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CIT - Q3 2008 CIT Group Earnings Conference Call

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CORPORATE PARTICIPANTS

Ken Brause
CIT Group - EVP, IR

Jeff Peek
CIT Group - Chairman & CEO

Alex Mason
CIT Group - President & CFO

Joe Leone
CIT Group - Vice Chairman, CFO

CONFERENCE CALL PARTICIPANTS

Bruce Harbig
Barclays Capital - Analyst

Sameer Gokhale
Keefe Bruyette & Woods - Analyst

David Hochstim
Buckingham Research Group - Analyst

Christopher Brendler
Stifel Nichoaus - Analyst

Howard Shapiro
Fox-Pitt - Analyst

Matt Burnell
Wachovia Securities - Analyst

Moshe Orenbuch
Credit Suisse - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to CIT's third quarter 2008 earnings call. My name is Shakwana, and I will be your operator today. Participating in today's call, from the company are Jeff Peek, Chairman and Chief Executive Officer. Joe Leone, Vice Chairman and Chief Financial Officer. Alex Mason, President and Chief Operating Officer, and Ken Brause Executive Vice President of Investor Relations. We will have a question-and-answer session later in the call. (OPERATOR INSTRUCTIONS) I will now like to turn the call over to Ken Brause, Executive Vice President of Investor Relations. Please proceed, sir.

Ken Brause - *CIT Group - EVP, IR*

Thank you, Shakwana and good morning, everyone. Welcome to CIT's third quarter conference call. Our call today will be hosted by Jeff Peek, our Chairman and CEO, Joe Leone, our CFO and Alex Mason, our President and Chief Operating Officer. Let me mention two items before we get started today. First, following the formal remarks we will have a Q&A session. We ask that you limit yourself to one question and return to the queue if you have additional questions. We will do our best to answer as many questions as possible in the allotted time.

Second, 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

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of this call. We disclaim any duty to update these statements due to new information, future events or otherwise. For information about risk factors relating to the business, please refer to our SEC report. Any references to certain non-GAAP financial measures are meant to provide meaningful insight and are reconciled with GAAP in the financial tables accompanying our Press Release. For more information on CIT please visit the Investor Relations section of our website at www.CIT.com. With that, it is my pleasure to hand l call over to Jeff Peek.

Jeff Peek - *CIT Group - Chairman & CEO*

Thank you very much and good morning, everyone and welcome to our third quarter conference call. Today, I will update you on a number of strategic issues and results for the quarter. Alex will provide his thoughts the performance of our commercial financial business units and Joe will reach our liquidity position and consolidated financial results. Then we'll be very happy to take your questions. I think we can all agree, these are unprecedented times. Challenging for you and challenging for us. But here are some key points to keep in mind about CIT.

We remain very liquid -- with a plan to meet at least twelve months of obligations without access to the unsecured bond markets. Our balance sheet is strong. Our tangible capital to manage asset ratio improved 9.2% this quarter and it's almost 11% if you exclude our $12 billion of U.S. government guaranteed student loans. During the quarter, we increased our reserve for credit losses by $75 million, as the economy has clearly deteriorated. And we continue to work hard to maintain our core commercial franchises - Corporate Finance, Vendor Finance, trade and Transportation Finance. That they are poised to fill the competitive void and grow earnings when conditions improve.

I think the key to viability and success in this environment is to be pro active and decisive. And I believe we've demonstrated both of those traits over the past several months. We raised capital when we saw the window in April. We sold assets late last year and throughout this year, including our entire subprime mortgage portfolio in order on shrink the balance sheet and control risks, and we entered into a long-term funding relationship with Goldman Sachs and are in the process of finalizing another such relationship with Wells Fargo.

Our critical priorities and operating the company have been clear - liquidity, balance sheet management and credit underwriting. These priorities begin at the top and are known throughout CIT. Starting with liquidity, I'm extremely pleased with the progress we've made, both in renewing existing facilities and raising new liquidity. We have generated over $11 billion of incremental liquidity since we drew the bank lines in March. In August, we prepaid the $2.1 billion of bank borrowings that are do you this month and we have also bought back $250 million of our short dated debt at a discount. And we successfully renewed $6 billion of security facility that was due to expire in third quarter which helped finance our Vendor Finance business and our liquidating student lone portfolio. These actions combined with other funding initiatives led us to retain our rail leasing unit - a great business we had considered selling solely to generate liquidity.

We've also been working hard to manage the balance sheet. In fact, even with some seasonal growth in trade finance, managed assets declined $0.5 billion this quarter. We have delevered the balance sheet as a result of the capital raise, and we will continue to pay of maturing debt and to buy back bonds at a discount. In short we have been managing for cash as we strive to find the right balance between serving our clients and preserving our franchise while enhancing liquidity. We have required each business to identify and execute a funding plan that does not rely upon the capital markets. Nearly half of Corporate Finance's new loans were originated through CIT bank this quarter. Transportation Finance is using the ECA facility for financing all new deliveries through 2009 and both Vendor and trade finance are self financing their new volume through cash flow from operations.

However, as a result of the events of the past few weeks, we are more actively managing new business originations with tightened underwriting standards and an emphasis on generating liquidity while continuing to service the needs of our of our most important clients. Specifically, new business volume was down $1 billion from the second quarter - from $4.9 billion to $3.9 billion. And looking forward, we anticipate continuing declines in origination volumes as competitors pull back and industry

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consolidation shrinks the number of providers. Now, clearly if the government programs work and liquidity returns to these markets, we will re-examine this approach.

