

TOOL01

TOOL FOR THE DEMONSTRATION AND ASSESSMENT OF ADDITIONALITY

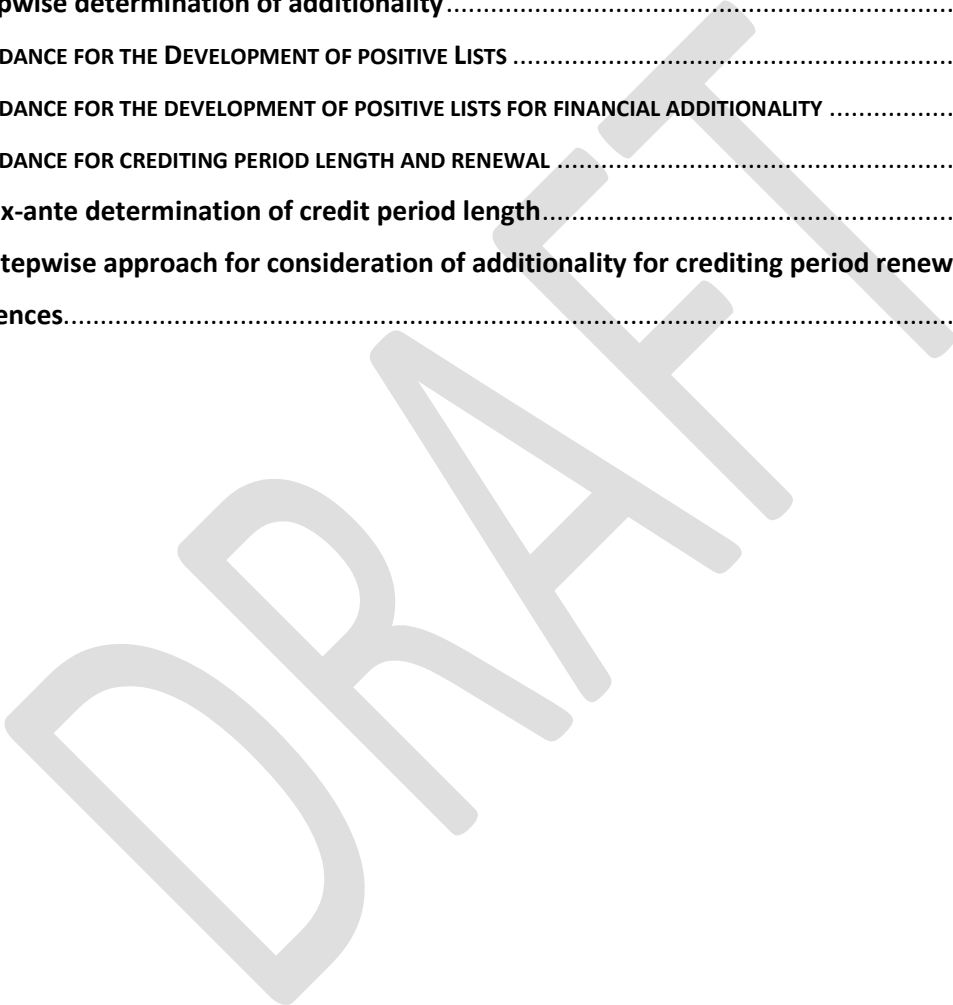
Tool

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INTRODUCTION

BACKGROUND

1. Additionality testing aims to ensure that only mitigation outcomes that require carbon market support are credited under baseline-and-credit schemes, so that carbon finance is not spent on mitigation that would have been achieved anyway. If carbon finance is directed toward such non-additional activities and redirects resources from where additional mitigation would occur, the efficiency of global efforts to address climate change will be undermined and global emissions will increase in case NDC targets are less ambitious than business-as-usual. If a host country has an ambitious NDC and is committed to achieve its targets, a non-additional mitigation outcome may be compensated for by additional action to achieve the NDC. However, that would still lead to an inefficient allocation of resources within the country and could make it difficult for the host country to achieve its NDC. If non-additional mitigation outcomes are transferred and not compensated for by more action in the host country, which is the case if the NDC has a target above business as usual, then offsetting emissions with such non-additional mitigation outcomes leads to an increase in global emissions, compared to a scenario without such transfers. Therefore, a robust assessment of additionality is key to ensuring the quality of the mitigation outcomes and the efficiency and environmental integrity of carbon market mechanisms.
2. As a criterion, additionality is known already from the Kyoto Protocol flexibility mechanisms - Joint Implementation (JI) and the Clean Development Mechanism (CDM). Under the CDM, methodologies included steps to determine additionality, and later these approaches were summarised in tools¹.
3. With the implementation of the Paris Agreement, determining additionality must be done in the context of the obligation of Parties to implement their NDCs and to increase ambition in mitigation and adaptation action to contribute to achieving the long-term objectives of the agreement. The Article 6 rulebook - in particular the rules, modalities, and procedures (RMP) of the Article 6.4 mechanism (A6.4M) - clarifies new principles and requirements for the demonstration and assessment of additionality.
4. In January 2022, the “International Initiative for Development of Article 6 Methodology Tools” (II-AMT) was launched with the aim of developing methodological tools that guide the revision of existing methodologies when applied to activities implemented in the context of Article 6 of the Paris Agreement. These tools cover additionality determination, baseline setting and MRV, while a guidance document covers NDC-related aspects.

