

## Governance and Risk Management

Our business activities expose us to a variety of risks and opportunities including, but not limited to, regulatory changes, rapidly changing market dynamics, and increased volatility in our key commodity markets. Our goal is to manage these risks and opportunities so that we are in position to develop our business and achieve our goals while remaining reasonably protected from an unacceptable level of risk or financial exposure. We use a multilevel risk management oversight structure to manage the risks and opportunities arising from our business activities, the markets in which we operate and the political environments and structures with which we interface.

### Governance

The key elements of our governance practices are:

- employees, management and the Board are committed to ethical business conduct, integrity, and honesty;
- we have established key policies and standards to provide a framework for how we conduct our business;
- the Chair of our Board and all directors, other than our Chief Executive Officer ("CEO"), are independent;
- the Board is comprised of individuals with a mix of skills, knowledge and experience that are critical for our business and our strategy;
- the effectiveness of the Board is achieved through annual evaluations and continuing education of our directors; and
- our management and Board facilitate and foster an open dialogue with shareholders and community stakeholders.

**Commitment to ethical conduct** is the foundation of our corporate governance model. We have adopted the following codes of conduct to guide our business decisions and everyday business activities:

- Corporate Code of Conduct, which applies to all employees and officers of TransAlta and its subsidiaries,
- Directors' Code of Conduct,
- Finance Code of Ethics, which applies to all financial employees of the Corporation, and
- Energy Trading Code of Conduct, which applies to all of our employees engaged in energy marketing.

Our codes of conduct outline the standards and expectations we have for our employees, officers and directors with respect to the protection and proper use of our assets. The codes also provide guidelines with respect to securing our assets, conflicts of interest, respect in the workplace, social responsibility, privacy, compliance with laws, insider trading, environment, health and safety, and our commitment to ethical and honest conduct. Our Corporate Code of Conduct goes beyond the laws, rules, and regulations that govern our business in the jurisdictions in which we operate; it outlines the principal business practices with which all employees must comply.

Our employees, officers, and directors are reminded annually about the importance of ethics and professionalism in their daily work, and must certify annually that they have reviewed and understand their responsibilities as set forth in the respective codes of conduct. This certification also requires our employees, officers, and directors to acknowledge that they have complied with the standards set out in the respective code during the last calendar year.

**The Board** is responsible for overseeing the management of the Corporation by establishing key policies and standards, including policies for the assessment and management of principal risks and strategic plans. The Board monitors and assesses the performance and progress of the Corporation's goals through candid and timely reports from the CEO and the senior management team. We have also established an annual evaluation process whereby our directors are provided with an opportunity to evaluate the Board, Board committees, individual directors, and the chair's performance.

In order to allow the Board to establish and manage the financial, environmental, and social elements of our governance practices, the Board has established the Audit and Risk Committee ("ARC"), the GESC, and the Human Resources Committee (the "HRC").

**The ARC**, consisting of independent members of the Board, provides assistance to the Board in fulfilling its oversight responsibility relating to the integrity of our financial statements and the financial reporting process; the systems of internal accounting and financial controls; the internal audit function; the external auditors' qualifications and terms and conditions of appointment, including remuneration; independence; performance and reports; and the legal and risk compliance programs as established by management and the Board. The ARC approves our Commodity and Financial Exposure Management policies and reviews quarterly Enterprise Risk Management reporting.

**The GESC** is responsible for developing and recommending to the Board a set of corporate governance principles applicable to the Corporation and for monitoring the compliance with these principles. The GESC is also responsible for Board recruitment and for the nomination of directors to the Board and its committees. In addition, the GESC assists the Board in fulfilling its oversight responsibilities with respect to the Corporation's monitoring of environmental, health and safety regulations and public policy changes and the establishment and adherence to environmental, health and safety practices, procedures, and policies. The GESC also receives an annual report on the annual Corporate Code of Conduct certification process.

