



Lead Plaintiff Waterford Township Police & Fire Retirement System and class member Michael L. Fox (collectively referred to herein as “Plaintiffs” or “Lead Plaintiffs”) make the allegations herein, except as to allegations specifically pertaining to Plaintiffs and their counsel, based upon the investigation undertaken by Plaintiffs’ counsel, which investigation included the review of United States Securities and Exchange Commission (“SEC”) and Federal Financial Institutions Examination Council (“FFIEC”) filings by Smithtown Bancorp, Inc. (“Smithtown Bancorp” or the “Company”), as well as an analysis of publicly available news articles and reports issued about the Company, securities analysts’ reports and advisories about Smithtown Bancorp, and information obtained from interviews with confidential sources, including former employees of the Company. Plaintiffs believe that substantial additional evidentiary support will exist for the allegations set forth herein after a reasonable opportunity for discovery.

#### **NATURE OF THE ACTION**

1. This is a federal securities class action on behalf of purchasers of the common stock of Smithtown Bancorp between March 13, 2008 and February 1, 2010, inclusive (the “Class Period”), against Smithtown Bancorp and certain of its officers and directors seeking to pursue remedies under the Securities Exchange Act of 1934 (the “Exchange Act”).

2. Defendant Smithtown Bancorp, through its subsidiaries, engaged in a full range of commercial and consumer banking services in the primary market area of Long Island, New York. During the Class Period, as detailed herein, Smithtown Bancorp engaged in a variety of unsafe and/or unsound banking practices. These practices rendered Smithtown Bancorp unable to timely identify and monitor past due loans, loans with emerging credit weaknesses; loans in violation of Company policy and even unable to assess the overall quality of the Company’s loan portfolio. Additionally, Smithtown Bancorp failed to calculate or maintain its allowance for loan losses in conformity with Generally Accepted Accounting Principles (“GAAP”). An allowance for loan

losses is the measure of future loan payments that are expected to be uncollectible and is established and maintained via a charge, which is also referred to as a “provision,” against a bank’s operating income. As a result of the foregoing, during the Class Period, Smithtown Bancorp materially overstated its operating results and fostered a materially misleading impression about the true state of the Company’s financial well-being.

3. Among other reasons, Defendants engaged in the fraudulent scheme, alleged herein, in order to enable Smithtown Bancorp to complete a series of capital raising transactions. Through these securities sales, the Company was able to generate approximately \$93 million of desperately needed capital on terms more favorable than it would have otherwise received had the truth about the Company and its banking practices been known to the market.

4. At the end of the Class Period, Smithtown Bancorp revealed in a series of disclosures that it was writing down the value of its loan portfolio by tens of millions of dollars and that it had entered into a Consent Agreement with the Federal Deposit Insurance Corporation (the “FDIC”) and a parallel Consent Order with the New York State Banking Department (the “NY Banking Department”) (referred to jointly as the “Consent Order”). A review of the Consent Order makes clear that Defendants had been running Smithtown Bancorp in an extremely reckless manner and lacked the controls necessary to properly run a bank. Thereafter, Smithtown Bancorp continued to record multi-million dollar charges for declines in the value of its loan portfolio. In response to these announcements, the price of Smithtown Bancorp common stock dropped precipitously causing Plaintiffs and other class members to suffer damages.

#### **JURISDICTION AND VENUE**

5. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act [15 U.S.C. §§78j(b) and 78t(a)] and Rule 10b-5 promulgated thereunder by the SEC [17 C.F.R. §240.10b-5].

6. This Court has jurisdiction over the subject matter of this action pursuant to 28 U.S.C. §1331 and Section 27 of the Exchange Act.

7. Venue is proper in this District pursuant to Section 27 of the Exchange Act and 28 U.S.C. §1391(b). Smithtown Bancorp maintained its principle corporate offices in this District and the wrongful acts and conduct complained of herein occurred in substantial part in this District.

8. In connection with the acts alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including, but not limited to, the mails, interstate telephone communications and the facilities of the NASDAQ Global Select Market (“NASDAQ”), a national securities exchange.

#### **PARTIES**

9. Lead Plaintiffs, as set forth in their respective certifications previously filed with this Court and incorporated by reference herein, purchased the common stock of Smithtown Bancorp during the Class Period and have been damaged thereby.

10. Defendant People’s United Financial, Inc. (“People’s United”) is a savings and loan holding company incorporated under the state laws of Delaware and the holding company for People’s United Bank, a federally-chartered stock savings bank headquartered in Bridgeport, Connecticut. On November 30, 2010, People’s United merged with and acquired Smithtown Bancorp and, therefore, assumed Smithtown Bancorp’s liabilities. Accordingly, Defendant People’s United is liable for the wrongful acts alleged herein based on its interests in Smithtown Bancorp as its successor.

11. Defendant Smithtown Bancorp, at all relevant times, was a New York State corporation and a bank holding company with one direct wholly-owned subsidiary, the Bank of Smithtown (the “Bank”), a New York State-chartered commercial bank. During the Class Period, Defendant Smithtown Bancorp maintained its headquarters in Hauppauge, New York.

12. Defendant Bradley E. Rock (“Rock”) served as Board Chairman and Chief Executive Officer (“CEO”) of Smithtown Bancorp and the Bank for more than 20 years. At all relevant times, Defendant Rock served as Board Chairman, President and CEO of Smithtown Bancorp and the Bank.

13. Defendant Anita M. Florek (“Florek”) served as an Executive Vice President (“EVP”) of Smithtown Bancorp and the Bank for more than 15 years. Defendant Florek served as EVP and as Chief Financial Officer (“CFO”) of Smithtown Bancorp and the Bank until November 19, 2009, when Defendant Florek was named Smithtown Bancorp’s and the Bank’s Chief Accounting Officer (“CAO”).

14. Defendants Rock and Florek are collectively referred to herein as the “Individual Defendants.”

#### **CLASS ACTION ALLEGATIONS**

15. Plaintiffs bring this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a class consisting of all those who purchased the common stock of Smithtown Bancorp between March 13, 2008 and February 1, 2010, inclusive, and who were damaged thereby (the “Class”). Excluded from the Class are Defendants, the officers and directors of the Company, at all relevant times, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which Defendants have or had a controlling interest.

16. The members of the Class are so numerous that joinder of all members is impracticable. Smithtown Bancorp had more than 14 million shares outstanding during the Class Period, which were actively traded on the NASDAQ. While the exact number of Class members is unknown to Plaintiffs at this time and can only be ascertained through appropriate discovery, Plaintiffs believe that there are hundreds, if not thousands, of members in the proposed Class. Thus,

the disposition of their claims in a class action will provide substantial benefits to the parties and the Court. Record owners and other members of the Class may be identified from records maintained by Smithtown Bancorp or its transfer agent. Notice can be provided to such record owners by a combination of published notice and first-class mail, using techniques and a form of notice similar to those customarily used in class actions arising under the federal securities laws.

17. Plaintiffs will fairly and adequately represent and protect the interests of the members of the Class. Plaintiffs have retained competent counsel experienced in class action litigation under the federal securities laws to further ensure such protection and intends to prosecute this action vigorously.

18. Plaintiffs' claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by Defendants' wrongful conduct in violation of federal law complained of herein.

19. Plaintiffs' claims are typical of the claims of the other members of the Class because Plaintiffs and all the Class members' damages arise from and were caused by the same false and misleading representations and omissions made by or chargeable to Defendants. Plaintiffs do not have any interests antagonistic to, or in conflict with, the Class.

20. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Since the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongful conduct alleged. Plaintiffs know of no difficulty that will be encountered in the management of this litigation that would preclude its maintenance as a class action.

21. Common questions of law and fact exist as to all members of the Class and

predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are:

(a) whether the federal securities laws were violated by Defendants' acts as alleged herein;

(b) whether Defendants omitted and/or misrepresented material facts about the business and operations of Smithtown Bancorp, including those facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading;

(c) whether Defendants knew or recklessly disregarded that their statements were false and misleading; and

(d) whether the price of Smithtown Bancorp common stock was artificially inflated during the Class Period.

22. the extent of injuries sustained by members of the Class and the appropriate measure of damages.

23. During the Class Period, the Individual Defendants, as senior executive officers and/or directors of Smithtown Bancorp, were privy to confidential and proprietary information concerning Smithtown Bancorp, its operations, finances, financial condition and present and future business prospects. The Individual Defendants also had access to material adverse non-public information concerning Smithtown Bancorp, as discussed in detail below. Because of their positions with Smithtown Bancorp, the Individual Defendants had access to non-public information about its business, finances, products, markets and present and future business prospects via internal corporate documents, conversations and connections with other corporate officers and employees, attendance at management and/or board of directors meetings and committees thereof, and via reports and other information provided to them in connection therewith. Because of their possession of such

information, the Individual Defendants knew or recklessly disregarded that the adverse facts specified herein had not been disclosed to, and were being concealed from, the investing public.

24. The Individual Defendants are liable as direct participants in the wrongs complained of herein. In addition, the Individual Defendants, by reason of their status as senior executive officers and/or directors, were “controlling persons” within the meaning of Section 20(a) of the Exchange Act and had the power and influence to cause the Company to engage in the unlawful conduct complained of herein. Because of their positions of control, the Individual Defendants were able to and did, directly or indirectly, control the conduct of Smithtown Bancorp’s business.

25. The Individual Defendants, because of their positions with the Company, controlled and/or possessed the authority to control the contents of its reports, press releases and presentations to securities analysts and through them, to the investing public. The Individual Defendants were provided with copies of the Company’s reports and press releases alleged herein to be misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Thus, the Individual Defendants had the opportunity to commit the fraudulent acts alleged herein.