OBJECTIVES

5. This TOOL01 provides a robust approach and guidance for project proponents to demonstrate that their proposed mitigation activities can be considered additional in the context of Article 6 of the Paris Agreement. TOOL01 has been developed based on experience with and lessons learned from the application of the CDM additionality tool and other approaches to additionality assessment applied in international carbon markets. It is a stand-alone tool for additionality under Article 6 for **project** and **programme**-level activities and does not cover sectoral or policy level interventions. A combined tool for baseline setting and additionality is not presented at this time.

The following experts of the II-AMT have led the development of this tool:

- a. Axel Michaelowa, Perspectives Climate Research, Switzerland

¹ The most widely applied CDM tools for additionality are the “Tool for the demonstration and assessment of additionality” with its latest version (version 7) adopted in November 2012 and the “Combined tool to identify the baseline scenario and demonstrate additionality” with the latest version (version 7) from September 2017. These tools refer to separate tools for common practice analysis, currently in version 3.1 from June 2015, and for investment analysis. The latter has been revised frequently, with the current version 11 adopted in October 2021.

- b. Randall Spalding-Fecher, Carbon Limits, Norway
- c. Derik Broekhoff, Stockholm Environment Institute, USA
- d. Jessica Wade-Murphy, Atmosphere Alternative, Colombia

The following experts supported the development of this tool:

- e. Clayton Munnings, Munnings Consulting, USA
- f. Kentaro Takahashi, International Institute for Global Environmental Studies, Japan
- g. Martha Ntabadde, freelance consultant and member of the CDM Methodology Panel, Uganda
- h. Ximena Samaniego, Perspectives Climate Research, Germany

RULES AND PRINCIPLES

- 6. This tool has been developed based on the following principles enshrined in the decision 2/CMA.3 and 3/CMA.3 adopted by the Parties to the Paris Agreement:
- 7. **Guidance on cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement**

“1. Internationally transferred mitigation outcomes (ITMOs) from a cooperative approach are:

(a) Real, verified and **additional**; [...]” (Decision 2/CMA.3, annex, paragraph 1)

- 8. **Rules, modalities, and procedures of the A6.4M**

31. The activity: (a) Shall be designed to achieve mitigation of GHG emissions that is **additional**, including reducing emissions, increasing removals and mitigation co-benefits of adaptation actions and/or economic diversification plans (hereinafter collectively referred to as emission reductions), and not lead to an increase in global emissions; [...]

38. Each mechanism methodology shall specify the approach to demonstrating the additionality of the activity. Additionality shall be demonstrated using a **robust assessment** that shows the activity **would not have occurred in the absence of the incentives from the mechanism**, taking into account all **relevant national policies, including legislation**, and **representing mitigation that exceeds any mitigation that is required by law or regulation**, and taking a **conservative approach** that **avoids locking in levels of emissions, technologies or carbon-intensive practices** incompatible with **paragraph 33²** above.

(Decision 3/CMA.3, annex, paragraphs 31 and 38)

- 9. In addition, the following principles are relevant for this tool:
 - a. Each participating party shall ensure that participation in Article 6 contributes to the implementation and achievement of their NDCs, LT-LEDS, and long-term goals of the Paris Agreement (most notably Decision 2/CMA.3, annex, paragraph 4.f and Decision 3/CMA.3, annex, paragraph 28.b) (see II-AMT GUIDE01)
 - b. The assessment shall deliver **consistent results** for similar activities in the same relevant context conditions. For that to work, the additionality tool must contain mandatory steps for all activities and only few optional assessments. To allow for **consistent validation** by third

² Paragraph 33 reads: “Mechanism methodologies shall encourage ambition over time; encourage broad participation; be real, transparent, conservative, credible, below ‘business as usual’; avoid leakage, where applicable; recognize suppressed demand; align to the long-term temperature goal of the Paris Agreement, contribute to the equitable sharing of mitigation benefits between the participating Parties; and, in respect of each participating Party, contribute to reducing emission levels in the host Party; and align with its NDC, if applicable, its long-term low GHG emission development strategy if it has submitted one and the long-term goals of the Paris Agreement.” (Decision 3/CMA.3, annex, paragraph 33).