In regards to overseeing and seeking to ensure that the Corporation consistently achieves strong environment, health, and safety ("EH&S") performance, the GESC undertakes a number of actions that include: (i) receiving regular reports from management regarding environmental compliance, trends, and TransAlta's responses; (ii) receiving reports and briefings on management's initiatives with respect to changes in climate change legislation, policy developments as well as other draft initiatives and the potential impact such initiatives may have on our operations; (iii) assessing the impact of the GHG policies implementation and other legislative initiatives on the Corporation's business; (iv) reviewing with management the EH&S policies of the Corporation; (v) reviewing with management the health and safety practices implemented within the Corporation, as well as the evaluation and training processes put in place to address problem areas; (vi) receiving reports from management on the near-miss reporting program and discussing with management ways to improve the EH&S processes and practices; and (vi) reviewing the effectiveness of our response to EH&S issues and any new initiatives put in place to further improve the Corporation's EH&S culture.

**The HRC** is empowered by the Board to review and approve key compensation and human resources policies of the Corporation that are intended to attract, recruit, retain, and motivate employees of the Corporation. The HRC also makes recommendations to the Board regarding the compensation of the Corporation's executive officers, including the review and adoption of equity-based incentive compensation plans, the adoption of human resources policies that support human rights and ethical conduct, and the review and approval of executive management succession and development plans.

The responsibilities of other stakeholders within our risk management oversight structure are described below:

The CEO and senior management review key risks quarterly. Specific Trading Risk Management reviews are held monthly by the Commodity and Compliance Risk Committee, and weekly by the Managing Director Commodity Risk, the commercial managing directors in Trading and Marketing, and the Senior Vice-President Trading and Marketing.

**The Investment Committee** is chaired by our Chief Legal and Compliance Officer and Corporate Secretary and is comprised of the CEO, Chief Financial Officer, Chief Legal and Compliance Officer and Corporate Secretary, and Chief Investment Officer. It reviews and approves all major capital expenditures including growth, productivity, life extensions, and major coal outages. Projects that are approved by the committee will then be put forward for approval by the Board, if required.

**The Commodity Risk & Compliance Committee** is chaired by our Chief Financial Officer and is comprised of the Chief Financial Officer, Chief Legal and Compliance Officer and Senior Vice President, Energy Marketing. It oversees the risk and compliance program in trading and ensures that this program is adequately resourced to monitor trading operations from a risk and compliance perspective. It also ensures the existence of appropriate controls, processes, systems and procedures to monitor adherence to policy.

TransAlta is listed on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange and is subject to the governance regulations, rules, and standards applicable under both exchanges. Our corporate governance practices meet the following governance rules of the TSX and Canadian Securities Administrators: (i) Multilateral Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings; (ii) Multilateral Instrument 52-110 - Audit Committees; (iii) National Policy 58-201 - Corporate Governance Guidelines; and (iv) National Instrument 58-101 - Disclosure of Corporate Governance Practices. As a "foreign private issuer" under US securities laws, we are generally permitted to comply with Canadian corporate governance requirements. Additional information regarding our governance practices can be found in our management proxy circular.

## Risk Controls

Our risk controls have several key components:

### Enterprise Tone

We strive to foster beliefs and actions that are true to, and respectful of, our many stakeholders. We do this by investing in communities where we live and work, operating and growing sustainably, putting safety first, and being responsible to the many groups and individuals with whom we work.

### Policies

We maintain a comprehensive set of enterprise-wide policies. These policies establish delegated authorities and limits for business transactions, as well as allow for an exception approval process. Periodic reviews and audits are performed to ensure compliance with these policies. All employees and directors are required to sign a code of conduct on an annual basis.

### Reporting

On a regular basis, residual risk exposures are reported to key decision makers including the Board, senior management, and the Commodity Risk & Compliance Committee. Reporting to this committee includes analysis of new risks, monitoring of status to risk limits, review of events that can affect these risks, and discussion and review of the status of actions to minimize risks. This quarterly reporting provides for effective and timely risk management and oversight.

### Whistleblower System

We have a process in place where employees, shareholders, or other stakeholders may anonymously report any potential ethical concerns. These concerns can be submitted confidentially and anonymously, either directly to the ARC or to TransAlta's Ethics Helpline. All complaints are investigated and the ARC receives a report at every scheduled committee meeting on all findings. If the findings are urgent, they will be reported to the Chair of the Board immediately.

