WRAPUP 2-CIT talks fall apart, bankruptcy looms

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CIT Group Inc (CIT.N), a lender to hundreds of thousands of small and mid-sized U.S. businesses, said bailout talks with the government had ended, a development that could ultimately drive the company into bankruptcy.

Wednesday's announcement followed last-ditch talks in which Treasury officials had expressed concern about a worsening liquidity crunch at the 101-year old lender and indications that government aid would not put it on a path to recovery.

It also showed the possible limits of Washington's ability and willingness to rescue companies, after multiple bailouts engineered by Treasury, the Federal Reserve and the Federal Deposit Insurance Corp for larger companies such as American International Group Inc (AIG.N) and Citigroup Inc. (C.N)

"At least in the eyes of the Fed and the eyes of the Treasury, we've turned the corner, such that the systemic kinds of risks facing the economy may be well past," said Mike Knebel, a portfolio manager at Ferguson Wellman Capital Management in Portland, Oregon, which recently sold CIT bonds.

In a brief statement, New York-based CIT said "discussions with government agencies had ceased" and that "there is no appreciable likelihood of additional government support being provided over the near term," CIT said its management, directors and advisers were evaluating alternatives.

CNBC, citing a source close to the company, said CIT is now pursuing a plan that is likely to include a Chapter 11 filing on Friday.

On Wednesday night, CIT's representatives were trying to line up at least $2 billion in rescue financing from existing debtholders, the Wall Street Journal reported, citing people familiar with the matter.

CIT could not be immediately reached for comment on the reports.

A Treasury official said the talks ended after it became clear that CIT's liquidity had deteriorated too much, and the company had failed to show that it could raise private capital to stay solvent. A CIT bankruptcy, nonetheless, is not a foregone conclusion, the official told Reuters.

The Treasury Department also said there were limits to its ability to help troubled companies.

"Even during periods of financial stress, we believe that there is a very high threshold for exceptional government assistance to individual companies," it said in a statement.

CIT's travails were also a vexing problem for the Obama administration, which had to assess the risk of failing to bail out a large company whose collapse would, by itself, likely not pose a "systemic" risk to the financial system.

To read more stories on CIT, click [ID:nN15377144]

Tarp Money Not Enough

If CIT were to go bankrupt, it would join Lehman Brothers Holdings Inc (LEHMQ.PK) and Washington Mutual Inc (WAMUQ.PK) among large financial companies to collapse since the credit crisis accelerated last September.

Standard & Poor's said on Monday that a CIT bankruptcy was possible if no federal aid emerged.

CIT ended March with $75.7 billion of assets, making it roughly one-ninth as large as Lehman and one-fourth as large as Washington Mutual, whose banking units were bought by JPMorgan Chase & Co. (JPM.N).

Prior to a trading halt on Wednesday afternoon, CIT shares last traded at $1.65, up 4 cents. CIT's 5 percent notes maturing in 2015 traded around 60 cents on the dollar, yielding 16 percent, before the company's announcement, according to MarketAxess. The bonds could be worth less in bankruptcy.

Standard & Poor's 500 stock futures SPc1 were down 0.3 percent after-hours.

Founded in St. Louis in 1908, CIT boasts on its website that 1 million business customers depend on it for financing.

Many may now have to depend on someone else, at a time credit markets remain tight, reducing business activity as the government tries to lift the economy out of recession.

Failure to meet its obligations "would be a disaster" for small and mid-market borrowers that depend on CIT, said Eric Goodison, a partner at Paul, Weiss, Rifkind, Wharton & Garrison LLP in New York.

Published reports said many customers drew down credit lines in recent days as CIT's problems became widely known.

Steve Bartlett, chief executive of the Financial Services Roundtable, said in an interview that 10,000 small businesses could be choked off from needed funds if CIT failed.

FDIC Objects

CIT's problems mushroomed two years ago in the wake of Chief Executive Jeffrey Peek's decision earlier this decade to expand into subprime mortgages and student loans, both potentially highly profitable but fraught with added risk.

Peek's status at CIT remains uncertain. The company was not available for further immediate comment.

CIT sought new help even after winning bank holding company status in December so it could draw $2.33 billion of taxpayer money from the government's Troubled Asset Relief Program.

Treasury had been considering an aid package that could have included a temporary loan, access to the Fed's discount window, or asset transfers to CIT's banking unit, a person familiar with the matter said. The person requested anonymity because the talks were private.

FDIC Chairman Sheila Bair, whose office is already under strain as banks fail by the dozens, had been reluctant to let CIT issue government-guaranteed debt, believing that a program allowing such issuance was designed for healthy institutions.

"It would be a shame if there were political decisions being made that stem from turf warfare," said Marshall Front, chairman of Front Barnett Associates LLC in Chicago.

The FDIC declined to comment.

CIT faces some $10 billion of debt coming due in the year ending March 31, 2010.

"The government has to draw the line at some point," said James Barth, an economist at the Milken Institute.

"I don't think it's going to be a catastrophe or become another Lehman Brothers, given the FDIC's apparent concern about the quality of the assets."

Earlier on Wednesday, Barney Frank, chairman of the House Financial Services Committee, said he hoped the government would find aid for CIT. "If CIT doesn't get structured help, then it will have a very negative effect, I'm told, on small businesses around the country," he said in an interview. (Reporting by Jennifer Ablan, Paritosh Bansal, Tom Hals, Peter Henderson, David Lawder, Patrick Rucker, Walden Siew, Jonathan Spicer, Rachelle Younglai and Ajay Kamalakaran; Editing by Tim Dobbyn, Ted Kerr and Anshuman Daga)