federal Deposit Insurance Company Improvement Act of 1991 ("FDICIA"), each federal banking regulator adopted non-capital safety and soundness standards for institutions under its authority. These standards include internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. An institution that fails to meet those standards may be required by the agency to develop a plan acceptable to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. The Company, on behalf of the Bank, believes that the Bank meets substantially all standards that have been adopted. FDICIA also imposes capital standards on insured depository institutions.

The Community Reinvestment Act ("CRA") requires that, in connection with the examination of financial institutions within their jurisdictions, the federal banking regulators evaluate the record of the financial institution in meeting the credit needs of their communities including low and moderate income neighborhoods, consistent with the safe and sound operation of those banks. These factors are also considered by all regulatory agencies in evaluating mergers, acquisitions and applications to open a branch or facility. As of the date of its most recent examination report, the Bank has a CRA rating of "Satisfactory."

The Dodd-Frank Act

The Dodd-Frank Act significantly changed the bank regulatory structure and affected the lending, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires the FRB to set minimum capital levels for bank holding companies that are as stringent as those required for insured depository institutions. The legislation also establishes a floor for capital of insured depository institutions and directs the federal banking regulators to implement new leverage and capital requirements. The new leverage and capital requirements must take into account off-balance sheet activities and other risks, including risks relating to securitized products and derivatives. Pursuant to the Dodd-Frank Act, the FDIC has backup enforcement authority over a depository institution holding company, such as the Company, if the conduct or threatened conduct of such holding company poses a risk to the Deposit Insurance Fund ("DIF"), although such authority may not be used if the holding company is generally in sound condition and does not pose a foreseeable and material risk to the DIF. In addition, the Dodd-Frank Act contains a wide variety of provisions (many of which are not yet effective) affecting the regulation of depository institutions, including restrictions related to mortgage originations, risk retention requirements as to securitized loans and the establishment of the Consumer Financial Protection Bureau ("CFPB").

Many aspects of the Dodd-Frank Act continue to be subject to rulemaking and have yet to take full effect, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry generally. Provisions in the legislation that affect deposit insurance assessments, payment of interest on demand deposits and interchange fees could increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

Regulatory Relief Act

On May 24, 2018, President Trump signed into law the "Economic Growth, Regulatory Relief and Consumer Protection Act" (the "Regulatory Relief Act"), which amends parts of the Dodd-Frank Act and other laws that involve regulation of the financial industry. While the Regulatory Relief Act keeps in place fundamental aspects of the Dodd-Frank Act's regulatory framework, it does make regulatory changes that are favorable to depository institutions with assets under $10 billion, such as the Bank and to bank holding companies("BHCs") with total consolidated assets of less than $10 billion, such as the Company. The Regulatory Relief Act also makes changes to consumer mortgage and credit reporting regulations and to the authorities of the agencies that regulate the financial industry. Certain provisions of the Regulatory Relief Act favorable to the Company and the Bank require the federal banking agencies to either promulgate regulations or amend existing regulations, and it will likely take some time for these agencies to implement the necessary regulations.

Provisions That Are Favorable to Community Banks. There are several provisions in the Regulatory Relief Act that will have a favorable impact on community banks such as the Bank. These are briefly referenced below.

Increase in Small Bank Holding Company Policy Threshold. The Regulatory Relief Act directs the FRB to increase the asset threshold for qualifying for the FRB's "Small Bank Holding Company Policy Statement" (the "Policy"), from $1 billion to $3 billion. The FRB's revisions to the Policy took effect on August 30, 2018. Small BHCs or savings and loan holding companies("SLHCs") are excluded from the Policy if they are engaged in significant nonbanking activities, engaged in significant off-balance sheet activities, or have a material amount of debt or equity registered with the SEC. The FRB also retains the authority to exclude any BHC or SLHC from the Policy if such action is warranted for supervisory purposes. The Policy allows covered BHCs to operate with higher levels of debt than would normally be permitted, subject to certain restrictions on dividends and the expectation that the BHC will reduce its reliance on debt over time. Also, BHCs that are subject to the Policy are exempt from the FRB's consolidated risk-based and leverage capital rules implementing Basel III. BHCs subject to the Policy also have less extensive regulatory reporting requirements than larger organizations filing reports on a semi-annual rather than quarterly basis. The Company meets the conditions of the FRB's Policy and is therefore currently excluded from consolidated capital requirements. However, the Bank remains subject to regulatory capital requirements administered by the federal banking agencies.

Increase in Asset Threshold for Qualifying for an 18-Month Examination Cycle. The Regulatory Relief Act increases the asset threshold for institutions qualifying for an 18-month on-site examination cycle from $1 billion to $3 billion in total consolidated assets.

Short Form Call Reports. The Regulatory Relief Act requires the federal banking agencies to promulgate regulations allowing an insured depository institution with less than $5 billion in total consolidated assets (and that satisfies such other criteria as determined to be appropriate by the agencies) to submit a short-form call report for its first and third quarters.

Deposit Insurance

Our deposits are insured up to applicable limits by the DIF of the FDIC. Deposit insurance is mandatory. We are required to pay assessments to the FDIC on a quarterly basis. The assessment amount is the product of multiplying the assessment base by the assessment amount.

The assessment base against which the assessment rate is applied to determine the total assessment due for a given period is the depository institution's average total consolidated assets during the assessment period less average tangible equity during that assessment period. Tangible equity is defined in the assessment rule as Tier 1 Capital and is calculated monthly, unless the insured depository institution has less than $1 billion in assets, in which case the insured depository institution calculates Tier 1 Capital on an end-of-quarter basis. Parents or holding companies of other insured depository institutions are required to report separately from their subsidiary depository institutions.

The FDIC's methodology for setting assessments for individual banks has changed over time, although the broad policy is that lower-risk institutions should pay lower assessments than higher-risk institutions. The FDIC now uses a methodology, known as the "financial ratios method," that began to apply on July 1, 2016, in order to meet requirements of the Dodd-Frank Act. The statute established a minimum designated reserve ratio (the "DFR"), for the DIF of 1.35% of the estimated insured deposits and required the FDIC to adopt a restoration plan should the reserve ratio fall below 1.35%. The financial ratios took effect when the DRR exceeded 1.15%. The FDIC declared that the DIF reserve ratio exceeded 1.15% by the end of the second quarter of 2016. Accordingly, beginning July 1, 2016, the FDIC began to use the financial ratios method. This methodology assigns a specific assessment rate to each institution based on the institution's leverage capital, supervisory ratings, and information from the institution's call report. Under this methodology, the assessment rate schedules used to determine assessments due from insured depository institutions become progressively lower when the reserve ratio in the DIF exceeds 2% and 2.5%.

The Dodd-Frank Act also raised the limit for federal deposit insurance to $250,000 for most deposit accounts and increased the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000.

The FDIC has authority to increase insurance assessments. A significant increase in insurance assessments would likely have an adverse effect on our operating expenses and results of operations. We cannot predict what insurance assessment rates will be in the future. Furthermore, deposit insurance may be terminated by the FDIC upon a finding that an insured depository institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC.

Capital Adequacy Guidelines

In December 2010, the Basel Committee on Banking Supervision released its final framework for strengthening international capital and liquidity regulation, or Basel III. Basel III requires banks to maintain a higher level of capital than previously required, with a greater emphasis on common equity. The Dodd-Frank Act imposed generally applicable capital requirements with respect to BHCs and their bank subsidiaries and mandated that the federal banking regulatory agencies adopt rules and regulations to implement the Basel III requirements.

In July 2013, the federal banking agencies adopted a final rule, or the Basel III Final Rule, implementing these standards. The Dodd-Frank Act provides for countercyclical capital requirements so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, consistent with safety and soundness. Under the Basel III Final Rule, which implements this concept, banks must maintain a capital conservation buffer consisting of additional common equity Tier 1 capital equal to 2.5% of risk-weighted assets above each of the required minimum capital levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying certain discretionary bonuses. This new capital conservation buffer requirement began to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and increased by this amount each year until it became fully implemented at 2.5% in January 2019.

For purposes of calculating risk-weighted assets, the Basel III Final Rule is designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks, to account for off-balance sheet exposures, and to minimize disincentives for holding liquid assets. Under this rule, assets and off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets, which reflect on- and off-balance sheet items.

For this purpose, certain off-balance sheet items are assigned certain credit conversion factors to convert them to asset-equivalent amounts to which an appropriate risk-weighting will apply. Those computations result in the total risk-weighted assets. Most loans are assigned to the 100% risk category, except for performing first mortgage loans fully secured by residential property, which carry a 50% risk weighting. Most investment securities (including, primarily, general obligation claims of states or other political subdivisions of the United States) are assigned to the 20% category. Exceptions include municipal or state revenue bonds, which have a 50% risk weighting, and direct obligations of the United States Treasury or obligations backed by the full faith and credit of the United States government, which have a 0% risk weighting. In converting off-balance sheet items, direct credit substitutes, including general guarantees and standby letters of credit backing financial obligations, are assigned a 100% credit conversion factor. Transaction-related contingencies such as bid bonds, standby letters of credit backing non-financial obligations, and undrawn commitments (including commercial credit lines with an initial maturity of more than one year) are assigned a 50% credit conversion factor. Short-term commercial letters of credit are assigned a 20% credit conversion factor, and certain short-term unconditionally cancelable commitments are assigned a 0% credit conversion factor.

Minimum capital standards under the Basel III Final Rule for banks of our size took effect on January 1, 2015 with a phase-in period that generally extended through January 1, 2019 for certain of the changes. As discussed under “-Prompt Corrective Action,” depository institutions and depository holding companies with less than $10 billion in total consolidated assets, such as the Company and the Bank, will be deemed to satisfy both the leverage and risk-based capital requirements, provided they satisfy a new “Community Bank Leverage Ratio” required to be promulgated by the Federal Banking agencies.

Under the Basel III Final Rule, the minimum ratio of total capital to risk-weighted assets (including certain off-balance sheet activities, such as standby letters of credit) is 8%. While there was previously no required ratio of “Common Equity Tier 1 Capital” (“CET1”) (which generally consists of common stock, retained earnings, certain qualifying capital instruments issued by consolidated subsidiaries, and Accumulated Other Comprehensive Income, subject to certain adjustments and deductions for items such as goodwill, other intangible assets, reciprocal holdings of other banking organizations’ capital instruments, investments in unconsolidated subsidiaries and any other deductions as determined by the appropriate regulator) to risk-weighted assets, a required minimum ratio of 4.5% became effective on January 1, 2015 as well. The required ratio of “Tier 1 Capital” (consisting generally of CET1 and qualifying preferred stock) to risk-weighted assets is 6%. The remainder of total capital, or Tier 2 Capital, may consist of (a) the allowance for loan losses of up to 1.25% of risk-weighted assets, (b) preferred stock not qualifying as Tier 1 Capital, (c) hybrid capital instruments, (d) perpetual debt, (e) mandatory convertible securities, and (f) certain subordinated debt and intermediate-term preferred stock up to 50% of Tier 1 Capital. Total Capital is the sum of Tier 1 Capital and Tier 2 Capital.

As of January 1, 2019, the Bank is required to maintain a minimum Tier 1 leverage ratio of 4.0%, a minimum CET1 to risk-weighted assets ratio of 7%, a Tier 1 capital to risk-weighted assets ratio of 8.5% and a minimum total capital to risk-weighted assets ratio of 10.5%.

The Basel III Final Rule also includes minimum leverage ratio requirements for banking organizations, calculated as the ratio of Tier 1 Capital to adjusted average consolidated assets. Prior to the effective date of the Basel III Final Rule, banks and BHCs meeting certain specified criteria, including having the highest regulatory rating and not experiencing significant growth or expansion, were permitted to maintain a minimum leverage ratio of Tier 1 Capital to adjusted average quarterly assets equal to 3%. Other banks and BHCs generally were required to maintain a minimum leverage ratio between 4% and 5%. Under the Basel III Final Rule, as of January 1, 2015, the required minimum leverage ratio for all banks is 4%.

As an additional means of identifying problems in the financial management of depository institutions, the federal banking regulatory agencies have established certain non-capital safety and soundness standards for institutions for which they are the primary federal regulator. The standards relate generally to operations and management, asset quality, interest rate exposure, and executive compensation. The agencies are authorized to take action against institutions that fail to meet such standards.

The requirements of the Dodd-Frank Act are still in the process of being implemented over time and most will be subject to regulations implemented over the course of several years. In addition, the Regulatory Relief Act modifies several provisions in the Dodd-Frank Act, but are subject to implementing regulations. Given the uncertainty associated with the how the provisions of the Dodd-Frank Act and the Regulatory Relief Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on our operations is unclear. On September 27, 2017, the federal banking agencies proposed a rule intended to reduce the regulatory compliance burden, particularly on community banking organizations, by simplifying several requirements in the Basel III-based capital rules. Specifically, the proposed rule simplifies the capital treatment for certain acquisition, development, and construction loans, mortgage servicing assets, certain deferred tax assets, investments in the capital instruments of unconsolidated financial institutions, and minority interest. In 2017, the federal banking agencies adopted an extension of the transition period for application of the Basel III-based capital rules to certain investments, effectively freezing the capital treatment of affected investments until the changes proposed in the September 2017 proposal are finalized and effective.

In December 2017, the Basel Committee published standards that it described as the finalization of the Basel III post-crisis regulatory reforms, which standards are commonly referred to as Basel IV. Among other things, these standards revise the Basel Committee’s standardized approach for credit risk (including the recalibration of the risk weights and the introduction of new capital requirements for certain “unconditionally cancellable commitments,” such as unused credit card lines of credit) and provides a new standardized approach for operational risk capital. Under the Basel framework, these standards will generally be effective on January 1, 2022, with an aggregate output floor phasing in through January 1, 2027. Under the current U.S. capital rules, operational risk capital requirements and a capital floor apply only to advanced approaches institutions, and not to the Bank. The impact of Basel IV on us will depend on how it is implemented by the federal bank regulators.

Prompt Corrective Action

In addition to the required minimum capital levels described above, federal law establishes a system of "prompt corrective actions" that federal banking agencies are required to take, and certain actions that they have discretion to take, based upon the capital category into which a federally regulated depository institution falls. Regulations set forth detailed procedures and criteria for implementing prompt corrective action in the case of any institution which is not adequately capitalized. Under the prompt corrective action rules, an institution is deemed "well capitalized" if its leverage ratio, Common Equity Tier 1 ratio, Tier 1 Capital ratio, and Total Capital ratio meet or exceed 5%, 6.5%, 8%, and 10%, respectively. An institution is deemed to be "adequately capitalized" or better if its leverage, Common Equity Tier 1, Tier 1, and Total Capital ratios meet or exceed the minimum federal regulatory capital requirements set forth in the Basel III Final Rule. An institution is "undercapitalized" if it fails to meet the minimum capital requirements. An institution is "significantly undercapitalized" if any one of its leverage, Common Equity Tier 1, Tier 1, and Total Capital ratios falls below 3%, 3%, 4%, and 6%, respectively, and "critically undercapitalized" if the institution has a ratio of tangible equity to total assets that is equal to or less than 2%.

The Regulatory Relief Act requires the federal banking agencies to promulgate a rule establishing a new "Community Bank Leverage Ratio" of 8% to 10% for depository institutions and depository institution holding companies, including banks and BHCs, with less than $10 billion in total consolidated assets, such as the Company and the Bank. If such a depository institution or holding company maintains tangible equity in excess of this leverage ratio, it would be deemed in compliance with all other capital and leverage requirements: (1) the leverage and risk-based capital requirements promulgated by the federal banking agencies; (2) in the case of a depository institution, the capital ratio requirements to be considered "well capitalized" under the federal banking agencies' "prompt corrective action" regime; and (3) any other capital or leverage requirements to which the depository institution or holding company is subject, in each case, unless the appropriate federal banking agency determines otherwise based on the particular institution's risk profile.

The prompt corrective action rules require an undercapitalized institution to file a written capital restoration plan, along with a performance guaranty by its holding company or a third party. In addition, an undercapitalized institution becomes subject to certain automatic restrictions, including a prohibition on payment of dividends and a limitation on asset growth and expansion in certain cases, a limitation on the payment of bonuses or raises to senior executive officers, and a prohibition on the payment of certain "management fees" to any "controlling person." Institutions that are classified as undercapitalized are also subject to certain additional supervisory actions, including increased reporting burdens and regulatory monitoring; limitations on the institution's ability to make acquisitions, open new branch offices, or engage in new lines of business; obligations to raise additional capital; restrictions on transactions with affiliates; and restrictions on interest rates paid by the institution on deposits. In certain cases, banking regulatory agencies may require replacement of senior executive officers or directors, or sale of the institution to a willing purchaser. If an institution is deemed to be "critically undercapitalized" and continues in that category for 90 days, the statute requires, with certain narrowly limited exceptions, that the institution be placed in receivership.

An insured depository institution's capital level may have consequences outside the prompt corrective action regime. For example, only well-capitalized institutions may accept brokered deposits without restrictions on rates, while adequately capitalized institutions must seek a waiver from the FDIC to accept such deposits and are subject to rate restrictions. Well-capitalized institutions may be eligible for expedited treatment of certain applications, an advantage not available to other institutions.

As noted above, Basel III integrates the new capital requirements into the prompt corrective action category definitions. As a result of the FRB's revisions to the Policy raising the total consolidated asset limit in the Policy from $1 billion to $3 billion, the Company is currently exempt from the consolidated capital requirements.

Capital Category	Total Risk-Based Capital Ratio	Tier 1 Risk-Based Capital Ratio	Common Equity Tier 1 (CET1) Capital Ratio	Leverage Ratio	Tangible Equity to Assets	Supplemental Leverage Ratio
Well Capitalized	10% or greater	8% or greater	6.5% or greater	5% or greater	n/a	n/a
Adequately Capitalized	8% or greater	6% or greater	4.5% or greater	4% or greater	n/a	3% or greater
Undercapitalized	Less than 8%	Less than 6%	Less than 4.5%	Less than 4%	n/a	Less than 3%
Significantly Undercapitalized	Less than 6%	Less than 4%	Less than 3%	Less than 3%	n/a	n/a
Critically Undercapitalized	n/a	n/a	n/a	n/a	Less than 2%	n/a

As of December 31, 2019, the Bank was “well capitalized” according to the guidelines as generally discussed above.

Safety and Soundness Standards

The federal banking agencies have adopted guidelines designed to assist the federal banking agencies in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems and internal audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) asset growth; (v) earnings; and (vi) compensation, fees and benefits.

In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and for evaluating and monitoring earnings to ensure that earnings are sufficient for the maintenance of adequate capital and reserves. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, an insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets; (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses; (iii) compare problem asset totals to capital; (iv) take appropriate corrective action to resolve problem assets; (v) consider the size and potential risks of material asset concentrations; and (vi) provide periodic asset quality reports with adequate information for management and the board of directors to assess the level of asset risk.

Anti-Terrorism, Money Laundering Legislation and OFAC

The Bank is subject to the Bank Secrecy Act(“BSA”) and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA Patriot Act”). These statutes and related rules and regulations impose requirements and limitations on specified financial transactions and accounts and other relationships intended to guard against money laundering and terrorism financing. The principal requirements for an insured depository institution include (i) establishment of an anti-money laundering program that includes training and audit components, (ii) establishment of a “know your customer” program involving due diligence to confirm the identities of persons seeking to open accounts and to deny accounts to those persons unable to demonstrate their identities, (iii) the filing of currency transaction reports for deposits and withdrawals of large amounts of cash and suspicious activities reports for activity that might signify money laundering, tax evasion, or other criminal activities, (iv) additional precautions for accounts sought and managed for non-U.S. persons and (v) verification and certification of money laundering risk with respect to private banking and foreign correspondent banking relationships. For many of these tasks a bank must keep records to be made available to its primary federal regulator. Anti-money laundering rules and policies are developed by a bureau within FinCEN, but compliance by individual institutions is overseen by its primary federal regulator.

The Bank has established appropriate anti-money laundering and customer identification programs. The Bank also maintains records of cash purchases of negotiable instruments, files reports of certain cash transactions exceeding $10,000 (daily aggregate amount), and reports suspicious activity that might signify money laundering, tax evasion, or other criminal activities pursuant to the BSA. The Bank otherwise has implemented policies and procedures to comply with the foregoing requirements.

The Treasury Department's Office of Foreign Assets Control ("OFAC"), administers and enforces economic and trade sanctions against targeted foreign countries and persons, as defined by various Executive Orders and Acts of Congress. OFAC publishes lists of persons that are the target of sanctions, including the List of Specially Designated Nationals and Blocked Persons. Financial institutions are responsible for, among other things, blocking accounts of and transactions with sanctioned persons and countries, prohibiting unlicensed trade and financial transactions with them and reporting blocked and rejected transactions after their occurrence. If the Company or the Bank finds a name or other information on any transaction, account or wire transfer that is on an OFAC list or that otherwise indicates that the transaction involves a target of sanctions, the Company or the Bank generally must freeze or block such account or transaction, file a suspicious activity report, and notify the appropriate authorities. Banking regulators examine banks for compliance with the economic sanctions regulations administered by OFAC.

The Bank has implemented policies and procedures to comply with the foregoing requirements.

Data Privacy and Cybersecurity

The GLB Act and the implementing regulations issued by federal regulatory agencies require financial institutions (including banks, insurance agencies, and broker/dealers) to adopt policies and procedures regarding the disclosure of nonpublic personal information about their customers to non-affiliated third parties. In general, financial institutions are required to explain to customers their policies and procedures regarding the disclosure of such nonpublic personal information and, unless otherwise required or permitted by law, financial institutions are prohibited from disclosing such information except as provided in their policies and procedures. Specifically, the GLB Act established certain information security guidelines that require each financial institution, under the supervision and ongoing oversight of its board of directors or an appropriate committee thereof, to develop, implement, and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, to protect against anticipated threats or hazards to the security or integrity of such information, and to protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer.

Recent cyber-attacks against banks and other financial institutions that resulted in unauthorized access to confidential customer information have prompted the federal banking regulators to issue extensive guidance on cybersecurity. Among other things, financial institutions are expected to design multiple layers of security controls to establish lines of defense and ensure that their risk management processes address the risks posed by compromised customer credentials, including security measures to authenticate customers accessing internet-based services. A financial institution also should have a robust business continuity program to recover from a cyberattack and procedures for monitoring the security of third-party service providers that may have access to nonpublic data at the institution.

The Consumer Financial Protection Bureau

The CFPB has authority through rulemaking, orders, policy statements, guidance, and enforcement actions to administer and enforce federal consumer financial laws, to oversee several entities and market segments not previously under the supervision of a federal regulator, and to impose its own regulations and pursue enforcement actions when it determines that a practice is unfair, deceptive, or abusive. The federal consumer financial laws and all the functions and responsibilities associated with them, many of which were previously enforced by other federal regulatory agencies, were transferred to the CFPB on July 21, 2011. While the CFPB has the power to interpret, administer, and enforce federal consumer financial laws, the Dodd-Frank Act provides that the federal banking regulatory agencies continue to have examination and enforcement powers over the financial institutions that they supervise relating to the matters within the jurisdiction of the CFPB if such institutions have less than $10 billion in assets. The Dodd-Frank Act also gives state attorneys general the ability to enforce federal consumer protection laws.

Mortgage Loan Origination

The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages, including a determination of the borrower's ability to repay. Under the Dodd-Frank Act and the implementing final rule adopted by the CFPB, or the ATR/QM Rule, a financial institution may not make a residential mortgage loan to a consumer unless it first makes a "reasonable and good faith determination" that the consumer has a "reasonable ability" to repay the loan. In addition, the ATR/QM Rule limits prepayment penalties and permits borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage,” as defined by the CFPB. For this purpose, the ATR/QM Rule defines a “qualified mortgage” to include a loan with a borrower debt-to-income ratio of less than or equal to 43% or, alternatively, a loan eligible for purchase by Fannie Mae or Freddie Mac while they operate under federal conservatorship or receivership, and loans eligible for insurance or guarantee by the Federal Housing Administration, Veterans Administration, or United States Department of Agriculture. Additionally, a qualified mortgage may not: (i) contain excess upfront points and fees; (ii) have a term greater than 30 years; or (iii) include interest only or negative amortization payments. The ATR/QM Rule specifies the types of income and assets that may be considered in the ability-to-repay determination, the permissible sources for verification, and the required methods of calculating the loan’s monthly payments. The ATR/QM Rule became effective in January 2014.

The Regulatory Relief Act provides that for certain insured depository institutions and insured credit unions with less than $10 billion in total consolidated assets, mortgage loans that are originated and retained in portfolio will automatically be deemed to satisfy the “ability to repay” requirement. To qualify for this, the insured depository institutions and credit unions must meet conditions relating to prepayment penalties, points and fees, negative amortization, interest-only features and documentation.

The Regulatory Relief Act directs Federal banking agencies to issue regulations exempting certain insured depository institutions and insured credit unions with assets of $10 billion or less from the requirement to establish escrow accounts for certain residential mortgage loans.

Insured depository institutions and insured credit unions that originated fewer than 500 closed-end mortgage loans or 500 open-end lines of credit in each of the two preceding years are exempt from a subset of disclosure requirements (recently imposed by the CFPB) under the Home Mortgage Disclosure Act (“HMDA”), provided they have received certain minimum CRA ratings in their most recent examinations.

The Regulatory Relief Act also directs the Comptroller of the Currency to conduct a study assessing the effect of the exemption described above on the amount of HMDA data available at the national and local level.

In addition, Section 941 of the Dodd-Frank Act amended the Securities Exchange Act of 1934, as amended (the “Exchange Act”) to require sponsors of asset-backed securities (“ABS”) to retain at least 5% of the credit risk of the assets underlying the securities and generally prohibits sponsors from transferring or hedging that credit risk. In October 2014, the federal banking regulatory agencies adopted a final rule to implement this requirement (the “Risk Retention Rule”). Among other things, the Risk Retention Rule requires a securitizer to retain not less than 5% of the credit risk of any asset that the securitizer, through the issuance of an ABS, transfers, sells, or conveys to a third party; and prohibits a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain. In certain situations, the final rule allows securitizers to allocate a portion of the risk retention requirement to the originator(s) of the securitized assets, if an originator contributes at least 20% of the assets in the securitization. The Risk Retention Rule also provides an exemption to the risk retention requirements for an ABS collateralized exclusively by Qualified Residential Mortgages (“QRMs”), and ties the definition of a QRM to the definition of a “qualified mortgage” established by the CFPB for purposes of evaluating a consumer’s ability to repay a mortgage loan. The federal banking agencies have agreed to review the definition of QRMs in 2019, following the CFPB’s own review of its “qualified mortgage” regulation. For purposes of residential mortgage securitizations, the Risk Retention Rule took effect on December 24, 2015. For all other securitizations, the rule took effect on December 24, 2016.

Other Provisions of the Dodd-Frank Act

The Dodd-Frank Act implements far-reaching changes across the financial regulatory landscape. In addition to the reforms previously mentioned, the Dodd-Frank Act also:

requires BHCs and banks to be both well capitalized and well managed in order to acquire banks located outside their home state and requires any BHC electing to be treated as a financial holding company to be both well managed and well capitalized;

eliminates all remaining restrictions on interstate banking by authorizing national and state banks to establish de novo branches in any state that would permit a bank chartered in that state to open a branch at that location; and

repeals Regulation Q, the federal prohibition on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Although a significant number of the rules and regulations mandated by the Dodd-Frank Act have been finalized, many of the requirements called for have yet to be implemented and will likely be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various agencies, the full extent of the impact such requirements will have on financial institutions' operations is unclear.

Other Laws and Regulations

Our operations are subject to several additional laws, some of which are specific to banking and others of which are applicable to commercial operations generally. For example, with respect to our lending practices, we are subject to the following laws and regulations, among several others:

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

HMDA, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed, or other prohibited factors in extending credit;

Fair Credit Reporting Act of 1978, as amended by the Fair and Accurate Credit Transactions Act, governing the use and provision of information to credit reporting agencies, certain identity theft protections, and certain credit and other disclosures;

Fair Debt Collection Practices Act, governing how consumer debts may be collected by collection agencies;

Real Estate Settlement Procedures Act, requiring certain disclosures concerning loan closing costs and escrows, and governing transfers of loan servicing and the amounts of escrows for loans secured by one-to-four family residential properties;

Rules and regulations established by the National Flood Insurance Program;

Rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

Our deposit operations are subject to federal laws applicable to depository accounts, including:

Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

Truth-In-Savings Act, requiring certain disclosures for consumer deposit accounts;

Electronic Funds Transfer Act and Regulation E of the FRB, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and

Rules and regulations of the various federal agencies charged with the responsibility of implementing these federal laws.

We are also subject to a variety of laws and regulations that are not limited to banking organizations. For example, in lending to commercial and consumer borrowers, and in owning and operating our own property, we are subject to regulations and potential liabilities under state and federal environmental laws. In addition, we must comply with privacy and data security laws and regulations at both the federal and state level.

We are heavily regulated by regulatory agencies at the federal and state levels. Like most of our competitors, we have faced and expect to continue to face increased regulation and regulatory and political scrutiny, which creates significant uncertainty for us, as well as for the financial services industry in general.

Future Legislation and Regulation

Regulators have increased their focus on the regulation of the financial services industry in recent years, leading in many cases to greater uncertainty and compliance costs for regulated entities. Proposals that could substantially intensify the regulation of the financial services industry have been and may be expected to continue to be introduced in the United States Congress, in state legislatures, and by applicable regulatory authorities. These proposals may change banking statutes and regulations and our operating environment in substantial and unpredictable ways. If enacted, these proposals could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We cannot predict whether any of these proposals will be enacted and, if enacted, the effect that these proposals, or any implementing regulations, would have on our business, results of operations, or financial condition.

Federal Securities Laws

The shares of the Company’s common stock are registered with the SEC under Section 12(b) of the Act and listed on the NASDAQ Global Select Market. The Company is subject to information reporting requirements, proxy solicitation requirements, insider trading restrictions and other requirements of the Exchange Act, including the requirements imposed under the Sarbanes-Oxley Act of 2002 and the rules of The NASDAQ Stock Market, LLC. Among other things, loans to and other transactions with insiders are subject to restrictions and heightened disclosure, directors and certain committees of the Board must satisfy certain independence requirements, and the Company is generally required to comply with certain corporate governance requirements.

Governmental Monetary and Credit Policies and Economic Controls

The earnings and growth of the banking industry and ultimately of the Company are affected by the monetary and credit policies of governmental authorities, including the FRB. An important function of the FRB is to regulate the national supply of bank credit in order to control recessionary and inflationary pressures. Among the instruments of monetary policy used by the FRB to implement these objectives are open market operations in U.S. Government securities, changes in the federal funds rate, changes in the discount rate of member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth of bank loans, investments and deposits and may also affect interest rates charged on loans or paid for deposits. The monetary policies of the FRB authorities have had a significant effect on the operating results of commercial banks in the past and are expected to continue to have such an effect in the future. In view of changing conditions in the national economy and in the money markets, as well as the effect of actions by monetary and fiscal authorities, including the FRB, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or their effect on the business and earnings of the Company and its subsidiaries.

AVAILABLE INFORMATION

The Company maintains an Internet site at www.shorebancshares.com on which it makes available, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the SEC. In addition, stockholders may access these reports and documents on the SEC’s website at www.sec.gov . The information on, or accessible through, our website or any other website cited in this Annual Report on Form 10-K is not part of, or incorporated by reference into, this Annual Report on Form 10-K and should not be relied upon in determining whether to make an investment decision.

Item 1A. RISK FACTORS.

An investment in our common stock involves significant risks. You should consider carefully the risk factors included below together with all of the information included in or incorporated by reference into this annual report, as the same may be updated from time to time by our future filings with the SEC under the Exchange Act, before making a decision to invest in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also have a material adverse effect on our business, financial condition and results of operations. If any of the matters included in the following information about risk factors were to occur, our business, financial condition, results of operations, cash flows or prospects could be materially and adversely affected. In such case, you may lose all or a substantial part of your investment. To the extent that any of the information contained in this document constitutes forward-looking statements, the risk factors below should be reviewed as cautionary statements identifying important factors that could cause actual results to differ materially from those expressed in any forward-looking statements made by us or on our behalf. See “Cautionary note regarding forward-looking statements.”

Risks Relating to Our Business

Changes in U.S. or regional economic conditions could have an adverse effect on our business, financial condition or results of operations.

Our business activities and earnings are affected by general business conditions in the United States and in our local market area. These conditions include short-term and long-term interest rates, inflation, unemployment levels, consumer confidence and spending, fluctuations in both debt and equity capital markets, and the strength of the economy in the United States generally and in our market area in particular. In the late 2000’s, the national economy experienced an extended recession, with rising unemployment levels, declines in real estate values and erosion in consumer confidence. Dramatic declines in the U.S. housing market during the recession, with falling home prices and higher levels of foreclosures, negatively affected the performance of mortgage loans and resulted in significant write-downs of asset values by many financial institutions. Although the housing sector has improved, real estate prices have rebounded and consumer confidence has shown improvement, historical trends indicate that a recession occurs every 8-10 years which could result in another economic downturn in the near future. A return to elevated levels of unemployment, declines in the values of real estate, or other events that affect household and/or corporate incomes could impair the ability of our borrowers to repay their loans in accordance with their terms and reduce demand for banking products and services.

A majority of our business is concentrated in Maryland and Delaware, a significant amount of which is concentrated in real estate lending, so a decline in the local economy and real estate markets could adversely impact our financial condition and results of operations.

Because most of our loans are made to customers who reside on the Eastern Shore of Maryland and in Delaware, a decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose loan portfolios are geographically diverse. Further, a significant portion of our loan portfolio is secured by real estate, including construction and land development loans, all of which are in greater demand when interest rates are low and economic conditions are good. Accordingly, a decline in local economic conditions would likely have an adverse impact on our financial condition and results of operations, and the impact on us would likely be greater than the impact felt by larger financial institutions whose loan portfolios are geographically diverse. The Company has made strides to make our loan portfolio more diverse by expanding its footprint closer to the metropolitan area of Baltimore which during the last recession rebounded at a much faster pace than the more rural areas of Maryland. We cannot guarantee that any risk management practices that we implement to address our geographic and loan concentrations will be effective in preventing losses relating to our loan portfolio.

Our concentrations of commercial real estate loans could subject us to increased regulatory scrutiny and directives, which could force us to preserve or raise capital and/or limit our future commercial lending activities.

The FRB and the FDIC, along with the other federal banking regulators, issued guidance in December 2006 entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" directed at institutions that have particularly high concentrations of commercial real estate loans within their lending portfolios. This guidance suggests that these institutions face a heightened risk of financial difficulties in the event of adverse changes in the economy and commercial real estate markets. Accordingly, the guidance suggests that institutions whose concentrations exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk. Federal bank regulatory guidelines identify institutions potentially exposed to commercial real estate concentration risk as those that have (i) experienced rapid growth in commercial real estate lending, (ii) notable exposure to a specific type of commercial real estate, (iii) total reported loans for construction, land development and other land loans representing 100% or more of the institution's capital, or (iv) total commercial real estate loans representing 300% or more of the institution's capital if the outstanding balance of the institution's commercial real estate loan portfolio has increased 50% or more during the prior 36 months. The guidance provides that banking regulators may require such institutions to reduce their concentrations and/or maintain higher capital ratios than institutions with lower concentrations in commercial real estate. Due to our emphasis on commercial real estate and construction lending, as of December 31, 2019, non-owner-occupied commercial real estate loans (including construction, land and land development loans) represented 270.4% of total risk-based capital. Construction, land and land development loans represent 57.4% of total risk-based capital. The commercial real estate portfolio has increased 63.0% during the prior 36 months. We may be subject to heightened supervisory scrutiny during future examinations and/or be required to maintain higher levels of capital as a result of our commercial real estate concentrations, which could require us to obtain additional capital, and may adversely affect shareholder returns. Management cannot predict the extent to which this guidance will impact our operations or capital requirements. Further, we cannot guarantee that any risk management practices we implement will be effective in preventing losses resulting from concentrations in our commercial real estate portfolio.