Party auditors, the tool must provide detailed guidance on how to apply the different steps (See II-AMT TOOL03, paragraph 65).

- c. The assessment shall include a characterisation of the inherent risks to additionality relevant to the general activity type and to the specific project conditions, as a reality check of the additionality assessment. Safeguards include:
 - Automatic financial additionality through **positive lists** shall only be applicable to activity types in circumstances where few, if any, activities are occurring without carbon credit revenue. National and international positive lists for financial additionality must be updated regularly.
 - Mandatory re-assessment of parts of additionality determination steps at the time of **crediting period renewal**.
 - Mandatory restriction of choices for **crediting period length** under certain circumstances.
- d. The assessment shall utilise information communicated in the respective host country NDC as a reference point for additionality demonstration.

SCOPE AND APPLICABILITY

10. This tool provides a general framework for demonstrating and assessing additionality of activities implemented in cooperative approaches under Article 6.2 of the Paris Agreement, subject to approval by participating Parties, and aims to inform the development of more detailed rules by the Supervisory Body of the Article 6.4 mechanism.
11. This tool provides for a **stepwise approach** to assess and demonstrate the additionality of **projects** and **programmatic** approaches (collectively called “mitigation activities”) in an applicable geographic area that is both in line with the Article 6.2 guidance and the RMPs of the A6.4M, the latter offering more detail on how to robustly determine additionality under Article 6. It is not applicable to mitigation activities on a higher level of aggregation such as sectoral approaches or mitigation policies. This tool does not replace the need for baseline methodologies to provide a stepwise approach to identify the baseline scenario for a mitigation activity. Activity participants shall ensure consistency between the determination of additionality of an activity and the determination of a baseline scenario (see II-AMT TOOL02).
12. In validating the application of this tool, independent designated operational entities shall carefully assess and verify the reliability and credibility of all data, rationales, assumptions, justifications³, and documentation provided by activity participants to support the demonstration of additionality. In this context, they shall also **identify and cross-check available independent sources and documentation**. The information checked during this assessment and the conclusions shall be documented transparently⁴. The host country NDC shall be one of the sources assessed during this process (see II-AMT TOOL03, paragraphs 65-68). In addition, designated operational entities should incorporate any comments from the global public consultation about the data rationale assumptions and make sure that it is properly addressed.
13. TOOL01 includes detailed guidance for a stepwise approach to determine additionality by considering the elements of “**prior consideration**”, “**regulatory** additionality”, and “**financial** additionality”, summarised in and detailed in paragraphs 18-21. The different steps entail⁵:

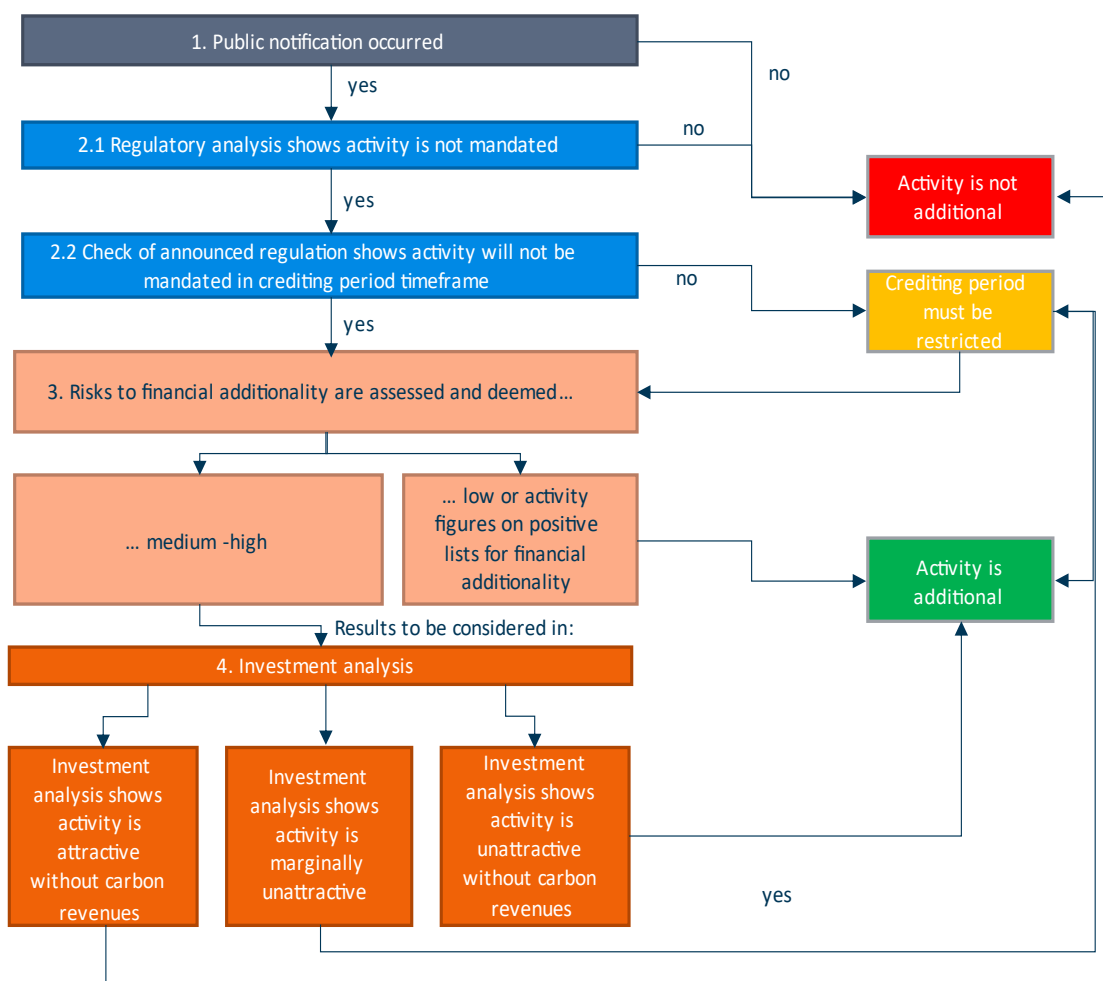
³ DOEs’ role and the level of detail of the guidance and the kinds of benchmarks or independent sources auditors should consult will be elaborated in a future version of the tool.

⁴ The II-AMT experts recommend exploiting the benefits of digitisation in Article 6 cooperation in this context. Governments participating in cooperative approaches could agree to keep information on data, assumptions and, benchmarks in a database that auditors can access to cross-check information provided in mitigation activity design documentation.

⁵ The tool does not include a step for common practice analysis. While the principle is important, there has been no robust operationalisation so far that provides added value for the determination of additionality, mostly given difficulties in accessing the necessary data.

- a. Checking for **public notification** of the intent to earn carbon credits prior to the start of the activity.
- b. Determining regulatory additionality to confirm that the activity is **neither mandated by law**, nor is the mitigation it achieves **effectively required by regulation**. This step also includes a check of whether existing and promulgated regulations would mandate the activity at any point during the crediting period.
- c. Evaluating the risk that the activity type is **financially attractive without carbon revenue**, to decide if an investment analysis is required.
- d. Determining financial additionality of the activity based on an investment analysis.

