We connect everyone and *create value* with a responsible business_

Telefónica

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TELEFÓNICA ANNUAL REPORT 2016

• The full 2016 Telefónica Annual Report consists of three documents.
 They can each be accessed on the corporate website:
 www.telefónica.com
• All are available in PDF and can be read from any device.

Integrated Report

Financial Report

Corporate Governance Report and Report on Remunerations

Interview with the Chairman & CEO_

José María Álvarez-Pallete
Chairman & CEO

What is your assessment after your first year as Chairman & CEO of Telefónica?
I am proud to say that, in 2016, we managed to keep our promises: the Company's results consolidated a change in trends and Telefónica has now embarked on a cycle of sustainable growth.

In 2016, main financial metrics grew organically. Revenue increased by 1.3%, driven by customer growth, now at 350 million accesses, and a higher average revenue per access. This proves that we are relevant to our customers who place their trust in Telefónica every day thanks to our convincing value proposition. OIBDA also grew, up by 4.7% year-on-year in organic terms, and OIBDA margin increased to 31.5%, exceeding our profitability targets.

With regards to our main challenge, namely free cash-flow generation, we have been able to grow for the first time in 5 years, up by 24% year-on-year, to almost 4.4 billion euros. We achieved this in a context of record levels of investment, totalling almost 9 billion euros, which leverages our almost 13,000 suppliers.

Beyond the financial figures, we met our goals with a sustainable business model, generating a positive impact in all our markets. We are one of the main drivers for economic progress. In

2016, we increased our contribution to GDP up to 0.6% in the countries in which we are present, generating over a million jobs, while at the same time boosting the proportion of renewable energy consumption, already reaching close to 44%.

Our drive towards digitalisation has placed us in a leading position in the deployment of fixed ultra-broadband in Europe and Latin America. Likewise, LTE technology was extended across all geographies. We are building one of the most powerful and advanced digital infrastructures in the world so that our customers can enjoy a differential experience.

In parallel, and always with customers at the heart of everything we do, we have accelerated end-to-end digitalisation. The digitalisation process goes far beyond creating an application, a solid distribution channel and an online customer service or digital billing. The true challenge lies in simplifying the complexity of the analogue world and digitalising processes so that all the information can be obtained in real time and we can apply Cognitive Systems. This enables us to better understand what our customers want.

We have also successfully completed financial initiatives, such as the recent partial sale of

Telxius and our outstanding financing activities in the markets. And we have taken difficult decisions, such as reviewing the shareholder remuneration policy to set a cash dividend of 0.40 euros per share for 2017. This allows for an attractive remuneration for our over 1.3 million shareholders and offers a dividend yield consistent with the market and represents a sustainable pay-out.

All this, together with organic deleveraging, enabled us to strengthen the Company's financial position. I am satisfied as we now depend on ourselves rather than on external factors to achieve our targets.

The enormous effort and strong commitment shown by the whole Telefónica team has received significant external recognition from indices such as the Dow Jones Sustainability Index (takes into account companies' economic, social and environmental progress), or the Carbon Disclosure Project (assesses how companies are handling climate change), as well as from Fortune magazine (selected Telefónica as the most admired telecommunications operator in Europe).

At the same time, the benefits of the profound transformation initiated a few years ago and the achievements in 2016 have contributed to the revaluation of Telefónica's shares by 16%

over the last twelve months to the end of April, far above the European Telco index (7.2%), and positioned us among the top 10 companies in the sector worldwide by market capitalization.

Overall, thanks to the commitment, talent and enthusiasm of the 127,000 professionals at Telefónica, 2016 has been a very positive year for the Company. For me, it is a source of pride and a great responsibility to be working with all of them every day.

What targets have been set for 2017 and the years ahead?

Our priorities have not changed. Our main goal is to continue to build the company we all want for the future: a business that enjoys sound short-term results while being able to turn the long-term challenges into huge opportunities.

Our ability to anticipate milestones has written our history. We have never been afraid of change, and now we are facing a context of constant profound change. Globalization, demographic shifts, the scarcity of resources, the stock market crisis and technological disruption are changing everything.

And digitalisation lies at the centre of this revolution in which we aim to be a key player. We don't have all the answers. But we do have the commitment and skills to drive progress and society forward.

Digitalisation is having a positive impact and will have very beneficial consequences in terms of growth. We want to keep on leading the development of the new digital society in those countries where we are present, through a customer-centred team with solid foundations based on integrity, transparency and commitment.

At Telefónica, we are convinced that life is digital. Technology is emerging as the driver for democratization in all areas of society, as it enables individuals to face social and environmental challenges, and helps improve people's quality of life.

That's why we have chosen to create, protect and encourage connections in life, so that everybody can access a world of infinite possibilities through technology.

We have started 2017 with confidence. This is going to be a year of sustainable growth based on the solid foundations we have consolidated. Our strategic priorities are very clear. To reach them, we need to advance with our own technological and cultural transformation by leveraging our geographic diversification.

We already have the best team to achieve this and we are going to strengthen it with even more diversity, digital profiles and new ways of working; we will improve both our Customer Promise and aspects such as privacy

and security, as well as helping users make a positive, responsible use of technology.

We aim to grow in all the main profit and loss statement metrics and in cash generation, increasing our margins. We will continue moving forward on our transformation path towards a platform company by driving end-to-end digitalisation and Cognitive Intelligence with investments focusing on fixed Ultra-Broadband and 4G connectivity.

Our ambition is to increase the universality, availability and energy efficiency of our network, progressing towards our 2030 commitment of 100% of energy consumed coming from renewable sources. And we will continue to simplify our procurement process in order to become more agile and build more sustainable relationships with our suppliers.

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We have chosen to *create, protect and encourage* connections in life, so that everybody can access a world of *infinite possibilities* through technology

We will manage our portfolio based on strategic criteria, adopting a transversal asset view to accelerate organic deleveraging and strengthen our balance sheet. At the same time, we will be offering attractive shareholder remuneration.

How is Telefónica positioned vis-à-vis the global challenges?

The dimension of what we are experiencing nowadays is unparalleled. We are an extremely fortunate generation of human beings, because no other generation in the history of humankind has lived-through such a wave of technological disruption as the one we are experiencing.

All these changes have led us to strengthen our commitment to sustainability as the main lever for social development. Technology opens the door to improvements in prosperity and wellbeing but, at the same time, it creates uncertainties and risks that need to be faced.

Reaching our goals is as important as how we achieve them. We are convinced that a responsible business model capable of generating trust among our customers, investors, employees, shareholders and throughout society, is the future.

We face the future with optimism and with well-defined principles that must guide us when taking decisions. We must ask ourselves

where we want to take society or how we want to share wealth in this new economy. To do so, we need values to build a better, fairer society that does not leave anyone behind in terms of participating in the new Digital Society, and to allow for a more balanced distribution of wealth.

In today's hyper-connected world, not everything is acceptable. We are responsible for shaping a society that will enable us, and the generations to follow, to live with freedom and privacy.

In this sense, our strategy as a responsible company includes major global challenges with a long-term perspective. I have already mentioned some examples of what we are already doing, such as network management systems for energy efficiency and reducing CO_2 emissions driven by greater use of renewable sources to slow down climate change. Or how, in response to customer uncertainty about data privacy, we at Telefónica are not only transparent about what we do with our customers' data but also strive to help them preserve their digital empowerment.

Another challenge is the transformation of the labour environment as a result of the impact of the new technological paradigm. At Telefónica, we are seeking to transform our

way of working to maximise the talent of a team that has to be increasingly diverse.

I would like to highlight the essential role of connectivity in meeting the United Nations' Sustainable Development Goals. Our core business has a very positive impact on the industry, innovation and infrastructures goal. Although our strategy as a responsible company and our projects aimed at driving sustainability enable us to contribute to the rest of the goals, with a more direct influence on those related to economic growth. In fact, several years ago now, we signed the UN Global Compact.

We feel especially proud of the various initiatives we are encouraging in the realm of education and, in particular, about the ProFuturo Foundation launched by the Telefónica Foundation and 'La Caixa' Banking Foundation. The mission of ProFuturo is to reduce the educational divide by providing high-quality digital education to children in vulnerable settings in Sub-Saharan Africa, Latin America and South-East Asia. It is a very ambitious goal: we want to transform the education of 10 million boys and girls by 2020, through technologies, educational contents and teaching methodologies for both teachers and students.

Thinking about technological advances, which one do you think will have the greatest impact on Telefónica and its customers?
Technology is key to be closer to our customers through the new service experience we want to create for them.

5G will radically transform connectivity. We are talking about a 1,000 times greater mobile data transport capacity, speeds that will multiply by 10 to 100 times, a significant reduction in latency, more powerful devices with more efficient batteries, … All this will make the explosion of the Internet of Things possible, with self-driving cars, remote surgical operations in real time, distance digital education or holographic communication, to mention just a few examples. It is already possible to glimpse the boom in Virtual Reality and Augmented Reality, and there is a new and more powerful technological wave advancing in the form of Cognitive Intelligence.

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We are responsible for shaping a society that will enable us, and the generations to follow, to live with *freedom and privacy*

This technological disruption facilitates a new world of information and knowledge; it enables us to be increasingly connected. We are talking here of unstoppable exponential growth.

The potential provided by the information generated in all these connected devices is enormous. By applying an intelligent use to all these data through Artificial Intelligence and Cognitive Systems, we will be capable of solving problems in health-care, education, energy and transport, with a positive impact on the lives of individuals and on society as a whole.

In a company like Telefónica, technology has always been and will always remain at the core. In addition, nowadays, when there is more technology available than ever before, we are working to place innovation and digital disruption at the service of our customers in an efficient and sustainable manner.

We are doing so by building a platform-based Telefónica. We have invested 48 billion euros since 2012, mostly to strengthen the first platform (our physical assets), followed by the second platform (our systems), and the third platform (products and services).

Furthermore, we have prepared the Company to continue pioneering in the field of Cognitive Intelligence, driving our fourth platform

(cognitive power) to be able to establish a new relationship with our customers, interacting with them in a simpler, more natural way.

We aspire to broaden the relationship with our customers aiming at increasing their satisfaction and providing new opportunities to enrich their digital life with us under the principles of transparency, security and control over their data. Our priority is to foster the trust of our customers every day.

I am convinced that the impact of the Cognitive Intelligence, embedded in our fourth platform, will be comparable in the near future to the impact of mobile telephony or broadband.

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We aspire to *broaden the relationship* with our customers aiming at increasing their satisfaction and providing new opportunities to *enrich their digital life*

What is the role of Telefónica on this road to innovation?

Innovation is part of Telefónica's DNA. The continuous transformation of Telefónica, over its almost 100 years of history, is pure innovation and reflects a mindset of anticipation and vision of any entrepreneur.

We are committed to technological innovation as a fundamental tool to help create a more sustainable world, while achieving a competitive advantage and differentiating products.

On the one hand, our strategy promotes our internal capabilities for R&D+I. Our in-house innovation model that enables us to stay at the forefront of the sector. In 2016, we invested almost 6.6 billion euros in R&D+I, positioning us as the fourth Telco in the world for R&D. We have 9 innovation centres and a portfolio of 577 patents.

On the other hand, the traditional sources of innovation are not enough and we are fostering open ecosystems through Open Future, an integrated programme that accompanies entrepreneurs through every stage of their growth cycle. Telefónica Open Future has already accelerated over 1,500 businesses and invested in over 700 start-ups.

Regarding Corporate Governance, what measures have been taken to enhance best practices?

Advancing in compliance with the recommendations and best practices of Good Corporate Governance is one of my top priorities and in the last two years the Company has made solid progress in this direction.

At the next General Shareholders' Meeting the following will be submitted for approval: the ratification and appointment of two new independent directors, Carmen García de Andrés and Francisco José Riberas Mera and the reduction of the number of members on the Board of Directors to seventeen, in accordance with the recommendations on Good Governance and international trends.

These new additions, together with the four in 2016, further strengthen the Company's highest management body, increasing its independence and diversity. Independent directors thus represent 53% of the total, and the proportion of female directors increases to 18%.

In parallel, the incorporation of Carmen García de Andrés as a member of the Audit and Control Committee and of José Javier Echenique and Luiz Fernando Furlán to the Appointments, Remuneration and Good Governance Committee, all of them

independent directors, strengthens our compliance with the Good Governance recommendations regarding the composition of the Board's Committees.

We are very fortunate to have a deeply committed Board that protects the future and the sustainability of the Company, a Board that works to ensure that Telefónica will continue to be more relevant than ever in society over the decades ahead with a responsible business model.

I would like to take this opportunity to thank César Alierta, Pablo Isla and Gonzalo Hinojosa for their dedication, commitment and great contribution during their many years of work on Telefónica's Board.

Company profile and values_

Telefónica is today one of the largest telecommunications companies in the world in terms of market capitalisation and number of customers. We have the best fixed, mobile and broadband networks, as well as an innovative range of digital and data services; therefore, we are favourably positioned to meet the needs of our customers and capture growth in new businesses.

We are sensitive to the new challenges demanded by society today and, therefore, we provide the means to facilitate communication between people, providing them with the most secure and cutting-edge technology.

We work every day with an innovative spirit and huge technological potential, multiplying our customers' ability to choose in a world in which technology forms an essential part of the human race. Our vision is focused on technology making people's lives easier and our aim is to promote progress in that direction, so that technology can make a positive impact on the world both socially and environmentally, and, ultimately, so as to provide value and trust in an ever-changing and accelerating world.

Our headquarters is in Madrid (Spain). We currently operate in 17 countries and have a customer base which surpasses 350 million connections throughout Spain, the United

Kingdom, Germany and Latin America, where most of our growth strategy is focused. We are, therefore, one of the most international companies in the sector, generating more than 75% of our business outside the domestic market. Movistar (Spain and Latin America, except for Brazil), Vivo (Brazil) and O2 (UK and Germany) are the main brand names around which we structure our market offering.

We are a wholly private company with 1,323,265 direct shareholders. We are listed on the continuous market of the Spanish stock exchanges, as well as on the stock exchanges in London, New York, Lima and Buenos Aires. Our subsidiaries, Telefónica Brazil and Telefónica Germany, are listed on those of Sao Paulo and Frankfurt, respectively.

The list of the companies comprising the Telefónica Group, together with their name, main corporate purpose, country, share capital, percentage of effective participation in the Group and the company or companies

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We want to create, protect and boost *life's connections* so that people can choose a world of infinite possibilities

through which they participate in the Group, can be found in the Perimeter Annex I of the Consolidated Financial Statements 2016.

We want to be a company in which our clients, employees, suppliers, shareholders, and society in general can trust. In order to achieve this, we communicate our strategy, business model and most relevant data to our stakeholders in a clear and transparent manner, so as to show the Company's sustainability and our ability to create value. Accordingly, in this document we present our Integrated Corporate Report for

2016, in which we include the progress made during the year.

Throughout this Report, links to further information are included. These provide a greater breakdown of certain of the issues discussed in specific chapters of the document. However, the information available via these links does not from an integral part of this Report.

The content herein is complemented by updated information on our website and Atlas Telefónica, as well as by the Annual Report on Corporate Governance and Director Remuneration, the Consolidated Statement of Annual Accounts and the corresponding Management Report for the year. The above documents are linked to this one for easy reference.

