EXPLANATORY MEMORANDUM TO

THE OVERSEAS PRUDENTIAL REQUIREMENTS REGIME (CREDIT INSTITUTIONS AND INVESTMENT FIRMS) REGULATIONS 2026

2026 No. 1116

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 Rachel Blake, 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4.1 The UK Capital Requirements Regulation (UK CRR) was revoked by the Financial Services and Markets Act 2023 (FSMA 2023) subject to commencement by HM Treasury. This revocation allows detailed, firm-facing regulatory requirements to be set by expert, independent regulators within an overall policy framework set by government and Parliament. This approach is known as the 'FSMA model' of regulation.

4.2 The Government is using this instrument to restate in legislation the equivalence provisions that are currently set out in the UK CRR and which need to be maintained in legislation in line with the government's approach to Overseas Recognition Regimes.

4.3 The instrument does this by restating the existing UK CRR equivalence regimes in legislation as one Overseas Prudential Requirements Regime (OPRR). The OPRR preserves the overall scope and effect of existing equivalence regimes. The instrument also preserves existing equivalence decisions, including the overall scope and effect of those decisions, by treating them as if they were designations (that is, decisions by HM Treasury to recognise an overseas jurisdiction under the regime) under the new OPRR. Further designations under the OPRR will require a subsequent Statutory Instrument and parliamentary approval. The precise prudential effect of designation under the new regime will apply in accordance with the FSMA model of regulation, under which the Prudential Regulation Authority (PRA), in most cases, sets the relevant prudential treatment (through regulatory risk-weights) in its rules.

4.4 The instrument also extends the scope of the OPRR to include an additional type of exposure, enabling the future recognition of overseas eligible covered bonds where

appropriate. This would allow the government to ensure the UK regulatory framework keeps pace with market developments and helps enhance the UK's position as a global financial centre whilst maintaining the UK's financial stability and reflecting the UK's commitment to strong regulatory standards. Any future designation of a specific jurisdiction in relation to covered bonds would require a subsequent Statutory Instrument and parliamentary approval.

Where does the legislation extend to, and apply?

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

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

5. Policy Context

What is being done and why?

5.1 When the UK left the EU, the body of EU legislation that applied directly in the UK at the point of exit was transferred onto the UK statute book by the European Union (Withdrawal) Act 2018 (EUWA). This is known as "assimilated law".

5.2 This included the assimilated law which provided for the EU's framework for financial services equivalence to apply in the UK, post-EU exit. The inherited body of EU financial services legislation 'onshored' into UK law under EUWA includes more than 40 EU equivalence regimes and more than 270 EU equivalence decisions.

5.3 The Financial Services and Markets Act 2023 (FSMA 2023) repeals assimilated EU law relating to financial services, subject to commencement by HM Treasury. The government continues to progress work on revoking assimilated law, focusing particularly on areas where there are potential benefits to competitiveness and growth. Where appropriate, the government is replacing assimilated law with rules set by our independent and expert regulators, operating within a legislative framework set by the government and Parliament. This regulatory approach was established by the Financial Services and Markets Act 2000 ('FSMA') and is known as the 'FSMA model' of regulation.

5.4 The government has a programme of work to replace the existing equivalence regimes inherited from the EU with legislation which is tailored to the UK's needs, and which fully reflects the government's outcomes-focused approach to the unilateral regulatory recognition of overseas jurisdictions. This programme of work is delivering a set of regimes known as 'Overseas Recognition Regimes'.

5.5 The assimilated law specifying institutions' capital requirements is primarily set out in the UK CRR. The UK CRR currently includes equivalence regimes which specify the approach that UK institutions (banks and investment firms) may adopt for certain exposures in jurisdictions which have been deemed equivalent. These equivalence regimes are aligned with international standards.