### Value at Risk and Trading Positions

Value at risk ("VaR") is one of the primary measures used to manage our exposure to market risk resulting from commodity risk management activities. VaR is calculated and reported on a daily basis. This metric describes the potential change in the value of our trading portfolio over a three-day period within a 95 per cent confidence level, resulting from normal market fluctuations.

VaR is a commonly used metric that is employed by industry to track the risk in commodity risk management positions and portfolios. Two common methodologies for estimating VaR are the historical variance/covariance and Monte Carlo approaches. We estimate VaR using the historical variance/covariance approach. An inherent limitation of historical variance/covariance VaR is that historical information used in the estimate may not be indicative of future market risk. Stress tests are performed periodically to measure the financial impact to the trading portfolio resulting from potential market events, including fluctuations in market prices, volatilities of those prices, and the relationships between those prices. We also employ additional risk mitigation measures. VaR at Dec. 31, 2017, associated with our proprietary commodity risk management activities was \$5 million (2016 - \$2 million). Refer to the Commodity Price Risk section of this MD&A for further discussion.

## Risk Factors

Risk is an inherent factor of doing business. The following section addresses some, but not all, risk factors that could affect our future results and our activities in mitigating those risks. These risks do not occur in isolation, but must be considered in conjunction with each other.

For some risk factors we show the after-tax effect on net earnings of changes in certain key variables. The analysis is based on business conditions and production volumes in 2017. Each item in the sensitivity analysis assumes all other potential variables are held constant. While these sensitivities are applicable to the period and the magnitude of changes on which they are based, they may not be applicable in other periods, under other economic circumstances, or for a greater magnitude of changes. The changes in rates should also not be assumed to be proportionate to earnings in all instances.

### Volume Risk

Volume risk relates to the variances from our expected production. For example, the financial performance of our Hydro, Wind, and Solar operations is partially dependent upon the availability of their input resources in a given year. Where we are unable to produce sufficient quantities of output in relation to contractually specified volumes, we may be required to pay penalties or purchase replacement power in the market.

#### We manage volume risk by:

- actively managing our assets and their condition in order to be proactive in plant maintenance so that our plants are available to produce when required;
- monitoring water resources throughout Alberta to the best of our ability and optimizing this resource against real-time electricity market opportunities;
- placing our facilities in locations that we believe to have adequate resources to generate electricity to meet the requirements of our contracts. However, we cannot guarantee that these resources will be available when we need them or in the quantities that we require; and
- diversifying our fuels and geography as one way of mitigating regional or fuel-specific events.

The sensitivity of volumes to our net earnings is shown below:

Factor	Increase or decrease (%)	Approximate impact on net earnings
Availability/production	1	12

### Generation Equipment and Technology Risk

There is a risk of equipment failure due to wear and tear, latent defect, design error or operator error, among other things, which could have a material adverse effect on the Corporation. Although our generation facilities have generally operated in accordance with expectations, there can be no assurance that they will continue to do so. Our plants are exposed to operational risks such as failures due to cyclic, thermal, and corrosion damage in boilers, generators, and turbines, and other issues that can lead to outages and increased volume risk. If plants do not meet availability or production targets specified in their PPA or other long-term contracts, we may be required to compensate the purchaser for the loss in the availability of production or record reduced energy or capacity payments. For merchant facilities, an outage can result in lost merchant opportunities. Therefore, an extended outage could have a material adverse effect on our business, financial condition, results of operations, or our cash flows.

As well, we are exposed to procurement risk for specialized parts that may have long lead times. If we are unable to procure these parts when they are needed for maintenance activities, we could face an extended period where our equipment is unavailable to produce electricity.

#### We manage our generation equipment and technology risk by:

- operating our generating facilities within defined and proven operating standards that are designed to maximize the availability of our generating facilities for the longest period of time;
- performing preventive maintenance on a regular basis;
- adhering to a comprehensive plant maintenance program and regular turnaround schedules;
- adjusting maintenance plans by facility to reflect the equipment type and age;
- having sufficient business interruption coverage in place in the event of an extended outage;

- having force majeure clauses in our thermal and other PPAs and other long-term contracts;
- using proven technology in our generating facilities;
- monitoring technological advances and evaluating their impact upon our existing generating fleet and related maintenance programs;
- negotiating strategic supply agreements with selected vendors to ensure key components are available in the event of a significant outage;
- entering into long-term arrangements with our strategic supply partners to ensure availability of critical spare parts; and
- developing a long-term asset management strategy with the objective of maximizing the life cycles of our existing facilities and/or replacing of selected generating assets.