We publish this Report on an annual basis and we present it at each General Shareholders' Meeting.

52,036
million euros in *revenue* during the 2016 financial year

127,323
employees as of 31 December 2016

17
countries in which we operate

1,323,265
direct shareholders as of 31 December 2016

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Main Magnitudes 2016

Main magnitudes_

All the economic data, in millions of euros

Legend:
- Revenue
- Provisioning
- Investment
- Salary costs
- Supported tax contributions

MEXICO 2016

Employees	2,829
Local suppliers	518
% local purchases	92.6%
Accesses (thousands)	27,654

Revenue: 1,292

Payments: 466 219 121 8

CENTRAL AMERICA 2016

Employees	1,703
Local suppliers	665
% local purchases	57.7%
Accesses (thousands)	13,556

Revenue: 903

Payments: 317 139 81 63

UNITED KINGDOM 2016

Employees	7,344
Local suppliers	456
% local purchases	60.1%
Accesses (thousands)	25,759

Revenue: 6,824

Payments: 3,165 931 576 77

GERMANY 2016

Employees	8,720
Local suppliers	633
% local purchases	70.4%
Accesses (thousands)	49,346

Revenue: 7,977

Payments: 2,361 1,108 666 132

COLOMBIA 2016

Employees	5,065
Local suppliers	458
% local purchases	76.6%
Accesses (thousands)	16,574

Revenue: 1,382

Payments: 388 330 119 124

VENEZUELA 2016

Employees	2,582
Local suppliers	358
% local purchases	92.2%
Accesses (thousands)	11,494

Revenue: 426

Payments: 56 91 71 30

ECUADOR 2016

Employees	1,307
Local suppliers	280
% local purchases	70.1%
Accesses (thousands)	4,579

Revenue: 539

Payments: 127 99 51 86

BRAZIL 2016

Employees	34,918
Local suppliers	2,052
% local purchases	99.7%
Accesses (thousands)	97,222

Revenue: 11,175

Payments: 2,192 2,138 1,230 902

PERU 2016

Employees	7,929
Local suppliers	926
% local purchases	74.1%
Accesses (thousands)	20,910

Revenue: 2,560

Payments: 746 717 270 165

CHILE 2016

Employees	4,569
Local suppliers	667
% local purchases	77.1%
Accesses (thousands)	12,307

Revenue: 2,170

Payments: 668 406 217 48

ARGENTINA 2016

Employees	15,591
Local suppliers	1,089
% local purchases	89.5%
Accesses (thousands)	27,117

Revenue: 3,124

Payments: 555 577 787 304

URUGUAY 2016

Employees	616
Local suppliers	373
% local purchases	29.5%
Accesses (thousands)	1,726

Revenue: 232

Payments: 75 34 24 17

SPAIN 2016

Employees	33,440
Local suppliers	1,856
% local purchases	90.8%
Accesses (thousands)	41,235

Revenue: 13,090

Payments: 3,893 1,847 3,738 867

TOTAL ACCESSES — Millions

341 (2014)
347 (2015)
350 (2016)

In December 2016 the Telefónica Group's total accesses increased by 1% compared with 2015 to reach 350 million, with a continuous improvement in the quality of the customer base. LTE customers stood at 66.3 million (1.8 times more than in the previous year), achieving a penetration rate of 25% (+10 p.p. year-on-year). We should also highlight the increase in *smartphones* (+17% year-on-year), which stood at 147.2 million, with a penetration of 57% (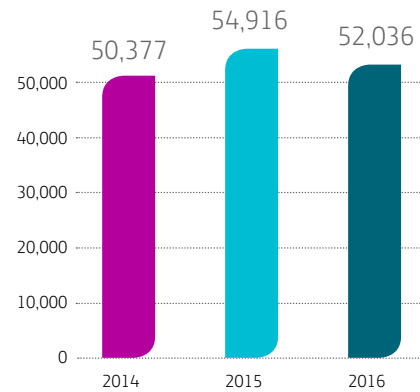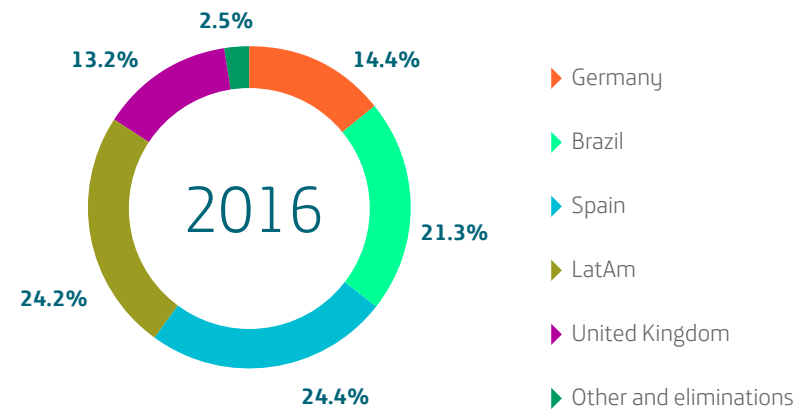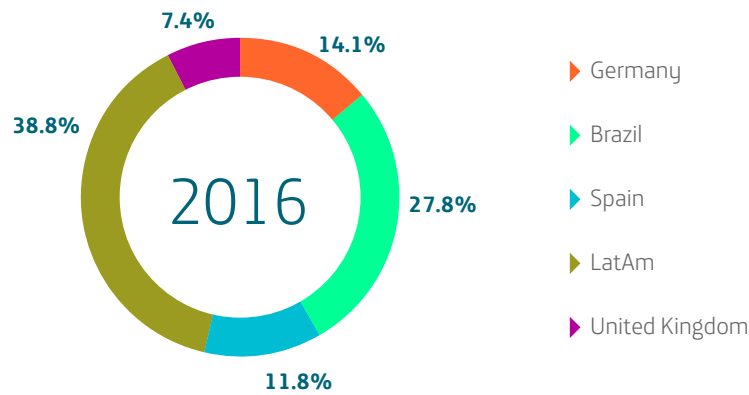+8 p.p. year-on-year) and FTTx and cable customers, who grew by 24% in comparison with 2015 and accounted for 43% of the total fixed broadband accesses (+8 p.p. year-on-year).

REVENUE — Millions of euros

50,377 (2014)
54,916 (2015)
52,036 (2016)

Revenue totalled 52,036 million euros, which represents +1.3% year-on-year organic growth (-5.2% in reported terms). Moreover, excluding the negative impact of regulation, revenue rose by +2.2% in 2016. The Company's high degree of diversification and scale is reflected in its revenue structure: thus, T. Spain accounted for 24.4% of the consolidated income in January-December, followed by T. Latin America (24.2%), T. Brazil (21.3%), T. Germany (14.4%) and T. United Kingdom (13.2%).

2016 (accesses)

- 14.1% Germany
- 27.8% Brazil
- 11.8% Spain
- 38.8% LatAm
- 7.4% United Kingdom

2016 (revenue)

- 14.4% Germany
- 21.3% Brazil
- 24.4% Spain
- 24.2% LatAm
- 13.2% United Kingdom
- 2.5% Other and eliminations

OIBDA
Millions of euros
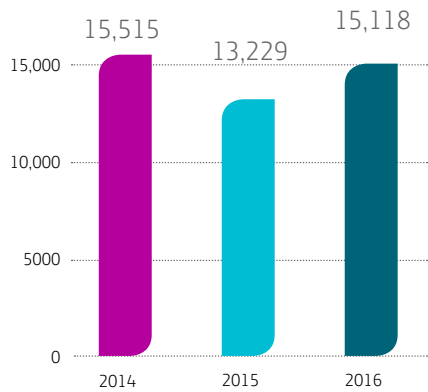
In 2016, the OIBDA totalled 15,118 million euros and increased by 4.7% in organic terms (+14.3% year-on-year in reported terms). In underlying terms, the OIBDA totalled 16,519 million euros. The OIBDA margin totalled 31.5% in organic terms and rose by 1.0 p.p. compared with the previous year.

NET PROFIT
Millions of euros

The underlying net profit totalled 4,038 million euros (2,369 million euros in reported terms) and increased by 4.8% year-on-year. The underlying basic net profit per share stood at 0.75 euros in January-December (+5.1% set against 2015).
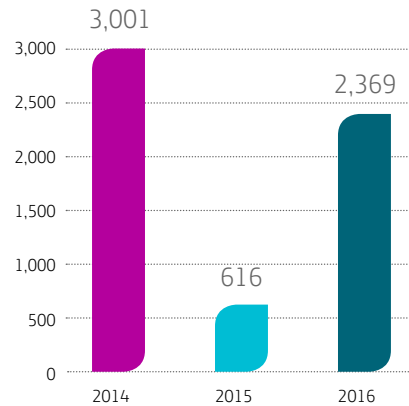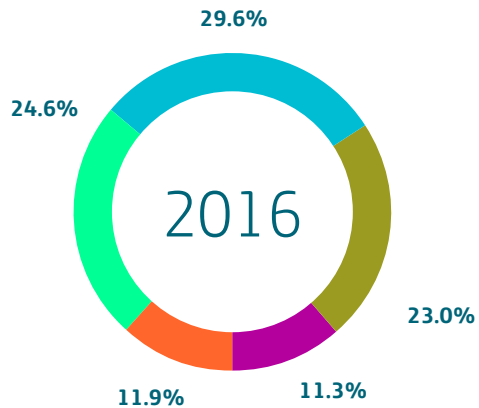

29.6%

24.6%

2016

23.0%

11.9%   **11.3%**

▶ Germany

▶ Brazil

▶ Spain

▶ LatAm

▶ United Kingdom

Others and Eliminations **(-0.3%)**

DEFINITIONS:

Organic growth: Constant average exchange rates are assumed in 2015; the impact of the adjustment due to hyperinflation in Venezuela is excluded from both years and the perimeter of consolidation is deemed constant. At an OIBDA and OI level, writedowns, capital gains/losses due to the sale of companies, sales of towers, restructuring costs and non-recurrent material impacts are excluded. The CapEx also excludes investments in spectrum.

Underlying growth: Reported figures excluding the effect of writedowns, capital gains/losses due to the sale of companies, sales of towers, restructuring costs and non-recurrent material impacts, as well as amortizations of assets arising from purchasing price assignation processes.

EMPLOYEES

People

123,500 — 2014
137,506 — 2015
127,323 — 2016
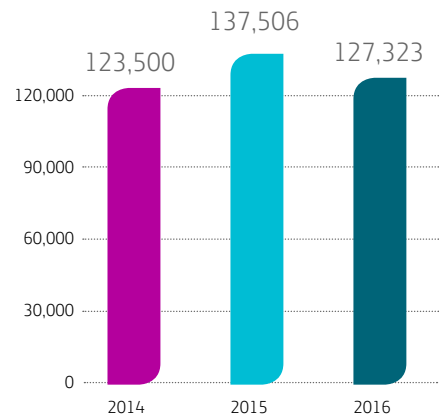
The number of Telefónica employees on 31 December 2016 totalled 127,323, which represents a decrease of 7.4% compared with the previous year. This decrease was mainly generated by the sales of Telefe in Argentina and Vocem in Venezuela, as well as the implementation of the Plan of measures for the individual suspension of the employment relationship in Spain for 2016 and 2017. The number of professional women stood at 47,933, or 37.6% of the total, while the number of men stood at 79,390, or 62.4% of the total. The percentage of women at management level stood at 20.5%.

INVESTMENT

Millions of euros

9,448 — 2014
10,461 — 2015
8,928 — 2016
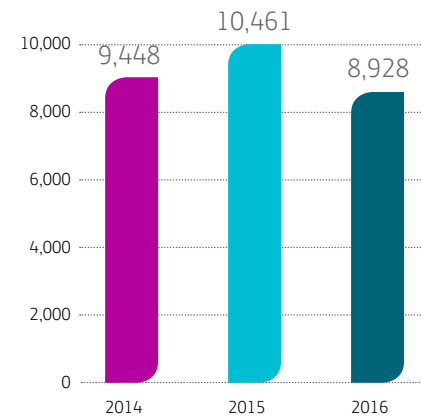
In 2016, the CapEx for January-December totalled 8,928 million euros, including 345 million euros for the acquisition of spectrum, and increased by 3.9% in organic terms compared with 2015 (-14.7% in reported terms). The investment effort was mainly focused on the deployment of ultra-fast networks, which meant that investment in growth and transformation accounted for 78.8% of the total (+0.2 p.p. year-on-year) and that investment levels over total income stood at 17%.

2016

- 6.8% Germany
- 27.4% Brazil
- 26.3% Spain
- 33.1% LatAm
- 5.8% United Kingdom
- 0.6% Others

2016

- 12.4% Germany
- 23.9% Brazil
- 20.7% Spain
- 29.3% LatAm
- 10.4% United Kingdom
- 3.3% Others

SUPPLIERS — Units

12,442 — 2014
12,707 — 2015
12,847 — 2016
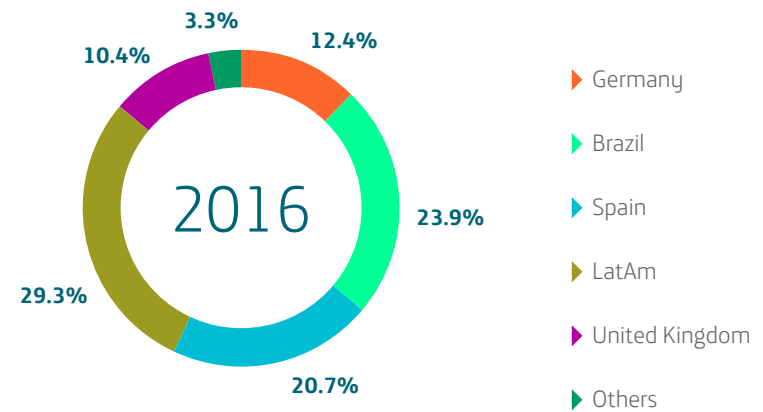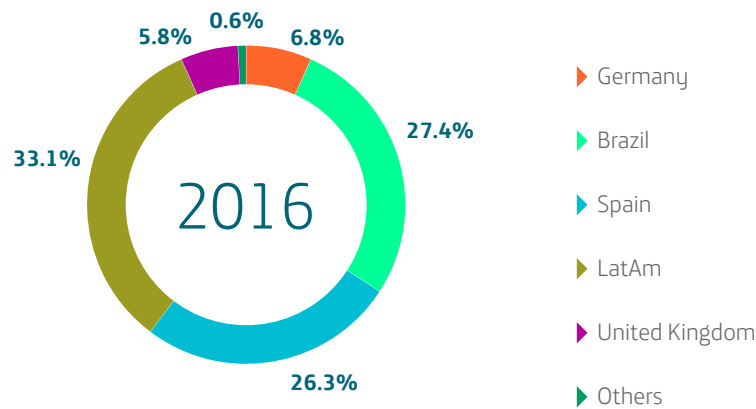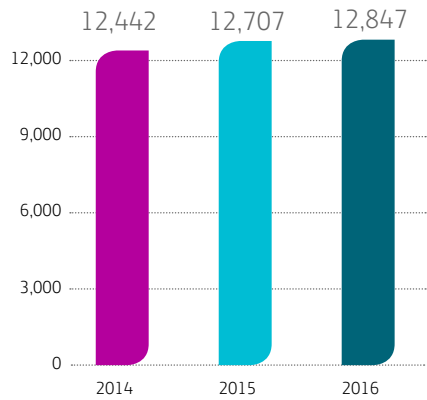
The total number of suppliers that worked with Telefónica during 2016 grew slightly to 12,847, with a total awarded volume of 26,063 million euros, of which 81.88% was awarded to local suppliers.

