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Response to CP2/25 leverage ratio threshold

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 have total assets of almost £525 billion and, together with their subsidiaries, hold residential mortgages of over £395 billion, 24% of the total outstanding in the UK. They also hold £399 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 40% 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.

Executive summary

The BSA is supportive of any increase in the threshold for the application of the leverage ratio framework compared to the alternative of leaving the threshold the same. However, we believe the threshold should be raised further as well as the PRA conducting a first principles review of whether the leverage ratio framework, including leverage ratio buffers, is an appropriate policy at all for low risk mutuals, where other structural features act to limit excessive growth and model risk. We believe this is an example of a policy designed and calibrated by the Basel Committee for internationally-active banks, then being applied to the mutuals model without proper consideration of its appropriateness or calibration. As a minimum, we believe this threshold should be equivalent to £105bn lending to align with the threshold for participation in the PRA's bank capital stress test. We believe that a framework with fewer simpler thresholds is better than one with multiple different ones. While we understand that the PRA will take multiple factors into consideration when deciding on thresholds, we do not see value in the thresholds themselves being calibrated differently which adds unnecessary complexity to the framework.

The BSA believes it is important to start this discussion with considering the purpose and policy intent of the leverage ratio component of the Basel framework, including its interactions with other requirements. When layered together, building societies are excessively constrained by the combination of hybrid IRB model adjustments, Basel 3.1, the IRB floor, leverage ratio, various buffers and MREL. We do not believe that the Basel Committee was considering the impact on low-risk UK domestic IRB building societies when it was calibrating the international capital framework, and we believe it is inappropriate to adopt a one-size-fits-all approach in this way.

We would like to also comment on the PRA's approach to thresholds more broadly. As commented in our responses to previous recent consultations we would like to repeat the following points:

- The reviews of thresholds should be holistic and re-consider whether the previous threshold needs updating for reasons other than inflation. As such, the review should not assume that the previous threshold was necessarily

correct at the point when it was set or that it remains appropriate given the world has changed
- The PRA should set out a framework for future increases to thresholds, such as a set of principles
- The PRA should commit to regular reviews of thresholds e.g. every 2-3years to help aid predictability and planning

FSMA requires the PRA to have regards to the impact of its policies on mutuals. A diverse range of financial services firms is beneficial for financial stability and, coupled with the Government's stated objective of doubling the size of the mutuals sector, we believe that this should be factored into the thresholds for the application of the leverage ratio framework which is a particularly harsh constraint on the building society low-risk monoline mortgage model.

PRA approach to regulatory thresholds

CP2/25 notes that the leverage ratio threshold has been increased in line with nominal GDP growth rather than inflation. While we welcome the PRA taking a broader view than purely adjusting for inflation, we feel that a better approach might be to consider all the thresholds within the UK system and consider whether they remain appropriate in light of any significant changes to the impact of any firm on the PRA's statutory objectives, including secondary competitiveness and growth objectives and also the need to have regards to the impact on mutuals. As such, the first question is whether the same or a different approach is needed for low-risk mutuals. Secondly, thresholds based on market share might be more appropriate, as is the case for the application of the stress testing framework, which was recently updated to a threshold of 5% of aggregate lending. As a point of detail, we note that the proposals include a significant time lag from the period of GDP growth assessed vs the period when any increase might take effect.[1]

BSA members take a 3-5 year view for planning purposes. This means that even societies that are not particularly close to the threshold at a point in time, will need to consider the anticipated level of the threshold over a 3-5 year period when considering their growth plans. As such, thresholds have a very direct impact on growth. This is particularly relevant at this juncture when the government is promoting growth of the mutual model, and has set policies to increase house building and home ownership. Lending to first-time buyers is the very reason that building societies were set up 250 years ago, and a driver of economic growth. So, in this context, we encourage the PRA to consider specifically the impact of thresholds, and the leverage ratio in particular, given its acute impact on the building society business model over the longer term.

