



Pulaski Financial Corp.

12300 Olive Boulevard ■ Saint Louis, MO 63141-6434
Office Phone: 314.878.2210 ■ Fax: 314.878.6037

Confidential Treatment Requested

March 4, 2009

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

Dear Mr. Barofsky:

On behalf of Pulaski Financial Corp. (the "Company"), I am responding to your request for information dated February 6, 2009. The \$32.5 million that the U.S. Department of the Treasury has invested in the Company has made a significant improvement in our balance sheet and is allowing us to continue to service the lending needs in our community. The information below will illustrate how the funds received through the TARP Capital Purchase Program are being utilized to support the mission of the TARP program.

For your convenience, I have restated your questions, followed by our response.

Question 1:

Please provide a narrative response specifically outlining (a) your anticipated use of TARP funds; (b) whether the TARP funds were segregated from other institutional funds; (c) your actual use of TARP funds to date; and (d) your expected use of unspent TARP funds. In your response, please take into consideration your anticipated use of TARP funds at the time that you applied for such funds, or any actions that you have taken that you would not have been able to take absent the infusion of TARP funds.

Response:

(b) (8)

- To invest approximately two-thirds of the proceeds into its subsidiary, Pulaski Bank (the "Bank"), to support the Bank's continued lending and growth.
- To repay senior debt of the Company that had been incurred earlier in the year to support the growing capital needs of the Bank.
- To retain the balance of funds at the Company to service operating needs and reduce the Company's dependence on dividends from the Bank.

A copy of the Company's supplemental application for TARP funds is attached as Exhibit A.

In 2008, the Company borrowed \$7.65 million from a correspondent bank and contributed \$5 million to the Bank as additional paid-in capital to support continued growth of the Bank. By using a portion of the TARP funds to repay this senior debt the Company would, in effect, make a permanent contribution of capital to the Bank of \$5 million. Repayment of the balance of the borrowing would relieve the Bank from the need to distribute funds to the Company to service principal and interest payments, thereby freeing the Bank to use those funds for continued lending.

The Company did not make specific public statements regarding its intended use of TARP funds. In a press release issued on December 22, 2008, the Company stated that participation in the TARP Capital Purchase Program "enhances our ability to provide increased credit to business and consumers in our market area. In addition, it provides the Company with added flexibility for future strategic opportunities that may become available." Following completion of the TARP transaction, the Company issued a press release on January 16, 2009 that repeated the first portion of the initial statement.

In the Company's annual report to stockholders, which was issued in late December 2008, the Company said: "We believe this additional capital will allow us to continue to support quality loan growth and possible opportunistic in-market acquisitions of 'challenged banks,' as well as provide an additional capital cushion as we work through what promises to be a challenging 2009 for the U.S. economy."

(b) The funds were not segregated from other Company funds upon receipt on January 16, 2009.

(c) (b) (8)

(b) (8) On January 19th, the Company invested \$20 million in the Bank as additional paid-in capital. In addition, the Company repaid \$7.65 million of senior debt of the Company. The remainder of the funds (\$4.9 million) were retained by the Company. These funds were loaned to the Bank through an intercompany loan agreement and are being used for general purposes by the Bank.

I wish to emphasize that the addition of capital does much more than provide the Bank with investable funds. Under applicable regulatory requirements, the Bank must maintain a ratio of total capital to risk-weighted assets of at least 10% to be qualified as

“well-capitalized.” This means that for every \$1 of capital, the Bank has the ability to raise an additional \$9 through deposits or borrowings, which it can then invest in loans or other interest-earning assets.

Prior to receiving the TARP funds, the Bank was experiencing increased capital pressure. A bank’s capital ratio is affected by changes in both the amount of capital (the numerator of the ratio) and by the amount of risk-weighted assets (the denominator of the ratio). Many banks have seen their capital ratios decline because of a reduction in capital due to loan losses and asset impairment. In the Bank’s case, however, its capital ratio has approached the minimum required to be well capitalized due to significant asset growth, which was primarily in loans.