NET FINANCIAL DEBT — Millions of euros

45,087 — 2014
49,161 — 2015
48,595 — 2016
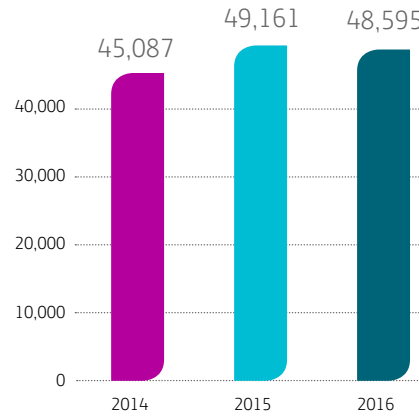
Net financial debt stood at 48,595 million euros in December 2016. In relation to the previous year, net financial debt decreased by 566 million euros, mainly due to i) the generation of free cash totalling 4,370 million euros, ii) net financial divestments amounting to 500 million euros, chiefly associated with the sale of shares in China Unicom and Telefe, and iii) the lower value in euros of the net foreign currency debt (91 million euros). On the other hand, the factors which increased the debt were: (i) shareholder remuneration (dividends, treasury stock, issuance of equity instruments net of coupons) totalling 2,389 million euros, (ii) the payment of labour-related commitments (738 million euros) and (iii) other factors affecting the valuation of the liabilities, totalling 1,268 million euros (including the refinancing of commercial liabilities).

2016

4.9%
16.0%
19.6%
3.5%
14.4%
41.5%

▶ Germany
▶ Brazil
▶ Spain
▶ LatAm
▶ United Kingdom
▶ Others
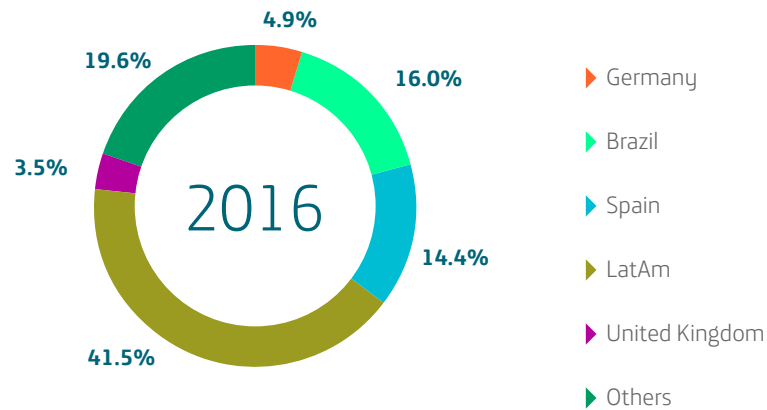
Consolidated results_

Millions of euros	2015	2016
Revenues	**54,916**	**52,036**
Internal expense capitalised	946	867
Operating expenses	(43,075)	(38,043)
Supplies	(16,547)	(15,242)
Personnel costs	(10,349)	(8,098)
Other operating expenses	(16,179)	(14,703)
Other net revenues (expenses)	270	186
Result of disposal of fixed assets	279	296
Impairment and goodwill	(106)	(224)
Underlying Operating Income Before Depreciation and Amortization (OIBDA)	**16,851**	**16,519**
Operating Income Before Depreciation and Amortization (OIBDA)	**13,229**	**15,118**
OIBDA Margin	**24.1%**	**29.1%**
Depreciation and amortization	(9,704)	(9,649)
Operating income (OI)	**3,525**	**5,469**
Share of investment results by the equity method	(10)	(5)
Net financial income	(2,609)	(2,219)
Pre-tax income	**906**	**3,245**
Income tax	(155)	(846)
Profit for the year	**751**	**2,399**
Attributable to minority interests	(135)	(30)
Net income	**616**	**2,369**
Weighted average number of ordinary shares outstanding (millions)	**5,071**	**5,071**
Basic net earnings per share (euros)	**0.07**	**0.42**
Underlying basic net earnings per share (euros)	**0.71**	**0.75**

Notes:

Since the second quarter of 2016, Telefónica United Kingdom's operations have ceased to be reported as discontinued operations, and its assets and liabilities as "held for sale", and are now reported line by line, using the global integration method in accordance with the IFRS. For comparative purposes, the Telefónica Group's consolidated results for 2015 and the first three months of 2016, until 31 March, are reported under the same criterion.

The weighted average number of shares outstanding during the period is obtained by applying the IAS 33, "Earnings per share". Therefore, the weighted average of treasury shares during the period is not counted as outstanding shares. Moreover, the denominators are adjusted with the operations which entail a modification of the number of outstanding shares, without an associated variation in the equity figure (as if they had occurred at the beginning of the first presented period), as in the case of the "scrip dividend" for 2015 and 2016. Likewise, the ordinary shares which are issued for the conversion of the imperatively convertible bonds issued on 24 September 2014 are included in the calculation from that date onwards.

The basic net earnings per share are obtained by dividing the figure for net income, adjusted for the allocation to the year of the net coupon corresponding to "Other equity instruments", between the weighted average of ordinary outstanding shares during the period.

The data reported in 2015 and 2016 include the adjustments for hyperinflation in Venezuela in both years.

The consolidated results of the Telefónica Group have consolidated the results of GVT and DTS since 1 May 2015.

The consolidated results of the Telefónica Group exclude Telefe, with effect from 1 November 2016.

Consolidated statement of financial position_

Millions of euros	2015	2016
Non-current assets	101,614	103,667
Intangible	21,149	20,518
Goodwill	27,395	28,686
Tangible fixed assets and investment properties	33,910	36,393
Equity-accounted investments	80	76
Non-current financial assets	10,405	9,765
Deferred tax assets	8,675	8,229
Current assets	18,715	19,974
Stocks	1,456	1,055
Debtors and other accounts receivable	10,226	10,675
Current financial assets	3,053	2,954
Tax receivables	1,341	1,533
Cash and cash equivalents	2,615	3,736
Non-current assets held for sale	24	21
Total Assets = Total Liabilities	**120,329**	**123,641**
Net worth	25,436	28,385
Net worth attributable to parent company shareholders and other equity instruments holders	15,771	18,157
Net worth attributable to minority interests	9,665	10,228
Non-current liabilities	60,509	59,805
Long-term financial debt	47,117	45,612
Creditors and other long-term accounts payable	2,388	1,925
Deferred tax liabilities	2,550	2,395
Long-term provisions	8,454	9,873
Current liabilities	34,384	35,451
Short-term financial debt	12,970	14,749
Creditors and other short-term accounts payable	17,134	16,150
Tax payables	2,241	2,332
Short-term provisions	2,022	2,220
Liabilities associated with non-current assets held for sale	17	-
Financial data		
Net financial debt [1]	49,161	48,595
Net financial debt / OIBDA	**2.87 (times)**	**2.95 (times)**

[1] Includes 418 million euros as of December 16, corresponding to the "O2 Refresh" product portfolio in the United Kingdom and generating the corresponding financial interests. The net financial debt for the comparative periods has been re-stated using the same criterion.

Notes:

Since the second quarter of 2016, Telefónica United Kingdom's operations have ceased to be reported as discontinued operations within the Telefónica Group, and its assets and liabilities as "held for sale", and are now reported line by line, using the global integration method in the financial statements of the Telefónica Group, in accordance with the IFRS. For comparative purposes, the Telefónica Group's consolidated results for 2015 and the first three months of 2016, until 31 March, are reported under the same criteria.

The data reported in 2015 and 2016 include the adjustments for hyperinflation in Venezuela in both years.

Main non-financial indicators_

ECONOMIC	Unit	2015	2016
Impact on communities			
% purchases awarded locally	Percentage	84.7%	81.9%
Average period for payment to suppliers (Spain)	Days	49	45
Global tax contribution: total contribution (borne and collected)	Millions of euros	11,454	11,364
Internal impact			
Number of audits or assessments performed on risk suppliers	Units	n.s. [1]	11,678
Risk suppliers with improvement plans arising from the audits performed	Units	608	468
Minimum salary for entry into local company vs local SMI (Spain)	Times	2.15	2.24
Customer			
Managed traffic (December 2016)	Tbytes/month	1,653,406	2,562,525
Customer satisfaction index	Points out of 10	7.51	7.46
Digital Trust			
Attendees at courses related to data protection	People	49,352	25,498
Number of fines confirmed due to data protection issues in 2016	Units	78	55
Internal complaint mechanisms			
Total number of complaints received	Units	822	1,152
Total number of valid complaints	Units	206	641
Measures taken to terminate the employment contract as a result of the valid complaints received	Units	38	135
Anti-corruption			
Number of confirmed cases of corruption	Units	0	2
Measures taken in relation to employees in the workplace as a result of confirmed cases of corruption	Units	0	2

ENVIRONMENTAL	Unit	2015	2016
Energy			
Total energy consumption	MWh	5,984,252	5,819,320
Energy from renewable sources	MWh	1,244,140	2,601,744
Emissions of greenhouse gases (GHG)			
Direct emissions (scope I)	tCO_2eq	137,014	137,043
Indirect emissions (scope 2, "method based on localisation")	tCO_2eq	1,835,220	1,586,302
Indirect emissions (scope 2, "method based on the market")	tCO_2eq	1,381,710	811,711
Waste			
Waste managed	Tonnes	26,782	23,508
% recycled waste	Percentage	96.5%	97.2%
Consumption			
Water	Thousands of cubic metres	3,926	3,754

SOCIAL	Unit	2015	2016
Internal (HR)			
Total number of employees at the end of the period	People	129,890	127,323
Percentage of women on the payroll	Percentage	37.7%	37.6%
Voluntary turnover	Percentage	7.8%	6.8%
Employees younger than 30 years of age	People	25,791	24,331
Percentage of women in management positions	Percentage	19.1%	20.5%
Number of employees with disabilities	People	886	855
Total average salary of women in comparison with that of men with no difference in seniority: managers (Spain)	Percentage	96.5%	97.3%
Total average salary of women in comparison with that of men with no difference in seniority: middle management (Spain)	Percentage	96.2%	95.9%
Percentage of employees covered by collective bargaining agreements	Percentage	70.4%	64.8%
Rating of overall work environment	Points out of 100	79.0	79.0
Number of training hours	Thousands of hours	3,986.4	4,910.1
Absenteeism rate (AR) [2]	Units		0.02
Incident rate (IR) [3]	Units	1.04	1.05
Number of discrimination cases detected	Units	0	0
Measures taken as a result of discrimination cases	Units	0	0
External			
Penetration of broadband over fixed plant	Percentage	52.8%	55.4%
Pre-pay mobile customers	Thousands	157,284	165,663

[1] The data for 2016 are not comparable with those of 2015, as from this year onwards the data also include the evaluations performed on suppliers and administrative audits.

[2] Number of days lost due to absences during the period/total number of days worked during the period.

[3] (Total number of accidents/total hours worked) x 200,000.

Share price performance

The European equity markets recorded volatile behaviour in 2016, a year marked by different political events. The initial months of the year were overshadowed by doubts regarding economic growth in China, adversely affecting the performance of the emerging countries. In June, the United Kingdom voted in a referendum not to continue within the European Union, triggering sharp falls in the markets, which recorded minimum annual levels. In November, the elections in the United States generated a further increase in market volatility. As for monetary policy, the European Central Bank (ECB) extended the debt repurchase programme and lowered interest rates to 0%, in order to generate greater economic activity and raise levels of inflation. For its part, the Federal Reserve delayed the expected rise in rates until December.
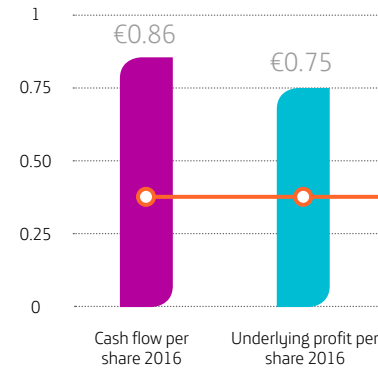
Within this context, the main European indices ended 2016 with a display of mixed behaviour (EStoxx-50 +0.7%). On the positive side, we can highlight the performance of the FTSE-100 (+14.4%), driven up by the strong influence of the mining companies and the depreciation of the pound, which favoured export companies and multinationals with limited exposure to the domestic market; as well as DAX (+6.9%) and CAC-40 (+4.9%). The Ibex-35 (-2.0%) and the FTSEMIB (-10.2%) were the only indices which ended the year with falls,

due to their exposure to the developing countries and, in the case of Italy, to doubts concerning the situation of the banking sector.

By sector, and within the DJ Stoxx-600 (-1.2%) in Europe, basic resources (+61.9%), energy (+22.9%) and construction materials (+9.2%) led the positive returns, while the health sector (-10.2%), travel and leisure (-11.1%) and telecommunications (-15.8%) registered the most negative. The comparatively bad performance of the telecommunications sector during the year was due to the cancellation of certain corporate operations, adverse regulatory news, weak revenue growth trends and concerns about increases in levels of investment, together with the stock market rotation towards more cyclical sectors following the elections in the United States.

Telefónica shares ended 2016 at 8.82 euros per share, with shareholder return totalling -6.3%, a reflection of the share price performance (-13.8%) and the dividends distributed over the year (0.40 euros in cash and 0.35 euros in

—
Telefónica offers attractive and sustainable *shareholder remuneration,* preserving cash and organic deleveraging

scrip). The return was higher than that of the sector in Europe overall, which registered a total shareholder return, after dividends, of -11.7%.

Telefónica closed 2016 with a market capitalisation of 44,433 million euros, making it the eleventh largest company in the telecommunications sector worldwide. The daily trading volume on the Spanish continuous market reached 24.6 million shares.

DIVIDEND PER SHARE

Dividend 2017
€0.40
100% cash

At the Shareholders' Office we ensure that we maintain smooth and transparent communication with our private investors. Over the past year we have attended a total of 67,246 calls on the shareholder information line (900 111 004), receiving a monthly average of 5,604 inquiries, and we have dealt with 6,271 inquiries via e-mail and post.

FURTHER INFORMATION 👉 Refer to the "Shareholders and Investors" section of our website

2

Contribution to progress

- Economic impact
- Environmental impact
- Impacts of the Network
- Contribution to local tax authorities

Economic impact_

IMPACT ON GDP

We are one of the most important driving forces of economic progress in the communities in which we are present. In 2016 we increased our contribution to the combined GDP of the countries in which we operate by 53,244 million euros, a figure which accounts for almost 0.6% of the total wealth generated by these countries as a whole.