26. As senior executive officers and/or directors and as controlling persons of a publicly traded company whose common stock was, and is, registered with the SEC pursuant to the Exchange Act, and was, and is, traded on the NASDAQ and governed by the federal securities laws, the Individual Defendants had a duty to promptly disseminate accurate and truthful information with respect to Smithtown Bancorp’s financial condition and performance, growth, operations, financial statements, business, products, markets, management, earnings and present and future business prospects, and to correct any previously issued statements that had become materially misleading or untrue, so that the market price of Smithtown Bancorp common stock would be based upon truthful

and accurate information. The Individual Defendants' misrepresentations and omissions during the Class Period violated these specific requirements and obligations.

27. The Individual Defendants are liable as participants in a fraudulent scheme and course of conduct, which operated as a fraud or deceit on purchasers of Smithtown Bancorp common stock by disseminating materially false and misleading statements and/or concealing material adverse facts. The scheme: (i) deceived the investing public regarding Smithtown Bancorp's business, operations and management and the intrinsic value of Smithtown Bancorp securities; (ii) enabled Smithtown Bancorp to sell securities to unsuspecting investors at artificially inflated prices; and (iii) caused Plaintiffs and other members of the Class to purchase Smithtown Bancorp common stock at artificially inflated prices.

## **SUBSTANTIVE ALLEGATIONS**

### **The Company and Its Business**

28. Defendant Smithtown Bancorp, through its subsidiaries, engaged in a full range of commercial and consumer banking services. During the Class Period, the Company also provided trust services to its clients, including demand, savings and time deposits accepted from consumers, businesses and municipalities located primarily within Long Island, New York.

29. Smithtown Bancorp's primary source of revenue has been interest income it receives on its loan portfolio, which accounted for more than 90% of the Company's total interest income during the Class Period.

30. In recent years, as interest rates declined, the average rates of return Smithtown Bancorp earned on its loan portfolio declined steadily, falling from average rate of return of 8.12% in fiscal 2007, to 6.62% in fiscal 2008, to 5.66% in fiscal 2009. During this same time frame, the lower yields derived from Smithtown Bancorp's loan portfolio were not fully offset by lower yields on its interest bearing liabilities, resulting in a considerable decline in Smithtown Bancorp's net

interest income. Net interest income, the primary contributor to Smithtown Bancorp's earnings, represented the difference between income on interest earning assets and interest expense it incurred on interest bearing liabilities and the interest rates respectively earned or paid on them.

31. To offset the adverse effects the reduction in Smithtown Bancorp's net interest income was having on the Company's operating results, Smithtown Bancorp rapidly grew the Company's loan portfolio. As detailed herein, the growth in Smithtown Bancorp's loan portfolio was predicated on unsafe and unsound banking practices. As a result, unbeknownst to investors, Smithtown Bancorp was saddled with tens of millions of dollars of highly risky loans which were overvalued on the Company's financial statements and would have to be written down.

#### **Smithtown Bancorp Engaged in Unsafe and Unsound Banking Practices**

32. During the Class Period, Defendants caused Smithtown Bancorp to engage in a myriad of unsafe and unsound bank practices that resulted in the material overstatement of Smithtown Bancorp's operating results and created a false impression about the true state of the Company financial well-being. These practices enabled Defendants to delay the recognition of approximately \$100 million in losses during the Class Period, thereby artificially inflating Smithtown Bancorp's financial results and facilitating the Company's ability to raise capital during a time when capital raising in the financial markets had ground to a decided a halt.

33. During the Class Period, Smithtown Bancorp engaged in the following unsafe and unsound banking practices which were not disclosed to investors:

- it failed to identify, monitor, and timely report past due loans and loans with emerging credit weaknesses;
- the Board of Directors and management failed to exercise appropriate monitoring and oversight over the loan review function;
- it lacked the necessary scope and depth of the loan review function such that the loan review process did not comport with industry standards;

- it failed to properly assess the overall quality of its loan portfolio such that a material portion of the portfolio was non-performing;
- it failed to have adequately staffed the Bank's Independent Loan Review ("ILR") function with personnel who are sufficiently independently qualified;
- it failed to employ proper loan classification or credit grading systems necessary to effectively identify, monitor, and address asset quality problems in an accurate and timely manner;
- it failed to properly document the support for loan credit ratings and demonstrate that the ILR conducted an independent quarterly review of the allowance for loan and lease losses ("ALLL");
- it failed to properly identify credit and collateral documentation exceptions;
- it failed to properly identify loans that were not in conformance with the Bank's lending policy or laws, rules, or regulations; and
- it failed to properly document the rationale for assigning a different loan classification than the ILR.

34. Indeed, a confidential witness ("CW"), who was employed as a Vice President and Controller of Smithtown Bancorp during the Class Period, stated that, despite having to support a family, she/he resigned from her/his position with the Company because she/he believed that Defendant Rock was "not truthful" about Smithtown Bancorp's financial condition.

35. As noted above, prior to and during the Class Period, Defendants sought to increase Smithtown Bancorp's net interest income by increasing the size of the Company's loan portfolio. The CW explained that, as part of this strategy, the Bank, during 2007 and 2008, began writing new loans that were initiated by outside mortgage brokers. Consistent with the FDIC's findings, the CW explained that the Bank did not possess the infrastructure necessary to manage its existing loan portfolio, let alone any expected growth.

36. For example, the CW stated that, during the Class Period, **the Bank only employed one credit review officer to review the Bank's entire loan portfolio and such credit review officer was a semi-retired, 80 year-old, who only worked in that capacity on a part-time basis.**

This highly unreasonable and reckless practice caused the Bank to operate in an unsafe and unsound manner, as Defendants knew or recklessly ignored.

37. According to the CW, and as Smithtown Bancorp's own SEC filings confirm, the credit review function, which the FDIC found was derelict in numerous and basic respects, is fundamental to the ability to reasonably account for a bank's loan losses. Given the absence of the above noted fundamental banking practices, the CW believed that during the Class Period, Smithtown Bancorp's allowance for loan losses was understated.

38. Moreover, the CW indicated that Smithtown Bancorp's top senior management was involved in setting the Bank's loan loss reserves.

39. In addition, the CW noted that in April or May 2009, Defendant Rock hired Christopher Becker ("Becker") to work alongside Defendant Florek, the Company's CFO. On November 19, 2009, Defendant Florek was named Smithtown Bancorp's and the Bank's CAO. The CW understood that, soon after being hired, Becker was of the view that the Bank's allowance for loan losses was understated.

40. Thereafter, the FDIC ordered that the Bank correct unsafe and unsound banking practices by, "maintain[ing] a reasonable ALLL" and mandating that the Bank's allowance for loan losses be "accounted for in accordance with GAAP and ALLL supervisory guidance."

**Smithtown Bancorp Enters into Consent Order  
with the FDIC and NY Banking Department**

41. On January 29, 2010, Smithtown Bancorp entered into a Consent Agreement with the FDIC and the parallel Consent Order. The Consent Order articulated the FDIC's findings that the Bank had been engaged in a myriad of unsafe and/or unsound banking practices and violations of banking laws and/or regulations. In order to correct these unsafe and/or unsound banking practices, Smithtown Bancorp was forced to correct the massive understatement of its allowance for loan

losses and recorded a \$10 million and a \$38 million charge for losses incurred on its loan portfolio in the third and fourth quarters of 2009.

42. Thereafter, in the first half of 2010, Smithtown Bancorp recorded additional charges of \$52.5 million. The totality of these charges depleted Smithtown Bancorp of the capital necessary to operate in compliance with its regulatory requirements.

43. The Consent Order required that the Bank take all actions necessary “to correct and prevent the unsafe or unsound banking practices and/or violations of law or regulation and all contraventions of federal banking agency policies and procedures and guidelines” that the FDIC had identified in its Report of Examination as of June 30, 2009 (the “ROE”).

44. The Consent Order mandated that the Bank take 17 different and discrete actions to correct the unsafe or unsound banking practices and/or violations of banking law or regulation that the FDIC had identified in its ROE. The Consent Order mandated the following corrective actions.

45. **Revisions to the Bank’s Loan Policy:** The FDIC ordered that the Bank review and make revisions necessary to strengthen its lending procedures and abate additional loan deterioration. Such changes were required to address the following then-existing unsafe and unsound banking practices: (a) deficiencies in loan department of lines of authority and operational responsibilities; (b) deficiencies with the identification, monitoring, and timely reporting of past due loans, loans with emerging credit weaknesses; (c) deficiencies in underwriting standards and procedures for loans and loan renewals, and appraisal reviews; (d) deficiencies in Board of Director and Audit Committee oversight of the Bank’s independent loan review function; (e) deficiencies in reappraising or evaluating real estate collateralizing the Bank’s loans; (f) deficiencies in complying with FDIC real estate appraisals and evaluations guidelines; (g) deficiencies in determining whether extensions of credit constitute troubled debt restructurings. Generally, a troubled debt restructuring

is one in which the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider; (h) deficiencies with the use and reporting of interest reserves. Generally, interest reserve is funded upon origination of a land acquisition, development or construction loan ("ADC loans") and is based on the feasibility of the project, the creditworthiness of the borrower and guarantors, and the protection provided by the real estate and other collateral. This account allows a lender to periodically advance loan funds to pay interest charges on the outstanding balance of the loan; (i) deficiencies in reporting loans on a watch list; and (j) deficiencies with the Bank's non-accrual policy and compliance with FFIEC instructions. The FFIEC is an interagency body of the United States government empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions.

46. **Revisions to the Bank's Loan Review Program:** The FDIC ordered that the Bank review and make revisions necessary to assess risks in the Bank's lending practices and minimize its credit losses. Such changes were required to address the following then-existing unsafe and unsound banking practices: (a) deficiencies in management and the Board of Directors' monitoring and oversight of the Bank's loan review function; (b) deficiencies in the scope and the depth of the Bank's loan review function; (c) deficiencies in assessing the overall quality of the loan portfolio; (d) deficiencies in the staffing of the Bank's ILR function with personnel who were sufficiently independent and qualified; (e) deficiencies in loan classification or credit grading systems that effectively identify, monitor, and address asset quality problems in an accurate and timely manner; (f) deficiencies in documenting the support for credit ratings and demonstrating that the ILR function conducted an independent quarterly review of the ALLL. The allowance for loan and lease losses and the allowance for loan losses are referred to herein synonymously; (g) deficiencies in identifying

and reporting exceptions to the Bank's interest reserve policy; (h) deficiencies in identifying credit and collateral documentation exceptions; (i) deficiencies in identifying loans that were not in conformance with the Bank's lending policy or laws, rules, or regulations and an action plan to address the identified deficiencies; and (j) deficiencies in documentation of the rationale for the Bank assigning a different classification than the ILR.

