

SHORE BANCSHARES INC  
Form 10-K  
March 16, 2007

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

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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, 2006

Commission File No. 0-22345

**SHORE BANCSHARES, INC.**

(Exact name of registrant as specified in its charter)

Maryland  
(State or Other Jurisdiction of  
Incorporation or Organization)

52-1974638  
(I.R.S. Employer  
Identification No.)

18 East Dover Street, Easton, Maryland  
(Address of Principal Executive Offices)

21601  
(Zip Code)

(410) 822-1400

Registrant's Telephone Number, Including Area Code

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

Title of Each Class:  
Common stock, par value \$.01 per share

Name of Each Exchange on Which Registered:  
Nasdaq Stock Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 16(d) of the Act.

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (check one): Large accelerated filer  Accelerated filer  Non-accelerated filer

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: \$213,253,981.

The number of shares outstanding of the registrant's common stock as of the latest practicable date: 8,384,794 as of March 1, 2007.

**Documents Incorporated by Reference**

Certain information required by Part III of this annual report is incorporated herein by reference to the definitive proxy statement for the 2007 Annual Meeting of Stockholders to be held on April 25, 2007.

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This Annual Report of Shore Bancshares, Inc. on Form 10-K may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of “forward-looking statements.” Statements that are not historical in nature, including the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “intend,” and similar expressions, are based on current expectations, estimates and projections about (among other things) the industry and the markets in which the Company and its subsidiaries operate; they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this Form 10-K, general economic, market or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in our competitive position or competitive actions by other companies; changes in the quality or composition of loan and investment portfolios; the ability to manage growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond the Company’s control. Consequently, all of the forward-looking statements made in this document are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on the Company’s business or operations. For a more complete discussion of these and other risk factors, see Item 1A of Part I of this report. Except as required by applicable laws, we do not intend to publish updates or revisions of forward-looking statements it makes to reflect new information, future events or otherwise.

Except as expressly provided otherwise, the term “Company” as used in this report refers to Shore Bancshares, Inc. and the terms “we”, “us” and “our” refer collectively to Shore Bancshares, Inc. and its consolidated subsidiaries.

## PART I

### Item 1. Business.

#### BUSINESS

##### General

The Company was incorporated under the laws of Maryland on March 15, 1996 and is registered as a financial holding company registered under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company’s primary business is acting as the parent company to three bank subsidiaries, The Centreville National Bank of Maryland (“Centreville National Bank”), The Talbot Bank of Easton, Maryland (“Talbot Bank”), and The Felton Bank (“Felton Bank”) (collectively, the “Banks”), two insurance producer firms, The Avon-Dixon Agency, LLC and Elliott Wilson Insurance, LLC, one insurance premium finance company, Mubell Finance, LLC (together with The Avon-Dixon Agency, LLC and Elliot Wilson Insurance, LLC, the “Insurance Subsidiaries”), and an investment adviser firm, Wye Financial Services, LLC (“Wye Financial”). The Company also has an inactive subsidiary, Shore Pension Services, LLC.

Talbot Bank owns all of the issued and outstanding securities of Dover Street Realty, Inc., a Maryland corporation that engages in the business of holding and managing real property acquired by Talbot Bank as a result of loan foreclosures. Centreville National Bank owns 20% of the issued and outstanding common stock of Delmarva Data Bank Processing Center, Inc. (“Delmarva Data”), a Maryland corporation that provides data processing services to banks located in Maryland, Delaware, Virginia and the District of Columbia, including Centreville National Bank and Talbot Bank.

We operate in two business segments: community banking and insurance products and services. Financial information related to our operations in these segments for each of the two years ended December 31, 2006 is provided in Note 24 to the Company’s Consolidated Financial Statements included in Item 8 of Part II of this report.

##### Banking Products and Services

Centreville National Bank is a national banking association that commenced operations in 1876. Talbot Bank is a Maryland commercial bank that commenced operations in 1885 and was acquired by the Company in its December 2000 merger with Talbot Bancshares, Inc. (“Talbot Bancshares”). Felton Bank is a Delaware commercial bank that commenced operations in 1908 and was acquired by the Company in April 2004 when it merged with Midstate Bancorp, Inc. The Banks operate 17 full service branches and 21 ATMs and provide a full range of commercial and consumer banking products and services to individuals, businesses, and other organizations in the Maryland counties of Kent, Queen Anne’s, Caroline, Talbot and Dorchester and in Kent County, Delaware. The Banks’ deposits are insured by the Federal Deposit Insurance Corporation (the “FDIC”).

The Banks are independent community banks and serve 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 Banks. Services provided to businesses include commercial checking, savings, certificate of deposit and overnight investment sweep accounts. The Banks offer all forms of commercial lending, including secured and unsecured loans, working capital loans, lines of credit, term loans, accounts receivable financing, real estate acquisition 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, PC and internet banking, and 24-hour automatic teller machine services. The Banks also offer nondeposit products, such as mutual funds and annuities, and discount brokerage services to their customers. Additionally, the Banks have Saturday hours and extended hours on certain evenings during the week for added customer convenience.

#### *Lending Activities*

The Banks originate 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 on 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 Company's general policy to obtain personal guarantees from the principals of the commercial loan borrowers.

Commercial real estate loans are primarily those secured by office condominiums, retail buildings, warehouses and general purpose business space. Low loan to value ratio standards, as well as the thorough financial analysis performed and the Banks' knowledge of the local economy in which they lend are employed to help reduce the risk associated with these loans.

The Banks provide 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, obtaining additional collateral when prudent, and closely monitoring construction projects to control disbursement of funds on loans.

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

The Banks also originate and sell long-term fixed rate residential mortgage loans on the secondary market. The Banks do not typically fund these loans, but they do receive commissions upon settlement.

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 on going monitoring of loans outstanding is performed in an effort to minimize risk of loss by identifying problem loans early.

#### *Deposit Activities*

The Banks offer a full array of deposit products including checking, savings and money market accounts, regular and IRA certificates of deposit, and Christmas Savings accounts. The Banks also offers the CDARS program, providing up to \$20 million of FDIC insurance to our customers. In addition, we offer our commercial customers packages which include Cash Management services and various checking opportunities.

*Trust Services*

Centreville National Bank established a trust department during the second quarter of 2005 and markets trust, asset management and financial planning services to customers within our market areas.

## Insurance Activities

The Insurance Subsidiaries were formed as a result of the Company's acquisition of the assets of The Avon-Dixon Agency, Inc., Elliott Wilson Insurance, Inc., Avon-Dixon Financial Services, Inc., Joseph M. George & Son, Inc. and 59th Street Finance Company on May 1, 2002. In November 2002, The Avon-Dixon Agency, LLC acquired certain assets of W. M. Freestate & Son, Inc., a full-service insurance producer firm located in Centreville, Maryland. The Insurance Subsidiaries offer a full range of insurance products and services to customers, including insurance premium financing.

## Seasonality

Management does not believe that our business activities are seasonal in nature. Demand for our products and services may vary depending on local and national economic conditions, but management believes that any variation will not have a material impact on our planning or policy-making strategies.

## Employees

At February 27, 2007, we employed 323 persons, of which 285 were employed on a full-time basis.

## COMPETITION

The banking business, in all of its phases, is highly competitive. Within our market areas, we compete with commercial banks (including local banks and branches or affiliates of other larger banks), savings and loan associations and credit unions for loans and deposits, with money market and mutual funds and other investment alternatives for deposits, with consumer finance companies for loans, with insurance companies, agents and brokers for insurance products, and with other financial institutions for various types of products and services. There is also competition for commercial and retail banking business from banks and financial institutions located outside our market areas.

The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations and office hours. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services and personalized services. The primary factors in competing for insurance customers are competitive rates, the quality and range of insurance products offered, and quality, personalized service.

