Ultrastability in Private Debt: A Regulatory System With Balance and Control

Jonathan Willoughby
Faculty of Law, Liverpool John Moores University
j.willoughby@2023.ljmu.ac.uk

1. Introduction

Private debt arose from the ashes of the Great Financial Crisis ("GFC") in 2010 due to the cretinous regulation imposed upon commercial banks. (Bavoso, 2023) Industry experts are calling for research (Noonan, 2024) into this segment of the market that is opaque by its very nature, with ill-informed opinions in academia calling for more regulation amid incitement of fear. (Ulgen, 2021) Despite this, the private debt sector has continued to perform admirably via self-regulation, (Ng, 2024) whilst the banking sector bounces from one crisis to the other. (Huang, 2025) However, in late 2025, two private debt funds collapsed, Tricolour and First Brands. (Bhatia, 2025) This has led to renewed calls for bank like regulation to be imposed upon the private debt sector. (House of Lords, 2026) Bank like regulation is not a panacea for creating stability within the financial sector, as can be seen from collapses such as Silicon Valley Bank, Credit Suisse and the LDI Crisis. One of the constants within these crises, all causally divergent and in different jurisdictions, with similar bank like regulatory environments, was the inaction of the regulators. (OIG Report, 2023, FINMA, 2023, House of Commons Report, 2023) It is apparent from these events that imposing bank like regulation on a lightly regulated sector such as private debt is not the solution to achieve ultrastability via balance and control. During these negative collapses, it was revealed that the regulators received early warnings years in advance of the actual event that there were issues with their respective institutions. It has since been claimed that the regulators do not have enough substance within a legal framework to either recognise an early warning, not act upon it and enforce any authority they may have. (ESMA, 2025) Additionally, these events have made the recognition public, that supervisory regulation views risk differently than do other professional bodies. The Pension Regulator ("TPR") in the UK believed it was acceptable for any defined benefit pension plan to have 3 x leverage on their assets leading up to the LDI Crisis. It is necessary to define parameters for what is acceptable risk when dealing with risk produced by private debt, especially the financial instruments being investigated in this research, namely, collateralised loan obligations ('CLOs'), Business Development Companies ('BDCs") and Direct Lending Funds ('DLFs'). To accomplish this, an evolutionary game model is employed to examine the dynamic interaction between financial institutions and regulators within the innovation-regulation relationship to provide financial control, balance and ultrastability. (An, 2021) These steps, when combined will provide a legal framework enabling the collection of real-time data, with an early warning system implemented within the regulators via the Viable System Model (Beer, 1981) and a risk analysis model via evolutionary game theory to alert the system when a fund has breached the pre-determined parameters of acceptable risk.

1.1 Research Questions

1. Why is current bank-like regulation not suitable for private debt?
2. How do deficiencies in the legal structure of regulators affect their ability to be proactive to a crisis?
3. Will an early warning system built into a regulatory body / system be beneficial?
4. Can a risk-analysis model be developed that will allow for real-time data analysis to prevent financial crisis in private debt funds?
5. What kind of legal structure will be required to accomplish this?

2. Literature Review

Corporate debt finance has evolved over the quarter of a century. (Ferran, 2023) As innovation in financing has increased, so too has the role of corporate debt in financing decisions. This has been mostly driven by the misinformed post-GFC regulation (Basel III, Dodd-Frank Act 2010), resulting in a blurred environment of financing providers, both traditional and non-traditional. (Martin and Sayrak, 2022) The development of a primary and secondary market for these term-loans assists debtholders in reducing their exposure to risk. Indentures utilising unique legal structures assist in this risk diversification, along with dynamic pricing strategies, mean that debtholders employ diversified strategies to provide finance to borrowers. It is the alleged interconnectedness of the apparent bi-furcation of corporate financing and the opaqueness of who is actually funding the rise of private debt (FSB, 2021) that has led to calls for bank-like regulation to be imposed upon private debt. (FT Article, 2024)