Our third priority has been credit. When I last spoke to you at the Lehman conference about six weeks ago, I provided our credit loss expectation based on the world as we saw it then, and expectations were for a slow, no growth, sputtering economy. Clearly, the world has changed meaningfully over the past few weeks, and our outlook has darkened. As you've seen, our credit metrics this quarter were mixed - an improvement in delinquencies, a modest increase in non performers and meaningfully higher level of charge-offs. The total charge-offs exceeded our expectations, largely due to a few discrete items. A commercial real estate loan in which we foreclosed, a bankrupt retailer, and the reassessment of a previously-acquired portfolio in Vendor Finance.

As we review the portfolio in light of the current and now anticipated economic downturn, we believe our full year 2008 commercial finance charge-offs will be in the range of 80 to 85 basis points and, on a preliminary basis, we estimate that 2009 we'll be 30 to 40 basis points higher than this year's total. We have, and we will, continue to tighten underwriting standards and scrutinize the portfolio intensively, remaining pro active in identifying and resolving problems. Let's talk about strategy for a minute and get away from tactics.

Strategically, I have been focused on a long-term solution to our funding model and how to make deposits a more significant component of our future mix. We continue to make good progress with CIT banks, both raising deposits and underwriting new loans. CIT bank originated over $600 million of new loans during the third quarter and we began raising term deposits again in August. About $800 million have been raised, have been issued so far, with average maturities of well over a year at an average cost of under 4%. We recognize, however, that our Utah bank is not sufficient to achieve our long-term goals. So as I indicated in September, we are exploring a variety of options that would allow us to expand our deposit-taking capabilities, particularly in light of the government's actions over the last several weeks and the last several days. In fact, anything that improves liquidity in the system and the functioning of the capital markets is good for CIT. So we expect to see ancillary benefits from these recent actions. But in addition, we are currently reviewing how the CIT bank as an FDIC insured institution can directly benefit from the recently-announced programs. More to come on all fronts on this topic.

It is disappointing to me that despite all of the hard work of our people, we were unable to report a profit this quarter as our core commercial earnings were largely erased by an accounting charge, good will impairment on Vendor and losses in our liquidating consumer business. Higher funding costs for government guaranteed student loans and credit costs for the private loan book. As Alex will describe in more detail, we had continued good performance in trade finance and Transportation Finance. Corporate Finance, while profit be, experienced both higher credit costs and a decline in fees, and as we've stated, Vendor Finance continues to underperform as we restructure that business. When I look back at the third quarter, the past three months, I am proud of how much the team here has accomplished. We sold Home Lending. We successfully completed numerous financings. We began the restructuring of Vendor Finance. We made significant progress on expense initiatives and headcount reduction and against this back tropical, we kept our customers front and center, our employees engaged, and our eye on preserving franchise value. Now, I want to turn it over to Alex.

Alex Mason - *CIT Group - President & CFO*

Thank you, Jeff. And good morning, everyone. As many of you, I've been in finance and banking my entire career and it won't surprise you that this is the most substantial financial market crisis I have seen. The credit markets are seized up, unemployment continues to rise and the economy is clearly in a recession, the extent of which no one at this point can accurately predict. And the impact on our business has been noticeable. What I would like to do is provide an update on each of our commercial franchises against this increasingly challenging market back drop. Let me say upfront that on the whole our commercial business has shown tremendous resiliency in a tough environment.

We have two businesses, as Jeff said, that continued to excel this quarter - Transportation and Trade Finance. One business, Corporate Finance, that performed admirably despite being severely hampered by market conditions, and a fourth business in

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Vendor, where we have set in motion an aggressive action plan to return this valuable franchise to appropriate levels of profitability. So let's start with Vendor, as turning this franchise around is at the top of my priorities. Since my arrival three months ago, I have spent quite a bit of my time meeting with business leaders and conducting a thorough review of this segment. My immediate impression is this is a valuable franchise and it benefits from great relationships with some of the leading global companies around the world. However, we obviously have challenges to overcome.

Our plan to improve Vendor Finance is multi-faceted and will occur in phases. First phase, which I just described, is completed and we believe we have identified the primary reasons why Vendor is underperforming. The next phase involves acting decisively and aggressively in tackling our challenges and I'll expand on our action plan in a minute. The final phase is to restore the acceptable returns that this business has historically generated. So let's get into specifics.

First, the organizational structure of Vendor was not conducive to taking quick and decisive action. During the quarter, we reorganized the segment, moving from co-heads to one global head while significantly streamlining the reporting structure. This better aligns us with our Vendor partners' coverage models while at the same time improving the decision-making cycle time and, importantly, management accountability. These changes will enable us to quickly respond to customer opportunities and needs, and marketships around the globe.

Second, we have implemented a cost reduction program across the segment to right-size the business and set it up for enhanced profitability in 2009, even if the current market environment extends into next year. In total, we should realize almost $40 million of annualized savings as we move forward.

Next, we have reprioritized use of capital to make it available strictly to strategic customers where we provide high value-added service. Simultaneously, we are continuing efforts to improve pricing where it involves revisiting established pricing arrangements with our large, long-standing vendor relationships, this may take a little bit of time. But in instances where we use rate cards or price on a deal-by-deal basis, we are able to move more quickly to effect pricing changes. In all cases, we are acting aggressively to get our pricing structure to more accurately reflect the changing market conditions. And let me be clear, we are focused on risk adjusted return on capital and thus we are willing to forego originations if our desired pricing is not there.

