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CIT - Q2 2010 CIT Group Earnings Conference Call

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CORPORATE PARTICIPANTS

Ken Brause
CIT Group - EVP, Investor Relations

John Thain
CIT Group - Chairman, CEO

Scott Parker
CIT Group - CFO

CONFERENCE CALL PARTICIPANTS

Operator

Chris Kotowski
Oppenheimer & Co. - Analyst

David Hochstim
Buckingham Research - Analyst

Henry Coffey
Stern, Agee & Leach - Analyst

Chris Brendler
Stifel Nicolaus - Analyst

Sameer Gokhale
Keefe, Bruyette & Woods - Analyst

Edelen Groshen
Height - Analyst

Matt Schultheis
Boenning & Scattergood - Analyst

Mosho Arumba
Credit Suisse - Analyst

Mike Turner
Compass Point - Analyst

Patrick Duff
Gilder, Gagnon & Howe - Analyst

Jordon Hymowitz
Philadelphia Financial - Analyst

Joseph Comstock
Bennett Management - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to CIT's second quarter 2010 earnings conference call. My name is Chanel, and I'll be your operator today. Participating in today's call are John Thain, Chairman and Chief Executive Officer, Scott Parker, Chief Financial Officer and Ken Brause, Head of Investor Relations. At this time, all participants are in a listen-only mode. There will be a question-and-answer session later in the call. Please limit yourself to one question and a follow-up. (Operator Instructions) As a reminder, this conference call is being recorded for replay purposes. I would now like to turn the call over to Ken Brause. Please proceed, sir.

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Ken Brause - *CIT Group - EVP, Investor Relations*

Thank you, Chanel, and good morning, everyone. Welcome to CIT's second quarter 2010 earnings conference call. Our call today will be hosted by John Thain, our Chairman and CEO and Scott Parker, our CFO. Following our formal remarks, we will have a Q&A session. We ask that you please limit yourself to one question and a follow-up and then return to the queue if you do have additional questions. We'll do our best to answer as many questions as possible in the time we have this morning.

Elements of this call are forward-looking in nature and may involve risks, uncertainties and contingencies that may cause actual results to differ materially from those anticipated. Any forward-looking statements relate only to the time and date of this call. We disclaim any duty to update these statements based on new information, future events or otherwise. For information about risk factors relating to the business, please refer to our 2009 Form 10-K that was filed with the SEC in March. Any references to certain non-GAAP financial measures are meant to provide meaningful insight and are reconciled with GAAP in our press release. For more information on CIT, please visit the investor relations section of our website at www.cit.com. I'd like to now turn the call over to John Thain.

John Thain - *CIT Group - Chairman, CEO*

Thank you, Ken. Good morning, everyone. Thanks for getting on the call. I'm going to make a few introductory comments and then turn the call over to Scott Parker, our new Chief Financial Officer. Scott joins us from Cerberus, but he spent most of his career at GE Capital in many of the same lines of businesses that CIT is in. As we said in our press release, we are continuing to deliver on the priorities that we discussed in the first quarter. First, we are substantially completed in building out our senior management team, many of which are in the room with me today this morning. But just to go through, Carol Hayles, our new Controller is here, Lisa Polsky, our new -- our Chief Risk Officer, Rob Row, our Chief Credit Officer, Mike Roamer, our Chief Auditor, Nelson Chai, our Head of Strategy and Chief Administrative Officer, Lisa Zonino, our new HR Head and Jeff Bardos, our Chief Regulatory Officer, and then we have two more hires that are in the fed approval process. And when those two get done, we'll have completed filling out our senior management team. In addition, later this morning, we're going to put out a press release announcing that David Moffett is joining our Board of Directors. David has extensive banking experience, and so that will be a very positive addition to our board, and we'll put out a press release later this morning.

Second, in terms of priorities is we are continuing to pay down our high-cost debt, and we're also continuing to access the capital markets for lower cost funding. In the second quarter we raised about $800 million in the capital markets, and continuing on this trend, we will begin discussions this week to refinance and repay the remaining $4 billion of first lien debt. I would expect us, subject of course to market conditions, to pay down about $1 billion of the first lien debt and then to begin the possess of refinancing with a new secured term loan the other $3 billion. We are also continuing the process -- and you saw this in the second quarter, of both reviewing and optimizing our portfolio. We did close the sale of our Australia, New Zealand vendor business. We also sold our half of our CIBC joint venture in Canada, and then we continued the process of selling loans. We sold in excess of $500 million in corporate finance loans. We also sold about $600 million of student loans. We are making progress on our written agreement with the fed. It helps a lot to have all of our people in place now so we can deal with a lot of the issues that the fed has raised, particularly on the risk management front, and so that is progressing.

We are also focused very much on expenses as our assets are shrinking, our ratio of expenses to net earning assets is going up. We are focused on that, although because of our need to invest in risk management and compliance and in systems, that ratio will be an issue for us, at least for a little while. But we are focused on managing expenses. And then I think most importantly, we're originating new profitable business. We originated over $1 billion of new loans in the quarter. We're also originating in CIT Bank. And so we're beginning the process of rebuilding our pipeline for new lending. So with that, I will turn the call over to Scott to get into more details, but I am very comfortable that we are making progress in our priorities in the quarter. Scott?

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Scott Parker - *CIT Group - CFO*

Thank you, John and good morning, everyone. I'm excited to join the team and by the opportunity we have to further our position as a leading provider of capital to small and medium size companies. I worked for our competitor for many years, as John mentioned, and CIT's reputation among clients is well earned. This morning I'm going to go -- spend some time providing additional insight into our revenue and credit trends which were the primary earnings drivers this quarter and are the metrics most impacted by fresh start accounting. I will also elaborate on our funding and liquidity progress since reducing our cost of capital remains a top priority.

