EXPLANATORY MEMORANDUM TO

THE CAPITAL REQUIREMENTS REGULATION (MARKET RISK TRANSITIONAL PROVISION) REGULATIONS 2026

2026 No. 491

1. Introduction

1.1 This Explanatory Memorandum has been prepared by His Majesty's Treasury and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Lucy Rigby KC MP, Economic Secretary to the Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Fayyaz Muneer, Deputy Director for Prudential and Sustainability at HM Treasury, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Deeven Seyan at HM Treasury can be contacted by email at the following address with any queries regarding the instrument: Deeven.seyan@hmtreasury.gov.uk.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument introduces a transitional provision requiring credit institutions and designated investment firms ("institutions") not to apply the Prudential Regulation Authority ("PRA")'s market risk rules on updated internal model requirements between 1 January 2027 and 31 December 2027 ("the transitional period"). The PRA rules will allow institutions to continue to use their existing models during the transitional period.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) of which it forms part of the law) is England and Wales, Scotland and Northern Ireland.

4.3 The territorial application of this instrument (that is, where it produces a practical effect) is England and Wales, Scotland and Northern Ireland.

5. Policy Context

What is being done and why?

5.1 The Basel Committee on Banking Supervision (BCBS) sets international standards for the amount of capital that internationally active institutions need to hold against the risks they take. Following the 2008 global financial crisis, the BCBS has developed a series of reforms to strengthen international banking regulation. The last part of these reforms are known in the UK as "Basel 3.1". Basel 3.1 is a central element of the BCBS's response to the global financial crisis. It addresses a number of shortcomings with the pre-crisis regulatory framework such as excessive variability of "risk-

weighted assets"[1] across different institutions, causing a wide range of stakeholders, including analysts and market participants, to lose faith in institutions' risk-weighted capital ratios. The Basel 3.1 standards are intended to be implemented consistently across major jurisdictions.

5.2 The UK remains committed to the full, timely and consistent adoption of the Basel reforms. In the UK, implementation of Basel 3.1 is being delegated to the Prudential Regulation Authority (PRA) – part of the Bank of England – under an accountability framework set out by the Financial Services and Markets Act 2023, as agreed by Parliament. HM Treasury has made the necessary legal changes to facilitate the PRA's regulations.

5.3 However, the timing of the implementation of Basel 3.1, particularly the new requirements relating to potential losses arising from changes in market prices ("market risk"), is not yet confirmed in some other major jurisdictions. The US has not yet finalised its proposed rules for implementing Basel 3.1.[2] The European Commission has adopted delegated acts to postpone the implementation of the market risk rules until 1 January 2027[3] and has launched a targeted consultation on further reforms to the market risk framework.[4]

5.4 Implementing the final UK market risk requirements for internationally active institutions' trading activities in advance of the EU and the US would risk creating additional operational burdens and complexity for UK institutions.

5.5 To balance these considerations, the PRA has therefore decided to delay implementation of the new internal model requirements for market risk to 1 January 2028. The PRA rules will allow institutions to continue to use their existing internal models under the current approach before moving to the PRA's new internal model approach from 1 January 2028. All other elements of Basel 3.1, including the trading book boundary, the Advanced Standardised Approach and the Simplified Standardised Approach, will be implemented on 1 January 2027.

5.6 The PRA's approach facilitates alignment with international peers, avoids placing undue burdens on internationally active institutions, and provides banks with the certainty they need to support economic growth. In the interim, the PRA will remain able to address any risks or potential risks to UK institutions through its general rulemaking and supervisory powers. Overall, this supports the international competitiveness of the UK financial sector and wider economy, while still ensuring full, timely and consistent implementation of the BCBS standards.

5.7 Legislative change is required to facilitate the PRA's transitional approach because institutions' capital requirements are currently set, in large part, through directly applicable legislation (the "UK Capital Requirements Regulation" or "UK CRR")[5].

