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# Operationalisation of The Bail-In Tool

## The Exchange Mechanic

*Disclosure according to EBA/GL/2023/01*

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**BANK OF GREECE**  
**EUROSYSTEM**

## Contents

<b>Abbreviations .....</b>	<b>3</b>
<b>Introduction .....</b>	<b>4</b>
<b>Legal framework.....</b>	<b>5</b>
<b>General aspects .....</b>	<b>6</b>
<b>Bail-in tool: Key features .....</b>	<b>9</b>
Scope of bail-in .....	9
Valuation .....	11
Resolution Decision.....	12
Execution of the bail-in tool – An example .....	13
<b>Bail-in Exchange Mechanic .....</b>	<b>16</b>
Main Stakeholders .....	16
Suspension of trading.....	16
Write-down of ordinary shares.....	18
Write-down and/or Conversion of other traded instruments .....	18
Admission to trading and listing of new instruments .....	19



**BANK OF GREECE**  
**EUROSYSTEM**

## Abbreviations

<b>ATHEX</b>	Athens Stock Exchange
<b>ATHEXCSD</b>	Hellenic Central Securities Depository
<b>BoG</b>	Bank of Greece
<b>BRRD</b>	Bank Recovery & Resolution Directive
<b>CCP</b>	Central Counterparties
<b>CET1</b>	Common Equity Tier 1
<b>CSD</b>	Central Securities Depository
<b>DSS</b>	Dematerialised Securities System
<b>EBA</b>	European Banking Authority
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>FOLTF</b>	Failing or likely to Fail
<b>HCMC</b>	Hellenic Capital Market Commission
<b>ICSD(s)</b>	International Central Securities Depository
<b>ISIN</b>	International Securities Identification Number
<b>LSIs</b>	Less Significant Institutions
<b>NAV</b>	Net Asset Value
<b>NCWO</b>	No Creditors Worse Off
<b>NRA</b>	National Resolution Authority
<b>RMC</b>	Resolution Measures Committee
<b>SIs</b>	Significant Institutions
<b>SPE</b>	Single Point of Entry
<b>SRB</b>	Single Resolution Board
<b>SRMR</b>	Single Resolution Mechanism Regulation
<b>SWIFT</b>	Society for Worldwide Interbank Financial Telecommunications
<b>UCITS</b>	Undertakings for collective investment in transferable securities
<b>WDCI</b>	Write-Down and Conversion of Capital Instruments



# BANK OF GREECE

## EUROSYSTEM

### Introduction

When a credit institution is assessed as FOLTF and meets the other two conditions for resolution<sup>1</sup>, the resolution authority adopts a resolution scheme outlining the resolution actions to be taken with the aim of meeting the resolution objectives. In this context, the bail-in resolution tool can be applied.

The actual execution of a bail-in may be challenging, as the exchange mechanic<sup>2</sup> is a complex matter, largely involving the implementation of national, non-harmonised legislation. The EBA, through its recommendation in its “Guidelines to resolution authorities on the publication of the write down and conversion and bail-in exchange mechanic”,<sup>3</sup> aims at fostering transparency, increasing predictability and minimising uncertainty for investors in resolution.

This document, responding to the EBA Guidelines, provides a high-level description of the process for the external execution of bail-in, excluding the preparatory and the post-resolution phase as well as the internal implementation by the credit institution under resolution. More specifically, it focuses on the bail-in mechanic, as this is expected to apply to a credit institution under resolution according to the provisions of the national legal framework.

It is noted that the NRA is not in charge of all aspects of the exchange mechanic that are hereby described. However, the aim is to identify the stakeholders that are responsible for certain actions and to describe the understanding of how these stakeholders would act to ensure the smooth implementation of the resolution strategy.

***It is noted that actual execution of write-down and conversion processes might differ from the one set out in this document.***

*The “Operationalisation of the Bail-in Tool - The Exchange Mechanic” is a living document susceptible to updates.*

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<sup>1</sup> Law 4335/2014, Articles 32 and 2(1) within Article 2, Recovery and Resolution of credit institutions and investments firms (incorporation of Directive 2014/59/EU) and other provisions”.

<sup>2</sup> Operational steps necessary to execute the write-down and conversion of relevant instruments or the use of the bail-in tool.

