



**SUSTAINABILITY-LINKED BOND: SFL
PRE-ISSUANCE SECOND-PARTY OPINION**



April 2021

CONTENT	PAGE
The parties	2
Summary	3
Rating scale	4
1. Methodology	4
2. Alignment with core principles	6
3. Alignment with strategy	11
4. Impact of the defined SPTs	13
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The issuer

SFL Corporation Ltd. (SFL, the “Company”, or the “Issuer”) is an international ship owning and chartering company with a large and diverse asset base across the maritime and offshore industries. SFL intends to issue a Sustainability-Linked Bond (SLB) in the spring of 2021. SFL has commissioned TGG to review the SLB and provide an opinion on the alignment of the bond with the ICMA Sustainability-Linked Bond Principles (SLBP).

The reviewer

The Governance Group AS (TGG) is an independent analysis and advisory firm based in Oslo, Norway. TGG provides expertise on environmental, social and governance (ESG) risk and compliance, and the firm applies leading ESG standards when conducting company benchmarking and gap analysis. The company publishes annually the [ESG 100 Oslo Stock Exchange report](#) based on the Euronext ESG reporting guidelines.



TGG is a member of SASB’s Standards Advisory Group on Marine Transportation and participates in the GRI Community, and the company was recently granted an observer status of the Green, Social, Sustainability and Sustainability-Linked Bond Principles.¹



Previously, TGG has published several ESG industry guidelines including for the [Norwegian Ship Owners’ Association](#). TGG has been appointed as the consultant on environmental and social issues by lenders for several project finance due diligence processes using the IFC Performance Standards for infrastructure projects. Furthermore, TGG has advised more than 15 listed companies in the shipping industry with their ESG management and reporting.



¹ The Secretariat of the Green Bond Principles, International Capital Market Association, has included TGG in the [membership list](#) on the ICMA website.

SUMMARY

This review was conducted in accordance with ICMA's external review guidelines² using publicly-available documentation from SFL as well as discussions with SFL's senior management. TGG confirms that the Company has in place processes to safeguard professional integrity, objectivity, competence, behaviour and confidentiality.³



*The Governance Group AS (TGG) is of the opinion that SFL's Sustainability-Linked Bond (SLB) is **aligned** with all five core components of the ICMA Sustainability-Linked Bond Principles of June 2020⁴ (SLBP).*

B

*TGG regards the Key Performance Indicator (KPI) to be **highly relevant and material** to the Issuer's operations (score: 3). The Sustainability Performance Target (SPT) is deemed as **fairly ambitious** (score: 3). This constitutes an overall B rating of the instrument.*

TGG's opinion is based on the following:

Principle One: Selection of Key Performance Indicators (KPIs)

SFL has selected one KPI for its SLB framework: The gross financial value of binding commitments towards vessel acquisitions, newbuildings and vessel retrofits, which can be powered by low-carbon/alternative fuel sources. The KPI measures the capital expenditures (USD) on upgrading and acquiring vessels that have the capability to run on alternative fuels.

TGG has assessed the potential alternative fuel options cited in the Framework. TGG regards the selected KPI as highly relevant and material for SFL and the KPI as explicit in its objective. TGG notes that the potential emission reductions that can be achieved vary greatly depending on the alternative fuel selected.

Principle Two: Calibration of Sustainability Performance Targets (SPTs)

At the end of five years from the date of issuance of the Bond, SFL plans to have a binding commitment of an amount equal to the size of the issue (presumed to be in the region of USD 150 million) on upgrades and acquisitions consistent with its KPI.

TGG views the SPT to be aligned with SFL's sustainability strategy (see pp. 8 to 10) and fairly ambitious.

Principle Three: Bond Characteristics

SFL's SLB contains the characteristics of a conventional bond but with a penalty provision attached. Failure to enter into binding contracts with a value at least equal to the size of the issue on vessel acquisitions, newbuildings and vessel retrofits that have the capability to run on alternative fuels at the end of five years from the date of the issuance of the Bond will result in SFL paying a penalty upon maturity.

TGG notes that SFL will accept a penalty rate which is in line with other comparable sustainability-linked bonds in the market.

Principle Four: Reporting

SFL commits to report on an annual basis on its performance on the KPI against the SPT. SFL will publish an annual SLB Report which will contain updated information on its KPI performance as well as specific information on investment commitments entered into during the year.

TGG views this to be in line with the ICMA SLBP.

Principle Five: Verification

SFL has pledged to have its commitments to vessel acquisitions, newbuildings and vessel retrofits that have the capability to run on alternative fuels verified annually either by an external auditor or a competent independent third party until maturity of the Bond.

TGG is of the opinion that SFL's verification scheme is in line with, or exceeds, the requirements outlined by ICMA principles in that SFL will commission a competent and independent third party to conduct the assurance.