Interest rates and other economic conditions will impact our results of operations.

Our results of operations may be materially and adversely affected by changes in prevailing economic conditions, including declines in real estate values, rapid changes in interest rates and the monetary and fiscal policies of the federal government. Our results of operations are significantly impacted by the spread between the interest rates earned on assets and the interest rates paid on deposits and other interest-bearing liabilities (i.e., net interest income), including advances from the Federal Home Loan Bank (the "FHLB") of Atlanta. Interest rate risk arises from mismatches (i.e., the interest sensitivity gap) between the dollar amount of repricing or maturing assets and liabilities. If more assets reprice or mature than liabilities during a falling interest rate environment, then our earnings could be negatively impacted. Conversely, if more liabilities reprice or mature than assets during a rising interest rate environment, then our earnings could be negatively impacted. Fluctuations in interest rates are not predictable or controllable. Changes in interest rates, particularly by the FRB, which implements national monetary policy in order to mitigate recessionary and inflationary pressures, also affect the value of our loans. In setting its policy, the FRB may utilize techniques such as: (i) engaging in open market transactions in United States government securities; (ii) setting the discount rate on member bank borrowings; and (iii) determining reserve requirements. These techniques may have an adverse effect on our deposit levels, net interest margin, loan demand or our business and operations. In addition, an increase in interest rates could adversely affect borrowers' ability to pay the principal or interest on existing loans or reduce their desire to borrow more money. This may lead to an increase in our nonperforming assets, a decrease in loan originations, or a reduction in the value of and income from our loans, any of which could have a material and negative effect on our results of operations.

Changes in market interest rates are affected by many factors beyond our control, including inflation, unemployment, money supply, international events, and events in world financial markets. We attempt to manage our risk from changes in market interest rates by adjusting the rates, maturity, re-pricing, and balances of the different types of interest-earning assets and interest-bearing liabilities, but interest rate risk management techniques are not exact. As a result, a rapid increase or decrease in interest rates could have an adverse effect on the net interest margin and results of operations. Changes in the market interest rates for types of products and services in various markets also may vary significantly from location to location and over time based upon competition and local or regional economic factors. At December 31, 2019, our interest rate sensitivity simulation model projected that net interest income would increase by 4.5% if interest rates immediately rose by 200 basis points. The results of an interest rate sensitivity simulation model depend upon a number of assumptions which may not prove to be accurate. There can be no assurance that we will be able to successfully manage interest rate risk.

The Bank may experience credit losses in excess of its allowances, which would adversely impact our financial condition and results of operations.

The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. Management at the Bank bases the allowance for credit losses upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of delinquencies and loan portfolio quality. If management's assumptions and judgments prove to be incorrect and the allowance for credit losses is inadequate to absorb future losses, or if the bank regulatory authorities, as a part of their examination process, require the Bank to increase its allowance for credit losses, our earnings and capital could be significantly and adversely affected. Material additions to the allowance for credit losses at the Bank would result in a decrease in the Bank's net income and capital and could have a material adverse effect on our financial condition.

Although we believe that our allowance for credit losses is maintained at a level adequate to absorb any inherent losses in our loan portfolio, these estimates of loan losses are necessarily subjective and their accuracy depends on the outcome of future events.

While we strive to carefully monitor credit quality and to identify loans that may become nonperforming, at any time there are loans included in the portfolio that have not been identified as nonperforming or potential problem loans, but that will result in losses. We cannot be sure that we will be able to identify deteriorating loans before they become nonperforming assets, or that we will be able to limit losses on those loans that are identified. As a result, future additions to the allowance may be necessary.

Economic conditions and increased uncertainty in the financial markets could adversely affect our ability to accurately assess our allowance for credit losses. Our ability to assess the creditworthiness of our customers or to estimate the values of our assets and collateral for loans will be reduced if the models and approaches we use become less predictive of future behaviors, valuations, assumptions or estimates. We estimate losses inherent in our loan portfolio, the adequacy of our allowance for credit losses and the values of certain assets by using estimates based on difficult, subjective, and complex judgments, including estimates as to the effects of economic conditions and how those economic conditions might affect the ability of our borrowers to repay their loans or the value of assets.

Our investment securities portfolio is subject to credit risk, market risk and liquidity risk.

As of December 31, 2019, we had classified 93.5% of our debt securities as available-for-sale pursuant to the Accounting Standards Codification ("ASC") Topic 320 ("ASC 320") of the Financial Accounting Standards Board ("FASB") relating to accounting for investments. ASC 320 requires that unrealized gains and losses in the estimated value of the available-for-sale portfolio be "marked to market" and reflected as a separate item in stockholders' equity (net of tax) as accumulated other comprehensive income (loss). The remaining debt securities are classified as held-to-maturity in accordance with ASC 320 and are stated at amortized cost. Equity securities with readily determinable fair values are recorded at fair value with changes in fair value recorded in earnings.

In the past, gains on sales of investment securities have not been a significant source of income for us. There can be no assurance that future market performance of our investment portfolio will enable us to realize income from sales of securities. Stockholders' equity will continue to reflect the unrealized gains and losses (net of tax) of these investments. There can be no assurance that the market value of our investment portfolio will not decline, causing a corresponding decline in stockholders' equity.

The Bank is a member of the FHLB of Atlanta. A member of the FHLB system is required to purchase stock issued by the relevant FHLB bank based on how much it borrows from the FHLB and the quality of the collateral pledged to secure that borrowing. Accordingly, our investments include stock issued by the FHLB of Atlanta. These investments could be subject to future impairment charges and there can be no guaranty of future dividends.

Management believes that several factors will affect the market values of our investment portfolio. These risk factors include, but are not limited to, rating agency downgrades of the securities, defaults of the issuers of the securities, lack of market pricing of the securities, and instability in the credit markets. Lack of market activity with respect to some securities has, in certain circumstances, required us to base our fair market valuation on unobservable inputs. Any changes in these risk factors, in current accounting principles or interpretations of these principles could impact our assessment of fair value and thus the determination of other-than-temporary impairment of the securities in the investment securities portfolio. Write-downs of investment securities would negatively affect our earnings and regulatory capital ratios.

Impairment of investment securities, goodwill, other intangible assets, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.

We are required to record a non-cash charge to earnings when management determines that an investment security is other-than-temporarily impaired. In assessing whether the impairment of investment securities is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability to retain our investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term.

Under current accounting standards, goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. Intangible assets other than goodwill are also subject to impairment tests at least annually. A decline in the price of the Company’s common stock or occurrence of a triggering event following any of our quarterly earnings releases and prior to the filing of the periodic report for that period could, under certain circumstances, cause us to perform goodwill and other intangible assets impairment tests and result in an impairment charge being recorded for that period which was not reflected in such earnings release. In the event that we conclude that all or a portion of our goodwill or other intangible assets may be impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. At December 31, 2019, we had recorded goodwill of $17.5 million and other intangible assets of $2.3 million, representing approximately 9.1% and 1.2% of stockholders’ equity, respectively.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Assessing the need for, or the sufficiency of, a valuation allowance requires management to evaluate all available evidence, both negative and positive, including the recent trend of quarterly earnings. Positive evidence necessary to overcome the negative evidence includes whether future taxable income in sufficient amounts and character within the carryback and carryforward periods is available under the tax law, including the use of tax planning strategies. When negative evidence (e.g., cumulative losses in recent years, history of operating loss or tax credit carry forwards expiring unused) exists, more positive evidence than negative evidence will be necessary. At December 31, 2019, our deferred tax assets were approximately $4.0 million. There was a valuation allowance for deferred taxes of $63 thousand recorded at December 31, 2019 on the parent company as management believes it is more likely than not that the losses in the current year will not be realized for state income tax purposes.

Any changes in the Federal or State tax laws may negatively impact our financial performance.

We are subject to changes in tax law that could increase the effective tax rate payable to the state or federal government. These law changes may be retroactive to previous periods and as a result, could negatively affect our current and future financial performance. On December 22, 2017, President Donald Trump signed into law the Tax Cuts and Jobs Act of 2017, which among other items reduces the federal corporate tax rate to 21% from 35% effective January 1, 2018. As a result, at December 31, 2017, the Company had to revalue its deferred tax assets which resulted in a write-down of approximately $582 thousand which subsequently increased income tax expense by the same amount. Although this one-time adjustment negatively affected our 2017 earnings, the impact of a lower federal tax rate in 2018 and 2019 had a positive impact on net income.

Changes in accounting standards or interpretation of new or existing standards may affect how we report our financial condition and results of operations.

From time to time the FASB and the SEC change accounting regulations and reporting standards that govern the preparation of the Company's financial statements. In addition, the FASB, SEC, bank regulators and the outside independent auditors may revise their previous interpretations regarding existing accounting regulations and the application of these accounting standards. These changes can be hard to predict and can materially impact how to record and report our financial condition and results of operations. In some cases, there could be a requirement to apply a new or revised accounting standard retroactively, resulting in the restatement of prior period financial statements.

Our future success will depend on our ability to compete effectively in the highly competitive financial services industry.

We face substantial competition in all phases of our operations from a variety of different competitors. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, money market funds and other mutual funds, as well as other local and community, super-regional, national and international financial institutions that operate offices in our primary market areas and elsewhere. Our future growth and success will depend on our ability to compete effectively in this highly competitive financial services environment.

Many of our competitors are well-established, larger financial institutions and many offer products and services that we do not. Many have substantially greater resources, name recognition and market presence that benefit them in attracting business. Some of our competitors are not subject to the same regulations that are imposed on us, including credit unions that do not pay federal income tax, and, therefore, have regulatory advantage over us in accessing funding and in providing various services. While we believe we compete effectively with these other financial institutions in our primary markets, we may face a competitive disadvantage as a result of our smaller size, smaller asset base, lack of geographic diversification and inability to spread our marketing costs across a broader market. If we have to raise interest rates paid on deposits or lower interest rates charged on loans to compete effectively, our net interest margin and income could be negatively affected. Failure to compete effectively to attract new or to retain existing, clients may reduce or limit our net income and our market share and may adversely affect our results of operations, financial condition and growth.

Our funding sources may prove insufficient to replace deposits and support our future growth.

We rely on customer deposits, advances from the FHLB, and lines of credit at other financial institutions to fund our operations. Although we have historically been able to replace maturing deposits and advances if desired, no assurance can be given that we would be able to replace such funds in the future if our financial condition or the financial condition of the FHLB or market conditions were to change. Our financial flexibility will be severely constrained and/or our cost of funds will increase if we are unable to maintain our access to funding or if financing necessary to accommodate future growth is not available at favorable interest rates. Finally, if we are required to place greater reliance on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our profitability would be adversely affected.

In addition, the FRB has issued rules pursuant to the Dodd-Frank Act governing debit card interchange fees that apply to institutions with greater than $10 billion in assets. Although we are not subject to these rules, market forces may effectively require all banks to adopt debit card interchange fee structures that comply with these rules, in which case our non-interest income for future periods could be materially and adversely affected.

The loss of key personnel could disrupt our operations and result in reduced earnings.

Our growth and profitability will depend upon our ability to attract and retain skilled managerial, marketing and technical personnel. Competition for qualified personnel in the financial services industry is intense, and there can be no assurance that we will be successful in attracting and retaining such personnel. Our current executive officers provide valuable services based on their many years of experience and in-depth knowledge of the banking industry. Due to the intense competition for financial professionals, these key personnel would be difficult to replace and an unexpected loss of their services could result in a disruption to the continuity of operations and a possible reduction in earnings.

The cost savings that we estimate for mergers and acquisitions may not be realized.

The success of our mergers and acquisitions may depend, in part, on the ability to realize the estimated cost savings from combining the acquired businesses with our existing operations. It is possible that the potential cost savings could turn out to be more difficult to achieve than anticipated. The cost savings estimates also depend on the ability to combine the businesses in a manner that permits those cost savings to be realized. If the estimates turn out to be incorrect or there is an inability to combine successfully, the anticipated cost savings may not be realized fully or at all or may take longer to realize than expected.

Combining acquired businesses with the Bank may be more difficult, costly, or time-consuming than expected, or could result in the loss of customers.

It is possible that the process of merger integration of acquired companies could result in the loss of key employees, the disruption of ongoing business or inconsistencies in standards, controls, procedures and policies that adversely affect the ability to maintain relationships with clients and employees or to achieve the anticipated benefits of the merger or acquisition. There also may be disruptions that cause the Bank to lose customers or cause customers to withdraw their deposits. Customers may not readily accept changes to their banking arrangements or other customer relationships after the merger or acquisition.

Our lending activities subject us to the risk of environmental liabilities.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage.

Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations of enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

We may be subject to other adverse claims.

We may from time to time be subject to claims from customers for losses due to alleged breaches of fiduciary duties, errors and omissions of employees, officers and agents, incomplete documentation, the failure to comply with applicable laws and regulations, or many other reasons. Also, our employees may knowingly or unknowingly violate laws and regulations. Management may not be aware of any violations until after their occurrence. This lack of knowledge may not insulate us or our subsidiary from liability. Claims and legal actions may result in legal expenses and liabilities that may reduce our profitability and hurt our financial condition.

We depend on the accuracy and completeness of information about customers and counterparties and our financial condition could be adversely affected if we rely on misleading information.

In deciding whether to extend credit or to enter into other transactions with customers and counterparties, we may rely on information furnished to us by or on behalf of customers and counterparties, including financial statements and other financial information, which we do not independently verify. We also may rely on representations of customers and counterparties as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. For example, in deciding whether to extend credit to customers, we may assume that a customer’s audited financial statements conform with U.S. GAAP and present fairly, in all material respects, the financial condition, results of operations and cash flows of the customer. Our financial condition and results of operations could be negatively impacted to the extent we rely on financial statements that do not comply with GAAP or are materially misleading.

Our exposure to operational, technological and organizational risk may adversely affect us.

We are exposed to many types of operational risks, including reputation, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees or operational errors, clerical or record-keeping errors, and errors resulting from faulty or disabled computer or telecommunications systems.

Certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We may also be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages), which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as are we) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate.

Our information systems may experience an interruption or breach in security.

We rely heavily on communications and information systems to conduct our business. We, our customers, and other financial institutions with which we interact, are subject to ongoing, continuous attempts to penetrate key systems by individual hackers, organized criminals, and in some cases, state-sponsored organizations. Any failure, interruption or breach in security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan and other systems, misappropriation of funds, and theft of proprietary Company or customer data. While we have policies and procedures designed to prevent or limit the effect of the possible failure, interruption or security breach of our information systems, there can be no assurance that any such failure, interruption or security breach will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failure, interruption or security breach of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny, or expose us to civil litigation and possible financial liability.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners, and personally identifiable information of our customers and employees, in our data centers and on our networks. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such access, disclosure or other loss of information could result in legal claims or proceedings, liability under laws that protect the privacy of personal information, and regulatory penalties, disrupt our operations and the services we provide to customers, damage our reputation, and cause a loss of confidence in our products and services, which could adversely affect our business, revenues and competitive position.

Our reliance on third party vendors could expose us to additional cyber risk and liability.

The operation of our business involves outsourcing of certain business functions and reliance on third-party providers, which may result in transmission and maintenance of personal, confidential, and proprietary information to and by such vendors. Although we require third-party providers to maintain certain levels of information security, such providers remain vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious attacks that could ultimately compromise sensitive information possessed by our company. Although we contract to limit our liability in connection with attacks against third-party providers, we remain exposed to risk of loss associated with such vendors.

We outsource certain aspects of our data processing to certain third-party providers which may expose us to additional risk.

We outsource certain key aspects of our data processing to certain third-party providers. While we have selected these third-party providers carefully, we cannot control their actions. If our third-party providers encounter difficulties, including those which result from their failure to provide services for any reason or their poor performance of services, or if we have difficulty in communicating with them, our ability to adequately process and account for customer transactions could be affected, and our business operations could be adversely impacted. Replacing these third-party providers could also entail significant delay and expense.

Our third-party providers may be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. Threats to information security also exist in the processing of customer information through various other third-party providers and their personnel. We may be required to expend significant additional resources to protect against the threat of such security breaches and computer viruses, or to alleviate problems caused by such security breaches or viruses. To the extent that the activities of our third-party providers or the activities of our customers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have an adverse effect on our financial condition and results of operations.

Our business is highly dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. We outsource many of our major systems, such as data processing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to provide customer service, compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

In addition, we provide our customers the ability to bank remotely, including online over the Internet. The secure transmission of confidential information is a critical element of remote banking. Our network could be vulnerable to unauthorized access, computer viruses, phishing schemes, spam attacks, human error, natural disasters, power loss and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. Further, we outsource some of the data processing functions used for remote banking, and accordingly we are dependent on the expertise and performance of our third-party providers. To the extent that our activities, the activities of our customers, or the activities of our third-party service providers involve the storage and transmission of confidential information, security breaches and viruses could expose us to claims, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could adversely affect our reputation, results of operations and ability to attract and maintain customers and businesses. In addition, a security breach could also subject us to additional regulatory scrutiny, expose us to civil litigation and possible financial liability and cause reputational damage.

Technological changes affect our business, and we may have fewer resources than many competitors to invest in technological improvements.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to serving customers better, the effective use of technology may increase efficiency and may enable financial institutions to reduce costs. Our future success will depend, in part, upon our ability to use technology to provide products and services that provide convenience to customers and to create additional efficiencies in operations. We may need to make significant additional capital investments in technology in the future, and we may not be able to effectively implement new technology-driven products and services. Many of our competitors have substantially greater resources to invest in technological improvements.

Increased regulatory oversight and uncertainty relating to the LIBOR calculation process and potential phasing out of LIBOR after 2021 may adversely affect the results of our operations.

On July 27, 2017, the United Kingdom’s Financial Conduct Authority, which regulates the London Interbank Offering Rate (“LIBOR”), announced that it intends to stop persuading or compelling banks to submit rates for the calculation of LIBOR after 2021. The announcement indicates that the continuation of LIBOR on the current basis cannot and will not be guaranteed after 2021. It is impossible to predict whether and to what extent banks will continue to provide LIBOR submissions to the administrator of LIBOR, whether LIBOR rates will cease to be published or supported before or after 2021 or whether any additional reforms to LIBOR may be enacted in the United Kingdom or elsewhere. Efforts in the United States to identify a set of alternative U.S. dollar reference interest rates include proposals by the Alternative Reference Rates Committee of the Federal Reserve Board and the Federal Reserve Bank of New York. Uncertainty as to the nature of alternative reference rates and as to potential changes in other reforms to LIBOR may adversely affect LIBOR rates and the value of LIBOR-based loans, and to a lesser extent securities in our portfolio, and may impact the availability and cost of hedging instruments and borrowings, including the rates we pay on our subordinated debentures and trust preferred securities. If LIBOR rates are no longer available or do not remain an acceptable market benchmark, any successor or replacement interest rates may perform differently, which may adversely affect our revenue or our expenses. We may incur significant costs to transition both our borrowing arrangements and the loan agreements with our customers from LIBOR, which may have an adverse effect on our results of operations. Further, we may face exposure to litigation over the nature and performance of any replacement index. The impact of alternatives to LIBOR on the valuations, pricing and operation of our financial instruments is not yet known.

Risks Relating to the Regulation of our Industry

We operate in a highly regulated environment, which could restrain our growth and profitability.

We are subject to extensive laws and regulations that govern almost all aspects of our operations. These laws and regulations, and the supervisory framework that oversees the administration of these laws and regulations, are primarily intended to protect depositors, the DIF and the banking system as a whole, and not shareholders and consumers. These laws and regulations, among other matters, affect our lending practices, capital structure, investment practices, dividend policy, operations and growth. Compliance with the myriad laws and regulations applicable to our organization can be difficult and costly. In addition, these laws, regulations and policies are subject to continual review by governmental authorities, and changes to these laws, regulations and policies, including changes in interpretation or implementation of these laws, regulations and policies, could affect us in substantial and unpredictable ways and often impose additional compliance costs. Further, any new laws, rules and regulations, such as the Dodd-Frank Act and regulatory capital rules, could make compliance more difficult or expensive. All of these laws and regulations, and the supervisory framework applicable to our industry, could have a material adverse effect on our business, financial condition and results of operations.

Federal and state regulators periodically examine our business, and we may be required to remediate adverse examination findings.

The FRB and the Commissioner periodically examine our business, including our compliance with laws and regulations. If, as a result of an examination, the FRB or the Commissioner were to determine that our financial condition, capital resource, asset quality, earnings prospects, management, liquidity or other aspects of any of our operations had become unsatisfactory, or that we were in violation of any law or regulation, it may take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance and place us into receivership or conservatorship. Any regulatory action against us could have a material adverse effect on our business, financial condition and results of operations.

Our FDIC deposit insurance premiums and assessments may increase.

The deposits of the Bank are insured by the FDIC up to legal limits and, accordingly, subject to the payment of FDIC deposit insurance assessments. The Bank's regular assessments are determined by its risk classifications, which are based on its regulatory capital levels and the level of supervisory concern that it poses. High levels of bank failures since the beginning of the financial crisis and increases in the statutory deposit insurance limits have increased resolution costs to the FDIC and put significant pressure on the DIF. In order to maintain a strong funding position and restore the reserve ratios of the DIF, the FDIC increased deposit insurance assessment rates and charged a special assessment to all FDIC-insured financial institutions. Further increase in assessment rates or special assessments may occur in the future, especially if there are significant additional financial institution failures. Any future special assessments, increases in assessment rates or required prepayments in FDIC insurance premiums could reduce our profitability or limit our ability to pursue certain business opportunities, which could have a material adverse effect on our business, financial condition and results of operations.

We are subject to numerous laws designed to protect consumers, including the Community Reinvestment Act and fair lending laws, and failure to comply with these laws could lead to a wide variety of sanctions.

The CRA, the Equal Credit Opportunity Act, the Fair Housing Act and other fair lending laws and regulations impose nondiscriminatory lending requirements on financial institutions. The Department of Justice and other federal agencies are responsible for enforcing these laws and regulations. A successful regulatory challenge to an institution's performance under the CRA or fair lending laws and regulations could result in a wide variety of sanctions, including damages and civil money penalties, injunctive relief, restrictions on mergers and acquisition activity, restrictions on expansion and restrictions on entering new business lines. Private parties may also have the ability to challenge an institution's performance under fair lending laws in private class action litigation. Such actions could have a material adverse effect on our business, financial condition and results of operations.

We are subject to evolving and extensive regulations and requirements. Our failure to adhere to these requirements or the failure or circumvention of our controls and procedures could seriously harm our business.

We are subject to extensive regulation as a financial institution and are also required to follow the corporate governance and financial reporting practices and policies required of a company whose stock is registered under the Exchange Act and listed on the NASDAQ Global Select Market. Compliance with these requirements means we incur significant legal, accounting and other expenses. Compliance also requires a significant diversion of management time and attention, particularly with regard to disclosure controls and procedures and internal control over financial reporting. Although we have reviewed, and will continue to review, our disclosure controls and procedures in order to determine whether they are effective, our controls and procedures may not be able to prevent errors or frauds in the future.

Faulty judgments, simple errors or mistakes, or the failure of our personnel to adhere to established controls and procedures may make it difficult for us to ensure that the objectives of the control system will be met. A failure of our controls and procedures to detect other than inconsequential errors or fraud could seriously harm our business and results of operations.

We face a risk of noncompliance and enforcement action with the BSA and other anti-money laundering statues and regulations.

The BSA, the USA PATRIOT Act of 2001 and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to the Company's Securities

Our common stock is not insured by any governmental entity.

Our common stock is not a deposit account or other obligation of any bank and is not insured by the FDIC or any other governmental entity. Investment in our common stock is subject to risk, including possible loss.

Our ability to pay dividends is limited by law and contract.

The continued ability to pay dividends to shareholders depends in part on dividends from the Bank. The amount of dividends that the Bank may pay to the Company is limited by federal laws and regulations. The ability of the Bank to pay dividends is also subject to its profitability, financial condition and cash flow requirements. There is no assurance that the Bank will be able to pay dividends to the Company in the future. The decision may be made to limit the payment of dividends even when the legal ability to pay them exists, in order to retain earnings for other uses.

The shares of our common stock are not heavily traded.

Shares of our common stock are listed on the NASDAQ Global Select Market, but are not heavily traded. Securities that are not heavily traded can be more volatile than stock trading in an active public market. Stock price volatility may make it more difficult for you to resell your common stock when you want and at prices you find attractive. Our stock price can fluctuate significantly and may decline in response to a variety of factors including:

- Actual or anticipated variations in quarterly results of operations;
- Developments in our business or the financial sector generally;
- Recommendations by securities analysts;
- Operating and stock price performance of other companies that investors deem comparable to us;
- News reports relating to trends, concerns and other issues in the financial services industry;
- Perceptions in the marketplace regarding us or our competitors;
- New technology used or services offered by competitors;
- Significant acquisitions or business combinations, strategic partnerships, joint venture or capital commitments by or involving us or our competitors;
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions;
- Regulatory changes affecting our industry generally or our business or operations; or
- Geopolitical conditions such as acts or threats of terrorism or military conflicts.

Management cannot predict the extent to which an active public market for the shares of the common stock will develop or be sustained in the future. Accordingly, holders of shares of our common stock may not be able to sell them at the volumes, prices, or times that they desire. General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes or credit loss trends, could also cause our stock price to decrease regardless of operating results. We urge you to obtain current market quotations for our common stock when you consider investing in our common stock.

Future sales of our common stock or other securities may dilute the value and adversely affect the market price of our common stock.

In many situations, the board of directors has the authority, without any vote of our shareholders, to issue shares of authorized but unissued stock, including shares authorized and unissued under our equity incentive plans. In the future, additional securities may be issued, through public or private offerings, in order to raise additional capital. Any such issuance would dilute the percentage of ownership interest of existing shareholders and may dilute the per share book value of our common stock. In addition, option holders may exercise their options at a time when we would otherwise be able to obtain additional equity capital on more favorable terms.

Our Articles of Incorporation and By-Laws and Maryland law may discourage a corporate takeover which may make it more difficult for stockholders to receive a change in control premium.

Our Amended and Restated Articles of Incorporation, as supplemented (the "Charter"), and Amended and Restated By-Laws, as amended (the "By-Laws"), contain certain provisions designed to enhance the ability of the board of directors to deal with attempts to acquire control of us. The Charter and By-Laws provide for the classification of the board into three classes; directors of each class generally serve for staggered three-year periods. No director may be removed except for cause and then only by a vote of at least two-thirds of the total eligible stockholder votes. The Charter gives the board certain powers in respect of our securities. First, the board has the authority to classify and reclassify unissued shares of stock of any class or series of stock by setting, fixing, eliminating, or altering in any one or more respects the preferences, rights, voting powers, restrictions and qualifications of, dividends on, and redemption, conversion, exchange, and other rights of, such securities. Second, a majority of the board, without action by the stockholders, may amend the Charter to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class that we have authority to issue. The board could use these powers, along with its authority to authorize the issuance of securities of any class or series, to issue securities having terms favorable to management to persons affiliated with or otherwise friendly to management.

Maryland law also contains anti-takeover provisions that apply to us. The Maryland Business Combination Act generally prohibits, subject to certain limited exceptions, corporations from being involved in any "business combination" (defined as a variety of transactions, including a merger, consolidation, share exchange, asset transfer or issuance or reclassification of equity securities) with any "interested shareholder" for a period of five years following the most recent date on which the interested shareholder became an interested shareholder. An interested shareholder is defined generally as a person who is the beneficial owner of 10% or more of the voting power of the outstanding voting stock of the corporation after the date on which the corporation had 100 or more beneficial owners of its stock or who is an affiliate or associate of the corporation and was the beneficial owner, directly or indirectly, of 10% or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period immediately prior to the date in question and after the date on which the corporation had 100 or more beneficial owners of its stock. The Maryland Control Share Acquisition Act applies to acquisitions of "control shares," which, subject to certain exceptions, are shares the acquisition of which entitle the holder, directly or indirectly, to exercise or direct the exercise of the voting power of shares of stock of the corporation in the election of directors within any of the following ranges of voting power: one-tenth or more, but less than one-third of all voting power; one-third or more, but less than a majority of all voting power or a majority or more of all voting power. Control shares have limited voting rights. The By-Laws exempt our capital securities from the Maryland Control Share Acquisition Act, but the board has the authority to eliminate the exemption without stockholder approval.

Although these provisions do not preclude a takeover, they may have the effect of discouraging, delaying or deferring a tender offer or takeover attempt that a stockholder might consider in his or her best interest, including those attempts that might result in a premium over the market price for the common stock. Such provisions will also render the removal of the board of directors and of management more difficult and, therefore, may serve to perpetuate current management. These provisions could potentially adversely affect the market price of our common stock.

We may issue debt and equity securities that are senior to the common stock as to distributions and in liquidation, which could negatively affect the value of the common stock.

In the future, we may increase our capital resources by entering into debt or debt-like financing or issuing debt or equity securities, which could include issuances of senior notes, subordinated notes, preferred stock or common stock. In the event of our liquidation, our lenders and holders of our debt or preferred securities would receive a distribution of our available assets before distributions to the holders of our common stock. Our decision to incur debt and issue securities in future offerings will depend on market conditions and other factors beyond our control. We cannot predict or estimate the amount, timing or nature of its future offerings and debt financings. Future offerings could reduce the value of shares of our common stock and dilute a stockholder’s interest in us.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our offices are listed in the tables below. The address of the Company and Bank's main office is 18 East Dover Street in Easton, Maryland. The Company owns the real property at 28969 Information Lane in Easton, Maryland, which also houses the Operations, Information Technology, Human Resources and Finance departments of the Company and its subsidiary.

Shore United Bank

Branches

Main Office 18 East Dover Street Easton, Maryland 21601	Elliott Road Branch 8275 Elliott Road Easton, Maryland 21601	Tred Avon Square Branch 212 Marlboro Road Easton, Maryland 21601
St. Michaels Branch 1013 South Talbot Street St. Michaels, Maryland 21663	Sunburst Branch 424 Dorchester Avenue Cambridge, Maryland 21613	Centreville Branch 109 North Commerce Street Centreville, Maryland 21617
Route 213 South Branch 2609 Centreville Road Centreville, Maryland 21617	Chester Branch 300 Castle Marina Road Chester, Maryland 21619	Denton Branch 850 South 5th Avenue Denton, Maryland 21629
Grasonville Branch 202 Pullman Crossing Grasonville, Maryland 21638	Stevensville Branch 408 Thompson Creek Road Stevensville, Maryland 21666	Tuckahoe Branch 22151 WES Street Ridgely, Maryland 21660
Washington Square Branch 899 Washington Avenue Chestertown, Maryland 21620	Felton Branch 120 West Main Street Felton, Delaware 19943	Milford Branch 698-A North Dupont Boulevard Milford, Delaware 19963
Camden Branch 4580 South DuPont Highway Camden, Delaware 19934	Dover Branch 800 S. Governors Avenue Dover, Delaware 19904	Arbutus Branch 1101 Maiden Choice Lane Baltimore, MD 21229
Elkridge Branch 6050 Marshalee Drive Elkridge, MD 21075	Owings Mills Branch 9612 Reisterstown Road Owings Mills, MD 21117	Onley Branch 25306 Lankford Highway Onley, VA 23418

ATMs

Memorial Hospital at Easton 219 South Washington Street Easton, Maryland 21601	Talbottown 218 North Washington Street Easton, Maryland 21601

Offices

Division Office - Wye Financial & Trust 16 North Washington Street, Suite 1 Easton, Maryland 21601	Loan Production Office – Middletown 651 North Broad Street Suite 201 Middletown, Delaware 19709	Loan Production Office – Ocean City 9748 Stephen Decatur Highway Unit 104 Ocean City, Maryland 21842
Administrative Office – 28969 Information Lane Easton, Maryland 21601	Administrative Office – 23 South Harrison Street Easton, Maryland 21601	

The Bank owns the real property on which all of its Maryland offices are located, except that it operates under leases at its St. Michaels branch, loan production office in Ocean City and the office of Wye Financial and Trust in Easton. The Bank leases the real property on which all of its Delaware offices are located, except that it owns the real property on which the Camden and Dover Branches are located. The Bank operates under a lease at its Onley branch in Virginia. For information about rent expense for all leased premises, see Note 5 to the Consolidated Financial Statements appearing in Item 8 of Part II of this annual report.

Item 3. Legal Proceedings.

We are at times, in the ordinary course of business, subject to legal actions. Management, upon the advice of counsel, believes that losses, if any, resulting from current legal actions will not have a material adverse effect on our financial condition or results of operations.

Item 4. Mine Safety Disclosures.

This item is not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

MARKET INFORMATION, HOLDERS AND CASH DIVIDENDS

The shares of the Company’s common stock are listed on the NASDAQ Global Select Market under the symbol “SHBI”. As of February 28, 2019, the Company had approximately 1,648 registered holders of record.

Shareholders received quarterly cash dividends on shares of common stock totaling $5.3 million in 2019 and $4.1 million in 2018. Dividends increased from 2018 due to the Company’s improved operating results from continuing operations and excess capital. As a general matter, the payment of dividends is at the discretion of the Company’s Board of Directors, based on such factors as operating results, financial condition, capital adequacy, regulatory requirements, and stockholder return. The Company anticipates continuing a regular quarterly cash dividend. However, we have no obligation to pay dividends and we may change our dividend policy at any time without notice to shareholders. Any future determination to pay dividends to holders of our common stock will depend on our results of operations, financial condition, capital requirements, banking regulations, contractual restrictions and any other factors that our board of directors may deem relevant.

The transfer agent for the Company’s common stock is:

Broadridge
51 Mercedes Way
Edgewood, NY 11717
Investor Relations: 1-800-353-0103
E-mail for investor inquiries: shareholder@broadridge.com .
www.broadridge.com

EQUITY COMPENSATION PLAN INFORMATION

The following table contains information about these equity compensation plans as of December 31, 2019.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants, and rights (b)	Number of securities remaining available for future issuance under equity compensation plans [excluding securities reflected in column (a)] (c)
Equity compensation plans approved by security holders(1)	11,671	9.25	636,465
Equity compensation plans approved by security holders(1)	—	—	—
Total	11,671	9.25	636,465

(1) In addition to stock options and stock appreciation rights, the 2016 Plan permits the grant of stock awards, stock units, and performance units, and the shares available for issuance shown in column (c) may be granted pursuant to such awards. Subject to the anti-dilution provisions of the Omnibus Plan, the maximum number of shares of restricted stock that may be granted to any participant in any calendar year is 50,000; the maximum number of restricted stock units that may be granted to any one participant in any calendar year is 30,000; and the maximum dollar value of

performance units that may be granted to any one participant in any calendar year is $1,000,000. As of December 31, 2019, the Company has granted 213,511 shares of restricted stock and 106,494 in restricted stock units that are not reflected in column (a) of this table.