### **Commodity Price Risk**

We have exposure to movements in certain commodity prices, including the market price of electricity and fuels used to produce electricity in both our electricity generation and proprietary trading businesses.

We manage the financial exposure associated with fluctuations in electricity price risk by:

- entering into long-term contracts that specify the price at which electricity, steam, and other services are provided;
- maintaining a portfolio of short-, medium- and long-term contracts to mitigate our exposure to short-term fluctuations in commodity prices,
- purchasing natural gas coincident with production for merchant plants so spot market spark spreads are adequate to produce and sell electricity at a profit; and
- ensuring limits and controls are in place for our proprietary trading activities.

In 2017, we had approximately 92 per cent (2016 - 88 per cent) of production under short-term and long-term contracts and hedges. In the event of a planned or unplanned plant outage or other similar event, however, we are exposed to changes in electricity prices on purchases of electricity from the market to fulfil our supply obligations under these short- and long-term contracts.

We manage the financial exposure to fluctuations in the costs of fuels used in production by:

- entering into long-term contracts that specify the price at which fuel is to be supplied to our plants,
- hedging emissions costs by entering into various emission trading arrangements, and
- selectively using hedges, where available, to set prices for fuel.

In 2017, 57 per cent (2016 - 79 per cent) of our cost of gas used in generating electricity was contractually fixed or passed through to our customers and 100 per cent (2016 - 100 per cent) of our purchased coal costs were contractually fixed.

Actual variations in net earnings can vary from calculated sensitivities and may not be linear due to optimization opportunities, co-dependencies and cost mitigations, production, availability, and other factors.

### **Coal Supply Risk**

Having sufficient fuel available when required for generation is essential to maintaining our ability to produce electricity under contracts and for merchant sale opportunities. At our coal-fired plants, input costs, such as diesel, tires, the price and availability of mining equipment, the volume of overburden removed to access coal reserves, rail rates, and the location of mining operations relative to the power plants are some of the exposures in our operations. Additionally, the ability of the mines to deliver coal to the power plants can be impacted by weather conditions and labour relations. At US Coal, interruptions at our supplier's mine, the availability of trains to deliver coal, and the financial viability of our coal suppliers could affect our ability to generate electricity.

We manage coal supply risk by:

- ensuring that the majority of the coal used in electrical generation in Alberta is from reserves permitted through coal rights we have purchased or for which we have long-term supply contracts, thereby limiting our exposure to fluctuations in the supply of coal from third parties;
- using longer-term mining plans to ensure the optimal supply of coal from our mines;
- sourcing the majority of the coal used at US Coal under a mix of short-, medium-, and long-term contracts and from multiple mine sources to ensure sufficient coal is available at a competitive cost;
- contracting sufficient trains to deliver the coal requirements at U.S. Coal;
- ensuring coal inventories on hand at Canadian Coal and US Coal are at appropriate levels for usage requirements;
- ensuring efficient coal handling and storage facilities are in place so that the coal being delivered can be processed in a timely and efficient manner;
- monitoring and maintaining coal specifications, carefully matching the specifications mined with the requirements of our plants;
- monitoring the financial viability of US coal suppliers; and
- hedging diesel exposure in mining and transportation costs.

### **Environmental Compliance Risk**

Environmental compliance risks are risks to our business associated with existing and/or changes in environmental regulations. New emission reduction objectives for the power sector are being established by governments in Canada (including as set forth in the Alberta CLP) and the US. We anticipate continued and growing scrutiny by investors relating to sustainability performance. These changes to regulations may affect our earnings by reducing the operating life of generating facilities, imposing additional costs on the generation of electricity, such as emission caps or tax, requiring additional capital investments in emission capture technology, or requiring us to invest in offset credits. It is anticipated that these compliance costs will increase due to increased political and public attention to environmental concerns.