On the revenue front, net finance revenues, which include net interest income and rent net of depreciation, was down 8% sequentially as we continue to shrink the balance sheet. Finance and leasing assets declined $3.9 billion, or about 9% as the $1 billion of new volume that John just mentioned was more than offset by asset sales and portfolio collections. Reported net finance margin was 4.03%, down a few basis points from the first quarter. Exclusive of fresh start accounting benefits and the prepayment fee on the first lien debt, which was about $45 million in the quarter, margin was about 68 basis points versus 65 basis points in the first quarter. We made progress, but not as much as expected as our average earning asset base contracted more than our high cost of debt and our cash balance increased.

Specifically, average earning assets fell $3.9 billion sequentially, which lowered our finance revenue by about $60 million. That was offset by the pickup of about $37 million of incremental interest expense savings on the first lien debt we paid down in February in April and about $20 million in lower interest on lower deposits and secured balances. The benefit of our recent $1.25 billion first lien repayment will materialize beginning in the third quarter as we paid that down at the end of the second quarter. On new originations, deals were strong and the marginal cost of funds on our new secured financing enabled us to be competitive.

Vendor and aircraft lease shields are still above 10%, corporate finance shields were down slightly from the first quarter, reflecting a higher proportion of new business being asset based lending. This new business is profitable when funded out of CIT Bank. Overall, we signed $180 million of new commitments in CIT Bank and funded about half of that amount. While this is relatively small, it is still nearly five times more of the business that we did in the first quarter. Other income was particularly strong, driven primarily by gains on asset sales and increased recoveries on pre-FSA charges.

As John mentioned, we sold the vendor Australia business, which was about $400 million in assets, 130 employees and the assumption of about $20 million in liabilities. We sold our interest, including $200 million in receivables in the CIBC joint venture in Canada.

On the portfolio side, the $500 million of corporate loans we sold were predominantly cash flow and almost equally split between US and international. These sales also included some non-accrual loans in several large exposures that we reduced. The $580 million of government guaranteed student loans were sold out of the bank. Also, we sold a few aircraft and other leased equipment. There was roughly $2 billion in second quarter asset sales. We have sold nearly $3 billion of non-strategic assets through June. Fee and other income was down slightly, and factoring commissions were essentially flat as volume and rates were largely unchanged. On the FX side, we hedged most of our open positions by early second quarter, mitigating the volatility we saw in the first quarter.

Turning to credit, as John mentioned, we have a new senior risk leadership and finance leadership team that continue to review the portfolio and the effects of fresh start accounting. We remain committed to transparency and giving you the metrics you need to understand our performance. On a reported or post-FSA basis, non-performing loans increased sequentially to $2.1 billion, primarily in corporate finance, and net charge-offs were off $64 million. However, as a result of FSA, net charge-offs are only net of recoveries on loans charged off this year, which have been minimal so far.

Recoveries on loans charged off pre-emergence are reported in other income. This quarter, we had $98 million of such recoveries, up $54 million from the first quarter. On a pre-FSA basis, non-performing loans were down slightly from the first quarter as the

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amount of loans migrating to non-accrual status was offset by charge-offs, asset sales and loan repayment. Pre-FSA gross charge-offs were up $16 million sequentially, principally commercial real estate and energy related. We have $157 million -- we added $157 million to our loan loss reserves in the period. The increase was driven by four items. First, higher reserves on performing loans, second, expectations for lower recoveries on a liquidating consumer program and vendor finance, third, the deterioration of certain real estate and energy accounts in corporate finance and finally, reserves on new originations. At $338 million, the reserve is 1.2% of recorded loans. Combining this reserve with the remaining non-accretable discount, we have over $1.5 billion, or roughly 5% coverage against pre-FSA loans. Overall, our aggregate portfolio metrics were similar the first quarter.

Now I'd like to move onto liquidity. Cash, as you see, increased $700 million to $10.7 billion. The primary cash sources in the quarter were $2 billion from the asset sales I just talked about. Another $2 billion were from net portfolio collections and also the $800 million plus that we got from secured financing with the trade in vendor programs. Primary cash uses were the $2.3 billion to pay down first lien debt, $1.0 billion in April and $800 million in June, and the following amounts were paid in early third quarter. $1.8 billion for other debt repayments, largely on secured financings with a minimal runoff in the deposits in CIT bank.

On the funding side, we have executed over $2.5 billion of secured financing against vendor, trade and aerospace assets this year and are funding eligible US corporate loans out of CIT Bank. Our average all-in cost to these facilities is around 4%, and we are working on additional secured facilities. On the first lien debt, we have cut the balance nearly in half and as John said, we are beginning discussions on refinancing alternatives later this week.

So in summary, we continue to execute on the plan that John has laid out. The balance sheet is strong, assets and liabilities were fair valued at year end 2009. We have over $10 billion in liquidity, and we are increasing book value. The management team is largely in place, and we are building the functions important to CIT operating as a bank holding company. And finally, we are funding new volume at attractive rates and focusing on paying down debt and refinancing high cost debt. With that, I'll turn the call -- turn it back to Chanel and we'll take some questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Please stand by for your first question. Your first question comes from the line of Chris Kotowski of Oppenheimer & Company.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Good morning. I wonder if you can kind of flesh out how much of your funding you think you will be able to move into the bank over the course of the next -- call it next 12 months? And I would just think from a political standpoint, it would behoove the regulators to see that your supplier of credit, the small businesses and that the regulators would be sympathetic to helping you fund that at an attractive rate. But on the other hand, you have the MOUs in place, and I'm just curious, what is your sense of that calculus on how quickly you can resolve some of these issues and start funding regularly out of the bank.

