Factsheet
February 2025

fi-compass Knowledge Hub

Do No Significant Harm and Climate-proofing in the context of ERDF/CF financial instruments in the 2021-2027 programming period

European Commission

European Investment Bank

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The Knowledge Hub

The Knowledge Hub has been developed to meet the growing need amongst experienced practitioners for events and materials that provide a more in-depth look into topics affecting financial instruments. Its format utilises email exchanges to promote a longer term engagement between participants together with traditional face to face workshops to allow experienced practitioners to work together to explore the subject matter through peer to peer exchange and expert-led sessions.

In order to encourage openness between the parties the discussions are undertaken under the Chatham House Rule which states: 'When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.'

In particular, the representatives of the European Commission, DG REGIO have participated in the Knowledge Hub to receive feedback from the Member States concerning the implementation of Do No Significant Harm and Climate-proofing in the context of ERDF/CF financial instruments in the 2021-2027 programming period. The participation of the representatives of the European Commission and the European Investment Bank should not be interpreted as an official endorsement of any of the suggestions that may be discussed and/or described during the Knowledge Hub.

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Introduction

In April 2024, financial instruments (FI) practitioners and experts from the European Commission (EC) and European Investment Bank (EIB) came together to discuss the application to FI operations of two new principles described in Appendix 2 introduced by the Common Provisions Regulation (2021/1060) (CPR), namely:

- The 'Do No Significant Harm' (DNSH) principle which applies to FIs by virtue of:
  - Recital 10 CPR which states, "the Funds should support activities that would respect the climate and environmental standards and priorities of the Union and would do no significant harm to environmental objectives within the meaning of Article 17 of Regulation (EU) No 2020/852" ("The Taxonomy Regulation"); and
  - Article 9(4) CPR which states, "the objectives of the Funds shall be pursued in line with the objective of promoting sustainable development as set out in Article 11 TFEU, taking into account the UN Sustainable Development Goals, the Paris Agreement and the 'do no significant harm' principle"; and
- The 'climate proofing' requirement under Article 73(2)(j) CPR for FI operations supporting investments in infrastructure with an expected lifespan of over 5 years.

During the session, participants considered several relevant documents which help describe the potential approaches to compliance with DNSH and climate proofing principles. In 2021, the European Commission published an explanatory note on the application of DNSH to Cohesion Policy (the EGESIF guidance)[1]. Technical guidance on the application of the DNSH principle in the context of the Recovery and Resilience Fund (RRF) was published by the Commission in 2023 (the RRF Guidance)[2]. Further technical guidance has been published in relation to sustainability proofing in the context of InvestEU[3] (InvestEU sustainability proofing guidance).

In addition, the JRC Science for Policy report entitled, 'The implementation of the Do No Significant Harm principle in selected EU instruments', (the JRC Report)[4] reflects how the DNSH principle is applied in the context of the ERDF/CF. This forms part of a comparative study which also considers the same question for the EU Taxonomy, Recovery and Resilience Fund (RRF), Just Transition Fund (JTF) and InvestEU[5].

1 EGESIF_21-0025- Commission explanatory note, 'Application of the "do no significant harm" principle under Cohesion Policy, including: ERDF, CF, ESF+ and JTF: https://ec.europa.eu/transparency/expert-groupsregister/core/api/front/document/64317/download.
2 Commission Notice – Technical guidance on the application of do no significant harm under the Recovery and Resilience Facility Regulation C/2023/6454.
3 COMMISSION NOTICE Technical guidance on sustainability proofing for the InvestEU Fund (2021/C 280/01).
4 Beltran Miralles, M., Gourdon, T., Seigneur, I., Arranz Padilla, M. and Pickard Garcia, N., The implementation of the 'Do No Significant Harm' principle in selected EU instruments, Publications Office of the European Union, Luxembourg, 2023, doi:10.2760/18850, JRC135691.
5 Technical guidance on the application of 'do no significant harm' under the Recovery and Resilience Facility Regulation'.

02 Key notes

DNSH applies to FIs implemented under the CPR and therefore managing authorities must be able to demonstrate compliance with the principle.

DNSH is a horizontal principle provided for in Article 9(4) of Regulation (EU) 2021/1060 ('CPR') that must be taken into account in pursuing the policy objectives of the programme. Member States are responsible for the implementation of this principle throughout the programming period. Therefore, application of DNSH must be ensured during both programming (ex-ante) and programme implementation (ex post).

The DNSH principle is operationalised at the level of the programme where managing authorities (MAs) ex-ante assess the compliance of each type of action with the principle, including ones that will be financed via financial instruments (FIs). FI operations need to fall under the scope of the types of actions which have been assessed as DNSH compliant in the adopted programmes.

The ex-post monitoring of the application of the DNSH principle in the process of implementation of FI and/or related investments will be needed in cases, where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action or related investments. Only in that case, is it recommended that the principle of DNSH be reflected or considered in the funding agreement between the MA and the bodies implementing FI. The DNSH principle may also be reflected or considered in national eligibility rules regardless of the form of support (grant or FI), where applicable.

Experience shared during the event showed that MAs had adopted a straightforward and practical approach to assessing the DNSH compliance of their programmes and all programmes contain a statement confirming that DNSH has been assessed.

The approach adopted was often a result of following approach taken from RRF Guidance although MAs usually adapted it to suit local circumstances. In many cases the simplified approach from the RRF guidance was considered sufficient given the nature of FI operations.

As many ERDF/CF FIs target relatively simple Energy efficiency and Renewable energy projects, it is often straightforward to demonstrate alignment with the DNSH principle. On the other hand, FIs supporting SME access to finance (including more specialist innovation FIs) and urban development are not by their nature necessarily directly aligned with DNSH but can, nevertheless be assessed as compliant at programme level.

Programme level assessments of DNSH compliance are relatively straightforward for ERDF and CF Policy Objective 2 FIs (a greener, low-carbon transitioning towards a net zero carbon economy and resilient Europe) (PO2) due to the nature of the actions. It is more complex for assessing SME access to finance given the diverse range of SMEs and their potential investments. However, SME financing may be considered DNSH compliant at programme level where it is proposed to incorporate a suitable exclusion list at the implementation stage. Likewise, urban development FIs, whilst not being directly linked to climate action can be assessed as DNSH compliant through a similar approach.