To compete with other financial services providers, we rely principally upon local promotional activities, including advertisements in local newspapers, trade journals and other publications and on the radio, personal relationships established by officers, directors and employees with customers, and specialized services tailored to meet its customers' needs. In those instances in which we are unable to accommodate the needs of a customer, we will arrange for those services to be provided by other financial services providers with which we have a relationship. We additionally rely on referrals from satisfied customers.

The following tables set forth deposit data for Kent, Queen Anne's, Caroline, Talbot and Dorchester Counties in Maryland and for Kent County in Delaware as of June 30, 2006, the most recent date for which comparative information is available.

Kent County, Maryland	Deposits (in thousands)	% of Total
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Peoples Bank of Kent County, Maryland	\$	159,981	35.04%
Mercantile Shore Bank		153,025	33.52
Chesapeake Bank and Trust Co.		59,257	12.98
Branch Banking & Trust		37,668	8.25
<b>The Centreville National Bank of Maryland</b>		<b>23,743</b>	<b>5.20</b>
SunTrust Bank		22,886	5.01
Total	\$	456,560	100.00 %

Source: FDIC DataBook

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Queen Anne's County, Maryland	Deposits (in thousands)	% of Total
The Queenstown Bank of Maryland	\$ 274,668	40.0%
<b>The Centreville National Bank of Maryland</b>	<b>196,517</b>	<b>28.62</b>
Bank of America, National Association	61,000	8.89
Mercantile Shore Bank	56,924	8.29
M&T	45,312	6.60
BankAnnapolis	32,076	4.67
Branch Banking & Trust	20,123	2.93
Total	\$ 686,620	100.00%

Source: FDIC DataBook

Caroline County, Maryland	Deposits (in thousands)	% of Total
Provident State Bank of Preston, Maryland	\$ 129,860	33.95%
Mercantile Shore Bank	100,673	26.32
Branch Banking & Trust	47,164	12.33
<b>The Centreville National Bank of Maryland</b>	<b>46,141</b>	<b>12.06</b>
M&T	30,716	8.03
Bank of America, National Association	18,770	4.91
Easton Bank & Trust	9,191	2.40
Total	\$ 382,515	100.00%

Source: FDIC DataBook

Talbot County, Maryland	Deposits (in thousands)	% of Total
<b>The Talbot Bank of Easton, Maryland</b>	<b>\$ 373,336</b>	<b>40.74%</b>
Mercantile Shore Bank	178,181	19.44
Bank of America, National Association	96,829	10.57
Easton Bank & Trust	94,809	10.34
SunTrust Bank	49,302	5.38
Branch Banking & Trust	42,451	4.63
M&T	28,979	3.16
The Queenstown Bank of Maryland	27,108	2.96
First Mariner Bank	15,898	1.73
Chevy Chase Bank	9,603	1.05
Total	\$ 916,496	100.00%

Source: FDIC DataBook

Dorchester County, Maryland	Deposits (in thousands)	% of Total
The National Bank of Cambridge	\$ 170,095	30.27%
Bank of the Eastern Shore	165,271	29.42

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Hebron Savings Bank	55,940	9.96
Branch Banking & Trust	41,447	7.38
Provident State Bank of Preston, Maryland	37,478	6.67
Bank of America, National Association	30,774	5.48
M&T	23,121	4.11
SunTrust Bank	20,954	3.73
<b>The Talbot Bank of Easton, Maryland</b>	<b>16,749</b>	<b>2.98</b>
Total	\$ 561,829	100.00%

Source: FDIC DataBook

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Kent County, Delaware	Deposits (in thousands)	% of Total
Wilmington Trust	\$ 573,896	33.28%
PNC Bank Delaware	266,867	15.48
Citizens Bank	249,539	14.47
First NB of Wyoming	232,825	13.50
Wachovia Bank of Delaware	151,671	8.80
Artisans Bank	68,641	3.98
<b>The Felton Bank</b>	<b>60,855</b>	<b>3.53</b>
Wilmington Savings Fund Society	44,810	2.60
County Bank	39,516	2.29
Commerce Bank National Assn	29,881	1.73
Fort Sill National Bank	5,880	0.34
Total	\$ 1,724,381	100.00%

Source: FDIC DataBook

For further information about competition in our market areas, see the Risk Factor entitled “We operate in a highly competitive market” in Item 1A of Part I of this annual report.

## 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. Changes in applicable laws and regulations may have a material effect on our business, financial condition and results of operation.

### 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.

Talbot Bank is a Maryland 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). Centreville National Bank is a national banking association subject to federal banking laws and regulations enforced and/or promulgated by the Office of the Comptroller of the Currency (the “OCC”), which is required by statute to make at least one examination in each calendar year. Felton Bank is a Delaware commercial bank subject to the banking laws of Delaware and to regulation by the Delaware Office of the State Bank Commissioner, who is entitled by statute to make examinations of Felton Bank as and when deemed necessary or expedient. The primary federal regulator of both Talbot Bank and Felton Bank is the FDIC, which is also entitled to conduct regular examinations. The deposits of the Banks are insured by the FDIC, so certain laws and regulations administered by the FDIC also govern their deposit taking operations. In addition to the foregoing, the Banks are 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 Banks, may be subject to examination by the Banks’ regulators from time to time. In addition, the Insurance Subsidiaries are each subject to licensing and regulation by the insurance authorities of the states in which they do business. Retail sales of insurance products by the Insurance Subsidiaries to customers of the Banks are also subject to the requirements of the

Interagency Statement on Retail Sales of Nondeposit Investment Products promulgated in 1994, as amended, by the FDIC, the FRB, the OCC, and the Office of Thrift Supervision. Wye Financial Services, LLC is subject to the registration and examination requirements of federal and state laws governing investment advisers.

### **Regulation of Financial Holding Companies**

In November 1999, the federal Gramm-Leach-Bliley Act (the “GLBA”) was signed into law. Effective in pertinent part on March 11, 2000, GLBA 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 GLBA, a bank holding company can elect, subject to certain qualifications, to become a “financial holding company.” GLBA provides that a financial holding company may engage in a full range of financial activities, including insurance and securities sales and underwriting activities, and real estate development, with new expedited notice procedures.

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Under FRB policy, the Company is expected to act as a source of strength to its subsidiary banks, and the FRB may charge the Company with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. In addition, under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”), 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.

### **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 Company and its affiliates are 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 Banks. Section 23B requires that transactions between any of the Banks and the Company and its nonbank affiliates be on terms and under circumstances that are substantially the same as with non-affiliates.

The Banks are 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 Banks 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 Banks, believes that the Banks meet substantially all standards that have been adopted. FDICIA also imposes new 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, each of the Banks has a CRA rating of “Satisfactory.”

## Capital Requirements

FDICIA established a system of prompt corrective action to resolve the problems of undercapitalized institutions. Under this system, federal banking regulators are required to rate supervised institutions on the basis of five capital categories: “well -capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized;” and to take certain mandatory actions, and are authorized to take other discretionary actions, with respect to institutions in the three undercapitalized categories. The severity of the actions will depend upon the category in which the institution is placed. A depository institution is “well capitalized” if it has a total risk based capital ratio of 10% or greater, a Tier 1 risk based capital ratio of 6% or greater, and a leverage ratio of 5% or greater and is not subject to any order, regulatory agreement, or written directive to meet and maintain a specific capital level for any capital measure. An “adequately capitalized” institution is defined as one that has a total risk based capital ratio of 8% or greater, a Tier 1 risk based capital ratio of 4% or greater and a leverage ratio of 4% or greater (or 3% or greater in the case of a bank with a composite CAMELS rating of 1).

FDICIA generally prohibits a depository institution from making any capital distribution, including the payment of cash dividends, or paying a management fee to its holding company if the depository institution would thereafter be undercapitalized. Undercapitalized depository institutions are subject to growth limitations and are required to submit capital restoration plans. For a capital restoration plan to be acceptable, the depository institution’s parent holding company must guarantee (subject to certain limitations) that the institution will comply with such capital restoration plan.