All other information required by this item is incorporated herein by reference to the section of the Company's definitive proxy statement to be filed in connection with the 2020 Annual Meeting of Stockholders entitled "Beneficial Ownership of Common Stock".

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered sales of the Company's stock during the fourth quarter of 2019.

On April 24, 2019 the Corporation's Board of Directors approved a stock repurchase program. Under the stock repurchase program, the Corporation is authorized to repurchase up to $10 million, or approximately 5%, of its common stock for 2019 and 2020. The program may be limited or terminated at any time without prior notice. During the three months ended December 31, 2019, the Corporation repurchased 242,000 shares under the recently approved stock repurchase program.

The following table provides information with respect to purchases made by or on behalf of us or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the fourth quarter of 2019.

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of the Publicly Announced Plans or Programs	Maximum Dollar Value Of Shares that May Yet Be Purchased Under the Plans or Programs
October 1, 2019 to October 31, 2019	54,400	$ 15.30	54,400	$ 8,609,504
November 1, 2019 to November 30, 2019	187,600	16.30	187,600	5,551,624
December 1, 2019 to December 31, 2019	—	—	—	5,551,624
Total	242,000	$ 15.97	242,000	

Item 6. Selected Financial Data

Not required.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion compares the Company's financial condition at December 31, 2019 to its financial condition at December 31, 2018 and the results of operations for the years ended December 31, 2019 and 2018. This discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto appearing in Item 8 of Part II of this annual report.

PERFORMANCE OVERVIEW

The Company recorded net income of $16.20 million for 2019 and net income of $25.00 million for 2018. The Company recorded net income from continuing operations of $16.28 million for 2019 and net income from continuing operations of $15.76 million for 2018, which excludes the sale of the Company's retail insurance business, Avon Dixon, LLC("Avon") on December 31, 2018 for net proceeds of $25.2 million and a net gain after tax of $9.2 million. The basic and diluted income per share was $1.27 which was comprised of $1.28 from continuing operations and ($.01) from discontinued operations for 2019 and $1.24 from continuing operations and $0.72 from discontinued operations for 2018. When comparing net income from continuing operations for 2019 to 2018, earnings improved due to an increase in noninterest income and a lower provision for credit losses, partially offset by lower net interest income and higher noninterest expenses.

Total assets were $1.559 billion at December 31, 2019, a $76.2 million, or 5.1%, increase when compared to the $1.483 billion at December 31, 2018. The primary factors contributing to the increase were increases in gross loans of $53.3 million, interest-bearing deposits with other banks of $25.6 million and other assets of $22.9 million which included the purchase of $26.5 million in bank owned life insurance ("BOLI") during 2019, partially offset by decreases of $31.6 million in investment securities.

Total deposits increased $129.0 million, or 10.6% to $1.341 billion at December 31, 2019. The increase was due to increases in rates paid on core deposits as well as rate specials on time deposits. Total stockholders' equity increased $9.6 million, or 5.2%, to $192.8 million, or 12.37% of total assets at December 31, 2019. The increase in total stockholders' equity was primarily due to current year earnings and other comprehensive income, which primarily consisted of unrealized gains in available-for-sale securities for 2019, compared to unrealized losses in 2018.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with GAAP and follow general practices within the industries in which it operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported.

The most significant accounting policies that the Company follows are presented in Note 1 to the Consolidated Financial Statements. These policies, along with the disclosures presented in the notes to the financial statements and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has determined that the accounting policies with respect to the allowance for credit losses and goodwill and other intangible assets are critical accounting policies. These policies are considered critical because they relate to accounting areas that require the most subjective or complex judgments, and, as such, could be most subject to revision as new information becomes available.

The allowance for credit losses represents management's estimate of credit losses inherent in the loan portfolio as of the balance sheet date. Determining the amount of the allowance for credit losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of similar loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheets. Note 1 to the Consolidated Financial Statements describes the methodology used to determine the allowance for credit losses. A discussion of the allowance determination and factors driving changes in the amount of the allowance for credit losses is included in the Asset Quality - Provision for Credit Losses and Risk Management section below.

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. Goodwill and other intangible assets are required to be recorded at fair value at inception. Determining fair value is subjective, requiring the use of estimates, assumptions and management judgment. Goodwill is tested at least annually for impairment, usually during the fourth quarter, or on an interim basis if circumstances dictate. Intangible assets that have finite lives are amortized over their estimated useful lives and also are subject to impairment testing. Impairment testing requires a qualitative assessment or that the fair value of each of the Company's reporting units be compared to the carrying amount of its net assets, including goodwill. If the fair value of a reporting unit is less than book value, an expense may be required to write down the related goodwill to record an impairment loss. As of December 31, 2019, the Company had only one banking reporting unit.

RECENT ACCOUNTING PRONOUNCEMENTS AND DEVELOPMENTS

The Notes to the Consolidated Financial Statements discuss new accounting policies that the Company adopted during 2019 and the expected impact of accounting policies recently issued or proposed but not yet required to be adopted. To the extent the adoption of new accounting standards materially affects our financial condition, results of operations or liquidity, the impacts are discussed in the applicable section(s) of this discussion and Notes to the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Net Interest Income and Net Interest Margin

Net interest income remains the most significant factor affecting our results of operations. Net interest income represents the excess of interest and fees earned on total average earning assets (loans, investment securities, federal funds sold and interest-bearing deposits with other banks) over interest owed on average interest-bearing liabilities (deposits and borrowings). Tax-equivalent net interest income is net interest income adjusted for the tax-favored status of income from certain loans and investments. As shown in the table below, tax-equivalent net interest income for 2019 was $50.3 million. This represented a $455 thousand, or less than 1%, decrease from 2018. Net interest income increased $5.0 million, or 10.9%, for 2018 when compared to 2017. The decrease in net interest income when comparing 2019 to 2018 was primarily the result of higher average balances and rates paid on interest-bearing deposits, partially offset by higher average balances and yields on loans. The increase in net interest income when comparing 2018 to 2017 was primarily due to funding loan growth with lower yielding assets and, to a lesser extent a higher overall yield on earning assets. When comparing 2019 to 2018, interest income increased $3.9 million while interest expense increased $4.4 million. When comparing 2018 to 2017, interest income increased $8.0 million while interest expense increased $3.0 million.

Our net interest margin (i.e., tax-equivalent net interest income divided by average earning assets) represents the net yield on earning assets minus the cost of average interest liabilities. The net interest margin is managed through loan and deposit pricing and asset/liability strategies. The net interest margin was 3.54% for 2019 and 3.74% for 2018. The net interest margin decreased when comparing 2019 to 2018 due to the significant increase in the average balance of interest-bearing deposits in conjunction with higher rates paid on these deposits, partially offset by an improvement in the yield on total earning assets and a reduction in the average balance of short-term borrowings. The net interest margin was stable in 2018 and 2017. The net interest spread, which is the difference between the average yield on earning assets and the rate paid for interest-bearing liabilities, was 3.20% for 2019, 3.57% for 2018 and 3.67% for 2017.

The following table sets forth the major components of net interest income, on a tax-equivalent basis, for the years ended December 31, 2019, 2018, and 2017.

	2019			2018			2017		
(Dollars in thousands)	Average Balance	Interest (1)	Yield/ Rate	Average Balance	Interest (1)	Yield/ Rate	Average Balance	Interest (1)	Yield/ Rate
Earning assets									
Loans (2), (3)	**$1,226,361**	**$55,553**	**4.53 %**	$1,153,169	$51,446	4.46 %	$ 983,484	$43,857	4.46 %
Investment securities:									
Taxable	**156,383**	**3,582**	**2.29**	189,879	4,289	2.26	201,792	3,847	1.91
Tax-exempt	—	—	—	—	—	—	87	5	5.42
Interest-bearing deposits	**39,944**	**794**	**1.99**	14,707	286	1.94	30,819	334	1.08
Total earning assets	**1,422,688**	**59,929**	**4.21 %**	1,357,755	56,021	4.13 %	1,216,182	48,043	3.95 %
Cash and due from banks	**18,241**			17,327			15,896		
Other assets	**68,399**			71,110			64,854		
Allowance for credit losses	**(10,425)**			(10,278)			(9,181)		
Total assets	**$1,498,903**			$1,435,914			$1,287,751		
Interest-bearing liabilities									
Demand deposits	**$ 252,907**	**1,735**	**0.69 %**	$ 215,600	700	0.32 %	$ 210,139	415	0.20 %
Money market and savings deposits	**389,000**	**2,782**	**0.72**	378,344	1,024	0.27	339,971	417	0.12
Brokered Deposits	**16,369**	**388**	**2.37**	14,844	315	2.12	—	—	—
Certificates of deposit $100,000 or more	**113,017**	**1,839**	**1.63**	98,331	654	0.67	118,723	605	0.51
Other time deposits	**146,344**	**1,982**	**1.35**	146,492	838	0.57	152,959	805	0.53
Interest-bearing deposits	**917,637**	**8,726**	**0.95**	853,611	3,531	0.41	821,792	2,242	0.27
Short-term borrowings	**18,453**	**481**	**2.61**	77,311	1,636	2.12	4,525	31	0.68
Long-term debt	**15,000**	**429**	**2.86**	3,616	105	2.89	—	—	—
Total interest-bearing liabilities	**951,090**	**9,636**	**1.01 %**	934,538	5,272	0.56 %	826,317	2,273	0.28 %
Noninterest-bearing deposits	**348,665**			326,677			296,283		
Other liabilities	**9,009**			5,917			5,410		
Stockholders' equity	**190,139**			168,782			159,741		
Total liabilities and stockholders' equity	**$1,498,903**			$1,435,914			$1,287,751		
Net interest spread		**$50,293**	**3.20 %**		$50,749	3.57 %		$45,770	3.67 %
Net interest margin			**3.54 %**			3.74 %			3.76 %

(1) All amounts are reported on a tax-equivalent basis computed using the statutory federal income tax rate of 21% for 2019 and 21% for 2018 and 35% for 2017, exclusive of the alternative minimum tax rate and nondeductible interest expense. The tax-equivalent adjustment amounts used in the above table to compute yields aggregated $162 thousand in 2019, $114 thousand in 2018 and $242 thousand in 2017.

(2) Average loan balances include nonaccrual loans.

(3) Interest income on loans includes amortized loan fees, net of costs, and all are included in the yield calculations.

On a tax-equivalent basis, total interest income was $59.9 million for 2019 compared to $56.0 million for 2018. The increase in interest income for 2019 compared to 2018 was primarily due to the increase in the average balance and yields on loans. For 2019 compared to 2018, the average balance of loans increased $73.2 million and the yield earned on these loans improved to 4.53% from 4.46%. The increased volume of loans coupled with a disciplined effort to maintain and attempt to improve rates on new loan originations resulted in an increase in tax-equivalent interest income of $4.1 million. Interest income on interest-bearing deposits with other banks increased $508 thousand or 177.6%, partially offset by a reduction in the average balance on taxable investment securities in 2019 compared to 2018.

On a tax-equivalent basis, total interest income was $56.0 million for 2018 compared to $48.0 million for 2017. The increase in interest income for 2018 compared to 2017 was primarily due to the increase in the average balance of loans coupled with a higher yield on taxable investment securities. Interest income on taxable investment securities increased

$442 thousand or 11.5% in 2018 compared to 2017. For 2018 compared to 2017, average loans increased $169.7 million and the yield earned on loans remained flat at 4.46%. The increased volume of loans coupled with a disciplined effort to maintain and attempt to improve rates on new loan originations resulted in an increase in tax-equivalent interest income of $7.6 million. Also impacting interest income is the accretion of acquisition accounting adjustments from the branch acquisition in 2017 for loans of $319 thousand and $506 thousand for 2018 and 2017, respectively, which is accounted for using a level yield method.

As a percentage of total average earning assets, loans, investment securities, and interest-bearing deposits were 86.2%, 11.0%, and 2.8%, respectively, for 2019 which reflected an increase in higher yielding earning assets as well as excess liquidity over 2018. The comparable percentages for 2018 were 84.9%, 14.0%, and 1.1%, respectively, and for 2017 were 80.9%, 16.6%, and 2.5%, respectively. When comparing 2019 to 2018, the overall increase in average balances of earning assets produced $3.9 million more in interest income the result of an increasing yield on loans, coupled with higher average balances in interest-bearing deposits, as seen in the Rate/Volume Variance Analysis below. When comparing 2018 to 2017, the overall increase in average balances of earning assets produced $7.1 million more in interest income the result of a stable yield on loans, coupled with higher yields on taxable investment securities and interest-bearing deposits which produced $860 thousand more in interest income, as seen in the Rate/Volume Variance Analysis below.

Interest expense was $9.6 million for 2019 compared to $5.3 million for 2018. The increase in interest expense for 2019 was primarily due to increases in the average balances and rates paid on interest-bearing deposits, partially offset by a reduction in the average balances on short-term borrowings. During 2019 demand deposits, money market/savings deposits and certificates of deposit over $100 thousand experienced the most significant growth with increases in the average balances of $37.3 million, $10.7 million and $14.7 million, respectively, while the rates paid on these deposits increased 37, 45 and 96 bps, respectively. Alternatively, the average balances on short-term borrowings decreased $58.9 million when compared to 2018, with a rate of 2.61% and 2.12%, respectively.

Interest expense was $5.3 million for 2018 compared to $2.3 million for 2017. The increase in interest expense for 2018 was primarily due to increases in short and long-term borrowings, rates paid on interest-bearing deposits and the addition of brokered deposits. The average balances on short-term and long-term deposits increased $72.8 million and $3.6 million when compared to 2017, with a rate of 2.12% and 2.89%, respectively. Additionally, brokered deposits were added during 2018 resulting in an average balance of $14.8 million with a rate of 2.12%. Both demand deposits and money market/savings deposits experienced growth with increases in average balances of $5.5 million and $38.4 million, respectively, while the rates paid on these deposits increased 12 and 15 bps, respectively. Also impacting interest expense is the accretion of acquisition accounting adjustments from the branch acquisition in 2017 for CD’s of $275 thousand.

During 2019, higher rates on interest-bearing liabilities produced $5.5 million more in interest expense and decreased volume produced $1.1 million less in interest expense, as shown in the table below. In 2018, higher rates on interest-bearing liabilities produced $1.2 million more in interest expense and increased volume produced $1.8 million more in interest expense.

The following Rate/Volume Variance Analysis identifies the portion of the changes in tax-equivalent net interest income attributable to changes in volume of average balances or to changes in the yield on earning assets and rates paid on interest-bearing liabilities. The rate and volume variance for each category has been allocated on a consistent basis between rate and volume variances, based on a percentage of rate, or volume, variance to the sum of the absolute two variances.

	2019 over (under) 2018			2018 over (under) 2017		
	Total	Caused By		Total	Caused By	
(Dollars in thousands)	Variance	Rate	Volume	Variance	Rate	Volume
Interest income from earning assets:						
Loans	**$ 4,107**	**$ 795**	**$ 3,312**	$ 7,589	$ —	$ 7,589
Taxable investment securities	**(707)**	**58**	**(765)**	442	679	(237)
Tax-exempt investment securities	**—**	**—**	**—**	(5)	—	(5)
Interest-bearing deposits	**508**	**7**	**501**	(48)	181	(229)
Total interest income	**3,908**	**860**	**3,048**	7,978	860	7,118
Interest expense on deposits and borrowed funds:						
Interest-bearing demand deposits	**1,034**	**936**	**98**	285	275	10
Money market and savings deposits	**1,758**	**1,729**	**29**	607	566	41
Brokered deposits	**73**	**67**	**6**	315	—	315
Time deposits	**2,329**	**2,249**	**80**	82	173	(91)
Short-term borrowings	**(1,155)**	**504**	**(1,659)**	1,605	186	1,419
Long-term debt	**324**	**(1)**	**325**	105	—	105
Total interest expense	**4,363**	**5,484**	**(1,121)**	2,999	1,200	1,799
Net interest income	**$ (455)**	**$ (4,624)**	**$ 4,169**	$ 4,979	$ (340)	$ 5,319

Noninterest Income

Noninterest income, excluding discontinued operations, increased $1.0 million, or 11.2%, in 2019 when compared to 2018. The increase in noninterest income in 2019 when compared to 2018 was primarily due to increases in other noninterest income of $1.0 million which was attributed to other loan and bank services fees for a combined $613 thousand, coupled with income from BOLI of $443 thousand, partially offset by lower trust and investment fee income of $35 thousand. The bank services fees increased due to a conscience effort by management to implement cross-selling services and products within our branch network. The increase in BOLI assets were attributed to the purchase of $26.5 million of additional insurance contracts during December of 2019 which will be used to offset future employee compensation benefit costs.

The following table summarizes our noninterest income from continuing operations for the years ended December 31.

	Years Ended		Change from Prior Year	
			2019/ 18	
(Dollars in thousands)	**2019**	2018	Amount	Percent
Service charges on deposit accounts	**$ 3,910**	$ 3,879	**$ 31**	**0.8 %**
Trust and investment fee income	**1,522**	1,557	**(35)**	**(2.2)**
Other noninterest income	**4,588**	3,577	**1,011**	**28.3**
Total	**$ 10,020**	$ 9,013	**$ 1,007**	**11.2**

Noninterest income from discontinued operations, excluding the gain on sale of Avon on December 31, 2018, decreased $9.3 million, or 99.8% when compared to 2018. The decrease in noninterest income from discontinued operations was primarily due to insurance agency commissions from Avon of $9.0 million in 2018. The sale of Avon resulted in a net gain before tax of $12.7 million for 2018.

Noninterest Expense

Noninterest expense, excluding discontinued operations, increased $726 thousand, or 2.0%, in 2019 when compared to 2018. The increase in noninterest expenses was primarily due to higher employee benefits of $1.3 million, due to an increase in medical claims from the Company’s self-funded insurance program and the additional of supplemental executive retirement plans (“SERPs”) during 2019, data processing of $459 thousand, the result of utilizing additional services from our core processor, legal and professional fees of $242 thousand and other noninterest expenses of $265 thousand, partially offset by decreases in salaries and wages of $1.1 million, the result of amortization of intangible assets of $261 thousand and FDIC insurance premiums of $427 thousand. The reduction in salaries and wages was primarily due to the reduction of a senior executive position at the beginning of 2019, coupled with the elimination of the long-term incentive plan during 2019 which was replaced by SERPs mentioned above.

Noninterest expense from discontinued operations, decreased $7.9 million, or 98.4% when compared to 2018. The decrease in noninterest expense was primarily attributable to the sale of Avon on December 31, 2018 and was primarily concentrated in salaries and wages of $5.1 million and employee benefits of $1.2 million related to Avon in 2018.

The Company had 294 full-time equivalent employees at December 31, 2019, 343 full-time equivalent employees at December 31, 2018 and 327 full-time equivalent employees at December 31, 2017.

The following table summarizes our noninterest expense from continuing operations for the years ended December 31.

	Years Ended		Change from Prior Year	
			2019/ 18	
(Dollars in thousands)	**2019**	**2018**	**Amount**	**Percent**
Salaries and wages	**$ 15,413**	$ 16,535	**$ (1,122)**	**(6.8)%**
Employee benefits	**5,283**	4,001	**1,282**	**32.0**
Occupancy expense	**2,758**	2,622	**136**	**5.2**
Furniture and equipment expense	**1,107**	950	**157**	**16.5**
Data processing	**3,790**	3,331	**459**	**13.8**
Directors’ fees	**479**	556	**(77)**	**(13.8)**
Amortization of intangible assets	**605**	866	**(261)**	**(30.1)**
FDIC insurance premium expense	**344**	771	**(427)**	**(55.4)**
Other real estate owned expenses, net	**425**	353	**72**	**20.4**
Legal and professional fees	**2,223**	1,981	**242**	**12.2**
Other noninterest expenses	**5,130**	4,865	**265**	**5.4**
Total	**$ 37,557**	$ 36,831	**$ 726**	**2.0**

Income Taxes

The Company reported an income tax expense for continuing operations of $5.6 million for 2019, compared to an income tax expense for continuing operations of $5.4 million for 2018. The effective tax rate for continuing operations was 25.6% for 2019 and 25.4% for 2018. The Company’s effective tax rate remained relatively unchanged for 2019 compared to 2018. Please refer to Note 16 of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K for further information.

REVIEW OF FINANCIAL CONDITION

Asset and liability composition, capital resources, asset quality, market risk, interest sensitivity and liquidity are all factors that affect our financial condition. The following sections discuss each of these factors.

Assets

Interest-Bearing Deposits with Other Banks and Federal Funds Sold

The Company invests excess cash balances (i.e., the excess cash remaining after funding loans and investing in securities with deposits and borrowings) in interest-bearing accounts and federal funds sold offered by our correspondent banks. These liquid investments are maintained at a level that management believes is necessary to meet current liquidity needs. Total interest-bearing deposits with other banks increased $25.6 million from $50.9 million at December 31, 2018 to $76.5 million at December 31, 2019. This significant increase was the result of deposit growth of $129.9 million, or 10.6%. Average interest-bearing deposits with other banks increased $25.2 million in 2019 when compared to 2018. The increase in 2019 was due to higher average balances on interest and noninterest-bearing deposits of $64.0 million and $22.0 million, respectively.

Investment Securities

The investment portfolio is structured to provide us with liquidity and also plays an important role in the overall management of interest rate risk. Investment securities available for sale are stated at estimated fair value based on quoted prices and may be sold as part of the asset/liability management strategy or which may be sold in response to changing interest rates. Net unrealized holding gains and losses on available for sale debt securities are reported net of related income taxes as accumulated other comprehensive income, a separate component of stockholders' equity. Investment securities in the held to maturity category are stated at cost adjusted for amortization of premiums and accretion of discounts. We have the intent and current ability to hold such securities until maturity. At December 31, 2019, 94% of the portfolio was classified as available for sale and 6% as held to maturity, similar to the 96% and 4%, respectively, at December 31, 2018. The percentage of securities designated as available for sale reflects the amount that management believes is needed to support our anticipated growth and liquidity needs. With the exception of municipal securities and corporate securities, our general practice is to classify all newly-purchased debt securities as available for sale. On September 16, 2019, the Company bought a $4.0 million corporate bond which it intends to hold to maturity of September 16, 2027. We do not typically invest in derivative securities and held no such investments at December 31, 2019 or December 31, 2018. Total investment securities decreased $31.1 million from $168.2 million at December 31, 2018 to $137.1 million at December 31, 2019. Average investment securities decreased $33.5 million in 2019.

Investment securities available for sale were $122.8 million at the end of 2019 and $154.4 million at the end of 2018. The Company purchased no available for sale securities in 2019 or 2018. The Company purchased a corporate bond of $4.0 million in the third quarter of 2019 which is classified as held to maturity and there were no purchases of held to maturity securities in 2018. At year-end 2019, 19.4% of the available for sale securities in the portfolio were U.S. Government agencies and 80.6% of the securities were mortgage-backed securities, compared to 21.0% and 79.0%, respectively, at year-end 2018. As seen in the table below, 43% of the available-for-sale portfolio will mature in over five through ten years and 37% will mature in over ten years based on contractual maturities. The comparable amounts for 2018 were 40% and 38%, respectively. Our investments in mortgage-backed securities are issued or guaranteed by U.S. Government agencies or government-sponsored agencies.

Investment securities held to maturity totaled $8.8 million at December 31, 2019. The comparable amount was $6.0 million at December 31, 2018.

The following table sets forth the maturities and weighted average yields of the bond investment portfolio as of December 31, 2019.

	1 Year or Less		1-5 Years		5-10 Years		Over 10 Years	
(Dollars in thousands)	Carrying Amount	Average Yield	Carrying Amount	Average Yield	Carrying Amount	Average Yield	Carrying Amount	Average Yield
Available for sale:								
U.S. Government agencies	$14,005	1.74 %	$ 8,973	1.54 %	$ —	— %	$ 848	4.16 %
Mortgage-backed	—	—	1,450	1.45	53,153	2.20	44,362	2.19
Total available for sale	$14,005	1.74	$10,423	1.53	$53,153	2.20	$45,210	2.23
Held to maturity:								
U.S. Government agencies	$ —	— %	$ —	— %	$ —	— %	$ 1,386	2.08 %
States and political subdivisions[1]	—	—	400	5.20	—	—	—	—
Other Debt Securities	—	—	—	—	7,000	4.21	—	—
Total held to maturity	$ —	—	$ 400	5.20	$ 7,000	4.21	$ 1,386	2.08

1 Yields have been adjusted to reflect a tax equivalent basis using the statutory federal tax rate of 21%.

Loans

The loan portfolio is the primary source of our income. Loans totaled $1.2 billion at December 31, 2019, an increase of $53.3 million, or 4.5%, from 2018. Most of our loans are secured by real estate and are classified as construction, residential or commercial real estate loans. The increase in loans was comprised of increases in commercial real estate loans of $63.1 million, or 12.1%, residential real estate loans of $12.9 million, or 3.0% and consumer loans of $10.5 million, or 143.8% at December 31, 2019 compared to December 31, 2018. These increases were partially offset by a decrease of $28.3 million, or 22.2% in construction loans. At December 31, 2019, the loan portfolio was comprised of 8.0% construction, 35.4% residential real estate and 47.0% commercial real estate. That compares to 10.7%, 35.9% and 43.8%, respectively, at December 31, 2018. Commercial and consumer loans were 8.2% and 1.4%, respectively, of the portfolio at December 31, 2019 and 9.0% and 0.6%, respectively, at December 31, 2018. At December 31, 2019, 75.5% of the loan portfolio had fixed interest rates and 24.5% had adjustable interest rates, compared to 73.3% and 26.7%, respectively, at December 31, 2018. See the discussion below under the caption "Asset Quality - Provision for Credit Losses and Risk Management" and Note 4, "Loans and Allowance for Credit Losses", in the Notes to Consolidated Financial Statements for additional information. At December 31, 2019 and 2018, the Company did not have any loans held for sale. We do not engage in foreign or subprime lending activities.

The table below sets forth trends in the composition of the loan portfolio over the past five years (including net deferred loan fees/costs).

	December 31,									
(Dollars in thousands)	2019		2018		2017		2016		2015	
Construction	**$ 99,829**	**8.0 %**	$ 127,572	10.7 %	$ 125,746	11.5 %	$ 84,002	9.6 %	$ 85,632	10.8 %
Residential real estate	**442,506**	**35.4**	429,560	35.9	399,190	36.5	325,768	37.4	307,063	38.6
Commercial real estate	**586,562**	**47.0**	523,427	43.8	464,887	42.5	382,681	43.9	330,253	41.5
Commercial	**102,020**	**8.2**	107,522	9.0	97,284	8.9	72,435	8.3	64,911	8.2
Consumer	**17,737**	**1.4**	7,274	0.6	6,407	0.6	6,639	0.8	7,255	0.9
Total	**$1,248,654**	**100.0 %**	$1,195,355	100.0 %	$1,093,514	100.0 %	$871,525	100.0 %	$795,114	100.0 %

The table below sets forth the maturities and interest rate sensitivity of the loan portfolio at December 31, 2019.

(Dollars in thousands)	Maturing within one year	Maturing after one but within five years	Maturing after five years	Total
Construction	$ 52,241	$ 37,809	$ 9,779	$ 99,829
Residential real estate	37,535	57,541	347,430	442,506
Commercial real estate	70,644	220,955	294,963	586,562
Commercial	14,111	30,770	57,139	102,020
Consumer	2,010	13,278	2,449	17,737
Total	$ 176,541	$ 360,353	$ 711,760	$ 1,248,654
Rate terms:				
Fixed-interest rate loans	$ 149,259	$ 342,157	$ 450,697	$ 942,113
Adjustable-interest rate loans	27,282	18,196	261,063	306,541
Total	$ 176,541	$ 360,353	$ 711,760	$ 1,248,654

Liabilities

Deposits

The Bank uses deposits primarily to fund loans and to purchase investment securities. Total deposits increased from $1.21 billion at December 31, 2018 to $1.34 billion at December 31, 2019 due to increases in every deposit product, with the exception of brokered deposits, which were zero at December 31, 2019. The increases in deposit products consisted of the following: interest-bearing checking deposits of $62.4 million, noninterest-bearing deposits of $26.2 million, time deposits greater than $100 thousand of $29.7 million, savings and money market accounts of $24.0 million and other time deposits of $8.8 million. Average interest-bearing deposits increased $64.0 million, or 7.5%, in 2019, compared to an increase of $31.8 million, or 3.9% in 2018. Average certificates of deposit and other time deposits increased $14.5 million, or 5.9% in 2019, compared to a decrease of $26.9 million, or 9.9% in 2018. Average noninterest-bearing deposits increased $22.0 million, or 6.7%, in 2019, compared to an increase of $30.4 million, or 10.3% in 2018. Deposits provided funding for approximately 89.0% and 86.9% of average earning assets for 2019 and 2018, respectively.

Average deposits increased for 2018 primarily in interest-bearing deposits of $31.8 million as well as an increase in noninterest-bearing deposits of $30.4 million, partially offset by a decline in certificates of deposit and other time deposits of $26.9 million.

The following table sets forth the average balances of deposits and the percentage of each category to total average deposits for the years ended December 31, 2019, 2018, and 2017.

	Average Balances					
(Dollars in thousands)	**2019**		2018		2017	
Noninterest-bearing demand	**$ 348,665**	**27.5 %**	$ 326,677	27.7 %	$ 296,283	26.5 %
Interest-bearing deposits						
Demand	**252,907**	**20.0**	215,600	18.3	210,139	18.8
Money market and savings	**389,000**	**30.7**	378,344	32.1	339,971	30.4
Brokered deposits	**16,369**	**1.3**	14,844	1	—	—
Certificates of deposit, $100,000 to $249,999	**81,696**	**6.5**	74,652	6.3	91,373	8.2
Certificates of deposit, $250,000 or more	**31,321**	**2.5**	23,679	2.0	27,350	2.4
Other time deposits	**146,344**	**11.5**	146,492	12.4	152,959	13.7
Total	**$ 1,266,302**	**100.0 %**	$ 1,180,288	100.0 %	$ 1,118,075	100.0 %

The following table sets forth the maturity ranges of certificates of deposit with balances of $250,000 or more as of December 31, 2019.

(Dollars in thousands)	
Three months or less	$ 1,210
Over three through 6 months	1,020
Over 6 through 12 months	12,337
Over 12 months	24,358
Total	$ 38,925

Short-Term Borrowings

Short-term borrowings generally consist of securities sold under agreements to repurchase and short-term borrowings from the FHLB. Securities sold under agreements to repurchase are issued in conjunction with cash management services for commercial depositors. We also borrow from the FHLB on a short-term basis and occasionally borrow from correspondent banks under federal fund lines of credit arrangements to meet short-term liquidity needs. At December 31, 2019 short-term borrowings included repurchase agreements and at December 31, 2018 short-term borrowings included advances and repurchase agreements.

The average balance of short-term borrowings decreased $58.9 million, or 76.1%, in 2019, while the average balance increased $72.8 million, or 1,608.5%, in 2018. While short-term borrowings were used to supplement deposits as a funding source in 2019 and 2018 the need for this funding source in 2019 was greatly reduced as a result of the increase in deposits in 2019.

The following table sets forth our position with respect to short-term borrowings at or for the periods presented.

	2019		2018		2017	
(Dollars in thousands)	Balance	Interest Rate	Balance	Interest Rate	Balance	Interest Rate
Average outstanding for the year	**$ 18,453**	**2.61 %**	$ 77,311	2.12 %	$ 4,525	0.68 %
Outstanding at year end	**1,226**	**0.81**	60,812	2.62	21,734	1.36
Maximum outstanding at any month end	**41,093**	**—**	113,418	—	21,734	—

Long-Term Debt

The Company uses long-term borrowings to meet longer term liquidity needs, specifically to fund loan growth when liquidity from deposit growth is not sufficient. The Company had $15.0 million outstanding at the end of 2019 and 2018. The $15.0 million in fixed rate long-term borrowings from Federal Home Loan Bank carries an interest rate of 2.82% and will mature in April 2020.

Capital Resources Management

Total stockholders' equity for the Company was $192.8 million at December 31, 2019, compared to $183.2 million at December 31, 2018. The increase in stockholders' equity in 2019 was primarily due to current year earnings and accumulated other comprehensive income, which primarily consisted of unrealized gains in available-for-sale securities, which was partially offset by dividends paid to common stockholders and stock repurchases. The ratio of period-end equity to total assets was 12.37% for 2019, as compared to 12.35% for 2018.

We record unrealized holding gains (losses), net of tax, on investment securities available for sale as accumulated other comprehensive income (loss), a separate component of stockholders' equity. At December 31, 2019, the portion of the investment portfolio designated as "available for sale" had a net unrealized holding gain, net of tax, of $218 thousand compared to net unrealized holding (losses), net of tax, of $(3.0) million at December 31, 2018.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios of common equity Tier 1, Tier 1, and total capital as a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 1,250%. The Bank is also required to maintain capital at a minimum level based on quarterly average assets, which is known as the leverage ratio.

In July 2013, federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with certain standards that were developed by Basel III and certain provisions of the Dodd-Frank Act. The final rule currently applies to all depository institutions and bank holding companies and savings and loan holding companies with total consolidated assets of more than $3 billion. The Company has total consolidated assets of less than $3 billion and is currently exempt from the consolidated capital requirements.

As of December 31, 2019, the Bank was in compliance with all applicable regulatory capital requirements to which it was subject, and was classified as "well capitalized" for purposes of the prompt corrective action regulations.

The following table compares the Bank's capital ratios to the minimum regulatory requirements as of December 31, 2019, 2018 and 2017.

(Dollars in thousands)	**2019**	2018	2017	Minimum Regulatory Requirements for 2019
Common equity Tier 1 capital	**$ 163,206**	$ 140,265	$ 126,751	
Tier 1 capital	**163,206**	140,265	126,751	
Tier 2 capital	**10,808**	10,644	10,082	
Total risk-based capital	**174,014**	150,909	136,833	
Net risk-weighted assets	**1,254,980**	1,185,050	1,107,074	
Adjusted average total assets	**1,533,919**	1,432,686	1,342,484	
Risk-based capital ratios:				
Common equity Tier 1	**13.00 %**	11.84 %	11.45 %	7.00* %
Tier 1	**13.00**	11.84	11.45	8.50*
Total capital	**13.87**	12.73	12.36	10.50*
Tier 1 leverage ratio	**10.64**	9.79	9.44	4.00

* includes phased in capital conservation buffer for 2019 of 2.50%

See Note 18 to the Consolidated Financial Statements for further information about the regulatory capital positions of the Bank (December 31, 2019 and 2018).

Asset Quality - Provision for Credit Losses and Risk Management

Originating loans involves a degree of risk that credit losses will occur in varying amounts according to, among other factors, the types of loans being made, the credit-worthiness of the borrowers over the terms of the loans, the quality of the collateral for the loans, if any, as well as general economic conditions. Through the Company's and the Bank's Asset/Liability Management Committees, the Company's Audit Committee and the Company's Board actively reviews critical risk positions, including credit, market, liquidity and operational risk. The Company's goal in managing risk is to reduce earnings volatility, control exposure to unnecessary risk, and ensure appropriate returns for risk assumed. Senior members of management actively manage risk at the product level, supplemented with corporate level oversight through the Asset/Liability Management Committee and internal audit function. The risk management structure is designed to identify risk through a systematic process, enabling timely and appropriate action to avoid and mitigate risk.