We can, therefore, regard ourselves as a great enhancer of the economies of these communities, both directly and due to our capacity to generate a wealth multiplier effect by means of our activity. Thus, according to PwC's impact calculation methodology, for each euro of GDP created directly in 2016, we generated an additional 1.14 euros in an indirect and induced manner through our expenditure and investments.

For each euro of gross operating margin (excluding the provision for the individual Suspension Plan included in the consolidated accounts for 2016) obtained in these countries, we generated 3.5 euros which contributed to these countries' GDP.

IMPACTS ON GDP GENERATED BY THE WHOLE TELEFÓNICA GROUP

Millions of euros (%)
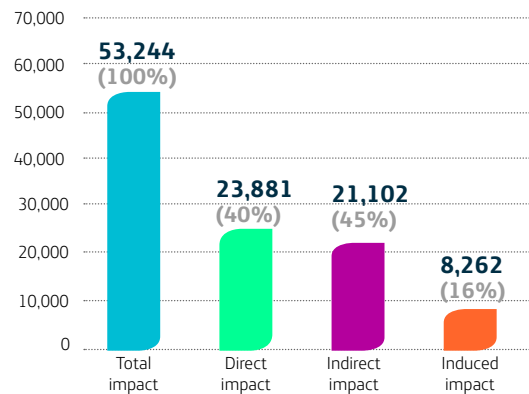
▶ Total impacts generated by corporate activity and Telefónica's expenditure and investments in the countries in which it operates.

▶ Impacts generated directly by Telefónica through the course of its activity.

▶ Impacts generated by Telefónica's expenditure and investments throughout its supply chain.

▶ Impacts generated by the increase in consumption arising from the increase in labour income generated by direct and indirect employment.

IMPACT ON THE MAIN COUNTRIES IN WHICH WE OPERATE

Millions of euros (% of local GDP)
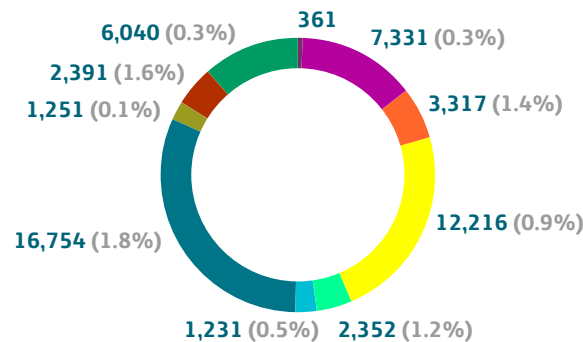
▶ Germany
▶ Argentina
▶ Brazil
▶ Chile
▶ Colombia
▶ Spain
▶ Mexico
▶ Peru
▶ United Kingdom
▶ Other countries

For every euro we generated, we contributed

3.5 euros

to the *GDP of the countries* in which we operate
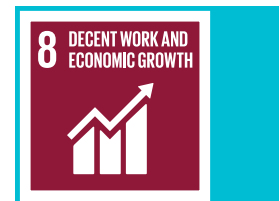
IMPACT ON EMPLOYMENT

The labour market is one of the main social concerns in some of the countries in which we operate and, therefore, it is also relevant to us as members of these communities.

In 2016 the impact that we had on employment in these countries reflected a total of 1,000,973 direct, indirect or induced jobs, according to PwC's impact methodology. Thus, as a result of our activity, for each person recruited into our workforce, we generated an additional 7 jobs in the countries in which we operate.

IMPACTS ON EMPLOYMENT GENERATED BY THE WHOLE TELEFÓNICA GROUP

People (%)

- **1,000,973 (100%)** Total impact
- **127,323 (12.72%)** Direct impact
- **577,916 (57.74%)** Indirect impact
- **295,734 (29.54%)** Induced impact
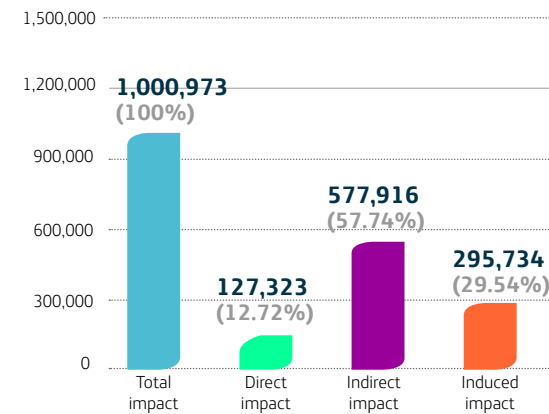
▸ Jobs generated by corporate activity and Telefónica's expenditure and investments in the countries in which we operate.

▸ Employees recruited directly by Telefónica.

▸ Jobs generated in the companies and sectors that receive the expenditure and investments of Telefónica and its respective suppliers.

▸ Jobs generated in the different economic sectors as a result of the economic activity generated in an induced manner.

IMPACT ON THE MAIN COUNTRIES IN WHICH TELEFÓNICA OPERATES

People (% of total local employees)
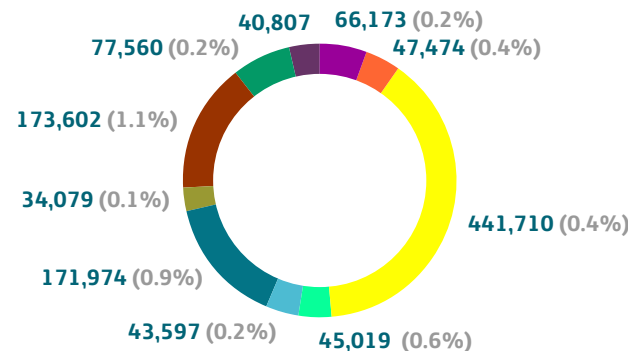
- 40,807
- 66,173 (0.2%)
- 47,474 (0.4%)
- 77,560 (0.2%)
- 173,602 (1.1%)
- 34,079 (0.1%)
- 171,974 (0.9%)
- 43,597 (0.2%)
- 45,019 (0.6%)
- 441,710 (0.4%)

▸ Germany
▸ Argentina
▸ Brazil
▸ Chile
▸ Colombia
▸ Spain
▸ Mexico
▸ Peru
▸ United Kingdom
▸ Other countries

For each worker recruited,
we generated
7 *additional jobs*
in the countries in which we operate

Environmental impact_

OUR FOOTPRINT

The carbon footprint we generate comes mostly from our Network, and, including scope 3 emissions, is equivalent to 2,392 $KtCO_2$, which represents 0.1% of the total emissions in the countries in which we operate.

Although our emissions are not particularly high in comparison with other sectors, they are equivalent to half of the emissions of a country like Nicaragua. For this reason, in 2016 we established our Energy and Climate Change goals for 2020 and 2030. Our objective is to align our efforts with the level of decarbonisation needed to limit global warming to under 2°C, reducing our greenhouse gas emissions by 30% by 2020.

In 2016, thanks to our Renewable Energy plan and our energy efficiency projects, we managed to reduce our carbon footprint by 26% (scopes 1+2), 22% if we include our entire value chain (scopes 1+2+3), and we avoided the emission of 938 $KtCO_2$, which is equivalent to almost 40% of our total emissions.

Objective *reduction of emissions* based on science by 2020:
-30%

Reduction of
26%
in 2016
(scopes 1+2)

OUR CARBON FOOTPRINT

1,019,875
291,770

2,392 KtCO₂

▶ Scope 1
▶ Scope 2
▶ Scope 3

1,080,374

REDUCTION OF EMISSIONS

15%
4.5%

22%

▶ Scope 1
▶ Scope 2
▶ Scope 3

30.8%

AVOIDED EMISSIONS
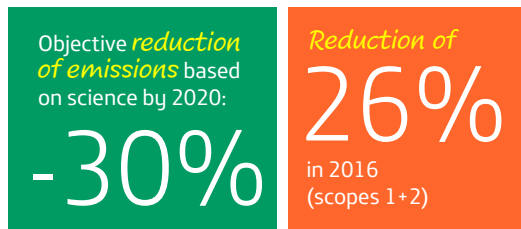tCO₂

68,229

938 KtCO₂

▶ Energy efficiency
▶ Renewable energy

869,742
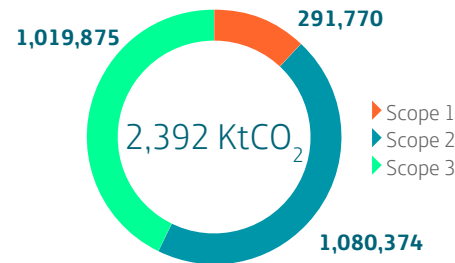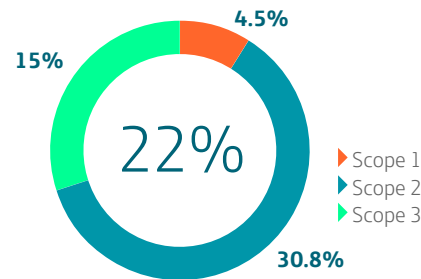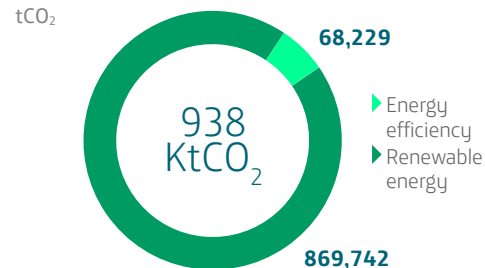
OUR ECO-SMART SERVICES

Our contribution to reducing and adapting to climate change goes beyond our own footprint. Through our services, we have the capacity to reduce emissions in other sectors and increase the resiliency of the communities in which we operate.

For example, our IoT services improve the mobility and energy efficiency of our customers. This has resulted in over 50 million euros in revenue and a reduction of 229,314 tCO_2.

For more information, see the chapters under the 'Commitment to the environment' section.

Reduction of
188 KtCO₂
thanks to our fleet management service

ECOSMART IoT REVENUE
Millions of euros

3.3
38.3
13.2
151.1

▶ IoT connectivity
▶ Smart mobility
▶ Smart energy
▶ Smart cities

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

13 CLIMATE ACTION

We have avoided the emission of
41 KtCO₂
by our customers thanks to our Energy Efficiency in Buildings services
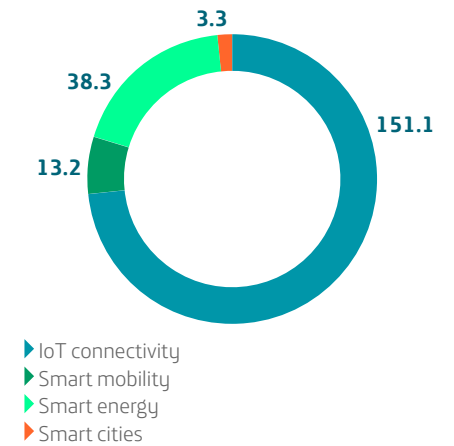
Impacts of the Network_

Numerous studies demonstrate that the introduction of broadband has a positive effect on the digital inclusion and economic growth of the communities in which we operate. Not only does it boost the telecommunications sector, but the development of broadband also contributes to an increase in the productivity and competitive capacity of local businesses.

The development of broadband generates a series of positive impacts on society which reach far beyond the purely quantitative to include, among others, better and greater customer access to information and culture, and the expansion of leisure and entertainment options.

It is both through and thanks to significant improvements in the speed and automation of processes, data processing and information circulation that new business models are being created and promoted.

You can find further information in the section titled "Digital inclusion".

8 DECENT WORK AND ECONOMIC GROWTH
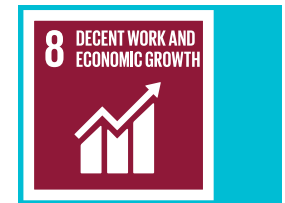
IMPACT CAUSED BY TELEFÓNICA BROADBAND (BB) AS A PERCENTAGE OF GDP

Source: PwC analysis

FIXED BB IMPACT
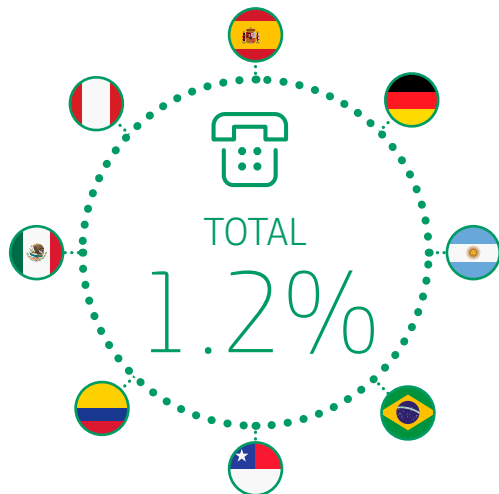
TOTAL
1.2%

MOBILE BB IMPACT

TOTAL
1.0%

TOTAL IMPACT (FIXED + MOBILE)

TOTAL
2.2%
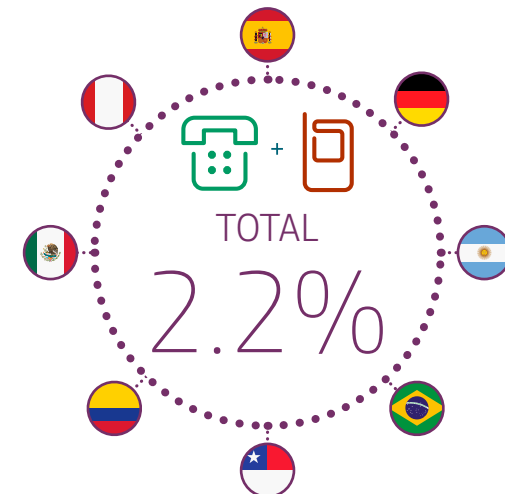
Contribution to local tax authorities

The current economic environment has placed the tax contributions of large multinational companies at the centre of the debate. Therefore, we are committed to acting with fiscal responsibility and transparency in the management of our business, and complying with all our tax obligations in the territories in which we operate.

In order to increase transparency, we have developed Responsible Business Principles in matters of tax compliance, upon the basis of which we are committed to acting with honesty and respect for the law in the management of fiscal matters.

Additionally, in 2010, by resolution of the Board of Directors, Telefónica, S.A. adopted the Code of Good Practice in Tax Affairs. As a result, and in accordance with the recommendations of the Code, the Company does not use corporate structures in the pursuance of its business activity for the purpose of covering up or reducing the transparency of its activities in the eyes of the tax authorities or any other interested party.

On the basis of these recommendations, our actions are rooted in reciprocal cooperation with the Tax Agency, based on good faith and mutual trust, and on the application of responsible fiscal policies approved by our Board of Directors.

Furthermore, in accordance with the Corporate Enterprises Act, the creation or procurement of shares in entities with special purposes or those domiciled in countries or territories which are considered tax havens, as well as any other transactions or operations of a similar nature which, owing to their complexity, could undermine the transparency of Telefónica, are reviewed and, where appropriate, subject to approval by the Board of Directors.

Telefónica will not create or acquire entities domiciled in any of the jurisdictions included in the list of tax havens established by Spanish regulations. If, for business reasons, the presence of an operator in a territory classified as a tax haven were to be necessary, authorisation would be sought from the Board of Directors.

The Group's operations in territories regarded by other bodies as having little or no taxation exist solely and exclusively for economic and commercial reasons (*Business Purpose*), and have the material and human resources needed to conduct their activities without being the object of these operations, and, under no circumstances shall transfer profits to those jurisdictions in order to obtain a reduction in the tax burden.