Significantly undercapitalized depository institutions may be subject to a number of other requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized and requirements to reduce total assets and stop accepting deposits from correspondent banks. Critically undercapitalized depository institutions are subject to the appointment of a receiver or conservator, generally within 90 days of the date such institution is determined to be critically undercapitalized.

As of December 31, 2006, the Banks were each deemed to be “well capitalized.” For more information regarding the capital condition of the Company, see Note 17 of Consolidated Financial Statements appearing in Item 8 of Part II of this report.

### **Deposit Insurance**

The deposits of the Banks are insured to a maximum of \$100,000 per depositor through the Deposit Insurance Fund, which is administered by the FDIC, and the Banks are required to pay semi-annual deposit insurance premium assessments to the FDIC. The Banks paid a total of \$87,878 in FDIC premiums during 2006. The Deposit Insurance Fund was created pursuant to the Federal Deposit Insurance Reform Act of 2005, which was signed into law on February 8, 2006. Under this new law, (i) the current \$100,000 deposit insurance coverage will be indexed for inflation (with adjustments every five years, commencing January 1, 2011), and (ii) deposit insurance coverage for retirement accounts was increased to \$250,000 per participant subject to adjustment for inflation. In addition, the FDIC will be given greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments.

### **USA PATRIOT Act**

Congress adopted the USA PATRIOT Act (the “Patriot Act”) on October 26, 2001 in response to the terrorist attacks that occurred on September 11, 2001. Under the Patriot Act, certain financial institutions, including banks, are required to maintain and prepare additional records and reports that are designed to assist the government’s efforts to combat terrorism. The Patriot Act includes sweeping anti-money laundering and financial transparency laws and required additional regulations, including, among other things, standards for verifying client identification when opening an account and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

### **Federal Securities Laws**

The shares of the Company’s common stock are registered with the Securities and Exchange Commission (the “SEC”) under Section 12(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and listed on the Nasdaq Stock Market’s Capital 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 federal Sarbanes-Oxley Act of 2002. 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 Corporation 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 Bank 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.

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## AVAILABLE INFORMATION

The Company maintains an Internet site at [www.shbi.net](http://www.shbi.net) 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 web site at [www.sec.gov](http://www.sec.gov).

### Item 1A. RISK FACTORS

The following factors may impact our business, financial condition and results of operations and should be considered carefully in evaluating an investment in shares of common stock of the Company.

#### **Risks Relating to the Business of the Company and its Affiliates**

##### **The Company's future depends on the successful growth of its subsidiaries**

The Company's primary business activity for the foreseeable future will be to act as the holding company of Talbot Bank, Centreville National Bank, Felton Bank, and its other subsidiaries. Therefore, the Company's future profitability will depend on the success and growth of these subsidiaries. In the future, part of the Company's growth may come from buying other banks and buying or establishing other companies. Such entities may not be profitable after they are purchased or established, and they may lose money, particularly at first. A new bank or company may bring with it unexpected liabilities, bad loans, or bad employee relations, or the new bank or company may lose customers.

##### **A majority of our business is concentrated in Maryland and Delaware; a significant amount of our business is concentrated in real estate lending**

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, we make many real estate secured loans, including construction and land development loans, all of which are in greater demand when interest rates are low and economic conditions are good. There can be no guarantee that good economic conditions or low interest rates will continue to exist. Moreover, the market values of the real estate securing our loans may deteriorate due to a number of unpredictable factors, which could cause us to lose money in the event a borrower failed to repay a loan and we were forced to foreclose on the property. Additionally, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, along with the other federal banking regulators, issued final guidance on December 6, 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 institutions whose commercial real estate loans exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk and may be required to maintain higher capital ratios than institutions with lower concentrations in commercial real estate lending. Based on our commercial real estate concentration as of December 31, 2006, we may be subject to further supervisory analysis during future examinations. Although we continuously evaluate our concentration and risk management strategies, we cannot guarantee that any risk management practices we implement will be effective to prevent losses relating to our commercial real estate portfolio. Management cannot predict the extent to which this guidance will impact our operations or capital requirements.

##### **Interest rates and other economic conditions will impact our results of operation**

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 profitability is in part a function of 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 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 and is measured in terms of the ratio of the interest rate sensitivity gap to total assets. More assets repricing or maturing than liabilities over a given time period is considered asset-sensitive and is reflected as a positive gap, and more liabilities repricing or maturing than assets over a given time period is considered liability-sensitive and is reflected as negative gap. An asset-sensitive position (*i.e.*, a positive gap) could enhance earnings in a rising interest rate environment and could negatively impact earnings in a falling interest rate environment, while a liability-sensitive position (*i.e.*, a negative gap) could enhance earnings in a falling interest rate environment and negatively impact earnings in a rising interest rate environment. Fluctuations in interest rates are not predictable or controllable. We have attempted to structure our asset and liability management strategies to mitigate the impact on net interest income of changes in market interest rates, but there can be no assurance that these attempts will be successful in the event of such changes.

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### **The Banks may experience loan losses in excess of their allowances**

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 of each of the Banks bases that Bank's allowance for loan losses upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and judgments about the ultimate collectability of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectability is considered questionable. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future losses, or if the bank regulatory authorities, as a part of their examination process, require our bank subsidiaries to increase their respective allowance for loan losses, our earnings and capital could be significantly and adversely affected. Although management uses the best information available to make determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the assumptions used or adverse developments arise with respect to the Banks' non-performing or performing loans. Material additions to the allowance for loan losses of one of the Banks would result in a decrease in that Bank's net income and capital and could have a material adverse effect on our financial condition.

### **The market value of our investments might decline**

As of December 31, 2006, we had classified 89% of our investment securities as available-for-sale pursuant to Statement of Financial Accounting Standards No. 115 ("SFAS 115") relating to accounting for investments. SFAS 115 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. The remaining investment securities are classified as held-to-maturity in accordance with SFAS 115 and are stated at amortized cost.

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.

Management believes that several factors will affect the market values of our investment portfolio. These include, but are not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation and the slope of the interest rate yield curve (the yield curve refers to the differences between shorter-term and longer-term interest rates; a positively sloped yield curve means shorter-term rates are lower than longer-term rates). Also, the passage of time will affect the market values of our investment securities, in that the closer they are to maturing, the closer the market price should be to par value. These and other factors may impact specific categories of the portfolio differently, and management cannot predict the effect these factors may have on any specific category.

### **The banking industry is heavily regulated; significant regulatory changes could adversely affect our operations**

Our operations are and will be affected by current and future legislation and by the policies established from time to time by various federal and state regulatory authorities. The Company is subject to supervision by the FRB; Talbot Bank is subject to supervision and periodic examination by the Maryland Commissioner and the FDIC; Centreville National Bank is subject to supervision and periodic examination by the OCC and the FDIC; and Felton Bank is subject to supervision and periodic examination by the Delaware Commissioner and the FDIC. Banking regulations,

designed primarily for the safety of depositors, may limit a financial institution's growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of securities or trust services. The Company and the Banks are also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that those institutions are found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Management also cannot predict the nature or the extent of the effect on our business and earnings of future fiscal or monetary policies, economic controls, or new federal or state legislation. Further, the cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

### **We operation in a highly competitive market**

We operate in a competitive environment, competing for loans, deposits, insurance products and customers with commercial banks, savings associations and other financial entities. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market and mutual funds and other investment alternatives. Competition for loans comes primarily from other commercial banks, savings associations, mortgage banking firms, credit unions and other financial intermediaries. Competition for other products, such as insurance and securities products, comes from other banks, securities and brokerage companies, insurance companies, insurance agents and brokers, and other nonbank financial service providers in our market areas. Many of these competitors are much larger in terms of total assets and capitalization, have greater access to capital markets, and/or offer a broader range of financial services than those offered by us. In addition, banks with a larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the needs of larger customers. 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.

