

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 a 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 President and CEO, are independent within the meaning of National Instrument 58-101 - *Disclosure of Corporate Governance Practices*;
- 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 robust 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;
- Supplier's 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, directors, consultants and suppliers with respect to, among other things, the protection and proper use of our assets. The codes also provide guidelines with respect to securing our assets, avoiding 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 and Directors' Code of Conduct each goes beyond the laws, rules and regulations that govern our business in the jurisdictions in which we operate; they outline the principal business practices with which all employees and directors 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 provides stewardship of the Corporation and ensures that the Corporation establishes key policies and procedures for the identification, 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 of the Board'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 AFRC, GSSC, the Human Resources Committee (the "HRC") and the Investment Performance Committee ("IPC").

The AFRC, consisting of independent members of the Board, provides assistance to the Board in fulfilling its oversight responsibility relating to the integrity of our consolidated 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 AFRC approves our Commodity and Financial Exposure Management policies and reviews quarterly Enterprise Risk Management reporting.

The GSSC is responsible for developing and recommending to the Board a set of corporate governance principles applicable to the Corporation and for monitoring compliance with these principles. The GSSC is also responsible for Board recruitment, succession planning and for the nomination of directors to the Board and its committees. In addition, the GSSC 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 GSSC also receives an annual report on the annual codes 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 GSSC undertakes a number of actions that include: a) receiving regular reports from management regarding environmental compliance, trends and TransAlta's responses; b) 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; c) assessing the impact of the GHG policies implementation and other legislative initiatives on the Corporation's business; d) reviewing with management the EH&S policies of the Corporation; e) 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; f) discussing with management ways to improve the EH&S processes and practices; and g) 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 CEO, 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 IPC is empowered by the Board to oversee management's investment conclusions and the execution of major, Board-approved capital expenditure projects that further the Corporation's strategic plans. The IPC undertakes a number of actions that include: a) reviewing and considering the substantive risks, returns, financing and other key elements relating to the Corporation's major capital projects; b) reviewing and assessing mitigation plans, expected outcomes, and implementation throughout the project life cycle with respect to substantive risks; c) reviewing and assessing cost-estimating methodologies employed throughout the project life cycle; d) reviewing and assessing progress reports including periodic updates on the project schedule, risks and costs at key milestones as projects advance through to execution; e) reviewing post-project look-backs; and f) reviewing and providing recommendations to the Board regarding capital expenditures associated with such capital projects.

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

The CEO and executive management review and report on key risks quarterly. Specific Trading Risk Management reviews are held monthly by the Commodity Risk and Compliance Committee, and weekly by the commodity risk team, the commercial managers in Trading and Marketing, and the Executive Vice-President, Finance & Trading and Chief Financial Officer.

The Investment Committee is chaired by our CEO and is comprised of the CEO, Executive Vice-President, Finance & Trading and Chief Financial Officer, Chief Operating Officer, Chief Development Officer, and Executive Vice-President, Legal, Commercial and External Affairs. It reviews and approves all major capital expenditures including growth, productivity, life extensions and major coal outages. Projects that are approved by the Investment Committee will then be put forward for approval by the Board, if required.

The Commodity Risk & Compliance Committee is chaired by our Executive Vice-President, Finance & Trading and Chief Financial Officer and is comprised of at least three members of senior management. 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.

The Hydro Operating Committee consists of two members who are Brookfield employees with expertise in hydro facility management, and two TransAlta members. This committee was formed in 2019 for the purpose of collaborating on matters in connection with the operation, and maximization of the value, of TransAlta's Alberta Hydro Assets. It is delivering on its objectives by thoroughly reviewing the operating, maintenance, safety and environmental aspects of TransAlta's Alberta Hydro Assets and, following that review, providing expert advice and recommendations to

TransAlta's hydro operational team. The Committee has an initial term of six years, which can be extended for an additional two years.

TransAlta is listed on the 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: a) Multilateral Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*; b) National Instrument 52-110 - *Audit Committees*; c) National Policy 58-201 - *Corporate Governance Guidelines*; and d) 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 most recent management information circular.