Post-GFC, private debt has grown from $200bn AUM to be an estimated $4.5tn AUM by 2030. (Blackrock, 2025) The amount of growth and the speed it has happened has further created insistence that private debt is the next great financial disaster to occur. (Lever et al, 2021) What has transpired in the intervening years, is that traditional institutions have collapsed and the situations were exacerbated by the post-GFC regulation. These incidents highlighted a common thread amongst regulators. They were not prepared for these events unfolding, nor could they see them developing and once they did develop, the regulators could do nothing about them. (BofE, 2023; OIG, 2023; BAFIM, 2023) Three core issues were illustrated in the events concerning the LDI crisis and the collapse of SVB and Credit Suisse. First, there was no early warning system within the regulatory bodies that would have alerted them to any potential dangers. Second, the regulators did not recognise any risk and allowed the conduct of their member institutions to continue until failure occurred. (OIG, 2023) Third, there is no legal framework which supports the activities of the regulators to be proactive, nor to sanction responsible parties for their part in causing an event or not taking remedial action once an event has been recognised. (ESMA, 2023) Should regulation be imposed upon private debt, then it should attend to these three challenges. For an early warning within an organisation such as a regulator, an answer can be discovered in the science of Cybernetics, particularly within the operational management structure of the Viable System Model ("VSM"). (Beer, 1981) This model allows an organisation to be structured with balance and stability in mind, essential components for any regulatory system. System 4 of the model interacts with the outside world; it is dynamic and a call to action. (Beer, 1981) It will recognise when the risk parameters of a private debt fund have been breached and will be a call to action, unlike the regulators in the above events. The regulators require a tool that works in real-time without any lag. It would calculate risk and would be the first stage in alerting the system 4 early warning system of the VSM. The boundaries for what constitute risk would be modelled from the work already completed (An et al, 2021) and would enable regulators to determine in real time, any increase in risk that could threaten the balance, control and ultrastability of the sector. Lastly, there would need to be a legal framework that coerced funds to provide information to regulators to use in the risk-analysis models and to sanction responsible parties should they exceed these parameters. (Austin, 1832) Law must be an institutional design, with adaptive statutory mandates, legal intervention triggers and learning obligations.

3. Aims and Objectives

The intended purpose of this research is to determine whether it would be preferrable to leave private debt as a self-regulatory system or to introduce the correct regulatory reforms onto it. If the latter is preferrable, then it must be a regulatory system that differs from the traditional bank-like regulation. Another objective would be to develop a range of tools to assist regulators in their task, thereby enabling regulators to perform the function they are designed to perform. This can be achieved by recognising the traditional form of regulation is not adaptable to private debt which is innovative and dynamic and developing a suite of tools for the benefit of both the regulators and the financial institutions they regulate. The central goal is to suggest a regulatory system that is provides ultrastability, control and balance. To have intrinsic controls that are dynamic and employ negative feedback loops to continuously learn and adapt to everchanging dynamic environments. Another objective is to utilise effective models and apply them to unique situations so that the private debt sector can maintain its autonomy and dynamism without being restricted and constrained similar to the banks post-GFC. This research will lead to further research from a socio-legal perspective regarding who the investors are in private debt, namely banks, insurance companies and pension funds. If we get this regulation wrong and the private debt sector suffers substantial losses, the effect upon society will be devastating. Private debt finances companies who employ 7 in 10 of all working people. If this sector collapses, employment, the ability to bank and earn money will be jeopardised, everyone's pensions may also be in danger. The University has a desire to help societies at home and around the world benefit from unique research that is produced at Liverpool john Moores University. The socio-legal aspects of this research fit that ambition.

4. Justification of the Research

This research offers a unique approach to the problem of financial regulation as opposed to the traditional solution of just more regulation. It provides an examination of when bank-like regulation has not performed as desired or expected and offers an alternative solution by addressing the failings of the traditional methods. The research will be essential to developing ultrastability of the private debt sector and can be expanded into the larger financial system via regression. By employing an inter-disciplinary approach to this research, it is hoped that the research will be robust and challenge the consensus whilst promoting the legal framework as the most essential factor in assisting regulators in performing the role successfully. It will also enable private debt funds to continue to be dynamic and innovate whilst ensuring they do not take any unnecessary risks and cause a financial crisis which will affect the whole of our society on many levels. This research aims to strike a balance between what a regulator can do (regulate or de-regulate) and what a financial institutional can do (innovate or conserve) to provide for a stable and balanced private debt sector.