In addition, current banking laws facilitate interstate branching, merger activity among banks, and expanded activities. Since September 1995, certain bank holding companies have been authorized to acquire banks throughout the United States. Since June 1, 1997, certain banks have been permitted to merge with banks organized under the laws of different states. As a result, interstate banking is now an accepted element of competition in the banking industry and the Corporation may be brought into competition with institutions with which it does not presently compete. Moreover, as discussed above, the GLBA revised the BHC Act in 2000 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. These laws may increase the competition we face in our market areas in the future, although management cannot predict the degree to which such competition will impact our financial conditions or results of operations.

#### **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.

#### **We may be subject to 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 the Company or our subsidiaries from liability. Claims and legal actions may result in legal expenses and liabilities that may reduce our profitability and hurt our financial condition.

#### **We may be adversely affected by recent legislation**

As discussed above, the GLBA repealed restrictions on banks affiliating with securities firms and permits bank holding companies that become financial holding companies to engage in additional financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities that are currently not permitted for bank holding companies. Although the Company is a financial holding company, this law may increase the competition we face from larger banks and other companies. It is not possible to predict the full effect that this law will have on us.

- (ii) if the transfer was in excess of the amount shown on the Declarations Page as the verification call-back amount for this Insuring Agreement, the voice instruction was verified by a call-back according to a prearranged procedure.

As used in this Insuring Agreement, Customer means an entity or individual which has a written agreement with the Insured authorizing the Insured to rely on voice instructions to initiate transfers and has provided the Insured with the names of persons authorized to initiate such transfers, and with which the Insured has established an instruction verification mechanism.

#### **TELEFACSIMILE TRANSFER FRAUD**

(CC-4) Loss resulting directly from the Insured having, in good faith, transferred or delivered Funds, Certificated Securities or Uncertificated Securities through a Computer System covered under the terms of the **COMPUTER SYSTEMS FRAUD** Insuring Agreement in reliance upon a fraudulent instruction received through a Telefacsimile Device, and which instruction:

(1) purports and reasonably appears to have originated from:

(a) a Customer of the Insured,

(b) another financial institution, or

(c) another office of the Insured

but, in fact, was not originated by the Customer or entity whose identification it bears, and

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**ENDORSEMENT# 6** (Continued)

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- (2) contains a valid test code which proves to have been used by a person who was not authorized to make use of it, and

(3) contains the name of a person authorized to initiate such transfer; provided that, if the transfer was in excess of the amount shown on the Declarations as the verification call-back amount for this Insuring Agreement, the instructions was verified by a call-back according to a prearranged procedure.

As used in this Insuring Agreement, Customer means an entity or individual which has a written agreement with the Insured authorizing the Insured to rely on Telefacsimile Device instructions to initiate transfers and has provided the Insured with the names of persons authorized to initiate such transfers, and with which the Insured has established an instruction verification mechanism.

**DESTRUCTION OF DATA OR PROGRAMS BY HACKER**

- (CC-5) Loss resulting directly from the malicious destruction of, or damage to, Electronic Data or Computer Programs owned by the Insured or for which the Insured is legally liable while stored within a Computer System covered under the terms of the **COMPUTER SYSTEMS FRAUD** Insuring Agreement.

The liability of the Company shall be limited to the cost of duplication of such Electronic Data or Computer Programs from other Electronic Data or Computer Programs which shall have been furnished by the Insured.

In the event, however, that destroyed or damaged Computer Programs cannot be duplicated from other Computer Programs, the Company will pay the cost incurred for computer time, computer programmers, consultants or other technical specialists as is reasonable necessary to restore the Computer Programs to substantially the previous level of operational capability.

**DESTRUCTION OF DATA OR PROGRAMS BY VIRUS**

- (CC-6) Loss resulting directly from the malicious destruction of, or damage to, Electronic Data or Computer Programs owned by the Insured or for which the Insured is legally liable while stored within a Computer System covered under the terms of the **COMPUTER SYSTEMS FRAUD** Insuring



Agreement if such destruction or damage was caused by a computer program or similar instruction which was written or altered to incorporate a hidden instruction designed to destroy or damage Electronic Data or Computer Programs in the Computer

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System in which the computer program or instruction so written or so altered is used.

The liability of the Company shall be limited to the cost of duplication of such Electronic Data or Computer Programs from other Electronic Data or Computer Programs which shall have been furnished by the Insured.

In the event, however, that destroyed or damaged Computer Programs cannot be duplicated from other Computer Programs, the Company will pay the cost incurred for computer time, computer programmers, consultants or other technical specialists as is reasonably necessary to restore the Computer Programs to substantially the previous level of operational capability.

**Special Condition:** Under this Insuring Agreement, **Single Loss** means all covered costs incurred by the Insured between the time destruction or damage is discovered and the time the Computer System is restored to substantially the previous level of operational capability. Recurrence of destruction or damage after the Computer System is restored shall constitute a separate **Single Loss**.

**VOICE COMPUTER SYSTEM FRAUD**

(CC-7) Loss resulting directly from charges for voice telephone long-distance toll calls which were incurred due to the fraudulent use or fraudulent manipulation of an Account Code or System Password required to obtain access to a Voice Computer System owned or leased by the Insured, installed on the Insured's premises, whose System Administration is performed and controlled by the Insured; provided, however, that the unauthorized access was not made possible by

- (1) failure to incorporate a System Password feature or failure to change the System Password at least once every 30 days thereafter, or
- (2) failure to have a call-disconnect feature in operation to automatically terminate a caller's access to the Voice Computer System after not more than three unsuccessful attempts to input an Account Code.

**Special Condition:** Under this Insuring Agreement, **Single Loss** means loss resulting from toll call charges made only on telephone lines directly controlled by one Voice Computer System and only toll call charges occurring for a period of not more than 30 days inclusive of the date on which the first such toll call charge was made.

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**ENDORSEMENT# 6** (Continued)

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5. GENERAL AGREEMENT A. ADDITIONAL OFFICES OR EMPLOYEES CONSOLIDATION, MERGER  
NOTICE is hereby deleted in its entirety and is replaced with the following:  
ADDITIONAL OFFICES OR EMPLOYEES OR COMPUTER SYSTEMS CONSOLIDATION, MERGER OR  
PURCHASE OF ASSETS OR COMPUTER SYSTEMS

A. If the Insured shall, while this bond is in force, establish any additional offices, other than by consolidation or merger with, or purchase or acquisition of assets or liabilities or computer systems of, another institution, such offices and computer systems shall be automatically covered hereunder from the date of such establishment without the requirement of notice to the Underwriter or the payment of additional premium for the remainder of the premium period.

If the Insured shall, while this bond is in force, consolidate or merge with, or purchase or acquire assets or liabilities or computer systems of, another institution, the Insured shall not have such coverage as is afforded under this bond for loss which:

- (a) has occurred or will occur in offices or premises or computer systems, or
- (b) has been caused or will be caused by an employee or employees of such institution, or
- (c) has arisen or will arise out of the assets or liabilities or computer systems acquired by the Insured as a result of such consolidation, merger or purchase of assets or liabilities or computer systems unless the Insured shall:
  - (i) give the Underwriter written notice within 60 days of the proposed consolidation, merger or purchase of assets or liabilities or computer systems prior to the proposed effective date of such action; and
  - (ii) obtain the written consent of the Underwriter to extend the coverage provided by this bond to such additional offices or premises or computer systems, Employees and other

exposures; and

(iii) upon obtaining such consent, pay to the Underwriter an additional premium.

6. Solely for the coverage provided by this rider, in Section 1. DEFINITIONS of the CONDITIONS AND LIMITATIONS of this bond, definition (b) Property is hereby amended to include Electronic Data and Computer Programs.