5.8 This instrument facilitates the PRA's transitional approach by requiring institutions not to apply the PRA's market risk rules for banks using internal model approaches during the transitional period between 1 January 2027 and 31 December 2027. This

[1] "Risk-weighted assets" or "RWAs" help measure how risky a bank's assets are. Instead of treating all loans and investments the same, risk-weighted capital requirements assign different "risk-weights" to assets based on how likely the bank is to lose money on them. The riskier the asset, the higher the risk weight or "RWA"
[2] www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm
[3] https://finance.ec.europa.eu/news/commission-proposes-postpone-one-additional-year-market-risk-prudential-requirements-under-basel-iii-2025-06-12_en
[4] https://finance.ec.europa.eu/news/commission-seeks-input-basel-iii-market-risk-rules-banks-2025-11-06_en
[5] https://www.legislation.gov.uk/eur/2013/575/contents

aligns the legislation and regulations that determine institutions' calculation of their capital requirements under the PRA's transitional approach.

5.9 The Government also considers it important for the UK to have the legislative flexibility to respond to developments in other jurisdictions' implementation of trading rules, given that these requirements apply to major banks' cross-border activities. As a result, this instrument enables the Treasury to extend the transitional period by regulations.

What was the previous policy, how is this different?

5.10 This instrument facilitates a PRA-led approach to setting capital requirements for institutions under the UK's FSMA model of regulation by introducing a time-limited, transitional arrangement for the new internal model approaches to capital requirements for market risk that the PRA is introducing under Basel 3.1.

5.11 Following the UK's withdrawal from the European Union, a large body of detailed and technical financial services regulation was brought onto the UK statute book. Under that framework, firms' internal models for market risk were determined by that retained EU legislation and associated PRA rules.

5.12 That approach does not fit well with the UK's established model of regulation for financial services, set out in Financial Services and Markets Act 2000 (FSMA 2000) and known as the "FSMA model", under which detailed regulatory requirements are designed and maintained by expert, independent regulators within an overall policy framework set by Government and Parliament.

5.13 This instrument supports the smooth introduction of the FSMA model for institutions' prudential requirements by introducing a time-limited transitional arrangement which requires institutions to continue to apply the current requirements under the internal model approach to market risk until 1 January 2028, when the PRA's new requirements come into effect.

6. Legislative and Legal Context

How has the law changed?

6.1 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ("CRR"), which was incorporated into UK law on the UK's withdrawal from the EU, imposes certain requirements on institutions in relation to the capital that they must hold to address these risks. In particular, article 325 of the CRR requires institutions to calculate their capital requirements for market risk in accordance with either the so-called standardised approach or the internal model approach (IMA). The standardised approach is the default approach while IMA allows institutions to use their own internal models subject to the PRA's approval in accordance with article 363.

6.2 The CRR is revoked by section 1 of, and Schedule 1 to, FSMA 2023. The revocation of most of the CRR provisions (including those relating to market risk) is brought into force on 1 January 2027 by virtue of the Financial Services and Markets Act 2023 (Commencement No. 12, Saving and Transitional Provisions) Regulations 2026[6]. The CRR market risk provisions will be replaced by PRA rules on 1 January 2027. The

[6] https://www.legislation.gov.uk/uksi/2026/45/contents/made

rules were made on 13 January 2026 by the PRA Rulebook: CRR Firms: (CRR) Instrument 2026.[7]

6.3 The PRA's new rules introduce new and updated methodologies for institutions to calculate minimum capital requirements for market risk. These include a new IMA, and a new standardised approach (advanced standardised approach) and a recalibrated version of the existing standardised approach, now known as the "simplified standardised approach", for institutions with limited derivative business. The different methodologies to calculate market risk reflect different degrees of sophistication among institutions: IMA is mostly used by major institutions that engage in cross-border trading activity while standardised approach typically apply to institutions with limited market risk and cross-border activity. The rules relating to the standardised approaches will come into force on 1 January 2027.

6.4 This instrument inserts new Article 465A of the CRR as a transitional provision relating to the PRA's IMA rules. Article 465A(1) requires institutions not to apply specified IMA rules during the transitional period. Article 465A(2) gives HM Treasury the power to extend that period. This aligns the requirements on institutions set in legislation with the requirements set on institutions set in the PRA's rules. HM Treasury considers the new Article necessary for the purposes set out in section 3(2)(e) and (i) of FSMA 2023.

6.5 The underlying obligation for institutions to meet prudential capital requirements is unchanged; this instrument alters only the timing of the transition between the current and updated internal model approaches. No novel legal issues arise from this change, which uses the powers under sections 3 and 84 of FSMA 2023 to amend the CRR.

Why was this approach taken to change the law?

6.6 This approach aligns with the UK model of regulation, known as the "FSMA model", under which detailed regulatory requirements are set by expert, independent regulators, operating within an overall policy and accountability framework set by the Government and Parliament.