Fourth, the traditional business model which relied on an integrated capital market strategy including the use of securitizations has obviously been severely hampered. As we go forward, we are not relying on off balance sheet securitizations and we are exploring alternative financing options in virtually every geography to replace that component of our funding strategy. Additionally, given the continued global economic pressures and tight liquidity markets, during the quarter we aligned our approach with respect remediating and collecting on certain acquired accounts with our core portfolio operating practices. This resulted in charging off $13 million of receivables in the quarter. We continue to evaluate the portfolio for similar actions, but would expect any further charge-offs in Q4 to be of significantly lesser magnitude.

Finally, as has already been noted, we evaluated and subsequently wrote off the entire good will and the majority of our intangibles allocated to this segment. Joe will expand on this in a moment. Collectively these assertive actions are designed to bring vendor's profitability back to appropriate levels for 2009.

Next, let me move to the Corporate Finance segment which has seen significant impact from the difficult market conditions. Secondary market pricing has been under extreme pressure of late, as loans are being sold, often indiscriminately to raise liquidity. Meanwhile, the syndication market is virtually nonexistent as the low prices in the secondary market are making the relative value of doing a new transaction with potential lenders that much more difficult. The combined effect has produced a major diminution of revenue from both those channels which have traditionally been strong contributors to non-spread revenue.

For reference, last year in Q3, revenue from sales and syndication activity totaled nearly $30 million, and the year prior, was almost $90 million. Please understand that opportunities to originate new loans at attractive prices with strong covenant packages are plenty. But due to size, most deals require more than one lender to show up at closing. As the market has tightened, many middle market participants are scaling back origination volume to preserve liquidity and the syndicates or clubs are simply

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harder to form. In the instances where we are originating, we are partnering with other high-quality lenders to provide strategic capital to our very best client with a concerted effort to originate through CIT banks. Indeed, in the third quarter over 40% of our Corporate Finance volume was originated in the CIT banks. In Q4, I would expect overall new business levels to come down and origination through CIT banks to increase.

In On the credit side, we saw losses increase by 30 basis points, with roughly 23 basis points of the impact coming from one commercial real estate account that was foreclosed in the quarter. While we still have yet to see any sustained or systemic losses in any given subsegment, we expect credit trends will likely continue to be pressured. Next, let me focus on Trade Finance, which remains a steady performer generating 14% ROE this quarter. Volumes were up most due to seasonal factors which in turn drove higher commissions. As expected, credit costs rose to 180 basis points as the retail sector continues to soften. Most of the losses this past quarter relate to one large bankrupt retailer.

Most note worthy, however, is the excellent job our credit team has done dodging so many of the recent stream of retail failures. I must tell you that since my arrival, I have been tremendously impressed with the ability of this management team to anticipate problems and to manage exposures accordingly. Under normal circumstances, we would be significantly ramping up volumes on our ability to charge higher commissions at this point in the credit cycle but we are in anything but normal times. But going forward, expect us to scale back factoring volumes as we manage risks aggressively by not taking on certainly retail accounts.

Finally, on to Transportation Finance. Utilization for both air and rail remain solid, and the segment as a whole returned 16%. In rail, utilization remained high at 96%. Rail generally benefits from higher fuel prices compared to trucking, given its efficiency. However, we saw the higher demand in Q3 being offset by overall reduction in freight transportation as a result of the softening economy. We will continue to monitor this dynamic as we move forward but in general we believe that our best in class management team along with our young, efficient and divorce fleet positions us well to weather a prolonged or significant downturn.

In air, demand for more fuel efficient types of aircraft remains strong in the face of increasing fuel prices. At the same time the wave of recent bankruptcies is causing a dampening effect on lease rates. From a credit prospective we have side stepped most of these failed airlines. And where we did have exposure, we moved quickly to redeploy those aircrafts elsewhere. All in all, air remains almost fully utilized and 19 of the 20 planes being delivered through 2009 have been placed. While two of of the planes that were scheduled to be delivered to a bankrupt carrier are very close to be redeployed.

Before we move on, let me say that our commercial franchises continue to have tremendous value. However, we are in unprecedented times and we will have to make some tough decisions. The common theme you may have picked up from my remarks is that liquidity is current our number one priority, or job one as I have described it before. To that end, we will continue to spend considerable time reviewing all facets of our businesses and will be strategic around where and when to use capital, with the likelihood that we would effectively pause or exit certain businesses and product offerings that seem unlikely to provide adequate returns during this period in the economic cycle. With that, I will turn the call over to Joe.

Joe Leone - *CIT Group - Vice Chairman, CFO*

Thank you, Alex. Good morning, everyone. Appreciate your spending some time with us on the call this morning. Clearly the markets are stressed. I don't have to tell you that, and while our securities and core profit drivers have been pressured, our focus has been keen on liquidity, continued client service, and our business model transformation. The company overall and my finance team specifically are working on the imperative that maximizing liquidity is priority one. And I'm proud of what we have accomplished. The third quarter was very busy with additional successes. Hopefully you find the frequent liquidity updates we have been providing you useful. Jeff highlighted many of the major accomplishments this quarter on liquidity. Let me add some color.

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First the Goldman's facility. We started funding under the facility as planned in Q3, and have received or drawn about $1.3 billion of $3 billion of the committed facility. Fundings to date have been backed by Corporate Finance assets, essentially middle market loans, from our existing portfolio. Clearly we want to utilize the entire facility by year-end since, as many of you know, draws on the facility are priced at LIBOR flat and we pay the 285 basis point commitment fee whether we use the facility or not. Our current thinking is to fund the combination of Corporate, Vendor, and Transportation Finance assets through the facility in the fourth quarter. The Wells Fargo facility we're working on is a five year, $500 million secured facility that we will use to fund middle market loans. The loans can either be from our current portfolio or new originations. We still need to complete the documentation. Wells is going through due diligence and we need to get through certain closing conditions and we want to start the funding, as I said, in the fourth quarter.