Finally, BSA members would prefer to have a consistent approach with fewer thresholds overall. While this could create a bigger cliff edge affect when crossing a threshold, this could be managed with a transition period, such as that available for firms entering MREL and/or a reduction in the applicable buffers when a firm first crosses the threshold, giving time to build up buffers without this being viewed negatively by market participants.

[1] The PRA references GDP growth up until Q2 2024, but the new threshold won't come in until 2026, so it will already be out of date.

Scope of application and purpose of the leverage ratio

The scope of the Basel framework is 'internationally active banks.' While this is an undefined term, the Basel Committee's Regulatory Consistency Programme (RCAP) which assesses Basel Committee member's compliance with the framework can be used as an indicator of which banks or building societies should be within scope of the UK implementation, in order to be compliant with the framework. The RCAP has covered the UK as part of its assessment of the EU implementation previously, and data was provided to support those reviews only for Barclays, HSBC, Lloyds Banking Group, Royal Bank of Scotland and Standard Chartered.[2]

The purpose of the leverage ratio, as quoted in CP2/25 is as follows:

"Its objective is to guard against – as a backstop measure – the risk of errors and uncertainties in assigning risk weights. It can also limit excessive balance sheet growth or act as a constraint to such excess before it occurs."

On both of these counts, the BSA would argue that there are specific considerations for mutually-owned building societies that need to be factored into the consideration of the policy objectives of the leverage ratio.

Firstly, the risk of modelling errors can exist with any model. However, this risk increases when there are fewer data points and/or shorter time periods and fewer past downturns. Mortgage models have existed for many years, and while actual losses are low on a mortgage portfolio, BSA members have data on mortgage losses dating back to the 1990s i.e. through several economic crises. We believe that all the other layers of conservatism e.g. hybrid model adjustments, the IRB floor, and prospective Basel 3.1 output floors collectively provide very robust additional conservatism. Therefore, we do not agree that mortgage models are at a significant risk of under-calibration compared with other portfolios. We also note the improvements in lending standards post Mortgage Market Review which have led to lower arrears levels through the recent COVID and cost-of-living crises.

In terms of the second purpose of the leverage ratio, there are three points to raise here. Mutuals are restricted in their growth due to their inability to raise capital as they cannot issue common shares. They can issue instruments such as CCDS but these are more limited overall. Secondly, building societies are constrained by the nature limits in the Building Societies Act. They must stick to their principal purpose of gathering retail deposits and offering loans on residential property. This constrains the types of products they can offer, how fast they can grow and the risk of excess leverage occurring. Finally, building societies do not have external shareholders. So, the incentives to leverage rapidly do not exist in the same way as they might for a challenger bank funded by venture capital. Building societies have existed for 250 years and that gives sufficient data to compare their rate of growth compared to banks. We request that the PRA looks again at the risk of excessive growth for this sector based on the historical evidence when compared to banks.

The PRA is saying that the leverage ratio should be a backstop, however, for building societies captured by the UK's leverage ratio framework, including the leverage ratio buffers, it is a frontstop. Its calibration when compared to the risk-weighted approach for a low-risk mortgage lender is likely to almost always be the binding

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[2] See list of banks in [Annex 12 of RCAP assessment of EU] which included Barclays, HSBC, Lloyds, Royal Bank of Scotland and Standard Chartered.

constraint. We show this in our analysis below. The PRA should ask itself what it means to be a backstop? Does it mean that the policy intent is that it should be binding some of the time, for example if the firm is growing too fast? Or is it appropriate that it applies all of the time for lower risk business models like building societies?

Impact on growth and the mutuals landscape

The cost-benefit-analysis (CBA) in paragraph 2.22 of CP2/25 states "no direct costs have been identified for firms."

The PRA appears to have looked at the costs in a narrow way, considering only the impact on those firms that will continue to be excluded from the leverage ratio, as a result of the increase in the threshold.