Credit risk is mitigated through loan portfolio diversification, limiting exposure to any single industry or customer, collateral protection, and prudent lending policies and underwriting criteria. The following discussion provides information and statistics on the overall quality of the Company's loan portfolio. Note 1 to the Consolidated Financial Statements describes the accounting policies related to nonperforming loans (nonaccrual and delinquent 90 days or more), TDRs and loan charge-offs and describes the methodologies used to develop the allowance for credit losses, including the specific, formula and unallocated components (also discussed below). Management believes the policies governing nonperforming loans, TDRs and charge-offs are consistent with regulatory standards. The amount of the allowance for credit losses and the resulting provision are reviewed monthly by senior members of management and approved quarterly by the Board of Directors.

The allowance is increased by provisions for credit losses charged to expense and recoveries of loans previously charged off. It is decreased by loans charged off in the current period. Loans, or portions thereof, are charged off when considered uncollectible by management. Provisions for credit losses are made to bring the allowance for credit losses within the range of balances that are considered appropriate.
The adequacy of the allowance for credit losses is determined based on management's estimate of the inherent risks associated with lending activities, estimated fair value of collateral, past experience and present indicators such as loan delinquency trends, nonaccrual loans and current market conditions. Management believes the current allowance is adequate to provide for probable losses inherent in our loan portfolio; however, future changes in the composition of the loan portfolio and financial condition of borrowers may result in additions to the allowance. Examination of the portfolio and allowance by various regulatory agencies and consultants engaged by the Company may result in the need for additional provisions based on information available at the time of the examination. The Bank maintains a separate allowance for credit losses, which is only available to absorb losses from their respective loan portfolios. The allowance set by the Bank is subject to regulatory examination and determination as to its adequacy.

The allowance for credit losses is comprised of three parts: (i) the specific allowance; (ii) the historical formula allowance; and (iii) the qualitative formula allowance. The specific allowance is established against impaired loans until charge offs are made. Loans are considered impaired when it is probable that the Company will not collect all principal and interest payments according to the loan's contractual terms. The qualitative formula allowance is determined based on management's assessment of industry trends and economic factors in the markets in which we operate. The determination of the formula allowance involves a higher risk of uncertainty and considers current risk factors that may not have yet manifested themselves in our historical loss factors.

The specific allowance is used to individually allocate an allowance to loans identified as impaired. An impaired loan may involve deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral. If it is determined that there is a loss associated with an impaired loan, a specific allowance is established until a charge off is made. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

The historical formula allowance is used to estimate the loss on internally risk-rated loans, exclusive of those identified as impaired. Loans are grouped by type (construction, residential real estate, commercial real estate, commercial or consumer). Each loan type is assigned allowance factors based on management's estimate of the risk, complexity and size of individual loans within a particular category using average historical charge-offs by segment over the last 16 quarters, except for 1-4 family residential and consumer loans which use the last 8 quarters.

The qualitative formula allowance is used to estimate the loss on loans stemming from more global factors such as delinquencies, loss history, trends in volume and terms of loans, effects of changes in lending policy, the experience and depth of management, national and local economic trends, concentrations of credit, the quality of the loan review system and the effect of external factors such as competition and regulatory requirements. Loans that are identified as pass-watch, special mention, substandard and doubtful are considered to have elevated credit risk.

These loans are assigned higher allowance factors than favorably rated loans due to management's concerns regarding collectability or management's knowledge of particular elements regarding the borrower.

As seen in the table below, the provision for credit losses was $700 thousand for 2019, $1.7 million for 2018 and $2.3 million for 2017. The decrease in the level of provision for credit losses in 2019 was primarily due to lower net charge-offs and improved credit quality when compared to 2018. Net loan charge-offs totaled $536 thousand in 2019, $1.1 million in 2018 and $1.2 million in 2017. Real estate loans were 59%, 58% and 44% of total net loans charged off during 2019, 2018 and 2017, respectively.

The allowance for credit losses was $10.5 million, or 0.86% of average outstanding loans at December 31, 2019, compared to an allowance of $10.3 million, or 0.90% of average outstanding loans at December 31, 2018. The lower allowance percentage at the end of 2019 when compared to the end of 2018 was the result of improved credit quality and a reduction in net charge-offs. At December 31, 2017, the allowance for credit losses was $9.8 million, or 0.99% of average outstanding loans. The ratio of net charge-offs to average loans was 0.04% in 2019, 0.10% in 2018 and 0.13% in 2017.

The overall credit quality improved in 2019 compared to 2018 primarily due to a reduction in nonaccrual loans and OREO. In addition, accruing TDRs declined $1.2 million when comparing 2019 to 2018 which reflects continued workout efforts on outstanding problem loans. When comparing 2019 to 2018 loan risk categories, special mention loans increased $4.6 million and substandard loans decreased $9.8 million. The increase in special mention loans was due to the downgrade of a few legacy loans which the Company has been monitoring for several years. The decrease in substandard loans was primarily due to property sales and credit risk rating upgrades during 2019. Management will continue to monitor and charge off nonperforming assets as rapidly as possible, and focus on the generation of healthy loan growth and new business development opportunities.

The following table sets forth a summary of our loan loss experience for the years ended December 31.

(Dollars in thousands)	**2019**	2018	2017	2016	2015
Allowance balance - beginning of period	**$ 10,343**	$ 9,781	$ 8,726	$ 8,316	$ 7,695
Charge-offs:					
Construction	**(3)**	(397)	(54)	(615)	(1,058)
Residential real estate	**(646)**	(406)	(445)	(580)	(283)
Commercial real estate	**—**	(240)	(100)	(503)	(920)
Commercial	**(411)**	(441)	(946)	(497)	(396)
Consumer	**(37)**	(27)	(32)	(45)	(67)
Total	**(1,097)**	(1,511)	(1,577)	(2,240)	(2,724)
Recoveries:					
Construction	**18**	43	30	35	125
Residential real estate	**27**	112	40	298	398
Commercial real estate	**206**	29	31	25	379
Commercial	**305**	203	215	428	319
Consumer	**5**	12	25	16	49
Totals	**561**	399	341	802	1,270
Net charge-offs	**(536)**	(1,112)	(1,236)	(1,438)	(1,454)
Provision for credit losses	**700**	1,674	2,291	1,848	2,075
Allowance balance - end of period	**$ 10,507**	$ 10,343	$ 9,781	$ 8,726	$ 8,316
Average loans outstanding during the period	**$1,226,361**	$1,153,169	$983,484	$825,475	$748,101
Net charge-offs (annualized) as a percentage of average loans outstanding during the period	**0.04 %**	0.10 %	0.13 %	0.17 %	0.19 %
Allowance for credit losses at period end as a percentage of total period end loans	**0.84 %**	0.87 %	0.89 %	1.00 %	1.05 %
Percentage of allowance for credit losses at year end to average loans	**0.86 %**	0.90 %	0.99 %	1.06 %	1.11 %

The following table sets forth the allocation of the allowance for credit losses and the percentage of loans in each category to total loans for the years ended December 31.

	2019		2018		2017		2016		2015	
(Dollars in thousands)	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans	Amount	% of Loans
Construction	**1,576**	**8.0 %**	2,662	10.7 %	2,460	11.5 %	2,787	9.6 %	1,646	10.8 %
Residential real estate	**2,501**	**35.4**	2,353	35.9	2,284	36.5	1,953	37.4	2,181	38.6
Commercial real estate	**4,032**	**47.0**	3,077	43.8	2,594	42.5	2,610	43.9	2,999	41.5
Commercial	**1,929**	**8.2**	1,949	9.0	2,241	8.9	1,223	8.3	558	8.2
Consumer	**469**	**1.4**	302	0.6	202	0.6	153	0.8	156	0.9
Unallocated	-	-	-	-	-	-	-	-	776	-
Total	**$10,507**	**100.0 %**	$10,343	100.0 %	$9,781	100.0 %	$8,726	100.0 %	$8,316	100.0 %

At December 31, 2019, nonperforming assets were $12.0 million, a decrease of $6.0 million, or 33.4%, when compared to December 31, 2018. The decrease in nonperforming assets was due to diligent workout efforts by the Company to reduce nonaccrual loans and other real estate owned properties. Accruing TDRs were $7.5 million at December 31, 2019, a decrease of $1.2 million, or 13.4%, when compared to December 31, 2018. At December 31, 2019, the ratio of nonaccrual loans to total assets was 0.68%, a decrease from 1.12% at December 31, 2018. The ratio of accruing TDRs to total assets at December 31, 2019 was 0.48% improving from 0.58% at December 31, 2018. When comparing December 31, 2018 to December 31, 2017, the negative trend in nonperforming assets, as well as the corresponding asset quality ratios, was primarily due to a delinquent agricultural loan relationship which was placed on nonaccrual late in the fourth quarter of 2018 for approximately $7.5 million. No losses have been incurred for this relationship since the fourth quarter of 2018.

The Company continues to focus on the resolution of its nonperforming and problem loans. The efforts to accomplish this goal include frequently contacting borrowers until the delinquency is cured or until an acceptable payment plan has been agreed upon; obtaining updated appraisals; provisioning for credit losses; charging off loans; transferring loans to other real estate owned; aggressively marketing other real estate owned; and selling loans. The reduction of nonperforming and problem loans is and will continue to be a high priority for the Company.

The following table summarizes our nonperforming assets and accruing TDRs as of December 31.

(Dollars in thousands)	**2019**	2018	2017	2016	2015
Nonperforming assets					
Nonaccrual loans					
Construction	**$ —**	$ 2,842	$ 3,003	$ 3,818	$ 7,529
Residential real estate	**2,475**	4,099	1,482	3,903	2,259
Commercial real estate	**7,817**	9,374	149	1,152	2,022
Commercial	**298**	340	337	—	161
Consumer	**—**	—	—	99	122
Total nonaccrual loans	**10,590**	16,655	4,971	8,972	12,093
Loans 90 days or more past due and still accruing					
Construction	**—**	—	—	—	—
Residential real estate	**556**	139	421	—	—
Commercial real estate	**770**	—	218	—	—
Commercial	**—**	—	—	10	—
Consumer	**—**	—	—	10	7
Total loans 90 days or more past due and still accruing	**1,326**	139	639	20	7
Other real estate owned	**74**	1,222	1,794	2,477	4,252
Total nonperforming assets	**$11,990**	$18,016	$ 7,404	$11,469	$16,352
Accruing TDRs					
Construction	**$ 41**	$ 51	$ 3,972	$ 4,189	$ 4,069
Residential real estate	**4,041**	4,454	4,536	3,875	5,686
Commercial real estate	**3,419**	4,158	4,818	4,936	5,740
Commercial	**—**	—	—	—	—
Consumer	**—**	—	—	—	—
Total accruing TDRs	**$ 7,501**	$ 8,663	$13,326	$13,000	$15,495
As a percent of total loans:					
Nonaccrual loans	**0.85 %**	1.39 %	0.45 %	1.03 %	1.52 %
Accruing TDRs	**0.60 %**	0.72 %	1.22 %	1.49 %	1.95 %
Nonaccrual loans and accruing TDRs	**1.45 %**	2.12 %	1.67 %	2.52 %	3.47 %
As a percent of total loans and other real estate owned:					
Nonperforming assets	**0.96 %**	1.51 %	0.68 %	1.31 %	2.05 %
Nonperforming assets and accruing TDRs	**1.56 %**	2.23 %	1.89 %	2.80 %	3.98 %
As a percent of total assets:					
Nonaccrual loans	**0.68 %**	1.12 %	0.36 %	0.77 %	1.07 %
Nonperforming assets	**0.77 %**	1.21 %	0.53 %	0.99 %	1.44 %
Accruing TDRs	**0.48 %**	0.58 %	0.96 %	1.12 %	1.37 %
Nonperforming assets and accruing TDRs	**1.25 %**	1.80 %	1.49 %	2.11 %	2.81 %

Market Risk Management and Interest Sensitivity

The Company's net income is largely dependent on its net interest income. Net interest income is susceptible to interest rate risk to the extent that interest-bearing liabilities mature or re-price on a different basis than interest-earning assets. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income. Net interest income is also affected by changes in the portion of interest-earning assets that are funded by interest-bearing liabilities rather than by other sources of funds, such as noninterest-bearing deposits and stockholders' equity.

The Company's interest rate risk management goals are (1) to increase net interest income at a growth rate consistent with the growth rate of total assets, and (2) to minimize fluctuations in net interest margin as a percentage of interest-earning assets. Management attempts to achieve these goals by balancing, within policy limits, the volume of floating-rate liabilities with a similar volume of floating-rate assets; by keeping the average maturity of fixed-rate asset and liability contracts reasonably matched; by maintaining a pool of administered core deposits; and by adjusting pricing rates to market conditions on a continuing basis.

The Company's Board of Directors has established a comprehensive asset liability management policy, which is administered by management's Asset Liability Management Committee ("ALCO"). The policy establishes limits on risk, which are quantitative measures of the percentage change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity or "EVE" at risk) resulting from a hypothetical change in the yield curve of U.S. Treasury interest rates for maturities from one day to thirty years. The Company evaluates the potential adverse impacts that changing interest rates may have on its short-term earnings, long-term value, and liquidity by outsourcing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology used by the Company. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. As an example, certain money market deposit accounts are assumed to reprice at 50% of the interest rate change in each of the up rate shock scenarios even though this is not a contractual requirement. As a practical matter, management would likely lag the impact of any upward movement in market rates on these accounts as a mechanism to manage the Company's net interest margin. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan customers' ability to service their debts, or the impact of rate changes on demand for loan, lease, and deposit products.

The Company presents a current base case and several alternative simulations at least once a quarter and reports the analysis to the Board of Directors. In addition, more frequent forecasts could be produced when interest rates are particularly uncertain or when other business conditions so dictate.

The statement of condition is subject to quarterly testing for six alternative interest rate shock possibilities to indicate the inherent interest rate risk. Average interest rates are shocked by +/- 100, 200, 300 and 400 basis points ("bp"), although the Company may elect not to use particular scenarios that it determines are impractical in a current rate environment. It is management's goal to structure the balance sheet so that net interest earnings at risk over a twelve-month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.

Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

The measures of equity value at risk indicate the ongoing economic value of the Company by considering the effects of changes in interest rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of assets and liabilities. The difference between these discounted values of the assets and liabilities is the EVE, which, in theory, approximates the fair value of the Company's net assets.

The following tables present the projected change in the Bank's net interest income and EVE at December 31, 2019 and 2018 that would occur upon an immediate change in interest rates based on independent analysis, but without giving effect to any steps that management might take to counteract that change:

Estimated Changes in Net Interest Income

Change in Interest Rates:	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Policy Limit	40 %	30 %	20 %	10 %	(10)%	(20)%
December 31, 2019	**8.1 %**	**6.3 %**	**4.5 %**	**2.4 %**	**(7.7)%**	**(13.2)%**
December 31, 2018	2.2 %	1.6 %	1.2 %	0.8 %	(5.6)%	(12.7)%

Estimated Changes in Economic Value of Equity

Change in Interest Rates:	+400 bp	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Policy Limit	25 %	20 %	15 %	10 %	(20)%	(35)%
December 31, 2019	**(3.6)%**	**(1.2)%**	**1.3 %**	**1.4 %**	**(7.7)%**	**(20.9)%**
December 31, 2018	(7.0)%	(5.0)%	(2.8)%	(0.6)%	(4.7)%	(12.6)%

As with any method of measuring interest rate risk, certain shortcomings are inherent in the method of analysis presented in the foregoing tables. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, if interest rates change, expected rates of prepayments on loans and early withdrawals from certificates of deposit could deviate significantly from those assumed in calculating the tables.

Off-Balance Sheet Arrangements

In the normal course of business, to meet the financing needs of its customers, the Bank is party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they use for on-balance sheet instruments. The Bank generally requires collateral or other security to support the financial instruments with credit risk. The amount of collateral or other security is determined based on management's credit evaluation of the counterparty. The Bank evaluates each customer's creditworthiness on a case-by-case basis.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Letters of credit and other commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the letters of credit and commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. Further information about these arrangements is provided in Note 21 to the Consolidated Financial Statements.

Management does not believe that any of the foregoing arrangements have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Liquidity Management

Liquidity describes our ability to meet financial obligations that arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of customers and to fund current and planned expenditures. Liquidity is derived through increased customer deposits, maturities in the investment portfolio, loan repayments and income from earning assets. To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in the short-term funds markets. We have arrangements with correspondent banks whereby we have $15 million available in federal funds lines of credit and a reverse repurchase agreement available to meet any short-term needs which may not otherwise be funded by the Bank's portfolio of readily marketable investments that can be converted to cash. The Bank is also a member of the FHLB, which provides another source of liquidity, and had credit availability of approximately $270.1 million from the FHLB as of December 31, 2019.

At December 31, 2019, our loan to deposit ratio was approximately 93.1%, lower than the 98.6% at year-end 2018. Investment securities available for sale totaling $122.8 million at the end of 2019 were available for the management of liquidity and interest rate risk. The comparable amount was $154.4 million at December 31, 2018. Cash and cash equivalents were $95.0 million at December 31, 2019, an increase of $27.7 million, or 41.3%, compared to the $67.2 million at year-end 2018, which reflects the increase in deposits during 2019. Management is not aware of any demands, commitments, events or uncertainties that will materially affect our ability to maintain liquidity at satisfactory levels.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information required by this item may be found in Item 7 of Part II of this annual report under the caption "Market Risk Management and Interest Sensitivity", which is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Shore Bancshares, Inc. (the "Company") is responsible for the preparation, integrity and fair presentation of the consolidated financial statements included in this annual report. The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and, as such, include some amounts that are based on the best estimates and judgments of management.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. This internal control system is designed to provide reasonable assurance to management and the Board of Directors regarding the reliability of the Company's financial reporting and the preparation and presentation of financial statements for external reporting purposes in conformity with accounting principles generally accepted in the United States of America, as well as to safeguard assets from unauthorized use or disposition. The system of internal control over financial reporting is evaluated for effectiveness by management and tested for reliability through a program of internal audit with actions taken to correct potential deficiencies as they are identified. Because of inherent limitations in any internal control system, no matter how well designed, misstatement due to error or fraud may occur and not be detected, including the possibility of the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019 based upon criteria set forth in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 COSO Framework).

Based on this assessment and on the foregoing criteria, management has concluded that, as of December 31, 2019, the Company's internal control over financial reporting is effective. Yount, Hyde & Barbour, the Company's independent registered public accounting firm that audited the financial statements included in this annual report, has issued a report on the Company's internal control over financial reporting, which appears in the following pages.

March 13, 2020

/s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Edward C. Allen
Edward C. Allen
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

YHB CPAs & Consultants

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors
Shore Bancshares, Inc.
Easton, Maryland

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Shore Bancshares, Inc. (the Company) as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 13, 2020 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Yount, Hyde & Barbour, P.C.

We have served as the Company's auditor since 2017.

Winchester, Virginia
March 13, 2020

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors
Shore Bancshares, Inc.
Easton, Maryland

Opinion on the Internal Control Over Financial Reporting

We have audited Shore Bancshares, Inc.'s (the Company) internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements of the Company, and our report dated March 13, 2020 expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 13, 2020

SHORE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEETS
December 31,

(In thousands, except share and per share data)	2019	2018
ASSETS		
Cash and due from banks	**$ 18,465**	$ 16,294
Interest-bearing deposits with other banks	**76,506**	50,931
Cash and cash equivalents	**94,971**	67,225
Investment securities:		
Available-for-sale, at fair value	**122,791**	154,432
Held to maturity, at amortized cost - fair value of $8,654 (2019) and $6,000 (2018)	**8,786**	6,043
Equity securities, at fair value	**1,342**	1,269
Restricted securities	**4,190**	6,476
Loans	**1,248,654**	1,195,355
Less: allowance for credit losses	**(10,507)**	(10,343)
Loans, net	**1,238,147**	1,185,012
Premises and equipment, net	**23,821**	22,711
Goodwill	**17,518**	17,518
Other intangible assets, net	**2,252**	2,857
Other real estate owned, net	**74**	1,222
Right-of-use assets	**4,771**	—
Other assets	**40,572**	17,678
Assets of discontinued operations	**—**	633
TOTAL ASSETS	**$ 1,559,235**	$ 1,483,076
LIABILITIES		
Deposits:		
Noninterest-bearing	**$ 356,618**	$ 330,466
Interest-bearing	**984,716**	881,875
Total deposits	**1,341,334**	1,212,341
Short-term borrowings	**1,226**	60,812
Long-term borrowings	**15,000**	15,000
Lease liabilities	**4,792**	—
Other liabilities	**4,081**	8,415
Liabilities of discontinued operations	**—**	3,323
TOTAL LIABILITIES	**1,366,433**	1,299,891
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, par value $.01 per share; shares authorized - 35,000,000; shares issued and outstanding - 12,500,372 (2019) and 12,749,497 (2018)	**125**	127
Additional paid in capital	**61,045**	65,434
Retained earnings	**131,425**	120,574
Accumulated other comprehensive income (loss)	**207**	(2,950)
TOTAL STOCKHOLDERS' EQUITY	**192,802**	183,185
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 1,559,235**	$ 1,483,076

The notes to the consolidated financial statements are an integral part of these statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31,

(In thousands, except per share data)	2019	2018
INTEREST INCOME		
Interest and fees on loans	**$ 55,391**	$ 51,332
Interest and dividends on investment securities:		
Taxable	**3,582**	4,289
Interest on deposits with other banks	**794**	286
Total interest income	**59,767**	55,907
INTEREST EXPENSE		
Interest on deposits	**8,726**	3,531
Interest on short-term borrowings	**481**	1,636
Interest on long-term borrowings	**429**	105
Total interest expense	**9,636**	5,272
NET INTEREST INCOME	**50,131**	50,635
Provision for credit losses	**700**	1,674
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	**49,431**	48,961
NONINTEREST INCOME		
Service charges on deposit accounts	**3,910**	3,879
Trust and investment fee income	**1,522**	1,557
Other noninterest income	**4,588**	3,577
Total noninterest income	**10,020**	9,013
NONINTEREST EXPENSE		
Salaries and wages	**15,413**	16,535
Employee benefits	**5,283**	4,001
Occupancy expense	**2,758**	2,622
Furniture and equipment expense	**1,107**	950
Data processing	**3,790**	3,331
Directors' fees	**479**	556
Amortization of other intangible assets	**605**	866
FDIC insurance premium expense	**344**	771
Other real estate owned expenses, net	**425**	353
Legal and professional fees	**2,223**	1,981
Other noninterest expenses	**5,130**	4,865
Total noninterest expense	**37,557**	36,831
Income from continuing operations before income taxes	**21,894**	21,143
Income tax expense	**5,610**	5,380
Income from continuing operations	**16,284**	15,763
(Loss) income from discontinued operations before income taxes	**(113)**	1,421
Gain on sale of insurance agency	**—**	12,736
Income tax (benefit) expense	**(27)**	4,923
(Loss) income from discontinued operations	**(86)**	9,234
NET INCOME	**$ 16,198**	$ 24,997

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SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF INCOME (CONTINUED)
For the Years Ended December 31,

Earnings per common share - Basic		
Income from continuing operations	**$ 1.28**	$ 1.24
(Loss) income from discontinued operations	**(0.01)**	0.72
Net income	**$ 1.27**	$ 1.96
Earnings per common share - Diluted		
Income from continuing operations	**$ 1.28**	$ 1.24
(Loss) income from discontinued operations	**(0.01)**	0.72
Net income	**$ 1.27**	$ 1.96
Dividends paid per common share	**$ 0.42**	$ 0.32

The notes to the consolidated financial statements are an integral part of these statements.

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SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31,

(Dollars in thousands)	2019	2018
Net income	**$ 16,198**	$ 24,997
Other comprehensive income (loss):		
Investment securities:		
Unrealized holding gains (losses) on available-for-sale-securities	**4,314**	(2,308)
Tax effect	**(1,178)**	639
Amortization of unrealized loss on securities transferred from available-for-sale to held-to-maturity	**29**	30
Tax effect	**(8)**	(8)
Total other comprehensive income (loss)	**3,157**	(1,647)
Comprehensive income	**$ 19,355**	$ 23,350

The notes to the consolidated financial statements are an integral part of these statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2019 and 2018

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income(Loss)	Total Stockholders' Equity
Balances, January 1, 2018	$ 127	$ 65,256	$ 99,662	$ (1,309)	$ 163,736
Cumulative effect adjustment (ASU 2016-01)	—	—	(6)	6	—
Net income	—	—	24,997	—	24,997
Other comprehensive (loss)	—	—	—	(1,647)	(1,647)
Stock-based compensation	—	447	—	—	447
Exercise of options and vesting of restricted stock, net of shares surrendered	—	(269)	—	—	
Cash dividends declared	—	—	(4,079)	—	(4,079)
Balances, December 31, 2018	$ **127**	**$ 65,434**	**$120,574**	**$ (2,950)**	**$ 183,185**
Net Income	**—**	**—**	**16,198**	**—**	**16,198**
Other comprehensive income	**—**	**—**	**—**	**3,157**	**3,157**
Retirement of common stock	**(3)**	**(4,449)**	**—**	**—**	**(4,452)**
Stock-based compensation	**—**	**149**	**—**	**—**	**149**
Exercise of options and vesting of restricted stock, net of shares surrendered	**1**	**(89)**	**—**	**—**	**(88)**
Cash dividends declared	**—**	**—**	**(5,347)**	**—**	**(5,347)**
Balances, December 31, 2019	$ **125**	**$ 61,045**	**$131,425**	**$ 207**	**$ 192,802**

The notes to the consolidated financial statements are an integral part of these statements.

SHORE BANCSHARES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31,

	For Year Ended December 31, 2019	For Year Ended December 31, 2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	**$ 16,198**	$ 24,997
Adjustments to reconcile net income to net cash provided by operating activities:		
Net accretion of acquisition accounting estimates	**(468)**	(679)
Provision for credit losses	**700**	1,674
Depreciation and amortization	**2,393**	2,297
Net amortization of securities	**512**	649
Stock-based compensation expense	**149**	447
Deferred income tax expense (benefit)	**241**	(1,610)
Losses on sales and valuation adjustments on other real estate owned	**417**	290
Net (gain) on disposal of discontinued operations	**—**	(12,736)
Fair value adjustment on equity securities	**(42)**	5
Bank owned life insurance income	**(443)**	(73)
Net changes in:		
Accrued interest receivable	**(110)**	164
Other assets	**2,304**	(3,258)
Accrued interest payable	**(274)**	539
Other liabilities	**(7,834)**	5,590
Net cash provided by operating activities	**13,743**	18,296
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities and principal payments of investment securities available for sale	**35,447**	38,914
Proceeds from maturities and principal payments of investment securities held to maturity	**1,282**	228
Purchases of securities held to maturity	**(4,000)**	—
Purchases of equity securities	**(31)**	(616)
Net change in loans	**(53,528)**	(102,644)
Purchases of premises and equipment	**(2,244)**	(1,133)
Proceeds from sales of other real estate owned	**731**	378
Net redemption of restricted securities	**2,286**	—
Net purchases of restricted securities	**—**	(2,741)
Net proceeds from disposal of discontinued operations	**—**	25,159
Purchases of bank owned life insurance	**(25,621)**	—
Net cash (used in) investing activities	**(45,678)**	(42,455)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net changes in:		
Noninterest-bearing deposits	**26,152**	2,144
Interest-bearing deposits	**103,002**	7,690
Short-term borrowings	**(59,586)**	39,078
Long-term borrowings	**—**	15,000
Proceeds from the issuance of common stock	**—**	—
Common stock dividends paid	**(5,347)**	(4,079)
Retirement of common stock	**(4,452)**	—
Repurchase of shares for tax withholding on exercised options and vested restricted stock	**(88)**	(269)
Net cash provided by financing activities	**59,681**	59,564
Net increase in cash and cash equivalents	**27,746**	35,405
Cash and cash equivalents at beginning of period	**67,225**	31,820
Cash and cash equivalents at end of period	**$ 94,971**	$ 67,225
Supplemental cash flows information:		
Interest paid	**$ 10,071**	$ 5,008
Income taxes paid	**$ 11,920**	$ 5,365
Lease liabilities arising from right-of-use assets	**$ 5,243**	$ —
Transfers from loans to other real estate owned	**$ —**	$ 96
Unrealized gain (loss) on securities available for sale	**$ 4,314**	$ (2,308)
Amortization of unrealized loss on securities transferred from available for sale to held to maturity	**$ 29**	$ 30

The notes to consolidated financial statements are an integral part of these statements.

[redacted]

SHORE BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 2019 and 2018

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of Shore Bancshares, Inc. and its subsidiary (collectively referred to in these Notes as the “Company”), with all significant intercompany transactions eliminated. The investment in subsidiary is recorded on the Company’s books (Parent only) on the basis of its equity in the net assets of the subsidiary. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (“GAAP”). For purposes of comparability, certain reclassifications have been made to amounts previously reported to conform with the current period presentation. Reclassifications had no effect on prior year net income or stockholders’ equity.

Nature of Operations

The Company engages in the banking business through Shore United Bank, a Maryland commercial bank with trust powers. The Company’s primary source of revenue is interest earned on commercial, real estate and consumer loans made to customers located in Maryland, Delaware and the Eastern Shore of Virginia. The Company engages in the trust services business through the trust department at Shore United Bank under the trade name Wye Financial & Trust.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, and affect the reported amounts of revenues earned and expenses incurred during the reporting period. Actual results could differ from those estimates. Estimates that could change significantly relate to the determination of the allowance for loan losses, fair values initially assigned in an acquisition and subsequent evaluations of the related goodwill and intangible assets for impairment.

Investment Securities Available for Sale

Investment securities available for sale are stated at estimated fair value based on quoted prices. They represent those debt securities which management may sell as part of its asset/liability management strategy or which may be sold in response to changing interest rates, changes in prepayment risk or other similar factors. Realized gains and losses are recorded in noninterest income and are determined on a trade date basis using the specific identification method. Premiums and discounts are amortized or accreted into interest income using the interest method over the lives of the individual securities. Interest on investment securities is recognized in interest income on an accrual basis. Net unrealized holding gains and losses on these securities are reported as accumulated other comprehensive income, a separate component of stockholders’ equity, net of related income taxes. Declines in the fair value of individual available-for-sale securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value and are reflected in earnings as realized losses. Factors affecting the determination of whether an other-than-temporary impairment has occurred include a downgrade of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a determination that management has the intent to sell the security or will be required to sell the security before recovery of its amortized cost.

Investment Securities Held to Maturity

Investment securities held to maturity are stated at cost adjusted for amortization of premiums and accretion of discounts. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. The Company intends and has the ability to hold such securities until maturity. Declines in the fair value of individual held-to-maturity securities below their cost that are other than temporary result in write-downs of the individual securities to their fair value. Factors affecting the determination of whether an other-than-temporary impairment has occurred include a downgrade of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or a determination that management has the intent to sell the security or will be required to sell the security before recovery of its amortized cost.

Equity Securities

Equity securities with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. Any equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar investments. Restricted equity securities are carried at cost and are periodically evaluated for impairment based on the ultimate recovery of par value. The entirety of any impairment on equity securities is recognized in earnings.

Loans

Loans are stated at their principal amount outstanding net of any deferred fees, premiums, discounts and costs and net of any partial charge-offs. Interest income on loans is accrued at the contractual rate based on the principal amount outstanding. Fees charged and costs capitalized for originating loans are being amortized substantially on the interest method over the term of the loan. A loan is placed on nonaccrual (i.e., interest income is no longer accrued) when it is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more, unless the loan is well secured and in the process of collection. Any unpaid interest previously accrued on those loans is reversed from income. Interest payments received on nonaccrual loans are applied as a reduction of the loan principal balance unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired if it is probable that the Company will not collect all principal and interest payments according to the loan’s contractual terms when due. An impaired loan may show deficiencies in the borrower’s overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral. The impairment of a loan is measured at the present value of expected future cash flows using the loan’s effective interest rate, or at the loan’s observable market price or the fair value of the collateral if the loan is collateral dependent. Generally, the Company measures impairment on such loans by reference to the fair value of the collateral. Once the amount of impairment has been determined, the uncollectible portion is charged off. Income on impaired loans is recognized on a cash basis, and payments are first applied against the principal balance outstanding (i.e., placing impaired loans on nonaccrual status). Generally, interest income is not recognized on impaired loans unless the likelihood of further loss is remote or the impairment analysis yielded no impairment for the loan. The allowance for credit losses may include specific reserves related to impaired loans. Specific reserves remain until charge offs are made. Reserves for probable credit losses related to these loans are based on historical loss ratios and an analysis of qualitative factors and are included in the formula portion of the allowance for credit losses. See additional discussion below under the section, “Allowance for Credit Losses”.

A loan is considered a troubled debt restructuring (“TDR”) if a borrower is experiencing financial difficulties and a creditor has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. Loans are identified to be restructured when signs of impairment arise such as borrower interest rate reduction request, slowness to pay, or when an inability to repay becomes evident. The terms being offered are evaluated to determine if they are more liberal than those that would be indicated by policy or industry standards for similar, untroubled credits. In those situations where the terms or the interest rates are considered to be more favorable than industry standards or the current underwriting guidelines of the Company’s banking subsidiary, the loan is classified as a TDR. All loans designated as TDRs are considered impaired loans and may be on either accrual or nonaccrual status. In instances where the loan has been placed on nonaccrual status, six consecutive months of timely payments are required prior to returning the loan to accrual status.

All loans classified as TDRs which are restructured and accrue interest under revised terms require a full and comprehensive review of the borrower’s financial condition, capacity for repayment, realistic assessment of collateral values, and the assessment of risk entered into any workout agreement. Current financial information on the borrower, guarantor, and underlying collateral is analyzed to determine if it supports the ultimate collection of principal and interest.

For commercial loans, the cash flows are analyzed, both for the underlying project and globally. For consumer loans, updated salary, credit history and cash flow information is obtained. Current market conditions are also considered. Following a full analysis, the determination of the appropriate loan structure is made. The Company does not participate in any specific government or Company sponsored loan modification programs. All TDR loan agreements are contracts negotiated with each of the borrowers.

Allowance for Credit Losses

The allowance for credit losses is maintained at a level believed adequate by management to absorb losses inherent in the loan portfolio as of the balance sheet date and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions and other observable data. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows or collateral value of impaired loans, estimated losses on pools of similar loans that are based on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loans, or portions thereof, that are considered uncollectible are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. The criteria for charge offs are addressed in the Bank's Collection and Workout Policy. Per the policy, the recognition of the loss of loans or portions of loans will occur when there is a reasonable probability of loss. When the amount of loss can be readily calculated, the loss will be recognized. In cases where a probable charge-off amount cannot be calculated, specific reserves will be maintained. A provision for credit losses is charged to income based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least quarterly and more often if deemed necessary.