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**ENDORSEMENT# 6** (Continued)

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7. Solely for the coverage provided by this rider, Section 1. DEFINITIONS of the CONDITIONS AND LIMITATIONS of this bond is hereby amended by adding the following definitions to the end thereof:

(i) Account Code means a confidential and protected string of characters which identifies or authenticates a person and permits that person to gain access to a Voice Computer System for the purpose of making toll calls or utilizing voice mail box messaging capabilities or other similar functional features of the System;

(ii) Computer Program means a set of related electronic instructions which direct the operations and functions of a computer or devices connected to it which enable the computer or devices to receive, process, store or send Electronic Data;

(iii) Computer System means:

(1) computers with related peripheral components, including storage components wherever located;

(2) systems and applications software;

(3) terminal devices; and

(4) related communication networks, including the internet  
by which Electronic Data are electronically collected, transmitted, processed, stored and retrieved;

(iv) Electronic Data means facts or information converted to a form usable in a Computer System by Computer Programs and which is stored on magnetic tapes or disks, or optical storage disks or other bulk media;

- (v) Funds means Money on deposit in an account;
- (vi) System Administration means the performance of security functions including but not limited to defining authorized persons to access a Voice Computer System and adding, changing and deleting Account Codes or passwords in connection therewith; and invoking or revoking a System option which directs telephone call routing or which adds, moves or drops telephone lines or which performs any other similar activity allowed by a hardware or software-based System option that has been incorporated by a manufacturer or vendor into a System or any component thereof provided said System option is not intended for the sole use of such manufacturer or vendor;
- (vii) System Maintenance means the performance of hardware and software installation, diagnostics and corrections and similar activities that are performed in the usual custom and practice by a manufacturer or vendor to establish or maintain the basic operational functionality of a Voice Computer System or any component thereof;

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**ENDORSEMENT# 6** (Continued)

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- (viii) System Password means a confidential and protected string of characters which identifies or authenticates a person and permits that person to gain access to a Voice Computer System or any portion thereof for the purpose of performing System Administration or System Maintenance activities;
- (ix) Telefacsimile Device means a machine capable of sending or receiving a duplicate image of a document by means of electronic impulses transmitted through a telephone line and which reproduces the duplicate image on paper;
- (x) Tested means a method of authenticating the contents of a communication by placing a valid test key on it which has been agreed upon by the Insured and a customer, automated clearing house, or another financial institution for the purpose of protecting the integrity of the communication in the ordinary course of business;
- (xi) Uncertificated Security means a share, participation or other interest in property of, or an enterprise of, the issuer or an obligation of the issuer, which is:
  - (1) not represented by an instrument and the transfer of which is registered upon books maintained for that purpose by or on behalf of the issuer;
  - (2) of a type commonly dealt in securities, exchanges or markets; and
  - (3) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests or obligations;
- (xii) Voice Computer System means a Computer System installed in one location which functions as a private branch exchange (PBX), voice mail processor, automated call attendant or provides a similar capability used for the direction or routing of telephone calls in a voice communications network.



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**ENDORSEMENT# 6** (Continued)

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8. Solely for the coverage provided by this rider, Section 2. EXCLUSIONS of the CONDITIONS AND LIMITATIONS of the bond is hereby amended by adding the following exclusions to the end thereof: THIS BOND DOES NOT COVER:

- (i) any loss of the type or kind covered by any other Insuring Agreement provided in this financial institution bond, regardless of any deductible amount or limit of liability;
- (ii) loss caused by a director or Employee of the Insured or by a person in collusion with any director or Employee of the Insured; (Collusion shall include the willful withholding of knowledge from the Insured by any director or Employee that a fraudulent act by a person not an Employee has been or will be perpetrated against the Insured.);
- (iii) loss resulting directly or indirectly from entry or change of Electronic Data or Computer Programs in a Computer System, unless covered under the **COMPUTER SYSTEMS FRAUD** or **DATA PROCESSING SERVICE OPERATIONS** Insuring Agreements;
- (iv) loss resulting directly or indirectly from the Insured having transferred Funds in reliance on the validity of a voice instruction, unless covered under the **COMPUTER SYSTEMS FRAUD** or **VOICE INITIATED TRANSFER FRAUD** Insuring Agreements;
- (v) loss resulting directly or indirectly by the Insured having transferred or delivered Funds, Certificated Securities or Uncertificated Securities in reliance on an instruction received through a Telefacsimile Device, unless covered under the **TELEFACSIMILE TRANSFER FRAUD** Insuring Agreement;
- (vi) loss resulting directly or indirectly from theft of confidential information;
- (vii) loss resulting directly or indirectly from the assumption of liability by the Insured by contract unless the liability arises from a loss covered by this rider and would be imposed on the Insured regardless of the

existence of the contract;

- (viii) the cost of duplication of Electronic Data or Computer Programs, unless covered under the **DESTRUCTION OF DATA OR PROGRAMS BY HACKER** or **DESTRUCTION OF DATA OR PROGRAMS BY VIRUS** Insuring Agreements;
- (ix) loss involving a Voice Computer System, unless covered under the **VOICE COMPUTER SYSTEM FRAUD** Insuring Agreement;

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**ENDORSEMENT# 6** (Continued)

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(x) loss resulting directly or indirectly from:

(1) written instructions or advices, or

(2) telegraphic or cable instructions or advices;

unless the instructions or advices are Tested and the loss is covered under the **COMPUTER SYSTEMS FRAUD or DATA PROCESSING SERVICE OPERATIONS** Insuring Agreements;

(xi) loss resulting directly or indirectly from negotiable instruments, securities, documents or other written instruments which bear a forged signature, or are counterfeit, altered or otherwise fraudulent and which are used as source documentation in the preparation of Electronic Data or manually keyed into a data terminal;

(xii) loss resulting directly or indirectly from the fraudulent preparation, or fraudulent modification of Computer Programs unless covered under the **COMPUTER SYSTEMS FRAUD or DATA PROCESSING SERVICE OPERATIONS** Insuring Agreements;

(xiii) loss resulting directly or indirectly from:

(a) mechanical failure, faulty construction, error in design, latent defect, fire, wear or tear, gradual deterioration, electrical disturbance or electrical surge which affects a Computer System; or

(b) failure or breakdown of electronic data processing media; or

(c) error or omission in programming or processing;

- (xiv) loss as a result of a threat to Computer System operations;
- (xv) loss resulting directly or indirectly from the use of a telephone credit, debit, charge, identification or similar card to gain access to the Insured's Voice Computer System;
- (xvi) loss resulting directly or indirectly from the input of Electronic Data into a Computer System terminal device either on the premises of a customer of the Insured or under the control of such customer by a person who had authorized access to the customer's authentication mechanism.
- (xvii) loss resulting directly or indirectly from payments made or withdrawals from a depositor's account involving items of deposit which are not finally paid for any reason;
- (xviii) loss of potential income, including but not limited to interest and dividends;

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**ENDORSEMENT# 6** (Continued)

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- (xix) loss of any type for which the Insured is legally liable, except compensatory damages, but not multiples thereof, arising directly from a loss covered under this policy;
  - (xx) any fees, costs and expenses incurred by the Insured;
  - (xxi) indirect or consequential loss of any nature;
  - (xxii) loss involving automated mechanical devices which on behalf of the Insured, disburse money, accept deposits, cash checks, drafts or similar written instruments, or make credit card loans;
  - (xxiii) loss due to riot or civil commotion or loss due to military, naval or usurped power, war or insurrection;
  - (xxiv) loss resulting directly or indirectly from the effects of nuclear fission or fusion or radioactivity; provided, however, that this exclusion shall not apply to loss resulting from industrial uses of nuclear energy; and
  - (xxv) loss as a result of a threat
    - 1) to do bodily harm to any person;
    - 2) to do damage to the premises or property of the Insured; or
    - 3) to Computer Systems operations;
9. Solely for the coverage provided by this rider, Section 4. LOSS - NOTICE - PROOF - LEGAL PROCEEDINGS of the CONDITIONS AND LIMITATIONS of the bond is hereby amended by adding the following to the end

thereof:

It is further understood and agreed that:

- (i) Proof of loss for claim under the Voice Initiated Transfer Fraud Insuring Agreement must include electronic recordings of such voice instructions and the verification call-back, if such call-back was required; and
- (ii) Proof of loss for claim under the Telefacsimile Transfer Fraud Insuring Agreement must include a copy of the document reproduced by the Telefacsimile Device.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

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**ENDORSEMENT# 7**

This endorsement, effective 12:01AM Mar 1, 2019 forms a part of  
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**FRAUDULENT TRANSFER INSTRUCTIONS**

In consideration of the premium charged, it is agreed that:

1. The following Insuring Agreement is added to this bond:  
(FTI) FRAUDULENT TRANSFER INSTRUCTIONS

Loss resulting directly from the Insured having, in good faith, transferred money on deposit in a Customer's account, or a Customer's Certificated Securities, in reliance upon a fraudulent instruction transmitted to the Insured via telefacsimile, telephone, or electronic mail; provided, however that

- (1) The fraudulent instruction purports, and reasonably appears, to have originated from:
  - (a) such Customer,
  - (b) an Employee acting on instructions of such Customer; or
  - (c) another financial institution acting on behalf of such Customer with authority to make such instructions; and
- (2) The sender of the fraudulent instruction verified the instruction with the password, PIN, or other security code of such Customer; and
- (3) The sender was not, in fact, such Customer, was not authorized to act on behalf of such Customer, and was not an Employee of the Insured; and



- (4) The instruction was received by an Employee of the Insured specifically authorized by the Insured to receive and act upon such instructions; and
- (5) For any transfer exceeding the Verification Threshold Amount set forth below, the Insured verified the instruction via a call back to a predetermined telephone number set forth in the Insured's Written agreement with such Customer or other verification procedure approved in writing by the Underwriter; and
- (6) The Insured preserved a contemporaneous record of the call back, if any, and of the instruction which verifies use of the authorized password, PIN or other security code of the Customer.

The Verification Threshold Amount applicable to this FRAUDULENT TRANSFER INSTRUCTIONS Insuring Agreement is: \$25,000.

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END 7

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**ENDORSEMENT# 7** (Continued)

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2. Solely with respect to the FRAUDULENT TRANSFER INSTRUCTIONS Insuring Agreement, the following definitions shall apply:

(FTI-1) **Certificated Security** means a share, participation or other interest in property of or an enterprise of the issuer or an obligation of the issuer, which is:

- (i) represented by a written instrument issued in bearer or registered form;
- (ii) of a type commonly dealt in on securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
- (iii) either one of a class or series or by its terms divisible into a class or series of shares, participations, interests or obligations.

(FTI-2) **Customer** means a natural person or entity which has a written agreement with the Insured authorizing the Insured to transfer money on deposit in an account or Certificated Securities in reliance upon instructions transmitted to the Insured via the means utilized to transmit the fraudulent instruction.

3. It shall be a condition precedent to coverage under the FRAUDULENT TRANSFER INSTRUCTIONS Insuring Agreement that the Insured assert any available claims, offsets or defenses against such Customer, any financial institution or any other party to the transaction.

4. The following additional Exclusions are added to the Bond applicable only to this Insuring Agreement:

(FTI-1) loss resulting directly or indirectly from a fraudulent instruction if the sender, or anyone acting in collusion with the sender, ever had authorized access to such Customer's password, PIN or other security code; and

(FTI-2) loss resulting directly or indirectly from the fraudulent alteration of an instruction to initiate an automated clearing house (ACH) entry, or group of ACH entries, transmitted as an electronic message, or as an attachment to an electronic message, sent via the Internet, unless:

- (i) each ACH entry was individually verified via the call back procedure without regard to the amount of the entry; or
- (ii) the instruction was formatted, encoded or encrypted so that any alteration in the ACH entry or group of ACH entries would be apparent to the Insured.

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END 7

**BRANCH**

127417 (11/17)

2

**ENDORSEMENT# 7** (Continued)

This endorsement, effective 12:01AM Mar 1, 2019 forms a part of  
policy number 01-194-44-35  
issued to SOLAR CAPITAL LTD.

by National Union Fire Insurance Company of Pittsburgh, Pa.

5. The *Optional Insuring Agreements and Coverages* section of Item 3 of the Declarations of this bond is amended by adding the following at the end thereof:

	Limit of Liability	Deductible
Insuring Agreement (FTI)- FRAUDULENT TRANSFER INSTRUCTIONS	\$ 3,000,000	\$ 25,000

6. Nothing contained herein shall be held to vary, alter, waive, or extend any of the terms, limitations, conditions or agreements of the attached bond other than as above stated.

AUTHORIZED REPRESENTATIVE

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END 7

**BRANCH**

127417 (11/17)

3

**ENDORSEMENT# 8**

This endorsement, effective 12:01AM Mar 1, 2019 forms a part of  
policy number 01-194-44-35  
issued to SOLAR CAPITAL LTD.

by National Union Fire Insurance Company of Pittsburgh, Pa.

**UNAUTHORIZED SIGNATURES COVERAGE**

In consideration of the premium charged, it is agreed that:

1. The following Insuring Agreement is added to this bond:  
(US) UNAUTHORIZED SIGNATURES

Loss resulting directly from the Insured having accepted, paid or cashed any check or withdrawal order made or drawn on a customer's account which bears the signature or endorsement of someone other than a person whose name and signature is on file with the Insured as a signatory on such account.

It shall be a condition precedent to the Insured's right of recovery under this UNAUTHORIZED SIGNATURES Insuring Agreement that the Insured shall have on file the signatures of all persons who are signatories on such account.

2. The *Optional Insuring Agreements and Coverages* section of Item 3 of the Declarations of this bond is amended by adding the following at the end thereof:

	Limit of Liability	Deductible
Insuring Agreement (US) - UNAUTHORIZED SIGNATURES	\$ 100,000	\$ 5,000

3. Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, limitations, conditions or agreements of the attached bond other than as above stated.

AUTHORIZED REPRESENTATIVE

END 8

***BRANCH***

127425 (11/17)

1

**ENDORSEMENT# 9**

This endorsement, effective 12:01AM Mar 1, 2019 forms a part of

policy number 01-194-44-35

issued to SOLAR CAPITAL LTD.

by National Union Fire Insurance Company of Pittsburgh, Pa.

**EMPLOYEE DEFINITION AMENDED**

**(REMOVE AND WHICH IS NOT A BANK )**

It is agreed that:

1. In SECTION 1. DEFINITIONS of the CONDITIONS AND LIMITATIONS of the bond, the definition of Employee is amended by deleting the paragraph immediately after subparagraph (d) in its entirety and replaced with the following:  
for an Investment Company named as Insured while performing acts coming within the scope of the usual duties of an officer or Employee of any Investment Company named as Insured herein, or while acting as a member of any committee duly elected or appointed to examine or audit or have custody of or access to Property of any such Investment Company, provided that only Employees or partners of a transfer agent, shareholder, accounting record-keeper or administrator which is an affiliated person as defined in the Investment Company Act of 1940, of an Investment Company named as Insured or is an affiliated person of the advisor, underwriter or administrator of such Investment Company, shall be included within the definition of Employee.
2. Nothing contained here shall be held to vary, alter, waive or extend any of the terms, limitations, conditions, or agreements of the attached bond other than as above stated.

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**BRANCH**

END 9

128351 (03/18)

1

**ENDORSEMENT# 10**

This endorsement, effective 12:01AM Mar 1, 2019 forms a part of

policy number 01-194-44-35

issued to SOLAR CAPITAL LTD.

by National Union Fire Insurance Company of Pittsburgh, Pa.