FIGURE 1: FLOWCHART OF PROPOSED STEPWISE PROCESS FOR DEMONSTRATION OF ADDITIONALITY

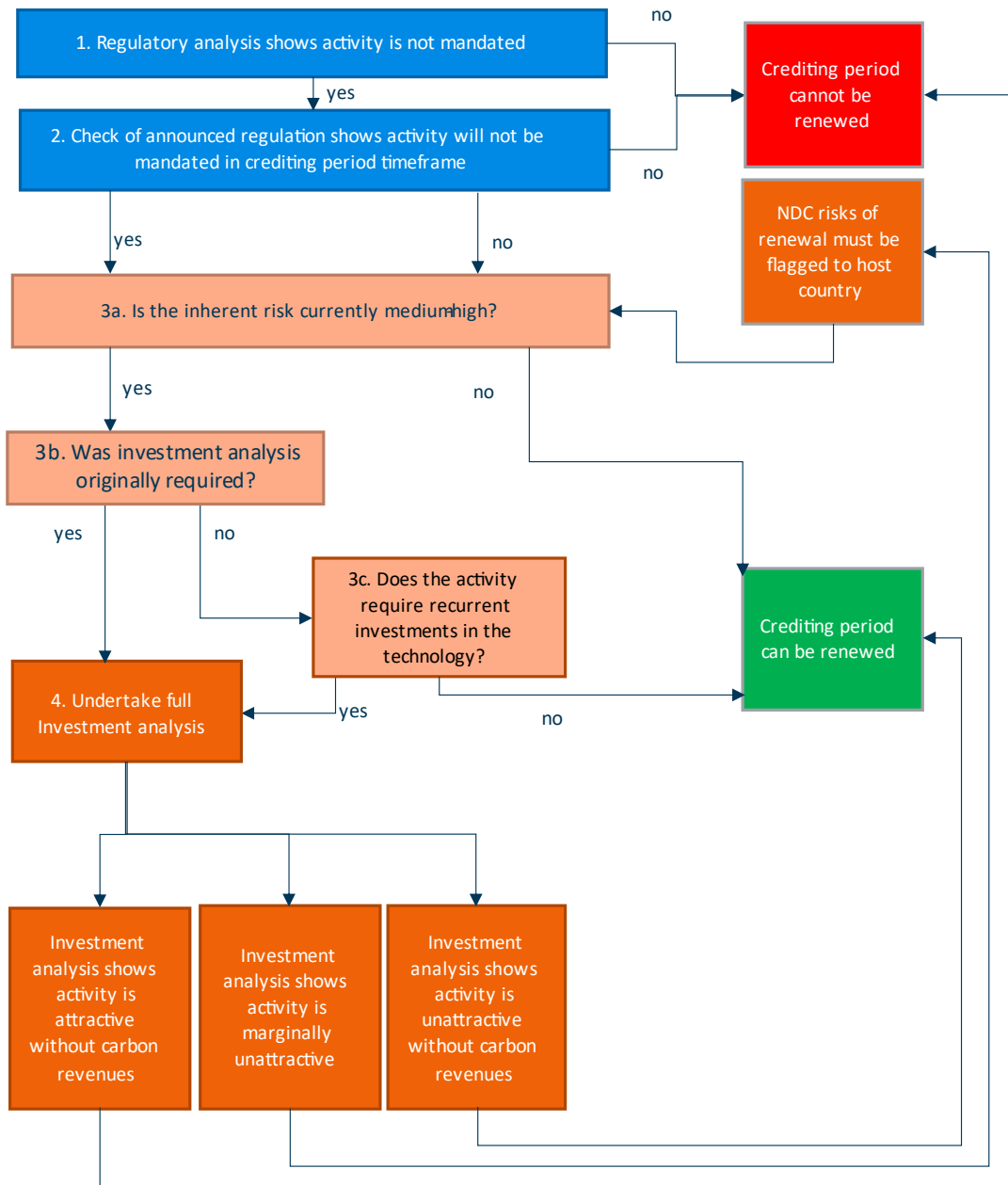


Source: II-AMT 2022

14. TOOL01 also includes guidance on the development of **positive lists** for financial additionality at different levels of aggregation. The guidance includes necessary requirements for elaborating and regularly updating positive lists. Details are provided in paragraphs 23-30
15. TOOL01 includes guidance on potential **restrictions of the crediting period length** based on financial and implementation characteristics of the mitigation activity. Longer crediting periods are required for projects with high up-front investments, long technical lifetimes and relatively low annual credit revenues. Further details are provided in paragraphs 31-32.

16. TOOL01 furthermore includes guidance on re-assessing regulatory, and financial additionality of the activity when applicable at **crediting period renewal** in a stepwise approach as depicted in Figure 2, with further details provided in paragraphs 33-34.