Exhibit B illustrates the effect on the Bank’s capital ratios of the receipt of a portion of the TARP funds. At December 31, 2008, the Bank’s total risk-based capital ratio had dropped to 10.26%. As a result, the Bank could grow its loan portfolio by only an additional \$30 to \$60 million, depending on the risk weighting of the loans, without jeopardizing its “well capitalized” level. As Exhibit B shows, the additional capital contributed to the Bank increased the Bank’s risk-based capital ratio to 12.02% on a pro forma basis (that is, based on financial data as of December 31, 2008 after giving effect to the contribution of \$20 million from the Company). With the additional \$20 million of capital, and the resulting improved capital ratios, the Bank gained the capacity to make \$200 to \$400 million of loans, depending on the risk weighting of the loans, while remaining well capitalized under current regulatory standards.

As of January 31, 2009, the Company had already made significant strides towards deploying the capital provided by the TARP funds. Exhibit C illustrates the changes in the Company’s balance sheet from December 31, 2008, which is before the closing of the TARP transaction, to January 31, 2009, which is after the closing of the TARP transaction. As this exhibit illustrates, the Company’s loan portfolio increased \$85 million. This increase was funded by the \$20 million in cash contributed to the Bank plus growth in non-brokered deposits of approximately \$66 million.

(d) The Bank’s primary activity is the origination of loans for sale and investment. As of December 31, 2008, 89.5% of the Company’s total assets were loans. We anticipate that the Bank will continue to leverage the capital provided by the TARP funds to make loans and grow its loan portfolio.

The remaining \$4.9 million retained by the Company will be used to meet future operating needs. The Company is a one-bank shell holding company. Its largest investment and primary source of income is its investment in the Bank. The Company receives a small amount of income from mortgage joint venture partnerships and investments that is sufficient to service its ordinary operating needs, such as public company expenses, but is insufficient to service its interest and dividend obligations. Currently, the Company pays interest on trust preferred securities and dividends on the preferred stock issued to the Treasury Department and on its common stock. The

Company requires periodic distributions from the Bank to make its interest and dividend payments.

The Company retained a portion of the TARP proceeds for the purpose of servicing the future debt and equity obligations of the Company. We currently expect that the cash reserve at the Company is sufficient to service the next year's cash obligations without any dependence on the Bank for dividends. Given the liquidity needs of the Company, management determined that it would be more efficient to retain a portion of the TARP funds at the Company rather than contribute those funds to the Bank and then have the Bank pay those funds back to the Company in the form of dividends within a short period of time.

Question 2:

Your specific plans, and the status of implementation of those plans, for addressing executive compensation requirements associated with the funding. Information provided regarding executive compensation should also include any assessments made of loan risks and their relationship to executive compensation; how limitations on executive compensation will be implemented in line with Department of Treasury guidelines; and whether any such limitations may be offset by other changes to other, longer-term or deferred forms of executive compensation.

Response:

Section 1.2(d)(iv) of the Securities Purchase Agreement – Standard Terms provides that it is a condition to the receipt of TARP funds that:

“the Company shall have effected such changes to its compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) (collectively, “*Benefit Plans*”) with respect to its Senior Executive Officers (and to the extent necessary for such changes to be legally enforceable, each of its Senior Executive Officers shall have duly consented in writing to such changes), as may be necessary, during the period that the Investor owns any debt or equity securities of the Company acquired pursuant to this Agreement or the Warrant, in order to comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008 (“*EESA*”) as implemented by guidance or regulation thereunder that has been issued and is in effect as of the Closing Date....”

In addition, rules promulgated by Treasury establish the following standards for the TARP Capital Purchase Program: (a) limits on compensation that exclude incentives for senior executive officers (SEOs) of financial institutions to take unnecessary and excessive risks that threaten the value of the financial institution; (b) required recovery of any bonus or incentive compensation paid to a SEO based on statements of

earnings, gains, or other criteria that are later proven to be materially inaccurate; (c) prohibition on the financial institution from making any golden parachute payment to any SEO; and (d) agreement to limit a claim to a federal income tax deduction for certain executive remuneration.

In connection with the receipt of the TARP funds, the Company complied with its obligations under the Securities Purchase Agreement by entering into a letter agreement with each of its SEOs that addresses several of the executive compensation requirements. The form of letter agreement is attached as Exhibit D.