<sup>3</sup> EBA, [Guidelines to resolution authorities on the publication of the write down and conversion and bail-in exchange mechanic](#), 13 February 2023.



**BANK OF GREECE**  
**EUROSYSTEM**

## **Legal framework**

- Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (hereinafter referred to as “SRMR”).
- Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, as amended (hereinafter referred to as “BRRD”).
- Greek Law 4335/2015, as amended by Law 4799/2021, transposing Directives 2014/59/EU and 2019/879/EU, respectively, of the European Parliament and of the Council.
- Greek Banking Law 4261/2014, “Access to the activity of credit institutions and prudential supervision of credit institutions and investment firms (transposition of Directive 2013/36/EU), repeal of Law 3601/2007, and other provisions”.
- EBA Guidelines on the rate of conversion of debt to equity in bail-in (EBA/GL/2017/03).
- EBA Handbook of Valuation for purposes of resolution (2019).
- EBA Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanic (EBA/GL/2023/01).



## **BANK OF GREECE**

### **EUROSYSTEM**

### **General aspects**

According to the SRMR and the BRRD, as transposed by Law 4335/2015, and amended by Law 4799/2021 transposing Directive 2019/879/EU of the European Parliament and of the Council – BRRD II, the Resolution Authority may apply bail-in when a credit institution meets the following conditions for resolution (internal Article 32 of Article 2 of Law 4335/2015):

- i. the credit institution is FOLTF;
- ii. there is no reasonable prospect that any alternative private sector measures or the use of any supervisory action taken in respect of the credit institution will prevent the failure of the institution within a reasonable timeframe; and
- iii. resolution action is in the public interest, meaning that resolution is necessary for the achievement of, and is proportionate to, one or more of the resolution objectives, as well as that winding up of the institution under normal insolvency proceedings will not meet those resolution objectives to the same extent.

The resolution objectives are:

- iv. ensuring the continuity of critical functions;
- v. avoiding a significant adverse effect on the financial stability;
- vi. protecting public funds by minimising reliance on extraordinary public financial support;
- vii. protecting covered depositors and investors; and
- viii. protecting client funds and client assets.

This document focuses on the implementation of the bail-in tool, which is one of the four resolution tools that the resolution authorities have at their disposal to intervene in a failing credit institution so as to ensure the continuity of critical functions, such as lending and deposit-taking, without exposing taxpayers to losses, and to minimise the impact on the economy and the financial system.

The particular tool is designed based on the principle that in a credit institution's failure the creditors should bear losses through the write-down of the credit institution's common shares, capital instruments and bail-inable liabilities, and for the purpose of



**BANK OF GREECE**  
**EUROSYSTEM**

recapitalisation through the conversion of its capital instruments and bail-inable liabilities into new shares.

The bail-in tool can be applied in combination with the other resolution tools, i.e. sale of business, asset separation and bridge bank. Where the bail-in tool is implemented without being combined with any other resolution tool, a business reorganisation plan should be submitted to the resolution authorities within one month after the application of the bail-in tool. Among other things, the business reorganisation plan shall ensure the long-term viability of the credit institution under resolution (Internal Article 52 of Article 2 of Law 4335/2015).

The current document describes the way in which the Greek Resolution Authority (hereinafter NRA) would effectively execute the write-down and conversion of capital instruments and bail-inable liabilities with the use of the bail-in tool, including the stakeholders involved, the write-down and conversion processes and the respective timeline. For simplification purposes, the WDCCI power and the bail-in tool are both referred to as “bail-in”.