GEOGRAPHIC DISTRIBUTION OF TAXES PAID BY TELEFÓNICA

- 0.7%
- 25.5%
- 5.6%
- 4.7%
- 43.5%
- 19.9%

- Germany
- Brazil
- Spain
- LatAm
- United Kingdom
- Others

TAXES BORNE
Euros

	Tax on profits	Taxes associated with employment	Taxes on products and services
	649,287	958,696	1,279,329
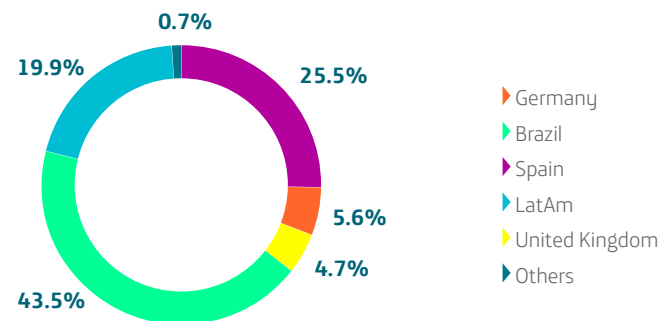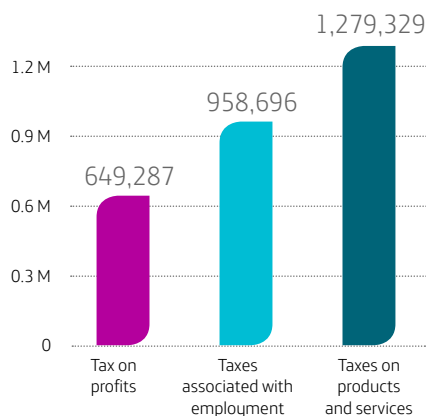
TAXES COLLECTED
Euros

	Tax on profits	Taxes associated with employment	Taxes on products and services
	746,323	878,967	6,852,284
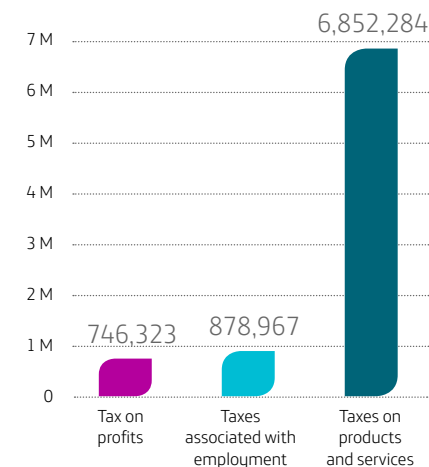
TAXES IN 2016

Our economic and social contribution is not only quantifiable via payment of Corporate Tax, but also through other specific contributions in the various countries where we operate, such as fees (for Public Domain Use, for Radio and Television Corporation Financing, etc.), local taxes, and Social Security payments, as well as other similar contributions in the remaining countries.

In addition to these directly borne taxes, we pay in to public coffers, as a result of our activity and on the part of other contributors, other amounts that must be considered within the total tax contribution that the Company makes, such as indirect taxes, workers' withholdings and other withholdings.

In this context and during 2016, our total tax contribution (TTC) amounted to 11,365 million euros (2,887 million euros for taxes borne and 8,478 million euros for taxes collected), accounting for 49% of the value distributed by Telefónica[1]. Brazil and Spain, the markets in we generate the most operating profit, are the jurisdictions which have most contributed to the payment of taxes.

The amount in absolute values of Telefónica's TTC for the 2016 tax year have decreased slightly in comparison to the 2015 tax year due to the evolution of the currencies in relevant Latin American countries.

Therefore, for every 100 euros of Company revenue, 21.8 euros were allocated to the payment of taxes (5.5 to the payment of taxes borne and 16.3 to the payment of taxes collected).

All the information about our tax practices is available on our website.

—

For every 100 euros
of Company revenue,
21.8 euros are allocated
to the payment of taxes

BREAKDOWN OF TELEFÓNICA'S OVERALL TAX CONTRIBUTION IN 2016
Thousands of euros

Country	Borne	Collected	Total
Germany	132,300	500,492	**632,792**
Argentina	303,953	619,322	**923,275**
Brazil	901,802	4,045,432	**4,947,234**
Chile	47,834	207,265	**255,099**
Colombia	124,309	140,521	**264,830**
Costa Rica	8,142	17,351	**25,494**
Ecuador	86,128	30,003	**116,131**
El Salvador	9,477	17,162	**26,639**
Spain	866,831	2,045,988	**2,912,819**
Guatemala	4,762	7,759	**12,521**
Mexico	8,266	77,634	**85,900**
Nicaragua	26,463	23,073	**49,537**
Panama	13,964	15,924	**29,889**
Peru	164,701	197,015	**361,717**
United Kingdom	77,047	455,562	**532,609**
Uruguay	17,364	14,622	**31,986**
Venezuela	29,954	48,968	**78,922**
Others	64,012	13,479	**77,491**
TOTAL	**2,887,311**	**8,477,574**	**11,364,885**

(1) Value distributed as taxes borne and collected/Total distributed value, the latter being the sum of the following items: value for the shareholder (profit after tax), wages and salaries net of taxes collected, net interests and taxes borne and collected.

3

Corporate Governance

Board of Directors_

With the support of its Committees, the Board of Directors of Telefónica, S.A. performs its activities in accordance with the standards of Corporate Governance which are chiefly contained in the Company Bylaws, the Rules governing the General Shareholders' Meeting and the Regulations of the Board of Directors.

The Board of Directors is the body which supervises and controls Company activity, bearing sole responsibility, among other decisions, for the general policies and strategies of the Company, including those related to Corporate Governance, Corporate Responsibility, remuneration of Directors and Senior Management and remuneration of shareholders, as well as strategic investments.

In order to strengthen the Company's Corporate Governance, the Board of Directors of Telefónica, S.A. has six Committees, which are responsible for the examination and monitoring of areas of particular importance.

Furthermore, in accordance with its Regulations, the Board of Directors entrusts the ordinary management of the businesses to the executive bodies and the management team of Telefónica, S.A.

More detailed information on this matter is contained in the Annual Corporate Governance Report and the Annual Report on the Remuneration of Directors.

Each year at Telefónica we publish a full report year on the remuneration of all our Directors, which includes the structure, the remuneration items, the fixed and variable short and long term payments, as well as other kinds of allowances. This information can be found in the Annual Corporate Governance Report and the Annual Report on Director Remuneration.

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The Board has *six Committees*, which are responsible for monitoring the most important areas

COMPOSITION OF THE BOARD OF DIRECTORS

	Executive directors	Proprietary external directors	Independent external directors	Other external directors
José María Álvarez-Pallete López (Chairman & CEO)	●			
Isidro Fainé Casas (Vice-Chairman)		●		
José María Abril Pérez (Vice-Chairman)		●		
Julio Linares López (Vice-Chairman)				●
Eva Castillo Sanz				●
Juan Ignacio Cirac Sasturain			●	
José Javier Echenique Landiríbar			●	
Peter Erskine			●	
Sabina Fluxà Thienemann			●	
Luiz Fernando Furlán			●	
Carmen García de Andrés			●	
Peter Löscher			●	
Antonio Massanell Lavilla		●		
Ignacio Moreno Martínez		●		
Francisco Javier de Paz Mancho			●	
Francisco José Riberas Mera			●	
Wang Xiaochu		●		
Ramiro Sánchez de Lerín García-Ovies (Non-voting Secretary)				
María Luz Medrano Aranguren (Non-voting Vice-Secretary)				

COMMITTEES OF THE BOARD OF DIRECTORS

	Delegated Committee	Audit and Control	Appointments, Remuneration and Good Governance	Regulation and Institutional Affairs	Service Quality and Customer Service	Strategy and Innovation
José María Álvarez-Pallete López (Chairman & CEO)	●					
Isidro Fainé Casas (Vice-Chairman)	●					
José María Abril Pérez (Vice-Chairman)	●					●
Julio Linares López (Vice-Chairman)				●	●	
Eva Castillo Sanz				●	●	●
Juan Ignacio Cirac Sasturain						●
José Javier Echenique Landiríbar	●	●	●			
Peter Erskine	●		●			●
Sabina Fluxà Thienemann			●			
Luiz Fernando Furlán			●			
Carmen García de Andrés		●				
Peter Löscher						●
Antonio Massanell Lavilla		●		●	●	●
Ignacio Moreno Martínez		●		●	●	
Francisco Javier de Paz Mancho	●	●	●	●		
Francisco José Riberas Mera						
Wang Xiaochu						

Committees of the Board of Directors

DELEGATED COMMITTEE

Functions. The Board of Directors, always in accordance with the current legal provisions, delegates its powers and attributions, except for those which cannot be delegated for legal, statutory or regulatory reasons, to a Delegated Committee. This Committee allows the Board of Directors greater operability and effectiveness in the exercise of its functions, inasmuch as it meets more frequently than the latter.

José María Álvarez-Pallete López	Chairman
Isidro Fainé Casas	Vice-Chairman
José María Abril Pérez	Vice-Chairman
José Javier Echenique Landiríbar	Member
Peter Erskine	Member
Francisco Javier de Paz Mancho	Member
Ramiro Sánchez de Lerín García-Ovies	Non-Voting Secretary

AUDIT AND CONTROL COMMITTEE

Functions. This Committee, among other tasks, supports the Board of Directors in its supervisory work and assumes the competences of: reporting on issues raised by shareholders on matters which are the responsibility of the Committee; proposing the appointment and terms of engagement of the accounts auditor; supervising the internal audit and the process of drawing up and submitting the regulated financial information; proposing the risk control and management policy; and establishing and maintaining an appropriate relationship with the accounts auditor. Sustainability risks are also reported to this Committee.

Composition	Position	Date of Appointment
José Javier Echenique Landiríbar	Chairman	8 April 2016
Carmen García de Andrés	Member	4 May 2017
Antonio Massanell Lavilla	Member	30 August 2000
Ignacio Moreno Martínez	Member	31 May 2013
Francisco Javier de Paz Mancho	Member	27 April 2016

APPOINTMENTS, REMUNERATION AND GOOD GOVERNANCE COMMITTEE

Functions. Assumes the tasks of informing, based upon criteria of objectivity and in keeping with the corporate interests, on proposals for the appointment, re-election and dismissal of Directors and Senior Managers of the Company and its subsidiaries, evaluating the skills, knowledge and experience required of the candidates to fill the vacancies. It also proposes to the Board of Directors, within the framework established in the Company Bylaws, the extent and amount of remuneration, rights and compensations of an economic nature, of the Chairman and Senior Managers of the Company, including the basic terms of their contracts for the purposes of their contractual implementation. It also monitors compliance with Telefónica's internal codes of conduct and the rules of Corporate Governance applicable at all times.

Composition	Position	Date of Appointment
Francisco Javier de Paz Mancho	Chairman	8 April 2016
José Javier Echenique Landiríbar	Member	4 May 2017
Peter Erskine	Member	27 February 2008
Luiz Fernando Furlán	Member	4 May 2017
Sabina Fluxà Thienemann	Member	27 April 2016

SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Functions. Among other tasks, it performs the examination, analysis and regular monitoring of the quality indices of the main services provided by the Telefónica Group companies. It also assesses the levels of service delivered by the Group companies to its customers.

Composition	Position	Date of Appointment
Antonio Massanell Lavilla	Chairman	26 March 1999
Eva Castillo Sanz	Member	16 December 2009
Julio Linares López	Member	27 April 2016
Ignacio Moreno Martínez	Member	31 May 2013

REGULATION AND INSTITUTIONAL AFFAIRS COMMITTEE

Functions. Among other capacities, it performs the following functions: (i) permanently monitor the main issues and topics of regulatory concern that affect the Telefónica Group at all times; (ii) act as a communication and information channel between Management and the Board of Directors on regulatory matters and, whenever necessary, notify the Board of Directors of any matters that it deems to be important or relevant to the Company or to any of the Group companies, and which require the taking of decisions or the establishment of a specific strategy; (iii) analyse, notify and propose to the Board of Directors the principles that the Group's Sponsorship and Patronage policy should follow, monitor it, and individually approve those sponsors or patrons whose amount or importance exceeds the threshold established by the Board, which must be approved by it; and (iv) promote development of the Telefónica Group's Reputation and Corporate Social Responsibility project together with the implementation of the core values of said group.

Composition	Position	Date of Appointment
Julio Linares López	Chairman	27 April 2016
Eva Castillo Sanz	Member	27 April 2016
Antonio Massanell Lavilla	Member	27 April 2016
Ignacio Moreno Martínez	Member	27 April 2016
Francisco Javier de Paz Mancho	Member	27 April 2016

STRATEGY AND INNOVATION COMMITTEE

Functions. Among other capacities, it performs the following functions: (i) support the Board of Directors in the analysis and monitoring of the Telefónica Group strategic policy at a global level; and (ii) advise and provide support in all matters related to innovation, performing the analysis, study and regular monitoring of the Company's innovation projects, providing good judgement and support to ensure their proper implementation and development throughout the Telefónica Group.

Composition	Position	Date of Appointment
Peter Erskine	Chairman	27 April 2016
José María Abril Pérez	Member	27 April 2016
Eva Castillo Sanz	Member	27 April 2016
Juan Ignacio Cirac Sasturain	Member	27 April 2016
Peter Löscher	Member	27 April 2016
Antonio Massanell Lavilla	Member	27 April 2016

Members of the Board_

José María Álvarez-Pallete López
Chairman & CEO

Graduate in Economic Sciences from the Complutense University of Madrid. Studies in Economic Sciences at the Free University of Brussels in Belgium. International Management Program (IMP) at the IPADE Business School (PanAmerican Institute for High Business Direction). Advanced Research Degree from the Department of Financial Economics and Accounting of the Complutense University of Madrid.

He has been Chairman & CEO of Telefónica S.A. since 8 April 2016, and a member of the Telefónica S.A. Board of Directors since July 2006. He is also a Trustee of the Telefónica Foundation. He has previously held several positions within the Telefónica Group since 1999, including General Director of Finance at Telefónica Internacional, S.A.U., General Director of Corporate Finance at Telefónica, S.A., Chairman & CEO of Telefónica Internacional, S.A.U., Chairman of Telefónica Latin America and Chairman of Telefónica Europe. From September 2012 until April 2016 he was Chief Executive Officer of Telefónica S.A.

He previously worked at Arthur Young Auditors, Benito & Monjardín/Kidder, Peabody & Co. and Cementos Portland (Cemex). He has been a Board Member, among other companies, of the Cemex Group in Indonesia, based in Jakarta, China Netcom Group Corporation Limited and Portugal Telecom SGPS, S.A.

In 2001 he was granted the "CFO Europe Best Practices" award in the Mergers & Acquisitions section 2000. In April 2003, he was named Member of Merit of the Carlos III Foundation Ibero-American Forum and, in July 2007, was awarded the Golden Master's from the Executive Management Forum. On 4 October 2011, he received the Economics Personality of the Year Award from the "*El Economista*" newspaper. On 14 December 2013, he received the 2013 Award for Excellence for his contribution to advances in telecommunications, granted by the Official Association of Telecommunications Engineers. The magazine Fast Company named him one of the 100 Most Creative People in Business in 2014. In 2017 we has named "Best CEO 2016" in Spain by the magazine Forbes.

