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Securitizing Notes of Small Businesses and Needy Workers

EDITORIAL NOTE
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Businesses, whether large ones or small ones, such as restaurants and small shops, are presently closed and some of their employees have been laid off.[1] Currently, the government is lending money to these small businesses[2] and the now unemployed workers for their sustenance. It then collects the payments from some of the borrowers and the source of the rest of the money is taxes.[3] Since not all, or perhaps only a few, small businesses own real estate, they might sign notes promising to repay the loans but can offer no asset backing. Presumably, the nation's financial deficit is growing.[4] The government adds the aggregate of the loans to the country's costs and tax collection.[5]

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[1] *E.g.,* Andrew Bender, *COVID-19 Claims Nearly 73,000 US Businesses, with No End in Sight,* Forbes, July 29, 2020, *available at* https://www.forbes.com/sites/andrewbender/2020/07/29/covid-19-claims-nearly-73000-us-businesses-with-no-end-in-sight/#42442d75d73f (last visited July 31, 2020).

[2] Brianna McGurran & Kelly Anne Smith, *List of Coronavirus (COVID-19) Small Business Loan and Grant Programs,* Forbes, Apr. 10, 2020, *available at* https://www.forbes.com/sites/advisor/2020/04/10/list-of-coronavirus-covid-19-small-business-loan-and-grant-programs/#50b8d323cc4b (last visited July 31, 2020).

[3] *See* Kelly Anne Smith, *Congress Approved More Funding for the Paycheck Protection Program. Here's What You Need To Know,* Forbes , Apr. 22, 2020, available at https://www.forbes.com/sites/advisor/2020/04/22/the-senate-approved-more-funding-for-the-paycheck-protection-program-heres-what-you-need-to-know/#329f97304084 (noting that loans will be forgiven if certain requirements are met).

[4] Cong. Budget Office, *Monthly Budget Review for June 2020, available at* https://www.cbo.gov/publication/56458 (last visited July 31, 2020) (noting that estimated "federal budget deficit in June 2020 was $863 billion, compared with a deficit of $8 billion in the same month last year," due "economic disruption caused by the 2020 coronavirus pandemic" and "federal government's response to it").

[5] *E.g.,* Jeff Cox, *The Government Budget Deficit Is About to Explode to Fight the Coronavirus,* CNBC, Mar. 22, 2020, *available at* https://www.cnbc.com/2020/03/22/government-budget-deficit-is-about-to-explode-to-fight-the-coronavirus.html (last visited July 1, 2020).

1. Is there any other way in which some, if not all, of these loans could be financed by investors? An imperfect model that was tried and succeeded, for a while, to an extent, it was the securitization of mortgages.[6] The good and bad experiences of the mortgage securitization helped design a better securitization system for the notes of small businesses and employees.[7] To be sure, mortgages make a more solid backing than notes. In addition, although we have a long track record of recessions, and therefore we may have a good sense of what recovery looks like in the current case, we do not, and cannot, know what the aftermath of the coronavirus crisis would be like. It might cause a fundamental change to our economy and, as importantly, changes in people's habits.

2. The securitization of the notes is not similar to that of mortgages and to mutual funds holding notes. The comparison of securitization of the proposed notes to the securitization of mortgages or to pools (mutual funds) of corporations' notes is not precise. In fact, the first step of securitization was the pooling of notes, but they were offered by very large corporations.[8] In addition, there are currently mutual funds that hold small notes issued by corporations. They are fairly safe and help both parties.[9] Moreover, small business investment companies make equity and debt investments in small businesses,[10] and business development companies generally invest in debt of middle-market companies.[11] Small restaurants and other small businesses during the coronavirus era are different from mortgages during a market decline. Most small businesses do not own real estate but rather rent their offices and restaurants.

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[6] *See, e.g.,* Stephen L. Schwarcz, *The Future of Securitization,* 41 Conn. L. Rev. 1313 (2009) (identifying defects with use of securitization).

[7] *See* Bd. of Governors of the Fed. Reserve Sys., Report to the Congress on the Availability of Credit to Small Businesses (Sept. 2017), *available at* https://www.federalreserve.gov/publications/2017-september-availability-of-credit-to-small-businesses.htm (last visited July 31, 2020) (noting that "securitization of small business loans has the potential to substantially influence the availability of credit to small businesses" and "[p]otential benefits exist for lenders, borrowers, and investors"; "[h]owever, the obstacles to securitizing small business loans are large").

[8] *See What Is the Difference Between Factoring and Securitization?,* Companeo, *available at* https://www.companeo.co.uk/factoring/FAQ/difference-factoring-and-securitisation (last visited Aug. 3, 2020) (noting that securitization is "better suited to large companies"); *see generally* Tamar Frankel & Arthur B. Laby, The Regulation of Money Managers (Ann Taylor Schwing ed., 3d ed. 2015); Tamar Frankel, Securitization: Structured Financing, Financial Assets Pools, and Asset-Backed Securities (Ann Taylor Schwing ed., 2d ed. 2005).