47. **Accounting for Loan Losses in Conformity with GAAP:** The FDIC ordered that the Bank account for its ALLL in accordance with GAAP and appropriate supervisory guidance and that it be funded by charges to current operating income. The FDIC ordered that the Bank "shall at all times maintain a reasonable ALLL" and that prior to each quarter end, its Board of Directors shall review the adequacy of the Bank's ALLL, which, at a minimum, should include: (1) the analysis required by Financial Accounting Standards Board Statement ("SFAS") Nos. 5 and 114; (2) the Bank's loan loss experience; (3) an estimate of potential loss exposure in the portfolio; and (4) trends of delinquent and non-accrual loans and prevailing and prospective economic conditions. The FDIC also ordered that the minutes of the Board of Director meetings, at which such reviews are undertaken, are to include complete details of the reviews and recommended increases in the ALLL.

48. **Eliminate Loans Classified as a Loss:** The FDIC ordered that the Bank eliminate from its books, by charge-off or collection, all assets or portions of assets it classified as "Loss" in the ROE and formulate a detailed written plan to reduce the remaining assets classified as "Doubtful" and "Substandard" in the ROE.

49. **Reduce Commercial Real Estate Loan Concentrations:** The FDIC ordered that the Bank develop a plan to systematically reduce and monitor its commercial real estate ("CRE") loan concentration. For this purpose, "reduce" meant to charge-off or collect CRE loans, or increase the

Bank's Tier 1 capital. Tier 1 capital is a financial measure used to assess the capital adequacy of a bank and includes equity capital and disclosed reserves.

### **Smithtown Bancorp's Fraudulent Financial Reporting**

50. During the Class Period, Defendants represented that Smithtown Bancorp's financial statements were presented in conformity with GAAP and that the Company maintained a sound system of internal controls over its financial reporting. As detailed herein, these representations were materially false and misleading.

51. Compliance with GAAP is a basic fundamental obligation of publicly traded companies. As set forth in SEC Rule 4-01(a) of SEC Regulation S-X, "[f]inancial statements filed with the [SEC] which are not prepared in accordance with [GAAP] will be presumed to be misleading or inaccurate." 17 C.F.R. §210.4-01(a)(1).

52. Pursuant to GAAP, Smithtown Bancorp was required to have adequate reserves for: (1) estimated credit losses for loans specifically identified as being impaired; (2) estimated credit losses for loans or groups of loans with specific characteristics that indicate probable losses; and (3) estimated credit losses inherent in the remainder of the portfolio based on current economic events and circumstances. *See, e.g.*, SFAS Nos. 5 and 114.

53. The SEC also provides explicit guidance on the proper accounting for loan losses that Defendants were required to follow, but did not. Staff Accounting Bulletin ("SAB") No. 102 states in pertinent part:<sup>1</sup>

It is critical that loan loss allowance methodologies incorporate management's current judgments about the credit quality of the loan portfolio through a **disciplined and consistently applied process**. . . . A registrant's loan loss allowance methodology generally should . . . **[c]onsider all known relevant internal and**

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<sup>1</sup> Unless otherwise noted, all emphasis is added.

**external factors that may affect loan collectability . . . [and] [b]e based on current and reliable data. . . .**

SAB No. 102 also provides:

Factors that should be considered in developing loss measurements includ[ing] . . . [l]evels of and trends in delinquencies and impaired loans . . . [and] [e]ffects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices. . . .

The SEC further states that:

For many entities engaged in lending activities, the allowance and provision for loan losses are significant elements of the financial statements. Therefore, the staff believes it is appropriate for an entity's management to review, on a periodic basis, its methodology for determining its allowance for loan losses.

54. In its Form 10-K for the year ended December 31, 2008 (the "2008 Form 10-K"), which was signed by the Individual Defendants, Smithtown Bancorp disclosed, in pertinent part:

- **The Bank monitors its entire loan portfolio on a regular basis**, with consideration given to detailed analysis of classified loans, repayment patterns, and probable incurred losses, past loss experience, current economic conditions and various types of concentrations of credit. Additions to the allowance are charged to expense and realized losses, net of recoveries, are charged to the allowance.
- **Individual valuation allowances are established in connection with specific loan reviews and the asset classification process, including the procedures for impairment testing under Statement of Financial Accounting Standard ("SFAS") No. 114, "Accounting by Creditors for Impairment of a Loan", an Amendment of SFAS Statements No. 5 and 15, and SFAS No. 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures", an Amendment of SFAS Statement No. 114.**
- **Pursuant to the Company's policy, loan losses must be charged-off in the period the loans, or portions thereof, are deemed uncollectible.** Assumptions and judgments by management, in conjunction with outside sources, are used to determine whether full collectibility of a loan is not reasonably assured. Assumptions and judgments also are used to determine the estimates of the fair value of the underlying collateral or the present value of expected future cash flows or the loan's observable market value. Individual valuation allowances could differ materially as a result of changes in these assumptions and judgments. Individual loan analyses are periodically performed on specific loans considered impaired. The results of the individual valuation allowances are aggregated and included in the overall allowance for loan losses.

- Although the allowance for loan losses has two separate components, one for impairment losses on individual loans and one for collective impairment losses on pools of loans, the entire allowance for loan losses is available to absorb realized losses as they occur whether they relate to individual loans or pools of loans. **At December 31, 2008, management believed the allowance for loan losses had been established and maintained at a level adequate to reflect the probable incurred losses in the Bank's loan portfolio.**

55. As the FDIC has now determined, these representations were materially false and misleading when made. Indeed, the Consent Order instructed the Bank to correct the unsafe and unsound banking practices by mandating that the Bank:

- (a) account for its allowance for loan losses accordance with GAAP;
- (b) “at all times maintain a reasonable ALLL” and that prior to each quarter end, its Board of Directors shall review the adequacy of the Bank's allowance for loan losses, which, at minimum, should include: (1) the analysis required by SFAS Nos. 5 and 114; (2) the Bank's loan loss experience; (3) an estimate of potential loss exposure in the portfolio; and (4) trends of delinquent and non-accrual loans and prevailing and prospective economic conditions;
- (c) revise the Bank's loan review program to ensure it provides for: (1) an increase in the scope and depth of loan review; (2) an assessment of the overall quality of the loan portfolio; (3) staff the Bank's ILR with personnel who are sufficiently independent and qualified; (4) an effective loan classification or credit grading systems that identifies, monitors, and addresses asset quality problems in an accurate and timely manner; and (5) the identification of loans that are not in conformance with the Bank's lending policy or laws, rules, or regulations;
- (d) identify, monitor, and timely report past due loans, loans with emerging credit weaknesses, and exceptions to the loan policy;
- (e) adopt adequate underwriting standards and procedures for loans, loan renewals, and appraisal reviews;

(f) ensure reappraisals or evaluations take place when real estate collateral declines in value; and

(g) ensure problem loans are identified on a watch list.

56. As Defendants knew or recklessly ignored, these unsafe and unsound banking practices that existed throughout the Class Period precluded Smithtown Bancorp from calculating its allowance for loan losses in accordance with GAAP.

57. Indeed, as Smithtown Bancorp's filings with the SEC made clear, monitoring the Bank's entire loan portfolio on a regular basis is fundamental in the calculus of a reasonable allowance for loan losses. Yet, according to the CW, during the Class Period, the Bank only employed **one semi-retired 80 year-old credit review officer on a part-time basis to review the Bank's entire loan portfolio.**

58. At the end of the Class Period, when Defendants, under the watchful eye of the FDIC could no longer carry out Smithtown Bancorp's financial deception, the Company announced that it recorded a \$38 million charge to increase its allowance for loan losses and a \$7 million charge to write-down its other real estate owned ("OREO") in the fourth quarter of 2009.<sup>2</sup>

#### **Materially False and Misleading Statements Issued During the Class Period**

59. The Class Period begins on March 13, 2008. On that date, Smithtown Bancorp filed with the SEC its Form 10-K for the year ended December 31, 2007, which was signed by the Individual Defendants (the "2007 Form 10-K"). In the 2007 Form 10-K, Defendants made

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<sup>2</sup> Generally, OREO is a class of property owned by a lender after an unsuccessful sale at a foreclosure auction.

representations about the Company's Disclosure Controls and Procedures stating in pertinent part as follows:

#### Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of December 31, 2007. **Based on that evaluation, the Company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.**

#### Report by Management On Internal Control Over Financial Reporting

Management of Smithtown Bancorp, Inc. is responsible for establishing and maintaining an effective system of internal control over financial reporting. The Company's system of internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. There are inherent limitations in the effectiveness of any system of internal control over financial reporting, including the possibility of human error and circumvention or overriding of controls. Accordingly, even an effective system of internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation.

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Management assessed the Company's system of internal control over financial reporting as of December 31, 2007. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. **Based on this assessment, management believes that, as of December 31, 2007, the Company maintained effective internal control over financial reporting based on those criteria.**

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**There has been no change in the Company's internal control over financial reporting during the quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.**

\* \* \*

I, [Defendants Rock and Florek], certify that:

1. I have reviewed this report on Form 10-K of Smithtown Bancorp;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the Registrant's internal controls over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal controls over financial reporting.
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal controls over financial reporting, to the Registrant's auditors and the audit committee of Registrant's Board of Directors (or persons performing the equivalent function):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably

likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

60. These representations about the Company's disclosure and internal controls, and the Individual Defendants' certifications thereon, were repeated in all material respects in Forms 10-K and 10-Q that Smithtown Bancorp filed with the SEC throughout the Class Period.