² <https://www.icmagroup.org/assets/documents/Sustainable-finance/Guidelines-for-GreenSocialSustainability-and-Sustainability-Linked-Bonds-External-Reviews-February-2021-170221.pdf>

³ TGG applies an international Standard on Quality Control 1 (IQCS) framework required for e.g. ISAE 3000 assignments

⁴ <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Sustainability-Linked-Bond-Principles-June-2020-171120.pdf>

1. Methodology

Scope of review and responsibilities

TGG's Second-Party Opinion (SPO) reflects TGG's independent opinion on the alignment of the reviewed SLB framework with the Sustainability Linked Bond Principles. TGG confirms that the company has:

- expertise in SLB framework requirements;
- assessed the environmental impact targeted by the SLB;
- reviewed the alignment with the four core components of the ICMA Principles; and
- evaluated the potentially material environmental risks associated with the project identified by the Issuer.

During the review, TGG relied on information provided by SFL's management team to understand the sustainability impact of their business strategy and SPT, and the reporting and verification procedures applicable to the SLB. SFL representatives have confirmed that:

- 1) They understand it is the sole responsibility of SFL to ensure that the information provided is complete, accurate and up to date.
- 2) They have provided TGG with all relevant information.
- 3) The provided material information has been duly disclosed in a timely manner.

TGG reviewed relevant public documents published by SFL and non-public information to prepare this report. The opinion should be read in conjunction with the Sustainability-Linked Bond Framework and other Bond Documents. TGG's SPO, while reflecting on the alignment of the Bond with market standards, is no guarantee of alignment with future versions of relevant market standards. TGG's SPO addresses the defined SPT of the KPI but does not measure the KPI. The measurement and reporting of the KPI is the sole responsibility of the Issuer.

No information provided by TGG under the present SPO shall be considered as being a statement, representation, warrant or argument either in favour or against, the truthfulness or completeness of any facts or statements and related surrounding circumstances that SFL has made available to TGG for the purpose of this SPO.

Alignment and rating scale

Alignment

When conducting a Second-Party Opinion (SPO) review, The Governance Group AS (TGG) assesses whether the proposed framework can be said to be *aligned* or *not aligned* with the Sustainability-Linked Bond Principles issued by International Capital Market Association (ICMA). In case evidence is found that the said principles are covered, TGG deems a framework to be *aligned*.

Materiality and relevance

When reviewing the Key Performance Indicator(s) (KPI(s)) to be material to the Issuer and the Sustainability Performance Target (SPT), TGG has applied the following ratings, when the Issuer:

Rationale	Degree of materiality	Score
Has applied a recognized and quantifiable method of identifying investments material to the business model and sustainability effects.	Very high degree of relevance and materiality	4
Has employed a structured approach when identifying investments material to the company.	Highly relevant and material	3
Explains without quantifiable evidence the materiality of its investment plans.	Medium degree of relevance materiality	2
Has insufficient explanation of the materiality of its investment plans.	Low level of relevance and materiality	1
Has no explanation of the materiality of its investment plans.	Clearly lacking relevance and materiality.	0

Level of ambition

When reviewing the ambition level of the Sustainability Performance Target (SPT), TGG has applied the following ratings, when the Issuer:

Rationale	Degree of ambition	Score
Provides an absolute and a relative benchmark of sustainability impact (i.e. > 25% improvement)	Highly ambitious	4
Provides evidence that the sustainability impact is material to society at large (i.e. 10-15% improvement)	Fairly ambitious	3
Describes how the target is important to the sustainable operation of the company, but not the effect on its surroundings (i.e. <10% improvement)	To some degree ambitious	2
Provides insufficient description and evidence of the sustainability impact	Low level of ambition	1
Provides no description and/or evidence of the sustainability impact	Lacking ambition	0

Overall rating

By combining the scores on materiality and level of ambition, TGG arrives at an overall score, ranging from E (lowest rating) to A (highest rating). Under normal circumstances, a D or E rating should signal that the issuer should refrain from using the term sustainability-linked bond. If a C rating has been awarded, it signals that the basic requirements regarding a sustainability-linked framework have been met. The two top to levels (A and B) indicate that the issuer has a sustainability-linked framework that is both material and ambitious.

Combined score	Rating
8	A
6-7	B
4-5	C
2-3	D
0-1	E

In the case of SFL and the Sustainability-Linked Bond, TGG assessed the KPI to be highly relevant and material (score: 3) to the Issuer and the SPT to be fairly ambitious (score: 3). This constitutes an overall B rating of the instrument.

2. Alignment with core principles

TGG is of the opinion that SFL's Sustainability-Linked Bond is aligned with the five core elements of the Sustainability-Linked Bond Principles (SLBP) of June 2020. The KPI and SPT employed by SFL are described in Table 1 and Table 2 below.