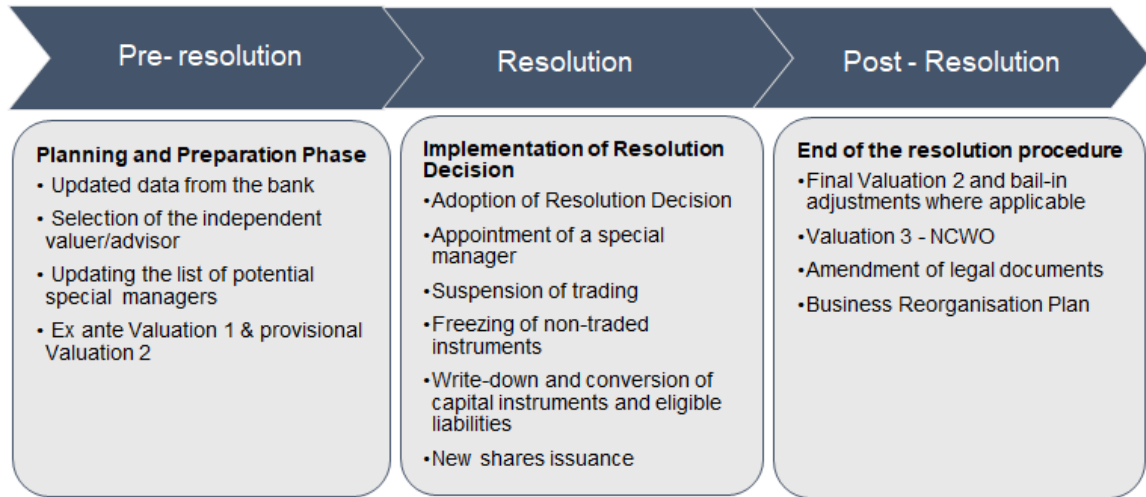
The scope of this document includes all credit institutions incorporated in Greece, irrespectively of whether they are Significant Institutions (SIs) that fall under the Single Resolution Board (SRB) remit or Less Significant Institutions (LSIs) that are under the direct responsibility of the Bank of Greece (BoG) in its role as NRA. For the purposes of this document, no distinction is made as regards the roles and the responsibilities of the NRA between those two cases, since the focus is on the external execution which is mainly a responsibility of the NRA in both cases.

Bail-in mechanic operational steps are realized through the three phases of resolution that is the Pre-Resolution, the Resolution Phase and the Post-Resolution Phase.



# BANK OF GREECE

## EUROSYSTEM







## **BANK OF GREECE**

### **EUROSYSTEM**

## **Bail-in tool: Key features**

### **Scope of bail-in**

The bail-in tool is applied to the capital instruments and bail-inable liabilities to absorb losses through the write-down process and to recapitalise the credit institution under resolution through the conversion process in order to restore its financial soundness and long-term viability.

The bail-in sequence is provided by Internal Article 60(1) of Article 2 of Law 4335/2015, whereby CET1 items, relevant capital instruments and bail-inable liabilities are used for the implementation of the bail-in tool as follows:

- i. Share capital and other CET1 items;
- ii. Additional Tier 1 instruments;
- iii. Tier 2 instruments;
- iv. Bail-inable liabilities corresponding to their ranking as insolvency claims in accordance with national insolvency law (Article 145A of Law 4261/2014). Bail-inable liabilities are liabilities and capital instruments other than those of CET1 capital, Additional Tier 1 capital or Tier 2 capital which are not excluded from the scope of application of the bail-in tool on the basis of Internal Article 44(2) of Article 2 of Law 4335/2015.

With reference to the write-down of CET1 items, retained earnings would absorb losses before share capital. The write-down and conversion are applied *pari passu* and *pro rata* on all shareholders and creditors belonging to the same class, proportionally to the nominal value of their claims, according to the national insolvency hierarchy and subject to the exclusions mentioned below.

According to Internal Article 44(2) of Article 2 of Law 4335/2015, there are certain liabilities that are excluded from the bail-in process. More specifically, the perimeter of the excluded liabilities includes:

- covered deposits;
- secured claims;
- liabilities in respect of client assets or client money including client assets or client money held on behalf of UCITS where the client is protected under applicable insolvency law;



## **BANK OF GREECE**

### **EUROSYSTEM**

- liabilities resulting from a fiduciary relationship, where the beneficiary is protected under applicable law;
- liabilities to institutions, excluding entities that are part of the same group, with an original maturity of less than seven days;
- liabilities with a remaining maturity of less than seven days, owed to payment or securities settlement systems or their participants;
- liabilities towards other entities of the resolution group without being themselves resolution entities;
- claims of employees;
- commercial or trade creditors arising from the supply of goods or services that are critical to the daily functioning of the credit institution's operations, including IT services, utilities and the rental, servicing and upkeep of premises;
- liabilities to tax and social security authorities, provided that those liabilities are preferred under the applicable law;
- liabilities to deposit guarantee schemes arising from contributions;
- deposits held by the deposit guarantee scheme (TEKE).