61. The 2007 Form 10-K also contained representations about the monitoring of the Bank's loan portfolio and the use of appraisals to value property on the Company's financial statements. The 2007 Form 10-K stated in pertinent part as follows:

The Bank monitors its entire loan portfolio on a regular basis . . .

Pursuant to our policy, loan losses must be charged-off in the period the loans, or portions thereof, are deemed uncollectible.

Properties held in OREO [other real estate owned] are periodically valued through appraisals and are carried at estimated fair value based on management's evaluation of these appraisals. Specific reserves are allocated to the properties as necessary, and these reserves may be adjusted based on changes in economic conditions.

62. On April 24, 2008, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended March 31, 2008. For the first quarter, the Company reported earnings of \$3,573,886, or \$.37 per share. With respect to the Company's asset quality and non-performing loans, the press release stated in pertinent part as follows:

**Asset quality remained strong. Nonperforming loans were .14% of total loans at the end of the quarter. The small increase of 7 basis points in nonperformers from \$687,000 at December 31st to \$1.6 million at March 31st is attributable to one relationship where the borrower has died and the loans are well-secured by multiple properties.**

Defendant Rock commented on the results, stating, in pertinent part, as follows:

It has become clear that the current economic environment is creating opportunities for us. **Many of our competitors have had to curtail lending** due to capital constraints or liquidity constraints caused by sub-prime mortgage problems and other difficulties. **As a result, we have greatly increased opportunities** for permanent commercial mortgage lending. Most of these loans are on fully-tenanted commercial and multi-family buildings with seasoned cash flows. Because of recent Fed rate cuts and **the high quality of these loans**, the rates on these loans are somewhat lower than what we are accustomed to, but the volume of these loans available to us is unprecedented for our Company. Last year, loans grew by \$135 million. For the first quarter of this year, loans grew by \$140 million. **We expect these increased lending opportunities to continue for the near future, which should allow us to build a significantly increased revenue stream.**

63. In response to Defendants' positive statements, the price of Smithtown Bancorp common stock rose 4.1%, to close at \$19.43 per share.

64. On May 8, 2008, Smithtown Bancorp filed its Form 10-Q for the quarter ended March 31, 2008 (the "2008 Q1 Form 10-Q") with the SEC, which was signed by the Individual Defendants. The 2008 Q1 Form 10-Q included Smithtown Bancorp's financial statements for the quarter ended March 31, 2008, which were represented to have been presented in conformity with U.S. GAAP. The 2008 Q1 Form 10-Q stated in pertinent part as follows:

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position and its results of operations for the periods presented.

The 2008 Q1 Form 10-Q also stated that the Company's non-performing loans as a percentage of total loans remain at a very low level and that "management feels the level of the allowance for loan losses provides adequate coverage" stating in pertinent part as follows:

Loans past due 30-89 days for the quarter increased by \$8.3 million to \$9.1 million. **This increase is primarily attributable to three land and construction loans and one residential mortgage**, of which \$7.5 million has been brought current as of the date of this writing. Nonperforming loans as of March 31, 2008 aggregate to \$1,612, an increase from \$687 at December 31, 2007. All properties within this category are either in foreclosure and expected to sell or should be brought current during the second quarter. **Nonperforming loans as a percentage of total loans remain at a very low level of .14%.**

\* \* \*

The allowance for loan loss account increased from December 31, 2007 to March 31, 2008 by \$789, a result of the provision for loan losses of \$800, and net charge-offs of \$11. Based on specific reserves for internally classified loans and multiple factors including historical loss experience and current economic conditions, **management feels the level of the allowance for loan losses provides adequate coverage.** At March 31, 2008 and December 31, 2007, the Bank's reserve ratio (the allowance for loan losses as a percentage of end of period loans) was .80% and .83%, respectively. This level of reserves is adequate due to the credit quality of the portfolio and is within the range of peer group banks with similar loan composition. **The allowance for loan losses is an amount that management currently believes will be adequate to absorb probable incurred losses inherent in the Bank's loan portfolio.**

65. On June 27, 2008, Smithtown Bancorp issued a press release announcing that it was added to the Russell 2000 index.

66. On July 17, 2008, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended June 30, 2008. For the quarter, the Company reported earnings of \$3,952,503 or \$.40 per share. The press release also represented that the Bank had "tightened construction loans standards," "asset quality remained very strong" and that the Bank's capital ratios were strong stating in pertinent part as follows:

Consistent with reduced construction activity in the area and **the Bank's tightened construction loan standards**, the pipeline of committed construction loans that have not yet been closed has been reduced substantially, down from \$115 million at March 31st to \$47 million at June 30th, a 59% reduction.

**Asset quality remained very strong. Nonperforming loans** were \$2.8 million or .21% of total loans at the end of the quarter. The **increase** of 7 basis points in nonperformers from March 31st **is attributable to one single-family construction loan** which management believes is well-secured. Loans 30-89 days past due were at \$150,000, or .01% of total loans. Net charge-offs for the first six months were \$1,400, or .0001% of average total loans.

The Bank does not hold any sub-prime loans, "Alt-A" loans, option ARMs, 2/28 ARMs or loans with teaser rates. **The Company's capital ratios also remained strong.** All of the Company's regulatory capital ratios are in the "well capitalized" range, with Tier I Leverage at 7.71%, Tier I Risk-Based Capital at 8.67% and Total Risk-Based Capital at 10.36%. **The Company regularly monitors its capital ratios**

**and evaluates all of its options in light of its asset growth, earnings growth and market conditions at the time.**

Defendant Rock commented on the results, stating in pertinent part as follows:

The current economic environment and competitive environment in our market area continues to create opportunities for us. Many of our competitors have had to curtail lending due to capital constraints or liquidity constraints caused by sub-prime mortgage problems and other difficulties. Other competitors have been acquired by large, out-of-state companies that are much less focused on mortgage lending in our market area. Finally, the 'conduit' market for commercial mortgage loans has dried up entirely. As a result of these multiple factors, we have greatly increased opportunities for permanent commercial mortgage lending. The loan mix in our portfolio is shifting toward more loans on fully-tenanted multi-family and commercial buildings with seasoned cash flows. We are pleased with this shift because it enables us to **continue to grow our loan portfolio while maintaining the strong credit quality that has been a hallmark of our Company for many, many years.**

67. In response to these positive statements, the price of Smithtown Bancorp common stock rose 7.5%, to close at \$18.23 per share.

68. On August 8, 2008, Smithtown Bancorp filed its Form 10-Q for the quarter ended June 30, 2008 (the "2008 Q2 Form 10-Q") with the SEC, which was signed by the Individual Defendants. The 2008 Q2 Form 10-Q included Smithtown Bancorp's financial statements for the quarter ended June 30, 2008, which were represented to have been presented in conformity with U.S. GAAP and stated in pertinent part as follows:

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position and its results of operations for the periods presented.

The 2008 Q2 Form 10-Q also contained representations about the Company's non-performing loans, its allowance for loan losses and its monitoring of its loan portfolio stating in pertinent part as follows:

Loans past due 30-89 days for the quarter decreased by \$8.98 million to \$150 thousand. Nonperforming loans as of June 30, 2008 aggregate to \$2,801, an increase from \$1,612 at March 31, 2008. **This increase is attributable to one single-family**

**construction loan which management believes to be well-secured. Nonperforming loans as a percentage of total loans remain at a very low level of .21%.**

\* \* \*

The allowance for loan losses is established and maintained through a provision for loan losses based on probable incurred losses inherent in the Bank's loan portfolio. Management, through its Asset Quality Committee, comprised of several members of executive management as well as the chief collection officer, evaluates the adequacy of the allowance on a quarterly basis. **Adjustments are made at this time to a level deemed adequate by the Committee, based on its risk evaluation of the portfolio in its entirety as well as in specific loan details.** The allowance is comprised of both individual valuation allowances and loan pool valuation allowances.

\* \* \*

**The Bank monitors its entire loan portfolio on a regular basis**, with consideration given to detailed analysis of classified loans, repayment patterns, probable incurred losses, past loss experience, current economic conditions and various types of concentrations of credit. Additions to the allowance are charged to expense and realized losses, net of recoveries, are charged to the allowance.

69. On September 30, 2008, Smithtown Bancorp issued a press release announcing that it had sold 1,965,000 common shares in a private offering raising \$26.3 million (the "September 2008 Private Offering").

70. On October 7, 2008, Smithtown Bancorp filed a Form S-3 registration statement (the "2008 Registration Statement") with the SEC offering to sell up to 3,000,000 of its common shares from time to time. The 2008 Registration Statement, which was signed by the Individual Defendants, also offered to sell up to 1,965,000 Smithtown Bancorp common shares owned by shareholders who acquired such shares in the September 2008 Private Offering.

71. On October 27, 2008, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended September 30, 2008. For the quarter, the Company reported earnings of \$4,607,000 or \$.47 per share. The press release also represented that the Bank had "tightened

construction loans standards,” “asset quality remained very strong” and that the Bank’ capital ratios “have been strong” and in the “well-capitalized range” stating in pertinent part as follows:

Consistent with reduced construction activity in the area and **the Bank’s tightened standards for land and construction loans**, the pipeline of such committed loans that have not yet been closed continues to be reduced substantially, down from \$122 million at March 31st to \$51 million at September 30th, a 58% reduction.

**Asset quality remained very strong.** Nonperforming loans were \$2.8 million or .19% of total loans at the end of the quarter. Loans 30-89 days past due were at \$432,000, or .03% of total loans. **Net charge-offs for the third quarter were \$90,316, resulting from the charge-off of one “small business” line of credit.** This charge-off represents less than .01% of average total loans during the third quarter. Net loan charge-offs for the first nine months were \$91,346, also representing less than .01% of average total loans for the period.