The letter agreement addresses the exclusion of incentives to take unnecessary and excessive risk by having the executive acknowledge that the Company is required to review its benefit plans to ensure that they do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of the Company and agree that to the extent any such review requires revisions to any benefit plan with respect to the officer, the officer agrees to negotiate such changes promptly and in good faith.

The letter agreement addresses the clawback of bonuses by having the executive acknowledge that any bonus and incentive compensation paid during a covered period is subject to clawback by the Company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

The letter agreement addresses the prohibition on making golden parachute payments by providing that if the payments provided under the contract and arrangements with the executive would exceed the golden parachute limitations of the Capital Purchase Program, the payments shall be reduced so that the payments do not exceed the limitations.

With respect to future action, applicable Treasury regulations require the Company's compensation committee to identify the features in the Company's SEO incentive compensation arrangements that could lead SEOs to take unnecessary and excessive risks that could threaten the value of the financial institution. The regulations require that the compensation committee review the SEO incentive compensation arrangements with the Company's senior risk officers, or other personnel acting in a similar capacity, to ensure that SEOs are not encouraged to take such risks. The regulations require such review promptly, and in no case more than 90 days, after the receipt of TARP funds.

In furtherance of its requirements under TARP, the Company's compensation committee identified the persons acting in a capacity similar to senior risk officers and met on March 2, 2009 to review SEO incentive compensation arrangements with those officers. The compensation committee identified two incentive programs that should be reviewed for compliance with the TARP requirements: the Annual Executive Bonus Program and the Divisional Profitability Bonus. Following review of these incentive

programs and discussion of the risks facing the Company, the compensation committee concluded that no revisions to these programs were required to eliminate incentives to take unnecessary and excessive risk.

* * * * *

The Company requests confidential treatment of this letter. The financial information contained in this letter and the exhibits hereto is financial information that is not otherwise available to the public and, therefore, is confidential. For this reason, this letter is protected under 5 U.S.C. § 552(b)(4).

* * * * *

The undersigned duly authorized senior executive officer of the Company hereby certifies, on behalf of the Company, and subject to the requirements and penalties set forth in Title 18, United States Code, Section 1001, that all statements, representations, and supporting information provided in and with this letter are true and complete to the best of my knowledge.

