Building Societies Association

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Author: Ruth Doubleday

Response to the HMT consultation on the treatment of covered bonds

About the Building Societies Association

The Building Societies Association (BSA) represents all 42 UK building societies, including both mutual-owned banks, as well as 7 of the largest credit unions. Building societies and mutual-owned banks have total assets of almost £650 billion. They hold residential mortgages of over £485 billion, 29% of the total outstanding in the UK. They are also helping 23 million people build their financial resilience, holding over £485 billion of retail deposits, accounting for 23% of all such deposits in the UK. Building societies and mutual-owned banks account for 47% of all cash ISA balances. With all their headquarters outside London, building societies employ around 52,300 full and part-time staff. In addition to digital services, they operate through approximately 1,300 branches, holding a 30% share of branches across the UK.

BSA response

The BSA supports all of the proposals in HMT's 'Applying the Financial Services and Markets Act 2000 model of regulation to the UK Capital Requirements Regulation' consultation document published on 15th July as part of the Chancellor's Leeds reforms package. We welcome approaches that are flexible and dynamic for the future which do not create unnecessary friction or cliff edges thereby supporting the smooth functioning of the markets.

Basel 3.1 timing

For Basel 3.1, we support the delayed implementation of the market risk framework til January 2028. We support this on the grounds that this allows the PRA more capacity to implement the other components of Basel 3.1 and the Strong and Simple SDDT regime in parallel on 1 January 2027. This is important to allow smaller firms to transition to a more proportionate framework at the earliest opportunity such that they are not de-prioritised in favour of larger more complex firms with more diversified balance sheets including trading books. These larger firms will also benefit from the earlier implementation of the other components, and this proposed approach therefore supports a more level playing field between smaller and larger firms.

Treatment of covered bonds & Prudential Overseas Recognition Regimes

The BSA supports the proposals to use the new Overseas Prudential Requirements Regime to designate certain jurisdictions as equivalent to allow for the preferential treatment of holdings of non-UK covered bonds for capital and liquidity purposes i.e. such that holdings of non-UK covered bonds are treated in the same way as UK covered bonds.

We agree that it is important to ensure that any designation does not create cliff edges in the treatment of non-UK covered bonds issued prior to any equivalence designation. We also agree that it is essential that the regime is flexible and does not create unnecessary and unhelpful friction into the market and hence reduce the liquidity of covered bonds in any way. This can relate to the liquidity of holdings of non-UK covered bonds, but it can also impact UK covered bonds where they are issued to holders in other jurisdictions if there are any reciprocal equivalence determinations to be made by other jurisdictions on the UK.

Building society use of covered bonds

Building societies are constrained by the limits set by the PRA under the Building Societies sourcebook SS20/15.[1] As set out in appendix 4 of that document, only societies on the extended or comprehensive treasury approach are permitted to hold covered bonds. This means that at the current time only the larger /mid-tier building societies are active investors in covered bonds. This may gradually change over time given the proposals in CP11/25 to retire the treasury approaches in SS20/15, thereby allowing societies to set their own risk appetite and limits and enabling greater choice and flexibility to manage their treasury and balance sheet risks.

Mid-tier societies are active investors in UK and non-UK covered bonds in major jurisdictions and major currencies. While actual holdings may vary over time and between societies, these can be significant, and provide opportunities to diversify liquidity. The ability to buy non-UK covered bonds also offers a degree of diversification away from the UK housing market, and any potential correlation risk of UK banks/building societies only purchasing each other's debt.

Larger building societies are also active in issuing covered bonds, primarily in GBP but also in other non-UK major currencies. Given the Government's agenda to grow the mutuals and cooperatives sector, it is important to foster reciprocal funding opportunities across markets. Non-UK investors in building society issuance can be significant, so its important not to hamper wholesale funding plans that support growth.

The BSA has previously made representations to the PRA to maintain the existing approach that recognises these non-UK covered bond assets are at least treated as level 2A HQLA for the purpose of calculating the Liquidity coverage ratio (LCR) or better still, Level 1. The announcement in April, despite its subsequent withdrawal, created uncertainty and disruption, that should in future always be avoided. As such, the joint HMT and PRA consultation process is very welcome.

Consultation questions

Question 1: Which jurisdictions do respondents consider to have the most material and liquid covered bond markets?

As mentioned above, the BSA considers all major jurisdictions to be important for covered bonds both in terms of issuance and investors. This also supports the widening of covered bonds markets in general. We would encourage any equivalence work to prioritise all EU member states, plus Australia, Canada and Singapore.

Question 2. What are the activities in which UK banks engage that would be facilitated by recognition of covered bonds from appropriate overseas jurisdictions?

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[1] See SS20/15

BSA members issue Sterling, Euro and Dollar-denominated covered bonds to global investors. They also invest in covered bonds in a range of jurisdictions and currencies as set out in our answer to question 1. Such issuance supports funding of the UK housing market which is a government priority as well as the government's objective to double the mutuals sector. The ability to invest in non-UK covered bonds allows firms to diversify their holdings beyond the UK economy while still being protected by a strong covered bond framework with the majority of bonds rated AAA.