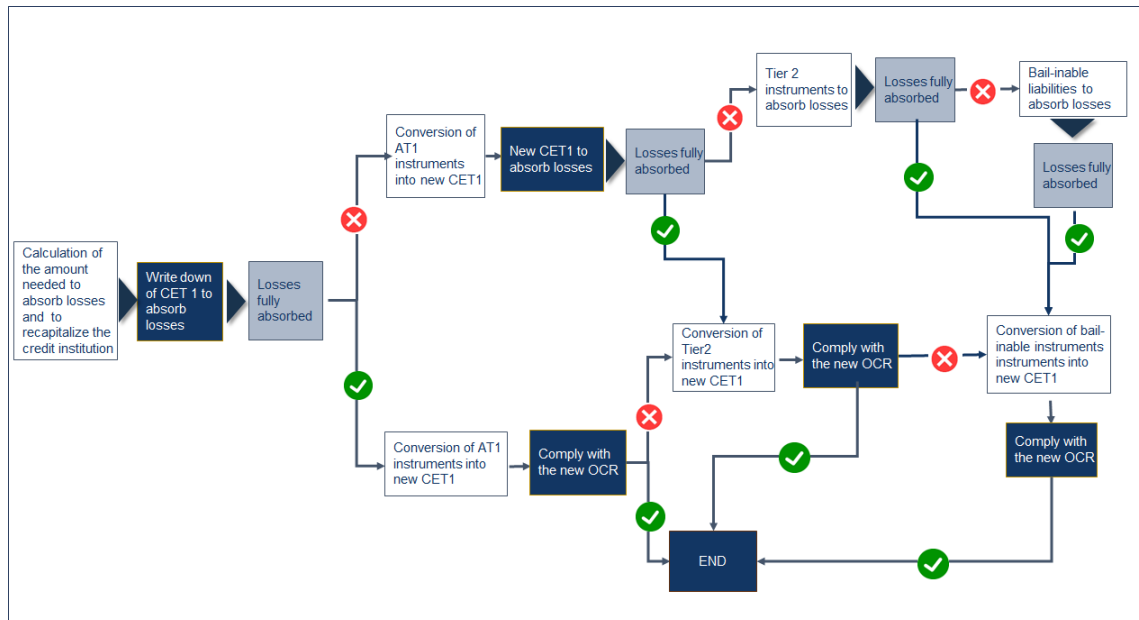
In addition to the liabilities excluded by the law, the resolution authority may in exceptional circumstances wholly or partially exclude certain claims from bail-in (discretionary exclusions), if:

- it is not possible to bail-in these liabilities within a reasonable time;
- the exclusion is necessary and proportionate to ensure the continuity of critical functions and core business lines;
- the exclusion is necessary and proportionate to avoid widespread contagion that would disrupt the functioning of financial markets; and
- the execution of the bail-in tool to these eligible liabilities would cause higher losses to other creditors compared to the non-execution of the bail-in.

The sequence of the actions for the implementation of bail-in is illustrated in the diagram below:



## BANK OF GREECE EUROSYSTEM



### Valuation

A critical process for the execution of bail-in is the valuation of the credit institution's assets and liabilities. More specifically:

Valuation 1 is performed either by an independent valuer<sup>4</sup> or by the resolution authority itself to assess whether the credit institution is FOLTF according to Internal Article 32(2a) of Article 2 of Law 4335/2015.

This is an accounting valuation of the credit institution's assets and liabilities, resulting in an updated balance sheet based on fair, prudent and realistic assumptions. Based on Valuation 1, the resolution authority assesses whether the conditions for resolution are met or the conditions for the write-down or conversion of capital instruments and bail-inable liabilities in accordance with Internal Article 59 of Article 2 of Law 4335/2015 could be applicable.

Valuation 2 is performed by an independent valuer to determine the economic value of the assets and liabilities of the institution in resolution, forming the basis for the selection of the resolution action. Valuation 2 should be completed before the

<sup>4</sup> For credit institutions under the SRB remit, the selection of the independent valuer is carried out by the SRB under its internal selection process.



## **BANK OF GREECE**

### **EUROSYSTEM**

implementation of the Resolution Decision; however, in urgent cases a provisional valuation can be conducted, by an independent valuer or if this is not possible by the resolution authority, including a buffer for additional losses, with appropriate justification. In the case of provisional valuation, a definitive/ final Valuation 2 has to be conducted as soon as practicable.