Table 1: KPI definition

KPI	Definition
<i>The gross financial value of binding commitments towards vessel acquisitions, newbuildings and vessel retrofits, which by being equipped with Alternative Fuel Source engines contribute to significant reductions of CO2 emissions compared to vessels running on conventional fuel.</i>	SFL's investment, measured in USD, in upgrades to existing vessels in SFL's fleet, upgraded vessels, as well as newly-built vessels that can be powered by alternative fuel sources. Use of alternative fuel sources are intended to result in lower-carbon emissions than comparable conventional fuel sources. Liquefied natural gas (LNG), bio- or electro-methane, hydrogen, biodiesel, liquefied petroleum gas (LPG), and ammonia are cited by the Framework as examples of low-carbon/alternative fuels.

Table 2: SPT and Past Performance

SPT	Historic annual investment
<i>By the Target Observation Date, SFL aims to have committed an amount at least equal to the size of the issue on upgrades of existing vessels and/or vessel acquisitions consistent with the KPI.</i>	Baseline set at zero, i.e. no historic investment in low-carbon/alternative fuel sources.

Principle One

Selection of Key Performance Indicators (KPIs)

Definition and methodology

SFL's Sustainability-Linked Bond includes one KPI:

SFL's KPI, the gross financial value of binding commitments towards vessel acquisitions, newbuildings and vessel retrofits, which can be powered by alternative fuel sources, measures the Company's investments and expenditures to upgrade and acquire newbuilds that can be powered by alternative or low-carbon fuels. SFL defines an alternative fuel source as a "fuel source that emits significantly less CO2 than with conventional technology". Liquefied natural gas (LNG), bio- or electro-methane, hydrogen, biodiesel, liquefied petroleum gas (LPG), and ammonia are cited by the Framework as examples of low-carbon/alternative fuels.

TGG is of the opinion that SFL's KPI is explicit, measurable and externally verifiable. The extent of the environmental impact, i.e., the reduction of CO2 and other GHG emissions, will depend on the alternative fuel source(s) targeted for investment. Liquefied natural gas (LNG) has the potential to achieve emission reductions between 15%⁵ and up to 25%⁶ compared to conventional fuels, while biofuels may provide a range of reductions which could reach 100%, and hydrogen and hydrogen-derived fuels may provide close to 100% reductions depending on the source of energy inputs.

⁵ Well-to-Wake: [Alternative fuels and flexible technology solutions](#), Valland & Lindstad et. al., webinar March 11 2020

⁶ Tank-to-Wake, <https://www.dnvgl.com/maritime/ing/new-reference-for-ling-propulsion.html>

TGG highlights the following regarding the specific fuel types cited in the Framework:

The Issuer has disclosed that the likely initial investments or expenditures it makes will be to acquire vessel(s) with high-pressure, dual-fuel engines that will run primarily on LNG (where infrastructure allows) in combination with a pilot fuel, which is intended to be low-sulphur heavy fuel oil, ultra-low sulphur fuel oil, or marine gas oil. LNG is recognized as having lower emissions than conventional fuels and is expected to play a key role in the shipping sector's transition to a low-carbon/zero emissions future. Refer to the chapter on *"Impact of the defined SPT"* for a further discussion on LNG technology.

LPG, primarily a mixture of propane, butane and other light hydrocarbons, is cited as one of the alternative fuel options defined in the Framework. LPG has higher CO₂ emissions than LNG during combustion due to its carbon content but is sulphur-free and offers significant reductions of nitrous oxide (NO_x) and particulate matter. Based on technical information provided by SFL, TGG recognizes the potential for LPG to act as a transitional fuel to low-carbon fuel sources, notably ammonia, since the installation of LPG systems in a ship may be suitable for future conversion to these fuels.

SFL has informed TGG that dual-fuel vessels will be chartered and, as a result, SFL has limited or no control over the speed and fuel of the vessels. However, through SFL's communication with its clients and the fact that the cost of the upgrade or acquisition of dual-fuel vessels will be reflected in the charter cost, SFL expects that the charterers will make use of the alternative fuel technology.

SFL's planned investments relate to onboard use of alternative fuels. While uptake of some of these fuels face additional constraints related to bunkering, storage and safety measures, in particular hydrogen and ammonia, these challenges are out of scope of this review.

SFL's methodology to calculate KPI:

The KPI is the sum of binding commitments or amount invested (in USD) by SFL in order to upgrade and acquire vessels and newbuilds that have the ability to run on lower-carbon emissions fuel, including dual-fuel vessels, over the five year period from the issuance of the bond (2021) to the maturity date.