Additional DNSH compliance assessments should be undertaken and/or selection criteria set at the implementation stage, in relation to specific FIs only in cases where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action or related investments.

Further DNSH related monitoring/ assessments can be undertaken where, for example, programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action. In such cases a DNSH assessment may be necessary during the selection of the bodies implementing the FI and/or as part of the Investment Strategy of the FI and it is recommended that the principle of DNSH be reflected or considered in the funding agreement between the MA and the bodies implementing FI. Additionally, in some cases where an FI channels Cohesion policy resources and Recovery and Resilience Fund investments, an assessment must be done as required by the RRF Regulation[6].

Where it has been necessary to pass DNSH assessment obligations down to the bodies implementing FIs, MAs have tried to simplify the procedure as far as possible. The use of checklists aligned to exclusion criteria is common.

Participants agreed that passing down DNSH assessment to bodies implementing FIs was not the usual approach. Wherever possible it should be avoided as passing down DNSH requirements to implementing bodies will both incur additional administrative burden and may result in excluding many projects putting the financing of the green/ clean transition at risk. Usually, once a positive assessment of DNSH compliance is ascertained at the level of the programme, where no mitigating measures have been identified, the subsequent funding agreements for the implementation do not require the implementing body to undertake DNSH assessments. However, where it has been necessary to do this, it was recognised that the MA should do all it can to simplify the procedure to be undertaken. In practice DNSH assessment can be undertaken at the ex-ante, set-up and operational phases of the FI life cycle, when it is necessary (exceptionally) to include a DNSH assignment during the implementation phase.

The requirement in Article 73(2)(j) CPR to ensure the climate proofing of investments in infrastructure applies to FI operations.

The MA must ensure that the body implementing the FI[7] undertakes a climate proofing assessment in accordance with the EC Technical Guidance[8] for all projects that involve the investment in infrastructure with an expected lifespan of at least five years.

The MA may define infrastructure so as best to capture the local context. The references to potential types of infrastructure in the EC Technical Guidance and other regulations, which is potentially very wide, should NOT be treated as formal definition.

The MA may define infrastructure by reference to local planning or Energy Performance rules (such as the definition of major infrastructure) introduced following the EC's Energy Performance of Buildings Directive[9] (EPBD). A minimum project size may also be adopted (for example the EUR 10 million threshold in the InvestEU sustainability proofing guidance was considered during the discussion) As long as the decision is reasonable and documented the MA can ensure an appropriate definition of infrastructure can be used for application of the Climate Proofing requirements.

6 Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility.
7 Also referred in the text as 'implementing body'.
8 CRITICAL INFRASTRUCTURE PROTECTION & RESILIENCE - EC Technical Guidance on Climate Proofing of Infrastructure (europa.eu) CRITICAL INFRASTRUCTURE PROTECTION & RESILIENCE - EC Technical Guidance on Climate Proofing of Infrastructure (europa.eu).
9 DIRECTIVE (EU) 2024/1275 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 April 2024 on the energy performance of buildings.

03 An introduction to DNSH

3.1 Scope of the DNSH principle

DNSH is a horizontal principle provided for in Article 9(4) of Regulation (EU) 2021/1060 ('CPR') that must be taken into account in pursuing the policy objectives of the programme. Member States are responsible for the implementation of this principle throughout the programming period. Therefore, application of the DNSH must be ensured during both programming (ex-ante) and programme implementation (ex post).

It follows from the above that the DNSH principle is operationalised at the level of the programme where managing authorities (MAs) ex-ante assess the compliance of each type of action with the principle, including ones that will be financed via financial instruments (FIs). Thereafter, FI operations need to fall under the scope of the types of actions which have been assessed ex-ante as DNSH compliant in the adopted the programmes.

The DNSH principle should also be reflected or considered in national eligibility rules regardless of the form of support (grant or FI), where applicable.

3.2 DNSH under Cohesion policy

The workshop considered the key legal aspects for the application of DNSH principle as well as its operationalisation focusing on DNSH assessments performed at the level of programmes. It can be summarised as follows:

- For the purposes of Common Provision Regulation (Regulation (EU) 2021/1060) (CPR), DNSH is to be interpreted within the meaning of Article 17 of the Taxonomy Regulation (EU) 2020/852 of the European Parliament and of the Council Article 17 (Taxonomy Regulation). This Article defines what constitutes 'significant harm' for the six environmental objectives covered by the Taxonomy Regulation;
- To operationalise the principle under Cohesion policy and to provide some guidance to Member States (MS) the EGESIF guidance was issued to Member States in September 2021. No further guidance documents have been issued in relation to DNSH requirements under CPR so far.

The importance of the programme level assessment was emphasised during the initial part of the workshop also following the EGESIF note, which confirmed that DNSH compliance is to be assessed at the programme level. If the action is considered DNSH compliant following DNSH assessment at programme level without any specific conditions/requirements, no further DNSH specific selection criteria are required to be set for individual operations.

Thus, the ex-post monitoring of the application of the DNSH principle in the process of implementation of FI and/or related investments will only be needed in cases where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action or related investments. Only in that case, it is recommended that the principle of DNSH be reflected or considered in the funding agreement between the MA and the bodies implementing FI.

If there are no eligibility criteria/conditions for a specific type of action or related investments set, MA should avoid imposing additional DNSH related requirements further in the implementation cycle of the FI to prevent any potential gold-plating or administrative burden to the final recipients.

3.3 DNSH in practice – early experiences

The workshop emphasized that DNSH principle needs to be considered at two key levels:

- Programming (MA's responsibility/verified by EC) – to make sure all actions in the programmes are DNSH compliant;
- Implementation (MA/Beneficiaries/final recipients) – to make sure DNSH principle is applied throughout the programming period.