**The Company’s capital ratios, which have always been strong and in the “well-capitalized” range, grew even stronger as a result of the Company’s completion of its \$27.5 million capital offering at the end of the quarter.** At September 30th, Tier I Leverage stood at 9.37%, Tier I Risk-Based Capital at 11.13% and Total Risk-Based Capital at 12.00%. The Company also filed a “shelf registration” which, when approved, will give the Company the ability to issue up to 3 million additional common shares in a public offering. The Company has no present intention to issue any additional common shares, but felt that the often-used tool of a “shelf registration” was a prudent step to take, particularly in light of the recent volatile economic conditions.

Defendant Rock commented on the results, stating, in pertinent part, as follows:

**We are also pleased with the results from our recent capital offering.** Despite the ‘financial crisis’ atmosphere, we were able to raise the full amount of capital we sought at a price that was consistent with the discounts in other similar transactions at the time. The alternative for us during the third quarter was plain: stop growing. **We could be happy that we don’t have the problems that have hurt others**, and shift to a ‘standstill’ position to ride out the balance of the storm. Such a choice would also bring the growth in shareholder value to a halt. We decided instead that the opportunities created by these turbulent times are too good to turn away. **The fact that we were one of the few community banking companies able to raise private capital in these times of economic distress represents a recognition of our Company’s consistently strong performance over a long period of time. We also feel that the significant earnings growth during the third quarter demonstrates that the opportunities in the marketplace are worthwhile.**

72. In response to these positive statements, the price of Smithtown Bancorp common stock rose 9.5%, to close at \$18.29 per share.

73. On November 7, 2008, Smithtown Bancorp filed its Form 10-Q for the quarter ended September 30, 2008 (the "2008 Q3 Form 10-Q") with the SEC, which was signed by the Individual Defendants. The 2008 Q3 Form 10-Q included Smithtown Bancorp's financial statements for the quarter ended September 30, 2008, which were represented to have been presented in conformity with U.S. GAAP stating in pertinent part as follows:

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position and its results of operations for the periods presented.

In addition, the 2008 Q3 Form 10-Q represented that non-performing loans remained at a very low level, loan loss reserves were adequate and the Company was monitoring its loans stating in pertinent part as follows:

Loans past due 30-89 days for the quarter increased to \$432 from \$150 at second quarter end. Nonperforming loans as of September 30, 2008 aggregate to \$2.8 million, the same level at which they were as of June 30, 2008. **Nonperforming loans as a percentage of total loans remain at a very low level of .19%.**

\* \* \*

The allowance for loan losses is established and maintained through a provision for loan losses based on probable incurred losses inherent in the Bank's loan portfolio. Management, through its Asset Quality Committee, comprised of several members of executive management as well as the chief collection officer, evaluates the adequacy of the allowance on a quarterly basis. **Adjustments are made at this time to a level deemed adequate by the Committee**, based on its risk evaluation of the portfolio in its entirety as well as in specific loan details. The allowance is comprised of both individual valuation allowances and loan pool valuation allowances.

\* \* \*

**The Bank monitors its entire loan portfolio on a regular basis**, with consideration given to detailed analysis of classified loans, repayment patterns, probable incurred losses, past loss experience, current economic conditions and various types of concentrations of credit. Additions to the allowance are charged to expense and realized losses, net of recoveries, are charged to the allowance.

74. On December 1, 2008, the 2008 Registration Statement was declared effective by the SEC.

75. On January 28, 2009, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended and year ended December 31, 2008. For the quarter, the Company reported earnings of \$3,590,010, or \$.31 per share and for the year the Company reported earnings of \$15,723,044. The press release also made positive representations about the Bank's credit quality ratios and loan quality stating in pertinent part, as follows:

**All of the Bank's credit quality ratios continue to be significantly better than those of peer group banks.** Nonperforming loans at year-end were at \$5.26 million, or .31% of total loans. This figure **increased from the previous quarter's end primarily as a result of adding five related three-family homes.** The borrower has reported that he has contracts to sell the homes for sums sufficient to satisfy the debts, but whether those sales are concluded or whether the Bank will have to foreclose the mortgages remains to be seen. **In spite of this small increase, the .31% nonperforming loan ratio compares very favorably to the peer group ratio of 1.88%.**

Loans 30-89 days past due were at \$5.23 million, or .31% of total loans also. Similarly, this figure has increased from the previous quarter's end as a result of adding two single-family homes. The borrowers have received offers to purchase the homes at prices that exceed the amount of the debts, but whether those sales will be concluded or whether the Bank will have to foreclose remains to be seen. **Again, in spite of this increase, the .31% ratio compares very favorably with the peer group ratio of .94%.**

\* \* \*

Net charge-offs for the fourth quarter were approximately \$56,000. Net charge-offs for the year 2008 were approximately \$147,000, with \$87,000 of these being attributable to loans and \$60,000 attributable to the Bank's overdraft protection program. The combined total net charge-offs represent less than .01% of average loans.

Defendant Rock commented on the results, stating, in pertinent part, as follows:

This past year was the most difficult year for our nation's economy and financial companies since the 1930's. **In spite of the 'financial crisis' conditions, we grew earnings at a double-digit pace and significantly expanded our market share. We did so by maintaining those parts of our strategy that worked well in the**

**past, and by shifting other parts of our strategy to take advantage of opportunities created by the year's unusual events and circumstances.**

**We shifted away from construction lending to reduce the risks** created by a slumping housing market and ailing economy. We increased multifamily lending to replace the construction loans with loans that historically have the lowest loss ratios, even during hard economic times. We also increased multi-family lending and other permanent mortgage lending to take advantage of competitive opportunities in our market area.

\* \* \*

Financial stocks were battered during the course of the year by the steady barrage of bad economic news and, although Smithtown Bancorp was no exception, **our Company's strong performance helped the shares fare better than those of most financial companies.** All three major stock indexes were 'underwater' for all 253 trading days during 2008. The S&P 500 was down 39%, the worst year in more than seven decades. The SNL index for Northeast banks was down 45%. The price for Smithtown Bancorp shares was down 27.66%, a hard hit to be sure, but nonetheless a demonstration of some resilience compared to other companies.

76. On March 12, 2009, Smithtown Bancorp filed the 2008 Form 10-K with the SEC, which was signed by the Individual Defendants. The 2008 Form 10-K included Smithtown Bancorp's financial statements for the year ended December 31, 2008, which represented, in part:

**The accounting and reporting policies of Smithtown Bancorp, Inc. and its bank subsidiary, Bank of Smithtown, reflect banking industry practices and conform to U.S. generally accepted accounting principles.**

\* \* \*

Properties held in OREO are periodically **valued through appraisals and are carried at estimated fair value based on management's evaluation of these appraisals.** Specific reserves are allocated to the properties as necessary, and these reserves may be adjusted based on changes in economic conditions. At December 31, 2008 and 2007, the Company carried \$6,972 of other real estate owned.

\* \* \*

**The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals.** These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available.

\* \* \*

**The Company regularly reviews and updates its internal controls, disclosure controls and procedures** and corporate governance policies and procedures.

\* \* \*

In spite of the current downturn in the economy, with the resultant increase in loan losses absorbed by many other banks, the Company's loan portfolio remains strong. However, the Bank is not immune to the credit and liquidity problems that exist within its market area, and as such, there has been an increase in nonperforming loans. As in past years, and particularly during 2008, **credit deterioration is mitigated by sound underwriting criteria, multiple levels of credit review, stratification analysis, and stress analysis** which are now critical to maintaining the highest level of asset quality.

\* \* \*

**The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.** Subsequent recoveries, if any, are credited to the allowance. **Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors.** Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

77. In addition, the 2008 Form 10-K represented that Smithtown Bancorp received offering proceeds of \$45.7 million from common stock and subordinated debt issuances during 2008.

78. On April 13, 2009, Smithtown Bancorp announced that Becker, with more than 20 years of banking experience, joined Smithtown Bancorp as an EVP.

79. On April 29, 2009, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended March 31, 2009. For the quarter, the Company reported earnings of \$3,616,425, or \$.31 per share. The press release also made positive representations about the Bank's credit quality ratios and loan quality stating in pertinent part, as follows:

**All of the Bank's credit quality ratios continue to be significantly better than those of peer group banks.** Nonperforming loans at quarter-end were at \$8.4 million, or .46% of total loans. This figure increased from the previous quarter's end primarily as a result of adding one home loan that is presently under foreclosure. A written offer has been made by a third party to purchase the property for an amount sufficient to satisfy the debt, but whether that sale will be concluded or whether the Bank will have to complete its foreclosure of the mortgage remains to be seen. During the first quarter, under similar circumstances, the Bank's borrowers sold three homes for amounts which satisfied the debts on those properties in full, thereby eliminating those loans from the nonperforming category prior to completion of the foreclosure. In any event, in spite of this small increase, the .46% nonperforming loan ratio compares very favorably to the ratio of 2.40% for the peer group of 293 banks in the nation with assets from \$1 billion to \$3 billion.

80. On May 8, 2009, Smithtown Bancorp filed its Form 10-Q for the quarter ended March 31, 2009 (the "2009 Q1 Form 10-Q") with the SEC, which was signed by the Individual Defendants. The 2009 Q1 Form 10-Q included Smithtown Bancorp's financial statements for the quarter ended March 31, 2009, which were represented to have been presented in conformity with U.S. GAAP stating in pertinent part as follows:

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position and its results of operations for the periods presented.

In addition, the 2009 Q1 Form 10-Q made positive representations concerning the Company's asset quality ratios and loan loss provisions stating in pertinent part:

**Asset quality ratios continue to be better than peer group banks,** but no financial institution can be totally immune to the economic impact of this deep recession.

\* \* \*

**The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals.**

\* \* \*

The provision for loan losses was \$800 for the first quarter of 2008 and \$1,200 for the first quarter of 2009. The increase in the provision expense was mainly the result of continued growth in total loans from \$1,124,033 at March 31, 2008 to \$1,823,185 at March 31, 2009, a 62.20% increase, coupled with the economic recession.