Based on the Valuation 2 results, the amount of shares, reserves, relevant capital instruments and bail-inable liabilities to be written down and/or converted is determined as well as the conversion rate for each class of equity and liability. Where the aforementioned process is based on provisional valuation results, necessary bail-in adjustments should be conducted upon the completion of the final Valuation 2 results.

Valuation 3 is carried out by an independent valuer as soon as possible after the resolution action in order to determine whether the shareholders and creditors would have received better treatment if the credit institution under resolution had entered into normal insolvency proceedings [no creditor worse off (NCWO) principle].

The aim of the NCWO assessment is to conclude whether shareholders, creditors, or DGS have incurred greater losses in resolution than they would have incurred under normal insolvency proceedings and thus they should be compensated accordingly.

### **Resolution Decision**

Where the institution is under the SRB remit, the SRB issues the resolution scheme decision which is then addressed to the NRA, and the latter issues the Implementing Order (RMC decision), specifying further the resolution scheme. For the purposes of this document, the SRB Resolution Scheme and the national Implementing Order will be referred to as a Resolution Decision, since in both cases the NRA is the responsible authority for the operationalisation of bail-in by exercising its resolution powers.

The Resolution Decision includes, among others, the following elements:

- a brief description of the institution and the rationale behind the decision for the resolution with the application of the bail-in tool;
- the outcome of the Valuation 2 and the amount of losses to be absorbed as well as the amount of recapitalisation needs;
- the amount of CET1 items to be written down or cancelled to absorb losses;



## **BANK OF GREECE**

### **EUROSYSTEM**

- the amount of other capital instruments (Additional Tier 1 and Tier 2 instruments) to be written down and/or converted into CET1 (including the write-down percentage and/or conversion rate);
- the amount of bail-inable liabilities to be written down and/or converted (with information on the write-down percentage and/or conversion rate).
- the effective date of the resolution;
- the liabilities subject to the discretionary exclusions in accordance with Internal Article 44(5) of Article 2 of Law 4335/2015;
- the use of the Single Resolution Fund (SRF) according to SRMR, Articles 76(1)(f) and 27(7), if applicable;
- any resolution powers to be exercised, such as stay powers according to Internal Articles 69-71 of Article 2 of Law 4335/2015;
- the appointment of a special manager by the NRA according to Internal Article 35 of Article 2 of Law 4335/2015, along with the mandate to exercise all the powers of shareholders and management body to implement resolution actions as directed by the resolution authority, if applicable.

The Resolution Decision is notified to the resolution entity and as soon as reasonably practicable to the authorities that are identified in the internal Article 82 of Article 2 of Law 4335/2015.

### **Execution of the bail-in tool – An example**

In what follows, a simplified bail-in scenario is presented, providing the main process of the bail-in implementation. The hypothetical bank described below is a stand-alone credit institution (not part of a group) without any subsidiary, the shares of which are listed in the ATHEX. An SPE resolution strategy has been applied to the particular bank. In the starting position, the bank meets the capital requirements.



**BANK OF GREECE**  
**EUROSYSTEM**

**Starting Position**

<b>Assets</b>	<b>(€mn)</b>	<b>Liabilities</b>	<b>(€mn)</b>
Cash & Balances with Central Banks	10	Equity	6
Loans & Advances	50	<i>o/w Share Capital</i>	1
		<i>o/w Reserves &amp; Retained earnings</i>	5
		Subordinated debt	5
		Senior unsecured debt	15
		Uncovered deposits	14
		Covered deposits	20
<b>Total Assets</b>	<b>60</b>	<b>Total Liabilities</b>	<b>60</b>

In our scenario, the bank's portfolio of mortgage loans comes under stress due to the poor economic conditions. The national supervisory authority has declared the bank as FOLTF after consultation with the NRA, because of an increasing amount of provisions taken to the specific asset class leading to a breach of the overall capital requirements. Having the bank declared as FOLTF, based on Valuation 1, the NRA assesses whether the other two conditions for resolution are met. The independent valuer appointed by the NRA performs Valuation 2. Based on Valuation 2 results, the bank's mortgage portfolio losses are equal to €10mn and the Net Asset Value (NAV) of the bank is negative (€-4mn).