**ADDITIONAL NAMED INSURED RIDER**

In consideration of the premium charged, it is hereby understood and agreed that:

1. In Item 1 of the Declarations page, the section entitled Name of Insured (herein called Insured), is amended to include the following at the end thereof:

Solar Senior Capital Ltd

Solar Capital Partners, LLC

Solar Capital Management, LLC

Solar Capital, LLC

SCP Private Credit Income BDC LLC

2. Nothing contained herein shall be held to vary, alter, waive, or extend any of the terms, limitations, conditions or agreements of the attached bond other than as above stated.

AUTHORIZED REPRESENTATIVE

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**BRANCH**

END 10

127423 (11/17)

1



**ENDORSEMENT# 11**

This endorsement, effective **12:01 am** **March 1, 2019** forms a part of  
policy number **01-194-44-35**  
issued to **SOLAR CAPITAL LTD.**

by **National Union Fire Insurance Company of Pittsburgh, Pa.**  
**NOTICE OF CLAIM**

**(REPORTING B Y E- MAIL)**

In consideration of the premium charged, it is hereby understood and agreed as follows:

1. *Email Reporting of Claims:* In addition to the postal address set forth for any Notice of Claim Reporting under this policy, such notice may also be given in writing pursuant to the policy's other terms and conditions to the Insurer by email at the following email address:  
c- claim @AIG.com

Your email must reference the policy number for this policy. The date of the Insurer's receipt of the emailed notice shall constitute the date of notice.

In addition to Notice of Claim Reporting via email, notice may also be given to the Insurer by mailing such notice to: AIG, Financial Lines Claims, P.O. Box 25947, Shawnee Mission, KS 66225 or faxing such notice to (866) 227-1750.

2. *Definitions:* For this endorsement only, the following definitions shall apply:
  - (a) Insurer means the Insurer, Underwriter or Company or other name specifically ascribed in this policy as the insurance company or underwriter for this policy.
  - (b) Notice of Claim Reporting means notice of claim / circumstance, notice of loss or other reference in the policy designated for reporting of claims, loss or occurrences or situations that may give rise or result in loss under this policy.
  - (c) Policy means the policy, bond or other insurance product to which this endorsement is attached.
3. This endorsement does not apply to any Kidnap & Ransom / Extortion Coverage Section, if any, provided by this policy.

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

AUTHORIZED REPRESENTATIVE

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**1-14180**

**END 011**

99758 (8/08)

**BRANCH COPY**

Page 1 of 1

**ENDORSEMENT# 12**

This endorsement, effective at **12:01 am** **March 1, 2019** forms a part of  
Policy number **01-194-44-35**  
Issued to: **SOLAR CAPITAL LTD.**

By: **National Union Fire Insurance Company of Pittsburgh, Pa.**  
**ECONOMIC SANCTIONS ENDORSEMENT**

*This endorsement modifies insurance provided under the following:*

Coverage shall only be provided and payment of loss under this policy shall only be made in full compliance with enforceable United Nations economic and trade sanctions and the trade and economic sanction laws or regulations of the European Union and the United States of America, including, but not limited to, sanctions, laws and regulations administered and enforced by the U.S. Treasury Department's Office of Foreign Assets Control ( OFAC ).

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

AUTHORIZED REPRESENTATIVE

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**1-14180**

**END 012**

119679 (9/15) **BRANCH COPY**

Page 1 of 1

**ENDORSEMENT# 13**

This endorsement, effective **12:01 am** **March 1, 2019** forms a part of  
 policy number **01-194-44-35**  
 issued to **SOLAR CAPITAL LTD.**

by **National Union Fire Insurance Company of Pittsburgh, Pa.**  
**FORMS INDEX ENDORSEMENT**

The contents of the Policy is comprised of the following forms:

FORM NUMBER	EDITION DATE	FORM TITLE
41205	03/95	INVESTMENT COMPANY BLANKET BOND
41206	09/84	Investment Company Blanket Bond guts
83231	01/09	NEW YORK LAW 3420 AMENDATORY ENDORSEMENT
69898	09/06	NEW YORK AMENDATORY - CANCELLATION/NONRENEWAL
127071	09/17	NEW YORK PUNITIVE DAMAGES AMENDATORY ENDORSEMENT
103011	10/09	OMNIBUS WORDING
113011	10/12	PROTECTED INFORMATION EXCLUSION
128310	03/18	COMPUTER CRIME COVERAGE RIDER
127417	11/17	FRAUDULENT TRANSFER INSTRUCTIONS
127425	11/17	UNAUTHORIZED SIGNATURES COVERAGE
128351	03/18	EMPLOYEE DEFINITION AMENDED
127423	11/17	ADDITIONAL NAMED INSURED RIDER
99758	08/08	NOTICE OF CLAIM (REPORTING BY E-MAIL)
119679	09/15	ECONOMIC SANCTIONS ENDORSEMENT
78859	10/01	FORMS INDEX ENDORSEMENT

ALL OTHER TERMS, CONDITIONS AND EXCLUSIONS REMAIN UNCHANGED.

AUTHORIZED REPRESENTATIVE

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**1-14180**

**END 013**

78859 (10/01)

**BRANCH COPY**

Page 1 of 1

**CERTIFICATE OF THE SECRETARY**

The undersigned, Richard L. Peteka, Chief Financial Officer, Treasurer and Secretary of Solar Capital Ltd., a Maryland corporation (the Corporation ), does hereby certify that:

1. This certificate is being delivered to the Securities and Exchange Commission (the SEC ) in connection with the filing of the Corporation s fidelity bond (the Bond ) pursuant to Rule 17g-1 of the Investment Company Act of 1940, as amended, and the SEC is entitled to rely on this certificate for purposes of the filing.
2. The undersigned is the duly elected, qualified and acting Chief Financial Officer, Treasurer and Secretary of the Corporation, and has custody of the corporate records of the Corporation and is a proper officer to make this certification.
3. Attached hereto is a copy of the resolutions approved by the Board of Directors of the Corporation, including a majority of the Board of the Directors who are not interested persons of the Corporation, approving the amount, type, form and coverage of the Bond.
4. Premiums have been paid for the period March 1, 2019 to March 1, 2020.

IN WITNESS WHEREOF, the undersigned has caused this certificate to be executed this 11th day of March, 2019.

/s/ Richard L. Peteka  
Richard L. Peteka  
Chief Financial Officer, Treasurer and  
Secretary

**Approval of Annual Fidelity Bond Renewal**

**WHEREAS**, Section 17(g) of the Investment Company Act of 1940, as amended (the *1940 Act* ), and Rule 17g-1(a) thereunder, require each business development company ( *BDC* ), such as Solar Capital Ltd. (the *Company* ) to provide and maintain a bond which shall be issued by a reputable fidelity insurance company, authorized to do business in the place where the bond is issued, to protect the BDC against larceny and embezzlement, covering each officer and employee of the BDC who may singly, or jointly with others, have access to the securities or funds of the BDC, either directly or through authority to draw upon such funds of, or to direct generally, the disposition of such securities, unless the officer or employee has such access solely through his position as an officer or employee of a bank (each, a *covered person* ); and

**WHEREAS**, Rule 17g-1 specifies that the bond may be in the form of (i) an individual bond for each covered person, or a schedule or blanket bond covering such persons, (ii) a blanket bond which names the Company as the only insured, or (iii) a bond which names the Company and one or more other parties as insureds in a joint insured bond, as permitted by Rule 17g-1; and

**WHEREAS**, Rule 17g-1 requires that a majority of directors who are not interested persons of the BDC, as such term is defined under the 1940 Act (the *Non-Interested Directors* ), approve periodically (but not less than once every 12 months) the reasonableness of the form and amount of the bond, with due consideration to the value of the aggregate assets of the Company to which any covered person may have access, the type and terms of the arrangements made for the custody and safekeeping of such assets, and the nature of securities and other investments to be held by the Company, and pursuant to factors contained in Rule 17g-1, which are described in the accompanying memorandum provided herewith; and