Nonperforming loans to total loans increased from .14% at March 31, 2008 to .46% at March 31, 2009. Loans 30-89 days past due increased to \$13,859 at the end of the first quarter of 2009 compared to \$1,583 at the end of the first quarter of 2008. Offsetting these trends has been a shift in the mix of the loan portfolio to permanent residential and commercial mortgages from construction lending. Residential and commercial mortgages made up 75.15% of total loans at March 31, 2009 compared to 66.73% at March 31, 2008. Construction loans made up 22.08% of total loans at March 31, 2009 compared to 28.83% at March 31, 2008. **Based on our continuing review of the overall loan portfolio, a 50% increase in the provision from the first quarter of 2008 compared to the first quarter of 2009 adequately addressed the measured risks in the portfolio.** In view of the adverse conditions in the local and national economy as well as the growth in our loan portfolio, there can be no assurance that our provision for loan losses will not be higher in future periods.

81. On May 20, 2009, Smithtown Bancorp announce that it raised net offering proceeds of \$26.5 million from the public sale of 2.8 million common shares.

82. On June 29, 2009, Smithtown Bancorp issued a press release announcing that it had completed the private sale of 1,965,000 common shares raising \$26.3 million in net proceeds.

83. On July 28, 2009, Smithtown Bancorp issued a press release announcing that it sold \$14 million of the Bank's subordinated notes due July 1, 2019, and warrants to purchase up to 350,000 shares of Smithtown Bancorp's common stock in a private placement to institutional accredited investors.

84. On July 29, 2009, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended June 30, 2009. For the quarter, the Company reported earnings of \$3.413 million, or \$.26 per share.

85. On August 7, 2009, Smithtown Bancorp its Form 10-Q for the quarter ended June 30, 2009 (the "2009 Q2 Form 10-Q") with the SEC, which was signed by the Individual Defendants. The 2009 Q2 Form 10-Q included Smithtown Bancorp's financial statements for the quarter ended June 30, 2009, which were represented to have been presented in conformity with U.S. GAAP stating in pertinent part as follows:

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position and its results of operations for the periods presented.

86. On September 24, 2009, Smithtown Bancorp filed a Form S-3 registration statement (the "2009 Registration Statement") with the SEC offering to sell from time to time up to \$100 million of unsecured senior or subordinated debt securities; common shares; preferred shares; depositary shares; warrants to purchase other securities; and units consisting of any combination of the above securities. The 2009 Registration Statement also offered to sell up to 475,000 Smithtown Bancorp common shares issuable upon the exercise of warrants purchased in private placements that occurred on June 29, 2009 and July 27, 2009 by selling shareholders.

87. On November 2, 2009, Smithtown Bancorp issued a press release announcing its earnings for the quarter ended September 30, 2009. For the quarter, the Company reported earnings of \$897,723, or \$.06 per share which "were reduced by a provision of \$10 million to the loan loss reserve."

Defendant Rock commented on the results, stating, in pertinent part, as follows:

**Earnings were negatively impacted during the third quarter by two factors** related to the continued economic recession. First, as many Long Island economists have agreed, the various impacts of **the recession** appear to have hit this region later than in other parts of the country. Second, as has been observed frequently by the Federal Reserve and in financial journals, **commercial real estate difficulties** appear to be surfacing later in the cycle than other manifestations of the recession (such as job losses, home foreclosures and reduced retail sales).

**Although nonperforming loans and charge-offs remain better than peer bank averages, we nonetheless have to increase loan loss provisions to protect against possible future losses based upon the deterioration observed in our loan portfolio during the third quarter. We also expect levels of nonperforming loans, loan loss provisions and charge-offs to continue to be higher than usual during the fourth quarter of this year and possibly into the first quarter of next year as commercial real estate markets and the region's economy continue to struggle.**

88. As a result of these negative disclosures, the price of Smithtown Bancorp stock declined from a closing price of \$10.35 per share on the previous trading day to \$8.91 on November 2, 2009, an approximate 14% decline. Thereafter, the price of Smithtown Bancorp common stock continued to decline as a portion of the artificial inflation came out of the stock price.

89. On November 9, 2009, Smithtown Bancorp filed its Form 10-Q for the quarter ended September 30, 2009 (the "2009 Q3 Form 10-Q") with the SEC, which was signed by the Individual Defendants. The 2009 Q3 Form 10-Q included Smithtown Bancorp's financial statements for the quarter ended September 30, 2009, which were represented to have been presented in conformity with U.S. GAAP, stating in pertinent part as follows:

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company's financial position and its results of operations for the periods presented.

90. On November 19, 2009, Smithtown Bancorp filed a Form 8-K with the SEC that represented in part, that Becker was named EVP and CFO of the Smithtown Bancorp and the Bank. Becker had served as an EVP of the Bank since April 2009, and Defendant Florek was named EVP of the Bank and the CAO of Smithtown Bancorp and the Bank.

91. On December 4, 2009, Smithtown Bancorp announced that Tom Stevens resigned from his positions of EVP and Chief Commercial Lending Officer.

92. On December 22, 2009, Smithtown Bancorp issued a press release announcing its Board of Directors had decided not to declare a cash dividend for the fourth quarter of 2009. Defendant Rock stated in pertinent part, as follows:

**We expect elevated levels of nonperforming loans and loan loss provisions for the near future**, as well as other challenges posed by the current economic and regulatory environment. Therefore, **we believe that this is a time to conserve capital**. During the last recession and real estate downturn of the early 1990's, the Company took similar steps by temporarily halting the cash dividend, and subsequently emerged stronger and more profitable. **We believe that the**

**fundamentals of the Company remain sound, and once we work through the problem credits precipitated by the recession and current real estate downturn,** we expect to return to levels of profitability more consistent with the past.

93. As a result of these negative disclosures, the price of Smithtown Bancorp stock declined by approximately 7.5% to \$8.91 on December 22, 2009 as a portion of the artificial inflation came out of the stock price.

94. The statements referenced above in ¶¶59-62, 64, 66, 68, 71, 73, 75, 76, 79, 80, 84, 85, 87, 89 and 92 were materially false and misleading when made because they misrepresented and failed to disclose the following adverse facts, which were known to Defendants or recklessly disregarded by them:

- (a) that management was not operating the Bank in a safe and sound manner;
- (b) that the Bank failed to appropriately employ the most basic and fundamental banking practices, including: (i) identifying, monitoring and timely reporting past due loans or loan with emerging credit weaknesses; (ii) ensuring that re-appraisals and re-evaluations take place when a decline in the value of real estate values collateralizing loans occurs; (iii) ensuring establishing guidelines concerning the use and reporting of interest reserves; (iv) ensuring problem loans are identified on a watch list; (v) ensuring interest reserves are used and reported appropriately; (vi) ensuring that the loan review program monitors and reviews its loan portfolio; (vii) staffing the ILR group with personnel that are sufficiently independent or qualified; (viii) ensuring that loan classification or credit grade systems appropriately identify, monitor and address asset quality problems in an accurate and timely manner; (ix) ensuring that the loan review program appropriately documents and supports loan credit ratings; and (x) ensuring that the loan review program identify loans that were not in conformance with the Banks lending policies;
- (c) that the Bank failed to maintain a reasonable allowance for loan losses;

(d) that the Bank's allowance for loan losses was not calculated in conformity with GAAP and requisite supervisory guidance;

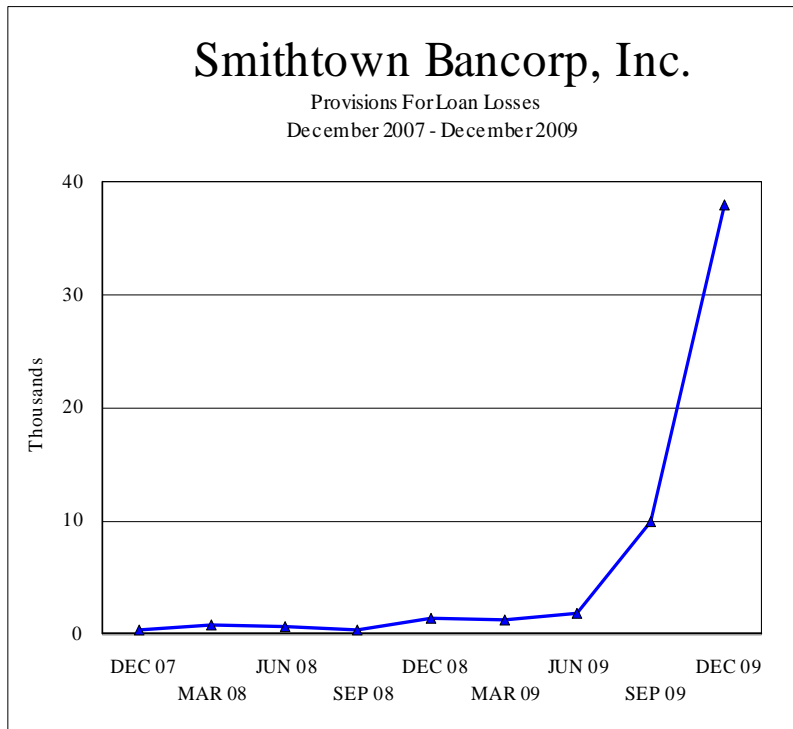
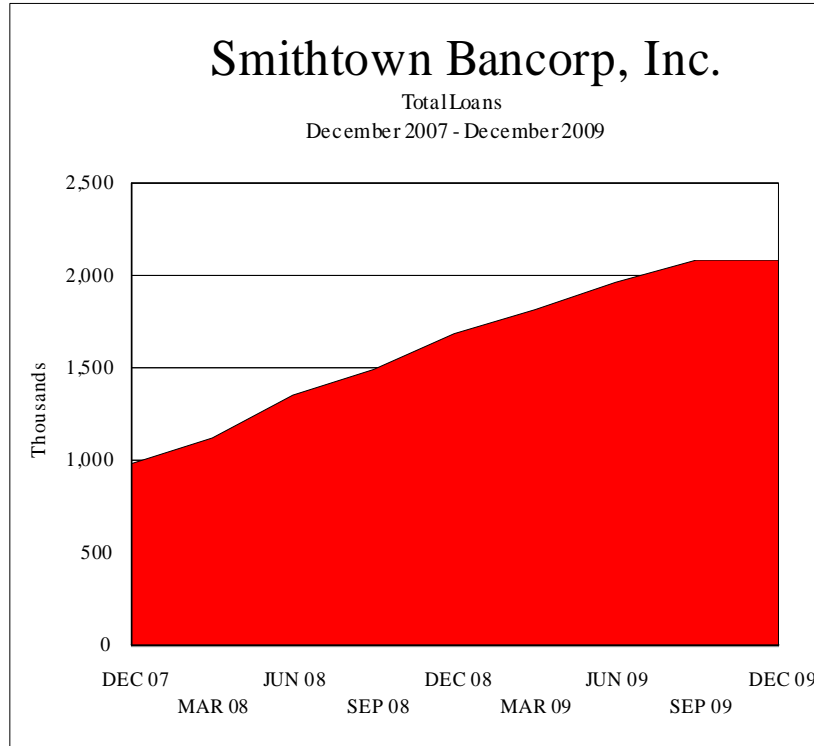
(e) that the Company's internal and disclosure controls were materially deficient;