With respect to aircraft, we have been funding new aircraft deliveries through secured facilities. Jeff mentioned that, about $400 million to date, and we expect to continue to finance new aircraft deliveries next year in the same fashion. As the 2009 delivery package we have, our Airbus aircraft. Funding under these facility is long term, about 12 years, and relatively attractive pricing. We sold $400 million of aircraft in the quarter and that brought our sales to over $1 billion. That was the goal we had set at the beginning of the year. We would like to continue to make some sales into the fourth quarter.

Third quarter gains, however, were muted somewhat as we had a high oil cost in the summer months, if you can remember that. I do. And there's been threats of additional supply, but as Alex mentioned, the demand for our fleet with all planes flying is very solid. Deposits - we've all spent a some part of our remarks on and it's been a big focus of ours and yours. Jeff mentioned we raised $800 million in the quarter and I want to remind you we did not start posting rates until mid-August as the bank had a lot of excess cash, over $1 billion in July.

The total deposits in the bank grew this quarter and the vast majority of that is time deposits. We have gotten questions about the stickiness of the deposits and I'll tell you that based upon the deposit agreements, which restrict withdrawals to certain conditions, we only had about $1 million of early redemption so far in 2008 and looking forward we would like to grow the bank deposits by about $500 million per quarter as we finance commercial loans to middle market customers in that institution. Our securities conduit facilities, Jeff mention we renewed and we had $6 billion of conduits expiring in the third quarter and we were successful in refinancing the facilities, which fund both student loans and equipment loans. General terms including pricing and advanced rate reflect the current market. That's code for they were more expense.

We do have another $2.8 billion of facilities expiring in the fourth quarter and these facilities mainly finance Trade Finance, receivables and equipment. Our current thinking on this is to work and refinance the trade finance facility and we have begun preliminary discussions on that. And we're evaluating the need on the equipment conduit given our recent renewal success and our plan for reduced originations in that segment. We did manage the balance sheet down with managed assets down $500 million in the quarter, despite our growth in factoring which is seasonal. We usually get those paydowns in December and January during the holiday season and in addition to the aircraft sales, which I mention were $400 million, we sold $200 million of middle market loans and volumes decreased $1 billion sequentially.

Very topical, credit commitments. At September 30th, when we report our Q, you will see we have about $8.5 or so billion of total unfunded commitments. About $1 billion of that relates to Vendor Finance, which are consumer oriented and require an asset to be purchased in order to access the line. Of the remaining $7.5 billion or so, we estimate roughly $2 plus billion dollars cannot be drawn for reasons that relate to the contract and for collateral short for reasons. The net at risk figure is closer to $5 to $5.5 billion. Of that $5.5 billion about half is asset or equipment based and the balance is cash flow. About $2.7 of that is cash flow.

What are we doing about the commitments? First, we have been monitoring commitment and draw activity closely, and we've seen a pickup but it's been slight in utilization. Our overall utilization is about 75%. We have not seen a large amount of unusual draws but we have seen some activity. That said, our liquidity forecast does assume further increases in line utilization based on our account by account analysis of the probability of draw, which we redefine everyday based on market conditions and our experience.

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Cash. Including what we had in Utah bank, decreased from $7.4 billion to $5.5 billion. Remember we paid down the bank lines early and we paid down about $1.5 billion of unsecured debt and had about $1 billion of outflows related to securization, some of that relates to higher advance rates on the new facilities, and some of that relates to cash we will get back in the fourth quarter. The inflows relate to Home Lending, $1.5 billion, and Goldman about $1.3 billion. That should give you the picture of how the quarter in liquidity sized up. How about looking forward. I know that's on your mind.

We estimate needs of roughly $13 billion to meet our maturing obligations over the next 12 months. And that's a little over $9 billion of unsecured debt, $2 billion of bank lines which are due in April, and about $1.5 billion of manufacturer purchase commitments in our rail and aerospace segment. While we would like to get back to the unsecured markets along with a lot of other companies, obviously our 12 month liquidity plan assumes we do not have such access. Let me walk you through in general terms what our plans are.

We had about $4.5 billion in cash at the end of September. We have an additional $1.7 billion of this capacity under the Goldman facility and we're working on finalizing the Wells facility for $500 million. We also expect to do $1.5 billion to $2.5 billion of additional secured or securitization financing. We expect the $1.5 billion in aircraft purchases to be financed by the ECA facility, and finally, we see portfolio decline, particularly our non bank portfolio, by $5 billion plus as we book loans through the Utah bank, we reduce non bank origination volumes, and including certain asset sales.

Our Utah bank, which has over $1 billion of cash today, as I said, will grow about $500 million per quarter and that's where the portfolio growth on the commercial finance side will be. Having said all all of that, there are other things we've are actively working on. Jeff mentioned some of them. None of the ideas in progress are in our base funding plan. We do anticipate continuing our opportunistic debt buyback programs, primarily in the front end of our liquidity runway.

So our liquidy objectives are clear. Jeff mention we want enough liquidity to meet the next 12 months or more of unsecured debt obligations, and we do that on a rolling basis, and we disclosed to you our 12 month view and we also target maintaining a relatively robust cash position of over $3 billion as we do that. I think we've been successful in managing both sides of the balance sheet. Our review of collections, disbursements and origination is stronger everyday and our ability to uncover new sources of liquidity has been quite successful.