During the workshop, the participants strongly endorsed the approach mandated by the Commission in the EGESIF Guidance to undertake the assessment of DNSH at programme level. However, in some limited cases shared by the participants MAs have adopted different approaches to reflect the transition to working with DNSH in the context of Cohesion policy FIs in this programming period. Examples given during the session, included:

- Where the initial programme level assessment was undertaken at a very high level, for example, to meet short deadlines for finalisation of programmes, the MA has then undertaken a further assessment at financial instrument level to provide further assurance/evidence to support the initial analysis;
- That, in some cases, MAs have been required by local Environmental Regulations to adopt specific DNSH measures for their FIs;
- Where DNSH conditions have been included in the description of one or more types of action described in the programmes and therefore must be complied with in the context of the implementation of the action and any FI established under it;
- Where the approach adopted for RRF operations (which require a DNSH assessment) has been applied also to the FI operations funded under Cohesion Policy; and
- One MA which has adopted a 'gold plating' approach attempting to minimise risk of audit findings and/or legal challenge to the programme.

The adoption of these additional activities relate in many cases to the specific circumstances of the 2021-2027 programming period during which DNSH has been introduced, adopting a prudent approach due to uncertainty about the extent of the requirements. It is likely that such transitional arrangements discussed during the Knowledge Hub would not be necessary in relation to future FI operations.

Whilst discussing the role of MAs in ensuring that the DNSH principle is respected throughout the programming period, it was commented how important it was that the MA bore as much of the 'burden' of assessing DNSH compliance as is possible at the level of the programme. If there is a need to cascade down any DNSH related requirements further in the FI implementation cycle, MAs may rely on the bodies implementing FIs. However, MAs can further support implementation through undertaking robust programme and/or (when applicable) operation level assessments (to avoid passing down this requirement to the bodies implementing FI), develop simple tools to ensure compliance such as exclusion criteria and checklists and by adopting a positive approach to securing DNSH compliance in the context of market facing instruments.

3.4 Sectoral specificities

In general, there was a strong consensus that assessing DNSH was relatively straightforward for climate related FI operations, in particular, those implemented under PO2. The Investment Strategy must be aligned with the EU's climate action/environmental sustainability objectives.

Thus, for FIs implemented under PO2, participants discussed that MAs should ensure that the assessment of DNSH compliance of the FI operation at the level of the programme is recorded and the decision is documented. The DNSH assessment at the level of the programme may set the DNSH criteria that should be addressed at the level of selection of implementing bodies and final recipients /investments.

The practices differ regarding FIs for SME competitiveness. During the workshop participants made a distinction regarding the different approach to DNSH principle needed as follows:

- FIs supporting working capital in SMEs can be said to be DNSH compliant, as long as the eligibility requirements (including excluded actions) of the Funds and of the programme are respected. Although not specifically discussed, equity investments would also fall within this category; and
- FI supporting SMEs investments whereby the FI finance an investment project of a business DNSH should normally be assessed at the level of the programme. Where it is not possible to determine the DNSH compliance at the level of the programme, the programme may identify exclusion criteria which may be included in the Investment Strategy.

Another sector which was potentially less straightforward in handling DNSH related aspects was urban development, reflecting the heterogeneous nature of the potential projects. In this case, given the relatively large size of each project a case-by-case approach may be justified.

3.5 DNSH and audit

The audit aspects relating to DNSH for any type of operation (grants or FIs) can be summarised as follows:

Auditors' role

- Auditor's role is within context of Audit Authority's its functions described in art.77 of the CPR. This can be achieved through system audits and audits of operations.
- The auditors' task will not be to challenge or re-perform the DNSH assessment and climate proofing, but to see how these principles are embedded in the selection and implementation of the operations.

System audits

- **Selection:** Does the selection methodology (design of the call, selection criteria etc.) ensure that the selected operations fall within the scope of the types of actions? (types of actions are compliant or compliant under conditions with DNSH).
- **Granting:** In case of DNSH-related conditions/ mitigating measures, are these incorporated to the Funding Agreements?
- **Implementation:** Does the MA have appropriate procedures In place to check the fulfilment of DNSH-related conditions (if such conditions were included in the Funding Agreement)?

Audit of operations

Example: in case DNSH-related conditions were set for the operation, is there adequate evidence that these were respected?

04 Programme level assessment of DNSH

4.1 Best practice and lessons learned

When preparing programmes, MAs must ensure that policy objectives, specific objectives, types of actions fall within the scope of Funds, are in line with horizontal principles and comply with the EU environmental acquis and the enabling conditions.

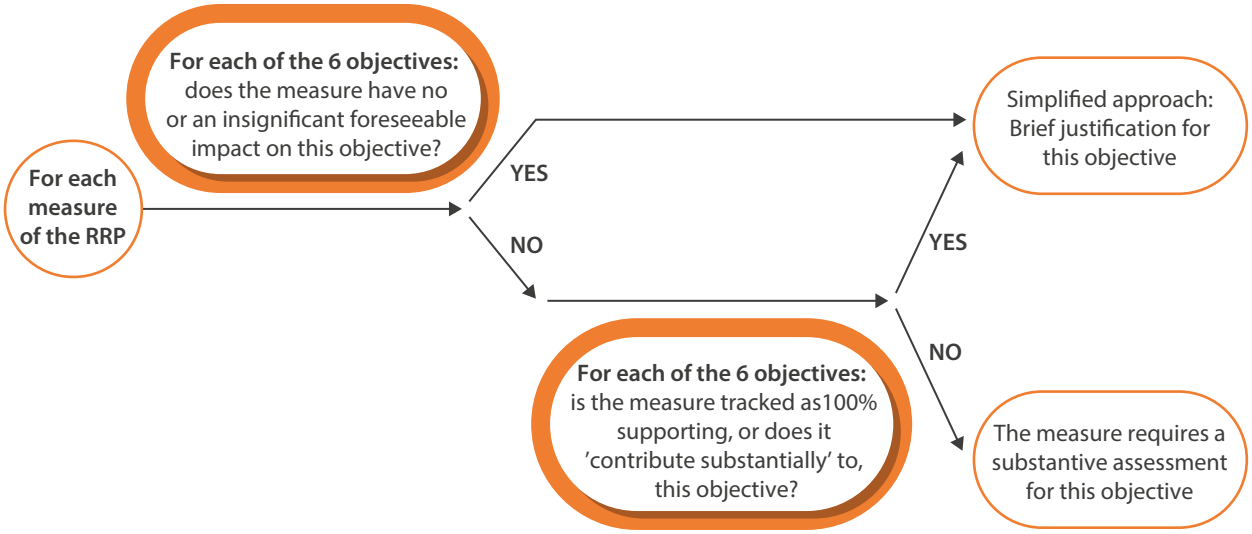
MA must carry out a dedicated DNSH assessment at programme level to prevent the inclusion of types of actions in the programmes that could do significant harm. The EGESIF guidance describes what the assessment should look like:

- A dedicated DNSH assessment at the level of the types of actions in the programmes is necessary, building also on the Strategic Environmental Assessment (SEA) findings. This is typically an Excel file;
- The programme template in the CPR does not provide for the possibility for including a detailed DNSH assessment in the programme. In order to demonstrate that the necessary assessment was carried out, each programme should include the appropriate statement under the heading "The related types of actions in section 2.1.1.1.1 Interventions of the Funds under each specific objective".