FIGURE 2: FLOWCHART OF PROPOSED STEPWISE APPROACH TO RE-ASSESS ADDITIONALITY AT CREDITING PERIOD RENEWAL



Source: II-AMT 2022

TERMS AND DEFINITIONS

17. The following terms and definitions are applied.

- a. **Applicable geographic area:** The area which is in line with the **level of aggregation** applied in the respective baseline approach. The default should be the national level, if lower levels of aggregation are applied, subnational jurisdictions should be used.
- b. **Barrier analysis:** A check whether **prohibitive, non-monetary barriers** exist that cannot be considered in an investment analysis. It must demonstrate that these barriers would not be faced by alternatives to the mitigation activity and that the expectation of carbon credit revenues is decisive for overcoming these barriers. Barrier types may include: unavailability of third-party financing, split incentives (e.g., the investor not being the beneficiary of cost savings associated with the investment) or other barriers if they are specific to the mitigation activity and/or region where the mitigation activity is implemented. The identification of the barriers shall be **specific** and, where possible, **quantified**. The analysis shall include clear, objective and verifiable evidence to demonstrate the prohibitive character of an identified barrier or their combination. Finally, the analysis must indicate how carbon revenues will be applied to overcome the identified barriers and demonstrate that expected revenues will be sufficient to do so.
- c. **Emissions intensive practice/technology:** A technology/technique that has a GHG emissions intensity per unit of production/consumption that exceeds intensity of the lowest emitting, technically feasible and commercially available production pathway for the product, service, or output delivered.⁶
- d. **Financially [viable][feasible]:** The activity would likely be undertaken without revenues from international carbon markets.
- e. **Host country approval list:** an activity on a host country approval list is deemed eligible for approval and authorisation by a host country government (definition of the term as used in the context of the II-AMT).
- f. **Lifetime of technology:** Total time for which the equipment is technically designed to operate from its first commissioning.
- g. **Lock-in of emission levels⁷:** The proposed activity does lead to a **prolongation** of the lifetime of emissions-intensive technologies (for both new installations and refurbishments of existing installations). For activities that lead to the replacement of technologies with a high emissions intensity by technologies with a lower emissions intensity: the emissions intensity of the new technology is not **aligned with generally accepted (IPCC/IEA) emissions scenarios** for reaching the long-term goal of the Paris Agreement or the host country LT-LEDS.
- h. **Payback period:** Amount of time required to recover the discounted cost of an investment.
- i. **Positive list:** An activity on a positive list is **deemed automatically additional** in relation to all or specific aspects (e.g., financial additionality, regulatory additionality).
- j. **Relevant Law / Mandate / Regulation / Policy:** Regardless of the exact terminology used in the respective national context, any legally binding laws, rules, mandates, regulations, statutes, agreements, or other legal requirements in force at national level, subnational, or local levels applicable to the proposed mitigation activity, and that [trigger] [require] technical, performance, or management actions.
- k. **Similar economic and social context:** key economic (GDP per capita, etc.) and social (Gini coefficient, etc.) parameters are in the range of $\pm 50\%$.

⁶ In the further process, the linkage between item c and g will be considered.

⁷ The applicability of this definition will be elaborated further in the next version.

- I. **Start date**⁸: The date on which the activity participants **commit to making expenditures** for the undertaking of the activity, or for the construction or modification of the main equipment or facility associated with the activity, or for the provision or modification of a service associated with the activity. Where a contract is signed for such expenditures, it is the date on which the contract is signed. In other cases, it is the date on which such expenditures are incurred. Activities incurring minor pre-project expenses (e.g., feasibility studies, and preliminary surveys) are not considered in the determination of the start date.

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⁸ Adjustment on this definition based on the discussion about prior notification will be elaborated further in the next version.

METHODOLOGY PROCEDURE

This section explains the step-by-step process to implement the tool.

STEPWISE DETERMINATION OF ADDITIONALITY

18. Step 1 - MANDATORY: Public notification of intent to earn carbon revenue prior to start of the activity

- a. Demonstrate that **carbon market revenues were considered** by the activity participants **in the investment decision** of the activity by undertaking a public notification of the intent to earn carbon revenue. This notification shall include the mitigation activity title, location, brief description, and identification of at least one activity participant. The notification may take the forms of:
 - i. A letter, fax or e-mail with date stamp from the activity participant to the host country government, the UNFCCC Secretariat, and/or the participating Parties of a cooperative approach.
 - ii. While available and until an A6.4 specific procedure is established, the CDM Prior Consideration procedure may be applied.
 - iii. Publication in a medium with date stamp, including a newspaper, magazine, newsletter, or social media post.
- b. The notification must occur prior to the start of the activity⁹. [In a transitional period until 31/12/2023, a grace period is applied where notification must occur within three months of the activity start date.]

19. Step 2 - MANDATORY: Determination of regulatory additionality:

- a. For this step, the **applicable jurisdictional boundaries** include regional/supra-national, national, subnational, and local jurisdictions pertinent to the mitigation activity. All relevant levels need to be covered.
- b. Only **specific policy instruments** are considered; overarching policy targets or generic plans without specified instruments or means of implementation are not considered
- c. Sub-step 2.1- MANDATORY: Regulatory analysis to determine that the proposed activity is **neither directly mandated by law nor otherwise triggered by legal requirements or agreements**.
- d. Sub-step 2.2- MANDATORY: Regulatory analysis to determine that there are **no forthcoming legal requirements** that trigger the activity once they go into effect during the activity's forthcoming crediting period. If forthcoming legal requirements are identified, then the crediting period initially shall be limited until the date the legal requirements are implemented.