John Thain - *CIT Group - Chairman, CEO*

Let me start with that. First of all, we are funding most of our new corporate finance originations in the bank. The bank has substantial amounts of cash. It is unlikely we would use all that cash up in the next 12 months. And so I expect most of our new corporate finance loans, which are in fact, loans to small and middle market companies, to be originated in the bank, and there's nothing that prevents us from doing that. We're also in the process of seeking permission to move more of our businesses into

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the bank. The one we're working on right now is our small business lending unit. That of course does -- just fit quite nicely with what you said in terms of good public policy. So I would hope that we can get the approval to move that into the bank soon. That -- it doesn't -- because it is -- because the majority of those loans are government guaranteed, it doesn't use up that much cash in the bank, but it is just one more place that we can, in fact, originate loans to small businesses. But we are actively using the bank to originate new loans now .

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. And I guess a follow-up is, to what extent, how can you get this to be a direct benefit in terms of repaying your high cost debt?

John Thain - *CIT Group - Chairman, CEO*

I think those are really separate issues. We are in the process and will continue to repay the high cost debt. To the extent that we fund loans in the bank, it doesn't use up funding capability or cash at the parent company. We are not permitted to upstream cash from the bank to the parent, but it's -- our ability to actually originate loans in the bank is helpful to the process of paying off the high cost debt.

Chris Kotowski - *Oppenheimer & Co. - Analyst*

Okay. Thank you.

Operator

Your next question comes from the line of David Hochstim from Buckingham Research.

David Hochstim - *Buckingham Research - Analyst*

Hi, thanks for taking my question. I wonder, could you talk a little bit more about the, I guess the rates you're getting on the new loans you're originating in the bank? What kind of spread is there on that marginal growth? And also, if you can talk about the competitive environment, where you see opportunities to get good rates on new loans.

John Thain - *CIT Group - Chairman, CEO*

Specifically in the bank?

David Hochstim - *Buckingham Research - Analyst*

In the bank and I guess what you have the capacity to fund outside the bank, too.

John Thain - *CIT Group - Chairman, CEO*

As I mentioned in my prepared remarks, the vendor business and the aircraft leasing business are still getting yields over 10%. And in the corporate finance business, depending on which segment, in the bank we're doing more in the asset back -- asset based lending, which is kind of in the 400 basis points range. And so I think, again, based on the conduits that we're using for the vendor business, those are good spreads.

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David Hochstim - *Buckingham Research - Analyst*

Okay. Are you ordering new aircraft now? It wasn't clear from -- any new orders?

John Thain - *CIT Group - Chairman, CEO*

Yes. We haven't placed any new orders. No, although we have deliveries. Yes. We have substantial orders that we're taking delivery of, and all of our deliveries through 2011, all of our new deliveries are already placed. But we did not place any new orders, for instance, at the most recent air show.

David Hochstim - *Buckingham Research - Analyst*

Right.

John Thain - *CIT Group - Chairman, CEO*

So we have 20 deliveries in 2010.

David Hochstim - *Buckingham Research - Analyst*

And then it looked like, in the release, you were referencing higher rates slightly in rail. Is that the case? You're seeing some uptick there besides utilization?

John Thain - *CIT Group - Chairman, CEO*

Yes. On the utilization side, rail, as you kind of suffer some of the railroad press releases, that some of the commodities with coal and other elements, the utilization on our per diem as well as other fleet picked up in the second quarter with the 93%.

David Hochstim - *Buckingham Research - Analyst*

And leasing rates there?

John Thain - *CIT Group - Chairman, CEO*

Leasing rates are still kind of tough in the cycle. So we're still kind of at rates a little above 2009, but not where they were historically.

David Hochstim - *Buckingham Research - Analyst*

Okay, thanks.

Operator

Your next question comes from the line of Henry Coffey from Sterne Agee.

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Henry Coffey - *Stern, Agee & Leach - Analyst*

Yes, good morning, everyone, and congratulations on a great quarter. Just to clarify a couple of things, you said you were lending in the corporate finance business at sort of L400. Are there floors in that, and what's the effective yield in the paper that you're putting on right now? The lease business was what, at around 10? And I was wondering if you could comment on what you are doing in the rest of your business lines in terms -- and also maybe give us some sense of what the future would look like in terms of what sorts of commitments and originations you're going to be looking at?

John Thain - *CIT Group - Chairman, CEO*

Well, the question on the asset based lending that we're putting into the bank, those did not have floors on them. Can you -- the other part of your conversation was --

Henry Coffey - *Stern, Agee & Leach - Analyst*

Well, I was just wondering what you're doing in vendor in terms of new product there.

John Thain - *CIT Group - Chairman, CEO*

The volume in vendor was flat with first quarter. A lot of that is being driven by the current economic environment. And so we still feel strong with the yields and the business that we're doing in the vendor business. As Scott mentioned before, the yields on new business are in excess of 10%.

Henry Coffey - *Stern, Agee & Leach - Analyst*

And then the liquid -- the vendor finance portfolio and liquidation is -- can you give us -- is that a European portfolio or a US portfolio?

John Thain - *CIT Group - Chairman, CEO*

The US portfolio is consumer. It's a book of business that we're in the process of winding down.

Henry Coffey - *Stern, Agee & Leach - Analyst*

Great. Thank you very much.

Operator

Your next question comes from the line of Chris Brendler, Stifel Nicolaus.

Chris Brendler - *Stifel Nicolaus - Analyst*

Hi, thanks. Good morning. Can you give us any additional granularity on the core finance portfolio and the trends you're seeing on the credit side. Again, still looking for some signs of stabilization there. I think we're seeing a little bit, but still, the rate at least up to the high teens in terms of nonperformance, the dollar has at least stabilized. But any color you can give on the components of that portfolio. Are you seeing weakness outside of the areas you have highlighted in the past as being

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underperforming parts of that portfolio? Is the weakness broadening, or are we seeing any light at the end of the tunnel? Thank you.