**Valuation Losses**

<b>Assets</b>	<b>(€mn)</b>	<b>Liabilities</b>	<b>(€mn)</b>
Cash & Balances with Central Banks	10	Equity	6-10=-4
Loans & Advances	50-10=40	<i>o/w Share Capital</i>	
	0	<i>o/w Reserves &amp; Retained earnings</i>	
		Subordinated debt	5
		Senior unsecured debt	15
		Uncovered deposits	14
		Covered deposits	20
<b>Total Assets</b>	<b>60-10=50</b>	<b>Total Liabilities</b>	<b>60-10=50</b>

Based on the valuation losses described above, the NRA places the bank into resolution and applies the bail-in tool (Resolution Decision specifying the details is issued). The amounts of liabilities that are subject to loss absorption and recapitalization needs have also been identified by the independent valuer.



**BANK OF GREECE**  
**EUROSYSTEM**

**Write-down & Conversion**

Assets	(€mn)	Liabilities	(€mn)
Cash & Balances with Central Banks	10	Equity	0
Loans & Advances	40	<i>o/w Share Capital</i>	<i>1-1=0</i>
		<i>o/w Reserves &amp; Retained earnings</i>	<i>5-5=0</i>
		Subordinated debt	5-4=1
		Senior unsecured debt	15
		Uncovered deposits	14
		Covered deposits	20
<b>Total Assets</b>	<b>50</b>	<b>Total Liabilities</b>	<b>50</b>

In this scenario, the share capital as well as the reserves and retained earnings are written down to zero, whereas subordinated debt is partially written down, leading to a NAV equal to zero.

**Recapitalisation**

Assets	(€mn)	Liabilities	(€mn)
Cash & Balances with Central Banks	10	Equity	6
Loans & Advances	40	<i>o/w newly issues Share Capital</i>	<i>6</i>
		<i>o/w Reserves &amp; Retained earnings</i>	<i>0</i>
		Subordinated debt	1-1=0
		Senior unsecured debt	15-5=10
		Uncovered deposits	14
		Covered deposits	20
<b>Total Assets</b>	<b>50</b>	<b>Total Liabilities</b>	<b>50</b>

In order for the bank to be recapitalised, the remaining amount of the subordinated debt as well as part of the senior unsecured debt are both converted into new shares. For simplification purposes, the targeted amount of capital after the recapitalisation is the amount existing before the portfolio of mortgage loans becomes under stress due to the poor economic conditions under the scenario used in the example.

The following section provides a high-level description of the bail-in exchange mechanic.



## **BANK OF GREECE**

### **EUROSYSTEM**

### **Bail-in Exchange Mechanic**

The implementation of the bail-in mechanic involves the following actions:

- a) suspension of trading and delisting or removal of instruments from the trading venues;
- b) write-down and cancellation of relevant capital instruments and bail-inable liabilities;
- c) conversion of bailed-in instruments or liabilities into new equity.

### **Main Stakeholders**

The main external domestic stakeholders to be involved in the bail-in exchange mechanic are the following:

- **HCMC**, that oversees the companies which have securities listed in a regulated market.
- **ATHEX**, that is the operator of the trading venues.
- **ATHEXCSD**, that acts as the CSD and provides services pertaining to transaction settlement, securities registration, corporate actions etc. for all transactions on the Athens Exchange. In addition, the ATHEXCSD constitutes the national organisation for the coding of transferable securities (National Numbering Agency - NNA) and is responsible for the issuance of the ISIN code.

Other key external stakeholders are foreign market authorities, ICSDs, as well as the operational agent that is appointed by the resolution entity and is responsible for acting on its behalf as agent mainly in markets where the credit institution has no access.

### **Suspension of trading**

Suspension of trading refers to a temporary interruption of the trading of shares and other securities to protect markets from the consequences of disorderly and rapid price declines. Although such suspension may occur *ex ante*, it is foreseen to be implemented upon the publication of the Resolution Decision to contribute to clarity and transparency as regards the owners of the securities to be bailed in.

### Suspension of trading of the ordinary shares

According to Internal Article 64(1)(c) of Article 2 of Law 4335/2015, the NRA specifies the suspension in the Resolution Decision and notifies the HCMC accordingly. Then, the latter, which is empowered to impose the trading suspension, requests from ATHEX





## **BANK OF GREECE**

### **EUROSYSTEM**

to suspend trading of shares and/or other instruments within the scope of bail-in issued by the credit institution under resolution in Greece.