[9] *See, e.g., Short-Term Debt Funds,* Coverfox.com, *available at* https://www.coverfox.com/personal-finance/mutual-funds/short-term-funds/#:~:text=What%20are%20short-term%20debt%20funds%3F%20A%20short-term%20debt,usually%20accompanied%20by%20stable%20returns%20and%20modest%20risks.

[10] U.S. Small Bus. Admin., *Apply to Be an SBIC, available at* https://www.sba.gov/partners/sbics/apply-be-sbic#section-header-0 (last visited Aug. 4, 2020).

[11] FS Investments, *Business Development Company (BDC), available at* https://fsinvestments.com/education/bdc/ (last visited Aug. 4, 2020); Andrew Weinberg, *Private Equity Will Show Its True Colors in the Covid-19 Recovery,* Forbes, July 8, 2020, *available at* https://www.forbes.com/sites/andrewweinberg/2020/07/08/private-equity-will-show-its-true-colors-in-the-covid-19-recovery/#2a4a61bc59ed (defining "middle-market" as firms with annual revenues of $25 million to $1 billion).

The notes they issue are of relatively small amounts. These small businesses may not reopen even after the virus is overcome. Small restaurants may already have outstanding loans. Customers might acquire the habit of ordering cooked food, or the habit, and perhaps, the pleasure of cooking at home. Supported employees might not return to work for health, age, or other reasons. In summation, the borrowers' note-obligations are fairly risky.

3. Would health recovery bring about the same businesses to full life? Not necessarily. Restaurants may have to share their business with the rising food and cooking suppliers and services. Besides, people may have changed their habit of meeting in restaurants.[12] Habits take time to form, but once they do, they take time to change or revert to old habits. History has demonstrated a similar result. Before cars took over and substituted horses and buggies, the "buggy whip" was necessary and highly used for transportation. When carts were substituted by cars, the industry that produced the "buggy whip" was gone.

4. In sum, the risk associated with loans to small businesses is different from the risks of loans in a traditional recession. To be sure, the government could substitute its direct lending by insuring some of the risk associated with the notes portfolio. That would give lending banks a measure of comfort that if a wave of bankruptcies occurred as a result of these general economic and habitual changes, they would not get caught holding all or most of the bad notes. Another possible support is the government's guarantee of bank losses, but some of the notes will support not only the banks' business, but also the small business.

5. What are the benefits in pooling such small notes and selling participations in the pool to investors? Why would investors buy such participations?

a. The Treasury may help. Let the Treasury give a discount from taxes to such investments. For some investors this might be sufficiently attractive to cover the risk of failures to pay the notes. The benefits of securitizing these notes are numerous for many participants as well as for the country.

b. The notes-issuers will not be worse off, except that they might be subject to bankruptcy rules rather than viewing their obligations as fully enforceable. There is some justification for this reaction; yet, the law may offer the borrowers in this case some relaxation as relief, and if the issuers go through banks, the government may allow

[12] *See, e.g.,* Heather Lalley, *How Will the COVID-19 Crisis Change Consumer Dining Behavior?,* Restaurant Bus. Online, Apr. 10, 2020, *available at* https://www.restaurantbusinessonline.com/consumer-trends/how-will-covid-19-crisis-change-consumer-dining-behavior (last visited Aug. 3, 2020) (citing poll data suggesting that consumers may have adopted long-term changes in restaurant dining behavior).

banks the type of relaxation that would help the borrowers. No law is necessary for these rules, because the Treasury may have the authority to offer it, provided it is offered to all banks in the same position. In fact, currently, banks have some discretion to relax their requirements with respect to any borrower. That is, although banks ordinarily are reluctant to lend to borrowers that are close to bankruptcy, they may set different criteria for this type of borrower.

c. Investors may be somewhat worse off as compared to lending to other businesses. However: (i) their investments are not a donation; (ii) the investment should be given public recognition that it deserves; (iii) the successful revival of any supported business should be publicized; (iv) the recipients of the money may be given a platform to thank the anonymous buyers of the securitized notes. Pictures may show the opened restaurants, and, if they so wish, their owners and workers. These are not and should not be financial rewards. Yet, they are valued more than any monetary rewards. The satisfaction of helping while risking some of one's money may balance the risk.

d. However, the donors' names, whether personal or incorporated or in groups, should not be publicized. If pressure to publicize is great, then it would be allowed only if the donees' group-members are joined. In sum, business and finance need not be drained of all humanity and satisfaction of sharing.

e. In addition, banks should institute appropriate safeguards. The bank should be responsible for the quality of the manager of the pool. Moreover, the cost of the pool should not be charged to any other mutual fund or pool.

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