John Thain - *CIT Group - Chairman, CEO*

I'll try to answer that. I think the weakness is kind of the similar areas we've been working through over the last several quarters. The commercial real estate portfolio is definitely decreasing, and we had a few charge-offs in the second quarter related to that. In the energy sector, we also had a few charge-offs in the second quarter as we worked through that. And then outside of that, it's kind of just a matter of specific credits that is difficult, I think, to forecast what the next area is going to be. But I think Lisa and Rob and the others are working with the team with respect to working through that portfolio in the last couple of months.

Chris Brendler - *Stifel Nicolaus - Analyst*

Do you think by the end of the year, the NPAs should be down, or is it too hard to tell at this point?

John Thain - *CIT Group - Chairman, CEO*

Yes. I think it's a little bit hard to tell right now. I think, as you see, we're still increasing; but it's up slightly in the second. I think a lot of that -- the answer to that question is kind of expectations to where the economy is going to be. So there's mixed messages in regards to where that's going. So as you know, a lot of our portfolio will be dependent on future economic growth. So I don't think it's appropriate to answer that forward thought right now. But it will depend a lot on what happens with the economy.

Chris Brendler - *Stifel Nicolaus - Analyst*

Sure, okay. On a separate topic, I'm a little bit surprised to see you looking to refinance the high cost first lien facility now. As you mentioned, it will probably be down in the $3 billion range after you make this next prepayment. And given your quarter by quarter success in financing opportunities as well as natural pay down in the portfolio, I would think you would be able to pay that down just naturally over the next two, at most three quarters. What kind of benefit -- what are some of the benefits of paying it off early? I imagine it's going to cost you quite a bit of fees up front to pay it off and structure a new one. Is there any rationale besides just accelerating the pay down and getting a lower cost facility in place, or is there something else going on? One thing I'd thought of in the past just is the encumbrance that that facility places on your balance sheet that would unlock additional secured financing opportunities. Just help me out a little bit there. Thank you.

John Thain - *CIT Group - Chairman, CEO*

Sure. It's a very good question, and it is one we also discuss a lot internally. And you're right, we could pay down the first lien debt over the next couple of quarters, given the pace at which we're generating cash.

But the thought process is as follows. First of all, we want to keep some first lien capacity, because if we paid it all down, then in essence the second lien becomes the first lien, and there's no ability for us to create any more first lien debt. So we're maintaining some of that debt capacity, really just as a protective measure to us. Second of all, when we refinance it, besides a much lower cost, we'll also strip out a lot of the more difficult covenants. And so I expect that the refinancing will result in more reasonable covenants and lower costs, and then we can start the processing of focusing on the second lien debt. But we really are just taking advantage of a market opportunity right now to bring down the cost faster.

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Chris Brendler - *Stifel Nicolaus - Analyst*

Okay, that makes sense. Lastly, any guidance or thoughts you can give us on the taxes you're paying right now? I'm not exactly sure how we shall be looking at it. I know it's mostly driven by the international operations, but is there anything you can give us that will help us think about look at taxes going forward? That would this helpful, thanks.

John Thain - *CIT Group - Chairman, CEO*

As you know, our year to date tax rate is about 32%. So that's our best estimate for the year, based on the factors we have. And as you said, I think the other item we will -- we're completing our analysis on the situation with respect to our election as part of our 2009 filing, which will be done the third quarter.

Chris Brendler - *Stifel Nicolaus - Analyst*

Okay, so you're not getting any fresh start benefit -- you're not getting any NOL benefit at this point. It's all about waiting for that election.

John Thain - *CIT Group - Chairman, CEO*

Well, I think the NOL is based on having, US taxable income which, based on our current situation, debt situation, interest cost, we're not profitable in the US. So I think the NOL election really more has to do with future use of the NOL.

Chris Brendler - *Stifel Nicolaus - Analyst*

Okay. Thank you.

Operator

Your next question comes from the line of Sameer Gokhale from KBW.

Sameer Gokhale - *Keefe, Bruyette & Woods - Analyst*

Hi, thank you. And Scott, I just want to congratulate you and the rest of the other newer additions to the senior management team at CIT as well for joining recently. Just a few questions.

Firstly, I just wanted to clarify something. In terms of your pre-FSA net charge-offs, if I'm doing my math correctly, it seems like on pre-FSA basis, those net charge-offs, net of recoveries declined $254 million from $192 million last quarter. And it seems like, based on the commentary, that the decline was due to -- at least partly due to an improvement in vendor finance net charge-offs. And I was trying to just -- if I recall your comments about the provisioning for vendor finance, and there might be some apples to oranges comparisons going on here, but it seems like you were referencing in the increased provision relative to last quarter lower recoveries on vendor finance assets. So I was just trying to figure out, is it lower recoveries or higher gross charge-offs in vendor finance, and that seems to be a little at odds with the commentary in the press release. So if you could just provide some more color on that, that would be helpful.

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John Thain - *CIT Group - Chairman, CEO*

Well, on the first part of your map, I need to get a little bit more insight on that. But the -- on the vendor side, it was an additional provision we put up, Sameer, on that one. And that's was what we were saying in regards to -- the reserve that we put up on that was for lower expectations of our recoveries, right, on that book as it's liquidating. So as it continues to decline, the expected losses we're seeing on that portfolio were provided for in the second quarter.

Sameer Gokhale - *Keefe, Bruyette & Woods - Analyst*

Okay. So you're seeing charge-offs come down, but you're just, relative to your previous expectations for net charge-offs because of lower recoveries, you've increased the reserve there essentially.

John Thain - *CIT Group - Chairman, CEO*

Correct. But remember, that reserve is against a liquidating consumer portfolio, which is not part of the core vendor business.

