

# A significant court ruling against US SEC financial regulation

Nick Beams  
11 June 2024

Attempts by the head of the Securities and Exchange Commission, Gary Gensler, to introduce some regulations covering the fast-growing private equity market suffered a major blow last week when a Federal Court in New Orleans unanimously threw out the proposed measures.

The decision has far-reaching implications for further efforts by the SEC to regulate this area of the financial system which has been identified by the International Monetary Fund and other bodies as a potential source of financial instability.

In the past decade, in response to low interest rates, the private equity market has expanded at a rapid rate as finance capital has sought to find new ways of accumulating profit, and pension funds and others have sought to obtain a better return on their assets. The size of the market is estimated to have topped \$2.1 trillion at the end of last year, up from \$1.4 trillion at the end of 2022 and \$875 billion in 2020, and is expected to reach \$2.3 trillion in 2027.

The new SEC rules would have required private equity firms and hedge funds to be more transparent by issuing quarterly financial statements detailing their performance and expenses as well as undergoing annual audits.

The measures would have also cut across the practice of offering preferential side deals to high profile investors at the expense of smaller ones.

The attempted SEC regulation aroused the immediate ire of the private funds which have long enjoyed so-called “light touch regulation,” that is, virtually no oversight at all. After failing to push back the changes, they launched legal action last September and decided to take it to New Orleans where they considered they had a better chance of success.

The case was another demonstration of the incestuous

character of the American political, judicial and financial system.

Their legal brief was prepared by Eugene Scalia, who served as labor secretary in the Trump administration and is the son of the late Supreme Court Justice Antonin Scalia. Scalia senior, as the World Social Web Site explained in an obituary, was notorious for his judgements which proceeded from a predetermined outcome and then battered the law into shape. He declared in his judgement in the 5-4 Supreme Court 2000 decision to halt vote counting in Florida that “there is no universal right of suffrage.”

The son, of course, is not the father but as the saying goes the apple does not fall far from the tree and Scalia junior has built his legal career by challenging government attempts to regulate business.

The SEC based its legal case on provisions of the Dodd-Frank Act, introduced after the 2008 financial crisis to impose new regulations on banks and finance. It was required to “facilitate the provision of simple and clear disclosures to investors” and “promulgate rules prohibiting of restricting certain sales practices, conflicts of interest and compensation schemes.”

The SEC argued that private funds now play an increasingly important role for pension funds, seeking higher returns on their assets comprising the retirement funds of millions of Americans. Support for this argument was provided by some of these funds which said in a court filing that they “simply do not have the resources to match those of the advisers with which they invest.”

In its three to zero decision, the Fifth Circuit Court of Appeals not only rejected SEC claims that the Dodd-Frank Act had given it the necessary power to intervene, but also that it had failed to link the new rules to its fraud-prevention powers.

The representatives of the private equity funds crowded from the rooftops in delight over the court's ruling.

"Today's ruling is a significant victory for markets, fund managers, and investors," said Bryan Corbett, president of the Managed Funds Association, when the decision was announced last Wednesday. "Unfortunately, this is just one instance of SEC overreach as it looks to push through the most aggressive agenda in decades."

Drew Maloney, the president of the American Investment Council, sang from the same song sheet.

"The court has sent Washington regulators a strong message that they cannot bypass Congress when pushing their extreme agenda."

In fact, the proposed regulations were relatively mild, and their main thrust was to provide increased disclosure. As far as the fast-growing private equity industry is concerned such measures are "extreme."

The decision, which may be appealed by the SEC to the Supreme Court but with little chance of success, has far reaching implications. The regulator has been considering other rules, particularly concerning the issue of financial stability, but they have now been placed in considerable doubt.

Last April in its *Global Financial Stability Report*, the IMF warned that there were significant risks in the migration of large amounts of lending from regulated banks and more transparent public markets to less regulated markets and into the more opaque world of private credit.

Summing up the findings in a blog post, it said: "Valuation is infrequent, credit quality isn't always clear or easy to assess and it's hard to understand how systemic risks may be building given the less than clear interconnections between private credit funds, private equity firms, commercial banks, and investors."

The IMF warned that while these vulnerabilities did not pose a risk to the financial system at present, the situation could change and "in a severe downturn, credit quality could deteriorate sharply."

This assessment is based on experience, most notably in the crisis of 2008 and again in March 2020 when the \$26 trillion Treasury market froze. The financial system had to be bailed out by the Federal Reserve to the tune of \$4 trillion.

In its recommendations for action, the IMF said it

was "imperative to adopt a more vigilant regulatory and supervisory approach" regarding private credit "focusing on monitoring and risk management, leverage, interconnectedness, and concentration of exposures."

However, as the latest court decision against the SEC makes clear, attempts to exercise even a modicum of control have run headlong into the obstacles of private property and a judicial system geared to defend its interests.



To contact the WSWS and the Socialist Equality Party visit:

**[wsws.org/contact](https://wsws.org/contact)**