Relevance and materiality of KPI

TGG views the issue addressed by the KPI to be a relevant, core and material for SFL:

- TGG notes that the KPI is based on planned capital expenditure, not a specific sustainability metric. While expenditures on qualifying vessels are expected to deliver environmental benefits, this is not directly measured by the KPI.
- TGG regards risks from emissions, effluents and waste as some of the most material issues facing companies in the shipping sector. The International Maritime Organization (IMO) and many regions and countries are beginning to further tighten carbon emissions thresholds for the shipping industry.
- Apart from the kind of fuel used, a ship's emissions can depend on several factors relating to its daily operation and maintenance, such as voyage and speed optimization, trim and draught management, maintenance of its engines, hull, bulbous bow, propellers, etc. SFL is an owner, operator and lessor of a diversified fleet of ocean-going vessels, leasing the majority of its fleet, and therefore has incomplete control over the vessels' speed and trade routes. Due to SFL's business model, the most material way to drive environmental impact is to improve physical factors relating to efficiency (such as cargo loadability or design efficiency) and to equip its vessels with systems that enable them to run on alternative or low-carbon fuels.

In the short term, the decarbonization of the shipping sector will rely upon the use of LNG as a lower-carbon fuel source on a transitional path towards carbon neutrality. SFL has disclosed that the first contributions to its KPI will likely take the form of LNG or dual-fuel ships.

The IMO expects a sharp growth in emissions from the international shipping sector and as a consequence in 2018 adopted emission reduction targets (see section 3). TGG views LNG as a transition fuel for the shipping industry given that the commercial development and scale of truly low-carbon fuels are currently limited in scope and availability.⁷

⁷ World Energy Outlook special report, IEA, July 2019

It is estimated that, compared to traditional fuels such as heavy fuel oil, LNG enables 15% to 25 % reduction in CO₂ emissions when burned in high-pressure injection fuel engines, given low methane slip throughout the supply chain and during combustion within the ship engine. However, it is acknowledged that the shipping industry must make rapid progress related to the uptake of low-carbon fuels such as hydrogen, ammonia and methanol in order to enable a decarbonization trajectory that is aligned with the climate goals set out in the Paris Agreement.

Ability to be benchmarked

The selected KPI is the measure of SFL's investment and expenditure in upgrading its existing fleet and acquiring new vessels that have the capability to run on alternative fuels. Although this KPI is a measure of financial expenditures, it is directly related to the number of new and refurbished low-carbon vessels introduced to SFL's fleet. While noting the difficulties in directly comparing levels of investment, TGG considers the number of vessels to be well-suited for comparison to both SFL's existing fleet as well as industry-wide trends in ship technology, and the selected KPI can therefore also be suitably benchmarked against peer group trends.

ASSESSMENT

In TGG's opinion, SFL employed a structured approach when identifying investments material to the company. The selected KPI is highly relevant and material to SFL, and the definition of the KPI is explicit in relation to how it is being measured. SFL has employed a structured approach when identifying investments material to the company. Nevertheless, some ambiguity is noted in relation to the sustainability benefits which will result from progress on the KPI, based on the wide variety of potential fuels and technologies which may be selected by SFL, including those which are currently in an early phase of development. TGG highlights in particular the role that LNG is expected to play in the transition of the shipping sector to low-carbon fuels, as SFL's short-term expenditures will likely be directed towards LNG ships.

Principle Two

Calibration of Sustainability Performance Targets (SPTs)

Alignment with the Issuer's sustainability strategy

SFL has set the following SPT for its KPI:

By the Target Observation Date, SFL aims to have committed an amount at least equal to the size of the issue on upgrades of existing vessels and/or vessel acquisitions consistent with the KPI.

In TGG's dialogue with the Company, the Company has communicated that the size of the issue will be in the region of USD 150 million. This implies that five years from the date of issuance of the Bond, SFL will have spent at least a sum in the region of USD 150 million on upgrades and acquisitions to lower the Company's CO₂ intensity.

TGG views the SPT to be aligned with SFL's sustainability strategy (refer to section 2 for discussion of SFL's sustainability strategy). SFL has identified emission reduction of its fleet as one of its primary environmental objectives. The IMO has launched a strategy towards 2030 and 2050⁸ in an effort to address the Paris Agreement to combat climate change. Compared to 2008 levels, the strategy aims to reduce CO₂ emissions per transport work by at least 40 % by 2030, and 70 % by 2050¹. SFL supports this strategy and is committed to increase its ships' efficiency and reduce the greenhouse gases emitted from its vessels. Through its efforts to lower the fleet's CO₂ emissions by increasing efficiency and upgrading engine technology, SFL supports UN SDG 13 – targeting the global fight against climate change. This is in line with the IMO's strategy. It should be noted that the EU is also working to address GHG emissions from the shipping sector, and further reduction requirements may be implemented.⁹

Strategy to achieve the SPTs

SFL intends to achieve the SPT through the following strategy:

SFL will achieve its SPT through capital expenditures on dual-fuel ship acquisitions and potentially through the cost of retrofits. In addition, SFL plans to facilitate the transport of "green technology-based capital goods", e.g., electric vehicles and wind turbines, on designated ro-ro vessels in its fleet. The size of the issue equates approximately to the

⁸ The initial GHG strategy was adopted by IMO's Marine Environment Protection Committee (MEPC), during its 72nd session.