5.6 At Mansion House 2025, the government set out its proposal to restate existing equivalence decisions made under these UK CRR equivalence regimes so that jurisdictions currently deemed equivalent are treated as designated under the OPRR and the overall effect of the current decisions is preserved, except in relation to exchanges (see below). The government also proposed to introduce sufficient flexibility through the OPRR to allow the recognition of further exposures, as appropriate.

5.7 Under the OPRR, decisions on recognising overseas jurisdictions will move to a more outcomes-based approach, in line with the government's wider Overseas Recognition Regimes framework. Under this approach, HM Treasury will assess whether recognising a jurisdiction is compatible with a set of policy outcomes that are central to the UK's prudential regulatory framework.

5.8 These policy outcomes are:

a) protecting the stability of the financial system in the United Kingdom;

b) the safety and soundness of UK institutions (that is, regulated banks and investment firms); and

c) promoting effective competition in financial services and markets, and/or supporting the international competitiveness of the UK economy and its medium- to long-term growth.

5.9 The instrument largely preserves the scope and effect of the existing equivalence regimes. However, it makes targeted adjustments to the scope of the regime in relation to two types of exposure.

5.10 First, in relation to exposures to exchanges, the instrument amends the effect of designations so that the prudential treatment of these exposures better reflects their underlying risk and aligns with the broader prudential framework.

5.11 Second, the instrument updates the definition of investment firms by replacing the existing 'third-country investment firm' definition with a new 'overseas investment firm' definition. This change is intended to align with the UK's post-EU framework, including the Investment Firms Prudential Regime, while maintaining the overall scope and effect of the existing treatment.

5.12 In addition, the instrument extends the scope of the regime to include covered bonds as a new category of exposure. This does not alter the treatment of any existing exposures or equivalence decisions. Any preferential treatment for covered bonds would arise only if HM Treasury designates a jurisdiction in the future, which would require a further Statutory Instrument and parliamentary approval.

5.13 This instrument amends the effect of designations for the purposes of exchanges under the regime. Currently, UK institutions can treat exposures to exchanges in equivalent overseas jurisdictions as if they were exposures to institutions (defined as credit institutions and designated investment firms under the UK CRR). The capital treatment for UK banks' exposures to overseas exchanges may also present these exposures as lower risk than firms' exposures to UK exchanges.

5.14 This approach does not always adequately reflect the risk of the underlying exposure and may not be compatible with prudential objectives, including safety and soundness and effective competition. Some exchanges which are in scope of the current preferential treatment may not be subject to prudential regulation, which may not be compatible with the safety and soundness of UK institutions. Preferential capital requirements for such exposures may also be inconsistent with effective competition between UK exchanges and overseas exchanges.

5.15 As a result, this legislation amends the effect of designations under the regime so that UK institutions can treat exposures to overseas exchanges as exposures to institutions, where this is permitted by the banking regulator in the designated overseas jurisdiction. Where this condition is not met, the PRA will be able to set capital requirements for exposures to exchanges in a manner which more accurately reflects

the underlying risk of the exposure. Typically, they will be treated as exposures to corporates.

5.16 This instrument replaces the definition of 'third-country investment firm' with a new definition of 'overseas investment firm'. Consistent with the general approach to Overseas Recognition Regimes, the government intends for the new definition of 'overseas investment firm' to maintain the scope and effect of equivalence decisions for UK institutions' exposures to investment firms at the point of EU withdrawal. This means no material change to the firms captured or the treatment of those exposures in practice. The new definition is intended to better reflect the introduction of both the Investment Firm Prudential Regime (IFPR) and of the OPRR.

5.17 This instrument provides HM Treasury with the ability to designate overseas jurisdictions in relation to the prudential treatment of UK firms' exposure to overseas covered bonds. This allows the government to facilitate preferential treatment for overseas covered bonds from jurisdictions with similar levels of protection as UK covered bonds if this is deemed compatible with HM Treasury's policy outcomes, including protecting financial stability and the safety and soundness of UK firms.

