

ALLETE, Inc. Financial Derivatives Policy

ALLETE and its subsidiaries (collectively, the “Company”) may use financial derivatives to manage or hedge commercial risks in accordance with this Policy. Speculative use of financial derivatives is prohibited. Permissible Financial Derivative transactions are limited to those that qualify for hedge accounting treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133).

ALLETE Background:

ALLETE is exposed to risks resulting from the changes in interest rates as a result of our issuance of variable rate debt. We manage our interest rate risk by varying the issuance and maturity dates of our fixed rate debt, limiting the amount of variable rate debt, and continually monitoring the effects of market changes in interest rates. We may also enter into derivative financial instruments which include, but are not limited to: swaps, forwards and options for interest rates and currencies to mitigate interest rate and currency exchange exposures.

Minnesota Power’s customers are exposed to price risk in energy, fuel, and other commodity (steel, copper, etc.) based transactions. Most of the time, this risk is managed through traditional purchases and sales (physical delivery, not financial derivatives). However, financial hedging has been utilized in the past to reduce commodity price exposure. Specifically, Minnesota Power has executed natural gas price swaps to mitigate price risk under formula priced sales contracts. These financial transactions, including swaps and options, are allowed under the Minnesota Power Risk Management Policy (“Risk Policy”) to mitigate commodity risk arising from balancing our energy supply and demand and other procurement activities. All commodity-based financial hedging transactions, including subsidiary transactions, require approval by the Risk Management Committee prior to execution.

The Company’s objectives for limiting the three main potential types of commercial risks are summarized below:

- Interest rate risk management is intended to minimize the cost of debt while managing exposure to higher (or potentially higher) interest rates than rates that are available in a prevailing market.
- Currency risk management is intended to minimize the variations and costs of foreign currencies while operating primarily in US dollar denominated markets.
- Commodity risk management is intended to minimize the cost of energy, fuel, or other purchase activities and mitigate price risk for open positions.

Regulatory Background:

Under regulations adopted by the Commodities Futures Trading Commission (“CFTC”) under the Dodd-Frank Act, certain over-the-counter (“OTC”) derivative trades that are not securities-based (known as “swaps”) are subject to mandatory clearing requirements and will need to be cleared unless an exception to the clearing requirement is available. Parties to a cleared swap will have to post liquid collateral (margin) on the swap. The Company would not have the ability to negotiate the amount of margin required for a cleared swap. As a result, the Company will seek to utilize an exception to the clearing requirement where available. One exception to the clearing requirement is the “commercial end-user exception.” This Policy is intended to allow ALLETE to meet the requirements of the commercial end-user exception.

The requirements to qualify for the commercial end-user exception are that a party (1) is a non-financial entity, (2) is using the swap to hedge or mitigate commercial risk, (3) notifies the CFTC how it generally meets its financial obligations associated with entering into non-cleared swaps, and (4) if the entity is an SEC filer (or subsidiary of an SEC filer), obtains approval by the Board or an appropriate committee of the Board to rely on the commercial end-user exception.

The CFTC has issued an Order exempting certain electric utility-related transactions from these Dodd-Frank requirements. The following transactions in the MISO market are exempt: Financial Transmission Rights; Energy Transactions in Day-Ahead and Real-Time Markets; Forward Capacity Transactions; and Reserve or Regulation Transactions. For that reason, this Policy does not apply to those transactions.

Responsibilities:

The Chief Financial Officer or Treasurer (each an “Authorized Officer”) must pre-approve the Company’s use of any interest rate or currency-related financial derivative prior to its execution.

In accordance with existing controls under the Risk Policy, the Risk Management Committee must pre-approve the use by the Company of any other commodity-related financial derivative prior to its execution.

The Audit Committee shall review and recommend affirmation of or any changes to this Financial Derivatives Policy to the Board at least annually and, as appropriate, more often if the use of such types of financial derivatives changes. The Board will review and vote on this Policy at least annually.

Controls:

Any interest rate or currency-related swaps that have been approved by an Authorized Officer may be executed by the Assistant Treasurer or Director - Investments. Additionally, when the CFO has authorized an interest rate or currency-related swap, the Treasurer may execute the

swap. All trade confirmations will be remitted to the staff managing ALLETE's daily cash balances.

In addition to the requirement for pre-approval of commodity-related derivatives by the Risk Management Committee, transaction approval thresholds and approved transaction types by functional role for commodity-based financial derivatives will be governed by the Risk Policy.

Products:

An interest rate or currency-related swap may be approved by an Authorized Officer or a commodity-related swap may be approved by the Risk Management Committee if it is (1) economically appropriate to the reduction of risks in the conduct and management of the Company's business, (2) not used for a purpose that is in the nature of speculation, investing, or trading, and (3) not used to hedge or mitigate the risk of another swap or security-based position, unless that other position itself is used to hedge or mitigate commercial risk.

The financial derivatives products for limiting commercial risks are summarized below:

- Interest Rate Risk products that may be employed include products designed to limit or mitigate interest rate risks such as interest rate swaps, Treasury-locks and caps/collars that are used to protect against swings in underlying reference rates of variable rate-based loans and liabilities.
- Currency Risk products that may be employed include currency swaps, currency options, foreign exchange swaps, and foreign exchange forwards that are used to protect against fluctuations in value of foreign-exchange based transactions.
- Commodity Risk products may include swaps and options to lock in power, natural gas, or other commodity-related prices on open positions or otherwise mitigate price risk.

Financial derivatives tenor and notional amounts should be structured to hedge the specific underlying loan, currency or commodity risk such that the derivative qualifies for Hedge Accounting under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133).

Counterparty Risk:

To mitigate against the non-performance of counterparties, the Company will require at the time of execution of the hedge that the counterparty shall be rated at least A (or equivalent) or higher by either Moody's Investors Service or Standard & Poor's Corporation and limit the notional amount of hedges with any one counterparty (including its affiliates) to no more than \$250 million.

Reporting:

The Company will reflect financial derivatives in its financial statements under US Generally Accepted Accounting Principles. Also, quarterly reporting of mark-to-market valuations will be provided to Accounting.

Recordkeeping:

The Finance Department will keep a copy of all records associated with interest rate or currency-related financial derivatives.

The Risk Management Department will keep a copy of all records associated with commodity-related financial derivatives.

Accounting will keep copies of all financial derivative records for purposes of complying with regulatory retention requirements (i.e., Dodd-Frank retention requirements). The records held by Accounting will be retained for five years after termination of each swap. The records may be kept either in electronic or paper format, but must be retrievable within five business days throughout the required retention period.