Sameer Gokhale - *Keefe, Bruyette & Woods - Analyst*

Okay. When you're referencing the core consumer business within vendor, what businesses? Are you referring to retail sales of -- like you had, I think you used to have a Dell arrangement in the US, which was basically financing PCs to many consumers. Is it similar times of assets, or could you give us more specifics around that?

John Thain - *CIT Group - Chairman, CEO*

You're correct. It's the characterization of the assets.

Sameer Gokhale - *Keefe, Bruyette & Woods - Analyst*

Okay, okay. That's helpful. And then as far as the asset sales, I know you referenced several of them. Some of them I think occurred after the quarter end. So during the second quarter itself, were the asset sales basically the $580 million of student loans, $485 million of the Australian New Zealand business and then $890 million of the corporate loans, or were there any other asset sales during the second quarter as well?

Scott Parker - *CIT Group - CFO*

You had the $580 million for the student loans. We had over $500 million in the corporate finance area. That doesn't include the CIBC joint venture that we sold in Canada, the Australia business. And then we also had some aircraft and other leased equipment that we sold that we didn't provide the dollar amount of that. So in the quarter, we did do $2 billion.

Sameer Gokhale - *Keefe, Bruyette & Woods - Analyst*

About $2 billion. Okay. That's roughly what I had. Okay. That's great. Thank you.

Operator

Your next question comes from the line of [Edelen Groshen] of Height.

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Edelen Groshen - *Height - Analyst*

Good morning, John and Scott. Thank you for taking my question. Just on a broader picture, and I know you kind of addressed it earlier with trying to move the small business program into the bank, and could you give us and update on the discussions with the FDIC with the movement of, really commercial lending business lines that are permissible in a bank into the bank? And then, have you looked at the new $30 billion small business TARP program as maybe not that CIT needs capital, but maybe as a step in a goodwill direction to try and -- to achieve CIT's goals?

John Thain - *CIT Group - Chairman, CEO*

Alright. Well, let me -- I'll try to answer that.

Edelen Groshen - *Height - Analyst*

I'm sorry. It's very broad, I know.

John Thain - *CIT Group - Chairman, CEO*

Yes. The FDIC is -- has no objections to our originating corporate finance loans to the banks. So that is the process that we're using. So there's no issue with that, and I expect us to continue to originate higher volumes of corporate finance loans in the bank. In terms of the $30 billion legislation, it's not clear to us right now how that might be applicable to us. So we're actually looking at that, but that, as of right now, I can't tell you whether there will be any particular benefit to us or not.

Edelen Groshen - *Height - Analyst*

Okay, I was just under the impression that CIT which was trying to push its business lines from the holdco into the bank, and that there were some discussions going on about that. Not that you couldn't do commercial lending out of the bank, but most of the business lines are at the holding company, and to your point, vendor is much more profitable at the bank, and can you push the whole thing into the bank?

John Thain - *CIT Group - Chairman, CEO*

Well over time, there is a -- one of our goals is to move more of our businesses into the bank. Right now we do corporate finance there. The next step is the small business lending, which we're working on right now. And then the next step after that would be to move the US vendor business into the bank. So yes, we do intend to do that. We're just doing it in stages. But we're still utilizing the ban,k even today.

Edelen Groshen - *Height - Analyst*

Okay, and do you have like a -- have you submitted a plan with the FDIC that they're monitoring as you go through it or anything along those lines? I guess my real question, John, is the FDIC prior to the fresh start was hesitant to allow CIT to do a lot of things back over a year ago, and I am just wondering, are they more warm to what CIT is doing, or are they still a little standoffish? And will they put hurdles in your way to accomplishing the goals that you're looking to accomplish?

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John Thain - *CIT Group - Chairman, CEO*

I can't really answer the part about the past, because I wasn't here then and really, Scott wasn't either.

Edelen Groshen - *Height - Analyst*

Right.

John Thain - *CIT Group - Chairman, CEO*

So neither of us can really say about what the relationship was in the past. The -- I would say that the -- there are constant dialogues all the time with the FDIC, so they are aware of our business and our business plans, and we're working with them.

Edelen Groshen - *Height - Analyst*

Great. Thank you so much.

Operator

Your next question comes from the line of Matt Schultheis of Boenning & Scattergood.

Matt Schultheis - *Boenning & Scattergood - Analyst*

Good morning.

John Thain - *CIT Group - Chairman, CEO*

Good morning.

Matt Schultheis - *Boenning & Scattergood - Analyst*

Quick question with you. With regard to the Frank Dodd bill, there was an unintended consequence related to rating agencies and ABS issuance that caused Ford some issues. Are you aware if any issues in that bill that may cause you some issues -- some challenges going forward, some things that you might have may have to take care of a little differently than you had originally planned?

John Thain - *CIT Group - Chairman, CEO*

Well, a lot of our transactions are kind of 144 A kind of private transactions that would not be impacted by that. But again, I think given the legislation, we will need to look at that on future products that we may be going to market with, so -- but I would say not immediately, but could impact depending on how that gets resolved.

Matt Schultheis - *Boenning & Scattergood - Analyst*

Okay.

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John Thain - *CIT Group - Chairman, CEO*

As you know, it's thousands of pages. But at least as with what we've gone through so far, it doesn't appear to have any particular impact on us.

Matt Schultheis - *Boenning & Scattergood - Analyst*

Okay. And actually a follow-up to the preceding questions that you were getting from the previous caller there. When you're talking to the FDIC, do you feel like you're making progress, or do you feel like you're running into a stone wall? Do you think you're getting a real response or just not really interested in hearing from you.

John Thain - *CIT Group - Chairman, CEO*

The best answer to that is we have a constructive dialogue with all of our regulators and in particular, our constructive dialogue with the FDIC.

Matt Schultheis - *Boenning & Scattergood - Analyst*

Okay. Thank you very much.

Operator

Your next question comes from the line of [Mosho Arumba] of Credit Suisse.