We manage environmental compliance risk by:

- seeking continuous improvement in numerous performance metrics such as emissions, safety, land and water impacts, and environmental incidents;
- having an International Organization for Standardization and Occupational Health and Safety Assessment Series-based environmental health and safety management system in place that is designed to continuously improve performance;
- committing significant experienced resources to work with regulators in Canada and the US to advocate that regulatory changes are well designed and cost effective;
- developing compliance plans that address how to meet or surpass emission standards for GHGs, mercury, SO<sub>2</sub>, and NO<sub>x</sub>, which will be adjusted as regulations are finalized;
- purchasing emission reduction offsets;
- investing in renewable energy projects, such as wind, solar, and hydro generation; and
- incorporating change-in-law provisions in contracts that allow recovery of certain compliance costs from our customers.

We strive to be in compliance with all environmental regulations relating to operations and facilities. Compliance with both regulatory requirements and management system standards is regularly audited through our performance assurance policy and results are reported quarterly to the GESC.

### **Credit Risk**

Credit risk is the risk to our business associated with changes in the creditworthiness of entities with which we have commercial exposures. This risk results from the ability of a counterparty to either fulfil its financial or performance obligations to us or where we have made a payment in advance of the delivery of a product or service. The inability to collect cash due to us or to receive products or services may have an adverse impact upon our net earnings and cash flows.

We manage our exposure to credit risk by:

- establishing and adhering to policies that define credit limits based on the creditworthiness of counterparties, contract term limits, and the credit concentration with any specific counterparty;
- requiring formal sign-off on contracts that include commercial, financial, legal, and operational reviews;
- requiring security instruments, such as parental guarantees, letters of credit, and cash collateral that can be collected

- if a counterparty fails to fulfil its obligation or goes over its limits; and
- reporting our exposure using a variety of methods that allow key decision-makers to assess credit exposure by counterparty. This reporting allows us to assess credit limits for counterparties and the mix of counterparties based on their credit ratings.

If established credit exposure limits are exceeded, we take steps to reduce this exposure, such as by requesting collateral, if applicable, or by halting commercial activities with the affected counterparty. However, there can be no assurances that we will be successful in avoiding losses as a result of a contract counterparty not meeting its obligations.

Our credit risk management profile and practices have not changed materially from Dec. 31, 2016. We had no material counterparty losses in 2017. We continue to keep a close watch on changes and trends in the market and the impact these changes could have on our energy trading business and hedging activities, and will take appropriate actions as required, although no assurance can be given that we will always be successful.

The following table outlines our maximum exposure to credit risk without taking into account collateral held or right of set-off, including the distribution of credit ratings, as at Dec. 31, 2017:

	Investment grade (Per cent)	Non-investment grade (Per cent)	Total (Per cent)	Total amount
Trade and other receivables <sup>(1)</sup>	87	13	100	933
Long-term finance lease receivables	96	4	100	215
Risk management assets <sup>(1)</sup>	-	100	100	899
Loan receivable <sup>(2)</sup>	-	100	100	33
<b>Total</b>				<b>2,080</b>

The maximum credit exposure to any one customer for commodity trading operations, including the fair value of open trading positions net of any collateral held, is \$40 million (2016 - \$14 million).

### Currency Rate Risk

We have exposure to various currencies as a result of our investments and operations in foreign jurisdictions, the cash flows from those operations, the acquisition of equipment and services and foreign-denominated commodities from foreign suppliers, and our US denominated debt. Our exposures are primarily to the US and Australian currencies. Changes in the values of these currencies in relation to the Canadian dollar may affect our cash flows or the value of our foreign investments to the extent that these positions or cash flows are not hedged or the hedges are ineffective.

We manage our currency rate risk by establishing and adhering to policies that allow for both designated hedges and economic hedges and include:

- hedging our net investments in US operations using US-denominated debt;
- entering into forward foreign exchange contracts to hedge future foreign denominated expenditures including our US-denominated debt that is outside the net investment portfolio; and
- hedging our expected foreign operating cash flows. Our target is to hedge a minimum of 60 per cent of our forecasted foreign operating cash flows over a four-year period, with a minimum of 90 per cent in the current year, 70 per cent in the next year, 50 per cent in the third year, and 30 per cent in the fourth year. The U.S. exposure will be managed with a combination of interest expense on our US-dollar-denominated debt and forward foreign exchange contracts; the Australian exposure will be managed with forward foreign exchange contracts.