⁹ Please see [The outcome](#) of IMO MEPC 75: GHG emissions, fuel oil sampling in the spotlight, Shipping body's climate plan '[ignores Paris Agreement](#)' and [EU Action](#): Reducing emissions from the shipping sector

cost to procure one-to-two new LNG-powered vessels.

The acquisition of dual-fuel vessels provides a way to increase the use of lower-carbon fuels in applications where operating vessels, which are powered solely by alternative fuels, would not be feasible or desirable for charterers.

SFL, as an owner, operator and lessor of vessels, has incomplete control over its vessels' speed and trade routes. Therefore, its focus lies in ensuring its vessels are well maintained and have been fitted with the technology necessary to reduce emissions, making acquisitions and retrofits a relevant strategy to achieve the desired sustainability outcomes.

Level of ambition, Baseline and Benchmarks

The target (SPT) established is based on SFL spending an amount equal to the issue size on eligible vessels, including new ships as well as refurbishment costs within a period of five years from the issuance of the Bond. Failure to spend this amount on retrofitting or acquiring vessels that can run on alternative fuels will result in SFL paying a higher principal payment at maturity of the Bond (see Bond Characteristics, below).

- SFL has confirmed that none of its vessels currently use alternative fuel, and that the baseline for this target is therefore zero dollars.
- It is estimated that currently there are about 360 LNG-fueled vessels in operation or on order worldwide.¹⁰ This makes up less than 1 % of the approximately 50,000 vessels in operation in 2019.¹¹ TGG views this statistic as supporting the ambition level of SFL's SPT.
- Since 2018, SFL has spent USD 200 million on the retrofitting of vessels to comply with IMO regulations, e.g. to meet requirements on SOx emissions and ballast water treatment. SFL has not yet retrofitted any vessels in its existing fleet to use alternative fuel sources.
- SFL has communicated that the size of the Bond issuance will be in the region of USD 150 million. TGG notes that the USD figure is not based on any external benchmark, however the sum is deemed to be of a moderate size in light of SFL's balance sheet.
- The SPT is defined in terms of total investments in vessels, through optimizations, retrofittings and acquisitions, to reduce GHG emissions vs a "business as usual" trajectory, but without a Company-wide emission reduction target. TGG regards the SPT as fairly ambitious¹² realizing that the planned investments are expected to achieve a moderate emissions reduction for the Company's existing fleet overall but still represent a contribution to alignment with the IMO's decarbonization trajectory. At present, there is a lack of commercially available and viable low-carbon alternative fuel solutions for deep-sea vessels. However, TGG views SFL's investment commitment as a contribution to foster technological innovation in low-carbon ship propulsion systems.

SFL has not established a KPI based on CO2 emissions in absolute or relative terms, however the updates in technology support a lowered CO2 emission profile for SFL and an improved CO2 intensity ratio, e.g. an Average Efficiency Ratio (AER) or Energy Efficiency Operational Indicator for acquired vessels should be at least 15 % better than current vessels with similar capacity.

ASSESSMENT

TGG regards SFL's SPT to be consistent with its stated sustainability strategy and the selected SPT to be *fairly ambitious* and representative of a commitment to improve the carbon efficiency of both the Company and the shipping sector. A target for improved vessel AER/EEOI would have enhanced TGG's evaluation of the level of SFL's ambition.

¹⁰ Small scale LNG and Hybrid energy infrastructure, JP Tuttunen, DNV GL 27.11.2019

¹¹ <http://infomaritime.eu/index.php/2020/05/07/top-15-shipowning-countries/>

¹² Please see page 2 for a more detailed description of the term "fairly ambitious"

Principle Three

Bond Characteristics

SFL's Sustainability-Linked Bond contains the characteristics of a conventional bond but with a penalty provision attached. Failure by SFL to enter into binding contracts with a value equal to the size of the issue to retrofit and/or acquire vessels that have the capability to run on alternative fuels after 5 years from the date of the issuance of the Bond will result in the Company paying a penalty upon maturity. This penalty will increase the principal payment upon maturity by a defined rate, according to the specific terms and documentation for the security being issued. The Bond contains no other trigger events, meaning there are no graduated outcomes, or any potential for SFL to improve the interest rate on the Bond. TGG has discussed the characteristics of the penalty with SFL, and SFL is ready to accept a penalty in line with market practice (e.g. an increase the principal payment upon maturity by 0.5 % (50 basis points)¹³).

ASSESSMENT

TGG notes that the penalty rate will be in line with other comparable sustainability-linked bonds in the market.

Principle Four

Reporting

SFL commits to report on an annual basis on its performance on the KPI against the SPT. SFL will publish an annual Sustainability-Linked Bond Performance Report which will contain updated information on its KPI performance as well as specific information on investment commitments entered into during the year.