With regards to the FIs there is no specific/exclusive requirement or derogations for MA set in CPR for the FIs in relation to DNSH at the programme level. In the context of FIs, several participants shared how the programme level assessment for DNSH compliance is reflected in the programmes adopted for the 2021-2027 period. This takes the form of a short statement included in the programme under each specific objective, indicating compliance of the types of actions with DNSH principle and, where necessary, mitigating measures.

The methodology adopted was often informed by the RRF Guidance, but adapted to suit the local context and, given the nature of the programmes, a simplified approach was generally sufficient.

Figure 1, Decision tree for DNSH assessment under the RRF Guidance.



The workshop agreed that it was important to document the decisions taken and the basis for the judgements made. This may be done in a 'Note to File' type document or a report or other record. The carrying out of the assessment and the conclusions reached may be subject to an audit in the future at which the MA will need to demonstrate the methodology used as well as the conclusions reached.

Participants confirmed that once a positive assessment of DNSH compliance is ascertained at the level of the programme, where no mitigating measures have been identified, the subsequent funding agreements for the implementation do not require the implementing body to undertake DNSH assessments on an individual project basis.

In addition, some of the participants described how in some cases, the initial programme assessment was supplemented by a more detailed assessment at the level of each FI operation. In both cases this assessment is undertaken by the MA, thus lessening the burden on the bodies that implement the FI.

In some cases, an alternative approach was taken where the DNSH obligations were passed down to the implementing bodies, such as National Promotional Banks and Institutions (NPBIs). In this case, the greater capacity within some public banks to perform compliance with the type of actions in the programme, can make them better suited to undertake the role of implementing body responsible also for assessing DNSH compliance when needed.

05 DNSH and implementation of FIs – selection, Funding Agreement, monitoring and control

In cases, where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action or related investments, the second level where the DNSH principle may need to be considered is at implementation of the FI.

5.1 When is a DNSH assessment needed at implementation stage?

Depending on the specific definition of the actions in the programmes and the conclusions of the accompanying DNSH assessment, in the cases mentioned above it may be necessary to establish further DNSH specific selection criteria that need to be met by implementing bodies or final recipients / investments to be eligible under the programme.

The need for integrating the different elements in the selection criteria (both for grant and FI operations) depends on the programme and its DNSH assessment. If DNSH assessment of the programme have set certain conditions and requirements under which specific investments can be considered DNSH compatible, this will need to be operationalised in the selection of implementing bodies or final recipients / investments. The selection criteria relevant to the DNSH principle shall be specific to the programme, based on the definition of the type of actions in the programme and the accompanying DNSH assessment of the programme.

5.2 Selection criteria

In the context of FI, the operation itself and process of selection of it differs from the one for grants.

There are 3 levels of FI implementation:

- selection of FI operation – done by MA in the programme on the basis of the ex-ante or other assessment;
- selection of body implementing FI – done by MA via direct award or public procurement;
- selection of final recipients – done by the body implementing FI.

If an FI operation is supporting DNSH-compliant action in the programme and no additional conditions/ mitigation measures for the investments are set at programme level, no requirements or checks should be cascaded down to the funding agreement and no need for DNSH specific selection criteria set for FI managers, financial intermediaries (banks). If programme or DNSH assessment of the programme triggers specific conditions/requirement for investments made via FIs, MA will need to ensure this through selection of the body implementing FI and may also need to include the related provisions in the Funding agreement.

If there are specific DNSH specific conditions/requirements set in the programme or its DNSH assessment, MA can address them differently depending on the content of the programme and its DNSH assessment:

- When DNSH specific requirements are generic, MA could address them while assessing the potential manager of FI, for example:
  - Ex-ante assessment – MA could include it in the ex-ante assessment;
  - outside or via selection procedure of the body implementing FI - by confirming it has relevant internal rules and procedures ensuring their overall actions and funded activities are in line with the Taxonomy Regulation and does no harm to the environment (e.g. in case of direct award to NPBI); or
  - via selection procedure – by setting a specific DNSH related selection criteria for selecting the body implementing financial instrument (e.g. in case of public procurement).
- When there are DNSH specific conditions/requirements for investments, it shall be transferred to Funding agreements. The ex-post monitoring of the application of the DNSH principle in the process of implementation of FI and related investments will be needed in cases, where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action and related investments. Only in that case, it is recommended that the principle of DNSH and/or DNSH specific eligibility criteria/conditions for a specific type of action or related investments are reflected or considered in the funding agreement between the MA and the bodies implementing FI. Such requirements could then potentially be subject to checks during audits.
- NB: gold plating shall be avoided in any case.

If the selection criteria are needed for the selection of body implementing FI, MA could look for inspiration in the existing guidance for defining them, such as:

- the Taxonomy Regulation with its Delegated Act:
  - detailed criteria for determining whether an economic activity causes no significant harm to any of the environmental objectives (90 activities covered);
  - Relevant sectors for Cohesion Policy investments: energy, water supply, sewerage, waste management and remediation, transport, manufacturing of renewable energy technologies, equipment for the production and use of hydrogen, low carbon technologies, energy efficiency equipment for buildings.
- The RRF Guidance on DNSH and Annex II:
  - An optional list of supporting evidence that can substantiate compliance of the investments with the DNSH principle (to facilitate the case-by-case assessment of the measures in RRPs by the MS and to help them to identify the type of evidence that can support their reasoning to establish that a measure is compliant with DNSH under the RRF);
  - In cases where designing DNSH specific criteria are needed under Cohesion policy – certain elements from the list could be used as criteria during the selection phase.