COVID-19

We have adopted a number of risk mitigation measures in response to the COVID-19 pandemic, including the formal implementation of TransAlta's business continuity plan on March 9, 2020. The Board and management have been monitoring the development of the outbreak and are continually assessing its impact on the Corporation's operations, supply chains and customers, as well as, more generally, to the business and affairs of the Corporation. Potential impacts of the pandemic on the business and affairs of the Corporation include, but are not limited to: potential interruptions of production, supply chain disruptions, unavailability of employees at TransAlta, potential delays in growth projects, increased credit risk with counterparties and increased volatility in commodity prices and the valuations of financial instruments. In addition, the broader impacts to the global economy and financial markets could have potential adverse impacts on the availability of capital for investment and the demand for power and commodity pricing.

To manage the risks resulting from COVID-19, we have taken a number of steps in furtherance of the Corporation's business continuity efforts:

Management Responses

- Formed a COVID-19 emergency team run by our Chief Operating Officer, reporting to the CEO;
- Regularly communicated with the Board and employees in regard to the Corporation's response to COVID-19;
- Created a team to develop, implement and update COVID-19 safety protocols, including a back-to-office and site strategy that will remain in place until a vaccine has been distributed;
- Established a committee to consider and respond to any claims of force majeure that may be received as a result of COVID-19; and
- Developed leadership plans, including contingent authorities.

Policy Changes

- Aligned all non-essential travel and quarantine requirements with local jurisdictional guidance for all TransAlta employees and contractors returning from air, bus, train or ship travel for all jurisdictions in which we operate.

Employee Changes

- Provided assurances to employees that their employment with TransAlta would not be impacted by the COVID-19 pandemic;
- Developed and implemented COVID-19-specific back-to-office protocols to ensure all TransAlta locations remain safe;
- Requested and received an essential workers quarantine exemption approval from Alberta Health to minimize disruptions in the event international technical assistance is required for our Alberta assets;
- Implemented health screening procedures, including questionnaires and temperature tests, enhanced cleaning measures and strict work protocols at the Corporation's offices and facilities in accordance with our back-to-office and site strategy;
- Implemented training and policies to seamlessly allow non-essential employees to work remotely, as appropriate; and
- Provided COVID-19 related town halls and information sessions for employees featuring medical and infectious disease experts.

Operational Changes

- Modified our operating procedures and implemented restrictions to non-essential access to our facilities to support continued operations through the pandemic;
- Reviewed the supply chain risk associated with all key power-generation process inputs and implemented weekly monitoring for changes in risk;
- Reached out to key supply chain contacts to determine strategies and contingencies to ensure we are able to continue to progress our growth projects, wherever possible; and
- Identified new cybersecurity risks associated with phishing emails and enhanced security protocols and increased awareness of potential threats.

Financial Oversight

- Continued to maintain a comprehensive commodity hedging program for our merchant assets that can respond to changes in underlying market conditions;
- Continued to monitor counterparties for changes in creditworthiness, as well as monitor their ability to meet obligations; and
- Continued to monitor the situation and communicate with our key lenders on any foreseeable impacts and on our response to the crisis. We maintain a strong financial position and significant liquidity with our existing committed credit facilities.

Overall, we continue to actively monitor the situation and advice from public health officials with a view to responding to changing recommendations and adapting our response and approach as necessary.

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, the AFRC, senior management and/or the Commodity Risk & Compliance Committee, as applicable. Reporting to this latter 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 monthly reporting provides for effective and timely risk management and oversight.

Whistleblower System

We have a process in place where employees, contractors, shareholders or other stakeholders may confidentially or anonymously report any potential legal or ethical concerns, including concerns relating to accounting, internal control accounting, auditing or financial matters or relating to alleged violations of any laws or our code of conduct. These concerns can be submitted confidentially and anonymously, either directly to the AFRC or through TransAlta's toll-free telephone or online Ethics Helpline. The AFRC Chair is immediately notified of any material complaints and, otherwise, the AFRC receives a report at every quarterly committee meeting on all findings related to any material complaints or complaints relating to accounting or financial reporting or alleged breaches in internal controls over financial reporting.

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, 2020, associated with our proprietary commodity risk management activities was \$1 million (2019 - \$1 million). Please refer to the Risk Factors – Commodity Price Risk section of this MD&A below 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 plans, performance, results or outcomes and our activities in mitigating those risks. These risks do not occur in isolation, but must be considered in conjunction with each other. For a further discussion of these and other risk factors affecting the Corporation, readers are encouraged to read the Risk Factors section of the AIF, available on our website at www.transalta.com and under our profile on SEDAR at www.sedar.com and on EDGAR at www.edgar.gov.