In addition, the resolution entity or the operational agent assigned by the institution may, upon the NRA's request, instruct the ATHEXCSD to prevent further settlement after the Record Date<sup>5</sup>. Following the instruction, ATHEXCSD suspends the settlement of the ordinary shares in the Dematerialised Securities System (DSS) records.

#### Suspension of trading of other traded instruments

A suspension of trading of the other issued traded instruments on all relevant markets within the EU and possibly beyond the EU will also take place according to the resolution decision. Within the EU, the ESMA has established a procedure for communicating decisions to suspend or remove financial instruments from trading. The HCMC is obliged to notify the suspension to the ESMA and also to the other relevant market authorities.

More specifically, for securities that are not traded in the ATHEX but in other European Union trading venues, the SARIS protocol (Suspension and Restoration Information System) is available to the HCMC, that enables communication between the domestic market authority and the other market authorities, in order for the relevant authorities to take the necessary actions.

Simultaneously with the aforementioned process, the operational agent should instruct foreign trading venues and ICSD(s) to suspend the trading of the instruments and to prevent further settlements after the Record Date respectively. Transactions entered into the ICSD(s) systems prior to Resolution Decision that are already matched for a future settlement date are still expected to settle. The instructions to the ICSD(s) should include, among other things, the complete list of the affected ISINs and the Record Date to execute the suspension.

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<sup>5</sup> Record Date is the date on which the relevant CSD closes its books for the purposes of capturing the positions that will be affected by the bail in (T+2, which is the time needed for the settlement of transactions that were already entered into the systems on the effective date of the resolution decision).



## **BANK OF GREECE**

### **EUROSYSTEM**

#### **Write-down of ordinary shares**

The execution of bail-in is of paramount importance for the loss absorption and recapitalization of the credit institution and takes place immediately after the entry into force of the Resolution Decision.

The credit institution's ordinary shares are the first type of instrument to be written down. In the event that NAV is negative, as in the scenario described in the previous section, the share capital should be reduced to zero euro (€0), since all the shares currently outstanding are fully written down. The credit institution sends instruction to the ATHEXCSD to execute the write-down process. The shares will be cancelled in the books of the ATHEXCSD, which acts as administrator of the DSS.

#### **Write-down and/or Conversion of other traded instruments**

The next creditors to be affected, based on the national insolvency law, are the owners of Additional Tier 1 and Tier 2 instruments, other contractually subordinated liabilities, Senior non-preferred liabilities, Senior preferred liabilities, etc. In order for the bail-in process to be executed, the credit institution communicates to the operational agent the perimeter of the write-down and conversion of the traded instruments. The operational agent prepares and forwards the technical instructions to the ICSD(s), which include indicatively the ISINs subject to the write-down and/or conversion, the applicable conversion rate, and the effective date of the write-down and/or conversion. Subsequently, the ICSD(s) perform the write-down per affected ISIN. In case of a full write-down, the value of the respective instrument is written down to zero and thus the instrument is cancelled. Finally, the ICSD(s) send SWIFT messages to the operational agent confirming the execution of the write-down.

Subsequently, in order to recapitalise the credit institution, bail-inable liabilities will be converted into newly issued shares. The Resolution Decision defines the recapitalisation needs including as a minimum the number of new shares and the nominal value of each share. Specifically for the traded instruments, the ICSD(s) should provide the credit institution with the list of bondholders who, following the conversion, will be the new shareholders. Based on the information received from the ICSD(s), the credit institution will share the list of new shareholders with the ATHEXCSD. The credit institution under resolution should take preparatory steps before the issuance of shares.



**BANK OF GREECE**  
**EUROSYSTEM**

These includes preparing documentation and liaising with the ATHEXCSD in order to obtain the ISINs for the new shares.

**Admission to trading and listing of new instruments**

The procedure for the listing of the new shares will be launched after all processes for loss absorption, write-down & conversion of capital instruments and bail-inable liabilities and issuance of the new shares have been finalised.

As foreseen in internal Article 53(2)(c) and (d) of Article 2 of Law 4335/2015, in conjunction with the Prospectus Regulation 2017/1129, Article 1(5)(c), there is no requirement for prospectus issuance regarding the admission to trading of new shares. New shares issued will not yet be traded. Return to trading is not mandatory. At the request of the NRA or upon proposal of the credit institution, the ATHEX would (re-) admit the new shares to trading.