We agree with the commentary in paragraphs 2.19 and 2.20 of CP2/25 that points out the benefits to firms that remain excluded from the requirements, and the positive impact this can have on growth and competition. We believe these factors should be considered across all firms, not just those that will not be captured by the proposed change in the threshold. The BSA has recently published research 'First time Buyers: The Missing millions'[3] which clearly demonstrates the increasing lack of access to the housing market. The calibration of capital requirements including the leverage ratio is clearly a contributing factor to building societies' lending capacity, particularly when the leverage ratio is binding. We believe the PRA's CBA should have considered the impact of its policies more broadly on these wider economic impacts, and the costs to society of the constraints on mortgage lending.

We also believe that the analysis on how the PRA has had regards to the impact on business model diversity and mutuals has not been sufficiently analysed. As mentioned above, the calibration of the leverage ratio is designed for firms that are subject to the Basel framework. The appropriate calibration for a mutually-owned mortgage provider like a building society is not the same as the appropriate calibration for an internationally active bank subject to the Basel framework. By applying the same calibration to building societies the leverage ratio becomes a front stop rather than a back-stop measure when compared to the risk-weighted requirements. This could create more risks than it mitigates. The PRA recognises this in its analysis of the impact on mutuals without picking it up specifically in the CBA.

Paragraph 2.51 of CP2/25 states "Mutuals which are sufficiently large enough to be captured by the increased retail deposits threshold could be affected differently from banks. For example, they may face greater challenges than banks in issuing Additional Tier 1 capital (AT1) – generally a cheaper form of capital – to meet any increase in capital requirements, because of more limited access to capital markets. Nonetheless, we think that this is justified prudentially. Mutuals will only become subject to the requirement as a consequence of having grown sufficiently to pose a greater risk to the UK financial system, to the point where a stronger guardrail against shortcomings in risk measurement is warranted." We do not agree with this second point which assumes that the risk of a building society is similar to the risk posed by a bank of the same balance sheet size. Building societies are significantly more constrained than banks by the Building Societies Act nature limits that ensure societies meet their primary purpose of accepting retail deposits and issuing

[3] First-Time Buyers: The Missing Millions

mortgage loans. It is also worth noting the absence of external shareholders that create incentives for higher growth in order to service dividend payments. This lower risk business model is not captured in the PRA's analysis.

Unintended consequences of non-risk-based framework

As mentioned above, the leverage ratio is designed to be a backstop. If capital requirements are not bound by the risk-weighted requirements then this creates incentives for such firms to move up the risk curve by undertaking more higher LTV lending to optimise capital utilisation. The BSA asks the PRA to consider whether this is the intended outcome to incentivise building societies to conduct more higher LTV lending?

Interactions between leverage ratio and MREL

The Bank of England's approach to setting MREL is to take the higher of the risk-based requirements or the leverage-based requirements. This means yet another layering up of requirements for loss-absorbing capacity despite the low-loss business model. One way in which the PRA could take a more pragmatic approach to tailoring the impact of the leverage ratio on low-risk mortgage mutuals could be to base MREL only on risk-based requirements not leverage requirements.

Impact of FPC decisions on countercyclical buffer on different business models

The FPC has set a positive neutral CCyB rate of 2%. There is a split in philosophies between Basel Committee members between those that adhere to the original policy intent of the CCyB as set out in the framework that it would be used infrequently[4] and those countries that feel it should be above zero in normal times, such as the UK. This approach is against the PRA's secondary objective on international competitiveness and growth. It also flows through the capital stack into the leverage ratio buffers even though the leverage ratio is supposed to be a non-cyclical backstop.

We believe the PRA and FPC should reconsider their calibration of the CCyB and how this flows through to MREL and the leverage ratio buffers, particularly for low-risk building societies that are at a lesser risk of excessive growth for the reasons mentioned above, such as their lesser ability to raise capital and the structural constraints or Nature Limits in the Building Societies Act.

As a minimum, we believe that the FPC should be subject to the same requirements as the PRA to consider the impact of its decisions on business models and mutuals,

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[4] See Basel framework RBC30 paragraph 30.7 "It will be deployed by national jurisdictions when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure the banking system has a buffer of capital to protect it against future potential losses. This focus on excess aggregate credit growth means that jurisdictions are likely to only need to deploy the buffer on an infrequent basis"

not least because diversity of business models is good for financial stability[5] and should therefore be encouraged.