Sincerely,



Gary W. Douglass
President and Chief Executive Officer

Exhibit A

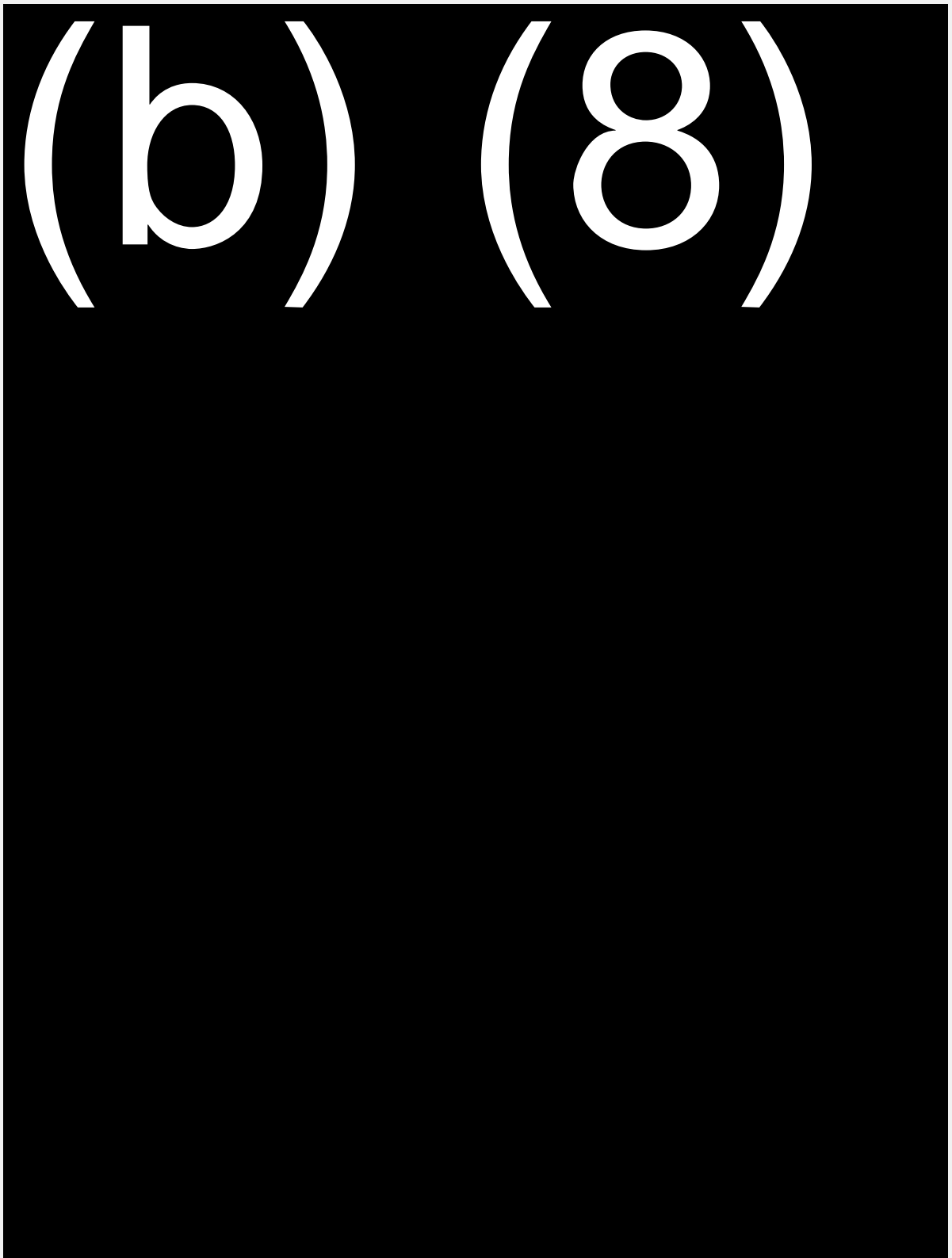


Exhibit B

The following tables shows the Bank's actual capital ratios at December 31, 2008 and pro forma capital ratios after giving effect to the receipt of TARP funds.

	Capital Ratios at 12/31/2008	Adjusted CPP Investment Pro-Forma 12/31/2008
Capital Guidelines		
Total Risk Based Capital	10.26%	12.02%
Tier 1 Risk Based Capital	9.12%	10.88%
Tier 1 Core Capital (Leverage)	7.65%	8.99%
Summary Data:		
Tier 1 Core Capital	103,854	123,854
Tier 2 Capital	13,011	13,011
Total Risk Based Capital	116,865	136,865
Total Risk Weighted Assets	1,138,720	1,138,720
Adjusted Total Assets	1,357,101	1,377,101

Exhibit C

The table below illustrates the changes in the Company's balance sheet from December 31, 2008 to January 31, 2009. The Company received the TARP funds on January 16, 2009.

Summary Changes in Balance Sheet				
Assets	1/31/2009	12/31/2008	Changes	% Change
Cash	26,157,260	23,917,860	2,239,400	9.4%
Investments	46,119,181	41,534,133	4,585,048	11.0%
Loans	1,305,527,630	1,220,630,595	84,897,035	7.0%
Premises & equipment	19,635,855	19,716,832	(80,977)	-0.4%
Other	57,083,959	57,358,776	(274,817)	-0.5%
Total Assets	1,454,523,885	1,363,158,196	91,365,689	6.7%
Liabilities				
Deposits	1,068,119,793	1,001,934,509	66,185,284	6.6%
FHLB & Federal Reserve borrowings	235,100,000	239,400,000	(4,300,000)	-1.8%
Other senior debt	-	7,640,000	(7,640,000)	-100.0%
Other liabilities	35,132,783	31,730,780	3,402,003	10.7%
Total Liabilities	1,338,352,576	1,280,705,289	57,647,287	4.5%
Equity				
Equity available to common	99,819,503	98,655,017	1,164,486	1.2%
Preferred stock	32,538,000	-	32,538,000	
Treasury	(16,186,194)	(16,202,110)	15,916	-0.1%
Stockholder Equity	116,171,309	82,452,907	33,718,402	40.9%
Liabilities and Equity				
Total Liabilities and Equity	1,454,523,885	1,363,158,196	91,365,689	6.7%