5.18 The introduction of the OPRR will make the bank capital regime easier to navigate by consolidating a range of existing, fragmented equivalence regimes into a single, more coherent framework. It will ensure the overall effect of the current equivalence decisions is preserved, allowing UK firms to continue to benefit from preferential treatment granted through equivalence regimes in the UK CRR. It also gives the government the power to allow the recognition of additional covered bond exposures only, where appropriate, in the future and where this aligns with HM Treasury's policy outcomes.

5.19 This instrument is not expected to impose material ongoing direct costs on firms. Its principal direct effect is expected to be limited to one-off familiarisation costs associated with understanding the new legislative framework. Any direct costs or benefits arising from future changes to prudential treatment under the OPRR will, in most cases, flow from PRA rules and are assessed through the PRA's Cost-Benefit Analyses (CBAs) as the PRA is responsible for setting the precise capital treatment, within the framework established by the OPRR.

What was the previous policy, how is this different?

5.20 Previously, prudential equivalence regimes were set out in assimilated law.

5.21 The new policy restates in legislation all relevant equivalence regimes as one OPRR, which reflects the government's more outcomes-focused approach to regulatory recognition of overseas jurisdictions. This will make the bank capital regime more agile to respond to developments in international financial services markets and will make the legislative framework for regulatory recognition easier to navigate.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument restates the Treasury's powers in Articles 81(1)(a)(iii), 82(a)(iii), 107(4), 114(7), 115(4), and 116(5) of the UK CRR, which were revoked by section 1 of, and Schedule 1 to FSMA 2023, with that revocation set to commence on 1 January 2027.

6.2 These changes are intended to preserve the overall scope and effect of the relevant prudential equivalence regimes and existing decisions made under those regimes,

except for the modifications made in relation to exposures to exchanges and exposures to investment firms, as explained above. The scope of the new OPRR will also enable HM Treasury to designate an overseas jurisdiction in relation to banks' exposures to covered bonds in that jurisdiction. The precise prudential effect of any designations made under the OPRR will depend on the corresponding treatment set out in PRA rules.

6.3 Further consequential amendments arising from the revocation of the Capital Requirements Regulation (CRR) will be made in a separate instrument before the end of the year and in advance of 1 January 2027.

Why was this approach taken to change the law?

6.4 This approach aligns with the UK's model of regulation, known as the 'FSMA model', which relies on detailed regulatory requirements being set by expert, independent regulators, operating within an overall legislative framework set by the government and Parliament. Under that approach, the overall framework for regulatory recognition of overseas jurisdictions is retained in legislation. This approach also gives effect to the government's more outcomes-focused approach to regulatory recognition under which all equivalence regimes in assimilated law are being restated in legislation as Overseas Recognition Regimes, in line with the government's Overseas Recognition Regime guidance document[1].

6.5 Section 4 of FSMA 2023 enables the restatement of provisions in assimilated law, through the use of secondary legislation, where it is necessary to retain provisions that would otherwise be revoked by section 1 of FSMA 2023. This instrument makes use of these powers as intended.

7. Consultation

Summary of consultation outcome and methodology

7.1 HM Treasury published a Policy Update at Mansion House 2025[2]. As part of this update, HM Treasury ran an 11-week consultation on its intention to apply the FSMA model of regulation to the UK CRR.

7.2 The Policy Update set out HM Treasury's plans to commence the revocation of certain provisions of the UK CRR and make the necessary restatements in UK legislation to facilitate the FSMA model of regulation. It also explained how the PRA will replace UK CRR provisions with regulator rules, supervisory statements, and statements of policy. The Policy Update covered HM Treasury's proposed approach to restating equivalence regimes in the UK CRR as the OPRR.

7.3 In response to the consultation and draft legislation, HM Treasury received nine written responses. These came from a variety of financial services firms, banks, consumer bodies, and trade associations.