20. Step 3- MANDATORY: Evaluation of inherent financial additionality risks of the specific activity type

- a. This is a pre-step for the determination of financial additionality to ensure realistic assumptions are provided by the activity proponent in comparison to the risk scenario described.
- b. Applicable geographical area: Country

⁹ The details of transitional period, i.e. linkage with the eligibility period established in the guidelines of the PA (pre and post 2020), and a more precise definition of the start date of the activity will be elaborated further in the next version.

- c. List and characterisation of the **inherent** financial additionality risks related to this specific activity type (e.g., evidence of potential profitability, ample experience, availability of subsidies, availability of competitive financing sources, etc.).
 - i. Includes analysis of whether the **only source of revenue or savings of the activity is the revenue from the sale of mitigation outcomes**. Activity types that feature such characteristics in all possible contexts shall be deemed to have a “low” inherent additionality risk.
- d. List and characterisation of **risks** to the activity type implementation (e.g., long payback periods, barriers including unavailability of the technology, lack of financing sources, lack of access to financing, lack of human capacity).
- e. Conclusions on:
 - i. The consolidated **inherent additionality** risk (high, medium, low):
 1. High, meaning the activity type is implemented **frequently** without incentives from the mechanism;
 2. Medium, meaning the activity type **has been implemented** without incentives from the mechanism; or
 3. Low, meaning the activity type **has not been implemented** without incentives from the mechanism.
 - ii. the consolidated **implementation risk** (high, medium, low)
- f. If consolidated inherent additionality risk is assessed as:
 - i. Low: Activities are eligible for a **global positive list** for financial additionality and do not have to go through Step 4
 - ii. Medium: Step 5 (**investment analysis**) is mandatory.
 - iii. High: Step 5 (investment analysis) is mandatory. In addition, the activity proponent must justify how the specific activity differs from the general implementation of the activity type by justifying the input(s) to its financial analysis that drive financial unattractiveness.
- g. If consolidated implementation risk is deemed
 - i. Low: **Barriers shall not be included** in the investment analysis and not considered further.
 - ii. Medium or High: Barriers to implementation may be incorporated in the investment analysis and impacts on the investment decision explained in step 4^{10, 11}.

21. Step 4: Determination of financial additionality of the activity through investment analysis (MANDATORY step if inherent financial additionality risk is medium or high):

- a. Investment analysis of the activity to determine that it is **not financially feasible** without the expected revenues from the sale of the certified mitigation outcomes **internationally**.
 - i. This analysis requires identification of what is a financially viable and realistic alternative(s) to the project in **similar social, economic, and regional contexts**. This will provide the point of comparison for the analysis to identify the value of the economic assessment parameter (e.g., internal rate of return, payback period) at which a project would **not** be deemed economically / financially feasible, considering all revenues and savings generated by the project¹².

¹⁰ Special circumstances of LDCs, SIDS apply in this step and for mitigation activities located in LDCs, barriers to implementation may be considered as a complement to the investment analysis, while for other countries they must be incorporated in the investment analysis as explained in Step 5.

¹¹ In the absence of such a decision, programme developers must refer to the latest version of the “guidelines on the assessment of investment analysis” approved by the CDM EB in its most recent version and in particular the default values for the expected return on equity listed therein.

¹² For the next version, experts will assess who to define “realistic” alternative scenarios. Definitions of alternative scenarios may be linked to the concept of best available technologies and techniques.

- ii. This analysis needs to include all revenues and savings generated for the activity, including any incentives related to policy instruments, such as all kinds of subsidies (e.g., grants, reverse auctions, contracts for difference etc.), avoided carbon taxes, financial impacts of emissions trading schemes, etc.
 - iii. The analysis may include any identified medium and high risks to implementation. These risks generated by the barriers identified need to be **expressed in monetary terms**, e.g., in changes in cash flow due to slower activity implementation, lower load factors, risk-adjusted discount rate, etc. If this is not possible, then the risk cannot be considered, which leads to conservative outcomes.
- b. Conclusions on degree of confidence on financial additionality:
- i. If the activity is like to be attractive without the revenues from credit sales, then the activity is not considered additional¹³.
 - ii. If the activity type is only **marginally unattractive**¹⁴ under a realistic sensitivity analysis, economic parameters such as IRR or payback period of the viable alternative and the mitigation activity overlap, the activity is considered financially additional, but the **crediting period must be restricted** as detailed in paragraph 31.
 - iii. If the investment analysis concludes to a medium to high degree of confidence that the activity would not be attractive without the revenues from credit sales, then the activity is financially additional.