ASSESSMENT

TGG views the reporting structure to be in line with the SLB principles. Furthermore, TGG trusts that SFL will publish and make readily available and accessible any information enabling bond investors to monitor the level of ambition of the KPI, including the development of its definition of low-carbon fuel as alternative propulsion technologies evolve.

Principle Five

Verification

The selected KPI is a measurement of the Company's financially binding commitment to vessel acquisitions, newbuildings and vessel retrofits that have the capability to run on alternative fuels. These capital expenditures are reflected in the Company's financial statements, specifically the income and expense statements and the balance sheet. SFL will have its financial commitments to vessel acquisitions, newbuildings and vessel retrofits that have the capability to run on alternative fuels verified annually either by an external auditor or a competent independent third party until maturity of the Bond.

ASSESSMENT

TGG is of the opinion that SFL's verification scheme is in line with, or exceeds, the requirements outlined by ICMA in that SFL will commission competent and independent third parties to conduct the assurance.

Alignment with Sustainability-Linked Bond Principles of June 2020

CONCLUSION

TGG finds that the SFL April 2021 SLB is aligned with the five core elements of the ICMA Sustainability-Linked Bond Principles.

¹³ Seaspan Sustainability-Linked Bond, [SPO](#)

3. Alignment with strategy

Objectives of SFL's sustainability strategy and ESG risk management

SFL has published an ESG (Environmental, Social and Governance) report based on the requirements in the Marine Transportation framework established by Sustainability Accounting Standards Board (SASB) annually since 2018. TGG's assessment is based on presentations by SFL's executive team and SFL's 2020 ESG report.

1. Environmental

SFL's Environmental Policy describes its commitment to energy efficiency, environmental due diligence and how spills and operational emissions of sulphur oxides, nitrogen oxides, waste and other discharges are to be managed. SFL has implemented a fleet-wide Ship Energy Efficiency Management Plan and has established a thorough system for incident reporting. SFL's Management System is ISO-compliant and in accordance with the ISM Code. SFL monitors every aspect of its fleet operations, including greenhouse gas emissions and energy efficiency. SFL has implemented several efficiency measures including a periodic plan for hull inspection with condition-based cleaning. This is part of SFL's effort to reduce fuel consumption by minimizing resistance in the water. SFL has periodic plans for propeller cleaning – typically conducted twice a year. To enhance its ESG management, SFL implemented a digital platform to track vessel fuel efficiency in 2020. Live tracking of each of the Company's vessel emissions and energy consumption is an important tool to monitor energy efficiency and emissions in accordance with regulations and Company targets.

In January 2020, the IMO 2020 came into effect placing a 0.5 % global cap on sulphur dioxide (SOx) content in shipping fuels. In combination with the NOx Emission Tier III standard in Emission Control Areas (ECA) from 2016, this marked a turning point for the industry. SFL prepared to meet these requirements by investing more than 200 million USD in sulphur abatement technology to reduce global SOx emissions from both operated and non-operated vessels. As of April 2020, 19 of SFL's vessels were fitted with scrubbers, representing about a quarter of its fleet. Based on current plans, scrubber installations will cover approximately half of the fleet.

In 2018 the IMO launched a strategy towards 2030 in line with the Paris Agreement to combat climate change. Compared to 2008 levels, the strategy aims to reduce CO2 emissions per transport work by at least 40 % by 2030, and 70 % by 2050¹. SFL supports this strategy and is committed to increasing the energy efficiency of their fleet and reduce the greenhouse gases emitted from their vessels. Among others, SFL supports UN SDG 13 – targeting the global fight against climate change. This is in line with the IMO 2030 strategy. SFL tracks and monitors their fleet continuously, including a full overview of when their vessels are sailing in protected areas. SFL has implemented a risk management system to avoid and handle potential spills and discharges. SFL had no spills during 2019 and SFL management has confirmed that the Company had no spills in 2020.

Whilst ballast water is essential for safe and efficient modern shipping operations, it may also represent serious ecological, economic and health risks due to the multitude of marine species it carries that can adversely affect biological diversity. The handling of ballast water is regulated by the International Convention for the Control and Management of Ships' Ballast Water and Sediments. SFL has made significant investments to mitigate ecological risks. At year-end 2019, 98 % of the Company's owned and operated vessels had installed ballast water exchange systems, and 53 % had installed treatment technology: SFL increased the BWTS (Ballast Water Treatment Systems) coverage rate by 6 % over the course of 2019. SFL's investment plan calls for further instalment to ensure full compliance with the Convention.

Ships contain hazardous materials, and ship recycling must be performed according to strict standards to protect human health, safety and the environment. The Hong Kong Convention aims to ensure that ships, when recycled after reaching the end of their operational lives, do not pose a risk to the safety of workers or to the environment. SFL has implemented a Ship Recycling Policy to make sure that any future recycling of SFL's ships may only take place at an approved yard compliant with the Hong Kong Convention and in alignment with the ten UN Global Compact principles. The latter principles refer not only to environmental issues, but also human rights and anti-corruption.