Isidro Fainé Casas
Vice-Chairman

Doctor in Economic Sciences. Diploma in Senior Management from the IESE. ISMP in Business Administration from Harvard University. Member of the Royal Academy of Economics and Finance and the Royal Academy of Doctorate Holders.

He is Chair of the Board of Trustees of the Caixa d'Estalvis i Pensions de Barcelona "La Caixa", Banking Foundation and Criteria Caixa, S.A.U., and of Gas Natural SDG, S.A.; and is a Board Member of "The Bank of East Asia", and the Suez Environnement Company.

Currently, he is Chair of the Spanish Confederation of Savings Banks (Spanish acronym: CECA) and European Savings Banks Group (ESBG) and Deputy Chair of the World Savings Banks Institute (WSBI). He is also Chair of the Spanish Confederation of Executives (Spanish acronym: CEDE), the Spanish Chapter of the Club of Rome and the Círculo Financiero.

José María Abril Pérez
Vice-Chairman

Graduate in Economic Sciences from the University of Deusto and Professor at the same University for nine years.

Among other positions, he has been Managing Director of Wholesale and Investment Banking at Banco Bilbao Vizcaya Argentaria, S.A. and a member of its Management Committee. He has also been Financial Director of the Sociedad Anónima de Alimentación (SAAL) and Sancel-Scott Ibérica, Executive Coordinator of Banco Español de Crédito, S.A., Managing Director of the BBV Industrial Group, a member of the Boards of Directors of Repsol, Iberia and Corporación IBV, as well as Vice-Chair of Bolsas y Mercados Españoles.

Julio Linares López

Vice-Chairman

Telecommunications Engineer. He joined Telefónica in May 1970 at the Research and Development Centre and, since then, has held several positions at Telefónica, including CEO of Telefónica Multimedia, Chairman & CEO of Telefónica España, Chair of the Supervisory Board of Cesky Telecom, Managing Director for Coordination, Business Development and Synergies and CEO of Telefónica, S.A.

He is currently a member of the Board of the GSM Association. He is a Trustee of the Mobile World Capital Barcelona Foundation, the CEDE-Spanish Confederation of Directors and Executives Foundation and the Telefónica Foundation. He is also currently a member of the Executive Committee and the Board of Directors of the CEOE, and Chair of the Digital Society Commission. He is also a member of the Governing Council of the Association for Progress in Management.

In addition, he is a member of COIT (the Official Association of Telecommunications Engineering) and the AEIT (the Spanish Association of Telecommunications Engineers). He is a Member of the Advisory Board of the Higher Technical School of Telecommunications Engineers.

Eva Castillo Sanz

Member of the Board

Graduate in Law and Business Administration from the Pontifical University of Comillas, ICADE (E-3) in Madrid.

She is currently Chairman of the Supervisory Board of Telefónica Deutschland Holding, AG and Independent Board Member of Bankia. Furthermore, she is a Trustee of the Telefónica Foundation, the Comillas-ICAI Foundation, and the Entreculturas Foundation.

Among other positions, she has been Chairman and CEO of Telefónica Europe, Chairman of the Supervisory Board of Telefónica Czech Republic, a.s. and Board Member of Old Mutual Plc.

She held various positions at Merrill Lynch until she was appointed Head of Merrill Lynch Private Banking for Europe, the Middle East and Africa (EMEA), a position she held until December 2009.

Juan Ignacio Cirac Sasturain

Member of the Board

Doctorate in Physics from the Complutense University of Madrid and a Degree in Theoretical Physics from the same University. Areas of specialisation are Theoretical Quantum Optics, Quantum Information, Atomic Physics and Quantum Many-Body Physics.

His professional experience includes Speaker at the International Max-Planck Insitute of Quantum Science and Technology Research (since 2016), "Honorarprofessor" at the Technical University of Munich (Department of Physics) (since 2002), Director of the Theory Division at the Max-Planck Institut für Quantenoptik and member of the Max Planck Society (since 2001).

Other activities include: Member of the Caixa Foundation Advisory Committee, Editor and Founder of the Quantum Information and Computation Magazine (English language version); Member of the Advisory Board of the Interdisciplinary Institute of Information Sciences, Tsinghua University (since 2015), Member of the Advisory Board of the Russian Quantum Centre (since 2012), Member of the Advisory Board of Annalen der Physik (since 2012), Member of the Review Panel, QSIT, Swiss National Science Foundation (since 2011), Member of the Scientific Advisory Committee of the BBVA Foundation (since 2010), Member of the Advisory Board of the Science Centre of Benasque (since 2008), Member of the Scientific Advisory Board, Centre of Quantum Technology, NUS, Singapore (since 2007) and Founding Managing Editor, Computing and Quantum Information (Spanish language - since 2001); member of the Advisory Council of the Caixa d'Estalvis i Pensions de Barcelona "La Caixa" Banking Foundation.

His national and international awards include: The Hamburg Prize for Theoretical Physics; Medal of Honour, García Cabrerizo Foundation; the Wolf Prize in Physics; Medal of Honour from the Niels Bohr Institute; and the Grand Cross of the Order of Dos de Mayo of the Community of Madrid. He also has the following distinctions: Elected member of the Royal Academy of Sciences, Spain; Doctor Honoris Causa, Polytechnic University of Valencia, Spain; Doctor Honoris Causa, University of Valencia, Spain; Visiting Miller Professorship Award, University of California, Berkeley, California, USA; Corresponding Member of the Royal Academy of Sciences and Arts of Barcelona, Spain; David Ben-Gurion Medal, Ben-Gurion University of the Negev, Israel; Professor at the Centre for Theoretical Science of Princeton, Princeton University, New Jersey, United States; Distinguished Lecturer, Technion, Haifa, Tsinghua Songjian Turing Lecturer, Beijing; and Erwin Schrödinger Distinguished Professor, Vienna.

He has been a guest lecturer at more than 200 international conferences, and has also done teaching work and held public classes.

José Javier Echenique Landiríbar
Member of the Board

Graduate in Economic and Actuarial Sciences from the University of the Basque Country and Professor of Social Security Quantitative Techniques at the Bilbao Faculty of Economic Sciences of the UPV for several years.

He is currently a member of the Board of Directors of Banco Sabadell (Vice-Chairman), Board Member of Repsol, S.A., ACS Actividades de Construcción y Servicios, S.A., ACS Servicios, Comunicaciones y Energía, S.L., and Grupo Empresarial ENCE, S.A.

He is also a Trustee of the Novia Salcedo Foundation, Director of the Deusto Business School and member of the Basque Businessmen Circle.

He has been Director and Director General of Allianz-Ercos and Director General of the BBVA Group (Head of Wholesale Banking). He has also been a member of the Board of Directors of Telefónica, S.A., Telefónica Móviles Mexico, S.A., Chairman of Banco Guipuzcoano, Sevillana de Electricidad, S.A., Acesa, Hidroeléctrica del Cantábrico, Corporación IBV, Metrovacesa, the Patricio Echeverria Corporation, the BBVA Seguros Group, the Edhardt Group, Uralita, the Porres Group (Mexico) and Abertis Infraestructuras, S.A.

Peter Erskine
Member of the Board

Graduate in Psychology from the University of Liverpool, appointed Doctor Honoris Causa by Reading University.

He is Chair of the Henley Business School Strategy Board, a Member of the Board of Reading University and a Member of the Strategy and Finance Committees of said University. Since May 2016, he is a member of the Telefónica Deutschland Holding AG Supervisory Board.

He began his professional career in the Marketing department at Polycell and Colgate Palmolive, with the MARS Group and at UNITEL. He also held different management positions at BT Mobile until being appointed CEO and Chair of O2, Plc. In December 2015 he resigned as Chair of Ladbrokes, Plc.

Sabina Fluxà Thienemann
Member of the Board

Graduate in Administration and Business Management & MBA from ESADE. Diploma in Senior Management from IESE.

In January 2005 she joined the Iberostar Group, where she currently holds the position of Co-Vice Executive Chairman and CEO.

She also holds the positions of member of the Baleares Regional Advisory Board of BBVA, member of the Governing Board of APD Illes Baleares, and Trustee of the Iberostar Foundation and the Endeavour Foundation.

Luiz Fernando Furlán
Member of the Board

Graduate in Chemical Engineering from the FEI (Industrial Engineering Faculty of São Paulo) and Business Administration from the University of Santana de Sao Paulo, specialising in Financial Administration at the Getulio Vargas Foundation in Sao Paulo.

He is currently a Member of the Board of Directors of Brasil Foods, S.A. (BRF), Telefónica Brazil, S.A. and the AGCO Corporation.

From 2003 to 2007 he was Minister of Industry, Development and Trade of the Government of Brazil. He was previously a Member of the Board of Directors and an Advisor for numerous companies, including Sadia, S.A., Panasonic (Japan), Wal-Mart (USA) and Abertis Infraestructuras, S.A. (Spain).

Carmen García de Andrés
Member of the Board

Graduate in Economic Sciences and Business Studies from the Comillas Pontifical University, ICADE.

She is currently Chair of the Tomillo Foundation.

She joined PricewaterhouseCoopers (Coopers & Lybrand Legacy) in 1985, was promoted to Director in 1995, and Partner of the firm in 2000. Since then she has held various leadership positions at Landwell-Abogados and Asesores Fiscales, and in the Fiscal Legal Department of PwC. Specialising in consultancy for large companies, she has been a representative for the Spanish firm in the International Group of specialists in Indirect Taxation for more than 6 years. Since 1998, her field of work has fundamentally been consulting for large, multinational companies established in Spain with significant international involvement.

From 2004 to 2007, she was Managing Partner for the Grupo de Gran Consumo, Distribución, Industria y Servicios of Madrid, with more than 30 specialists in various legal and tax fields. Between 2005 and 2007, she was also head of the Diversity, Women programme at PwC.

Member of the Board of Trustees at the Tomillo Foundation since 2006, taking on the role of Director General of this not-for-profit entity in March 2008, and Executive Chair in 2014.

She is also the Director of the Tomillo Tietar Foundation and a member of its Board of Trustees. From 2013 until April 2017, she was the Chair of the Youth Business Spain Foundation, and is currently a member of its Board of Trustees.

Since June 2011, she has been a Member of the Board of Directors of the Spanish Foundation Association (AEF), and is currently its Treasurer.

She is a member of the Board of Trustees for the Rais Foundation and Xavier de Salas Foundation, as well as member of the Board for the collective initiative Juntos por el Empleo (Together for Employment) for the most disadvantaged.

From 2005 until 2010, she collaborated with the Lidera Programme and MET (Mujer, Empresa y Tecnología - Woman, Business and Technology) of the Instituto de Empresa. She was also a professor of International Taxation at ESADE during the 2005/06 and 2006/07 academic years, and facilitator for Circles of Trust –Centre for Courage and Renewal– 2017.

Peter Löscher
Member of the Board

He studied Economics at the Vienna University of Economics, and Business Administration at the Chinese University of Hong Kong. He obtained an MBA from the Vienna University of Economics and completed the Advanced Management Program at the Harvard Business School.

Chairman of the Supervisory Board of OMV Aktiengesellschaft, Chairman of Sulzer AG, and member of the Supervisory Board of Deutsche Bank AG.

From March 2014 to March 2016 he was CEO of Renova Management AG (Switzerland). Former Chairman and CEO of Siemens AG. He was previously President of Global Human Health and Member of the Executive Board of Merck & Co., Inc., CEO of GE Healthcare Bio-Sciences and member of the GE Corporate Executive Council, Director of Operations and Member

of the Board of Amersham Plc. He held senior leadership positions at Aventis and Hoechst.

He served as Chair of the Board of Trustees of the Siemens Foundation and was a Member Emeritus of the Advisory Council of the Economic Development Board of Singapore. He is also a Member of the International Advisory Council of Bocconi University.

He is Honorary Professor at the University of Tongji (Shanghai), has received an Honorary Doctorate in Engineering from Michigan State University and is Doctor Honoris Causa a the Slovak University of Engineering in Bratislava.

He holds the Gold Decoration of Honour for Services to the Republic of Austria, the Order of Friendship from the Russian Federation and is Knight Commander of the Order of Civil Merit of Spain.

Antonio Massanell Lavilla
Member of the Board

Graduate in Economic Sciences and Business Studies from the University of Barcelona.

He is currently Deputy Chair of CaixaBank, S.A. He is also a member of the following Boards of Directors: Cecabank (Non-executive Chair), Board Member of SAREB (Company for the Management of Assets proceeding from Restructuring of the Banking System), member of the Supervisory Board of ERSTE Group Bank and Board Member for Repsol, S.A.

In addition, he is Vice-Chairman of the Board of Trustees of COTEC (Foundation for Technological Innovation), Chair of the Barcelona Centre Financer Europeu Association, a Member of the Plenary Body of the Chamber of Commerce of Barcelona (since 2010) and a member of the ERPB (Euro Retail Payments Board), representing the European Savings and Retail Banking Group (since April 2014).

During his career he has served on the Boards of Directors of several companies, including Visa España, Inmobiliaria Colonial and Boursorama, S.A., as Chairman of Port Aventura Entertainment, S.A. and the Barcelona Digital Technology Centre; and Vice-Chairman of Mediterranea Beach & Golf Community, S.A.

Ignacio Moreno Martínez
Member of the Board

Graduate in Economic Sciences and Business Studies from the University of Bilbao. Master's Degree in Marketing and Sales Management at the Instituto de Empresa. Master's Degree in Business Administration (MBA) at INSEAD.

He is currently Chairman of TESTA Residencial, Socimi, S.A; Chairman of Metrovacesa Suelo and Promoción, S.A.; and Board Member of Obrascón Huarte Lain, S.A. (OHL).

Until October 2016, he was CEO of Metrovasca, S.A. Previously, he held the position of Company Chairman.

He has worked at Banco de Vizcaya, Banco Santander de Negocios, Mercapital, Corporación Bancaria de España, S.A., Argentaria Bolsa, Sociedad de Valores and Banco Bilbao Vizcaya Argentaria, S.A., where he was Director General of the Presidency Area. He has also been CEO of N+1 Private Equity.

Francisco Javier de Paz Mancho
Member of the Board

Holds a degree in Publicity and Information; Law studies; diploma in Senior Management from the IESE (University of Navarre).

Chairman of Telefónica Ingeniería de Seguridad, S.A.; and Board Member of Telefónica de Argentina, S.A., Telefónica Brasil, S.A. And of Telefónica Móviles México, S.A. de C.V.

Other positions he has held include Chairman of Telefónica Gestión de Servicios Compartidos España, S.A.U., Chair of Atento Inversiones y Teleservicios, S.A.U., of the National MERCASA Company, Board Member of Tabacalera, S.A., Assistant to the Chair and Director of Corporate Strategy of the Panrico Donuts Group, Director General of Internal Trade of the Ministry of Commerce and Tourism, Board Member of the Panrico Group and Member of the Executive Committee of the Higher Council of Chambers. Additionally, from September 2014 until March 2016, he was Chairman of Telefónica Gestión de Servicios Compartidos España, S.A.U.