Financial results. Let me give you a little color on two of the unusual items that impacted the quarter. First the good will and intangible charge that Alex mentioned. We have been testing good will for impairment quarterly. We've said that to you and put it in our disclosures, primarily given fact that our stock has been trading below book value. The tests are computed or calculated at the segment level, and it compares book value, including goodwill and equity, to estimated fair values based upon market data. We've looked at discounts cash flows, peer earning multiples and price to book ratios. Given the expectation for lower vender earnings performance as we restructure it, and the general reduction in market valuation for financials, the analysis indicated that the goodwill and most of the related intangibles were impaired.

Secondly, we did have and did record a reserve of $18 million related to our investment of some of our overnight moneys in the reserve primary money market funds, which as you know broke the book in late September in the wake of Lehman's bankruptcy. We put our redemption request and received confirmation at a 97% payout, thus the 3% charge this quarter but we have not received a distribution and we closely monitor the situation. While on Lehman, I should give you our remaining exposure. Our remaining exposure is essentially related to derivative transactions in which we were in the money. We had a receivable. The derivatives were terminated upon Lehman's filing and CIT now has a $33 million claim against one of the bankrupt subsidiaries. Right now it's early to predict the specific outcome.

In terms of financial metrics, margins went down about 14 basis points sequentially. The majority came from higher costs of funds. For example $1.5 billion of unsecured debt that matured in the quarter had a cost of LIBOR plus 25. Those were the good old days about a year ago. $1.3 billion of advances refinanced them under the Goldman facility at LIBOR plus 2.85 - that's the market we're in today.

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Also contributing to the margin decline were increased costs to fund the conduit receivables, somewhat higher non-accruals, and slightly lower rentals than rail. As we look forward, we see some headwind as debt is repriced in the current environment, specifically, we're ramp up the Goldman's facility we mentioned and the conduits will be in place for the full quarter. On the flip side and you see this in the Corporate Finance results, pricing on new originations, particularly in the lending businesses continues to increase and the funding of new loans with the deposits will also allow us to rales that funding benefit. Fees and other income impacted by the market activity. We did sell or syndicate $400 million of commercial loans in the quarter. We sold the aircraft at a slight gain. And assets held for sale, a metric that many of you have been following and we've been on for a year, has declined again to $600 million from $1 billion in June. The pipeline is clearing. Factoring commissions were up seasonally, but not to last years levels as Alex discussed.

Regarding credit quality, I think Jeff and Alex covered most of that. I was happy to see a decrease in our 60 plus delinquency. That did benefit from a large energy account coming current. I think we said we predicted that when we reported our second quarter results. And the foreclosure on the real estate property as that asset gets moved to other assets.

Non-performing assets increased only slightly. Based on that and our long loss reserve modeling measures, we increase the reserves by $75 million in the quarter, $52 million in commercial, and $20 million plus in consumer. And on a year-to-date basis our charge-offs were about 75 basis points with 70 basis points or so in the commercial book.

On operating expense as Jeff mentioned we made progress. I was happy to see the progress. We saw the salaries and benefits line start to come down based upon our actions, and year-to-date were down over 10%. We have additional quarterly run rate savings of about $10 million to realize based on this quarter's restructuring, so when you put it altogether, with the restructuring initiatives we've put in place, other cost-cutting measures relative to G&A, we are targeting to deliver over $200 million of annualized run rate savings. That is good. It's necessary, as we continue to reduce expenses to levels appropriate in light of the new environment we all operate in.

On taxes, confusing quarter between continuing discontinued operations and fact that goodwill is generally not tax deductible. We had an effective tax benefit of 40% on continuing operations and 90% on discontinued operations as we still have not realized or see clear our ability to realize in the the near term the Home Lending NOL. We think that will come on later on -- not this year but in later reporting periods.

In terms of looking forward we don't see a lot of tax expense to book in the fourth quarter depending on where we raise the earnings or where the earnings are generated, and at this time we expect our effective tax rate going forward on continuing operations to be in the 20% area longer term.

Finally, let me close with a few words balance sheet and ratings. First, ratings. The dialog with the agencies is very active, including treasury discussions with the agencies and senior management meetings. Three of the four agencies rate us a minus with the fourth rating us at triple B plus. Moody's today placed our ratings on negative watch given the continued credit market difficulties. We think our strategy is designed to navigate through this uncertainly period, which we hope will favorably address forward-looking concerns that the agencies may have. Additionally Jeff went through this but I think it's important to note. Our balance sheet remains strong. We have a strong cash position. We increased loss reserves. Our capital ratios were not impacted by the goodwill write down. Our capitalization is almost at 9.2% and we will continue to build the balance sheet strength as we reduce asset levels and return to profitability. With that, operator, we turn it over to you for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS) Your first question comes from the line of Bruce Hartin with Barclay. Please proceed.

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Bruce Harbig - *Barclays Capital - Analyst*

Thank you. Joe, can you talk about the consumer segment losses and the private loan portfolio and what you expect to develop in that portfolio and coming quarters and also a little more commentary on margin outlook overlaid on top of the ratings outlook and the way the CDS are trading and the other plans you have for liquidity in the next quarters?

Joe Leone - *CIT Group - Vice Chairman, CFO*

That's one question.

Bruce Harbig - *Barclays Capital - Analyst*

I'm sorry.

Joe Leone - *CIT Group - Vice Chairman, CFO*

That's okay. These are difficult time for all of us. First of all, I won't remember all of your question just remind me of pieces or Ken will remind me of the pieces. On the consumer side, the margins have been under pressure because of the cost of financing the student loan book primarily. Given that, we expect that pressure to continue given the cost of the conduits. Generally the loss in the quarter was generated by reserve building. Charge-offs were about $30 million in the quarter, a little less than 1% but we built the reserves in that book by some $30 million. So that's what caused essentially the loss of about $40 million, was the provisioning of $60 million plus dollars. That's number one.