The allowance for credit losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: (i) Topic 450, " *Contingencies* ", of the Financial Accounting Standards Board's Accounting Standards Codification ("ASC"), which requires that losses be accrued when they are probable of occurring and estimable; and (ii) ASC Topic 310, " *Receivables* ", which requires that losses be accrued based on the differences between the loan balance and the value of collateral, present value of future cash flows or values that are observable in the secondary market. Management uses many factors to estimate the inherent loss that may be present in our loan portfolio, including economic conditions and trends, the value and adequacy of collateral, the volume and mix of the loan portfolio, and our internal loan processes. Actual losses could differ significantly from management's estimates. In addition, GAAP itself may change from one previously acceptable method to another. Although the economics of transactions would be the same, the timing of events that would impact the transactions could change.

Three basic components comprise our allowance for credit losses: (i) the specific allowance; (ii) the historical formula allowance; and (iii) the qualitative formula allowance. Each component is determined based on estimates that can and do change when the actual events occur. The specific allowance is established against impaired loans (i.e., nonaccrual loans and troubled debt restructurings ("TDRs")) based on our assessment of the losses that may be associated with the individual loans. The specific allowance remains until charge-offs are made. An impaired loan may show deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors and/or the fair market value of collateral.

The historical formula allowance is used to estimate the loss on internally risk-rated loans, exclusive of those identified as impaired. Loans are grouped by type (construction, residential real estate, commercial real estate, commercial or consumer). Each loan type is assigned allowance factors based on management's estimate of the risk, complexity and size of individual loans within a particular category using average historical charge-offs by segment over the last 16 quarters or 8 quarters. Loans identified as pass-watch, special mention, substandard, and doubtful are considered to have elevated credit risk. These loans are assigned higher allowance factors than favorably rated loans due to management's concerns regarding collectability or management's knowledge of particular elements regarding the borrower. The qualitative formula allowance captures losses that have impacted the portfolio but have yet to be recognized in either the specific or historical formula allowance. A pass-watch loan has adequate risk and may include loans which may have been upgraded from another higher risk category. A special mention loan has potential weaknesses that could result in a future loss to the Company if the weaknesses are realized. A substandard loan has certain deficiencies that could result in a future loss to the Company if these deficiencies are not corrected. A doubtful loan has enough risk that there is a high probability that the Company will sustain a loss.

Management has significant discretion in making the adjustments inherent in the determination of the provision and allowance for credit losses, including in connection with the valuation of collateral, the estimation of a borrower's prospects of repayment, and the establishment of the allowance factors in the formula allowance and unallocated allowance components of the allowance. The establishment of allowance factors is a continuing exercise, based on management's ongoing assessment of the totality of all factors, including, but not limited to, delinquencies, loss history, trends in volume and terms of loans, effects of changes in lending policy, the experience and depth of management, national and local economic trends, concentrations of credit, the quality of the loan review system and the effect of external factors such as competition and regulatory requirements, and their impact on the portfolio. Allowance factors may change from period to period, resulting in an increase or decrease in the amount of the provision or allowance, based on the same volume and classification of loans. Changes in allowance factors will have a direct impact on the amount of the provision, and a corresponding effect on net income. Errors in management's perception and assessment of these factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions or charge-offs.

Premises and Equipment

Land is carried at cost and premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the assets. Useful lives range from three to 10 years for furniture, fixtures and equipment; three to five years for computer hardware and data handling equipment; and 10 to 40 years for buildings and building improvements. Land improvements are amortized over a period of 15 years and leasehold improvements are amortized over the term of the respective lease. Maintenance and repairs are charged to expense as incurred, while improvements which extend the useful life of an asset are capitalized and depreciated over the estimated remaining life of the asset.

Long-lived assets are evaluated periodically for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of a long-lived asset are less than its carrying value. In that event, the Company recognizes a loss for the difference between the carrying amount and the estimated fair value of the asset.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. Goodwill and other intangible assets are initially required to be recorded at fair value. Determining fair value is subjective, requiring the use of estimates, assumptions and management judgment.

Goodwill is tested at least annually for impairment, usually during the fourth quarter, or on an interim basis if circumstances dictate. Intangible assets that have finite lives are amortized over their estimated useful lives and also are subject to impairment testing.

Impairment testing requires a qualitative assessment or that the fair value of each of the Company's reporting units be compared to the carrying amount of its net assets, including goodwill. If the fair value of a reporting unit is less than book value, an expense may be required to write down the related goodwill to record an impairment loss. As of December 31, 2019, the Company had one reporting unit and operating segment (i.e., the Bank).

During the fourth quarter of 2019 and 2018, goodwill and other intangible assets were subjected to the annual assessment for impairment. As a result of the assessment, it was determined that it was not more likely than not that the fair values of the Company's reporting units were less than their carrying amounts so no impairment was recorded.

Other Real Estate Owned

Other real estate owned represents assets acquired in satisfaction of loans either by foreclosure or deeds taken in lieu of foreclosure. Properties acquired are recorded at fair value less estimated selling costs at the time of acquisition, establishing a new cost basis. Thereafter, costs incurred to operate or carry the properties as well as reductions in value as determined by periodic appraisals are charged to operating expense. Gains and losses resulting from the final disposition of the properties are included in noninterest expense.

Borrowings

Short-term and long-term borrowings are comprised primarily of FHLB borrowings. A portion of the Company's short-term borrowings are repurchase agreements. The repurchase agreements are securities sold to the Company's customers, at the customers' request, under a continuing "roll-over" contract that matures in one business day. The underlying securities sold are U.S. Government agency securities, which are segregated from the Company's other investment securities by its safekeeping agents.

Income Taxes

The Company and its subsidiary file a consolidated federal income tax return. The Company accounts for income taxes using the liability method in accordance with required accounting guidance. Under this method, deferred tax assets and liabilities are determined by applying the applicable federal and state income tax rates to cumulative temporary differences. These temporary differences represent differences between financial statement carrying amounts and the corresponding tax bases of certain assets and liabilities. Deferred taxes result from such temporary differences.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date. A valuation allowance, if needed, reduces deferred tax assets to the expected amount most likely to be realized. Realization of deferred tax assets is dependent on the generation of a sufficient level of future taxable income, recoverable taxes paid in prior years and tax planning strategies. The Company evaluates all positive and negative evidence before determining if a valuation allowance is deemed necessary regarding the realization of deferred tax assets.

The Company recognizes accrued interest and penalties as a component of tax expense. Significant judgement is required in evaluating the Company's uncertain tax positions and determining its provision for income taxes.

The provision for income taxes includes the impact of reserve provisions and changes in the reserves that are considered appropriate as well as the related net interest and penalties. In addition, the Company is subject to the continuous examination of its income tax returns by the IRS and other tax authorities which may assert assessments against the Company. The Company regularly assesses the likelihood of adverse outcomes resulting from these examinations and assessments to determine the adequacy of its provision for income taxes. The Company remains subject to examination for tax years ending on or after December 31, 2016.

Basic and Diluted Earnings Per Common Share

Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding and does not include the effect of any potentially dilutive common stock equivalents. Included in this calculation due to dividend participation rights are restricted stock awards which have been granted. Diluted earnings per share is calculated by dividing net income by the weighted-average number of shares outstanding, adjusted for the effect of any potentially dilutive common stock equivalents.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (i) the assets have been isolated from the Company, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Cash and Cash Equivalents

Cash and due from banks, interest-bearing deposits with other banks and federal funds sold are considered “cash and cash equivalents” for financial reporting purposes. Certain interest-bearing deposits with banks may exceed balances that are recoverable under Federal Deposit Insurance Corporation (“FDIC”) insurance. Balances in excess of FDIC insurance at December 31, 2019 were approximately $4.9 million.

Share-Based Compensation

The Company may grant share-based compensation to employees and non-employee directors in the form of restricted stock, restricted stock units and stock options. The fair value of restricted stock is determined based on the closing price of the Parent’s common stock on the date of grant. The Company recognizes compensation expense related to restricted stock on a straight-line basis over the vesting period for service-based awards, plus additional recognition of costs associated with accelerated vesting based on the projected attainment of Company performance measures. The fair value of RSUs is initially valued based on the closing price of the Parent’s common stock on the date of grant and is amortized in the statement of income over the vesting period. The RSUs are subsequently remeasured in each reporting period until settlement based on the quantity of awards for which it is probable that the performance conditions will be achieved. The fair value of stock options is estimated at the date of grant using the Black-Scholes option pricing model and related assumptions. The Company uses historical data to predict option exercise and employee termination behavior. Expected volatilities are based on the historical volatility of the Parent’s common stock. The expected term of options granted is derived from actual historical exercise activity and represents the period of time that options granted are expected to be outstanding. The risk-free rate is derived from the U.S. Treasury yield curve in effect at the time of grant based on the expected life of the option. The dividend yield is equal to the dividend yield of the Parent’s common stock at the time of grant. Expense related to stock options is recorded in the statements of income as a component of salaries and benefits for employees and as a component of other noninterest expense for non-employee directors, with a corresponding increase to capital surplus in shareholders’ equity.

Fair Value

The Company measures certain financial assets and liabilities at fair value, with the measurements made on a recurring or nonrecurring basis. Financial instruments measured at fair value on a recurring basis are investment securities available for sale. Impaired loans and other real estate owned are financial instruments measured at fair value on a nonrecurring basis. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. In determining fair value, the Company is required to maximize the use of observable inputs and minimize the use of unobservable inputs, reducing subjectivity. See Note 21 for a further discussion of fair value.

Advertising Costs

Advertising costs are generally expensed as incurred. The Company incurred advertising costs for continuing operations of approximately $425 thousand for the year ended December 31, 2019 and $509 thousand for the year ended December 31, 2018.

Comprehensive Income

Unrealized gains and losses on available-for-sale securities and unrealized losses on securities transferred from AFS to HTM are the two components of accumulated other comprehensive income for the Company. There were no reclassifications from accumulated other comprehensive income (loss) in 2019 and 2018.

Discontinued Operations

During the year ended December 31, 2018, the Company completed the sale of its Insurance Agency, Avon Dixon ("Avon"), which represented the Company's Insurance segment. In accordance with ASC 205-20, the Company determined that the sale of Avon and the discontinued operation of the Company's Premium Finance Company, Mubell Finance, LLC ("Mubell"), including assets and liabilities that will be sold or settled separately within one year met the criteria to be classified as a discontinued operation and the related operating results and financial condition have been presented as discontinued operations on the consolidated financial statements. See Note 2 for additional information. Unless otherwise indicated, information included in these notes to the consolidated financial statements is presented on a consolidated operations basis, which includes results from both continuing and discontinued operations, for all periods presented.

Segment Reporting

In connection with the sale of Avon and the discontinued operation of Mubell, which represented the Company's Insurance segment, the Company reassessed its reportable operating segments. Based on this internal evaluation, the Company determined that its previously disclosed reportable segment, Insurance products and services, is no longer applicable. Accordingly, to better reflect how the Company is now managed and how information is reviewed by the chief operating decision maker, the Company's chief executive officer, the Company determined that all services offered by the Company relate to Commercial Banking. As a result, the Company's only reportable segment is Commercial Banking.

Recent Accounting Standards

ASU No. 2016-13 - In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. At the FASB's October 16, 2019 meeting, the Board affirmed its decision to amend the effective date of this ASU for many companies. Public business entities that are SEC filers, excluding those meeting the smaller reporting company definition, will retain the initial required implementation date of fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. All other entities will be required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. At this time, the Company has established a project management team which meets periodically to discuss and assign roles and responsibilities, key tasks to complete, and a general timeline to be followed for implementation. The team has been working with an advisory consultant and has purchased a vendor model for implementation. Historical data has been collected and uploaded to the new model and the team is in the process of finalizing the methodologies that will be utilized. The team is currently running a parallel simulation to its current incurred loss impairment model. The Company is continuing to evaluate the extent of the potential impact of this standard and continues to keep current on evolving interpretations and industry practices via webcasts, publications, conferences, and peer bank meetings.

ASU No. 2017-04 – In January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are U.S. Securities and Exchange Commission (SEC) filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The guidance is not expected to have a significant impact on the Company's financial positions, results of operations or disclosures.

ASU No. 2018-13 – In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Company's Consolidated Financial Statements.

ASU No. 2019-04 – In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments." This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various TRG Meetings. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

ASU No. 2019-05 - In May 2019, the FASB issued ASU 2019-05, "Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief." The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. The amendments should be applied on a modified-retrospective basis by means of a cumulative-effect adjustment to the opening balance of retained earnings balance in the balance sheet. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

ASU No. 2019-11 - In November 2019, the FASB issued ASU 2019-11, "Codification Improvements to Topic 326, Financial Instruments – Credit Losses." This ASU addresses issues raised by stakeholders during the implementation of ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." Among other narrow-scope improvements, the new ASU clarifies guidance around how to report expected recoveries. "Expected recoveries" describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. While applying the credit losses standard, stakeholders questioned whether expected recoveries were permitted on assets that had already shown credit deterioration at the time of purchase (also known as PCD assets). In response to this question, the ASU permits organizations to record expected recoveries on PCD assets. In addition to other narrow technical improvements, the ASU also reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities. The ASU includes effective dates and transition requirements that vary depending on whether or not an entity has already adopted ASU 2016-13. The Company is currently assessing the impact that ASU 2019-11 will have on its consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes." The ASU is expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers' application of certain income tax-related guidance. This ASU is part of the FASB's simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-12 will have on its consolidated financial statements.

In January 2020, the FASB issued ASU 2020-01, "Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) – Clarifying the Interactions between Topic 321, Topic 323, and Topic 815." The ASU is based on a consensus of the Emerging Issues Task Force and is expected to increase comparability in accounting for these transactions. ASU 2016-01 made targeted improvements to accounting for financial instruments, including providing an entity the ability to measure certain equity securities without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Among other topics, the amendments clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting. For public business entities, the amendments in the ASU are effective for fiscal years beginning after December 31, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2020-01 will have on its consolidated financial statements.

Effective November 25, 2019, the SEC adopted Staff Accounting Bulletin (SAB) 119. SAB 119 updated portions of SEC interpretative guidance to align with FASB ASC 326, "Financial Instruments – Credit Losses." It covers topics including (1) measuring current expected credit losses; (2) development, governance, and documentation of a systematic methodology; (3) documenting the results of a systematic methodology; and (4) validating a systematic methodology.

NOTE 2. SALE OF SUBSIDIARY

Avon-Dixon Agency Sale

On December 31, 2018, the Company completed the sale of specific assets and activities related to its Insurance Agency, Avon Dixon, LLC ("Avon") to Alera Group Agency, LLC ("Alera"). Also, on this date the Company discontinued its operations of its Premium Finance Company, Mubell Finance, LLC ("Mubell"). Together, these companies are referred to as the "Insurance Subsidiaries". The Insurance subsidiaries represented the Company's insurance products and services segment, the activities of which related to originating, servicing and underwriting retail insurance policies. Assets sold to Alera included various intangible assets and a 40% interest in a segregated portfolio of Eastern Re. Ltd., a specialty reinsurance company. The Mubell Company, along with certain other assets and liabilities that were to be sold or settled separately within one year, were classified as discontinued operations in the accompanying Consolidated Balance Sheets and Consolidated Statements of Income.

The specific assets acquired by Alera include, among other things, the insurance origination offices, insurance expirations, workforce and system procedures, trade names and goodwill. Alera has assumed certain obligations and liabilities of the Company under the acquired leases, and with respect to the employment of transferred employees. The Company received $25.2 million cash payment, upon the closing of the transaction.

The following table summarizes the calculation of the net gain on disposal of discontinued operations:

($ in thousands)		**Year Ended December 31, 2018**
Proceeds from the transaction	$	29,276
Compensation expense related to the transaction		2,588
Broker fees		935
Other transaction costs		594
Net cash proceeds		25,159
Net assets sold		(12,423)
Net gain on disposal	**$**	**12,736**

The following tables present the financial information of discontinued operations as of the dates and for the periods indicated:

Balance Sheets of Discontinued Operations

($ in thousands)	December 31, 2019	December 31, 2018
ASSETS		
Goodwill	**$ —**	$ 8
Other assets	**—**	625
Assets of discontinued operations	**$ —**	$ 633
LIABILITIES		
Accrued expenses and other liabilities	**$ —**	$ 3,323
Liabilities of discontinued operations	**$ —**	$ 3,323

Statements of Income of Discontinued Operations

($ in thousands)	For Year Ended December 31, 2019	2018
Noninterest income		
Net gain on disposal	**$ —**	$ 12,736
Insurance agency commissions	**—**	9,006
All other income	**15**	335
Total noninterest income	**15**	22,077
Noninterest expense		
Salaries and wages	**28**	5,156
Employee benefits	**7**	1,173
Occupancy expense	**14**	428
Furniture and equipment	**1**	—
Amortization of intangible assets	**—**	47
Legal and professional fees	**73**	77
Other noninterest expenses	**5**	1,039
Total noninterest expense	**128**	7,920
(Loss) income from discontinued operations before income taxes	**(113)**	14,157
Income tax (benefit) expense	**(27)**	4,923
(Loss) income from discontinued operations	**$ (86)**	$ 9,234

NOTE 3. INVESTMENT SECURITIES

The following table provides information on the amortized cost and estimated fair values of investment securities.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
December 31, 2019				
U.S. Government agencies	**$ 23,854**	**$ 3**	**$ 31**	**$ 23,826**
Mortgage-backed	**98,638**	**574**	**247**	**98,965**
Total	**$ 122,492**	**$ 577**	**$ 278**	**$ 122,791**
December 31, 2018				
U.S. Government agencies	$ 34,285	$ 2	$ 651	$ 33,636
Mortgage-backed	124,162	115	3,481	120,796
Total	$ 158,447	$ 117	$ 4,132	$ 154,432

The Company adopted ASU 2016-01 effective January 1, 2018 and equity securities with an aggregate fair value of $1.3 million at December 31, 2019 and 2018 are presented separately on the balance sheet. The fair value adjustment recorded through earnings totaled $42 thousand for 2019 and $(5) thousand for 2018, respectively.

(Dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Held-to-maturity securities:				
December 31, 2019				
U.S. Government agencies	**$ 1,386**	**$ —**	**$ 5**	**$ 1,381**
States and political subdivisions	**400**	**1**	**—**	**401**
Other Debt securities	**7,000**	**—**	**128**	**6,872**
Total	**$ 8,786**	**$ 1**	**$ 133**	**$ 8,654**
December 31, 2018				
U.S. Government agencies	$ 1,642	$ —	$ 25	$ 1,617
States and political subdivisions	1,401	14	—	1,415
Other Debt securities	3,000	—	32	2,968
Total	$ 6,043	$ 14	$ 57	$ 6,000

The following table provides information about gross unrealized losses and fair value by length of time that the individual securities have been in a continuous unrealized loss position at December 31, 2019 and 2018.

	Less than 12 Months		More than 12 Months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2019						
Available-for-sale securities:						
U.S. Government agencies	**$ 4,995**	**$ 5**	**$ 18,516**	**$ 26**	**$ 23,511**	**$ 31**
Mortgage-backed	**12,180**	**27**	**22,282**	**220**	**34,462**	**247**
Total	**$ 17,175**	**$ 32**	**$ 40,798**	**$ 246**	**$ 57,973**	**$ 278**
Held-to-maturity securities:						
U.S. Government agencies	**1,381**	**5**	**—**	**—**	**1,381**	**5**
Other debt securities	**3,905**	**95**	**2,967**	**33**	**6,872**	**128**
Total	**$ 5,286**	**$ 100**	**$ 2,967**	**$ 33**	**$ 8,253**	**$ 133**

	Less than 12 Months		More than 12 Months		Total	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2018						
Available-for-sale securities:						
U.S. Government agencies	$ 1,079	$ 10	$ 32,362	$ 641	$ 33,441	$ 651
Mortgage-backed	13,981	261	99,904	3,220	113,885	3,481
Total	$ 15,060	$ 271	$ 132,266	$ 3,861	$ 147,326	$ 4,132
Held-to-maturity securities:						
U.S. Government agencies	—	—	1,617	25	1,617	25
Other debt securities	2,968	32	—	—	2,968	32
Total	$ 2,968	$ 32	$ 1,617	$ 25	$ 4,585	$ 57

All of the securities with unrealized losses in the portfolio have modest duration risk, low credit risk, and minimal losses when compared to total amortized cost. The unrealized losses on debt securities that exist are the result of market changes in interest rates since original purchase and are not related to credit concerns. Because the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before recovery of their amortized cost bases, which may be at maturity for debt securities, the Company considers the unrealized losses to be temporary. There were thirty-three available-for-sale securities in an unrealized loss position at December 31, 2019, of which twenty-six were mortgage-backed and seven were U.S. Government agencies. Three held-to-maturity securities were in an unrealized loss position at December 31, 2019, two corporate securities and one agency.

The following table provides information on the amortized cost and estimated fair values of investment securities by maturity date at December 31, 2019.

	Available for sale		**Held to maturity**	
(Dollars in thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$ 14,012	$ 14,005	$ —	$ —
Due after one year through five years	10,449	10,423	400	401
Due after five years through ten years	52,894	53,153	7,000	6,872
Due after ten years	45,137	45,210	1,386	1,381
Total	$ 122,492	$ 122,791	$ 8,786	$ 8,654

The maturity dates for debt securities are determined using contractual maturity dates.

The following table sets forth the amortized cost and estimated fair values of securities which have been pledged as collateral for obligations to federal, state and local government agencies, and other purposes as required or permitted by law, or sold under agreements to repurchase. All pledged securities are in the available-for-sale investment portfolio.

	December 31, 2019		December 31, 2018	
(Dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Pledged available-for-sale securities	**$ 66,904**	**$ 67,142**	$ 99,729	$ 97,170

There were no obligations of states or political subdivisions with carrying values, as to any issuer, exceeding 10% of stockholders' equity at December 31, 2019 or 2018.

Proceeds from sales of investment securities were $0 for the years ended December 31, 2019 and 2018, respectively. There were no gains on the sale or call of investment securities for the years ended December 31, 2019 and 2018. Gross losses on sales or calls were less than $1 thousand and $0 for the years ended December 31, 2019 and 2018, respectively.

NOTE 4. LOANS AND ALLOWANCE FOR CREDIT LOSSES

The Company makes residential mortgage, commercial and consumer loans to customers primarily in Baltimore City, Baltimore County, Howard County, Kent County, Queen Anne's County, Caroline County, Talbot County and Dorchester County in Maryland, Kent County, Delaware and in Accomack County, Virginia. The following table provides information about the principal classes of the loan portfolio at December 31, 2019 and 2018.

(Dollars in thousands)	**2019**	2018
Construction	**$ 99,829**	$ 127,572
Residential real estate	**442,506**	429,560
Commercial real estate	**586,562**	523,427
Commercial	**102,020**	107,522
Consumer	**17,737**	7,274
Total loans	**1,248,654**	1,195,355
Allowance for credit losses	**(10,507)**	(10,343)
Total loans, net	**$ 1,238,147**	$ 1,185,012

In the normal course of banking business, loans are made to officers and directors and their affiliated interests. These loans are made on substantially the same terms and conditions as those prevailing at the time for comparable transactions with persons who are not related to the Company and are not considered to involve more than the normal risk of collectability. As of December 31, 2019 and 2018, such loans outstanding, both direct and indirect (including guarantees), to directors, their associates and policy-making officers, totaled approximately $18.8 million and $13.2 million, respectively. During 2019 and 2018, loan additions were approximately $15.7 million and $1.9 million, respectively, and loan repayments were approximately $8.6 million and $2.6 million, respectively. Due to changes in the composition of related parties, $1.4 million of loans included in the total for the prior year end were no longer reported as related party loans at December 31, 2019. Net loan origination costs, included in balances above, totaled $1.8 million and $789 thousand as of December 31, 2019 and 2018, respectively. At December 31, 2019 and December 31, 2018 included in total loans were $79.2 million and $92.8 million in loans, respectively, acquired as part of the 2017 NWBI branch acquisition. These balances are presented net of the related discount which totaled $1.1 million at December 31, 2019 and $1.4 million at December 31, 2018.

In the normal course of banking business, risks related to specific loan categories are as follows:

Construction loans – Construction loans are offered primarily to builders and individuals to finance the construction of single family dwellings. In addition, the Bank periodically finances the construction of commercial projects. Credit risk factors include the borrower's ability to successfully complete the construction on time and within budget, changing market conditions which could affect the value and marketability of projects, changes in the borrower's ability or willingness to repay the loan and potentially rising interest rates which can impact both the borrower's ability to repay and the collateral value.

Residential real estate – Residential real estate loans are typically made to consumers and are secured by residential real estate. Credit risk arises from the borrower's continuing financial stability, which can be adversely impacted by job loss, divorce, illness, or personal bankruptcy, among other factors. Also impacting credit risk would be a shortfall in the value of the residential real estate in relation to the outstanding loan balance in the event of a default or subsequent liquidation of the real estate collateral.

Commercial real estate – Commercial real estate loans consist of both loans secured by owner occupied properties and non-owner occupied properties where an established banking relationship exists and involves investment properties for warehouse, retail, and office space with a history of occupancy and cash flow. These loans are subject to adverse changes in the local economy and commercial real estate markets.

Credit risk associated with owner occupied properties arises from the borrower's financial stability and the ability of the borrower and the business to repay the loan. Non-owner occupied properties carry the risk of a tenant's deteriorating credit strength, lease expirations in soft markets and sustained vacancies which can adversely impact cash flow.

Commercial – Commercial loans are secured or unsecured loans for business purposes. Loans are typically secured by accounts receivable, inventory, equipment and/or other assets of the business. Credit risk arises from the successful operation of the business which may be affected by competition, rising interest rates, regulatory changes and adverse conditions in the local and regional economy.

Consumer – Consumer loans include home equity loans and lines, installment loans and personal lines of credit. Credit risk is similar to residential real estate loans above as it is subject to the borrower's continuing financial stability and the value of the collateral securing the loan.

The following tables include impairment information relating to loans and the allowance for credit losses as of December 31, 2019 and 2018.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
December 31, 2019						
Loans individually evaluated for impairment	**$ 41**	**$ 7,072**	**$ 12,006**	**$ 298**	**$ —**	**$ 19,417**
Loans collectively evaluated for impairment	**99,788**	**435,434**	**574,556**	**101,722**	**17,737**	**1,229,237**
Total loans	**$ 99,829**	**$ 442,506**	**$ 586,562**	**$ 102,020**	**$ 17,737**	**$ 1,248,654**
Allowance for credit losses allocated to:						
Loans individually evaluated for impairment	**$ —**	**$ 395**	**$ 580**	**$ —**	**$ —**	**$ 975**
Loans collectively evaluated for impairment	**1,576**	**2,106**	**3,452**	**1,929**	**469**	**9,532**
Total allowance	**$ 1,576**	**$ 2,501**	**$ 4,032**	**$ 1,929**	**$ 469**	**$ 10,507**

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
December 31, 2018						
Loans individually evaluated for impairment	$ 2,893	$ 8,553	$ 13,532	$ 340	$ —	$ 25,318
Loans collectively evaluated for impairment	124,679	421,007	509,895	107,182	7,274	1,170,037
Total loans	$ 127,572	$ 429,560	$ 523,427	$ 107,522	$ 7,274	$ 1,195,355
Allowance for credit losses allocated to:						
Loans individually evaluated for impairment	$ 320	$ 301	$ 104	$ 36	$ —	$ 761
Loans collectively evaluated for impairment	2,342	2,052	2,973	1,913	302	9,582
Total allowance	$ 2,662	$ 2,353	$ 3,077	$ 1,949	$ 302	$ 10,343

The allowance for loan losses was 0.84% of total loans at December 31, 2019, compared to 0.87% at December 31, 2018.

The following tables provide information on impaired loans and any related allowance by loan class as of December 31, 2019 and 2018. The difference between the unpaid principal balance and the recorded investment is the amount of partial charge-offs that have been taken and interest paid on nonaccrual loans that has been applied to principal.

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	Quarter-to-date average recorded investment	Year-to-date average recorded investment	Interest recorded investment
December 31, 2019							
Impaired nonaccrual loans:							
Construction	$ —	—	—	—	—	1,076	—
Residential real estate	2,660	678	1,797	215	2,052	2,691	—
Commercial real estate	8,242	5,680	2,137	561	8,533	9,421	—
Commercial	421	298	—	—	301	313	—
Consumer	—	—	—	—	—	—	—
Total	$ 11,323	$ 6,656	$ 3,934	$ 776	$ 10,886	$ 13,501	$ —
Impaired accruing TDRs:							
Construction	$ 41	$ 41	$ —	$ —	$ 41	$ 46	$ 10
Residential real estate	4,041	2,583	1,458	180	4,052	4,157	171
Commercial real estate	3,419	2,748	671	19	3,438	3,496	125
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	$ 7,501	$ 5,372	$ 2,129	$ 199	$ 7,531	$ 7,699	$ 306
Other Impaired accruing loans:							
Construction	$ —	$ —	$ —	$ —	$ —	$ —	$ —
Residential real estate	556	556	—	—	—	—	—
Commercial real estate	770	770	—	—	—	—	—
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	$ 1,326	$ 1,326	$ —	$ —	$ —	$ —	$ —
Total impaired loans:							
Construction	$ 41	$ 41	$ —	$ —	$ 41	$ 1,122	$ 10
Residential real estate	7,257	3,817	3,255	395	6,104	6,848	171
Commercial real estate	12,431	9,198	2,808	580	11,971	12,917	125
Commercial	421	298	—	—	301	313	—
Consumer	—	—	—	—	—	—	—
Total	$ 20,150	$ 13,354	$ 6,063	$ 975	$ 18,417	$ 21,200	$ 306

(Dollars in thousands)	Unpaid principal balance	Recorded investment with no allowance	Recorded investment with an allowance	Related allowance	Quarter-to-date average recorded investment	Year-to-date average recorded investment	Interest income recognized
December 31, 2018							
Impaired nonaccrual loans:							
Construction	$ 3,219	$ 127	$ 2,715	$ 320	$ 2,932	$ 2,988	$ —
Residential real estate	4,281	2,605	1,494	118	2,820	1,884	—
Commercial real estate	10,029	9,307	67	67	4,283	2,149	—
Commercial	445	—	340	36	329	336	—
Consumer	—	—	—	—	—	—	—
Total	$ 17,974	$ 12,039	$ 4,616	$ 541	$ 10,364	$ 7,357	$ —
Impaired accruing TDRs:							
Construction	$ 51	$ 51	$ —	$ —	$ 52	$ 866	$ 35
Residential real estate	4,454	1,440	3,014	183	4,585	4,606	125
Commercial real estate	4,158	1,286	2,872	37	4,164	4,416	149
Commercial	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—
Total	$ 8,663	$ 2,777	$ 5,886	$ 220	$ 8,801	$ 9,888	$ 309
Total impaired loans:							
Construction	$ 3,270	$ 178	$ 2,715	$ 320	$ 2,984	$ 3,854	$ 35
Residential real estate	8,735	4,045	4,508	301	7,405	6,490	125
Commercial real estate	14,187	10,593	2,939	104	8,447	6,565	149
Commercial	445	—	340	36	329	336	—
Consumer	—	—	—	—	—	—	—
Total	$ 26,637	$ 14,816	$ 10,502	$ 761	$ 19,165	$ 17,245	$ 309

The following tables provide a roll-forward for troubled debt restructurings as of and for the years ended December 31, 2019 and December 31, 2018.

(Dollars in thousands)	1/1/2019 TDR Balance	New TDRs	Disbursements (Payments)	Charge-offs	Reclassifications/ Transfer In/ (Out)	Payoffs	12/31/2019 TDR Balance	Related Allowance
For year ended December 31, 2019								
Accruing TDRs								
Construction	$ 51	$ —	$ (10)	$ —	$ —	$ —	$ 41	$ —
Residential real estate	4,454	41	(101)	—	—	(353)	4,041	180
Commercial real estate	4,158	—	(739)	—	—	—	3,419	19
Commercial	—	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—	—
Total	$ 8,663	$ 41	$ (850)	$ —	$ —	$(353)	$ 7,501	$ 199
Nonaccrual TDRs								
Construction	$ 2,798	$ —	$ (1,402)	$ (3)	$ (1,393)	$ —	$ —	$ —
Residential real estate	—	—	—	—	1,393	—	1,393	113
Commercial real estate	—	—	—	—	—	—	—	—
Commercial	320	—	(21)	—	—	—	299	—
Consumer	—	—	—	—	—	—	—	—
Total	$ 3,118	$ —	$ (1,423)	$ (3)	$ —	$ —	$ 1,692	$ 113
Total	$11,781	$ 41	$ (2,273)	$ (3)	$ —	$(353)	$ 9,193	$ 312

(Dollars in thousands)	1/1/2018 TDR Balance	New TDRs	Disbursements (Payments)	Charge-offs	Reclassifications/ Transfer In/ (Out)	Payoffs	12/31/2018 TDR Balance	Related Allowance
For year ended December 31, 2018								
Accruing TDRs								
Construction	$ 3,972	$ —	$ (229)	$ (397)	$ (695)	$ (2,600)	$ 51	$ —
Residential real estate	4,536	—	(85)	—	541	(538)	4,454	183
Commercial real estate	4,818	—	(441)	—	—	(219)	4,158	37
Commercial	—	—	—	—	—	—	—	—
Consumer	—	—	—	—	—	—	—	—
Total	$ 13,326	$ —	$ (755)	$ (397)	$ (154)	$ (3,357)	$ 8,663	$ 220
Nonaccrual TDRs								
Construction	$ 2,878	$ —	$ (163)	$ —	$ 83	$ —	$ 2,798	$ 320
Residential real estate	—	—	—	(80)	80	—	—	—
Commercial real estate	83	—	—	—	(83)	—	—	—
Commercial	337	—	(17)	—	—	—	320	16
Consumer	—	—	—	—	—	—	—	—
Total	$ 3,298	$ —	$ (180)	$ (80)	$ 80	$ —	$ 3,118	$ 336
Total	$ 16,624	$ —	$ (935)	$ (477)	$ (74)	$ (3,357)	$ 11,781	$ 556

The following tables provide information on loans that were modified and considered TDRs during 2019 and 2018.

(Dollars in thousands)	Number of contracts	Premodification outstanding recorded investment	Postmodification outstanding recorded investment	Related allowance
TDRs:				
For year ended				
December 31, 2019				
Construction	**—**	**$ —**	**$ —**	**$ —**
Residential real estate	**3**	**2,310**	**2,119**	**—**
Commercial real estate	**1**	**2,152**	**1,531**	**—**
Commercial	**—**	**—**	**—**	**—**
Consumer	**—**	**—**	**—**	**—**
Total	**4**	**$ 4,462**	**$ 3,650**	**$ —**
For year ended				
December 31, 2018				
Construction	—	$ —	$ —	$ —
Residential real estate	—	—	—	—
Commercial real estate	—	—	—	—
Commercial	—	—	—	—
Consumer	—	—	—	—
Total	—	$ —	$ —	$ —

During the year ended December 31, 2019, there was one new TDR and three previously recorded TDR's which were modified.

The following tables provide information on TDRs that defaulted during 2019 and 2018 within 12 months of their restructuring. Generally, a loan is considered in default when principal or interest is past due 90 days or more, the loan is placed on nonaccrual, charged-off, or there is a transfer to OREO or repossessed assets.