Other considerations for adjustments

The BSA supports the PRA considering other appropriate adjustments to the leverage ratio to better tailor it to the UK market. For example, 0% risk weighted assets that are required to be held as HQLA such as government debt could be excluded from the calculation.

[5] See research by Barbara Casu, Professor of Banking & Finance, Bayes Business school as referenced at the 2025 BSA Conference [The origin of financial instability and systemic risk: Do bank business models matter? - ScienceDirect]

Supporting data

The following figures are taken from reported YE 2024 pillar III disclosures of relevant building societies and banks. Numbers are for group consolidated level. Total risk-based requirements include the combined Basel buffers but exclude the PRA buffer as this is not disclosed. The leverage requirements shown are for 3.25% excluding central bank reserves. For the firms currently subject to the UK leverage ratio framework - Nationwide, Barclays, HSBC and Lloyds - the leverage ratio includes the two leverage ratio buffers as disclosed. For other societies in the table, the 3.25% leverage ratio is not a binding requirement but a reportable item.

In conclusion, the column in grey shows any additional capital in percentage terms that needs to be held as a result of the leverage ratio (and leverage ratio buffers) being the binding constraint. The numbers clearly demonstrate that the leverage ratio including leverage ratio buffers is performing as designed by acting as a backstop for banks (given that the risk weighted requirements are higher). Whereas the impact on the mutual mortgage lender business model is that the leverage ratio (without any leverage ratio buffers) is broadly similar to the risk weighted requirements for IRB societies. However, once above the leverage ratio threshold, and adding in the leverage ratio buffers mean that this will be the binding constraint for the mutual mortgage lender business model. As such, the consequences could be for a society to undertake riskier lending to more efficiently optimise their capital.

Nominal figures in £m	Expected losses (IRB)	Credit risk capital reqs[6]	Total capital reqs (TCR)	TCR + combined buffer (CCoB + CCyB + systemic)	Leverage ratio capital reqs including buffers if applicable or disclosure amount 3.25%	Leverage ratio reqs as % of risk-weighted requirements (red if LE binding)	MREL requirement (red if LE binding)	MREL + buffers
Nationwide (April 24)[7]	696	3,774	7,156 (13.1%)	10,160 (18.6%)	10,718 (4.3%)	+105.5% LR	16,202 (6.5%LE)	19,207 (7.71%LE)
Coventry (Dec 24)[7]	84	653	990 (10.6%)	1,410 (15.1%)	1,744 (3.25%)	+123.7% LR	1,980 (21.2%)	2,400 (25.7%)
Yorkshire (standardised)	n/a	1,594	1,734 (8.0%)	2,709 (12.5%)	1,919 (3.25%)	70.8% RW	3,468 (16.0%)	4,443 (20.5%)
Skipton	57	582	832 (10.1%)	1,190 (14.4%)	1,168 (3.25%)	98.2% RW	1,656 (20.1%)	2,010 (24.4%)
Leeds	62	442	683 (11.1%)	960 (15.6%)	939 (3.25%)	97.8% RW	1,643.2 (22.1%)	1,977.3 (26.6%)
Principality	34	264	289 (11.1%)	563 (15.6%)	423 (3.25%)	75.1% RW	n/a	n/a
HSBC Holding Plc ($m)	8,700	51,859	88,860 (10.6%)	132,451 (15.8%)	106,697 (4.15%)	80.5% RW	185,265 (22.1%)	192,107 (22.7%)
Barclays Plc	2,393	15,983	45,124 (12.6%)	63,030 (17.6%)	49,467 (4.1%)	78.5% RW	90,248 (25.2%)	108,154 (30.2%)
Lloyds Banking Group plc	2,783	14,267	23,811 (10.6%)	33,695 (15.0%)	23,256 (3.45%)	69.0% RW	47,847 (21.3%)	57,506 (25.6%)

[6] Credit risk RWAs as at YE24 excluding counterparty credit risk and CVA, this does not include Basel 3.1 changes nor the IRB floor
[7] Nationwide and Coventry exclude recent transactions with Virgin and Co-op Bank