2. Social - safety, labor conditions and human rights

SFL has a Corporate Code of Business Ethics and Conduct in place which regulates how SFL employees are to operate. A whistleblowing channel allows any suspected intentional deviation from the Code or external regulation to be reported. SFL has implemented risk assessment systems to review all identified risks to the Company's ships and personnel, establishing appropriate safeguards. SFL fleet managers formally supervise ship managers through quarterly performance review meetings where all performance criteria, including safety matters, are discussed to

ensure compliance. SFL's frameworks, procedures and practices support its aim for zero accidents for incidents. An annual audit is performed by Class according to the ISM Code and where appropriate for ISO 9001 and ISO 14001.

A detailed analysis of accidents and incidents for the entire fleet is prepared for SFL by SeaTech Safety in accordance with the OCIMF guidelines on Lost Time Injuries (LTIs) and Total Recordable Cases and Frequency (TRC and TRCF). SFL and its subcontractors adhere to industry best practice according to the OCIMF TMSA framework when investigating incidents and take appropriate actions to prevent similar incidents from reoccurring. LTIR was 0.68 in 2019, representing an improvement and decrease from 1.03 in 2018.

All SFL's vessels are regularly audited through the ISM, ISPS and MLC regulations. These follow a regime of interim, initial, periodic and renewal stages as stipulated by Class, the IMO and Flag State. Annual audits are performed of the safety management system in accordance with the same regulatory framework for all vessels and office functions involved in operating the vessels.

SFL complies with the OCIMF providing expertise in the safe and environmentally responsible transport and handling of hydrocarbons in ships and terminals and setting standards for continuous improvement. SFL abides by the requirements set out in the International Labour Conventions and the Maritime Labour Convention. As part of safeguarding seafarers labour rights, these conventions include the right to Collective Bargaining Agreements with Flag State, and that no employee is discriminated based on nationality, race, ancestry or any other basis. SFL has implemented the Port State Control (PSC) and the OCIMF Ship Inspection Report Programme (SIRE) to ensure that applicable labour rights are being complied with. SFL is committed to respecting and protecting internationally recognized human rights as laid out in the UN Guiding Principles on Business and Human Rights (UNGPR). SFL planned to implement a third-party compliance screening procedure in 2020 to ensure adherence in all its business relations and update its policies so that Anti-Slavery clauses are implemented diligently.

3. Governance

SFL has implemented enterprise-wide anti-corruption and money laundering policies modelled on the UK Bribery Act and US Foreign Corrupt Practices Act (FCPA). These policies are embodied in SFL's Corporate Code of Business Conduct and Financial Crime Policy. Suspected deviations from SFL's policies can be reported to the line manager or by making use of a telephone or web-based compliance hotline as outlined in the Company's Complaints Procedure. SFL was not involved in any legal proceedings associated with bribery, corruption or anti-competition in 2019. SFL is a member of the Marine Anti-Corruption Network (MACN). SFL supports SDG target 16.5 which aims at substantially reducing corruption and bribery in all their forms.

Assessment of the SLB in light of SFL's sustainability strategy

CONCLUSION

SFL has defined a set of relevant sustainability parameters that are material to the Company and has implemented policies, measures, and monitoring procedures in management systems to improve its sustainability performance and to ensure compliance with relevant laws and conventions. SFL is working to enhance energy efficiency and reduce the greenhouse gases emitted by its vessels and these efforts are aligned with the Company's overall business strategy. TGG regards the SPT as fairly ambitious realizing that the planned investments are expected to achieve a moderate emissions reduction for the Company's existing fleet overall but still represent a contribution to alignment with the IMO's decarbonization trajectory. At present, there is a lack of commercially available and viable low-carbon alternative fuel solutions for ocean-going vessels. However, TGG views SFL's investment commitment as a contribution to enhance the demand for, and technological innovation in, low-carbon ship propulsion systems.

In sum, TGG regards the KPI, SPT and the capital expenditures identified as the aim of this Bond issuance (see Section 1), as integral to SFL's sustainability strategy.

4. Impact of the defined SPT

It is estimated that the shipping sector accounts for approximately 3 %¹⁴ of global GHG emissions, whereas transportation in total contributes to 14 %¹⁵ of the world's GHG emissions. It is worth noting that the main transport mode for global trade is ocean shipping: around 90% of traded goods are carried over the waves.¹⁶

Following the Paris Agreement, IMO recognised the need to reduce GHG emissions from the maritime sector, and in 2018 IMO set emission reduction targets for the shipping sector: By 2050, IMO has an ambition to reduce CO₂ intensity across international shipping by 70% within 2050, and the absolute emissions to be reduced by at least 50 % as compared to 2008 levels.¹⁷ To reach these targets considerable amounts of capital will need to be invested. Investments in the region of USD 1.65 trillion may be required by 2050 to decarbonize the shipping sector.¹⁸ Given the size of its operations, SFL's effort to transform its fleet by upgrading, retrofitting and acquiring vessels that can run on alternative fuels will contribute to a shipping sector with a lower carbon footprint.