The sensitivity of our net earnings to changes in foreign exchange rates has been prepared using management's assessment that an average four cent increase or decrease in the US or Australian currencies relative to the Canadian dollar is a reasonable potential change over the next quarter, and is shown below:

(1) Letters of credit and cash and cash equivalents are the primary types of collateral held as security related to these amounts.

(2) Counterparty has no external credit rating. Excludes \$5 million current portion classified in trade and receivables.

Factor	Increase or decrease	Approximate impact on net earnings
Exchange rate	\$0.04	12

### Liquidity Risk

Liquidity risk relates to our ability to access capital to be used to engage in trading and hedging activities, capital projects, debt refinancing and payment of liabilities, capital structure, and general corporate purposes. Investment grade credit ratings support these activities and provide a more reliable and cost-effective means to access capital markets through commodity and credit cycles. Changes in credit ratings may also affect our ability and/or the cost of establishing normal course derivative or hedging transactions, including those undertaken by our Energy Marketing segment. Counterparties enter into certain electricity and natural gas purchase and sale contracts for the purposes of asset-backed sales and proprietary trading. The terms and conditions of these contracts require the counterparties to provide collateral when the fair value of the obligation pursuant to these contracts is in excess of any credit limits granted. Downgrades in creditworthiness by certain credit rating agencies may challenge our ability to enter into these contracts or any ordinary course contract, decrease the credit limits granted, and increase the amount of collateral that may have to be provided. Certain existing contracts contain credit rating contingent clauses, that, when triggered, automatically increase costs under the contract or require additional collateral to be posted. Where the contingency is based on the lowest single rating, a one-level downgrade from a credit rating agency with an originally higher rating may not, however, trigger additional direct adverse impact.

We are focused on strengthening our financial position and flexibility and achieving stable investment grade credit ratings with rating agencies. Credit ratings issued for TransAlta, as well as the corresponding rating agency outlooks, are set out in the Financial Capital section of this MD&A. Credit ratings are subject to revision or withdrawal at any time by the rating organization, and there can be no assurance that TransAlta's credit ratings and the corresponding outlook will not be changed, resulting in the adverse possible impacts identified above.

As at Dec. 31, 2017, we have liquidity of \$1.6 billion comprised of amounts not drawn under our committed credit facilities and cash on hand.

We manage liquidity risk by:

- monitoring liquidity on trading positions;
- preparing and revising longer-term financing plans to reflect changes in business plans and the market availability of capital;
- reporting liquidity risk exposure for commodity risk management activities on a regular basis to the Commodity Risk & Compliance Committee, senior management and the ARC;
- maintaining investment grade credit ratings; and
- maintaining sufficient undrawn committed credit lines to support potential liquidity requirements.

### Interest Rate Risk

Changes in interest rates can impact our borrowing costs and the capacity revenues we receive from our Alberta PPA plants. Changes in our cost of capital may also affect the feasibility of new growth initiatives.

We manage interest rate risk by establishing and adhering to policies that include:

- employing a combination of fixed and floating rate debt instruments; and
- monitoring the mixture of floating and fixed rate debt and adjusting where necessary to ensure a continued efficient mixture of these types of debt.

At Dec. 31, 2017, approximately six per cent (2016 - six per cent) of our total debt portfolio was subject to changes in floating interest rates through a combination of floating rate debt and interest rate swaps.

The sensitivity of changes in interest rates upon our net earnings is shown below:

Factor	Increase or decrease (%)	Approximate impact on net earnings
Interest rate	0.15	-

### Project Management Risk

On capital projects, we face risks associated with cost overruns, delays, and performance.