(f) as a result of the foregoing, Smithtown Bancorp's financial statements were not fairly presented in conformity with U.S. GAAP and were materially false and misleading; and

(g) based on the foregoing, Defendants lacked a reasonable basis for their positive statements about the Company, its prospects and growth.

95. Then, on February 1, 2010, Smithtown Bancorp issued a press release announcing its fourth quarter and full year 2009 results (the "2009 Q4 Press Release"). With regard to the Company's financial results, Smithtown Bancorp announced that it recorded a \$38 million charge to increase its loan loss reserves in the fourth quarter and a \$7 million charge to write down the value of its OREO property. In addition, Smithtown Bancorp disclosed that it had entered into the Consent Order, which revealed that the Company had been engaged in a myriad of unsafe and/or unsound banking practices.

96. As illustrated in the charts below, during the approximate two year Class Period, the amount of Smithtown Bancorp's loan portfolio more than doubled. During this same time frame, Smithtown Bancorp's provision, or charge against earnings for uncollectable loans, was artificially understated until the FDIC forced Defendants to correct such understatement via massive charges after its June 2009 examination:



97. Indeed, Smithtown Bancorp’s allowance for loan loss reserves were so understated that, in an attempt to true up such reserves, the Company needed to record additional provisions for

loan losses of \$25 million and \$27.5 million during the first and second quarters of 2010, respectively.

98. The 2009 Q4 Press Release stated, in part:

Smithtown, NY, February 1, 2010 - Smithtown Bancorp (NASDAQ: SMTB) today announced a loss of **\$19.8 million** for the fourth quarter of 2009, or (\$1.34) per fully diluted share. Operating earnings were more than offset by a provision of **\$38 million to the loan loss reserve and a write-down of an other real estate owned property of \$7 million**. The net loss for the year was \$11.8 million, or (\$.87) per fully diluted share.

\* \* \*

The allowance for loan losses was \$38.5 million at December 31, 2009, or 1.84% of total loans. Asset quality deterioration became an increasing problem in 2009 as the economic recession, especially commercial real estate difficulties, hit our region later than other areas of the country. Nonperforming loans ended the quarter at \$130.2 million, or 6.23% of total loans. Loans 30-89 days past due decreased from \$51.2 million at the end of the third quarter to \$20.8 million, or .99% of total loans, at the end of the fourth quarter. Net charge-offs for the fourth quarter were \$22.6 million and for the year were \$23.8 million, or 1.22% of average loans.

The 2009 Q4 Press Release also disclosed:

**The Company further announced that, on January 29, 2010, its subsidiary, Bank of Smithtown, entered into a Consent Agreement with the Federal Deposit Insurance Corporation (FDIC) and a parallel Consent Order with the New York State Banking Department (NYSBD), hereinafter collectively referred to as the "Consent Agreement."**

\* \* \*

Regarding the Consent Agreement with the FDIC and NYSBD, the **Bank is required to improve credit administration, loan underwriting and internal loan review processes and maintain an adequate allowance for loan losses. Other required actions include the implementation of plans to reduce classified assets, decrease the Bank's concentration in commercial real estate loans and increase profitability. The Bank's payment of dividends and growth in average assets require prior approval of the FDIC and NYSBD. In addition, the Bank is required to maintain no later than June 30, 2010, Tier 1 Capital at least equal to 7% of Total Assets, Tier 1 Risk-Based Capital at least equal to 9 percent of Total Risk-Weighted Assets and Total Risk-Based Capital at least equal to 11 percent of Total Risk-Weighted Assets.**

99. In response to this announcement, on the next trading day, the price of Smithtown Bancorp stock fell approximately 15%, to close at \$4.60 per share, on extremely heavy trading volume.

100. The market for Smithtown Bancorp common stock was open, well-developed and efficient at all relevant times. As a result of these materially false and misleading statements and failures to disclose, Smithtown Bancorp common stock traded at artificially inflated prices during the Class Period. Plaintiff and other members of the Class purchased or otherwise acquired Smithtown Bancorp common stock relying upon the integrity of the market price of Smithtown Bancorp common stock and market information relating to Smithtown Bancorp, and have been damaged thereby.

101. During the Class Period, Defendants materially misled the investing public, thereby inflating the price of Smithtown Bancorp common stock, by publicly issuing false and misleading statements and omitting to disclose material facts necessary to make Defendants' statements, as set forth herein, not false and misleading. Said statements and omissions were materially false and misleading in that they failed to disclose material adverse information and misrepresented the truth about the Company, its business and operations, as alleged herein.

102. At all relevant times, the material misrepresentations and omissions particularized in this Complaint directly or proximately caused, or were a substantial contributing cause of, the damages sustained by Plaintiffs and other members of the Class. As described herein, during the Class Period, Defendants made or caused to be made a series of materially false or misleading statements about Smithtown Bancorp's business, prospects and operations. These material misstatements and omissions had the cause and effect of creating in the market an unrealistically positive assessment of Smithtown Bancorp and its business, prospects and operations, thus causing

the Company's common stock to be overvalued and artificially inflated at all relevant times. Defendants' materially false and misleading statements during the Class Period resulted in Plaintiffs and other members of the Class purchasing the Company's common stock at artificially inflated prices, thus causing the damages complained of herein.

#### **Additional Scienter Allegations**

103. As alleged herein, Defendants acted with scienter in that Defendants knew, or recklessly disregarded, that the public documents and statements they issued and disseminated to the investing public in the name of the Company or in their own name during the Class Period were materially false and misleading. Defendants knowingly and substantially participated or acquiesced in the issuance or dissemination of such statements and documents as primary violations of the federal securities laws. Defendants, by virtue of their receipt of information reflecting the true facts regarding Smithtown Bancorp, their control over, and/or receipt and/or modification of Smithtown Bancorp's allegedly materially misleading misstatements, were active and culpable participants in the fraudulent scheme alleged herein.

104. Defendants knew and/or recklessly disregarded the falsity and misleading nature of the information which they caused to be disseminated to the investing public. The fraudulent scheme described herein could not have been perpetrated during the Class Period without the knowledge and complicity or, at least, the reckless disregard of the personnel at the highest levels of the Company, including Defendants Rock and Florek.

105. Defendants Rock and Florek, because of their positions with Smithtown Bancorp, controlled the contents of the Company's public statements during the Class Period. Each Individual Defendant was provided with or had access to copies of the documents alleged herein to be false and/or misleading prior to or shortly after their issuance and had the ability and opportunity to prevent their issuance or cause them to be corrected. Because of their positions and access to

material non-public information, these Defendants knew or recklessly disregarded that the adverse facts specified herein had not been disclosed to and were being concealed from the public and that the positive representations that were being made were false and misleading. As a result, each of these Defendants is responsible for the accuracy of Smithtown Bancorp's corporate statements and are therefore responsible and liable for the representations contained therein.

106. The scienter of Defendants is underscored by the Sarbanes-Oxley mandated certifications of Defendants Rock and Florek, which acknowledged their responsibility to investors for establishing and maintaining controls to ensure that material information about Smithtown Bancorp was made known to them and that the Company's internal controls, which the FDIC found were derelict in numerous respects, were operating effectively.

107. Defendants were motivated to engage in the fraudulent course of conduct alleged herein in order to complete a series of capital raising transactions, which raised approximately \$93 million in proceeds during the Class Period. Those proceeds would have been unobtainable if not for Defendants' fraudulent concealment of the material overstatement of Smithtown Bancorp's operating results during the Class Period, especially given the market conditions for capital raising during that time period.

108. Indeed, after the end of the Class Period, Smithtown Bancorp recorded additional charges of \$52.5 million in the first half of 2010 to true up its allowance for loan losses. These charges depleted Smithtown Bancorp of the capital necessary to operate in compliance with its regulatory requirements and forced Defendants to merge Smithtown Bancorp with another entity. In its Definitive Proxy Statement associated with Smithtown Bancorp's merger with People's United filed with the SEC on October 12, 2010, Smithtown Bancorp disclosed:

Smithtown Bancorp projects that these trends in loan losses will continue for the foreseeable future. These loan losses and the related necessity for increased loan loss

provisions, and the operating losses resulting from the continuing deterioration in credit quality, have depleted Smithtown Bancorp's capital, and future operating losses will further deplete capital.