5.3 Assessing DNSH in practice

Participants shared several different approaches that have been adopted to pass down DNSH requirements to bodies implementing FIs. One pragmatic approach, which avoids the need for case-by-case assessments to be undertaken is to include additional exclusion criteria to limit the scope of the eligible investments for the FI. This approach may be suitable to mitigate the risks of non DNSH compliant investments for FIs which were initially identified as more challenging, such as SME and urban development FIs. However, some participants felt that exclusion clauses should only be used as a matter of last resort, preferring instead to rely on the assessment at programme level. By including such exclusion clauses, the MA may be able to reasonably conclude that the FI operation is DNSH aligned thus avoiding the need for specific projects to be assessed.

The participants identified several examples of 'potentially problematic' investments. For example, is it DNSH compliant to finance investment by a motor mechanic SME business? Another example given was where a mining company might want finance for the installation of PV panels at its offices. Does the nature of the final recipient's business render an otherwise eligible investment ineligible? It was felt that, both such investments could be eligible (including DNSH compliant) as long as the investment project was eligible under the relevant Cohesion policy funds (i.e. respecting the fossil fuel exclusion) and under the programme, irrespective of the underlying business of the final recipient.

The RRF guidance was discussed, and participants commented that whilst it provides a useful starting point for understanding DNSH assessments, the methodology is better adapted for large grant funded schemes (which predominate within RRPs) and does not translate well to classic FI model. It was acknowledged that there is flexibility to adopt a different approach to assessing DNSH compliance where this is necessary, and some participants are in the process of developing alternatives better adapted to FIs.

Other considerations that were identified by participants in relation to DNSH included adopting a proportionate approach whereby the level of assessment reflects the size of investment. In this context it was discussed how whilst the EC require DNSH to apply to all projects, proportionality should apply small loans can be subject to a simplified approach/screening. This approach can be described in the programme as part of the programme-level DNSH assessment.

06 Conclusions – a pragmatic pathway through the DNSH framework

To conclude there are a few general points to note for MA stemming from the CPR:

- The CPR takes horizontal approach to DNSH principle. The compliance with the DNSH principle is performed at the level of the actions in the programme. Each type of action has to be declared DNSH compatible in the adopted programmes. The relevant statement in the programme is accompanied by a DNSH assessment of the types of actions, which was carried out and documented by the national authorities;
- The MA will need to ensure that FI operations selected for funding fall under the scope of the types of actions which have been assessed as DNSH compliant in the adopted programmes;
- There is no obligation in CPR requiring a case-by-case assessment of compliance of each FI operation with the DNSH principle per se;
- There is no generic legal requirement to establish DNSH specific selection criteria for all FI operations;
- The ex-post monitoring of the application of the DNSH principle in the process of implementation of FI and/or related investments will be needed in cases, where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action or related investments. Only in that case, it is recommended that the principle of DNSH be reflected or considered in the funding agreement between the MA and the bodies implementing FI.

Although the topic remains relatively new and challenging the discussion and exchange amongst participants may also allow for some tentative conclusions to be drawn in terms of how MAs are meeting their DNSH obligations. These include:

- The use of programme level DNSH assessments should be the first option in most cases. This is the extent of the DNSH requirement under the CPR and MAs should feel confident to rely on the assessment undertaken of the programme. Thereafter the demonstration that individual operations fall within the description of the types of action described in the programme does not require any further DNSH assessment;
- The DNSH assessment at the programme level shall be focused on the assessment of actions to be financed. For example, the KH participants explained that in the case of Energy efficiency measures, MA can list the actions and how these can be compliant with DNSH principles;
- The recognition that certain Cohesion policy actions are by their nature DNSH compliant, which should allow for a straightforward assessment of DNSH compatibility at programme level. This is particularly relevant for operations implemented under PO2 but may also be applied to measures under other POs such as a 'green loan for SMEs' FI implemented under PO1 or an urban development fund implemented in line with the NEB TDM under PO5. In such cases the use of exclusion criteria for 'non-compliant' investments in the Funding Agreement (to mirror the programme requirements) which cannot be supported by the FI may be used as a mitigating factor for further assurance;

- Similarly making a distinction between products developed for SMEs to support working capital/venture investment and those for investments may also assist DNSH assessment of these operations (when applicable). Where the FI is targeting general liquidity support and not investments it may be reasonably concluded that such operations are DNSH compliant, as long as the eligibility conditions of the Fund and of the programme are met;
- Investment finance for SMEs will in many cases require a more holistic approach. This is because of the heterogenous nature of the investment projects and the large size of the portfolio of investments. The use of guarantee and/or risk sharing loans implemented through commercial banks adds further to the complexity of the structure implementing FIs. Nevertheless, several possible tools were identified which may be suitable for MAs to consider to ensure DNSH compliance and avoid the need for a case by case assessment by the implementing body. These may include:
  - The use of exclusion criteria to exclude investment in non-DNSH compliant projects;
  - Perform verifications ex-ante on the intended use of support, for example by checking whether the proposed investments by final recipients according to the applications and business plans (or equivalent) are in line with the requirements for the programme operations; and
  - The DNSH assessment should be done by the NPBIs where possible not to burden the commercial banks.
- Where DNSH related conditions (mitigating measures) were included in the programme and subsequently in funding agreement, the MA should ensure the DNSH conditions are respected. (e.g. provisions in funding agreement). However, wherever possible gold plating of the existing guidance should be avoided; and
- Finally, to ensure the DNSH approach adopted is available for future audits, the assessments undertaken and approaches adopted for implementation should be well documented with appropriate levels of evidence to justify the approach taken.

For further examples of how DNSH is applied in the contexts of FIs please see the recent Q&A exchange between the European Commission and Member States at the Annex.

07

Climate Proofing - application to FIs and best practice

7.1 Introduction

The session started with a presentation of climate proofing and the EC technical guidance released by the Commission, which is applicable to Cohesion Funds. Climate proofing involves preventing infrastructure from being vulnerable to climate impacts while ensuring that the level of greenhouse gas emissions arising from the project aligns with the climate neutrality objective for 2050.