Francisco José Riberas Mera
Member of the Board

Graduate in Law (1987) and Graduate in Economics and Business (1988) at the Pontifical University of Comillas (ICADE E-3).

In 1989, he began his professional career at Grupo Gonvarri in the Management Control department, and later took on the role of Director of Corporate Development and CEO. In 1997, he promoted foundation of Gestamp, taking on the role of CEO there since its beginnings.

Currently, Gestamp is the global leader in metallic components for the automotive industry. The company is ranked 28 out of all the TIER-1 automotive providers in the annual ranking by Automotive News.

In 1998, following the privatisation process of Aceralia Corporación Siderúrgica, he joined its Board of Directors, a position he held until that company was incorporated into Grupo Arcelor.

Currently, he holds the positions of Co-Chairman of ACEK holding company and of Gestamp, and is a member of the Boards of Directors of Gonvarri Industrial, CIE Automotive, and other companies of the Gestamp Group.

He is also a member of the Board of Directors of the Instituto de Empresa Familiar and is a part of the Spanish Council of Endeavor, an ONG created to help coming generations of entrepreneurs to achieve success through mentoring and assistance in investment programmes.

Wang Xiaochu
Member of the Board

Senior Professor of Engineering; Graduate in Telecommunications Engineering in 1989 from the Institute of Posts and Telecommunications in Beijing. Doctorate in Business Administration from Hong Kong Polytechnic University in 2005.

He is currently Chairman of China United Network Communications Group Company Limited ("Unicom Group"), as well as Chair and CEO of China Unicom (Hong Kong) Limited.

He has been General Manager of Hangzhou Telecommunications Bureau in Zhejiang Province and General Manager of Tianjin Posts and Telecommunications Administration. He has also been Chair and CEO of China Mobile (Hong Kong) Limited, Vice-Chair of China Mobile Communications Corporation, Chair and CEO of China Telecom Corporation Limited, Chair of China Telecommunications Corporation and Chair and Non-Executive Director of China Communications Services Corporation Limited.

Executive Committee_

Telefónica's Executive Committee aims to give more visibility to local operators, bringing them closer to centre of decisions, and aims to reinforce cross-departmental interaction to improve flexibility and agility in decision-making. The organisation revolves around a management team whose main focus is the definition of strategy and the monitoring of business development.

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Vision, flexibility and agility are the strong points of our Executive Committee

José María Álvarez-Pallete
Chairman & CEO

Guillermo Ansaldo
Global Resources

Mariano de Beer
Commercial and
Digital Development

Ángel Vilá
Strategy and Finance

Ramiro Sánchez de Lerín
General Secretary
and Board Secretary

José Luis Gómez-Navarro
Corporate Communications
and Institutional Marketing

Carlos López Blanco
Public Affairs and
Regulation

Chema Alonso Cebrián
Chief Data Officer

María García-Legaz
Chairman's Office

Laura Abasolo
Planning, Budgets
and Control

Eduardo Caride
Telefónica LatAm.

Mark Evans
Telefónica UK

Luis Miguel Gilpérez
Telefónica España

Markus Haas
Telefónica Germany

Eduardo Navarro
Telefónica Brazil

4

Responsible business

- Sustainability governance and management
- Managing our stakeholders and reputation
- Materiality analysis
- Identifying and managing risks
- Business ethics and compliance
- Managing the supply chain

Sustainability governance and management_

Our Company vision sees digital life as life, and technology as an essential part of mankind. We want to responsibly create, protect, and boost life's connections. With this objective we promote a responsible business model that generates trusts in our customers, investors, employees, shareholders, and society in general.

This responsible business implies a culture of integrity, commitment, and trust as basic principles. To achieve this, we have our Responsible Business Global Plan, approved and followed by the Board of Director's Regulation and Institutional Affairs Committee.

This Plan establishes our priorities in three areas up to 2020: risk compliance and management, responsible productivity, and sustainability as growth leverage to improve both our business and the world.

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We work to ensure that the communities in which we operate are more *prosperous* and *inclusive*

The Global Responsible Business Plan currently focuses on five lines of work that have their own objectives and challenges:

1 **Client Promise and Digital Trust**

2 **Responsible Management of the Supply Chain**

3 **Talent and Diversity**

4 **Environmental Strategy**

5 **Sustainable Innovation**

This work path takes concrete form in different local plans in the countries where we are present. Thus, in 2016, in addition to the Global Responsible Business Plan, the plans for Germany, Argentina, Brazil, Chile, Colombia, Ecuador, Spain, Mexico, and Peru were also approved.

In this way, our sustainability strategy is based on the responsible management of our business, not only focused on managing certain risks, but also on seizing opportunities, efficiency, and sustainable growth. This allows us to contribute to the social and economic development of society, allowing the communities in which we operate to be more prosperous and to have better and more inclusive drivers of progress. Thus, we link the responsible business objectives with the development and management of the business, incorporating them into our processes and goals so that they become part of our essence as a Company.

GLOBAL RESPONSIBLE BUSINESS PLAN

Growth
Take advantage of market trends

Productivity
Increase efficiency and productivity through more rigorous standards

Compliance
Avoid regulatory risks and comply with established standards

Client Promise and Digital Trust

Sustainable Innovation

Responsible Management of the Supply Chain

Environmental Strategy

Talent and Diversity

Integrity, Transparency, and Commitment

ACTION MODEL

Growth:
We place value in the social and environmental benefits of the products and services we offer to our customers, companies, and individuals. In addition, we work to make the digital environment increasingly open and secure so that the opportunities of technology are within everybody's reach, promoting its geographical, social, and personal accessibility.

Productivity:
We strive to improve our productivity by transversally incorporating sustainability criteria to all our processes. In addition to the quality and service offer to customers, we seek efficiencies and value through a long-term commitment to talent management, energy efficiency and environmental issues, the supply chain or taxation and, in general, a culture of ethics and integrity which pervades all our actions.

Compliance:
We guarantee compliance with our international, national, and local regulatory framework, coordinating it at a corporate level in order to anticipate legislative trends or changes, in a setting in which the economic, social and environmental areas are being increasingly targeted by regulation.

To achieve all of this, we base ourselves on an action model structured over three levels of commitment that cover our entire value chain.

In 2016 we also created a Sustainability Advisory Panel that allows us to periodically interact with our main stakeholders, discover what the most important issues are, create a map of aspects stemming from the impact of our activity that need to be controlled, and integrate them into our Global Responsible Business Plan.

All of this contributes towards a greater impact on the United Nations Sustainable Development Goals. As a company in the telecommunications industry, our business has a clear impact on Goal 9 (industry, innovation, and infrastructures), even though our responsible business strategy and the projects aimed at boosting sustainability allow us to have an impact on the other 16 goals, albeit with a more direct impact in those related to economic growth, education, climate action, the development of sustainable societies, and strategic alliances.

SUSTAINABLE DEVELOPMENT GOALS

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
We have recorded more than 350 million accesses and invest more than 6.5 billion euros in R&D&I

4 QUALITY EDUCATION
Number 3 worldwide in investment in education, with **67 million** euros

11 SUSTAINABLE CITIES AND COMMUNITIES
A 30% reduction of public lighting through Smart-Light solutions

1 NO POVERTY

7 AFFORDABLE AND CLEAN ENERGY

8 DECENT WORK AND ECONOMIC GROWTH
1,278,194 direct, indirect, and induced jobs

17 PARTNERSHIPS FOR THE GOALS
National and international agreements

13 CLIMATE ACTION
Emissions avoided through energy efficiency: **41,114 tCO$_2$eq**

10 REDUCED INEQUALITIES

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

5 GENDER EQUALITY

16 PEACE, JUSTICE AND STRONG INSTITUTIONS

The strategy and implementation of the concept of Responsible Business in our Company is acknowledged by the most prestigious sustainability indices and analysts worldwide, such as the Dow Jones Sustainability Index (DJSI), Carbon Disclosure Project (CDP), Sustainalytics, Ethibel, MSCI, and FTSE4Good.

In addition, we also have the GOLD level of recognition for the assessment of our performance in matters of sustainability, awarded by EcoVadis, a collaborative platform which allows companies to measure their own performance in this area, as well as that of their suppliers.

HOW WE GOVERN SUSTAINABILITY

The highest body responsible for sustainability in our Company is the Board of Directors. On the one hand, the Regulation and Institutional Affairs Committee is in charge of approving and monitoring the Global Responsible Business Plan and, on the other, the risks are reported to the Audit and Control Committee. Both Committees meet regularly on a bi-monthly basis.

At an executive level, the Global Corporate Ethics and Responsible Business Directorate is responsible for proposing and coordinating the

sustainability strategy, reporting directly to the Public Affairs and Regulation General Directorate.

In addition, the Responsible Business Office is the transversal body responsible for the implementation of the Global Plan in all the Company's activities. This Office is replicated in each of the countries, in practically all of our operations, and is made up of the areas of Human Resources, Internal Audit, General Secretariat, Chief Commercial Development Officer, Purchasing, Operations, Communications, Marketing, and the Global Corporate Ethics and Responsible Business Directorate.

We also have specific organisational units for the purpose of maintaining integrity and transparency in the management of our risks:

▸ Internal audit units in all the countries in which we maintain significant interests.

▸ An inspection unit specialising in fraud prevention work and the investigation of complaints.

▸ A payments intervention unit in the most important companies.

▸ Global management and local sustainability units.

▸ A corporate risk management unit which centralises and reports the risk information received from the local risk management areas implemented in the main operators.

▸ Responsible Business Offices in each country.

▸ A global Compliance unit, created in 2016, that reports directly to the Board of Directors, and which has the goal of reinforcing and promoting ethical culture throughout the Company.

Managing our stakeholders and reputation_

Trust is an increasingly significant value in our society, taking on more importance in the face of the current challenges in which we find ourselves immersed, in both the social and environmental arenas, as well as in the economic.

Currently, the level of trust in institutions (companies, media, government and NGOs) has deteriorated. Within this generalised loss of trust, the more than 15-point difference between the trust of the informed public and the general population particularly stands out.

We understand that this is a challenge, but it is also an opportunity to strengthen the connection with our stakeholders. Particularly keeping in mind the current context, in which society demands that companies play a role that goes beyond mere economic development.

The keys to rebuilding trust are based on understanding and dealing with our stakeholders' expectations: being alert to trends and establishing alliances that facilitate the implementation of measures that jointly generate benefit and improve the economic and social conditions of the communities in which we operate.

Therefore, in 2016 we established a Responsible Business Advisory Panel, which helps us to align sustainability and business, in addition to facilitating the connection and collaboration with our main stakeholders.

THE TRUST IN INSTITUTIONS IS DETERIORATING
Percentage of trust
(According to the Edelman Trust Barometer)

▶ 2016
▶ 2017

	Government	Media	Businesses	NGOs
2016	42	48	53	55
2017	41	43	52	53
	-1	-5	-1	-1

TRUST
PROACTIVITY
COMMITMENT

COLLABORATION
(collective impact)

Integration/
Responsible business

COMMITMENT
(proactive)

CONSULTATION
(accessible, reactive)

Compliance/
Responsibility

COMMUNICATION
(one-directional, reactive)

—
Society demands that we, *as a company,* play a role that goes beyond mere *economic development*

17 PARTNERSHIPS FOR THE GOALS

In this first year, we've focused our energy on selecting the organisations to comprise the panel, its chairman and the materials to be discussed. The graphics detail the Panel's roadmap in its very first year, and identify the most significant issues.

More than *200 interviews* allowed us to identify *7 significant issues*

IDENTIFICATION OF 7 SIGNIFICANT ISSUES

25 internal interviews (Corp and OBs)

190 external interviews

>300 stakeholders identified (Phase 1)

>600 stakeholders identified (Final Phase 2)

THE ROUTE TO A SOLID, HOMOGENEOUS AND INNOVATIVE PROCESS

Oct. 15 - Mar. 16

Identification of relevant Stakeholders

Internal interviews with more than **25** local and global representatives

Identification of **7 key issues** and more than 800 local and global stakeholders

Jun. 16

Constitution of the Panel

On 2 levels:

▶ Advisory panel(*), detailed debate, formed by 16 different organisations

▶ Extended panel: Sustainability Pulse, bi-annual surveys, over 170 interviews

Jun. 16 - Mar. 17

Evaluated issues (1st year)

Bi-annual meetings of the **Advisory panel**(*):

▶ Materiality matrix

▶ Ethical and responsible behaviour

▶ Placing customers at the centre

▶ Sustainable Innovation

Mar. 17

Materiality Analysis

Definition and **standardisation** of the process:

▶ Update of the materiality matrix based on **direct input from the stakeholders**

▶ Incorporation of the **input into the business strategy**

(*) Global and main market focus: Germany, Spain, Brazil, Mexico and Chile.

Ethical Behaviour

Digital Trust

Sustainable Innovation

Supply Chain

Customer

Environment and Climate Change

Diversity

The Panel is structured over two levels. The first provides us with the analysis of significant issues.

RESPONSIBLE BUSINESS ADVISORY PANEL

▶ Platform for structured dialogue.

▶ Formed by experts from 16 organisations with a global focus and from the major markets (Spain, Germany, Brazil, Mexico and Chile).

▶ Quarterly meetings.

▶ One critical issue debated per meeting, with detailed feedback.

▶ The area in charge of managing the issue on debate. It presents Telefónica's strategy and answers the panelists' questions.

In its first year, the panel's permanent members came from:

Customers

Santander

Suppliers

ATENTO:

ERICSSON

Investors

Allianz

EUROPEAN WOMEN SHAREHOLDERS DEMAND GENDER EQUALITY

Corporate Sustainability Index ISE 2015

NGOs

Cemefi
CENTRO MEXICANO PARA LA FILANTROPÍA

CEDHA

Industry organisations

GSMA

ASIET

Multi-industry organisations

FUNDACIÓN país digital

GLOBAL PARTNERSHIP FOR SUSTAINABLE DEVELOPMENT DATA

Professional services

KREAB

systain

eRevalue

Best Practices

TATA CONSULTANCY SERVICES

FIRST YEAR ASSESSMENT

"In these times of rapid and intense change in technology and customer relations, investing in a structured dialogue with stakeholders becomes more important than ever. Congratulations! The initiative is excellent! This is a good first step, but we have to continue working. We're now faced with the challenge of strengthening the panel with committed and active experts that feel like a team. Telefónica's involvement is key to achieving the maximum benefit".