Number two. Margin outlook. In terms of margin outlook, what we would like to do is figure out a cheaper way to finance these student loans because that's what is going to hurt us in the fourth quarter as this funding facility we've recently put in place is much more expensive then the one we had in place a year or so ago. That's where we think a lot of margin pressure will come from. On the commercial book side, lease rate in plains and trains seem to be flattening out, with some dilution in Q3 in rail.

On the lending side, commercial financial rates are as high as they've ever been. LIBOR plus 600 or more and Corporate Finance had better margins in the quarter overall. So when we put that together, given the funding cost that we're looking at, basically LIBOR plus 285, I would expect the margin to be under some pressure on the consumer side and some light slight pressure on the commercial side. In terms of ratings, clearly our CDS is not reflective of our ratings level. I can't explain the CDS market to you. I think others will have to do that to America because I don't understand it but I think on ratings, we're happy that we have a good dialog with the agencies. We're happy with our A ratings from three. We're disappointed with our triple B rating from Moody's. B AA plus, I may have misstated that before. We're disappointed with that and what we think we have on do is prove our liquidity runway can continue to be extended and that we can make better utilization of the bank strategy that Jeff described. Hopefully I got all of that, Bruce.

Bruce Harbig - *Barclays Capital - Analyst*

Thank you, thank you very much.

Operator

Your next question comes from the line of Sameer Gokhale, please proceed.

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Sameer Gokhale - *Keefe Bruyette & Woods - Analyst*

Hi, good morning. Just a couple of questions, Jeff, I think you talked about potentially trying to become direct beneficiaries to some of the government actions and I'm assuming that means trying to in some way shape or form, become a bank holding company or financial holding company, and maybe you can refresh my memory but it seems like when Deutsche Bank owned a percentage of CIT this may have been an issue back then as to how they could retain a bank holding company status, depending on some of CIT's activities. If you can refresh us whether those rules have eased. Whether that's still true.

If you're planning to become a bank holding company or financial holding company and then just a quick question on pension liabilities for Joe. It seems like you have a net pension liability, maybe about $150 million. How should we think about that within the context of some of the changes to discount rates in discussions with your actuaries, just some thoughts that would be helpful.

Jeff Peek - *CIT Group - Chairman & CEO*

I'll take the first part. We are obsessively interested in the new government programs that have been put forth in the last two or three days and so we're spending a fair amount of time analyzing that to see exactly how that impacts our current position and where we could move from that and as we said back at the beginning of September, we really feel like our funding model obviously we got to move towards less reliance on capital markets, more reliance on other types of financing, including deposits. So what's happened in the last week or so, clearly facilitates that kind of analysis and that kind of thought.

To your specific question, as we look at that, three of our four commercial finance units could be accommodated within the depository, within the bank, and the fourth, which would probably be our operating lease business, Transportation Finance, certainly could be eligible to be a non bank subsidiary, financed off the corporate balance sheet or the holding company. So hope that's helpful, but as we said, the events of the last three or four days, we think underline some of the initiative we talked about in September and certainly accelerates our interest in exploring all aspects of that. And I'll pass it too for the pension accounts question.

Joe Leone - *CIT Group - Vice Chairman, CFO*

Just to add to what Jeff said, I was here under the Deutsche ownership period. I'm trying to scratch my head and remember what the constraints were and I don't remember any specific business constraints that were problematical. I clearly remember a lot of more financial reporting and clearly remember that acquisitions of regulatory approval of acquisitions was a required. So I don't remember any specific business restrictions. Clearly leasing and short-term leasing are activities that had been prohibit railroad not as positively viewed by the regulators, but as Jeff said, we would handle that through a non bank subsidy at the holding level in.

If terms of pension, I can answer your question generally, somebody reminded me that the other thing that we had is in rail we had used third party for maintenance of the rail cars and that was helpful from a regulatory point of view so we were not business of washing fixing and scrubbing. Just getting to the pension plan, I think that's a great question for all of corporate America in terms of what is going to happen in 2009. Clearly the performance of the plan has been negative in 2009. We've got a fairly robust process. Our pension plan is generally outperformed the industries. Having said that we have provided a little more expense in the third quarter as a result. We are anticipating as we look at our '09 plan that the expense rates would be higher but funding has generally been very limited over the last several years. Additional funding into the pension plan. I think what happens with the actuaries and the plan is we meet with the actuaries at the end of the year and get the assumptions for the coming year and I think I'll have a much more substantial deeper answer at next call.

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Sameer Gokhale - *Keefe Bruyette & Woods - Analyst*

That's really helpful. Thanks a lot, guys.

Operator

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

David Hochstim - *Buckingham Research Group - Analyst*

Good morning. In your review of what the FDIC is offering under the temporary liquidity guarantee program can you tell at this point if you became a financial holding company or a bank holding company if the existing debt at the holding company that's due at June 30th would be eligible for the guarantee when it's reissued?

Jeff Peek - *CIT Group - Chairman & CEO*

I think David we're doing some analysis on that. We obvious I have an FDIC insured bank charter, but we're not a bank holding company at this point nor a financial holding company and our analysis is what would be the route to that if we wanted to go that route and we're spending lot of time on that and have been to Washington to talk to people and that type of thing.

David Hochstim - *Buckingham Research Group - Analyst*

If you did make that change, would the debt that was in existence at September 30th, qualify under the plan, do you think?

Jeff Peek - *CIT Group - Chairman & CEO*

We would hope so.