A reference herein to a material adverse effect on the Corporation means such an effect on the Corporation or its business, operations, financial condition, results of operations and/or its cash flows, as the context requires.

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 2020. 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. The financial performance of our hydro, wind and solar operations is highly dependent upon the availability of their input resources in a given year. Shifts in weather or climate patterns, seasonal precipitation and the timing and rate of melting and runoff may impact the water flow to our facilities. The strength and consistency of the wind resource at our facilities impacts production. The operation of thermal facilities can also be impacted by ambient temperatures and the availability of water and fuel. 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 facility maintenance so that our facilities 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 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 to mitigate 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	\$8 million

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 facilities are exposed to operational risks such as failures due to cyclic, thermal and corrosion damage in boilers, generators and turbines, as well as other issues that can lead to outages and increased volume risk. If facilities 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 facilities within defined industry standards that optimizes availability over their commercial operating life;
- Performing preventive maintenance in accordance with applicable industry practices, major equipment supplier recommendations and our operating experience;
- Adhering to comprehensive maintenance programs and regular turnaround schedules;
- Adjusting maintenance plans by facility to reflect equipment type, age and commercial risk;
- Having adequate business interruption insurance in place to cover extended forced outages;
- Having clauses in our PPAs and other long-term contracts that allow us to declare force majeure in the event of an unforeseen failure;
- Selecting and applying proven technology in our generating facilities, where practical;
- Where technology is newer, ensuring service agreements with equipment suppliers include appropriate availability and performance guarantees;
- Monitoring our fleet against industry performance to identify issues or advancements that may impact performance and adjusting our maintenance and investment programs accordingly;
- Negotiating strategic supply agreements with selected vendors to ensure key components are readily 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
- Implementing long-term asset management strategies that optimize the life cycles of our existing facilities and/or identify replacement requirements for 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 facilities 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 2020, we had approximately 90 per cent (2019 – 90 per cent) of production under short-term and long-term contracts and hedges. In the event of a planned or unplanned 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 cost of fuels used in production by:

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

In 2020, 89 per cent (2019 – 66 per cent) of our gas consumption used in generating electricity was contractually fixed or passed through to our customers and 78 per cent (2019 – 76 per cent) of our purchased coal was 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 facilities, 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 facilities are some of the exposures in our operations. Additionally, the ability of the mines to deliver coal to the power facilities can be impacted by weather conditions and labour relations. At Centralia, 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;
- Sourcing the coal used at Centralia from different mine sources to ensure sufficient coal is available at a competitive cost;
- Contracting sufficient trains to deliver the coal requirements at Centralia;
- Ensuring coal inventories on hand at Alberta Thermal and Centralia 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, and carefully matching the specifications mined with the requirements of our facilities;
- Co-firing natural gas with coal;
- Monitoring the financial viability of Centralia suppliers; and
- Hedging diesel exposure in mining and transportation costs.

Natural Gas Supply and Price Risk

Having sufficient natural gas and natural gas transportation services available so that we can blend natural gas in with coal at our Alberta thermal facilities, and for the ultimate conversion of those units to natural gas, is essential to maintaining the reliability and availability of those facilities. Using natural gas at our coal-fired facilities, and ultimately converting these facilities to natural gas, allows us to reduce overall carbon emissions and costs, reduce the risk of coal opacity issues, and improves our operating and sustaining capital costs. Ensuring adequate pipeline transportation service and natural gas supply for our Alberta thermal units may be impacted by, among other things, the timing of receiving regulatory and other approvals for firm transportation commitments, weather-related events, work stoppages, system maintenance, variability in pipeline hydraulics pressure and flows, and impacts due to other naturally created events. Pricing of natural gas is driven by market supply and demand fundamentals for natural gas in North America and globally. We are exposed to changes in natural gas prices, which may impact the profitability of our facilities and how the facilities are dispatched into the market.