7.4 Respondents supported the overall approach of restating the existing equivalence regimes as the OPRR and preserving the effect of the current equivalence decisions. The topic most frequently raised was on the designation of appropriate overseas jurisdictions in relation to the prudential treatment of UK firms' exposure to overseas covered bonds, in relation to which respondents expressed support for the proposed

[1] https://assets.publishing.service.gov.uk/media/687527f655c4bd0544dcae12/Overseas_Recognition_Regimes_Guidance_Document_final_.pdf

[2] https://assets.publishing.service.gov.uk/media/6890b1a5e8ba9507fc1b09af/Applying_the_FSMA_2000_model_of_regulation_to_the_UK_Capital_Requirements_Regulation_-_Policy_Update_2025_.pdf

future ability for HM Treasury to designate overseas jurisdictions in relation to covered bonds. Respondents also provided technical suggestions to the policy approach.

7.5 The comments were carefully considered together with further engagement with regulators and industry to help clarify and understand the issues raised. On this basis, HM Treasury published a consultation response on 19 February 2026[3] which provides further detail on the government's final policy approach and response to the issues raised by respondents. Alongside this response, HM Treasury published the draft regulations for the OPRR[4]and sought industry views through a six-week technical consultation.

7.6 The technical consultation on the draft regulations received one response. Following analysis of this response, HM Treasury has not changed the final legislation.

7.7 Nevertheless, HM Treasury does intend to provide clarity on the use of the phrase 'Exposures to an institution', through this Explanatory Memorandum. As defined in the instrument, where the phrase "exposure to an institution" is used this means an exposure which meets the requirements specified in paragraph A1 of article 119 of the Credit Risk: Standardised Approach (CRR) Part of the PRA Rulebook. This applies to the relevant credit institutions, investment firms, and exchanges that are eligible as set out in the Instrument.

7.8 Financial services policy is a reserved matter.

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 the legislation relates to the maintenance of the overall scope and effect of existing equivalence decisions, subject to the adjustments described above and the precise impact of any OPRR designations being dependent on relevant PRA rules. A de minimis Impact Assessment has been prepared and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

Impact on businesses, charities and voluntary bodies

9.2 There is no significant ongoing impact on business, charities or voluntary bodies because the legislation preserves the overall effect of existing equivalence decisions and does not itself introduce any new designations. The direct costs to business are expected to be minimal and limited to one-off familiarisation costs associated with reading and understanding the instrument. Annual direct costs to business are expected to be zero, and total direct costs over ten years are expected to be negligible. Any indirect impacts or variations in firm benefits flow from how individual firms choose to apply preferential treatments alongside relevant risk-weights established under the PRA's Basel 3.1 rules.

[3] https://assets.publishing.service.gov.uk/media/69947796c0aa8279cb9c77c6/Applying_the_FSMA_2000_model_of_regulation_to_the_CRR_2025_-_Policy_Update_Response.pdf

[4] https://assets.publishing.service.gov.uk/media/6994777dc0aa8279cb9c77c5/The_Overseas_Prudential_Requirements_Regime_-_draft_regulations.pdf

9.3 The intention of the instrument is to preserve the overall treatment of overseas exposures. In the absence of this legislation, the revocation of existing equivalence provisions without replacement would be expected to lead to a cliff-edge increase in capital requirements for affected firms' overseas exposures.

9.4 There is no significant impact on small or micro businesses, as the instrument applies to banks and investment firms rather than small or micro entities.

9.5 There is no significant impact on the public sector.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 As with all legislation, the Government will keep it under review.

10.2 However, as this Statutory Instrument does not introduce new regulatory requirements on businesses, it does not include a statutory review clause.

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 (Rachel Blake) has made the following statement regarding Human Rights:
"In my view the provisions of the Overseas Prudential Requirements Regime (Credit Institutions and Investment Firms) 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").

13.2 It does relate to the withdrawal of the United Kingdom from the European Union as it forms part of the process of revoking assimilated law from legislation.