**WHEREAS**, under Rule 17g-1, the Company is required to make certain filings with the U.S. Securities and Exchange Commission (the *Commission* ) and give certain notices to each member of the Company's Board of Directors (the *Board* ) in connection with the bond, and designate an officer who shall make such filings and give such notices; and

**WHEREAS**, the Board, including all of the Non-Interested Directors, have considered the expected aggregate value of the securities and funds of the Company to which the Company's officers and employees may have access (either directly or through authority to draw upon such funds or to direct generally the disposition of such securities), the type and terms of the arrangements made for the custody of such securities and funds, the nature of securities and other investments to be held by the Company, the accounting procedures and controls of the Company, the nature and method of conducting the operations of the Company, the requirements of Section 17(g) of the 1940 Act and Rule 17g-1 thereunder, and all other factors deemed relevant by the Board, including the Non-Interested Directors;

**NOW, THEREFORE, BE IT RESOLVED**, that having considered the expected aggregate value of the securities and funds of the Company to which the Company's officers and employees may have access (either directly or through authority to draw upon such funds or to direct generally the disposition of such securities), the type and terms of the arrangements made for the custody of such securities and funds, the

nature of securities and other investments to be held by the Company, the accounting procedures and controls of the Company, the nature and method of conducting the operations of the Company, the requirements of Section 17(g) of the 1940 Act and Rule 17g-1 thereunder, and all other factors deemed relevant by the Board, including the Non-Interested Directors, the Board, including all of the Non-Interested Directors, determine that the amount, type, form, premium and coverage, covering the officers and employees of the Company and insuring the Company against loss from fraudulent or dishonest acts, including larceny and embezzlement, issued by National Union Fire Insurance Company of Pittsburgh, Pennsylvania in the amount of \$3,000,000 (the *Joint Fidelity Bond* ) be, and hereby are approved; and

**FURTHER RESOLVED**, that the Board, including all of the Non-Interested Directors, have determined the portion of the premium to be paid by the Company be, and it hereby is, approved, taking all relevant factors into consideration including, but not limited to, the number of the other insured parties named as insureds, the nature of business activities of the other insured parties, the amount of the Joint Fidelity Bond and the amount of the premium for such Joint Fidelity Bond, the ratable allocation of the premium among the insureds, and the extent to which the share of the premium allocated to the Company is less than the premium the Company would have had to pay had such joint insured bond not been obtained; and

**FURTHER RESOLVED**, that the Authorized Officers of the Company be, and each of them hereby is, authorized and directed to cause the Company to pay its ratable allocation of the annual premium payable with respect to the Joint Fidelity Bond and to enter into and execute, on behalf of the Company, an agreement reflecting the provisions of the Joint Fidelity Bond and relating to the division of proceeds in the event of a joint fidelity loss, as required by Rule 17g-1(f) (the *Joint Insured Bond Allocation Agreement* ); and

**FURTHER RESOLVED**, that the terms and conditions of the Joint Insured Bond Allocation Agreement, in substantially the form provided herewith, be, and hereby are, approved and adopted in all respects, with such amendments thereto as an Authorized Officer may approve, and with approval of such further amendments evidenced by their inclusion in the Joint Insured Bond Allocation Agreement; and

**FURTHER RESOLVED**, that the Authorized Officers be, and each of them hereby is, authorized to make filings with the Commission, in consultation with counsel to the Company, and to give notices as may be required, from time to time, pursuant to Rule 17g-1(g) and Rule 17g-1(h) under the 1940 Act; and

**FURTHER RESOLVED**, that the Company's Authorized Officers be, and each of them hereby is, authorized and directed to amend the Joint Fidelity Bond, in consultation with counsel to the Company, and to execute such other documents as he or she may deem necessary or appropriate to effect the intent of this resolution; and

**FURTHER RESOLVED**, that each of the Authorized Officers is hereby authorized in the name and on behalf of the Company, to make or cause to be made, and to execute and deliver, all such additional agreements, documents, instruments and certifications and to take all such steps, and to make all such payments, fees and remittances, as any one or more of such officers may at any time or times deem necessary or desirable in order to effectuate the purpose and intent of the foregoing resolutions; and



**FURTHER RESOLVED**, that any and all actions previously taken by the Company or any of its directors, officers or other employees in connection with the documents, and actions contemplated by the foregoing resolutions be, and they hereby are, ratified, confirmed, approved and adopted in all respects as and for the acts and deeds of the Company; and

**FURTHER RESOLVED**, that for the purposes of the foregoing resolutions, the Authorized Officers of the Company shall be the Chief Executive Officer, the Chief Operating Officer, and the Chief Financial Officer and Secretary (the *Authorized Officers* ).

AGREEMENT REGARDING THE ALLOCATION OF  
FIDELITY BOND RECOVERIES

THIS AGREEMENT is made as of March 11, 2019, by and among Solar Capital Ltd., Solar Senior Capital Ltd. and SCP Private Credit Income BDC LLC (each, an Insured, and, together, the Insureds ), each acting on behalf of itself.

**WHEREAS**, each Insured is a closed-end management investment company which has elected to be regulated as a business development company under the Investment Company Act of 1940, as amended (the 1940 Act ); and

**WHEREAS**, each of the Insureds is named as an insured party under a joint fidelity bond (the Bond ); and

**WHEREAS**, the Insureds desire to confirm the criteria by which recoveries under the Bond shall be allocated between the Insureds;

**NOW, THEREFORE**, it is agreed as follows:

1. In the event that recovery is received under the Bond as a result of a loss sustained by more than one Insured, the following rules shall apply for determining the priorities for satisfaction of such claims under the Bond:
  - a. First, each Insured shall receive an equitable and proportionate share of the recovery, but at least equal to the amount it would have received had it provided and maintained a single insured bond with the minimum coverage required under Rule 17g-1(d)(1) under the 1940 Act; and
  - b. Second, the remaining amount of recovery, if any, shall then be applied to each claim of each Insured in proportion to the amount of the unreimbursed loss in excess of such minimums incurred by each Insured.
2. The obligations of an Insured under this Agreement are not binding upon any of the board members of an Insured or Insured shareholders individually, but are binding only with respect to the assets of that Insured.

*[Remainder of Page Intentionally Left Blank]*

IN WITNESS WHEREOF, the insured parties have caused this Agreement to be executed by their respective officers thereunto duly authorized.

SOLAR CAPITAL LTD.

By: /s/ Richard L. Peteka  
Name: Richard L. Peteka  
Title: Chief Financial Officer, Treasurer and  
Secretary

SOLAR SENIOR CAPITAL LTD.

By: /s/ Richard L. Peteka  
Name: Richard L. Peteka  
Title: Chief Financial Officer, Treasurer and  
Secretary

SCP PRIVATE CREDIT INCOME BDC LLC

By: /s/ Richard L. Peteka  
Name: Richard L. Peteka  
Title: Chief Financial Officer, Treasurer and  
Secretary

**EXHIBIT D**

I have examined the Fidelity Bond limit requirements, as prescribed in Rule 17g-1 for the parties insured under National Union Fire Insurance Company of Pittsburgh Pennsylvania Bond No. 01-194-44-35. This limits analysis is based upon the total asset value of each registrant as stated in the relevant renewal application.

The results of the analysis are as follows:

<b>Registrant</b>	<b>Asset value</b>	<b>Required Limit</b>
Solar Capital Ltd.	\$ 1,683,429,000	\$ 1,500,000
Solar Senior Capital Ltd.	\$ 459,295,000	\$ 750,000
SCP Private Credit Income BDC LLC	\$ 1,000	\$ 50,000
<b>Total Limit:</b>		\$ 2,300,000

As you are aware, the limit under the current bond is \$3,000,000. Therefore, according to these calculations, the bond amount is sufficient to meet requirements of Rule 17g-1.

Sincerely,

/s/ Richard L. Peteka  
Richard L. Peteka  
Chief Financial Officer, Treasurer and  
Secretary