We manage gas supply and price risk by:

- Working to ensure that we have at least two pipelines supplying the gas used in electrical generation in Alberta;
- Contracting for firm gas delivery and supply;
- Monitoring the financial viability of gas producers and pipelines;
- Hedging gas price exposure;
- Monitoring pipeline maintenance schedules and transportation availability; and
- Incorporating the ability to continue using coal in some of the units as the units transition from coal to 100 per cent natural gas.

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 and the US. We anticipate continued and growing scrutiny by investors and other stakeholders relating to sustainability performance. These changes to regulations may affect our earnings by reducing the operating life of generating facilities and imposing additional costs on the generation of electricity through such measures as emission caps or taxes, 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, SO₂, and NO_x, 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 are committed to remaining 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 to the GSSC.

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 or third-party credit insurance if a counterparty goes over its limits. Such security instruments can be collected if a counterparty fails to fulfil its obligation; 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.

Amidst the current economic conditions resulting from the COVID-19 pandemic, TransAlta has implemented the following additional measures to monitor its counterparties for changes in their ability to meet obligations:

- daily monitoring of events impacting counterparty creditworthiness and counterparty credit downgrades;
- weekly oversight and follow-up, if applicable, of accounts receivables; and
- review and monitoring of key suppliers, counterparties and customers (i.e., offtakers).

As needed, additional risk mitigation tactics will be taken to reduce the risk to TransAlta. These risk mitigation tactics may include, but are not limited to, immediate follow-up on overdue amounts, adjusting payment terms to ensure a portion of funds are received sooner, requiring additional collateral, reducing transaction terms and working closely with impacted counterparties on negotiated solutions.

Our credit risk management profile and practices have not changed materially from Dec. 31, 2019. We had no material counterparty losses in 2020. 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, 2020:

	Investment grade (%)	Non-investment grade (%)	Total (%)	Total amount
Trade and other receivables ⁽¹⁾	92	8	100	583
Long-term finance lease receivables	100	—	100	228
Risk management assets ⁽¹⁾	93	7	100	692
Loan receivable ⁽²⁾	—	100	100	52
Total				1,555

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

(2) The counterparties have no external credit ratings.

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 \$22 million (2019 — \$5 million).

Currency Rate Risk

We have exposure to various currencies as a result of our investments and operations in foreign jurisdictions, the earnings 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 earnings 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 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 US exposure will be managed with a combination of interest expense on our US-denominated debt and forward foreign exchange contracts and the Australian exposure will be managed with a combination of interest expense on our Australian-dollar denominated debt and 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 \$0.03 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:

Factor	Increase or decrease	Approximate impact on net earnings
Exchange rate	\$0.03	\$12 million

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. Credit ratings facilitate these activities and changes in credit ratings may affect our ability and/or the cost of accessing capital markets, 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 impact 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 continue to focus on maintaining our financial position and flexibility. 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, 2020, we have liquidity of \$2.1 billion comprised of amounts not drawn under our committed credit facilities and cash on hand that is available to draw on for projects in 2021.

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 AFRC;
- Maintaining a strong balance sheet; and
- Maintaining sufficient undrawn committed credit lines to support potential liquidity requirements.

Interest Rate Risk

Changes in interest rates can impact our borrowing costs. 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 to ensure efficiency.

At Dec. 31, 2020, approximately seven per cent (2019 – 11 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	30	\$1 million before tax

IBOR reform could impact interest rate risk with respect to the Corporation's credit facilities and the Poplar Creek non-recourse bond held by a TransAlta subsidiary. The facility references LIBOR for US-dollar drawings and the Canadian Dollar Offer Rate ("CDOR") for Canadian-dollar drawings; in addition, the non-recourse bond references the three-month CDOR. To date, no US-dollar drawings have been made on the facility and there is currently a plan to discontinue the six- and 12-month CDOR, which does not impact the facility or the non-recourse bond.

Outstanding forward starting interest rate swaps in both Canadian and US dollars should not be affected as they are set to settle in 2021 prior to any IBOR changes being made. The Corporation is monitoring the reform and does not expect any material impacts.