Mosho Arumba - *Credit Suisse - Analyst*

Hi, I'm not sure if you mentioned this or not, but could you say how many of the $1 billion of originations was actually done at the bank?

Scott Parker - *CIT Group - CFO*

The committed amount was about a little bit over -- about $100 million.

Mosho Arumba - *Credit Suisse - Analyst*

Okay.

Scott Parker - *CIT Group - CFO*

$180 million, sorry. $180 million was committed, and we funded about half of that in the bank in the second quarter.

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Mosho Arumba - *Credit Suisse - Analyst*

Thank you. Secondly, when we look at the vendor business, it continues to lose money. Could you separate out in some way maybe -- I don't know if there was a gain or loss on sale of the piece that you sold or any kind of runoff portfolio. How do we think about the ongoing profitability of that business?

Scott Parker - *CIT Group - CFO*

In the second quarter, there were three key drivers to vendor profitability. One was the fact that the assets were down another 10% from the first quarter, which had and impact on the revenue line. It also had higher interest allocations. As you know, we allocate all that cost across our PNLs, and because of the prepayment penalty as well as the negative carry we have on the cash, they get impacted by that.

And then the last piece is what we talked about is that we did have increased provisioning with respect to this liquidating consumer business. So in regards to what's happening in the second quarter, and I think maybe, as you do look at year to date, I think as that business stabilizes in regards to the asset side as well as we attack the interest cost, that's probably a better approximation of how we see the vendor business. We do expect -- we know that new vendor business is profitable, and we do expect the vendor business to be profitable.

Mosho Arumba - *Credit Suisse - Analyst*

Okay. And then, could you reconcile the change in comp expense second to first quarter? What are the differences there for that increase?

Scott Parker - *CIT Group - CFO*

As I think we talked about in the press release, it was an adjustment for expenses related to retention payments for our employees as we continue to move forward on the -- restructuring the business. We thought it was very beneficial in order to keep our employees motivated in regards to the strategic framework that John has laid out.

Mosho Arumba - *Credit Suisse - Analyst*

So that was the entire increase? Was it --

Scott Parker - *CIT Group - CFO*

It was the majority of it.

Mosho Arumba - *Credit Suisse - Analyst*

Majority of it, okay. And just lastly, could you address what the cash buffer that you intend to maintain as you go through and are continuing to advance your paydown and refinancing of the original debt?

Scott Parker - *CIT Group - CFO*

That's also and ongoing discussion here about exactly how much of a cushion do we need to maintain. But we run a whole series of stress-type scenarios to see what kind of cash drains we can experience under a stressed environment. We also have

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undrawn credit facilities, which we have to be able to fund. And then we are definitely maintaining a significant cushion to our liquidity right now. And part of that is just the getting comfortable with the data and the systems that feed our risk management systems. So we will probably carry what will look like relatively high amounts of cash for the foreseeable future. Until we get more comfortable with it, we have very good management information systems.

Mosho Arumba - *Credit Suisse - Analyst*

Great, thank you.

Operator

Your next question comes from the line of Mike Turner of Compass Point.

Mike Turner - *Compass Point - Analyst*

Hi, good morning. Just wanted to find out on your $1 billion in originations, how much of that was funded versus committed on a consolidated basis in the second quarter and also versus the first quarter?

Scott Parker - *CIT Group - CFO*

In the second quarter, the majority of the volume that we do would have been funded.

Mike Turner - *Compass Point - Analyst*

Okay.

Scott Parker - *CIT Group - CFO*

The small piece is the corporate finance portfolio or deals that we did in the bank, the asset based ones. So back to the first quarter, I don't have that information. We can follow up with IR. But in the second quarter, I think it's just really (inaudible) funded.

Mike Turner - *Compass Point - Analyst*

Okay. And also, I think previously you had said you are going to look -- you've always said you were going to look to do more securitizations, I belive you mentioned rail in the past. How much -- what is the asset base that you could conceivably -- that's really available to secure ties from, as far as like the rail portfolio would be, that's unencumbered?

Scott Parker - *CIT Group - CFO*

The exact number we're not really going to quantify. But we have the ability to do multiple billions of dollars of securitized financings. And the number also changes, because as we -- so for instance, when we add new aircraft to our fleet, which we're doing, those become available for our financings as well. So I guess one way to think about it, which doesn't quantify it for you, but it's multiple billions of dollars.

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Mike Turner - *Compass Point - Analyst*

Okay. And then also, remind me what the size of your NOL is and then what your valuation allowance is again.

Scott Parker - *CIT Group - CFO*

It's about -- the NOL is about $2.5 billion. I'll have to get back to you on the specific valuation allowance against that.

Mike Turner - *Compass Point - Analyst*

Okay, but you have -- the DTA on the balance sheet is significantly less, correct?

Scott Parker - *CIT Group - CFO*

Yes, if you look at --

John Thain - *CIT Group - Chairman, CEO*

Yes, if you look in the 10K, kind of gives you the details of the netting of the deferred tax asset and its deferred tax liability.

Mike Turner - *Compass Point - Analyst*

And I guess lastly, when you talk to your portfolio companies now, and I know you said you're getting mixed messages in the economy, what are they telling your and what are you seeing right now in terms of line utilization from the -- from corporate finance borrowers in terms of credit? Are they -- what are you hearing and seeing from them right now? Do they have plans to hire? And what are some of those thoughts?

John Thain - *CIT Group - Chairman, CEO*

That's -- it's a very good question. We've actually been spending a lot of time looking at that. Remember, our customer base is small in middle market companies, not the large -- and particularly not the large global companies. And I would say that the small middle market companies are still not very confident about their prospects, not very confident about the outlook for the economy, and so they're being very cautious. They're not drawing on the lines, they're not hiring people, they're not spending money on plant, property and equipment.