6.7 Introducing this transitional provision in legislation ensures that the legislative and regulatory requirements which apply to institutions' calculation of capital requirements are aligned during the transitional period. It provides the UK with flexibility to respond legislatively to developments in other major jurisdictions' implementation of the market risk elements of Basel 3.1, while leaving the detailed prudential standards to be set in the PRA Rulebook. It also ensures transparency to Parliament and stakeholders about the UK's approach to the timing of Basel 3.1 implementation.

7. Consultation

Summary of consultation outcome and methodology

7.1 HM Treasury published a Policy Update in July 2025 setting out the Government's intention to introduce a transitional provision allowing institutions to continue using their existing internal models for market risk until after 31 December 2027 and delaying the application of the updated internal model requirements until 1 January 2028. The Government published and consulted on draft legislation as part of this policy update. The consultation ran from 15 July to 12 September 2025 and invited

[7] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2026/january/ps126app1.pdf

comments from industry on the overall approach and technical input on the draft legislation. Alongside this, the PRA issued a consultation on its detailed regulations.

7.2 Respondents to HM Treasury's consultation recognised the benefit of HM Treasury legislating to facilitate the PRA's proposed delay of the internal modelled approach to market risk. Some respondents outlined concerns that HM Treasury's legislation could introduce unintended operational challenges, such as firms being required to run two systems in parallel. Some respondents also sought clarity on the coordination of the making of this legislation with the wider timeline for the application of the regulatory approach under FSMA 2000 to the UK CRR.

7.3 Responses to HM Treasury's draft legislation and the PRA's consultation have been carefully considered, together with further engagement with stakeholders to clarify and understand the issues raised.

7.4 Most materially, HM Treasury's legislative approach facilitates the PRA's implementation of the detailed firm-facing requirements. The PRA's Policy Statement 1/26 has explained how it has sought to address any unintended operational challenges as a result of its proposed delay to the internal modelled approach for market risk.[8] HM Treasury has taken steps to provide as much clarity to industry as possible on the wider timeline for legislative changes, including through its regular Policy Updates,[9] the Regulatory Initiatives Grid[10], and the Plan Through to 2035[11] provided as part of the Financial Services Competitiveness and Growth Strategy.

8. Applicable Guidance

8.1 There is no applicable guidance.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because, in line with Better Regulation guidance, the government considers that the net impact of this instrument upon businesses will be less than net £10 million Equivalent Annual Net Direct Costs to Business.

9.2 These costs solely relate to familiarisation with the legislation as the costs on institutions will be determined by the impact of the PRA's rules. The PRA has published a cost benefit analysis of its proposals as part of its consultation paper CP17/25 - Basel 3.1: Adjustments to the market risk framework[12].

Impact on businesses, charities and voluntary bodies

9.3 There is no significant impact on business, charities, or voluntary organisations because the PRA rules give effect to the requirements which are placed on institutions. The PRA has published a cost benefit analysis of its obligations.

[8] https://www.bankofengland.co.uk/prudential-regulation/publication/2026/january/implementation-of-the-basel-3-1-final-rules-policy-statement

[9] https://www.gov.uk/government/publications/applying-the-fsma-2000-model-of-regulation-to-the-capital-requirements-regulation#full-publication-update-history

[10] https://www.fca.org.uk/publications/corporate-documents/regulatory-initiatives-grid

[11] https://assets.publishing.service.gov.uk/media/687e612692957f2ec567c621/Financial_Services__Growth__Competitiveness_Strategy_final.pdf

[12] https://www.bankofengland.co.uk/prudential-regulation/publication/2025/july/basel-3-1-adjustments-to-the-market-risk-framework-consultation-paper

9.4 Similarly, the legislation does not have a significant impact on small or micro businesses.

9.5 There is no impact on the public sector as the requirements apply solely to UK institutions.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 In line with the requirements of the Small Business, Enterprise and Employment Act 2015 the Economic Secretary to the Treasury, Lucy Rigby KC MP has made the following statement:

"It is not proportionate to include a review clause in this instrument because the estimated annual net direct cost to business is less than £10 million and the number of small businesses in scope is very low."

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury, Lucy Rigby KC MP, has made the following statement regarding Human Rights: "In my view the provisions of the Capital Requirements Regulation (Market Risk Transitional Provision) Regulations 2026 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").