Project Management Risk

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

We manage project risks by:

- Ensuring all projects follow established corporate processes and policies;
- Identifying key risks during every stage of project development and ensuring mitigation plans are factored into capital estimates and contingencies;
- Reviewing project plans, key assumptions and returns with senior management prior to Board of Director approvals;
- Consistently applying project management methodologies and processes;
- Determining contracting strategies that are consistent with the project scope and scale to ensure key risks, such as labour and technology, are managed by contractors and equipment suppliers;
- Ensuring contracts for construction and major equipment include key terms for performance, delays and quality backed by appropriate levels of liquidated damages;
- Reviewing projects after achieving commercial operation to ensure learnings are incorporated into the next project;
- Negotiating contracts for construction and major equipment to lock-in key terms such as price, availability of long lead equipment, foreign currency rates and warranties as much as is economically feasible before proceeding with the project; and
- Entering into labour agreements to provide security around labour cost, supply 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 2020, 46 per cent (2019 – 46 per cent) of our labour force was covered by 10 (2019 – 10) collective bargaining agreements. In 2020, two (2019 – four) agreements were renegotiated. We anticipate the successful negotiation of three collective agreements in 2021.

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 within each of the jurisdictions in which we operate. 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 carbon pricing policies and funding.

We manage these risks systematically through our Legal and Regulatory groups and our Compliance program, which is reviewed periodically to ensure its effectiveness. We also 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 industry- and government-agency-led stakeholder engagement processes.

Through these and other avenues, we engage in advocacy and policy discussions at a variety of levels. These stakeholder consultations have allowed us to engage in proactive discussions with governments and regulatory agencies 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 such 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 is key to our ability to deliver energy produced at our power facilities 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 faster 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 and transparent basis;
- Applying innovative technologies to improve our operations, work environment and environmental footprint;
- 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, including the annual Code of Conduct sign-off.

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 partnerships and the payment of funds by our subsidiaries and partnerships in the form of distributions, loans, dividends or otherwise. In addition, our subsidiaries and partnerships 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 and data used for the safe operation of our assets. In today's ever-evolving cybersecurity landscape, any attacks or other breaches of network or information systems may cause disruptions to our business operations. Cyberattackers may use a range of techniques, from exploiting vulnerabilities within our user-base, to using sophisticated malicious code on a single or distributed basis to try to breach our network security controls. Attackers may also use a combination of techniques in their attempt to evade safeguards that we have in place such as firewalls, intrusion prevention systems and antivirus software that exist on our network infrastructure systems. A successful cyberattack may allow for the unauthorized interception, destruction, use or dissemination of our information and may cause disruptions to our business operations.

We continuously take measures to secure our infrastructure against potential cyberattacks that may damage our infrastructure, systems and data. TransAlta's cybersecurity model consists of three pillars: technology, processes and people. Each of these pillars can be reinforced independently to address specific cyber risks and threats that are confronting TransAlta. Significant cyber risks that could pose a threat to TransAlta include phishing, ransomware, social engineering, supplier chain, commodity hostage, state sponsored, artificial intelligence, machine learning attacks and a high risk of cybersecurity employee turnover. Proactive controls and safeguards to mitigate cybersecurity risk and threats posed to the organization include:

- Leveraging in place technologies to restrict communication within TransAlta's networks thus limiting the ability for adversaries to achieve their aim;
- Partnering with a third-party cybersecurity specialty firm to outsource critical components of our cybersecurity program;
- Enhancing our policies and processes through the use of periodic reviews and table-top exercises;

- Maintaining an effective and robust cybersecurity awareness training and campaign;
- Integrating cybersecurity into our business processes and performing robust cybersecurity risk assessments; and
- Continuously improving our cybersecurity program to ensure it is effective in responding to and addressing cybersecurity risks.

While we have cyber insurance (as well as 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 and data), there can be no assurance that these measures will be sufficient or 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.

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	\$3 million

Legal Contingencies

We are occasionally named as a party in various disputes, claims and legal or regulatory proceedings that arise during the normal course of our business. We review each of these claims, including the nature and merits of the claim, the amount in dispute or claimed, and the availability of insurance coverage. There can be no assurance that any particular dispute, claim or proceeding will be resolved in our favour or our liabilities with respect to such claims will not have a material adverse effect on us or our business, operations or financial results. Please refer to the Other Consolidated Analysis section of this MD&A for further details.

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 Dec. 31, 2020. 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. All insurance policies are subject to standard exclusions. Cyber coverage is not currently purchased.