Mike Turner - *Compass Point - Analyst*

Okay. Alright, well thank you very much. Great quarter.

Operator

Your next question comes from the line of Chris Brendler, Stifel Nicolaus.

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Chris Brendler - *Stifel Nicolaus - Analyst*

Hi, thanks. I just had a follow-up question. On the -- I guess one that was already asked, but just trying to get a better sense of as you head into the second half of the year, do you expect to have the same level of success in balance sheet opportunities? Either secured financings, securitizations, asset sales? I think the first half has been better than I had expected. I just wanted to know as you lay out the second half of the year, do you see additional opportunities? Also also, if you could you comment any update on your thoughts on the student loan portfolio? Thanks.

John Thain - *CIT Group - Chairman, CEO*

I guess on the first part, the financing again is all subject to the market conditions and kind of what goes on over the remaining of the year. But we do have several additional secured financings that we're working on. We feel good about that as of now. But it's, again, subject to when we get those out there and the receptivity to the market. So I think we're continuing to work on that, and the -- Glenn and the treasury team have done a great job, as you said, putting the secured financing together for the first half of the year, and we'll continue to hopefully have that same type of progress in the second half.

Chris Brendler - *Stifel Nicolaus - Analyst*

Okay, and then one final question for me is on the credit reserve, should we expect you to continue to build up an on balance sheet reserve to the extent that the non-accretable discount comes down and you're basically just plowing that back into reserves? So at some point next year, you probably look like you have a more normal level of reserves, or is it going to slow down a little bit?

Scott Parker - *CIT Group - CFO*

In our reserving process, we evaluate the adequacy of our reserves every quarter. And there's a lot of components that go into estimating the reserve with respect to changes in loss expectations in the portfolio, what's going on with market conditions, our collection efforts and other factors like that. So I don't -- say when you try to forecast that out, it's really dependent on a lot of those factors that we are seeing in regards to the portfolio, and our experiences is that kind of get us to the point of what we reserve in the provision line. So --

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Chris Brendler - *Stifel Nicolaus - Analyst*

The confusion I have with this is fresh start accounting creates additional level of uncertainty and noise around this. I think in general, I would obviously think a portfolio that's shrinking, your reserves would be going down unless credit was getting worse. So maybe you can just give me a little color commentary on how you feel about the credit trends in the quarter. Does the fact that you're adding to reserves -- I don't necessarily think that means things have gotten worse. I think it's more of an accounting issue. Any thoughts on that?

Scott Parker - *CIT Group - CFO*

I think the piece I think you're bringing up in regards to FSA is normally you have recoveries are netted against your charge-offs within the provision line. That maybe is what you're talking about. With fresh start accounting, there is a geography difference between those two. So I think as you get further out and the FSA book runs off and you're looking at the new originations and the new assets coming on, there will be -- those two will be more in line. I think in regards to the portfolio itself, again, I think as you look at that as we're getting through -- past the year end point, we're six months after that, so a lot of things, as we talked about, could change in our portfolio, and that's what we continue to look at on a quarterly basis and update our estimates based on that information that we're seeing.

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Chris Brendler - *Stifel Nicolaus - Analyst*

Okay, great. Thank you.

Operator

Your next question comes from the line so if Henry Coffey with Sterne Agee.

Scott Parker - *CIT Group - CFO*

Yes, just follow-up. I know you probably can't offer full detail on this, but the current plan is to -- if I understand it correctly, you're going to pay down "a billion dollars of the first lien", and I'm assuming that's either being done with cash flow or from existing lines. And then the refinance of the rest, is there any way you can give a sense of what that deal would be structured like, or maybe make some reference to other market rates or something that can help us with our modeling? Well, the billion dollars would come from cash, and we can't really give you any more color on the refinancing, because we haven't even started it, but we will start it this week. So we will start that process this week and over the course of the next couple of weeks, through Ken, you can probably get some better color. But we can't give you any right at the moment.

Henry Coffey - *Stern, Agee & Leach - Analyst*

Thank you.

Operator

Your next question comes from the line of Patrick Duff of Gilder, Gagnon & Howe.

Patrick Duff - *Gilder, Gagnon & Howe - Analyst*

Yes, hi, good morning. Thank you. You answered part of this question earlier, but I'll just ask it in its entirety for the full response. In the prepared comments, you talked about the needed investment in new systems, risk management and what have you. And so what I was curious about is first of all, how long do you think it will take to put those investments in place? How much of an impediment is it on your current business not having those systems and risk management in place at the moment? And whether or not making those investments have any impact on your discussions with the Federal Reserve and the overall MOU.

John Thain - *CIT Group - Chairman, CEO*

Yes, that's a very good and insightful question. The answer is -- I'll kind of go backwards. Yes, our investments in risk management and systems have a lot to do with our discussions with the fed and with our written agreement with the fed. Many of the fed's issues with us have to do with risk management and risk management systems and information systems. The best answer I can give you in terms of the nature of your question is in terms of people, we have the people in place now to deal with the risk management structure and with the issues that the fed has been raising. In terms of systems, we still have a lot of work to do, and we will need to invest in systems. And as you probably know, fixing systems takes a long time. So I think that the timeframe to get the systems in order is going to be at least 12 months.

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Patrick Duff - *Gilder, Gagnon & Howe - Analyst*

Okay, and is it too much to say that before those systems are in place, kind of a relaxation or return to complete normalcy with regulators and what have you would probably be presumptuous on our part?

John Thain - *CIT Group - Chairman, CEO*

Well, I guess -- I've actually answered this question a little bit before. The -- although we are making substantial progress with the regulators, I wouldn't expect that we will return to whatever normal means. Normal these days, I'm not sure what that means anymore, but I don't think we will eliminate all of issues that we have with the regulators until we solve the system issues.

Patrick Duff - *Gilder, Gagnon & Howe - Analyst*

Okay, great. Thanks very much.