We manage project risks by:

- ensuring all projects are reviewed to see that established processes and policies are followed, risks have been properly identified and quantified, input assumptions are reasonable, and returns are realistically forecasted prior to senior management and Board of Directors approvals;
- using consistent and disciplined project management methodologies and processes;
- performing detailed analysis of project economics prior to construction or acquisition and by determining our asset contracting strategy to ensure the right mix of contracted and merchant capacity before starting construction;
- partnering with those who have previously been able to deliver projects economically and on budget;
- developing and following through with comprehensive plans that include critical paths identified, key delivery points, and backup plans;
- managing project closeouts so that any learnings from the project are incorporated into the next significant project;
- fixing the price and availability of the equipment, foreign currency rates, warranties, and source agreements as much as is economically feasible prior to proceeding with the project; and
- entering into labour agreements to provide security around cost and productivity.

### Human Resource Risk

Human resource risk relates to the potential impact upon our business as a result of changes in the workplace. Human resource risk can occur in several ways:

- potential disruption as a result of labour action at our generating facilities;
- reduced productivity due to turnover in positions;
- inability to complete critical work due to vacant positions;
- failure to maintain fair compensation with respect to market rate changes; and
- reduced competencies due to insufficient training, failure to transfer knowledge from existing employees, or insufficient expertise within current employees.

We manage this risk by:

- monitoring industry compensation and aligning salaries with those benchmarks;
- using incentive pay to align employee goals with corporate goals;
- monitoring and managing target levels of employee turnover; and
- ensuring new employees have the appropriate training and qualifications to perform their jobs.

In 2017, 52 per cent (2016 - 53 per cent) of our labour force was covered by 11 (2016 - 11) collective bargaining agreements. In 2017, four (2015 - five) agreements were renegotiated. We anticipate the successful negotiation of four collective agreements in 2018.

### Regulatory and Political Risk

Regulatory and political risk is the risk to our business associated with potential changes to the existing regulatory structures and the political influence upon those structures. This risk can come from market regulation and re-regulation, increased oversight and control, structural or design changes in markets, or other unforeseen influences. Market rules are often dynamic and we are not able to predict whether there will be any material changes in the regulatory environment or the ultimate effect of changes in the regulatory environment on our business. This risk includes, among other things, uncertainties associated with the development of capacity markets for electricity in the provinces of Alberta and Ontario, uncertainties associated with the development of carbon pricing policies, the qualification of our renewable facilities in Alberta to the generation of tradable GHG allowances as part of the transition from the Specified Gas Emitters Regulation to new regulation to be formulated to give effect to the Alberta CLP in 2018, as well as the influence of regulation on the value of allowances or credits generated.

We manage these risks systematically through our Legal and Regulatory groups and our Compliance program, which is reviewed periodically to ensure its effectiveness. We work with governments, regulators, electricity system operators, and other stakeholders to resolve issues as they arise. We are actively monitoring changes to market rules and market design, and we engage in market-sponsored stakeholder engagement processes. Through these and other avenues, we engage in advocacy and policy discussions at a variety of levels. These stakeholder negotiations have allowed us to engage in proactive discussions with governments over the longer term.

International investments are subject to unique risks and uncertainties relating to the political, social, and economic structures of the respective country and the country's regulatory regime. We mitigate this risk through the use of non-recourse financing and insurance.

### **Transmission Risk**

Access to transmission lines and transmission capacity for existing and new generation are key in our ability to deliver energy produced at our power plants to our customers. The risks associated with the aging existing transmission infrastructure in markets in which we operate continue to increase because new connections to the power system are consuming transmission capacity quicker than it is being added by new transmission developments.

### **Reputation Risk**

Our reputation is one of our most valued assets. Reputation risk relates to the risk associated with our business because of changes in opinion from the general public, private stakeholders, governments, and other entities.

We manage reputation risk by:

- striving as a neighbour and business partner in the regions where we operate to build viable relationships based on mutual understanding leading to workable solutions with our neighbours and other community stakeholders;
- clearly communicating our business objectives and priorities to a variety of stakeholders on a routine basis;
- maintaining positive relationships with various levels of government;
- pursuing sustainable development as a longer-term corporate strategy;
- ensuring that each business decision is made with integrity and in line with our corporate values;
- communicating the impact and rationale of business decisions to stakeholders in a timely manner; and
- maintaining strong corporate values that support reputation risk management initiatives.