(Dollars in thousands)	Number of contracts	Recorded investment	Related allowance
TDRs that subsequently defaulted:			
For year ended			
December 31, 2019			
Construction	**—**	**$ —**	**$ —**
Residential real estate	**—**	**—**	**—**
Commercial real estate	**—**	**—**	**—**
Commercial	**—**	**—**	**—**
Consumer	**—**	**—**	**—**
Total	**—**	**$ —**	**$ —**
For year ended			
December 31, 2018			
Construction	—	$ —	$ —
Residential real estate	—	—	—
Commercial real estate	—	—	—
Commercial	—	—	—
Consumer	—	—	—
Total	—	$ —	$ —

Management uses risk ratings as part of its monitoring of the credit quality in the Company's loan portfolio. Loans that are identified as special mention, substandard or doubtful are adversely rated. These loans and the pass/watch loans are assigned higher qualitative factors than favorably rated loans in the calculation of the formula portion of the allowance for credit losses. At December 31, 2019, there were no nonaccrual loans classified as special mention or doubtful and $10.6 million of nonaccrual loans were classified as substandard. Similarly, at December 31, 2018, there were no nonaccrual loans classified as special mention or doubtful and $16.7 million of nonaccrual loans were classified as substandard.

The following tables provide information on loan risk ratings as of December 31, 2019 and 2018.

(Dollars in thousands)	Pass/Performing	Pass/Watch	Special Mention	Substandard	Doubtful	Total
December 31, 2019						
Construction	**$ 84,357**	**$ 13,068**	**$ 2,404**	**$ —**	**$ —**	**$ 99,829**
Residential real estate	**404,500**	**29,223**	**5,549**	**3,234**	**—**	**442,506**
Commercial real estate	**455,388**	**115,190**	**4,822**	**11,162**	**—**	**586,562**
Commercial	**80,816**	**20,130**	**746**	**328**	**—**	**102,020**
Consumer	**17,347**	**383**	**2**	**5**	**—**	**17,737**
Total	**$ 1,042,408**	**$ 177,994**	**$ 13,523**	**$ 14,729**	**$ —**	**$ 1,248,654**

(Dollars in thousands)	Pass/Performing	Pass/Watch	Special Mention	Substandard	Doubtful	Total
December 31, 2018						
Construction	$ 93,977	$ 30,735	$ —	$ 2,860	$ —	$ 127,572
Residential real estate	386,553	33,739	3,769	5,499	—	429,560
Commercial real estate	389,219	113,873	4,515	15,820	—	523,427
Commercial	90,777	15,727	642	376	—	107,522
Consumer	6,805	466	—	3	—	7,274
Total	$ 967,331	$ 194,540	$ 8,926	$ 24,558	$ —	$ 1,195,355

The following tables provide information on the aging of the loan portfolio as of December 31, 2019 and 2018.

	Accruing						
(Dollars in thousands)	Current	30-59 days past due	60-89 days past due	Greater than 90 days	Total past due	Nonaccrual	Total
December 31, 2019							
Construction	**$ 99,234**	**$ 595**	**$ —**	**$ —**	**$ 595**	**$ —**	**$ 99,829**
Residential real estate	**435,671**	**3,021**	**783**	**556**	**4,360**	**2,475**	**442,506**
Commercial real estate	**577,015**	**743**	**217**	**770**	**1,730**	**7,817**	**586,562**
Commercial	**101,476**	**246**	**—**	**—**	**246**	**298**	**102,020**
Consumer	**17,680**	**57**	**—**	**—**	**57**	**—**	**17,737**
Total	**$1,231,076**	**$ 4,662**	**$ 1,000**	**$ 1,326**	**$ 6,988**	**$ 10,590**	**$1,248,654**
Percent of total loans	**98.6 %**	**0.4 %**	**0.1 %**	**0.1 %**	**0.6 %**	**0.8 %**	**100.0 %**

	Accruing						
(Dollars in thousands)	Current	30-59 days past due	60-89 days past due	Greater than 90 days	Total past due	Nonaccrual	Total
December 31, 2018							
Construction	$ 124,535	$ 195	$ —	$ —	$ 195	$ 2,842	$ 127,572
Residential real estate	423,732	1,384	206	139	1,729	4,099	429,560
Commercial real estate	512,252	253	1,548	—	1,801	9,374	523,427
Commercial	107,089	83	10	—	93	340	107,522
Consumer	7,238	30	6	—	36	—	7,274
Total	$1,174,846	$ 1,945	$ 1,770	$ 139	$ 3,854	$ 16,655	$1,195,355
Percent of total loans	98.3 %	0.2 %	0.1 %	— %	0.3 %	1.4 %	100.0 %

The following tables provide a summary of the activity in the allowance for credit losses allocated by loan class for 2019 and 2018.

Allocation of a portion of the allowance to one loan class does not preclude its availability to absorb losses in other loan classes.

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
2019						
Allowance for credit losses:						
Beginning Balance	**$ 2,662**	**$ 2,353**	**$ 3,077**	**$ 1,949**	**$ 302**	**$ 10,343**
Charge-offs	**(3)**	**(646)**	**—**	**(411)**	**(37)**	**(1,097)**
Recoveries	**18**	**27**	**206**	**306**	**4**	**561**
Net charge-offs	**15**	**(619)**	**206**	**(105)**	**(33)**	**(536)**
Provision	**(1,101)**	**767**	**749**	**85**	**200**	**700**
Ending Balance	**$ 1,576**	**$ 2,501**	**$ 4,032**	**$ 1,929**	**$ 469**	**$ 10,507**

(Dollars in thousands)	Construction	Residential real estate	Commercial real estate	Commercial	Consumer	Total
2018						
Allowance for credit losses:						
Beginning Balance	$ 2,460	$ 2,284	$ 2,594	$ 2,241	$ 202	$ 9,781
Charge-offs	(397)	(406)	(240)	(441)	(27)	(1,511)
Recoveries	43	112	29	203	12	399
Net charge-offs	(354)	(294)	(211)	(238)	(15)	(1,112)
Provision	556	363	694	(54)	115	1,674
Ending Balance	$ 2,662	$ 2,353	$ 3,077	$ 1,949	$ 302	$ 10,343

Foreclosure Proceedings

Consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure totaled $23 thousand and $949 thousand as of December 31, 2019 and 2018. There were no residential real estate properties included in the balance of other real estate owned at December 31, 2019 and December 31, 2018.

All accruing TDRs were in compliance with their modified terms. One loan was transferred to nonaccrual during 2018. Both performing and non-performing TDRs had no further commitments associated with them as of December 31, 2019 and December 31, 2018.

NOTE 5. LEASES

On January 1, 2019, the Company adopted ASU No. 2016-02 *"Leases (Topic 842)"* and all subsequent ASUs that modified Topic 842. The Company elected the prospective application approach provided by ASU 2018-11 and did not adjust prior periods for ASC 842. The Company also elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. As stated in the Company's 2018 Form 10-K, the implementation of the new standard resulted in recognition of right-of-use assets and lease liabilities totaling $3.8 million at the date of adoption, which are primarily related to the Company's lease of premises used in operations. Since adoption of the leasing standard in January 2019, the Company recognized additional right-of-use assets and lease liabilities of $1.4 million, primarily related to the lease of additional premises used in operations.

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The Company's long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably certain of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The following tables present information about the Company's leases:

(Dollars in thousands)	December 31, 2019
Lease liabilities	$ 4,792
Right-of-use assets	$ 4,771
Weighted average remaining lease term	11.76 years
Weighted average discount rate	3.13 %

Lease cost (in thousands)	For the year ended December 31, 2019
Operating lease cost	$ 620
Short-term lease cost	—
Total lease cost	$ 620
Cash paid for amounts included in the measurement of lease liabilities	$ 587

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities is as follows:

Lease payments due (in thousands)	As of December 31, 2019
Twelve months ending December 31, 2020	$ 659
Twelve months ending December 31, 2021	627
Twelve months ending December 31, 2022	625
Twelve months ending December 31, 2023	589
Twelve months ending December 31, 2024	547
Thereafter	3,152
Total undiscounted cash flows	$ 6,199
Discount	1,407
Lease liabilities	$ 4,792

NOTE 6. PREMISES AND EQUIPMENT

The following table provides information on premises and equipment for our continuing operations at December 31, 2019 and 2018.

(Dollars in thousands)	2019	2018
Land	$ 8,509	$ 7,884
Buildings and land improvements	21,250	20,597
Furniture and equipment	7,354	6,387
	37,113	34,868
Accumulated depreciation	(13,292)	(12,157)
Total	$ 23,821	$ 22,711

Depreciation expense of continuing operations totaled $1.1 million for 2019 and $1.0 million for 2018.

NOTE 7. GOODWILL AND OTHER INTANGIBLE ASSETS

The following table provides information on the significant components of goodwill and other acquired intangible assets at December 31, 2019 and 2018. On December 31, 2018 the Company sold its insurance subsidiary, Avon Dixon, LLC and discontinued operations of its premium finance company, Mubell, LLC, which have been removed from the table. In addition, on May 19, 2017, the Bank acquired three branches located in Arbutus, Owings Mills and Elkridge, Maryland from NWBI. The purchase of these branches resulted in core deposit intangibles of $4.0 million and goodwill of $15.0 million.

December 31, 2019					
(Dollars in thousands)	Gross Carrying Amount	Accumulated Impairment Charges	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (in years)
Goodwill	$ 19,728	$ (1,543)	$ (667)	$ 17,518	—
Other intangible assets					
Amortizable					
Core deposit intangible	$ 3,954	$ —	$ (1,702)	$ 2,252	5.7
Total other intangible assets	$ 3,954	$ —	$ (1,702)	$ 2,252	

December 31, 2018					
(Dollars in thousands)	Gross Carrying Amount	Accumulated Impairment Charges	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (in years)
Goodwill	$ 19,728	$ (1,543)	$ (667)	$ 17,518	—
Other intangible assets					
Amortizable					
Core deposit intangible	$ 3,954	$ —	$ (1,097)	$ 2,857	7.2
Total other intangible assets	$ 3,954	$ —	$ (1,097)	$ 2,857	

The aggregate amortization expense was $605 thousand and $866 thousand for the years ended December 31, 2019 and 2018, respectively.

The following table provides information on current period and estimated future amortization expense for amortizable other intangible assets.

(Dollars in thousands)	Amortization Expense
2020	$ 533
2021	461
2022	389
2023	317
2024	246
Thereafter	306
Total amortizing intangible assets	$ 2,252

NOTE 8. OTHER ASSETS

The Company had the following other assets at December 31, 2019 and 2018, excluding discontinued operations.

(Dollars in thousands)	**2019**	2018
Accrued interest receivable	**$ 3,455**	$ 3,345
Deferred income taxes	**2,754**	4,182
Prepaid expenses	**1,157**	1,067
Cash surrender value on life insurance	**29,770**	3,726
Income taxes receivable	**175**	—
Other assets	**3,261**	5,358
Total	**$ 40,572**	$ 17,678

NOTE 9. OTHER LIABILITIES

The Company had the following other liabilities at December 31, 2019 and 2018, excluding discontinued operations.

(Dollars in thousands)	**2019**	2018
Accrued interest payable	**$ 330**	$ 604
Deferred compensation liability	**1,401**	1,040
Income taxes payable	**—**	3,454
Other liabilities	**2,350**	3,317
Total	**$ 4,081**	$ 8,415

NOTE 10. DEPOSITS

The approximate amount of certificates of deposit of $250,000 or more was $38.9 million and $26.7 million at December 31, 2019 and 2018, respectively.

The following table provides information on the approximate maturities of total time deposits at December 31, 2019 and 2018.

(Dollars in thousands)	**2019**	2018
Due in one year or less	**$ 126,055**	$ 128,268
Due in one to three years	**116,979**	90,942
Due in three to five years	**34,084**	41,521
Total	**$ 277,118**	$ 260,731

As of December 31, 2019 and 2018, deposits, both direct and indirect, to directors, their associates and policy-making officers, totaled approximately $5.5 million and $3.9 million, respectively.

At December 31, 2019 we had no brokered deposits and $22.1 million at December 31, 2018.

NOTE 11. BORROWINGS

The Company may periodically borrow from a correspondent federal funds line of credit arrangement, under a secured reverse repurchase agreement, or from the Federal Home Loan Bank to meet short-term liquidity needs.

The following table summarizes certain information on short-term borrowings for the years ended December 31, 2019 and 2018.

	2019		2018	
(Dollars in thousands)	Amount	Rate	Amount	Rate
Average for the Year				
Repurchase agreements	**$ 1,061**	**1.39 %**	$ 3,341	1.09 %
FHLB Advances	**17,378**	**2.68**	73,970	2.16
Overnight Fed Funds purchased	**14**	**2.86**	—	—
At Year End				
Repurchase agreements	**$ 1,226**	**0.81 %**	$ 823	1.87 %
FHLB Advances	**—**	**—**	59,989	2.63
Overnight Fed Funds purchased	**—**	**—**	—	—

Securities sold under agreements to repurchase are securities sold to customers, at the customers' request, under a "roll-over" contract that matures in one business day. The underlying securities sold are U.S. Government agency securities, which are segregated in the Company's custodial accounts from other investment securities.

The Bank had $15.0 million in federal funds lines of credit and a reverse repurchase agreement available on a short-term basis from correspondent banks at December 31, 2019 and 2018. In addition, the Bank had secured credit availability of approximately $270.1 million and $154.7 million from the Federal Home Loan Bank at December 31, 2019 and 2018, respectively. These lines of credit are paid for monthly on a fee basis of 0.09%. The Bank has pledged as collateral, under a blanket lien, all qualifying residential loans under borrowing agreements with the Federal Home Loan Bank. The Bank had no short-term borrowings from the Federal Home Loan Bank at December 31, 2019 and $60.0 million at December 31, 2018. At December 31, 2019, the Bank had $15.0 million of fixed rate long-term borrowings from the Federal Home Loan Bank, which carry an interest rate of 2.82% and mature in April 2020.

NOTE 12. BENEFIT PLANS

401(k) and Profit Sharing Plan

The Company has a 401(k) and profit sharing plan covering substantially all full-time employees. The plan calls for matching contributions by the Company, and the Company makes discretionary contributions based on profits. Company contributions to this plan excluding discontinued operations and included in noninterest expense totaled $580 thousand and $532 thousand for 2019 and 2018, respectively.

NOTE 13. STOCK-BASED COMPENSATION

At the 2016 annual meeting, stockholders approved the Shore Bancshares, Inc. 2016 Stock and Incentive Plan ("2016 Equity Plan"), replacing the Shore Bancshares, Inc. 2006 Stock and Incentive Plan ("2006 Equity Plan"), which expired on that date. The Company may issue shares of common stock or grant other equity-based awards pursuant to the 2016 Equity Plan. Stock-based awards granted to date generally are time-based, vest in equal installments on each anniversary of the grant date and range over a one- to three-year period of time, and, in the case of stock options, expire 10 years from the grant date. As part of the 2016 Equity Plan, a performance equity incentive award program, known as the “Long-term incentive plan” allows participating officers of the Company to earn incentive awards of performance share/restricted stock units if certain pre-determined targets are achieved at the end of a three-year performance cycle. Stock-based compensation expense based on the grant date fair value is recognized ratably over the requisite service period for all awards and reflects forfeitures as they occur. The 2016 Equity Plan originally reserved 750,000 shares of common stock for grant, and 636,465 shares remained available for grant at December 31, 2019.

The following tables provide information on stock-based compensation expense for 2019 and 2018.

	December 31,	
(Dollars in thousands)	**2019**	2018
Stock-based compensation expense	**$ 149**	$ 447
Excess tax benefits related to stock-based compensation	**7**	34

	December 31,	
(Dollars in thousands)	**2019**	2018
Unrecognized stock-based compensation expense	**$ 35**	$ 223
Weighted average period unrecognized expense is expected to be recognized	**0.1 years**	0.9 years

The following table summarizes restricted stock award activity for the Company under the 2016 Equity Plan for the two years ended December 31, 2019.

	Year Ended December 31, 2019		Year Ended December 31, 2018	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at beginning of period	**—**	**$ —**	15,913	$ 15.39
Granted	**15,702**	**15.36**	15,826	18.63
Vested	**—**	**—**	(31,739)	17.05
Forfeited	**—**	**—**	—	—
Nonvested at end of period	**15,702**	**$ 15.36**	—	$ —

The total fair value of restricted stock awards that vested was $0 thousand in 2019 and $585 thousand in 2018.

Restricted stock units (RSUs) are similar to restricted stock, except the recipient does not receive the stock immediately, but instead receives it upon the terms and conditions of the Company’s long-term incentive plans which are subject to performance milestones achieved at the end of a three-year period. Each RSU cliff vests at the end of the three-year period and entitles the recipient to receive one share of common stock on a specified issuance date. The recipient does not have any stockholder rights, including voting rights, with respect to the shares underlying awarded RSUs until the recipient becomes the holder of those shares.

In the second quarter of 2019, the Long-Term Incentive Plan culminating December 31, 2020 was terminated by the Board’s Compensation Committee and all outstanding RSUs were forfeited as presented in the table below. To replace this compensation incentive plan, the Compensation Committee elected to institute individual Supplemental Executive Retirement Plans (“SERPs”) which will be executed in the beginning of 2020, with the exception of three SERPs which began on July 19, 2019 for Lloyd L. Beatty, Jr., President and Chief Executive Officer, Edward C. Allen, Executive Vice President and Chief Financial Officer and Donna J. Stevens, Executive Vice President and Chief Operating Officer. These individuals also forfeited their RSUs in the LTI culminating December 31, 2019.

During 2017, the Company entered into a long-term incentive program agreement with officers of the Company and its subsidiaries to award RSUs based on a performance metric to be achieved as of December 31, 2019. Assuming the performance metric is achieved, these awards will cliff vest on this date, in which the final number of common shares to be issued will be determined. The range of RSUs which could potentially be awarded at the end of the performance cycle is between 6,178 shares and 24,726 shares, assuming a certain performance metric is met. The table below presents management's evaluation of the probable number of common stock awards to be issued at the end of the performance cycle.

The following table summarizes restricted stock units activity based on management's evaluation of the probable number of common stock awards to be issued at the end of the performance cycle for the Company under the 2016 Equity Plan for the two years ended December 31, 2019.

	Year Ended December 31, 2019		Year Ended December 31, 2018	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	**38,562**	**$ 14.69**	90,266	$ 12.08
Granted	**—**	**—**	11,194	17.36
Vested	**(15,577)**	**11.68**	(40,423)	9.49
Forfeited	**(16,534)**	**16.78**	(22,475)	16.55
Outstanding at end of period	**6,451**	**$ 16.57**	38,562	$ 14.69

The fair value of restricted stock units that vested during 2019 and 2018 was $241 thousand and $383 thousand, respectively.

The following table summarizes stock option activity for the Company under the 2016 Equity Plan for the two years ended December 31, 2019.

	Year Ended December 31, 2019		Year Ended December 31, 2018	
	Number of Shares	Weighted Average Grant Date Exercise Price	Number of Shares	Weighted Average Exercise Prices
Outstanding at beginning of period	**27,249**	**$ 9.68**	62,429	$ 8.47
Granted	**—**	**—**	—	—
Exercised	**(15,578)**	**10.01**	(35,180)	7.54
Expired/Cancelled	**—**	**—**	—	—
Outstanding at end of period	**11,671**	**$ 9.25**	27,249	$ 9.68
Exercisable at end of period	**11,671**	**$ 9.25**	27,249	$ 9.68

There were no stock options granted during 2019 and 2018, respectively. The Company estimates the fair value of options using the Black-Scholes valuation model with weighted average assumptions for dividend yield, expected volatility, risk-free interest rate and expected lives (in years). The expected dividend yield is calculated by dividing the total expected annual dividend payout by the average stock price. The expected volatility is based on historical volatility of the underlying securities. The risk-free interest rate is based on the Federal Reserve Bank's constant maturities daily interest rate in effect at grant date. The expected contract life of the options represents the period of time that the Company expects the awards to be outstanding based on historical experience with similar awards.

At December 31, 2019, the aggregate intrinsic value of the options outstanding and exercisable under the 2016 Equity Plan was $95 thousand based on the $17.36 market value per share of Shore Bancshares, Inc.'s common stock at December 31, 2019. Similarly, the aggregate intrinsic value of the options outstanding and exercisable was $132 thousand at December 31, 2018. The intrinsic value of options exercised during 2019 was $72 thousand based on the $14.66 market value per share of the Company's common stock at January 15, 2019. The intrinsic value of options exercised in 2018 was $376 thousand based on the $18.22 market value per share of the Company's common stock at January 31, 2018. At December 31, 2019, the weighted average remaining contract life of options outstanding and exercisable was 4.8 years.

NOTE 14. DEFERRED COMPENSATION

The Company has multiple deferred compensation agreements with current and former employees. The Executive Deferred Compensation Plan (the "Plan") is reserved for members of management and highly compensated employees of the Company and the Bank. During 2019, the Plan was expanded to include additional officers who had not previously participated. The Plan permits a participant to elect, each year, to defer receipt of up to 100% of his or her salary and bonus to be earned in the following year. The Plan also permits the participant to defer the receipt of performance-based compensation not later than six months before the end of the period for which it is to be earned. The deferred amounts are credited to an account maintained on behalf of the participant and are invested at the discretion of each participant in certain deemed investment options selected by the Compensation Committee of the Board of the Company. The actual investments purchased are owned by the Company and held in a Rabbi Trust. The accounts of the Rabbi Trust are consolidated and the investments are included in other assets on the Consolidated Balance Sheets. The Company and the Bank may also make matching, mandatory and discretionary contributions for certain participants. A participant is fully vested at all times in the amounts that he or she elects to defer. Any contributions by the Company will vest over a five-year period.

The following table provides information on Shore Bancshares, Inc.'s contributions and participant deferrals to the Plan for 2019 and 2018 and the related deferred compensation liability at December 31, 2019 and 2018.

(Dollars in thousands)	2019	2018
Deferred compensation contribution	**$ —**	$ —
Elective deferrals	**133**	—
Deferred compensation liability	**363**	268

During 2019, the Company introduced a new SERP plan for executive officers of the Company and the Bank. The related liability is unfunded; however, BOLI was purchased in order to offset the benefit costs. The following table provides information on the expense recognized during the year ended December 31, 2019, as well as the balance of the unfunded SERP liability and the cash surrender value of policies purchased to offset the SERP benefit cots as of December 31, 2019. The unfunded SERP liability and cash surrender value were included in other liabilities and other assets, respectively.

(Dollars in thousands)	2019
Cash surrender value	**$ 26,721**
Deferred compensation liability - SERP	**347**
SERP Expense	**347**

Lastly, in 2016, the Bank assumed agreements held by the former CNB Bank under which its former directors had elected to defer part of their fees and compensation while serving on the former Board of CNB. The amounts deferred were invested in insurance policies on the lives of the respective individuals. Amounts available under the policies are to be paid to the individuals as retirement benefits over future years.

The following table includes information on the deferred compensation liability and cash surrender value at December 31, 2019 and 2018.

(Dollars in thousands)	2019	2018
Deferred compensation liability	**$ 691**	$ 772
Cash surrender value	**2,919**	3,726

NOTE 15. OTHER EXPENSES

The following table summarizes the Company's other noninterest expenses for the years ended December 31, excluding discontinued operations:

(Dollars in thousands)	2019	2018
Advertising and marketing	**$ 425**	$ 509
Other customer expense	**400**	352
Other expense	**2,220**	1,888
Other loan expense	**277**	336
Software expense	**1,001**	934
Travel and entertainment expense	**322**	328
Trust professional fees	**485**	518
Total noninterest expense	**$ 5,130**	$ 4,865

NOTE 16. INCOME TAXES

The following table provides information on components of income tax expense for continuing operations for each of the two years ended December 31.

(Dollars in thousands)	2019	2018
Current tax expense:		
Federal	**$ 3,974**	$ 4,110
State	**1,395**	1,167
	5,369	5,277
Deferred income tax (benefit) expense:		
Federal	**122**	(120)
State	**119**	223
	241	103
Total income tax expense	**$ 5,610**	$ 5,380

The U.S. Tax Cuts and Jobs Act ("Tax Act") was enacted on December 22, 2017 and introduced significant changes to U.S. income tax law. Among other things, the Tax Act reduced the U.S. statutory tax rate from 35% to 21% beginning in 2018.

The following table provides a reconciliation of tax computed at the statutory federal tax rate to the actual tax expense for continuing operations for each of the two years ended December 31.

	2019	2018
Tax at federal statutory rate	**21 %**	21 %
Tax effect of:		
Tax-exempt income	**(1.0)**	(0.5)
State income taxes, net of federal benefit	**5.5**	5.2
Other	**0.1**	(0.3)
Actual income tax expense rate	**25.6 %**	25.4 %

The following table provides information on significant components of the Company's deferred tax assets and liabilities as of December 31.

(Dollars in thousands)	2019	2018
Deferred tax assets:		
Allowance for credit losses	**$ 2,850**	$ 2,797
Write-downs of other real estate owned	**9**	273
Nonaccrual loan interest	**353**	260
Unrealized losses on available-for-sale securities	**—**	1,105
Unrealized losses on available-for-sale securities transferred to held to maturity	**4**	12
Other	**735**	605
Total deferred tax assets	**3,951**	5,052
Less valuation allowance	**(63)**	—
Deferred tax assets net of valuation allowance	**3,888**	5,052
Deferred tax liabilities:		
Depreciation	**198**	238
Acquisition accounting adjustments	**508**	247
Deferred capital gain on branch sale	**194**	200
Unrealized gains on available-for-sale securities	**74**	—
Other	**160**	185
Total deferred tax liabilities	**1,134**	870
Net deferred tax assets	**$ 2,754**	$ 4,182

NOTE 17. EARNINGS PER COMMON SHARE

Basic earnings per common share is calculated by dividing net income available to (allocable to) common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income available to (allocable to) common stockholders by the weighted average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents (stock-based awards). The following table provides information relating to the calculation of earnings per common share.

(In thousands, except per share data)	2019	2018
Net income from continuing operations	**$ 16,284**	$ 15,763
Net (loss) income from discontinued operations	**(86)**	9,234
Net Income	**$ 16,198**	$ 24,997
Weighted average shares outstanding - Basic	**12,725**	12,739
Dilutive effect of common stock equivalents-options	**5**	12
Dilutive effect of common stock equivalents-restricted stock units	**—**	2
Weighted average shares outstanding - Diluted	**12,730**	12,753
Basic earnings per common share		
Income from continuing operations	**$ 1.28**	$ 1.24
(Loss) income from discontinued operations	**(0.01)**	0.72
Net income	**$ 1.27**	$ 1.96
Diluted earnings per common share		
Income from continuing operations	**$ 1.28**	$ 1.24
(Loss) income from discontinued operations	**(0.01)**	0.72
Net income	**$ 1.27**	$ 1.96

For all periods presented, the calculations of diluted income per common share excluded no weighted average common stock equivalents because the effect of including them would have anti-dilutive.

NOTE 18. REGULATORY CAPITAL REQUIREMENTS

Banks and bank holding companies are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Banks' assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Banks' capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Basel III

The FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for U.S. banks. Under the final rules, minimum requirements increased for both the quantity and quality of capital held by the Company. The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets to 6.0%, require a minimum ratio of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increased each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets. At December 31, 2019 the capital conservation buffer was 2.50% and the Bank's specific capital buffer was 5.87%.

The phase-in period for the final rules began on January 1, 2015, with full compliance with all of the final rules' requirements phased in over a multi-year schedule, ending on January 1, 2019.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain amounts and ratios (set forth in the table below) of Common Equity Tier 1, Tier 1 and total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (leverage ratio). As of December 31, 2019, management believes that Shore United Bank met all capital adequacy requirements to which it was subject.

As of December 31, 2019, the most recent notification from the Federal Reserve Bank categorized Shore Untied Bank, as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes would change the Bank's classification. To be categorized as well capitalized, the Bank must maintain minimum common equity Tier 1, Tier 1 risk-based and total risk-based capital ratios, and Tier 1 leverage ratios, which are described below.

The minimum ratios for capital adequacy purposes are 7.00%, 8.50%, 10.50% and 4.00% for the common equity Tier 1, Tier 1 risk-based capital, total risk-based capital and leverage ratios, respectively which include a capital conservation buffer of 2.50% respectively. To be categorized as well capitalized, a bank must maintain minimum ratios of 6.50%, 8.00%, 10.00% and 5.00% for its common equity Tier 1, Tier 1 risk-based capital, total risk-based capital and leverage ratios, respectively.

The following tables present the capital amounts and ratios as of December 31, 2019 and 2018.

(Dollars in thousands) **December 31, 2019**	Common Equity/ Tier 1 Capital	Total Risk-Based Capital	Net Risk-Weighted Assets	Adjusted Average Total Assets	Common Equity Tier 1 ratio	Tier 1 Risk-Based Capital Ratio	Total Risk-Based Capital Ratio	Tier 1 Leverage Ratio
Shore United Bank	$ 163,206	$ 174,014	$ 1,254,980	$ 1,533,919	13.00 %	13.00 %	13.87 %	10.64 %

(Dollars in thousands) December 31, 2018	Common Equity/ Tier 1 Capital	Total Risk-Based Capital	Net Risk-Weighted Assets	Adjusted Average Total Assets	Common Equity Tier 1 ratio	Tier 1 Risk-Based Capital Ratio	Total Risk-Based Capital Ratio	Tier 1 Leverage Ratio
Shore United Bank	$ 140,265	$ 150,909	$ 1,185,050	$ 1,432,686	11.84 %	11.84 %	12.73 %	9.79 %

In August of 2018 the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") directed the Federal Reserve Board ("FRB") to revise the Small Bank Holding Company Policy Statement to raise the total consolidated asset limit in the Policy Statement from $1 billion to $3 billion. The Company was previously required to comply with the minimum capital requirements on a consolidated basis; however, the Company continues to meet the conditions of the revised policy statement and was, therefore, exempt from the consolidated capital requirements at December 31, 2019 and 2018.

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Company.

At December 31, 2019, the Bank could pay dividends to the parent to the extent of its earnings so long as it maintained required capital ratios. The Bank paid $0 and $4.0 million of dividends to Shore Bancshares, Inc. for the years ended December 31, 2019 and 2018, respectively. Shore Bancshares, Inc. had no outstanding receivables from its subsidiary at December 31, 2019 or 2018.

NOTE 19. ACCUMULATED OTHER COMPREHENSIVE INCOME

The Company records unrealized holding gains (losses), net of tax, on investment securities available for sale as accumulated other comprehensive income (loss), a separate component of stockholders' equity. The following table provides information on the changes in the components of accumulated other comprehensive income (loss) for 2019 and 2018.

(Dollars in thousands)	Unrealized gains (losses) on available for sale securities	Unrealized gains (losses) on securities transferred from Available-for-sale to Held-to-maturity	Accumulated other comprehensive income (loss)
Balance, December 31, 2018	**$ (2,918)**	**$ (32)**	**$ (2,950)**
Other comprehensive income	**3,136**	**21**	**3,157**
Balance, December 31, 2019	**$ 218**	**$ (11)**	**$ 207**
Balance, December 31, 2017	$ (1,255)	$ (54)	$ (1,309)
Cumulative effect adjustment (ASU 2016-01)	6	—	6
Other comprehensive income (loss)	(1,669)	22	(1,647)
Balances, December 31, 2018	$ (2,918)	$ (32)	$ (2,950)

NOTE 20. FAIR VALUE MEASUREMENTS

Accounting guidance under GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. This accounting guidance also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and equity securities with readily determinable fair values are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans, loans held for sale and other real estate owned (foreclosed assets). These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Under fair value accounting guidance, assets and liabilities are grouped at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine their fair values. These hierarchy levels are:

> Level 1 inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.
>
> Level 2 inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.
>
> Level 3 inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity’s own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Assets Measured at Fair Value on a Recurring Basis

Investment Securities Available for Sale

Fair value measurement for investment securities available for sale is based on quoted prices from an independent pricing service. The fair value measurements consider observable data that may include present value of future cash flows, prepayment assumptions, credit loss assumptions and other factors. The Company classifies its investments in U.S. Treasury securities, if any, as Level 1 in the fair value hierarchy, and it classifies its investments in U.S. Government agencies securities and mortgage-backed securities issued or guaranteed by U.S. Government sponsored entities as Level 2.

Equity Securities

Fair value measurement for equity securities is based on quoted market prices retrieved by the Company via on-line resources. Although these securities have readily available fair market values, the Company deems that they be classified as level 2 investments in the fair value hierarchy due to not being considered traded in a highly active market.

The tables below present the recorded amount of assets measured at fair value on a recurring basis at December 31, 2019 and 2018. No assets were transferred from one hierarchy level to another during 2019 or 2018.

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Securities available for sale:				
U.S. Government agencies	**$ 23,826**	**$ —**	**$ 23,826**	**$ —**
Mortgage-backed	**98,965**	**—**	**98,965**	**—**
	122,791	**—**	**122,791**	**—**
Equity	**1,342**	**—**	**1,342**	**—**
Total	**$124,133**	**$ —**	**$124,133**	**$ —**

(Dollars in thousands)	Fair Value	Quoted Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Securities available for sale:				
U.S. Government agencies	$ 33,636	$ —	$ 33,636	$ —
Mortgage-backed	120,796	—	120,796	—
	154,432	—	154,432	—
Equity	1,269	—	1,269	—
Total	$ 155,701	$ —	$ 155,701	$ —

Assets Measured at Fair Value on a Nonrecurring Basis

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loan impairment is measured using the present value of expected cash flows, the loan's observable market price or the fair value of the collateral (less selling costs) if the loans are collateral dependent and these are considered Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable. The value of business equipment, inventory and accounts receivable, discounted on management's review and analysis. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and the client's business.

Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the factors identified above. Valuation techniques are consistent with those techniques applied in prior periods.

Other Real Estate Owned (Foreclosed Assets)

Foreclosed assets are adjusted for fair value upon transfer of loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value and fair value. The estimated fair value for foreclosed assets included in Level 3 are determined by independent market based appraisals and other available market information, less costs to sell, that may be reduced further based on market expectations or an executed sales agreement. If the fair value of the collateral deteriorates subsequent to the initial recognition, the Company records the foreclosed asset as a non-recurring Level 3 adjustment. Valuation techniques are consistent with those techniques applied in prior periods.

The following tables set forth the Company's financial assets subject to fair value adjustments (impairment) on a nonrecurring basis at December 31, 2019 and 2018, that are valued at the lower of cost or market. Assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Quantitative Information about Level 3 Fair Value Measurements					
(Dollars in thousands)	Fair Value	Valuation Technique		Unobservable Input		Range
December 31, 2019						
Nonrecurring measurements:						
Impaired loans	$ **2,489**	Appraisal of collateral	(1)	Liquidation expense	(2)	10%
Impaired loans	$ **2,599**	Discounted cash flow analysis	(1)	Discount rate		4% - 7.25%
Other real estate owned	$ **74**	Appraisal of collateral	(1)	Appraisal adjustments	(2)	0% - 31%
				Liquidation expense	(2)	10%

	Quantitative Information about Level 3 Fair Value Measurements					
(Dollars in thousands)	Fair Value	Valuation Technique		Unobservable Input		Range
December 31, 2018						
Nonrecurring measurements:						
Impaired loans	$ 3,839	Appraisal of collateral	(1)	Appraisal adjustments	(2)	0% - 17%
				Liquidation expense	(2)	0% - 10%
Impaired loans	$ 5,902	Discounted cash flow analysis	(1)	Discount rate		4% - 7.25%
Other real estate owned	$ 1,222	Appraisal of collateral	(1)	Appraisal adjustments	(2)	15% - 40%
				Liquidation expense	(2)	5% - 10%

(1) Fair value is generally determined through independent appraisals of the underlying collateral (impaired loans and OREO) or discounted cash flow analyses (impaired loans), which generally include various level III inputs which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

Fair Value of Financial Assets and Financial Liabilities

The carrying amounts and estimated fair values of the Company's financial instruments are presented in the following tables. Fair values for December 31, 2019 and December 31, 2018 were estimated using an exit price notion.