David Hochstim - *Buckingham Research Group - Analyst*

Okay and maybe followup to what Joe was talking about with ratings. Can you just review with us what impact there is on existing debt or I guess secured financings from the rate further downgrades?

Joe Leone - *CIT Group - Vice Chairman, CFO*

Generally, the ratings triggers that we do have relate to below investment grade ratings and on our securitization, the one that comes to mind is if we have a below investment grade rating, there's a servicing transfer from CIT to a third party servicer. There's not calls or money that would be put back to us generally in the any of the debt indentures based on rate triggers.

David Hochstim - *Buckingham Research Group - Analyst*

One followup on debt repurchases, is there's some practical limit? Because it seems if you're buying debt at a big discount you're actually generating gains which reduces capital and reduces your liabilities - wouldn't you want to be doing that a lot more?

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Jeff Peek - *CIT Group - Chairman & CEO*

It's really a balance between near term liquidity and how far out we go in terms of repurchasing the debt. So far, we've restricted ourselves pretty much to six to 12 months probably closer to six months in advance. We haven't gone out in the future any farther than six months in terms of repurchasing. You'll see us back in the market repurchasing debt here quite quickly. Now that we're through our blackout periods.

David Hochstim - *Buckingham Research Group - Analyst*

Thanks.

Operator

Your next question comes from the line of Christopher Brendler with Stifel Nicolaus. Please proceed.

Christopher Brendler - *Stifel Nichoaus - Analyst*

Jeff, when you reported back in April, I think you mentioned that one of the rationales for doing that was take the real downside risk off of the table for potential bankruptcy and since then you've done the Goldman transaction. You sold mortgage portfolio, shrunk the balance sheet. Made a lot of progress but the market seems to think that you haven't made enough progress and you're outlook is pretty dire. What is the market missing about your outlook? What is the worst case scenario for funding? Moody's is telling us you're on watch but also saying you have liquidity through 2009. Is there a worst case scenario that we're missing or is the market just overestimating how bad it is for you right now and assuming you'll never get back into the financing markets and one other the followup - is there a potential for the Wells Fargo facility to be upsized at all?

Jeff Peek - *CIT Group - Chairman & CEO*

Sure, let me make a couple of comments, and Alex's being a relative newcomer to the situation, he's got some thought on this. First on the Wells' situation, I think as you know we have had a series of transactions with Wells. We have terrific respect in the institution. This transaction's a little different in its structure than the Goldman financing and so we wanted to start at $500 million and make sure we understood exactly how it was going to work and we were close to finalizing the documentation so we can actually start doing the loan. I think that would be our hope and their hope is that we could start at $500 and maybe go a little bit higher than that. I think your more general question is what's being missed? I think that the market doesn't know quite how to value the bottom of the liquidity crisis and our team I think has done -- thank you for your complements - has done an excellent job in generating liquidity over the last six months and I think that as all three of us said that's job one, our top priority we're managing for cash and not profitability unfortunately right now and I think the market probably doesn't see some of the alternatives as well as we do although we have great respect for the markets now obviously. Let me just toss it to Alex and I think may have a view on that.

Alex Mason - *CIT Group - President & CFO*

I think we all know the market tends to tar with the same brush and I think we do suffer from that at times. There's no question that the wholesale funding model has been under attack and it's been that I think that has effected the brokerages most significantly. We get mentioned in the same sentence with them quite often as a result of our wholesale funding model but we need to remember that our model looks very different from theirs. They're in the trading business.

They rely on overnight funding and the confidence in the markets everyday to be able to stay alive and we've seen that has undone some of the most prominent brokerages in the country. Our funding model is very different. We're not in the markets

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overnight. We're not in the commercial paper market. We're not doing the same kind of overnight funding that they have had to undertaking and I think as a result, our profile's very different. And I think we sleep at night, I think knowing that we have a 12 month runway. And that we really can keep the house in order over that time period. We remind, frankly, the rating agencies of that when we talk to them because eve the rating agencies as sophisticated as they are sometimes forget that our model does look very differently than others I know would say the same by the way for the banks who also do rely on the short-term markets much more than do we.

Christopher Brendler - *Stifel Nichoaus - Analyst*

One quick followup if I could. Any comment on the regulatory relationship? Is this FDIC and your regulator comfortable with your deposit growth and have you had any meaningful discussions on selling the company in light of all of pressures that are out there?

Alex Mason - *CIT Group - President & CFO*

Let me take the first. We've worked extremely closely with our regulator at our ILC in terms of mapping the growth of CIT bank and they are very comfortable with us. We talk to them all the time. We're growing that institution very quickly but we're growing it in a very ordered manner and we're growing it in fact arm and arm with the regulators. So I think I'm very comfortable from that prospective. Before I turn it back to Jeff on the larger question, I understand that in my remarks earlier, I was heard to say that trade credit losses were at 180 basis points. I thought I had said 108 basis points. I apologize for any confusion I may have caused. Jeff? To the larger question?

Jeff Peek - *CIT Group - Chairman & CEO*

Thanks for getting that one in before they closed the door on you. First I would say three things, first I think we're very oriented towards maximizing the value for the shareholders. It is certainly not a live free or die kind of attitude here. We're very practical about that type of thing. I think one of the reasons that we come to work everyday and struggle on the liquidity and try to build it up is on the asset side of our business, we see so many competitors falling by the way side that to the extend that we are successful in getting through these difficult times, we think there's terrific opportunity in the middle market going forward.