To put the figures into context: Substituting the containership *MSC Margarita* with a similar sized ship with LNG propulsion would, assuming the same sailing pattern, lead to a reduction of at least 12 700 tonnes of CO₂ per year. This CO₂-reduction equals removing some 2 700 passenger cars¹⁹ from the roads for an entire year. As such, substituting one to two vessels in the coming years, SFL significantly reduces CO₂ emissions.

The role of LNG

Participants and analysts of the shipping sector suggest that LNG will play a considerable role as a transition fuel in the next decade.²⁰ According to estimates provided by DNV GL, in 2014 there were approximately 119 LNG fueled ships in operation or on order.²¹ This has increased to about 358 LNG fueled ships that are currently in operation or on order by mid-2019.²² For reference, the world merchant fleet consisted of more than 51,000 vessels at the end of 2019.²³

As the LNG technology is currently the only viable solution to implementing low GHG emission fuels, SFL is making the correct assumption in mentioning this technology as the first step to reduce the carbon intensity of its business model. It is however important to note SFL's commitment to continue to assess other approaches and technologies to ensure that the company's assets will be attractive in 2030 and towards 2050.

SFL's alignment with and contribution to the UN SDGs

The UN Sustainable Development Goals (SDGs) were launched in September 2015 and represent an agenda for achieving sustainable development by the year 2030. In TGG's opinion, SFL's Sustainability-Linked Bond advances mainly the following SDG goals and targets:

¹⁴ [https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/652754/IPOL_BRI\(2020\)652754_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/652754/IPOL_BRI(2020)652754_EN.pdf)

¹⁵ <https://www.epa.gov/ghgemissions/global-greenhouse-gas-emissions-data>

¹⁶ <https://www.oecd.org/ocean/topics/ocean-shipping/>

¹⁷ <https://www.imo.org/en/MediaCentre/HotTopics/Pages/Reducing-greenhouse-gas-emissions-from-ships.aspx>

¹⁸ <https://www.globalmaritimeforum.org/content/2020/01/Aggregate-investment-for-the-decarbonisation-of-the-shipping-industry.pdf>

¹⁹ <https://www.epa.gov/greenvehicles/greenhouse-gas-emissions-typical-passenger-vehicle>

²⁰ <https://www.dnvgl.com/expert-story/maritime-impact/Prepare-for-a-decarbonization-pathway.html>

²¹ https://www.dnvgl.com/Images/LNG_report_2015-01_web_tcm8-13833.pdf

²² <https://www.norwep.com/Market-info/Markets/Norway/Events/Older/Small-Scale-LNG-and-Hybrid-Solutions>

²³ <http://infomaritime.eu/index.php/2020/05/07/top-15-shipowning-countries/>

KPI	SDG	SDG targets
The aggregate financial value of binding commitments towards vessel acquisitions, newbuildings, and vessel retrofits, which can be powered by low-carbon/alternative fuel sources	9. Industry, innovation, and infrastructure	9.4. By 2030, upgrade infrastructure and retrofit industries to make them sustainable, with increased resource-use efficiency and greater adoption of clean and environmentally sound technologies and industrial processes, with all countries taking action in accordance with their respective capabilities. <i>In TGG's view, SFL contributes with transportation infrastructure representing a key part of global trade. Lowering the emissions from transportation infrastructure is of great importance.</i>
	13. Take urgent action to combat climate change and its impacts	13.2 Integrate climate change measures into national policies, strategies and planning. <i>In TGG's view, SFL's ambition to invest in lower-emission technology is a strategy which corresponds well with SDG 13.</i>

Sustainability impact of the defined SPT

CONCLUSION

SFL intends to issue a Sustainability-Linked Bond which will tie the principal amount due upon maturity to the achievement of the following SPT: An amount equal to the size of the issue in capital expenditures during a period of five years from the date of issuance of the Bond, on upgrading and acquiring ships that have the capability to run on low carbon/alternative fuels.

TGG has performed a review of SFL's SLB framework and considers the KPI to be relevant, material and aligned with the Company's sustainability strategy. In TGG's view, SFL's SPT is deemed *fairly ambitious*, as it constitutes an important step to reduce GHG emissions vs a "business as usual" trajectory. The move to low-carbon/alternative fuel sourced vessels represents an important part of the short-term transition of the shipping industry which in the long-term must be combined with more advanced decarbonization technologies in order to be aligned with the Paris Agreement climate goals. TGG considers reporting and verification commitments to be aligned with current market standards.

Based on the foregoing, TGG regards SFL's SLB to be aligned with the core elements of the ICMA SLBP and the potential achievement of the SPT to be impactful.

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