Article 73(2)(j) CPR states that "in selecting operations, the managing authority shall ensure the climate proofing of investments in infrastructure which have an expected lifespan of at least 5 years". So, if the Member State sets up a financial instrument supporting investments in infrastructure, the managing authority may, for example, require bodies implementing financial instruments under the terms of the funding agreement (Article 59(5) CPR) to apply the requirements under climate proofing in their co-financed investments (e.g. by incorporating them in the selection).

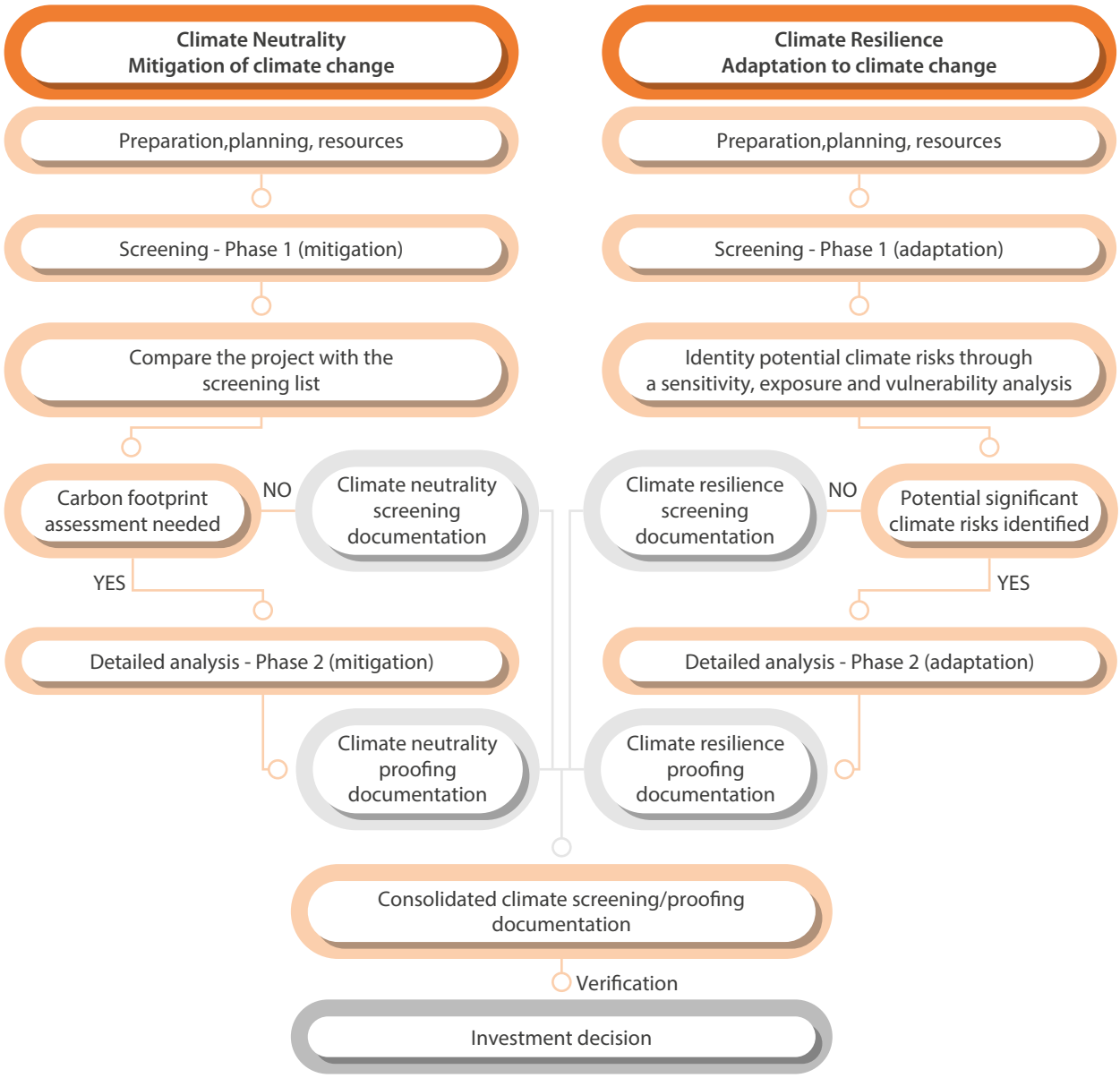
The Commission released a technical guidance on the climate proofing of investments in network infrastructure and physical assets covering the programming period 2021-2027[10] (the EC Technical Guidance).

The process is divided into two pillars (mitigation, covered also by DNSH, adaptation) and two phases (screening, detailed analysis). The second phase "detailed analysis" is subject to the outcome of the screening phase which ensures only those projects with a significant impact/sensitivity to climate are analysed in detail.

The high-level assessment process is shown in Figure 2 below. It shows how for each of the pillars, a screening is carried out with only the most complex of cases passing through the second stage to allow the compliance with the 'climate proofing' to be assessed more deeply.

10 CRITICAL INFRASTRUCTURE PROTECTION & RESILIENCE - EC Technical Guidance on Climate Proofing of Infrastructure (europa.eu).

Figure 2, Climate proofing assessment methodology



It was noted that there is an alignment between the 'Climate Neutrality' pillar and DNSH. However, the 'Climate Resilience' pillar adds a further dimension to the assessment of projects.

7.2 Defining infrastructure

As there is no official definition of infrastructure, it is for MAs and bodies implementing FIs to determine what constitutes infrastructure, in the respect of the regulatory provisions, for the purpose of their FI operations.

An example was given of the installation of photovoltaic cells. Whilst the construction of a commercial solar farm would be an infrastructure project and subject to the 'climate proofing' requirements under Article 73(2)(j), the supply and installation of PV in a domestic or small commercial building may be better classified as financing a product (and thus fall outside the climate proofing requirements).

This approach was echoed by other experience such as an approach where investments below a certain threshold were considered to be outside the definition of infrastructure, in part because all projects of that size would easily fall below the threshold of the Climate Proofing screening process for the climate neutrality objective in the Technical Guidance. This methodology has a high GHG emissions / savings threshold, which needs to be reached (20,000 tonnes) to trigger the requirement for the investment to pass on to the second stage of the assessment. It was also noted that the InvestEU sustainability proofing guidance provides a threshold of EUR 10 million in relation to the application of the detailed screening procedure. Other Member States confirmed that they use thresholds based on total project cost as part of their definition of infrastructure so that a climate proofing assessment is only needed for projects over an investment size considered significant Thus, for projects below such a threshold, it is not treated as infrastructure and there would be no requirement to carry out a climate proofing assessment.