	December 31, 2019		December 31, 2018	
(Dollars in thousands)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets				
Level 1 inputs				
Cash and cash equivalents	**$ 94,971**	**$ 94,971**	$ 67,225	$ 67,225
Level 2 inputs				
Investment securities held to maturity	**$ 8,786**	**$ 8,654**	$ 6,043	$ 6,000
Restricted securities	**4,190**	**4,190**	6,476	6,476
Cash surrender value on life insurance	**29,770**	**29,770**	3,726	3,726
Level 3 inputs				
Loans, net	**$1,238,147**	**$1,242,867**	$ 1,185,012	$ 1,150,418
Financial liabilities				
Level 2 inputs				
Deposits:				
Noninterest-bearing demand	**$ 356,618**	**$ 356,618**	$ 330,466	$ 330,466
Checking plus interest	**302,227**	**302,227**	239,809	239,809
Money market	**262,050**	**262,050**	232,613	232,613
Savings	**143,322**	**143,322**	148,723	148,723
Club	**387**	**387**	387	387
Brokered Deposits	**—**	**—**	22,084	22,075
Certificates of deposit, $100,000 or more	**127,600**	**128,167**	97,905	96,435
Other time	**149,130**	**149,209**	140,354	136,292
Short-term borrowings	**1,226**	**1,226**	60,812	60,812
Long-term borrowings	**15,000**	**15,040**	15,000	15,012

NOTE 21. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the normal course of business, to meet the financing needs of its customers, the Bank is party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and standby letters of credit. The Banks' exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as they do for on-balance sheet instruments. The Bank generally requires collateral or other security to support the financial instruments with credit risk. The amount of collateral or other security is determined based on management's credit evaluation of the counterparty. The Bank evaluates each customer's creditworthiness on a case-by-case basis.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Letters of credit and other commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the letters of credit and commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

The following table provides information on commitments outstanding as of December 31, 2019 and 2018.

(Dollars in thousands)	December 31, 2019	December 31, 2018
Commitments to extend credit	$ 211,652	$ 210,463
Letters of credit	7,691	6,917
Total	$ 219,343	$ 217,380

The Bank has established an reserve for off balance sheet credit exposures. The reserve is established as losses are estimated to have occurred through a loss for off balance sheet credit exposures charged to earnings. Losses are charged against the allowance when management believes the required funding of these exposures is uncollectible. While this evaluation is completed on a regular basis, it is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

NOTE 22. RELATED PARTY TRANSACTIONS

Shore Bancshares Inc. and its Bank subsidiary will periodically rent ballroom space and conference meeting space from the Tidewater Inn located in Easton, Maryland and the Chesapeake Beach Club and Resort located in Kent Island, Maryland to hold company meetings and events. A director of the board of Shore Bancshares Inc. holds a 61% interest in a limited liability company which owns the Tidewater Inn and 100% of the Chesapeake Beach Club and Resort. During 2019 and 2018, approximately $11 thousand and $27 thousand in expenses were paid for rental and catering services.

NOTE 23. CONTINGENCIES

In the normal course of business, Shore Bancshares, Inc. and its Bank subsidiary may become involved in litigation arising from banking, financial, and other activities. Management, after consultation with legal counsel, does not anticipate that the future liability, if any, arising out of current proceedings will have a material effect on the Company’s financial condition, operating results, or liquidity.

NOTE 24. PARENT COMPANY FINANCIAL INFORMATION

The following tables provide condensed financial information for Shore Bancshares, Inc. (Parent Company Only).

Condensed Balance Sheets
December 31,

(Dollars in thousands)	2019	2018
Assets		
Cash	$ 7,522	$ 26,583
Investment securities available for sale, at fair value	—	918
Investment in subsidiaries	183,183	157,855
Premises and equipment, net	—	3,772
Other assets	2,483	1,593
Total assets	$ 193,188	$ 190,721
Liabilities		
Accrued interest payable	$ —	$ 1
Other liabilities	386	6,494
Short-term borrowings	—	1,041
Total liabilities	386	7,536
Stockholders' equity		
Common stock	125	127
Additional paid in capital	61,045	65,434
Retained earnings	131,425	120,574
Accumulated other comprehensive income (loss)	207	(2,950)
Total stockholders' equity	192,802	183,185
Total liabilities and stockholders' equity	$ 193,188	$ 190,721

Condensed Statements of Income
For the Years Ended December 31,

(Dollars in thousands)	**2019**	2018
Income		
Dividends from subsidiaries	**$ —**	$ 4,000
Management and other fees from subsidiaries	**498**	2,535
Gain on sale of subsidiary	**—**	12,736
Other operating income	**66**	30
Total income	**564**	19,301
Expenses		
Interest expense	**22**	54
Salaries and employee benefits	**111**	1,626
Occupancy and equipment expense	**—**	106
Other operating expenses	**932**	1,274
Total expenses	**1,065**	3,060
(Loss) income before income tax (benefit) expense and equity in undistributed net income of subsidiaries	**(501)**	16,241
Income tax (benefit) expense	**(131)**	4,298
(Loss) income before equity in undistributed net income of subsidiaries	**(370)**	11,943
Equity in undistributed net income of subsidiaries	**16,568**	13,054
Net income	**$ 16,198**	$ 24,997

Condensed Statements of Cash Flows
For the Years Ended December 31,

(Dollars in thousands)	2019	2018
Cash flows from operating activities:		
Net income	**$ 16,198**	$ 24,997
Adjustments to reconcile net income to cash provided by operating activities:		
Equity in undistributed net income of subsidiaries	**(16,568)**	(13,054)
Depreciation and amortization	**—**	469
Stock-based compensation expense	**149**	447
Gain on sale of subsidiary	**—**	(12,736)
Net (increase) decrease in other assets	**(1,093)**	1,001
Net (decrease) increase in other liabilities	**(6,109)**	3,267
Net cash (used in) provided by operating activities	**(7,423)**	4,391
Cash flows from investing activities:		
Proceeds from maturities and principal payments of investment securities available for sale	**—**	187
Purchases of premises and equipment	**—**	(590)
Purchase of bank owned life insurance	**(139)**	—
Transfer to subsidiary	**(571)**	—
Cash of subsidiary retained upon disposal	**—**	726
Proceeds from sale of subsidiary	**—**	25,159
Net cash (used in) provided by investing activities	**(710)**	25,482
Cash flows from financing activities:		
(Decrease) increase in short-term borrowings	**(1,041)**	375
Common stock dividends paid	**(5,347)**	(4,079)
Retirement of common stock	**(4,452)**	—
Repurchase of shares for tax withholding on exercised options and vested restricted stock	**(88)**	(269)
Net cash used in financing activities	**(10,928)**	(3,973)
Net (decrease) increase in cash and cash equivalents	**(19,061)**	25,900
Cash and cash equivalents at beginning of year	**26,583**	683
Cash and cash equivalents at end of year	**$ 7,522**	$ 26,583
Supplemental cash flow information:		
Transfer of building, available for sale securities and other assets to banking subsidiary	**$ 5,032**	$ —

NOTE 25. REVENUE RECOGNITION

On January 1, 2018, the Company adopted ASU No. 2014-09 "*Revenue from Contracts with Customers" (Topic 606)* and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided.

Check orders and other deposit account related fees are largely transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or at the end of the month through a direct charge to customers' accounts.

Trust and Investment Fee Income

Trust and investment fee income are primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company's performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives.

Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered.

Other Noninterest Income

Other noninterest income consists of: fees, exchange, other service charges, safety deposit box rental fees, and other miscellaneous revenue streams. Fees and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that rentals and renewals of safe deposit boxes will be recognized on a monthly basis consistent with the duration of the performance obligation.

The following presents noninterest income, segregated by revenue streams in-scope and out-of-scope of Topic 606, for December 31, 2019 and 2018.

(Dollars in thousands)	December 31, 2019	December 31, 2018
Noninterest Income		
In-scope of Topic 606:		
Service charges on deposit accounts	**$ 3,910**	$ 3,879
Trust and investment fee income	**1,522**	1,557
Interchange income	**2,678**	2,441
Other noninterest income	**1,354**	990
Noninterest Income (in-scope of Topic 606)	**9,464**	8,867
Noninterest Income (out-of-scope of Topic 606)	**556**	146
Total Noninterest Income	**$ 10,020**	$ 9,013

(1) Noninterest income associated with discontinued operations is reported in Note 2.

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity’s obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company’s noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2019 and December 31, 2018, the Company did not have any significant contract balances.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports filed under the Exchange Act with the SEC, such as this annual report, is recorded, processed, summarized and reported within the time periods specified in those rules and forms, and that such information is accumulated and communicated to the Company's management, including the principal executive officer (the "PEO") and the principal financial officer ("PFO"), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls as of December 31, 2019 was carried out under the supervision and with the participation of the Company's management, including the PEO and the PFO. Based on that evaluation, the Company's management, including the PEO and the PFO, has concluded that the Company's disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

During the fourth quarter of 2019, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

As required by Section 404 of the Sarbanes-Oxley Act of 2002, management has performed an evaluation and testing of the Company's internal control over financial reporting as of December 31, 2019. Management's report on the Company's internal control over financial reporting and the related attestation report of the Company's independent registered public accounting firm are included in Item 8 of Part II of this annual report, and each such report is incorporated into this Item 9A by reference thereto.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The Company has adopted a Code of Ethics that applies to all of its directors, officers, and employees, including its principal executive officer, principal financial officer, principal accounting officer, or controller, or persons performing similar functions. A written copy of the Company's Code of Ethics will be provided to stockholders, free of charge, upon request to: W. David Morse, Secretary, Shore Bancshares, Inc., 18 East Dover Street, Easton, Maryland 21601 or (410) 763-7800.

All other information required by this item is incorporated herein by reference to the following sections of the Company's definitive proxy statement to be filed in connection with the 2020 Annual Meeting of Stockholders:

- Election of Directors (Proposal 1);
- Continuing Directors;
- Executive Officers;
- Qualifications of Director Nominees and Continuing Directors;
- Delinquent Section 16(a) Reports; and
- Corporate Governance Matters (under the heading, "Board Committees").

Item 11. Executive Compensation.

The information required by this item is incorporated herein by reference to the following sections of the Company's definitive proxy statement to be filed in connection with the 2020 Annual Meeting of Stockholders:

- Executive Compensation
- Director Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The Company maintains the Shore Bancshares, Inc. 2016 Stock and Incentive Compensation Plan (the "2016 Plan") under which it may issue shares of common stock or grant other equity-based awards (stock options, stock appreciation rights, stock awards, stock units, and performance units) to directors, executive officers, and key employees at the discretion of the Compensation Committee of the Board of Shore Bancshares, Inc. The plan was approved by the Company's Board of Directors and its stockholders.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this item is incorporated herein by reference to the sections of the Company's definitive proxy statement to be filed in connection with the 2020 Annual Meeting of Stockholders entitled "Certain Relationships and Related Transactions" and "Corporate Governance Matters" (under the heading, "Director Independence").

Item 14. Principal Accounting Fees and Services.

The information required by this item is incorporated herein by reference to the section of the Company's definitive proxy statement to be filed in connection with the 2020 Annual Meeting of Stockholders entitled "Audit Fees and Services".

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a)(1), (2) and (c) Financial statements and schedules:

Reports of Independent Registered Public Accounting Firm
Consolidated Balance Sheets at December 31, 2019 and 2018
Consolidated Statements of Income — Years Ended December 31, 2019 and 2018
Consolidated Statements of Comprehensive Income — Years Ended December 31, 2019 and 2018
Consolidated Statements of Changes in Stockholders' Equity — Years Ended December 31, 2019 and 2018
Consolidated Statements of Cash Flows — Years Ended December 31, 2019 and 2018
Notes to Consolidated Financial Statements for the years ended December 31, 2019 and 2018

(a)(3) and (b) Exhibits required to be filed by Item 601 of Regulation S-K:

The exhibits filed or furnished with this annual report are shown on the Exhibit Index that follows the signatures to this annual report, which index is incorporated herein by reference.

Item 16. Form 10-K Summary.

Not applicable

EXHIBIT LIST

Exhibit No.	Description
3.1(i)	Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed on December 14, 2000)
3.1(ii)	Articles Supplementary relating to the Fixed Rate Cumulative Perpetual Preferred Stock, Series A (incorporated by reference Exhibit 4.1 of the Company's Form 8-K filed on January 13, 2009)
3.1(iii)	Articles Supplementary relating to the reclassification of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, as common stock (incorporated by reference Exhibit 3.1(i) of the Company's Form 8-K filed on June 17, 2009)
3.2(i)	Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2(i) of the Company's Form 10-K for the year ended December 31, 2010)
3.2(ii)	First Amendment to Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2(ii) of the Company's Form 10-K for the year ended December 31, 2010)
3.2(iii)	Second Amendment to Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2(iii) of the Company's Form 10-K for the year ended December 31, 2010)
3.2(iv)	Third Amendment to Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2(iv) of the Company's Form 10-K for the year ended December 31, 2010)
4.1	Description of Registrant's Securities (filed herewith)
4.2	Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 of the Company's Form S-3 filed on June 25, 2010)
10.1	Shore Bancshares, Inc. Management Incentive Plan (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed on April 21, 2010)
10.2	Shore Bancshares, Inc. Amended and Restated Executive Deferred Compensation Plan (incorporated by reference to Exhibit 10.2 of the Company's Form 8-K filed on February 14, 2007)
10.3	Shore Bancshares, Inc. 2006 Stock and Incentive Compensation Plan (incorporated by reference to Appendix A of the Company's 2006 definitive proxy statement filed on March 24, 2006)
10.4	Form of Restricted Stock Award Agreement under the 2006 Stock and Incentive Compensation Plan (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on April 11, 2007)
10.5	Form of Performance Share/Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on July 8, 2015).
10.6	Shore Bancshares, Inc. 2016 Stock and Incentive Compensation Plan (incorporated by reference to Appendix A of the Company's 2016 definitive proxy statement filed on March 15, 2016)
10.7	Form of Restricted Stock Award Agreement under the 2016 Stock and Incentive Compensation Plan (filed herewith)
10.8	Form of Restricted Stock Units Award under the 2016 Stock and Incentive Compensation Plan (filed herewith)

10.9	Change in Control Agreement, dated October 31, 2017, between Shore United Bank and Edward C. Allen (incorporated by reference to Exhibit 10.4 to the Company's Form 8-K filed on November 1, 2017)
10.10	Change in Control Agreement, dated November 2, 2018 between Shore United Bank and Lloyd L. Beatty, Jr. (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on November 2, 2018)
10.11	Change in Control Agreement, dated November 2, 2018 between Shore United Bank and Donna J. Stevens (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on November 2, 2018)
10.12	Shore Bancshares Announces Stock Repurchase Plan (Incorporated by reference to Exhibit 99.1 to the Company's Form 8-K filed on April 24, 2019).
10.13	Supplemental Executive Retirement Plan for Lloyd L. Beatty, Jr. (Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on July 25, 2019).
10.14	Supplemental Executive Retirement Plan for Edward C. Allen (Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on July 25, 2019).
10.15	Supplemental Executive Retirement Plan for Donna J. Stevens (Incorporated by reference to Exhibit 10.3 to the Company's Form 8-K filed on July 25, 2019).
10.16	2019 Deferred Compensation Plan (filed herewith)
21	Subsidiaries of the Company (included in the "BUSINESS—General" section of Item 1 of Part I of this Annual Report on Form 10-K)
23.1	Consent of Yount, Hyde & Barbour, P.C. (filed herewith)
31.1	Certifications of the PEO pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith)
31.2	Certifications of the PFO pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith)
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith)
101.INS	XBRL Instance Document (filed herewith)
101.SCH	XBRL Taxonomy Extension Schema (filed herewith)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (filed herewith)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (filed herewith)
101.LAB	XBRL Taxonomy Extension Label Linkbase (filed herewith)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (filed herewith)

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Shore Bancshares, Inc.

Date: March 13, 2020

By: /s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Blenda W. Armistead
Blenda W. Armistead, Director
March 13, 2020

/s/ Clyde V. Kelly, III
Clyde V. Kelly, III, Director
March 13, 2020

/s/ David A. Fike
David A. Fike, Director
March 13, 2020

/s/ David J. Bates
David J. Bates, Director
March 13, 2020

/s/ David W. Moore
David W. Moore, Director
March 13, 2020

/s/ Edward C. Allen
Edward C. Allen
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)
March 13, 2020

/s/ Frank E. Mason, III
Frank E. Mason, III, Director
March 13, 2020

/s/ James A. Judge
James A. Judge, Director
March 13, 2020

/s/ Jeffery E. Thompson
Jeffery E. Thompson, Director
March 13, 2020

/s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr
Director, President, and Chief Executive Officer
(Principal Executive Officer)
March 13, 2020

/s/ R. Michael Clemmer, Jr.
R. Michael Clemmer, Jr., Director
March 13, 2020

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Section 2: EX-4.1 (EX-4.1)

Exhibit 4.1

DESCRIPTION OF REGISTRANT'S SECURITIES

As of December 31, 2019, Shore Bancshares, Inc. (the "Company," "we," or "our") had one class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"): our common stock, $0.01 par value per share ("common stock").

DESCRIPTION OF CAPITAL STOCK

General

The following description of the current terms of our capital stock is a summary and is not meant to be complete. It is qualified in its entirety by reference to the Maryland General Corporation Law (the "MGCL"), federal law, the Company's Amended and Restated Articles of Incorporation (the "Charter") and the Company's Amended and Restated Bylaws, as amended (the "By-laws").

Authorized Capital Stock

We are authorized by our Charter to issue up to 35,000,000 shares of capital stock, par value $0.01 per share , all of which are currently classified as common stock.

Voting Rights

The holders of our common stock are entitled to one vote for each share held of record on all matters submitted to a vote of stockholders. Holders of shares of common stock are not entitled to cumulative voting rights in the election of directors.

No Preemptive or Similar Rights

Holders of common stock have no preemptive rights and have no rights to convert their common stock into any other securities. The common stock is not redeemable. All of the outstanding shares of our common stock are fully paid and nonassessable.

Dividend Rights

Each holder of our common stock is entitled to receive ratably such dividends as may be declared by our Board of Directors (the "Board") out of funds legally available for dividends, subject to preferences that may be applicable to outstanding shares of preferred stock, if any, or limitations and restrictions under applicable bank holding company regulations.

Liquidation Rights

In the event of our liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities and liquidation preferences, if any, on any outstanding shares of preferred stock.

Anti-takeover Provisions

The provisions of Maryland law and our Charter and By-Laws that we summarize below may have an anti-takeover effect and may delay, defer or prevent a tender offer or takeover attempt that a stockholder might consider in his or her best interest, including those attempts that might result in a premium over the market price for the common stock.

Business Combinations under Maryland Law

Section 3-602 of the MGCL, as in effect on the date hereof, generally prohibits corporations from being involved in any "business combination" (defined as a variety of transactions, including a merger, consolidation, share exchange, asset transfer or issuance or reclassification of equity securities) with any "interested stockholder" for a period of five years following the most recent date on which the interested stockholder became an interested stockholder. An interested stockholder is defined generally as a person who is the beneficial owner of 10% or more of the voting power of the outstanding voting stock of the corporation after the date on which the corporation had 100 or more beneficial owners of its stock or who is an affiliate or associate of the corporation and was the beneficial owner, directly or indirectly, of 10% percent or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period immediately prior to the date in question and after the date on which the corporation had 100 or more beneficial owners of its stock.

A business combination that is not prohibited must be recommended by the board of directors, and approved by the affirmative vote of at least 80% of the corporation's outstanding shares entitled to vote and two-thirds of the outstanding shares entitled to vote which are not held by the interested shareholder with whom the business combination is to be effected, unless, among other things, the corporation's common stockholders receive an acceptable price (as determined in accordance with criteria set forth in the MGCL) for their shares, in cash or in the same form as paid by the interested stockholder for its shares. These provisions will not apply if the board of directors has exempted the transaction in question or the interested stockholder prior to the time that the interested stockholder became an interested stockholder. In addition, the board of directors may adopt a resolution approving or exempting specific business combinations, business combinations generally, or generally by type, as to specifically identified or unidentified existing or future stockholders or their affiliates from the business combination provisions of the MGCL.

Control Share Acquisitions

Maryland's control share acquisition law (Sections 3-701 to 709 of the MGCL), as in effect on the date hereof, generally provides that "control shares" of a Maryland corporation acquired in a "control share acquisition" have no voting rights except to the extent approved by the stockholders at a meeting by the affirmative vote of two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares. "Control shares" are shares of stock that, if aggregated with all other shares of stock of the corporation previously acquired by a person or in respect of which that person is entitled to exercise or direct the exercise of voting power, except solely by virtue of a revocable proxy, entitle that person, directly or indirectly, to exercise or direct the exercise of the voting power of shares of stock of the corporation in the election of directors within any of the following ranges of voting power: one-tenth or more, but less than one-third of all voting power; one-third or more, but less than a majority of all voting power; or a majority or more of all voting power. "Control share acquisition" means the acquisition, directly or indirectly, by any person, or ownership of, or the power to direct the exercise of voting power with respect to, issued and outstanding control shares, subject to certain exceptions. If voting rights or control shares acquired in a control share acquisition are not approved at a stockholders' meeting, then, subject to certain conditions, the issuer may redeem any or all of the control shares for fair value. If voting rights of such control shares are approved at a stockholders' meeting and the acquiror becomes entitled to vote a majority of the shares of stock entitled to vote, all other stockholders may exercise appraisal rights.

Our By-Laws contain a provision exempting all shares of our capital stock from the MGCL's control share acquisition law.

Preference Stock Authorization

The Charter gives our Board the authority to, without stockholder approval, create and issue a class or series of capital stock with rights superior to the rights of the holders of our common stock. As a result, this "blank check" stock, while not intended as a defensive measure against takeovers, could be issued quickly and easily, could adversely affect the rights of holders of common stock and could be issued with terms calculated to delay or prevent a change of control of the Company or make removal of management more difficult.

Advance Notice Procedure for Stockholder Proposals

Our Charter and By-Laws allow stockholders to submit director nominations and stockholder proposals. For nominations and proposals to properly come before the meeting, however, the proposing stockholder must have given timely notice in writing to the Secretary of the Company pursuant to the By-Laws.

For an annual meeting, notice of intention to make a director nomination must be delivered or mailed to the Secretary at the Company's principal executive offices not less than 120 days nor more than 180 days prior to the meeting called for the election of directors. In the event that the date of the annual meeting is advanced by more than 30 days or delayed by more than 60 days from the anniversary date of the preceding year's annual meeting, notice by the stockholder must be delivered not earlier than the 180th day prior to such annual meeting and no later than close of business on the later of the 120th day prior to such annual meeting of the 10th day following the day on which public announcement of the date of such annual meeting is first made. In the case of a special meeting called for the purpose of electing directors, a stockholders' notice must be given not later than the close of business on the 10th day following the day on which notice of the date of the special meeting was mailed or public announcement of the meeting was made, whichever occurs first. Notice to the Secretary shall set forth:

- the name and address of each proposed nominee;
- the principal occupation of each proposed nominee;

- the number of shares of capital stock owned by each proposed nominee;

- the name and residence address of the notifying stockholder;

- the number of shares of capital stock owned by the notifying stockholder;

- the consent in writing of the proposed nominee as to the proposed nominee's name being placed in nomination for director;

- a description of all arrangements or understandings between the notifying stockholder and each proposed nominee and any other person(s) (including their names) pursuant to which the nomination(s) are to be made by the notifying stockholders;

- a representation that such notifying stockholder intends to appear in person or by proxy at the meeting to make the nomination; and

- any other information relating to the nominee required to be disclosed in a proxy statement in connection with the solicitation of proxies for election of directors by Regulation 14A under the Exchange Act and Rule 14a-11 promulgated thereunder.

A stockholder proposal will be timely if it is delivered or mailed and received by the Secretary at the Company's principal executive offices not less than 60 days nor more than 90 days prior to the first anniversary of the preceding year's annual meeting. If, however, the date of the annual meeting is advanced by more than 30 days or delayed by more than 60 days from the anniversary date of the preceding year's annual meeting, then notice by the stockholder must be so delivered not earlier than the 90th day prior to such annual meeting and not later than the close of business on the later of the 60th day prior to such annual meeting or the tenth day following the day on which public announcement of the date of such meeting is first made. Notice to the Secretary shall set forth as to each proposal:

- a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the meeting;

- the name and address of such stockholder as they appear on the Company's books and of the beneficial owner, if any, on whose behalf the proposal is made;

- the class or series and number of shares of capital stock of owned beneficially or of record by such stockholder and such beneficial owner;

- a description of all arrangements or understandings between the stockholder and any other person(s) (including their names) in connection with the proposal and any material interest of such stockholder in such business; and

- a representation that such stockholder intends to appear in person or by proxy at the meeting to make the proposal.

Classified Board; Removal of Directors

Our Charter provides that the members of our Board are divided into three classes as nearly equal as possible. Each class is elected for a three-year term. At each annual meeting of stockholders, approximately one-third of the members of the Board are elected for a three-year term and the other directors remain in office until their three-year terms expire. Our By-Laws provide that a director may be removed only in accordance with the provisions of Maryland law. The MGCL provides that, because our Board is divided into classes, no director may be removed without cause. Any removal for cause requires the affirmative vote of the holders of at least a majority of the voting power of the outstanding capital stock entitled to vote for the election of directors. Thus, control of the Board cannot be changed in one year without removing the directors for cause as described above; rather, at least two annual meetings must be held before a majority of the members of the Board could be changed. Generally, an amendment or repeal of these provisions requires the authorization of the Board and the approval of the holders of at least 80% of the aggregate votes entitled to be cast on the matter; however, two-thirds of the entire Board may alter the number of directors set by the Charter to not exceeding 25 nor less than one, but such action may not affect the tenure of office of any director.

Restrictions on Ownership of Company Common Stock

The ability of a third party to acquire our stock is also limited under applicable U.S. banking laws, including regulatory approval requirements. The Bank Holding Company Act of 1956 (the “BHCA”) requires any “bank holding company,” as defined in that BHCA, to obtain the approval of the Board of Governors of the Federal Reserve System (the “Federal Reserve”) prior to acquiring more than 5% of our outstanding common stock. Any corporation or other company that becomes a holder of 25% or more of our outstanding common stock, or 5% or more of our common stock under certain circumstances, would be subject to regulation as a bank holding company under the BHCA. In addition, any person other than a bank holding company may be required to obtain prior approval of the Federal Reserve to acquire 10% or more of our outstanding common stock under the Change in Bank Control Act of 1978.

Stock Exchange Listing

Our common stock is listed on the NASDAQ Global Select Market under the symbol “SHBI.”

Transfer Agent and Registrar

The transfer agent and registrar for our common stock is Broadridge.

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Section 3: EX-10.7 (EX-10.7)

Exhibit 10.7

SHORE BANCSHARES, INC.

Form of
Restricted Stock Award Agreement

THIS AGREEMENT, dated as of the ____day of ____, 20__, between SHORE BANCSHARES, INC., a Maryland corporation (the “Company”), and ______ (“Participant”), is made pursuant and subject to the provisions of the Shore Bancshares, Inc. 2016 Stock and Incentive Compensation Plan, effective April 27, 2016 (the “Plan”). All capitalized terms used but not defined herein shall have the meanings given such terms in the Plan.

1. **Award of Restricted Stock**. Pursuant to the Plan, the Company, on ________ (the “Award Date”),

granted Participant _____ shares of restricted Common Stock ("Restricted Stock"), subject to the terms and conditions of the Plan and subject further to the terms and conditions set forth herein (the "Award").

2. **Restrictions**. Except as provided in this Agreement, the shares of Restricted Stock are not transferable and are subject to a substantial risk of forfeiture.

3. **Vesting**. Participant's interest in the shares of Restricted Stock shall become transferable and non-forfeitable ("Vested") as follows:

Amount of Award Vested	Vesting Date

Notwithstanding the foregoing, any shares of Restricted Stock that have not Vested or been forfeited shall become Vested as of the earlier of (i) the date of a Change in Control or (ii) the date of the Participant's death.

4. **Forfeiture**. Upon the termination of Participant's employment with the Company or an Affiliate, any and all shares of Restricted Stock that have not then become Vested pursuant to Section 3 shall lapse and be forfeited and canceled.

5. **Shareholder Rights**. Participant shall have all the rights of a stockholder of the Company with respect to the shares of Restricted Stock that are not Vested, including the right to receive dividends on and to vote such shares of Restricted Stock; provided, however, that (i) Participant may not sell, transfer, pledge, exchange, hypothecate or otherwise dispose of any such shares, (ii) the Company shall retain custody of the certificates evidencing such shares as provided in Section 6, and (iii) Participant will deliver a stock power in accordance with Section 7.

6. **Custody of Certificates**. Custody of all stock certificates evidencing the shares of Restricted Stock shall be retained by the Company for so long as such shares are not Vested. The Company shall place a legend on each certificate evidencing a share of Restricted Stock restricting the transfer of such share. As soon as practicable after

[redacted]

shares of Restricted Stock become Vested, the Company shall remove the restrictive legend and deliver to Participant one ore more stock certificates evidencing such shares.

7. **Stock Power**. Upon signing this Agreement, Participant shall deliver to the Company a stock power, endorsed in blank, with respect to the shares of Restricted Stock granted pursuant to this Award. The Company shall use the stock power to cancel any shares of Restricted Stock that do not become Vested. The Company shall return the stock power to Participant with respect to any shares of Restricted Stock that become Vested.

8. **Fractional Shares**. Fractional shares shall not be issuable hereunder, and when any provision hereof or the Plan may entitle Participant to a fractional share, such fraction shall be disregarded.

9. **Taxes**. At the time shares of Restricted Stock become Vested, the Company shall have the right to retain and withhold from such Vested shares that portion representing the amount of taxes required by any governmental agency to be withheld or otherwise deducted and paid with respect to such Vested shares, calculated based on the Fair Market Value of a share of Common Stock as of the date such shares become Vested. Any shares so withheld shall be canceled by the Company.

10. **No Right to Continued Employment**. This Agreement does not confer upon Participant any right with respect to continuance of employment by the Company, nor shall it interfere in any way with the right of the Company to terminate Participant's employment at any time.

11. **Governing Law**. This Agreement shall be governed by the laws of the State of Maryland, without regard to any conflict of laws principles that would apply the law of another jurisdiction.

12. **Participant Bound by Plan**. Participant acknowledges, by executing this Agreement, that (1) this Agreement is subject in all respects to the provisions of the Plan, as amended from time to time, the terms of which are incorporated herein by reference and made a part hereof, (2) that a copy of the Plan and all amendments thereto through the date hereof were provided to Participant on the date hereof, and (3) he/she understands and accepts all of the terms and conditions of the Plan. In the event of any conflict between the provisions of the Plan and the provisions of this Agreement, the provisions of the Plan shall govern.

13. **Entire Agreement**. This Agreement sets forth the entire agreement of the parties with respect to the subject matter hereof. Any and all prior agreements or understandings with respect to such matters are hereby superseded.

14. **Binding Effect**. Subject to the limitations stated above and in the Plan, this Agreement shall be binding upon and inure to the benefit of the legatees, distributees, and personal representatives of the Participant and the successors of the Company.

[redacted]

IN WITNESS WHEREOF, the Company has caused this Agreement to be signed on its behalf, and the Participant has affixed his signature hereto.

SHORE BANCSHARES, INC.

By______________________________

____
(Printed Name)

PARTICIPANT

____

____
(Printed Name)

____
Date

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Section 4: EX-10.8 (EX-10.8)

Exhibit 10.8

FORM OF
PERFORMANCE SHARE /RESTRICTED STOCK UNIT
AWARD AGREEMENT

Non-transferable

GRANT TO

("*Grantee*")

by SHORE BANCSHARES, INC. (the "Company") of restricted stock units (the "Units") representing a right to earn, on a one-for-one basis, shares of the Company's Common Stock, $0.01 par value per share (the "Stock"), pursuant to and subject to the provisions of the Shore Bancshares, Inc. 2016 Stock and Incentive Compensation Plan (the "Plan") and to the terms and conditions set forth on the following pages of this award agreement (the "Agreement"). Capitalized terms used herein and not otherwise defined shall have the meanings assigned to such terms in the Plan.

The target number of shares of Stock subject to this award is ______ (the "Target Award"). Depending on the Company's level of attainment of specified performance goals for the period beginning on the Grant Date and ending December 31, 20__ (the "Performance Period"), Grantee may earn ______ shares of Stock (the "Threshold Award") to ______ shares of Stock (the "Maximum Award"), in accordance with the performance metrics described in Appendix A hereto and the terms of this Agreement. If the Company's level of attainment of specified performance goals falls between threshold and target levels or between target and maximum levels, the Company's Compensation Committee (the "Committee") will use a proportional approach to determine the number of shares earned by the Grantee.

By accepting this award, Grantee shall be deemed to have agreed to the terms and conditions of this Agreement and the Plan.

IN WITNESS WHEREOF, Shore Bancshares, Inc., acting by and through its duly authorized officers, has caused this Agreement to be duly executed as of the Grant Date.

SHORE BANCSHARES, INC.

By: ______________________________

Chief Human Resources Officer

Grant Date: _______ __, 20__

Accepted by Grantee: ______________________________

[redacted]

TERMS AND CONDITIONS

1. Grant of Units. The Company hereby grants to Grantee, subject to the terms and conditions set forth in the Plan and in this Agreement, the Units indicated on page 1 hereof, which represent the right to receive an equal number of shares of the Company's Stock on the terms set forth in this Agreement.

2. Vesting of Units. The Units have been credited to a bookkeeping account on behalf of Grantee. The Units will be earned in whole, in part, or not at all, as provided on Appendix A attached hereto. Following the end of the Performance Period, the Committee shall determine the Company's achievement of the performance goals set forth on Appendix A and shall certify such results in writing. Upon such certification, the Units shall become vested on such date (the "Vesting Date") to the extent such performance goals are attained, provided that Grantee remains in Continuous Service on such date. Any Units that fail to vest in accordance with the terms of this Agreement will be forfeited and reconveyed to the Company without further consideration or any act or action by Grantee.

3. Conversion to Stock. Except as otherwise provided in Section 4, the Units for which the relevant vesting criteria are satisfied will be converted to shares of Stock (the "Conversion") on the Vesting Date (the "Conversion Date"). The shares of Stock will be registered in the name of Grantee as of the Conversion Date, and certificates for the shares of Stock shall be delivered to Grantee or Grantee's designee upon request of Grantee after the Conversion.

4. Termination of Continuous Service. If Grantee's Continuous Service is terminated during the Performance Period, the following provisions of this Section 4 shall govern the vesting of the Units:

(i) Death or Disability. If Grantee's Continuous Service is terminated by reason of death or Disability during the Performance Period, then all relevant performance goals will be deemed to have been achieved at the "Target" level.