Operator

Your next question comes from the line of Ryan Stevens with Philadelphia Financial.

Jordon Hymowitz - *Philadelphia Financial - Analyst*

Hey, guys. It's Jordan Hymowitz. Thanks for taking my questions. Two quick questions. On the rail, can you talk about how much the pricing of similar assets was down on a rollover basis? In other words, GMT Organics said it was down about 18% year-over-year -- I'm sorry, on a repricing basis. Can you comment what yours was down?

Scott Parker - *CIT Group - CFO*

You're talking about on renewals?

Jordon Hymowitz - *Philadelphia Financial - Analyst*

Right. How much the pricing was down on renewals in a comparable basis in the quarter?

Scott Parker - *CIT Group - CFO*

I don't have that data right now. We'll see if we can get it before the call is over. What was the other one?

Jordon Hymowitz - *Philadelphia Financial - Analyst*

I'm sorry, go ahead.

Scott Parker - *CIT Group - CFO*

What was the other question?

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Jordon Hymowitz - *Philadelphia Financial - Analyst*

As well as the term, in other words, if they went out at 60 more terms before, are they still at 60 or are they at 40 or something like that? And actually my other question was -- actually, I'm sorry, one more thing, I apologize. On your student lending portfolio, your fell portfolio which is no longer being originated, are you going to keep the portfolio and run it off, or would you be looking to sell it?

John Thain - *CIT Group - Chairman, CEO*

Alright, let me -- I'll answer the second one as we're getting you the answer on the first one. The -- as you saw, we sold you a piece of the portfolio, and we're constantly evaluating what is the best thing to do with that portfolio. So we don't -- other than us looking to see what makes the most sense for us, that's really the only answer on that.

Jordon Hymowitz - *Philadelphia Financial - Analyst*

Could you say what price you sold it for as a percent of par?

John Thain - *CIT Group - Chairman, CEO*

Well, no. I actually won't do that. But what I will do is I'll say that we sold it at slightly above where we were carrying it at.

Jordon Hymowitz - *Philadelphia Financial - Analyst*

Okay.

John Thain - *CIT Group - Chairman, CEO*

These things, you can get market prices for these things. It's a little bit unfair because block prices are not the same as where small amounts trade. But we did sell the block that we sold at slightly above where we're carrying it at.

Jordon Hymowitz - *Philadelphia Financial - Analyst*

Okay.

Scott Parker - *CIT Group - CFO*

And to your question on the rail, in regards to our kind of renewal rate, we kind of track versus the previous rates of those cars rolling off. So it is probably not going to be apples to apples with I think what you mentioned, but it's probably down about 15% on our renewal rates, so that's a blend between when the cars came on. But I would say in general, pricing is down kind of 10% plus in regards to the peak. And then on the term side, the terms are kind of in the 40 month kind of range right now from the last couple of quarters that we have seen. But we are trying to keep them shorter just because the rates are lower.

Jordon Hymowitz - *Philadelphia Financial - Analyst*

Got it. Thank you very much. I appreciate you taking my questions.

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Operator

Your next question comes from the line of [Joseph Comstock] of Bennett Management.

Joseph Comstock - *Bennett Management - Analyst*

Hey, guys, good quarter. Can you give us the interest expense associated with your first lien loans here in the second quarter?

Scott Parker - *CIT Group - CFO*

The -- yes, if you want the actual dollar amount of interest expense on the first lien debt, just call Ken afterwards. He can get it for you. You also probably -- you should just tell us where you want it before the prepayment penalties or after, because the prepayment penalties impact that number.

Joseph Comstock - *Bennett Management - Analyst*

So the interest expense that's recorded alongside of interest income includes prepayment penalties?

Scott Parker - *CIT Group - CFO*

Yes.

Joseph Comstock - *Bennett Management - Analyst*

And could you -- I know that discussed this earlier, but you mentioned the need to keep some of the first lien loans outstanding to keep that first lien basket open? Could you expand on that?

Scott Parker - *CIT Group - CFO*

Yes. We don't have to do that, we're choosing to do that. And the reason is, if we extinguish all the first lien debt, the provisions in the second lien debt would not allow us to ever replace -- to create any first lien debt on top of it.

Joseph Comstock - *Bennett Management - Analyst*

So does the entire, roughly $7.5 million or $8 million basket remain open as long as there's some first lien debt outstanding?

Scott Parker - *CIT Group - CFO*

No. Only the amount that's outstanding remains open.

Joseph Comstock - *Bennett Management - Analyst*

And so how do you anticipate refinancing this? Will you refinance it where you step into the shoes of the existing -- you step into the existing first lien basket? I didn't really understand your comments regarding the refinancing.

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Scott Parker - *CIT Group - CFO*

Alright. So again, this is all subject to market conditions, and we're just starting the discussion, but the intent would be to keep the $3 billion basket of first lien debt the place with a new facility basically refinanced out.

Joseph Comstock - *Bennett Management - Analyst*

And does it make sense to do that before the provision -- the call provision collapses on the expansion loan?

Scott Parker - *CIT Group - CFO*

That's -- it's a very good question, but you tell me what the market is going to be like when those provisions fall off, and then we can decide that. We're really saying we think there's an opportunity today to do it on attractive terms, and there's obviously risk to waiting.

Joseph Comstock - *Bennett Management - Analyst*

Got it. Okay, great quarter, guys.

Scott Parker - *CIT Group - CFO*

Thank you.

Operator

That concludes the Q&A session. I'd now like to turn our call back over to Ken Brause for any closing remarks.

Ken Brause - *CIT Group - EVP, Investor Relations*

Any follow-ups, please give us a call at investor relations. We appreciate your participation today, and we'll talk to you next quarter.

Operator

Thank you for participating in today's call. You may now disconnect.

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