

## **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 Financial Derivatives Policy (“Policy”). Speculative use of financial derivatives is prohibited. If a contract meets the Generally Accepted Accounting Principles (GAAP) definition of a financial derivative then it must qualify for hedge accounting treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133). If a contract does not meet the GAAP definition of a financial derivative, it is still subject to the Policy requirements below.

### ***ALLETE Background:***

The Company is exposed to a number of business risks that can be appropriately mitigated through the application of various financial instruments. An example of such risks are the changes in interest rates as a result of issuance of variable rate debt. ALLETE manages its interest rate risk by varying the issuance and maturity dates of its fixed rate debt, limiting the amount of variable rate debt, and continually monitoring the effects of market changes in interest rates. The Company may also enter into derivative financial instruments which include, but are not limited to, swaps, forwards, and options on 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 purchase and sale contracts (physical delivery, not under financial derivative contracts). However, financial hedging has also been utilized to reduce commodity price exposure. Specifically, Minnesota Power has executed natural gas price swaps to mitigate pricing 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 energy supply and demand and other procurement activities.

ALLETE Clean Energy (“ACE”) may be exposed to energy price risk and basis risk between generating nodes and contract pricing hubs or between day ahead and real-time markets. In addition, ACE may be exposed to other commodity-based risks (e.g., contracts containing price inflators). The energy price risk would be traditionally managed through a fixed price power sale agreement with the off-taker purchasing the entire output of the generating facility. However, as the renewable energy markets and ACE’s customer base continues to evolve, ACE may use financial contracts for differences (e.g. fixed for floating energy pricing swaps commonly referred to as virtual Power Sale Agreements (PSAs), bank hedges, or proxy revenue swaps), virtual energy transactions, financial transmission rights, and/or transmission congestion rights to address energy price and basis risk.

All commodity-based financial hedging transactions, including subsidiary transactions, require approval by the ALLETE Risk Management Committee prior to execution.

The three main potential types of commercial risks and the Company’s objectives for limiting them 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 derivative trades that are not securities-based (known as “swaps”) are subject to mandatory clearing and exchange trading requirements and will need to be cleared and traded on an exchange or swap execution facility unless an exception to the clearing and exchange trading requirement is available. Parties to a cleared swap will have to post liquid collateral (margin) on the swap, both upfront and on a mark-to-market basis (generally referred to as initial and variation margin). The Company would not have the ability to negotiate the amount of initial or variation margin required for a cleared swap. As a result, the Company will seek to utilize an exception to the clearing and exchange trading 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 of the party’s Board of Directors (“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:***

ALLETE’s Chief Financial Officer or Corporate 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 ALLETE Risk Management Committee must pre-approve the use by the Company of any other commodity-related financial derivative prior to its execution. In accordance with ALLETE Clean Energy’s Power Sales Agreements Energy and Capacity Transactions Approval Policy (“ACE Transaction Approval Policy”), all ACE financial derivative transactions will require approvals of the ALLETE Risk Management Committee and ACE Board.

The Audit Committee shall review and recommend to the Board affirmation of, or any changes to, this Financial Derivatives Policy 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 Authorized Officers. 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 ALLETE 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 and ACE Transaction Approval 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 ALLETE 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 swap 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 exposure is limited to the underlying loan, currency, or commodity, and is not an open position nor a speculative transaction. If applicable, financial derivative contracts should be structured 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 financial counterparties, the Company will: (1) require at the time of execution of the hedge with a financial counterparty, that the counterparty is rated at least A by S & P Global Ratings, A2 by Moody's Investors Service, or an equivalent rating by Fitch and (2) limit the notional amount of hedges with any one counterparty (including its affiliates) to no more than \$250 million. Financial derivative contracts with commercial and industrial customers will require an investment grade credit rating by either Moody's Investors Service or S & P Global Ratings for the counterparty or another counterparty providing credit support (i.e., parental guarantor).

**Reporting:**

If applicable, the Company will reflect financial derivatives in its financial statements under US GAAP. Also, for contracts that qualify as derivatives under GAAP, quarterly reporting of mark-to-market valuations will be provided to ALLETE Accounting.

**Recordkeeping:**

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

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

ALLETE Accounting will handle any resulting compliance filings and 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.