We feel like many of our competitors won't be there and the ones that are will have to be probably more targeted in their approach and at the large universal bank we've think the middle market won't be where we put all of their priorities. We feel there is upside at the end of this and we can be a player there. I think in this current environment, you are really not seeing whole company acquisitions, except on a supervisory-assisted basis, even though stock prices are at an almost generational low, you're not opening up the paper on Monday and seeing people buying whole companies except under duress. I think if these government agencies have their impact rapidly or more slowly, I think you'll see it turn quickly and I think you'll see consolidation and I think we'll be a player in that.

Christopher Brendler - *Stifel Nichoaus - Analyst*

Thanks.

Operator

Your next question comes from the line of Howard Shapiro with Fox-Pitt. Please proceed.

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Howard Shapiro - *Fox-Pitt - Analyst*

Hi, just a real brief question. Is there a time frame for returning the vendor business to profitability?

Alex Mason - *CIT Group - President & CFO*

I think I indicated in my remarks earlier that we're looking for that business to be substantially more profitable in 2009. I think we'll make progress to that effect in the fourth quarter.

Howard Shapiro - *Fox-Pitt - Analyst*

Okay, thanks.

Operator

Your next question comes from the line of Matt Burnell with Wachovia. Please proceed.

Matt Burnell - *Wachovia Securities - Analyst*

Good morning, thanks for taking my question and Joe, I appreciate the additional information in terms of liquidity you provided both on the Press Release and on the call. Most of my questions have been asked and answered but I guess I have one specific question and one bigger picture question . Can you give us an update on how you're thinking about the fixed charge coverage ratio going forward? You were just over 1.1 times at the end of the second quarter, obviously this quarter's loss would appear to put you under the 1.1 times minimum so just could you update us on your thoughts that and I guess may be a question for Jeff in a bigger picture sense. You just mentioned industry consolidation, clearly the banking industry is going to be consolidating. Can you give us your thoughts as to how you think about competing with those admittedly larger but better capitalizes institutions going forward, assuming you can get through 2009 with the funding plan you've got in

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Joe Leone - *CIT Group - Vice Chairman, CFO*

I'll start with the fixed charge coverage. That's a good question, Matt. Yes, clearly in the third quarter, we did not make the 1.1 fixed -- fixed charge coverage ratio. I guess we would remind you it's a rolling fourth quarter calculation. Number two. Built into it was a corrective mechanism so we could pay the dividends on the preferred. That requires us to issue equity to do that and I think some of the analysts have picked up fact that or have read into it that we're using the cash. We don't have the cash to pay the dividend and our thinking on that is obviously we have the cash and liquidity plan. Our thinking on that is we want to pay all of our obligations and paying the preferred hybrid shareholders their return has been an important objective of ours and we thought that was the greater good to keep all of the securities in the market current. We would continue to look at issue that way. Obviously that ends up being a board decision, not a management decision.

Jeff Peek - *CIT Group - Chairman & CEO*

We're running over time a little bit so I'll be brief in my response. I think we have an underdog mentality here at CIT. For the last 50, if not 70 years, we've been competing against the banks and the bigger banks and cost of funds is part of the equation in terms of how you get business. Relationships, speed of turn around. Personal knowledge of people also is quite important.

Right now, we're turning business away. Because we're one of the last people still in the marketplace and if there was ever a time when just being bigger was going to dominate how you get business it would be in a time like this and as I said, we have more business than we can write at this point based on liquidity. I think it's our focus. It's the only business we have. It's not one

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of seven or eight different delicatessens that we're running in a financial services supermarket. We can talk offline more but I think it's always been that way as far back as I ever heard at CIT it was always can they survive against the banks. Thanks for your question. I think we have time for one more. I know it's a busy morning for all of you.

Operator

Your next question comes from the line of Moshe Orenbuch with credit Suisse.

Jeff Peek - *CIT Group - Chairman & CEO*

Is that you?

Moshe Orenbuch - *Credit Suisse - Analyst*

That's me and I would say most of the things that I was thinking of asking have been asked and answered. You had mentioned the tax losses the mortgage portfolio, not yet being able to be realized. What factors would need to have to happen for them to be realized? Is it just generating taxable income and is there a time frame over which you might see that?

Joe Leone - *CIT Group - Vice Chairman, CFO*

Moshe, we need to generate taxable income in the right jurisdiction as well and that jurisdiction is the U.S. because that's where the mortgage losses were. So as we return vendor and Corporate Finance profitability, that sort of deferred or valuation reserve that we had set up that's significant, would begin to start being able to be recognize. So hopefully with some improvement in the environment in '09 and some improvement in our Vendor Finance restructure, we should be able to hopefully get to that at some point in '09 or whenever we turn to profitability in the U.S. It's not profitability overall my it's profitability in the US. For example, aerospace is very profitable but that doesn't help us.

Moshe Orenbuch - *Credit Suisse - Analyst*

Got it, thanks.

Jeff Peek - *CIT Group - Chairman & CEO*

All right, just want to thank you all for joining us again this morning. These are no doubt extremely challenging times and we continue to work for the benefit of all of our investors and stake holders. We will communicate with you and whenever we have something note worthy to share have a few parting thoughts. Just to leave with you our core commercial finance businesses are navigating the storm relatively well and retaining their value. As all of us have said in, liquidity, balance sheet management and credit risk, education, will remain our top priorities. We are appropriately capitalized a taxable equity ratio of over 9%. We will work very quickly to explore additional deposit taking initiatives and focus on the profitability of our commercial branch franchises.

I want to thank our employees for all of their dedication and hard work and our clients for working with us through this difficult period and all of our investors on the call for your belief in the value of the CIT franchise and I know that will be recognized and rewarded in the future. As always, Ken Brause and the Investor Relations team are available to answer any questions we did not get to today. Thank you very much.

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