FORM OF LETTER AGREEMENT WITH SENIOR EXECUTIVE OFFICERS

[Insert Name and Address]

Dear [Insert Name],

Pulaski Financial Corp. (the "*Company*") anticipates entering into a letter agreement ("*Agreement*") with the United States Department of the Treasury ("*Treasury*") that provides for the Company's participation in the Treasury's Capital Purchase Program (the "*CPP*"). If the Company does not participate in the CPP, this letter shall be of no further force and effect.

For the Company to participate in the CPP and as a condition to the closing of the investment contemplated by the Agreement, the Company is required to meet specified standards for incentive compensation to its senior executive officers and to make changes to its compensation arrangements. To comply with these requirements, and in consideration of the benefits that you will receive as a result of the Company's participation in the CPP, you agree as follows:

(1) *No Golden Parachute Payments.* The Company shall not make any golden parachute payment to you during any period during which (A) you are a senior executive officer and (B) Treasury holds an equity or debt position acquired from the Company in the CPP (a "*CPP Covered Period*").

(2) *Recovery of Bonus and Incentive Compensation.* Any bonus and incentive compensation paid to you during a CPP Covered Period is subject to recovery or "clawback" by the Company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria.

(3) *Compensation Program Amendments.* Each of the Company's compensation, bonus, incentive and other benefit plans, arrangements and agreements (including golden parachute, severance and employment agreements) (collectively, "*Benefit Plans*") with respect to you is hereby amended to the extent necessary to give effect to provisions (1) and (2). For reference, certain affected Benefit Plans are set forth in Appendix A to this letter. If the payments and benefits provided under the Benefit Plans would exceed the golden parachute limitations of the CPP, the payments and benefits shall be reduced or revised, in the manner determined by you (subject to the next sentence), by the amount, if any, which is the minimum necessary to result in no portion of the payments and benefits exceeding the limitations. The Company, at its expense, will determine the extent of any reduction in the payments and benefits to be made pursuant to this letter. In addition, the Company is required to review its Benefit Plans to ensure that they do not encourage senior executive officers to take unnecessary and excessive risks that threaten the value of the Company. To the extent any such review requires revisions to any Benefit Plan with respect to you, you and the Company agree to negotiate such changes promptly and in good faith.

(4) *Definitions and Interpretation.* This letter shall be interpreted as follows:

(i) "Senior executive officer" means the Company's "senior executive officers" as defined in subsection 111(b)(3) of EESA and 31 C.F.R. § 30.2.

(ii) "Golden parachute payment" has the meaning given to such term in Section 111(b)(2)(C) of EESA and 31 C.F.R. § 30.9.

(iii) "EESA" means the Emergency Economic Stabilization Act of 2008.

(iv) The term "Company" includes any entities treated as a single employer with the Company under 31 C.F.R. § 30.1(b). You are also delivering a waiver pursuant to the Agreement, and, as between the Company and you, the term "employer" in that waiver will be deemed to mean the Company as used in this letter.

(v) The term "CPP Covered Period" shall be limited by, and interpreted in a manner consistent with, 31 C.F.R. § 30.11.

(vi) Provisions (1) and (2) of this letter are intended to, and will be interpreted, administered and construed to, comply with Section 111 of EESA (and, to the maximum extent consistent with the preceding, to permit operation of the Benefit Plans in accordance with their terms before giving effect to this letter).

(5) *Miscellaneous.* To the extent not subject to federal law, this letter will be governed by and construed in accordance with the laws of [Insert Jurisdiction]. This letter may be executed in two or more counterparts, each of which will be deemed to be an original. A signature transmitted by facsimile will be deemed an original signature.

Yours sincerely,

PULASKI FINANCIAL CORP.

Name:
Title:

Intending to be legally bound, I agree with and accept the foregoing terms on the date set forth below.

[Insert Name]

Date: _____