22. Step 5 – MANDATORY: Re-assessment of regulatory additionality at the point of crediting period renewal (see paragraph 31).

- a. Reapply Step 2 as specified in para 19 above.

¹³ Barrier analysis exemptions may be applicable for activities located in LDCs, SIDS. If an activity is in an LDC and implementation risk is medium or high, if the identified implementation non-monetary barrier is overcome by the fact that the activity is framed as an Article 6 activity and receives carbon revenues, it may be deemed additional. Specific barriers need to be defined in this context.

¹⁴ How to define this category and how would be evaluated in relation to the crediting period renewal will be elaborated further in the next version.

GUIDANCE FOR THE DEVELOPMENT OF POSITIVE LISTS

- 23.** In the following, positive lists are defined as a list of activity types **deemed automatically additional** in relation to all or specific aspects (e.g., financial additionality, regulatory additionality). In the context of the II-AMT, positive lists for additionality must meet minimum criteria specified below before they can be used to substitute step 5 of the procedure (i.e., financial additionality) of this Tool.
- 24.** The process for developing global and national positive lists should include the following
- Inputs from experts in the development of the list
 - Public consultation period
 - Independent assessment and validation of the outcomes of the development process
- 25.** Positive lists may be adopted by the Article 6.4 Supervisory Body (for use in the Article 6.4 mechanism or in cooperative approaches), other independent standards as well as parties to the Paris Agreement (for use in cooperative approaches).

GUIDANCE FOR THE DEVELOPMENT OF POSITIVE LISTS FOR FINANCIAL ADDITIONALITY

In the development of positive lists for financial additionality, the following approaches may be considered. Further approaches may also be elaborated by the A6.4 SB:

- 26.** Activity types that under all contexts can show that their net present value of costs significantly, e.g., by at least 25%, exceeds revenues and savings without carbon finance are eligible to be put on a **global positive list** of “low risks to financial additionality”.
- 27.** Activity types are eligible to be put on a **national positive list** if they in their national context can show that
- their costs significantly exceed revenues and savings so that their **IRR is negative under conservative assumptions** regarding the discount rate.
 - their **levelized costs of delivering a product or service** are more than 25% higher than the industry average,
 - their **marginal abatement cost** exceeds a country specific benchmark value.
- 28.** Global and national positive lists for financial additionality are to be **reviewed every three years**

GUIDANCE FOR CREDITING PERIOD LENGTH AND RENEWAL

- 29.** Guidance for crediting period length and renewal is based on the analysis of the relationship between technology lifetime and type and timing of investment decisions (e.g., for **one-off** investments versus **replacement** and **renewed investment decisions** into the same activity), building on the crediting period length fixed under the Article 6.4 mechanism at either a maximum five years renewable twice or at ten years non-renewable.

EX-ANTE DETERMINATION OF CREDIT PERIOD LENGTH

- 30.** If the activity is marginally unattractive, restriction of crediting period
- to the **payback period** of the project investment if the investment decision is one-off
 - the **lifetime of technology** if the activity requires replacement and additional investments.
- 31.** In case of replacement and/or additional investments and a technology with a lifetime of less than five years (e.g., 3 years), the initial crediting period should be a maximum of five years renewable.

STEPWISE APPROACH FOR CONSIDERATION OF ADDITIONALITY FOR CREDITING PERIOD RENEWAL

- 32. Step 1 - MANDATORY: Assessment of regulatory additionality**
- 33. Step 2: Assessment of financial additionality for replacement and/or new investments into the activity**

- a. Whether this step is mandatory depends on the relationship of technology lifetime and investment decision:
 - i. In case no investment analysis was required, and the **inherent risk is still considered low** (i.e., due to low financial additionality risk) a re-assessment of financial additionality risk is **not** required. If risk is now deemed medium-high for activity type, investment analysis is now required based on current data.
 - ii. In case of a **one-off investment** decision in a technology with a lifetime that is longer than the crediting period, re-assessment of financial additionality is not required if this was done for the first crediting period.
 - iii. In case of **replacement investments** in a technology with a lifetime shorter than the crediting period or additional investments to scale up the activity, the project is required to undertake an investment analysis for the renewal.

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