### **Corporate Structure Risk**

We conduct a significant amount of business through subsidiaries and partnerships. Our ability to meet and service debt obligations is dependent upon the results of operations of our subsidiaries and the payment of funds by our subsidiaries in the form of distributions, loans, dividends, or otherwise. In addition, our subsidiaries may be subject to statutory or contractual restrictions that limit their ability to distribute cash to us.

### **Cybersecurity Risk**

We rely on our information technology to process, transmit and store electronic information, including information we use to safely operate our assets. Cyberattacks or other breaches of network or information technology systems security may cause disruptions to our operations. Cyberattackers may use a range of techniques, from manipulating people to using sophisticated malicious software and hardware on a single or distributed basis. Some cyberattackers use a combination of techniques in their attempt to evade safeguards such as firewalls, intrusion prevention systems, and antivirus software found in our systems and networks. A successful attack on our systems, networks, and infrastructure may allow for the unauthorized interception, destruction, use, or dissemination of our information and may cause disruptions to our operations.

We take measures to secure our infrastructure against potential cyberattacks that may damage our infrastructure, systems and data. Our cybersecurity program aligns with industry best practices to ensure that a holistic approach to security is maintained. We have implemented security controls to help secure our data and business operations, including access control measures, intrusion detection and prevention systems, logging and monitoring of network activities, and implementing policies and procedures to ensure the secure operations of the business.

While we have systems, policies, hardware, practices, data backups, and procedures designed to prevent or limit the effect of the security breaches of our generation facilities and infrastructure, there can be no assurance that these measures will be sufficient and that such security breaches will not occur or, if they do occur, that they will be adequately addressed in a timely manner. We closely monitor both preventive and detective measures to manage these risks.

#### General Economic Conditions

Changes in general economic conditions impact product demand, revenue, operating costs, the timing and extent of capital expenditures, the net recoverable value of PP&E, financing costs, credit and liquidity risk, and counterparty risk.

#### Income Taxes

Our operations are complex and located in several countries. The computation of the provision for income taxes involves tax interpretations, regulations, and legislation that are continually changing. Our tax filings are subject to audit by taxation authorities. Management believes that it has adequately provided for income taxes as required by IFRS, based on all information currently available.

The Corporation is subject to changing laws, treaties, and regulations in and between countries. Various tax proposals in the countries we operate in could result in changes to the basis on which deferred taxes are calculated or could result in changes to income or non-income tax expense. There has recently been an increased focus on issues related to the taxation of multinational corporations. A change in tax laws, treaties, or regulations, or in the interpretation thereof, could result in a materially higher income or non-income tax expense that could have a material adverse impact on the Corporation.

On Dec. 22, 2017, the US government enacted H.R.1, originally known as the *Tax Cuts and Jobs Act*, which includes legislation to decrease its federal corporate income tax rate from 35 per cent to 21 per cent. The Corporation's net deferred tax liability associated with its directly owned US operations is made up of a deferred tax asset and a deferred tax liability that net to \$6 million. The decrease in the US federal corporate income tax rate resulted in a decrease to the deferred tax asset of \$104 million, all of which is recorded as deferred tax expense in the Consolidated Statement of Earnings, offset by a decrease to the deferred tax liability of \$110 million, of which \$1 million is recorded as deferred tax expense in the Consolidated Statement of Earnings with an offsetting \$111 million deferred tax recovery recorded in the Consolidated Statement of Other Comprehensive Income.

The sensitivity of changes in income tax rates upon our net earnings is shown below:

Factor	Increase or decrease (%)	Approximate impact on net earnings
Tax rate	1	1

#### Legal Contingencies

We are occasionally named as a party in various claims and legal regulatory proceedings that arise during the normal course of our business. We review each of these claims, including the nature of the claim, the amount in dispute or claimed, and the availability of insurance coverage. There can be no assurance that any particular claim or proceedings will be resolved in our favour or that such claims may not have a material adverse effect on us.

#### Other Contingencies

We maintain a level of insurance coverage deemed appropriate by management. There were no significant changes to our insurance coverage during renewal of the insurance policies on December 31. Our insurance coverage may not be available in the future on commercially reasonable terms. There can be no assurance that our insurance coverage will be fully adequate to compensate for potential losses incurred. In the event of a significant economic event, the insurers may not be capable of fully paying all claims.