\* \* \*

On January 29, 2010, Bank of Smithtown entered into a Consent Agreement with the FDIC and a parallel Consent Order with the New York State Banking Department (the "NY Banking Department") (together referred to as the "Consent Agreements"). Under the Consent Agreements, Bank of Smithtown is required to improve credit administration, loan underwriting and internal loan review process and maintain an adequate allowance for loan losses. Other required actions include the implementation of plans to reduce classified assets, decrease Bank of Smithtown's concentration in commercial real estate loans and increase profitability. Bank of Smithtown's payment of dividends and growth in quarterly average assets require prior approval of the FDIC and NY Banking Department. In addition, Bank of Smithtown is required to maintain no later than June 30, 2010, a ratio of Tier 1 Capital to Total Assets of at least 7.00%, a ratio of Tier 1 Risk-Based Capital to Total Risk-Weighted Assets of at least 9.00%, and a Total Risk-Based Capital ratio of at least 11.00%.

\* \* \*

On May 25, 2010, Sandler O'Neill, Smithtown Bancorp's financial advisor, advised Smithtown Bancorp's board of directors that the most promising alternatives for Smithtown Bancorp to address its capital needs would be either to undertake a significant new offering of Smithtown Bancorp common stock or to attempt to merge or sell Smithtown Bancorp in a transaction in which the surviving entities would be well capitalized. Analyses performed by Sandler O'Neill indicated that a public or private stock offering to raise capital would require as much as \$150 million in order to successfully address Smithtown Bancorp's capital needs, fulfill the requirements of the Consent Agreements and provide stockholders with an adequate capital cushion against potential future credit losses. Smithtown Bancorp, following discussions with Sandler O'Neill, concluded that such a capital raise might be possible, but involved doubt as to whether it would be achievable under the circumstances and given current market conditions

\* \* \*

As a result, Sandler O'Neill, Smithtown Bancorp management and Smithtown Bancorp's board of directors concurred that a strategic sale or merger should be the primary option to be pursued. Smithtown Bancorp's board of directors authorized Sandler O'Neill to contact prospective buyers on May 25, 2010 after such discussion.

### **Loss Causation/Economic Loss**

109. During the Class Period, as detailed herein, Defendants engaged in a scheme to deceive the market and a course of conduct which artificially inflated the prices of Smithtown Bancorp common stock and operated as a fraud or deceit on Class Period purchasers of Smithtown Bancorp common stock. By failing to timely disclose the unsafe and unsound banking practice that were materially overstating Smithtown Bancorp's financial health and operating results, Defendants presented a misleading picture of Smithtown Bancorp's business and prospects. Defendants' false and misleading statements had the intended effect and caused Smithtown Bancorp common stock to trade at artificially inflated levels throughout the Class Period, reaching as high as \$24.50 per share on September 29, 2008.

110. When Defendants' prior misrepresentations and fraudulent conduct were disclosed and became apparent to the market, the price of Smithtown Bancorp common stock declined as the prior artificial inflation came out. As a result of their purchases of Smithtown Bancorp common stock during the Class Period, Plaintiffs and the other Class members suffered economic loss, *i.e.*, damages, under the federal securities laws.

111. On November 2, 2009, Smithtown Bancorp revealed that it was going to record a \$10 million charge for loan losses. In response to this announcement, the price of Smithtown Bancorp stock declined from a closing price on the previous trading day of \$10.35 per share to \$8.91, an approximate 14% decline. Thereafter, the price of Smithtown Bancorp common stock continued to decline as a portion of the artificial inflation came out of the stock price.

112. On February 1, 2010, Smithtown Bancorp announced that it recorded a \$38 million charge to increase its loan loss reserves in the fourth quarter and a \$7 million charge to write down the value of its OREO property. In addition, Smithtown Bancorp disclosed that it had entered into the Consent Order, which revealed that the Company had been engaged in a myriad of unsafe and/or

unsound banking practices. In response to these announcements, on the next trading day, shares of the Company stock fell approximately 15%, to close at \$4.60 per share, on extremely heavy trading volume.

113. These declines removed the inflation from the price of Smithtown Bancorp common stock, causing real economic loss to investors who had purchased Smithtown Bancorp common stock during the Class Period.

114. The precipitous decline in the price of Smithtown Bancorp common stock was a direct result of the nature and extent of Defendants' fraud finally being revealed to investors and the market. The timing and magnitude of the price declines in Smithtown Bancorp common stock negate any inference that the loss suffered by Plaintiffs and the other Class members was caused by changed market conditions, macroeconomic or industry factors or Company-specific facts unrelated to Defendants' fraudulent conduct. The economic loss, *i.e.*, damages, suffered by Plaintiffs and the other Class members was a direct result of Defendants' fraudulent scheme to artificially inflate the prices of Smithtown Bancorp common stock and the subsequent significant decline in the value of Smithtown Bancorp common stock when Defendants' prior misrepresentations and other fraudulent conduct were revealed.

**Applicability of Presumption of Reliance:  
Fraud on the Market Doctrine**

115. At all relevant times, the market for Smithtown Bancorp common stock was an efficient market for the following reasons, among others:

- (a) Smithtown Bancorp common stock met the requirements for listing, and was listed and actively traded on the NASDAQ, a highly efficient and automated market;
- (b) as a regulated issuer, Smithtown Bancorp filed periodic public reports with the SEC and the NASDAQ;

(c) Smithtown Bancorp regularly communicated with public investors via established market communication mechanisms, including regular disseminations of press releases on the national circuits of major newswire services and other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services; and

(d) Smithtown Bancorp was followed by several securities analysts employed by major brokerage firms who wrote reports which were distributed to the sales force and certain customers of their respective brokerage firms. Each of these reports was publicly available and entered the public marketplace.

116. As a result of the foregoing, the market for Smithtown Bancorp common stock promptly digested current information regarding Smithtown Bancorp from all publicly available sources and reflected such information in the prices of the stock. Under these circumstances, all purchasers of Smithtown Bancorp common stock during the Class Period suffered similar injury through their purchase of Smithtown Bancorp common stock at artificially inflated prices and a presumption of reliance applies.

#### **No Safe Harbor**

117. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this Complaint. Many of the specific statements pleaded herein were not identified as “forward-looking statements” when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements were made, the particular speaker knew that the particular forward-looking statement was

false, and/or the forward-looking statement was authorized and/or approved by an executive officer of Smithtown Bancorp who knew that those statements were false when made.

118. By virtue of the foregoing, Defendants have violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder. As a direct and proximate result of Defendants' wrongful conduct, Plaintiffs and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's securities during the Class Period

## COUNT I

### **Violation of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder Against All Defendants**

119. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

120. During the Class Period, Defendants disseminated or approved the materially false and misleading statements specified above, which they knew or deliberately disregarded were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

121. Defendants violated Section 10(b) of the Exchange Act and Rule 10b-5 in that they:

- (a) employed devices, schemes, and artifices to defraud;
- (b) made untrue statements of material facts and/or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and
- (c) engaged in acts, practices, and a course of business that operated as a fraud or deceit upon Plaintiffs and others similarly situated in connection with their purchases of Smithtown Bancorp common stock during the Class Period.

122. Plaintiffs and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for Smithtown Bancorp common stock. Plaintiffs and the Class would not have purchased Smithtown Bancorp common stock at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by Defendants' misleading statements.

123. As a direct and proximate result of Defendants' wrongful conduct, Plaintiffs and the other members of the Class suffered damages in connection with their purchases of Smithtown Bancorp common stock during the Class Period.

## **COUNT II**

### **Violation of Section 20(a) of the Exchange Act Against the Individual Defendants**

124. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

125. The Individual Defendants acted as controlling persons of Smithtown Bancorp within the meaning of Section 20(a) of the Exchange Act as alleged herein. By reason of their positions as officers and/or directors of Smithtown Bancorp, and their ownership of Smithtown Bancorp stock, the Individual Defendants had the power and authority to cause Smithtown Bancorp to engage in the wrongful conduct complained of herein. By reason of such conduct, the Individual Defendants are liable pursuant to Section 20(a) of the Exchange Act.

**WHEREFORE**, Plaintiffs pray for relief and judgment, as follows:

A. Determining that this action is a proper class action, designating Plaintiff as Lead Plaintiffs and certifying Plaintiffs as Class representatives under Rule 23 of the Federal Rules of Civil Procedure and Plaintiffs' counsel as Lead Counsel;

B. Awarding compensatory damages in favor of Plaintiffs and the other Class members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

C. Awarding Plaintiffs and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

D. Such other and further relief as the Court may deem just and proper.

**JURY TRIAL DEMANDED**

Plaintiffs hereby demand a trial by jury.

DATED: October 14, 2011

ROBBINS GELLER RUDMAN  
& DOWD LLP  
SAMUEL H. RUDMAN  
DAVID A. ROSENFELD

*/s/ Samuel H. Rudman*  
\_\_\_\_\_  
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*Additional Counsel for Plaintiff*

**CERTIFICATE OF SERVICE**

I, Samuel H. Rudman, hereby certify that on October 14, 2011, I caused a true and correct copy of the attached:

CONSOLIDATED AMENDED CLASS ACTION COMPLAINT

to be served electronically on all counsel registered for electronic service for this case.

/s/ Samuel H. Rudman

SAMUEL H. RUDMAN



**United States District Court  
for the Eastern District of New York**

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**Hon. Carol Bagley Amon, Chief Judge  
Douglas C Palmer, Clerk of Court**



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## System Status

As of October 14, 2011

ECF/Pacer live 5.03	<p><b>Outside access to CM/ECF &amp; Pacer is currently experiencing connectivity issues. We are working to resolve this issue and will provide updates as they are available.</b></p> <p><b>On Friday, October 14, 2011 CM/ECF will NOT be available from 6:00 to 8:00 P.M. The 2nd round of CM/ECF updates will be applied on the servers.</b></p>
ECF/Pacer train 5.1.1	<p><b>Outside access to CM/ECF &amp; Pacer is currently experiencing connectivity issues. We are working to resolve this issue and will provide updates as they are available.</b></p> <p><b>On Friday, October 14, 2011 CM/ECF will NOT be available from 6:00 to 8:00 P.M. The 2nd round of CM/ECF updates will be applied on the servers.</b></p>

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