5. References

An, H. and others, (2021) An Evolutionary Game Theory Model for the Inter-Relationships between Financial Regulation and Financial Innovation, *The North American Journal of Economics and Finance,* pp.1-15.

Austin, J. (1832) The Province of Jurisprudence Determined. John Murray.

Basel Committee on Banking Supervision, (2019) *The Basel Framework* <https://www.bis.org/basel_framework/> accessed 25 October 2024.

Beer, S. (1981) Brain of the Firm. Wiley and Sons.

Bhatia, A. (2025) Lessons from First Brands and Tricolor <https://www.nb.com/en/global/insights/article-lessons-from-first-brands-and-tricolor> accessed 10 January 2026.

Board of Governors of the Federal Reserve System, (2023) Material Loss Review of Silicon Valley Bank, *Office of Inspector General Evaluation Report*, 2023-SR-B-013.

Bovaso, V. (2023) Rethinking Banks and Banking Regulation in the Age of Financial Instability. *Law and Financial Markets Review*, 17, 306

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) Codified at 15 U.S.C. § 78o.

ESMA (2025) ESMA Welcomes Commission's Ambitious Proposal on Market Integration <https://www.esma.europa.eu/press-news/esma-news/esma-welcomes-commissions-ambitious-proposal-market-integration> accessed 12 January 2026.

Ferran, E., Howell, E. and Steffek, F. (2023) Principles of Corporate Finance Law. Third edition, Oxford University Press.

Financial Stability Board, (2021) Global Monitoring Report on Non-Bank Financial Intermediation

FINMA, (2023) FINMA Publishes Report and Lessons Learned from the Credit Suisse Crisis (*Eidgenössische Finanzmarktaufsicht FINMA*) <https://www.finma.ch/en/news/2023/12/20231219-mm-cs-bericht/> accessed 4 June 2025.

Gaw, K. (2025) BlackRock Predicts Private Credit AUM Will Reach $4.5tn by 2030. *Alternative Credit Investor*, <https://alternativecreditinvestor.com/2025/04/07/blackrock-predicts-private-credit-aum-will-reach-4-5tn-by-2030/> accessed 25 April 2025.

Huang, C-S. and Charteris, A. (2025) Shockwaves across Borders: Did the 2023 Banking Crisis Reshape Global Banking Sector Linkages? *Science Direct Finance Research Letters*, 82, pp.1-10

Martin, J. and Sayrak, A. (2022) Collateralized Loan Obligations: A Primer. *Journal of Applied Corporate Finance* 34, (3), pp.35-51.

Ng, L. (2024) Private Credit: Exploring Systemic Risk Concerns and Regulatory Architecture. *Butterworths Journal of International Banking and Financial Law*, pp.507-509

Noonan, L. (2023) Bank of England Warns about Risks in Private Credit and Leveraged Lending <https://www.ft.com/content/def3be28-dc2e-4d81-9a2e-84d621e12279> accessed 3 December 2025.

Noonan, l. (2024) Bank of England Deputy Governor Calls for More Research into Non-Bank Lenders <https://www.ft.com/content/8e7ad06b-2f3f-4f55-b894-1382f9727e47?accessToken=zwAGElwTrNz4kdOOetBrLz9PVdO4lBOC-XJ-Rw.MEUCIQDBv7UJoGRynZa6Lo9oJvI9MnblLy9WPZySrEzz8cJ79QIgE6psWvjfc6Qcg2vauO67vqsS68wKsmRQK64jZv4ErIk&sharetype=gift&token=a2321513-b9d5-4798-adb1-b05a81c508f8> accessed 27 February 2024.

Pinter, G. (2023) An anatomy of the 2022 gilt market crisis*, Bank of England Staff Working Paper No. 1,019*, pp1-95.

The Financial Services Regulation Committee, (2026) Private Markets: Unknown Unknowns, *House of Lords*, HL Paper 235, pp.1-63.

Ülgen, F (2021) Financial Regulation: From Commodification to Public Action, *Journal of Economic Issues*, 55:2, pp.531-538