Another similar approach was based on an initial view of the vulnerability of the asset. Thus, projects were classed as infrastructure where they were potentially vulnerable to influence or be impacted upon by climate change. This 'common sense' approach ensured that the requirements to ensure climate proofing were met in a proportionate way. It was acknowledged that such an approach may be appropriate for certain types of FIs such as energy efficiency instruments where the investments in infrastructure were all similar in nature.

In certain countries, there are definitions of infrastructure at national level. When this is the case, it is recommended to apply the national definition.

In certain Member States, infrastructure may also be defined based on additional EU regulatory frameworks, such as the Energy Performance of Buildings Directive (EPBD). This Directive distinguishes between single or smaller scale energy efficiency measures (e.g. boiler, window replacement), and large-scale energy efficiency investments in infrastructure – also called major renovations (when at least 30% of the building is being affected by the renovation etc).

7.3 Approaches used to verify compliance with climate proofing

While there is no threshold for the application of the climate proofing requirements for single projects, the assessment to be carried out to verify compliance with climate proofing requirements needs to be proportionate to the size of investment in infrastructure. It was also proposed in the discussion to simplify the screening process, based on pre-screening requirements.

As mentioned above the high threshold of GHG emissions (20 000 tonnes) for application of the second stage of screening for climate neutrality will be an important tool for streamlining assessments for smaller projects.

However, it was recognised that for the climate resilience pillar, the climate risk assessment may be relevant also for infrastructure projects which have smaller investment sizes, as it is context and location specific. However, the level of detail of such an analysis should be proportionate to the size of the investment. As an example, the development of a new large-scale port would require an ad-hoc climate risk assessment, while the construction of a new hospital might require a screening of relevant climate vulnerabilities, and a potential identification of remediation measures, based on standardised tools and checklists. It was agreed however, that whilst building permit documentation may be helpful in this assessment, it is often the case that supplementary information may be required to be submitted by the architect acting for the final recipient. However, in general terms such resilience assessments should be undertaken in any event and thus the requirement to satisfy the climate proofing requirements should not require additional work (and therefore cost) on the part of the final recipient and its project team.

MAs shared the approaches used to ensure compliance with climate proofing requirements.

One such method was the use of checklists, to be filled either by a technical expert (e.g. the architect in charge of the infrastructure development). In the case of climate resilience assessments, MAs highlighted the difficulties they are facing in implementing the required assessment process, given that such analysis requires expert knowledge on climate adaptation. Projects exist but it is difficult to find relevant data to assess risk exposure.

A valuable solution which was mentioned by MAs was the use of specialised online tools, which can inform on the potential level of climate vulnerability (under the Climate Resilience pillar) of the given investment in infrastructure based on the project location. Once the context of vulnerability is defined and the actual climate risks are identified, checklists are used to establish if remediation measures are required (ex. investments in soft / hard infrastructure).

7.4 Conclusions on Climate Proofing

Some of the key messages included:

- If the Member States decides to implement a FI operation to support investments in infrastructure, it may be reasonable to exclude smaller scale investments from the definition of infrastructure through the use of thresholds. Member States may have regard to other similar approaches for other funds when deciding a reasonable threshold for their investments in infrastructure. The InvestEU sustainability proofing guidance, for example, has a threshold of EUR 10 million for the application of the full climate proofing assessment;
- Where FIs will finance infrastructure projects (within their own definition of infrastructure) with a lifespan of at least five years, in the respect of regulatory provisions they may require the bodies implementing the instruments to undertake climate proofing screening for the climate neutrality pillar and the climate resilience pillar;
- Where the definition of infrastructure includes relatively small projects the climate resilience assessment maybe still be relevant, as it is context and location specific. However, it is expected that the level of detail of such an analysis will be proportionate to the size of the investment in infrastructures; and
- MAs have developed checklists to ensure compliance with climate proofing requirements. In the case of climate resilience assessments, MAs highlighted that they are facing difficulties in implementing the required assessment process, given that such analysis requires expert knowledge on climate adaptation. The use of specialised online tools, which can inform on the potential level of climate vulnerability of the given investment in infrastructures based on the project location, was highlighted as a potential solution to bridge the knowledge gap.
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October, 2019
82%
18°
Humidity
Temperature

Annex

EUROPEAN COMMISSION
DIRECTORATE-GENERAL
REGIONAL AND URBAN POLICY

Director-General

Questions and Answers

'Do No Significant Harm' (DNSH) principle in the context of Financial Instruments

Disclaimer: This file includes answers to Member States' questions on the provisions relevant to the Funds covered by the CPR. The answers in this file express the view of the Commission services and do not commit the European Commission. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law.

Relevant Article: Recital 10 CPR and Article 9(4) CPR

Question 1 (including any relevant facts and information):

The CPR stipulates that Member States should control if support provided through the financial instrument is to be used for its intended purpose. This means that only ex ante control should be performed. Do we understand correctly that this rule applies to eligibility criteria that include the principle 'do no significant harm' (DNSH)? In other words, application of DNSH principle should be done only ex ante?

Answer 1:

DNSH is a horizontal principle provided for in Article 9(4) of Regulation (EU) 2021/1060 ('CPR') that must be taken into account in pursuing the policy objectives of the programme. Member States are responsible for the implementation of this principle throughout the programming period. Therefore, application of the DNSH must be ensured during both programming (ex-ante) and programme implementation (ex post).

It follows from the above that the DNSH principle is operationalised at the level of the programme where managing authorities (MAs) ex-ante assess the compliance of each type of action with the principle, including ones that will be financed via financial instruments (FIs). Therefore, selected FI operations need to fall under the scope of the types of actions which have been assessed as DNSH compliant in the adopted programmes. There is no legal requirement to establish DNSH specific selection criteria for all operations.