(ii) Change in Control. If there is a Change in Control (as defined in the Plan) during the Performance Period, all relevant performance goals will be deemed to have been achieved at the "Target" level on the effective date of the Change in Control.

(iii) Retirement. If Grantee retires during the course of the Performance Period but at least one year into the Performance Period, the Units shall be prorated by a factor equal to the quotient of each full month of Continuous Service from the Grant Date to the date of such retirement, divided by the number of total months in the Performance Period, and all relevant performance goals will be deemed to have been achieved at the "Target" level.

(iv) Termination by the Company Not For Cause. In the event Grantee is terminated by the Company without cause (as determined by the Company) during the course of the Performance Period but at least one year into the Performance Period, the Units shall be prorated by a factor equal to the quotient of each full month of Continuous Service from the Grant Date to the date of such termination, divided by the number of total months in the Performance Period, and all relevant performance goals will be deemed to have been achieved at the "Target" level.

(v) Any Other Reason. If Grantee's employment is terminated for any other reason, all of Grantee's Units shall be forfeited.

5. Rights as Stockholder. Grantee shall not have voting or any other rights as a stockholder of the Company with respect to the Units. Dividends or dividend equivalents will not be paid with respect to the Units. Upon Conversion of the Units into shares of Stock, Grantee will obtain full voting and other rights as a stockholder of the Company.

6. Restrictions on Transfer. No right or interest of Grantee in the Units may be pledged, encumbered, or hypothecated to or in favor of any party other than the Company or an Affiliate, or shall be subject to any lien, obligation, or liability of Grantee to any other party other than the Company or an Affiliate. The Units are not assignable or transferable by Grantee other than to a beneficiary or by will or the laws of descent and distribution.

7. Clawback. The Units and any Stock issued thereunder shall be subject to any compensation recoupment policy of the Company that is applicable by its terms to Grantee and to awards of this type.

8. No Right of Continued Service. Nothing in this Agreement shall interfere with or limit in any way the right of the Company or an Affiliate to terminate Grantee's employment or service at any time, nor confer upon Grantee any right to continue in the employ or service of the Company or an Affiliate.

9. Payment of Taxes. The Company or an employing Affiliate has the authority and the right to deduct or withhold, or require Grantee to remit to the Company or an employing Affiliate, an amount sufficient to satisfy federal, state, and local taxes (including Grantee's FICA obligation) required by law to be withheld with respect to any taxable event arising as a result of the grant, vesting or conversion of the Units. To the extent not prohibited by applicable laws or regulations, the withholding requirement may be satisfied, in whole or in part, at the election of the Grantee, by withholding from the Award

[redacted]

shares having a Fair Market Value on the date of withholding equal to the minimum amount (and not any greater amount) required to be withheld for tax purposes, all in accordance with such procedures as the Company establishes. The obligations of the Company under this Agreement will be conditional on such payment or arrangements, and the Company, and, where applicable, its Affiliates will, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to Grantee.

10. Amendment. The Committee may amend, modify or terminate this Agreement without approval of Grantee; provided, however, that such amendment, modification or termination shall not, without Grantee's consent, adversely affect the rights or obligations of the Grantee.

11. Plan Controls. The terms contained in the Plan are incorporated into and made a part of this Agreement and this Agreement shall be governed by and construed in accordance with the Plan. In the event of any actual or alleged conflict between the provisions of the Plan and the provisions of this Agreement, the provisions of the Plan shall be controlling and determinative.

12. Governing Law. This Agreement shall be construed in accordance with and governed by the laws of the State of Maryland, United States of America, regardless of the law that might be applied under principles of conflict of laws. Grantee hereby agrees and submits to jurisdiction in the state and federal courts of the State of Maryland and waives objection to such jurisdiction.

13. Successors. This Agreement shall be binding upon any successor of the Company, in accordance with the terms of this Agreement and the Plan.

14. Severability. If any one or more of the provisions contained in this Agreement is deemed to be invalid, illegal or unenforceable, the other provisions of this Agreement will be construed and enforced as if the invalid, illegal or unenforceable provision had never been included.

15. Notice. All notices hereunder shall be sufficiently made if personally delivered to Grantee or sent by regular mail addressed (a) to Grantee at Grantee's address as set forth in the books and records of the Company or an Affiliate, or (b) to the Company or the Committee at the principal office of the Company clearly marked "Attention: Compensation Committee."

PERFORMANCE GOALS

Goal	Threshold	Threshold Award	Target	Target Award	Maximum	Maximum Award

These goals must be achieved at threshold levels for the awards to vest. If the Company's level of attainment of specified performance goals falls between threshold and target levels or between target and maximum levels, the Committee will use a proportional approach to determine the number of shares earned by the Grantee. Additional qualifiers in order for the awards to vest include no additional consent orders in place, and no decline in the composite CAMELS rating by the end of the performance cycle as compared to the ratings as of the Grant Date.

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Section 5: EX-10.16 (EX-10.16)

Exhibit 10.16

SHORE BANCSHARES, INC.
DEFERRED COMPENSATION PLAN

JANUARY 1, 2019

1. Background and Purpose. **Shore Bancshares, Inc.** (the **"Company")** has established the Shore Bancshares, Inc. Deferred Compensation Plan (the **"Plan")** to allow eligible employees to defer certain types of compensation earned in 2019 or later, effective January 1, 2019.

The Plan is an unfunded program and has been established for the purpose of providing deferred compensation for a select group of management or highly compensated employees.

2. Definitions.

(a) **"Account"** shall mean the interest of a Participant in the Plan as represented by the bookkeeping entries kept by the Company or Participating Company. A separate Account shall be established for each Participant and may include separate subaccounts, such as annual Deferral Accounts, as may be required.

(b) **"Affiliate"** shall mean any company that (i) is included as a member with the Company in a controlled group of corporations, within the meaning of section 414(b) of the Code; (ii) is a trade or business (whether or not incorporated) included with the Company in a group of trades or business under common control, within the meaning of section 414(c) of the Code; or (iii) is required to be aggregated with the Company pursuant to section 414(m) or 414(o) of the Code and regulations thereunder.

(c) **"Base Salary"** shall mean a Participant's base salary payable from the Company and its Affiliates.

(d) **"Beneficiary"** shall mean the person, persons or entity last designated by the Participant to receive any benefits payable after Participant's death pursuant to Section 9 of the Plan.

(e) **"Board"** shall mean the Board of Directors of the Company.

(f) **"Cause"** shall mean (i) an action or failure to act by the Participant constituting fraud, misappropriation or damage to the property or business of the Company; (ii) conduct by the Participant that amounts to fraud, personal dishonesty or breach of fiduciary duty; (iii) the Participant's conviction (from which no appeal may be, or is, timely taken) of a felony or willful violation of any law, rule or regulation (other than traffic violations or similar offenses); (iv) the Participant's breach of any of his obligations hereunder; (v) the unauthorized use, misappropriation or disclosure by the Participant of any Confidential Information (as hereinafter defined) of the Company or of any confidential information of any other party to whom the Participant owes an obligation of nondisclosure as a result of his relationship with the Company; (vi) the willful violation of any final cease and desist or consent order; (vii) a knowing violation by the Participant of federal and state banking laws or regulations which is likely to have a material adverse effect on the Company, as determined by the Board; (viii) the determination by the Board, in the exercise of its reasonable judgment and in good faith, that the Participant's job performance is substantially unsatisfactory and that he has failed to cure such performance within a reasonable period (but in no event more than 30 days) after written notice specifying in reasonable detail the nature of the unsatisfactory performance; (ix) the Participant's material breach of any of the Company's written policies; or (x) the issuance of any order by the Maryland Commissioner of Financial Regulation, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, or any other supervisory agency with jurisdiction over the Company permanently prohibiting the continued service of the Participant with the Company. No act or failure to act on the part of the Participant shall be considered "willful" unless it is done, or omitted to be done, by the Participant in bad faith or without reasonable belief that the Participant's action or omission was in the best interests of the Company. Any act or failure to act that is based upon authority given pursuant to a resolution duly adopted by the Board, or upon the advice of legal counsel for the Company, shall be conclusively presumed to be done, or omitted to be done, by the Participant in good faith and in the best interest of the Company. For purposes of this Cause definition, the term "Confidential Information" means all information of any member of the Company and its Affiliates, whether oral, written, computerized, digitized or otherwise, regarding the business of the Company and its Affiliates, including, without limitation, information regarding the Company's and its Affiliates' customers, referral sources, insurance carriers, sales and marketing information, costs, prices, earnings, business plans, financial information and forecasts, contracts, business arrangements, methods of operation, business strategies, prospects, and "intellectual property" (defined as any and all information, reports, other documents and other works, whether in an electronic format or otherwise, created by the Participant for or on behalf of the Company during the Participant's service with the Company, whether or not developed on the Company's premises or equipment or during the Company's normal business hours), whether or not such information is deemed "trade secrets" under applicable law. Confidential Information does not include information that (i) becomes generally available to the public other than as a result of disclosure by the Participant in violation of this Agreement, (ii) was available to the public on a non-confidential basis from a source other than the Company or its Affiliates, (iii) is made available to a third party on a non-confidential basis by the Company or its Affiliates, (iv) was already known to the Participant at the time of disclosure by the Company or its Affiliates, or (v) is required to be disclosed by legal process or applicable law.

(g) **"Change in Control"** shall be deemed to have occurred if the conditions set forth in any one of the following paragraphs shall have been satisfied provided that in each case, it also qualifies as a "change in control event" under Treasury regulation section 1.409A-3(i)(5):

(i) any one person, or more than one person acting as a group, acquires ownership of securities of the Company that, together with securities held by such person or group, constitutes more than 50 percent of the total fair market value or total voting power of the securities of the Company;

(ii) either (A) any one person, or more than one person acting as a group, acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) ownership of securities of the Company possessing 35 percent or more of the total voting power of the securities of the Company; or (B) a majority of members of the Board is replaced during any 12-month period by Directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election; or

(iii) any one person, or more than one person acting as a group, acquires (or has acquired during the 12-month period ending on the date of the most recent acquisition by such person or persons) assets from the Company that have a total gross fair market value equal to or more than 40 percent of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions. For this purpose, gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

Notwithstanding the foregoing, ownership or control of the Company's voting stock, individually or collectively, by the Company's bank subsidiaries (the "Banks") or any benefit plan sponsored by the Company or the Banks shall not constitute a Change in Control. For purposes of this paragraph only, the term "person" refers to an individual or a corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization of any other form of entity not specifically listed herein.

(h) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(i) **"Committee"** shall mean the Compensation Committee of the Board of Directors of the Company.

(j) **"Company"** shall mean Shore Bancshares, Inc.

(k) **"Compensation"** shall mean Base Salary, bonuses, and other incentive compensation identified by the Company, and designated by a Participant, on a Deferral Election.

(1) **"Deferral Election"** means a commitment by a Participant to defer a portion of his or her Compensation or, with respect to a Director, retainer fees under this Plan and for which an election form has been submitted by the Participant to the Company or the administrator either in writing or electronically. A Deferral Election shall become irrevocable on December 31 of the year prior to the Deferral Period to which the Deferral Election applies.

(m) **"Deferral Period"** shall mean the calendar year.

(n) **"Director"** shall mean a member of the Board or a person serving as a member of the board of directors, board of managers or other governing body of one of the Company's Affiliates.

(o) **"Disability"** or **"Disabled"** shall mean a Participant who is determined to be disabled under the Company's long-term disability plan or the equivalent long-term disability plan of the Participant's employer. The determination of Disability shall be made in accordance with section 409A of the Code and applicable regulations.

(p) "Eligible Individual" shall mean, for any calendar year, an employee or Director of the Company or a Participating Company who is eligible to participate in the Plan, as described in Section 3 below.

(q) "Employer Discretionary Contribution" shall mean the amount, if any, the Company or Participating Company credits to a Participant's Account as a nonelective contribution in accordance with Section 5(b) of the Plan.

(r) "ERISA" shall mean the Employee Retirement Income Security Act of 1974, as amended.

( ) "Key Employee" shall mean an Employee who, at any time during the 12-month period ending on the identification date, is a "specified employee" under section 409A of the Code, as determined by the Committee or its delegate. The determination of Key Employees, including the number and identity of persons considered specified employees and the identification date, shall be made by the Committee or its delegate in accordance with the provisions of sections 416 (i) and 409A of the Code and the regulations issued thereunder.

(s) "Participant" shall mean any Eligible Individual who has elected to defer Compensation or, with respect to a Director, retainer fees pursuant to Section 4 of the Plan or is otherwise credited with Employer Discretionary Contributions.

(t) "Participating Company" shall mean the Company and any subsidiary of the Company who elects to adopt the Plan.

(u) "Retirement" shall mean the Participant's Separation from Service with the Company and its Affiliates at or after the date on which the sum of the Participant's age and Years of Service equals at least 65.

(v) "Separation from Service" means the Participant's termination of employment with the Company or Participating Company employing such Participant and all affiliated and subsidiary entities that are considered to be part of a controlled group with the Company pursuant to Code Section 414(b) or (c), except that in applying Code Section 1563 "fifty percent" shall be substituted for "eighty percent." Whether a termination of employment has occurred is detennined based on whether the facts and circumstances indicate that the Company and the Participant reasonably anticipate that no further services will be performed after a certain date. Separation from Service shall be determined consistent with and pursuant to section 409A(a)(2)(A)(i) of the Code.

(w) "Years of Service" shall mean the cumulative years of continuous full-time employment with the Company or Participating Company employing a Participant, beginning on the date the Participant first began service with the Company or Participating Company and counting each anniversary thereof, without regard for any leave of absence of six (6) months or less approved by the Company, or a longer period if the right to return to employment after such period is protected by law or contract, as determined in the discretion of the Committee. Service with a predecessor or other related entity may also be taken into account in the complete and sole discretion of the Committee.

3. Participation.

(a) Eligibility. Any select employee or Director designated and approved by the Committee shall be eligible to participate in the Plan, as of the Effective Date, as of any subsequent January 1, or as set forth in Section 4(b) below with respect to a newly Eligible Individual.

(b) Participation. An Eligible Individual may elect to participate in the Plan by electing to defer compensation under the Plan or by being credited with Employer Discretionary Contributions.

4. Deferral Elections.

(a) Election Timing and Deferral Amount. Each year, an Eligible Individual may make a Deferral Election each year in the form and manner prescribed by the Committee, as follows. If any amounts are to be paid at Retirement, each year the Participant must designate in his or her Deferral Election the time and manner in which his or her Account will be paid upon Retirement (referred to as a **"Retirement Distribution Election").** The Deferral Election shall become effective on the first day of the Deferral Period and will become irrevocable on the December 31 immediately prior to the beginning of the Deferral Period to which the Deferral Election applies. A Deferral Election shall terminate on the date a Participant experiences a Separation from Service (including, but not limited to as a result of Retirement, death or Disability). If no Deferral Election is submitted for a particular Deferral Period, no deferrals shall be permitted for such Deferral Period. A Deferral Election may be cancelled upon a finding by Committee that the Participant has suffered a hardship as described in Section 8(f). A Deferral Election shall continue to be effective for Compensation or, with respect to a Director, retainer fees earned during a Deferral Period in which a Participant is demoted to a position that would otherwise be ineligible to participate in the Plan. In addition, in a Deferral Election, a Participant must designate the time and form of any distribution of such Compensation or, with respect to a Director, retainer fees during the applicable Deferral Period.

(i) Base Salary or Retainer Fees. Prior to the beginning of each calendar year, each Eligible Individual may elect to defer receipt of all or a portion of any Base Salary or retainer fees that will be earned by such person in the next calendar year. An Eligible Individual may elect to defer not less than 5% and up to a maximum of 50% of the Eligible Individual's Base Salary or 100% of other Compensation, provided that the percentage deferred must be in whole numbers.

(ii) Payroll Taxes. The Company shall have the right to reduce the amount of the Participant's deferral by the amount of payroll taxes required to be withheld on such deferral.

(iii) Bonuses.

(1) Annual Bonuses. Except as provided in paragraph (b) below for newly eligible Participants, a Participant must file a Deferral Election with respect to a bonus in the calendar year before the year in which the services are performed with respect to which the bonus is paid (regardless of whether the bonus amount is determined and paid in the year following the year in which the services were performed). For example, if a Participant desires

to defer a portion of his or her bonus earned with respect to services performed in 2019, the Participant must file a Deferral Election by, and the Deferral Election becomes irrevocable on, December 31, 2018 regardless of whether the bonus amount is calculated and paid in 2020.

(2) Performance-Based Bonuses. In accordance with section 409A of the Code and the regulations thereunder, with respect to any bonus or other Compensation that meets the criteria for performance-based compensation, an initial deferral election may be made with respect to such bonus or other Compensation on or before the date that is six months before the end of the performance period, provided that (i) the service provider performs services continuously from the later of the beginning of the performance period or the date the performance criteria are established through the date an election is made, (ii) the performance period is at least twelve months long and (iii) that in no event may an election to defer performance-based compensation be made after such compensation has become readily ascertainable.

(b) Newly Eligible Individuals. If an Eligible Individual is hired or is promoted into an Eligible Individual position, the Committee may allow the Eligible Individual to elect to participate in the Plan with respect to any Base Salary, retainer fees, or other Compensation to be earned for that calendar year after the date of the Deferral Election. The eligibility date for a new hire is his or her employment date, and the eligibility date for a promoted employee is the date the Participant is notified of his or her promotion into an Eligible Individual position. If the Committee determines that such an Eligible Individual is eligible to participate in the Plan, the Eligible Individual must elect to participate in the Plan within 30 days receiving notice of eligibility. The election to participate shall apply only to the Eligible Individual's Base Salary, retainer fees or annual bonus earned after the date of the Deferral Election (i.e., the annual bonus would be prorated to reflect bonus earned with respect to services performed after eligibility), consistent with section 409A of the Code. When an Eligible Individual first elects to participate in the Plan, the Eligible Individual becomes a Participant and must designate the timing of payment of his or her Account to be made upon a specified date or event. The Participant must submit the initial distribution elections, on a properly executed Deferral Election form, in the manner prescribed by the Committee. Any Deferral Elections made after the initial Deferral Election will be governed by Section 4(a).

(c) Irrevocable Elections: All elections under the Plan shall be irrevocable and may not be modified by the Participant except as provided herein.

5. Participant Accounts.

(a) Participant Accounts. The Company shall establish and maintain an Account for each Participant. A Participant's Account shall consist of amounts that the Participant has elected to defer with respect to a Participant's Base Salary, retainer fees, or other Compensation, as applicable, including interest or earnings credited on the deferred amounts. The Base Salary, retainer fees, or other Compensation deferred under the Plan shall be credited to the Participant's Account as of the date on which the Participant's Base Salary, retainer fees, or other Compensation would otherwise have been paid to the Participant.

(b) Employer Discretionary Contributions. The Company and each Participating Company is under no obligation to make any contribution to the Plan; however, in the employing Company's or Participating Company's sole and absolute discretion, the Company may credit any amount to a Participant's Employer Discretionary Contribution Account. The amount may be determined in any way by the Company and/or Participating Company and need not be consistent among the Participants in the Plan. Any contribution made will be allocated to a Participant's Employer Discretionary Contribution Account as of the date determined by the Company. Directors will not be eligible to receive Employer Discretionary Contributions.

( ) Debits to Accounts for Distributions. Each Participant's Account shall be debited by the amount of any distribution as of the date the distribution is made.

(c) Earnings on Accounts. A Participant who is not a Director deferring retainer fees shall elect from among a series of hypothetical investment alternatives, which may include a fixed rate alternative, designated by the Committee into which the Participant's deferrals of Base Salary or bonuses or any Employer Discretionary Contributions shall be deemed invested. The investment gains and losses credited to the Participant's Account shall be measured based upon the investment alternatives selected and calculated after the investment managers' expenses have been deducted but before any insurance-related or other expenses have been deducted. Participants may change investment alternatives periodically by following such procedures as may be determined by the Committee. Earnings, gains and losses shall continue to be credited to all Accounts until all benefits have been paid. The Committee may, in its sole discretion, add, remove or change the hypothetical investment alternatives from which Participants may choose, at any time, in its sole discretion. A Participant who is not a Director and who fails to designate investment alternatives shall be deemed to have selected the money market investment alternative. A Director's deferral of retainer fees shall be deemed invested in units of Company shares of common stock and may not be deemed investment in any other asset.

6. Vesting. Each Participant shall be fully vested at all times in all deferred Compensation or retainer fees credited to each Participant's Account. Participants receiving Employer Discretionary Contributions shall vest in the contribution at a rate to be determined by the Company at such time as it makes any Employer Discretionary Contributions. In the event the Company fails to designate a vesting period at the time of making an Employer Discretionary Contribution, such contribution shall vest on the third anniversary of the date of the Employer Discretionary Contribution. Notwithstanding the foregoing, Participants shall immediately fully vest in all Employer Discretionary Contributions upon the occurrence of any of the following events: death, Disability, attainment of age 66, or a Change in Control. Any Employer Discretionary Contributions, whether vested or unvested, shall be forfeited upon a Separation from Service due to Cause.

7. Payment of Benefits. A Participant's benefits shall be paid on the earliest date described below and shall be paid in cash unless such benefits have been designated to Company stock in which case, the benefit shall be distributed in stock. A Participant may subsequently change a payment date previously designated if, and only if, such election change is submitted to the Committee in writing or electronically in such form approved by the Committee at least twelve months prior to the original payment date (or in the case of a series of installments, the date the first installment becomes payable), such change in election does not take effect for at least

twelve months after it is submitted to the Committee in writing, and the changed election defers the payment of benefits from the Participant's account for at least five years from the date of the initial payment date (or in the case of a series of installments, the fifth anniversary of the date the first such installment was previously payable). For purposes of clarity, Employer Discretionary Contributions are only payable upon a Separation from Service other than for Cause (including, but limited to a Separation from Service due to Retirement, death or Disability).

(a) Retirement. If a Participant incurs a Separation from Service due to Retirement, the Account shall be distributed in a lump sum payment within 60 days of Retirement or in annual installments payable in over five, ten or fifteen years as designated in the Participant's Retirement Distribution Election with the first annual installment commencing within 60 days of Retirement. If a Participant fails to provide a properly completed Retirement Distribution Election, such payment shall be made in a lump sum payment within 60 days of the Participant's Separation from Service.

(b) Separation from Service. If a Participant's incurs a Separation from Service due to any reason other than Retirement (including, but not limited to due to death or Disability), the Participant's Account shall be distributed to the Participant or the Participant's Beneficiary, as applicable, in a lump sum payment within 60 days of the Participant's Separation from Service. The Account will be valued as of the last business day of the month immediately preceding the month in which the distribution occurs.

(c) Fixed Payment Date. If a Participant who is not a Director designates a fixed payment date on a properly executed Deferral Election form that is at least three years after the corresponding deferral, a Participant shall receive any Compensation deferred pursuant to a Deferral Election and credited to the Participant's Account in a lump sum payment within 60 days of such fixed payment date or in four annual installments, with the first annual installment commencing within 60 days of the fixed payment date. Directors may not elect a fixed payment date as a distribution event with respect to deferred retainer fees and no Employer Discretionary Contributions shall be distributed when a Participant elects a fixed payment date as a payment event.

(d) Hardship. At any time prior to commencement of payment of a Participant's Account, a Participant may request payment of all or a portion of a Participant's Compensation or retainer fees deferred pursuant to a Deferral Election and credited to the Participant's Account on account of financial hardship. The decision to approve or deny such a request shall be in the absolute discretion of the Committee. Such a request shall be approved only upon a finding that the Participant has suffered a severe financial hardship, which has resulted from an illness or accident of the Participant, the Participant's spouse, or a dependent (as defined in section 152(a) of the Code) of the Participant, loss of the Participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the Participant's control. The hardship distribution may not exceed the amount reasonably necessary to satisfy the emergency need, including amounts necessary to pay income taxes or penalties reasonably anticipated to result from the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or by liquidation of the Participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship). In the event such a request is approved, payment of all or a portion of the Participant's Account, to the extent approved by the Committee, shall be made as soon as practicable to the Participant. The Participant's Account otherwise payable hereunder shall be reduced to take into account such financial hardship payment. The Committee shall administer hardship distribution requests consistently with section 409A of the Code and the regulations thereunder. No Employer Discretionary Contributions shall be distributed pursuant to the paragraph (d).

(e) Delay for Key Employees. Notwithstanding any provision of the Plan to the contrary, if a Participant is a Key Employee and becomes entitled to receive a distribution on account of Separation from Service, the distribution may not be made earlier than six months following the date of the Participant's Separation from Service, if required by section 409A of the Code and the regulations thereunder. If distributions are delayed pursuant to section 409A of the Code, the accumulated amounts withheld on account of section 409A of the Code shall be paid the first business day after the end of the six-month period. If a Participant dies during such six-month period, the amounts withheld on account of section 409A of the Code shall be paid to the Participant's Beneficiary 90 days after the date of his or her death.

8. Beneficiary Designation. Each Participant shall have the right, at any time, to designate any person or persons as a Beneficiary (both primary and contingent) to whom payment of the Participant's Accounts under the Plan shall be made in the event of the Participant's death provided that any Beneficiary designation shall be valid or effective only as permitted under applicable law. A married Participant spouse is required to be the Participant's primary Beneficiary unless his or her spouse completes and submits to the Committee a valid spousal waiver in such form as provided by the Committee that is witnessed by a notary. Such designation may be changed or canceled at any time without the consent of any such Beneficiary except that a married Participant's spouse must consent to such change in a valid spousal waiver in such form as provided by the Committee that is witnessed by a notary. Any such designation, change or cancellation shall be made in a form approved by the Committee and shall not be effective until received by the Committee or its designee. If no Beneficiary has been named, or if the designated Beneficiary shall have predeceased the Participant, the Beneficiary shall be the Participant's estate. If a Participant designates more than one Beneficiary, the interests of such beneficiaries shall be paid in equal shares, unless the Participant has specifically designated otherwise.

9. Source of Funds; Scope of Liability. The Plan shall be unfunded, and payments hereunder shall be made from the general assets of the Company or Affiliate that employs the Participant. Any assets that may be set aside, earmarked or identified as being intended for the provision of payments hereunder shall remain an asset of the Company or an Affiliate and shall be subject to the claims of its or their general creditors. Each Participant shall be a general creditor of the Company or an Affiliate to the extent of the value of a Participant's Accounts hereunder. A Participant shall have no right, title or interest in any specific assets that may be set aside or designated as intended to be applied to payments under the Plan. Payments in accordance with the terms of the Plan shall completely discharge all obligations of the Company and its Affiliates hereunder.

10. Amendment and Termination. The Company reserves the right to amend or terminate this Plan at any time by action of the Company's Board of Directors or the Committee; provided,

however, that on or after a Change in Control, no amendment or termination of the Plan shall reduce the amount credited to a Participant's Accounts as of the date of the amendment or termination. In the event of a termination of this Plan, accounts shall be distributed in accordance with section 409A of the Code.

11. Nonalienation of Benefits. None of the benefits or rights of a Participant or any Beneficiary of a Participant shall be subject to the claim of any creditor, and, in particular, to the fullest extent permitted by law, all such benefits and rights shall be free from attachment, garnishment or any other legal or equitable process available to any creditor of the Participant or Beneficiary. Neither the Participant nor the Participant's Beneficiary shall have the right to alienate, anticipate, commute, pledge, encumber, or assign any of the payments which either of them may expect to receive, contingently or otherwise under this Plan.

12. Administration. This Plan shall be administered by the Committee, which shall be responsible for the interpretation of the Plan and establishment of the rules and regulations governing its administration. Any decision or action made or taken by the Committee, arising out of or in connection with the construction, administration or interpretation of the Plan or of its rules and regulations, shall be conclusive and binding upon all Participants, subject only to such review by a court of competent jurisdiction as is permitted by ERISA. In making any such decision or taking any such action, the Committee shall have full and complete discretion and authority to make eligibility determinations, construe provisions of the Plan and resolve issues. Participation in the Plan shall be made conditional upon a Participant's acknowledgement, in writing or by acceptance of participation, that all decisions and determinations of the Committee shall be final and binding on the Participant, the Participant's beneficiaries, and any other persons having or claiming an interest under the Plan. All expenses of administering the Plan shall be paid by the Company and shall not affect the Participant's right to or amount of benefits.

13. Section 409A of the Code. The Plan is intended to comply with the applicable requirements of section 409A of the Code and applicable regulations, and shall be maintained and administered in accordance with section 409A of the Code to the extent section 409A of the Code applies to the Plan. Notwithstanding anything in the Plan to the contrary, distributions from the Plan may only be made in a manner, and upon an event, permitted by section 409A of the Code and applicable regulations. If a payment is not made by the designated payment date under the Plan, the payment shall be made by December 31 of the calendar year in which the designated payment date occurs. For purposes of section 409A of the Code, the right to series of installment payments under this Plan shall be treated as a right to series of separate payments. In no event may a Participant directly or indirectly designate the calendar year of payment.

14. Claims Procedure.

(a) Claim. A Participant or, following the Participant's death, a Beneficiary (collectively referred to in this Section 15 as a "claimant") may submit a claim for benefits under the Plan. Any claim for benefits under the Plan shall be made in writing to the Committee.

(b) Claim Decision. In the case of a claim for benefits that is wholly or partially denied, within 90 days (or 180 days in special cases if the Committee furnishes notice of the extension before the end of the initial 90-day period) after the claim has been filed, the Committee shall provide the person who filed the claim a written approval or denial of the claim. A notice of the denial of a claim, in whole or in part, shall set forth:

(i) the reason or reasons for the denial;

(ii) reference to the specific Plan provisions upon which the denial is based;

(iii) a description of any additional material needed before the claim can be considered and an explanation of why such material or information is necessary; and

(iv) an explanation of the claim review procedure set forth below and the time limits applicable to appeals, including a statement of the claimant's right to bring a civil action under section 502(a) of ERISA following an adverse benefit determination on appeal.

(c) <u>Request for Review.</u> Within 60 days of the receipt of a notice denying a claim, the claimant or the claimant's duly authorized representative may request, in writing, a full review of the claim by the Committee. In connection with any such review, the claimant or the claimant's authorized representative (i) will be provided, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant to the claim for benefits and (ii) may submit issues and comments in writing to the Committee. The Committee shall make a decision within 60 days after the request for a review (or 120 days in the event of special circumstances if the Committee furnishes notice of the extension before the end of the initial 60-day period). The Committee's decision will be binding on all parties. A final notice of the denial of the claim on appeal, in whole or in part, shall set forth:

(i) the reason or reasons for the denial;

(ii) reference to the specific Plan provisions upon which the denial is based;

(iii) the claimant's right to, upon request and free of charge, reasonable access to, and copies of, all documents, records and other information relevant to the claim for benefits; and

(iv) a statement of the claimant's right to bring a civil action under section 502(a) of ERISA.

(d) <u>Exhaustion; Scope of Review.</u> No claimant may bring an action for any alleged wrongful denial of Plan benefits in a court of law unless the claims procedures set forth above are exhausted and a final determination is made by the Committee. If a claimant challenges a decision under this Section 15, a review by the court of law will be limited to the facts, evidence and issues presented during the claims procedure set forth above. Facts and evidence that become known to the claimant after having exhausted the claims procedure must be brought to the attention of the Committee for reconsideration of the claims determination. Issues not raised during the claims procedure shall be deemed waived.

15. <u>Clawback.</u> Notwithstanding any other provisions in this Plan, any portion of a Participant's Account, which is subject to recovery under any law, government regulation or

stock exchange listing requirement, will be subject to such deductions and clawback as may be required to be made pursuant to such law, government regulation or stock exchange listing requirement (or any policy adopted by the Company pursuant to any such law, government regulation or stock exchange listing requirement).

16. Withholding Taxes. The Participant, or, following the Participant's death, the Participant's Beneficiary, shall make appropriate arrangements with the Company for satisfaction of any U.S. Federal, state and local income and payroll tax withholding requirements applicable to the payment of benefits under the Plan. If no such arrangements are made, the Company may provide, at its discretion, for such withholding and tax payments as may be required.

17. No Contract of Employment. Nothing contained herein shall be construed as conferring upon any person the right to be employed or continue in the employ of the Company or any of its Affiliates, nor shall it interfere with the rights of the Company or its Affiliates to terminate the employment of any Participant and to take any personnel action affecting any Participant without regard to the effect which such action may have upon such Participant as a recipient of benefits under the Plan.

18. Notice. Any notice or filing required or permitted to be given to the Company under the Plan shall be sufficient if in writing hand-delivered or sent by registered or certified mail, return receipt requested, to the principal office of the Company, directed to the attention of General

Counsel, W. David Morse, telephone 410-820-6867. Such notice
shall be deemed given as of the date of delivery, or if delivery is made by mail, as of the date shown on the postmark on the receipt for registration or certification.

19. Successors of the Company. The rights and obligations of the Company under the Plan shall inure to the benefit of, and shall be binding upon, the successors and assigns of the Company.

20. Applicable Law. This Plan shall be construed under the laws of the state of Maryland except where the laws of the state of Maryland are preempted by ERISA.

IN WITNESS WHEREOF, Shore Bancshares, Inc. has caused this Plan to be executed by its duly authorized officer this 11th day of November, 2018.

/s/Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President and CEO

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Section 6: EX-23.1 (EX-23.1)

Exhibit 23.1

YHB CPAs & Consultants

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in Registration Statements (No. 333-225614, 333-206110, 333-195527, 333-167762, 333-157141, and 333-143002) on Form S-3 and Registration Statements (No. 333-211736, 333-134955, and 333-105159) on Form S-8 of Shore Bancshares, Inc. of our reports dated March 15, 2019, relating to the consolidated financial statements and the effectiveness of internal control over financial reporting of Shore Bancshares, Inc., which appear in this Annual Report on Form 10-K of Shore Bancshares, Inc. for the year ended December 31, 2019.

/s/ Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 13, 2020

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Section 7: EX-31.1 (EX-31.1)

Exhibit 31.1

Certifications of the Principal Executive Officer
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Lloyd L. Beatty, Jr., certify that:

1. I have reviewed this report on Form 10-K of Shore Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: March 13, 2020

By:/s/ Lloyd L. Beatty, Jr.
Lloyd L. Beatty, Jr.
President and Chief Executive Officer
(Principal Executive Officer)

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Section 8: EX-31.2 (EX-31.2)

Exhibit 31.2

Certifications of the Principal Accounting Officer
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Edward C. Allen, certify that:

1. I have reviewed this report on Form 10-K of Shore Bancshares, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: March 13, 2020

By:/s/ Edward C. Allen
Edward C. Allen
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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Section 9: EX-32 (EX-32)

Exhibit 32

Certification of Periodic Report
Pursuant to 18 U.S.C. Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, the undersigned hereby certify that (i) the Annual Report of Shore Bancshares, Inc. on Form 10-K for the year ended December 31, 2019 filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Shore Bancshares, Inc.

Date:	March 13, 2020	/s/ Lloyd L. Beatty, Jr. Lloyd L. Beatty, Jr. President and Chief Executive Officer (Principal Executive Officer)
Date:	March 13, 2020	/s/ Edward C. Allen Edward C. Allen Senior Vice President and Chief Financial Officer (Principal Financial Officer)

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