The ex-post monitoring of the application of the DNSH principle in the process of implementation of FI operations and/or related investments will be needed in cases, where a programme and/or its DNSH assessment triggers/sets DNSH specific eligibility criteria/conditions for a specific type of action or related investments. Only in that case, it is recommended that the principle of DNSH be reflected or considered in the funding agreement between the MA and the bodies implementing FI.

The DNSH principle should also be reflected or considered in national eligibility rules regardless of the form of support (grant or FI), where applicable.

Question 2:

The DNSH principle will be part of the contract with the beneficiary as well as with financial intermediaries. The Managing Authority is obliged to check whether these institutions follow the DNSH rules using methodology drafted by our regulatory bodies. Do we understand correctly that at the level of final recipients the DNSH principle should not be checked and will not be audited by the European Court of Auditors or EC (since CPR stipulates that no audits shall be done on the level of final recipients)?

Answer 2:

According to Article 81(1) and Article 81(3) CPR, on-the-spot management verifications by managing authority (MA) and audits by audit authority (AA) shall be carried out at the level of bodies implementing FI (or bodies delivering underlying new loans).

The Commission audits cover the audit work done by AA and management verifications conducted by MA, and may be complemented by checks at the level of bodies implementing FI.

An appropriate audit trail according to Annex XIII CPR has to be maintained at all levels (AA, MA, bodies implementing FI), including on relevant documentation collected from/ concluded with final recipients (e.g. application forms, business plans or equivalent, contractual arrangements). All elements of the audit trail may be subject to audits by the AA and Commission.

It follows from point (1)(d) of Annex X to the CPR that the funding agreement must set out rules for bodies implementing FI to monitor the implementation of the financial instrument

Question 3:

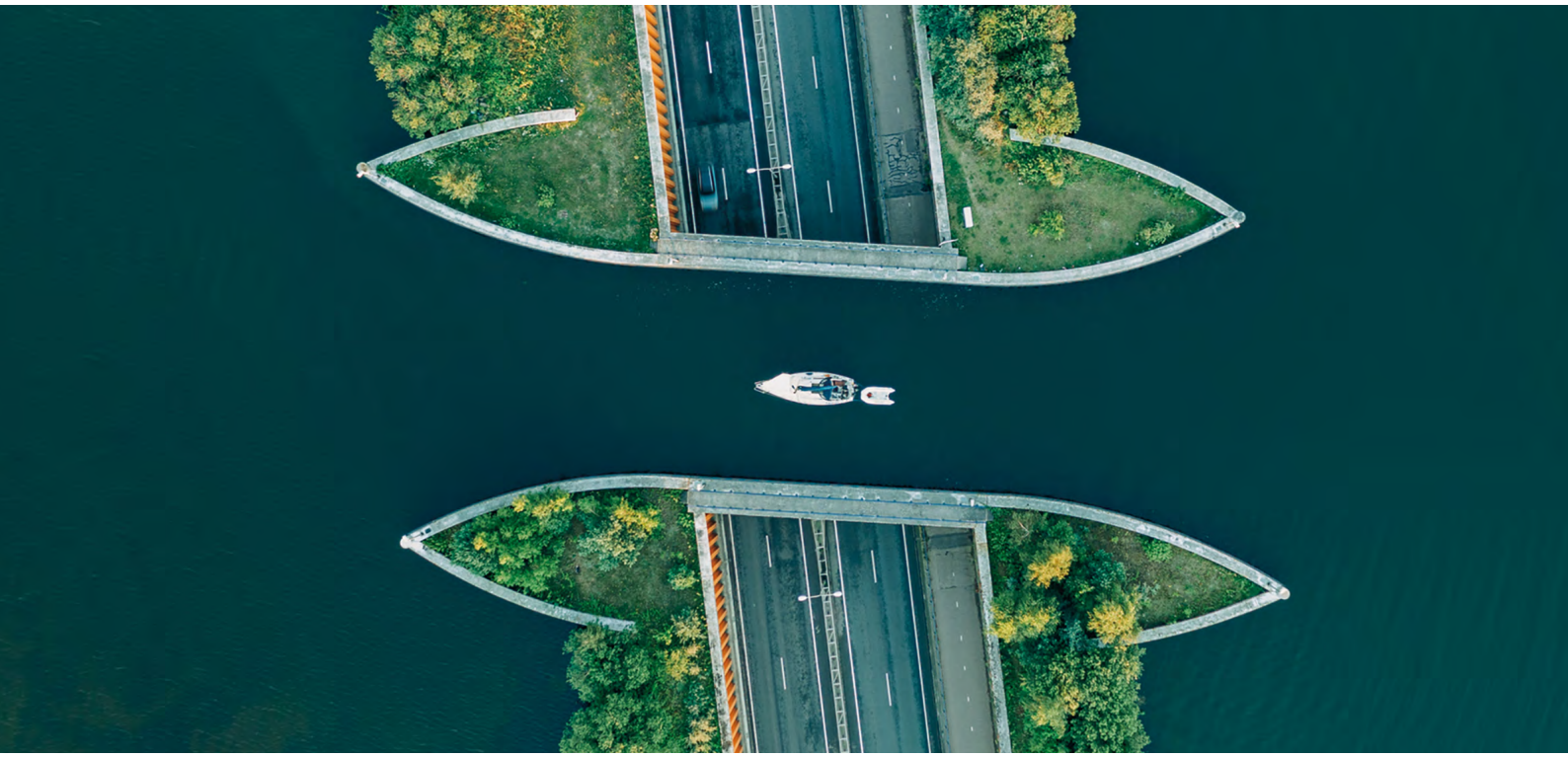
Most of the funding that will be used through financial instruments will go to support SMEs. Most of this support will be in the form of guarantees that will stimulate new leveraged loans. These loans will be used as working capital, which means the companies may use them in whatever way they need. This may include buying machinery, cars etc., but neither the banks, nor the Managing Authority will check this, as neither they nor SMEs will know beforehand on what exactly money will be used. Do we understand correctly that we do not need to control these operations or whether this working capital was used in line with the DNSH principle or DNSH is not applied at all on the level of final recipient in case of working capital?

Answer 3:

If working capital for SMEs was approved as DNSH compliant action in the programme, no further monitoring is needed, as described in the Answer 1.

Please note that normally cars and machinery are tangible assets, rather than current assets, therefore, they are not in the category of support provided to final recipients for working capital.

Notes



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