Chairman of the Panel
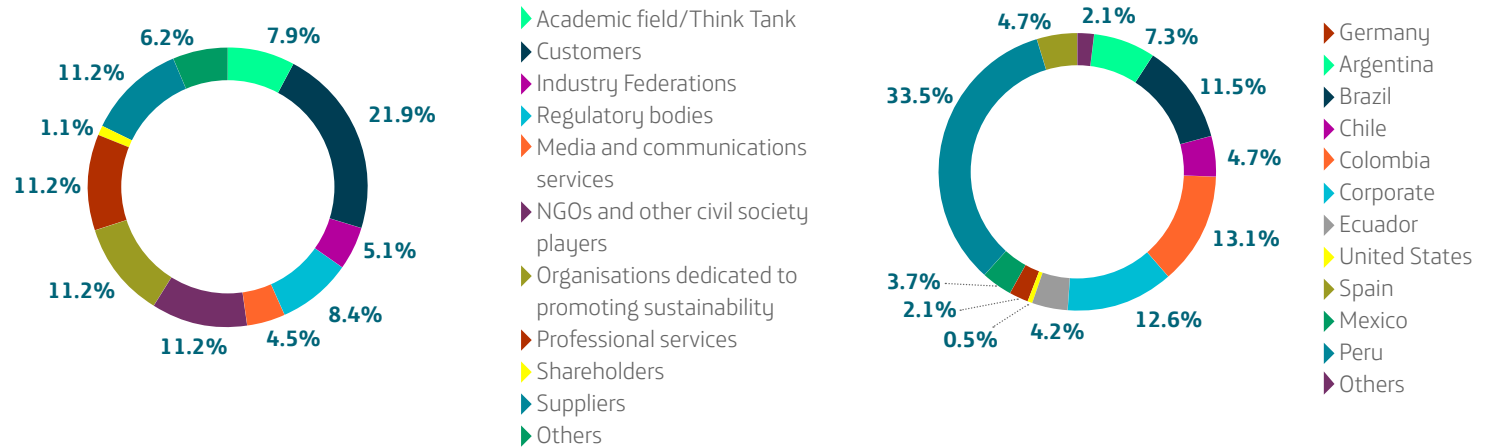
ERNST LIGTERINGEN

Cooperability

The following level allows us to identify the significant issues, while also covering our entire geographic footprint.

EXTENDED PANEL

▸ Platform for measuring the perception and identification of trends.

▸ Variable pull from stakeholders. Local and global focus. In 2016 it was comprised of more than 170 organisations representing the countries where we have a presence.(*)

▸ Bi-annual online consultations, which go deeper into the issues identified by the Advisory Panel.

▸ Getting the "Telefónica Stakeholder Pulse".

▸ Input for the Advisory Panel, for the areas of internal management and for development of the materiality matrix (local and global).

(*) With the exception of the United Kingdom, Central America and Uruguay.

The composition of the Extended Panel in 2016 was:

- Academic field/Think Tank
- Customers
- Industry Federations
- Regulatory bodies
- Media and communications services
- NGOs and other civil society players
- Organisations dedicated to promoting sustainability
- Professional services
- Shareholders
- Suppliers
- Others

- Germany
- Argentina
- Brazil
- Chile
- Colombia
- Corporate
- Ecuador
- United States
- Spain
- Mexico
- Peru
- Others

MAIN FINDINGS FROM THE EXTENDED PANEL

▸ The informed stakeholders perceive our reputation considerably better than society as a whole. There is a great deal of variability in the comparison between different profiles within this group of stakeholders.

The graphic displays the reputation levels measured by the Extended Panel according to the nature of the participating organisations.

▸ The perception the Extended Panel members have of our performance in matters of sustainability is similar to the reputation level: 6.3 points over 10.

▸ The key aspects that these stakeholders consider most relevant to the ICT sector, both now and in the near future, is customer centred management and ethical and responsible behaviour.

▸ Management of the supply chain is where the least evolution is perceived.

▸ In addition to the evaluated issues, two new categories suggested by experts have been identified: the need for internal and external alignment with the Company's purpose and management of the corporate reputation in general.

In this sense, we must acknowledge the importance of alignment between our daily activities and our purpose, as well as the need for management of reputational assets. We have been working on both aspects for a while, as described in this Report.

The evaluation has served to reinforce the Groups' materiality matrix, as well as the initiatives that comprise our Global Responsible Business Plan.

Customers | NGOs and other civil society players | Organisations dedicated to promoting sustainability | Professional services | Suppliers

ALIGNMENT WITH TELEFÓNICA'S PURPOSE

We are aware of the importance of a corporate purpose; it helps us channel our contribution to the communities where we operate, making us feel a part of something bigger, and facilitating the creation of alliances.

We are working on this alignment both internally (with employees on the 'why' of the Company) and externally (with customers and society to improve and demonstrate the positive impact of our activity and our fundamental purpose). It was as a result of this work that, in 2015, we launched the "Elige Todo" (Choose it all) programme, which we have continued throughout 2016.

—

This panel complements *the engagement activity* that we undertake at a local, regional, national and international level

OTHER DIALOGUE CHANNELS

CUSTOMERS

Methodology: Through the local level dialogue channels, which we establish at the moment of sale via our customer services, the satisfaction monitoring and the Customer Defence Service (CDS), as well as through the marketing plans, market studies, discussion forums and meeting areas, we can understand the consumer experience, needs and expectations of our products and services.

Examples of engagement and interaction with customers:

▸ For residential customers we have customer service channels in each of our geographical areas, with the Movistar Community; in addition to our Twitter profiles (Telefónica on Twitter, Movistar on Twitter, among others).

▸ In the field of large corporate and multinational customers, in addition to our Business Solutions division, we should highlight the TBS (Telefónica Business Solutions) Quality Week, the Telefónica Leadership Conference and other events such as the International Telecoms Week.

SHAREHOLDERS

Methodology: We organise and attend both individual and collective continuous meetings with institutional investors and industry analysts. Moreover, as a result of the online channels we can understand the issues which are most relevant to the investment community, including SRI (Socially Responsible Investment) Institutions and/or specific projects for responsible investment, and signatories of the Responsible Investment Principles.

Examples of engagement and interaction: Telefónica Shareholders and Investors, Forums and events for Shareholders and Investors, European Sustainable Investment Forum (Eurosif), Societé Generale, RobecoSam, Integrated Reporting.

SUPPLIERS

Methodology: The Purchasing area maintains ongoing dialogue with our main suppliers, promoting the search for joint solutions in partnership with each of the internal areas which demand the product and/or service. The involvement of the suppliers is key, especially in processes where contact with our customers is performed directly by our suppliers. One example of this is the case of technical and commercial services, about 80% of which is provided by suppliers in many countries.

Examples of engagement and interaction:

▸ The Aliados Programme, implemented in our main operations in Latin America.

▸ Meetings with some of our main suppliers at a global level to share our strategies on sustainability issues and to exchange best practices.

▸ Energy and Climate Change Workshops organised annually by Telefónica and attended by some of our main suppliers.

INDUSTRY ORGANISATIONS

Methodology: We actively participate in forums and associations which discuss the various issues affecting our sector, in order to improve measurements, standardise indicators and share the best experiences.

Examples of engagement and interaction: GSMA, International Telecommunication Union (ITU), ASIET, Global e-Sustainability Initiative, European Internet Forum, Telecommunications Industry Dialogue, ICT Coalition, Internet Governance Forum, Global Reporting Initiative, ASIET and ETNO.

EMPLOYEES

Methodology: We promote the use of the internal network 'Yammer', both as a communication and an inquiry and productivity tool. The platform has 98,681 members (some 7,500 users more than last year) and more than 500 active communities on average per month on the Company network.

This network has been a key tool for facilitating dialogue and debate prior to the launch of the new Company programme. The presentation event was followed live via streaming by more than 40,000 employees.

Best practices:
▸ During 2016, we launched an Intranet with the description of the Company programme 'Elige Todo', which received a total of 738,368 visits.

▸ We sent out weekly global newsletters, which describe the Company's current status, as well as topics related to our strategic programme.

▸ Más allá del Power Point (Onlife TV) (Beyond Power Point): was a series of explanatory videos about our Company programme. Each season (we currently have 4) is focused on different strategic lines. During 2016 it received 280,000 views.

INTERNATIONAL ORGANISATIONS

Methodology: The dialogue is mainly structured by geographical area, grouping together the different interlocutors by their fields of action (local, regional, national and global). Within each field of action we maintain fluent dialogue with those responsible for telecommunications, innovation, consumer, educational, social, regulatory and economic services, etc.

Examples of engagement and interaction: World Economic Forum, International Labour Organization, World Health Organisation, United Nations Development Programme, Global Compact, Carbon Disclosure Project and Centre for Information Policy Leadership.

NON-GOVERNMENTAL ORGANISATIONS

Methodology: We encourage continuous dialogue with the various NGOs, mainly at a local level, through forums and other events, in order to respond to the needs of the communities in which we operate.

Best practices: In the case of Spain, we collaborate with more than 25 NGOs, by means of the Premium messaging service, delivering to the NGO 100% of what customers give in the solidarity SMS.
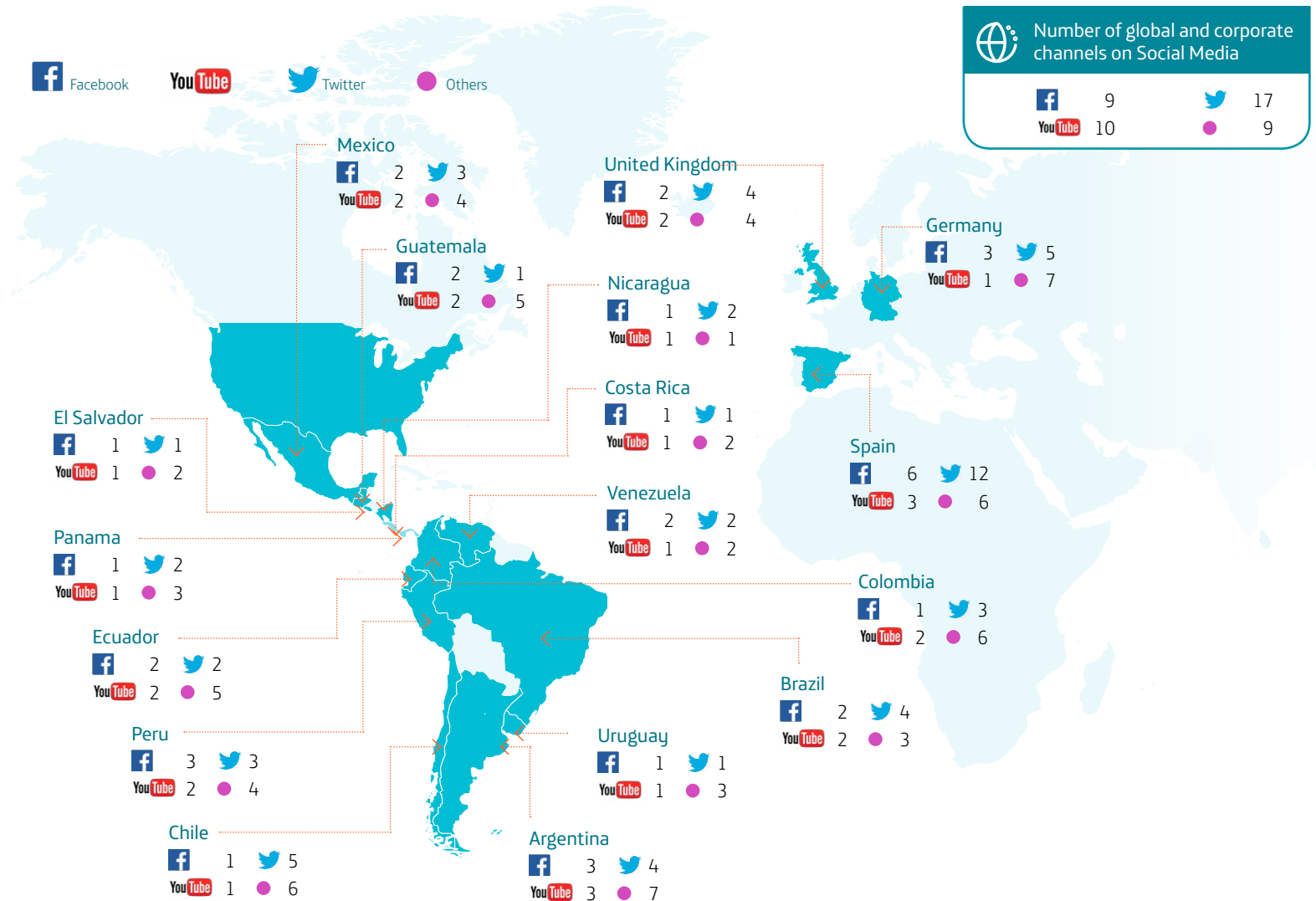
Examples of engagement and interaction: Fundación ONCE - ILUNION, Red Cross, UNICEF, Oxfam Intermón, International Plan, ACNUR, Spanish Committee of Representatives of People with Disabilities (CERMI), National Centre of Accessibility Technologies (CENTAC).

TELEFÓNICA CHANNELS ON THE SOCIAL NETWORKS

Keeping our stakeholders informed and interacting with them is key to our management process. Therefore, throughout 2016 we continued working on the integration of our corporate website, www.telefonica.com, which received 11,974,407 visits. In this sense, we also worked on simplifying channels on social networks and blogs, using the Think Big Blog as a reference guide, in order to better address customer concerns and the latest technology trends.

Facebook   **You Tube**   **Twitter**   **Others**

Number of global and corporate channels on Social Media

Facebook	9	Twitter	17
You Tube	10	Others	9

Mexico
Facebook 2   Twitter 3
You Tube 2   Others 4

United Kingdom
Facebook 2   Twitter 4
You Tube 2   Others 4

Germany
Facebook 3   Twitter 5
You Tube 1   Others 7

Guatemala
Facebook 2   Twitter 1
You Tube 2   Others 5

Nicaragua
Facebook 1   Twitter 2
You Tube 1   Others 1

El Salvador
Facebook 1   Twitter 1
You Tube 1   Others 2

Costa Rica
Facebook 1   Twitter 1
You Tube 1   Others 2

Spain
Facebook 6   Twitter 12
You Tube 3   Others 6

Panama
Facebook 1   Twitter 2
You Tube 1   Others 3

Venezuela
Facebook 2   Twitter 2
You Tube 1   Others 2

Colombia
Facebook 1   Twitter 3
You Tube 2   Others 6

Ecuador
Facebook 2   Twitter 2
You Tube 2   Others 5

Brazil
Facebook 2   Twitter 4
You Tube 2   Others 3

Peru
Facebook 3   Twitter 3
You Tube 2   Others 4

Uruguay
Facebook 1   Twitter 1
You Tube 1   Others 3

Chile
Facebook 1   Twitter 5
You Tube 1   Others 6

Argentina
Facebook 3   Twitter 4
You Tube 3   Others 7

MANAGING AND MEASURING REPUTATION

Reputation is a key asset that forms part of our Control Panel that the Board and Executive Commission follow on a quarterly basis. We understand reputation to be the judgement that our stakeholders make of us, our activity and actions as a whole.

Given the relevance of reputation and its impact on our business, since 2005 we've measured reputation among the General Public through the RepTrak model, developed by the Reputation Institute.

The model measures the emotional appeal of the Company, by means of the RepTrak Pulse indicator, which is built upon the basis of the values of esteem, admiration, trust and impression generated.

Reputation does not reside with the Company, but with each stakeholder, which is why we have gradually incorporated different groups of stakeholders into the reputation measurement model and, in addition to the General Public, which formed the initial model, the model now includes employees, suppliers and the informed public. This last group was incorporate in 2016 through queries to the Extended Panel.
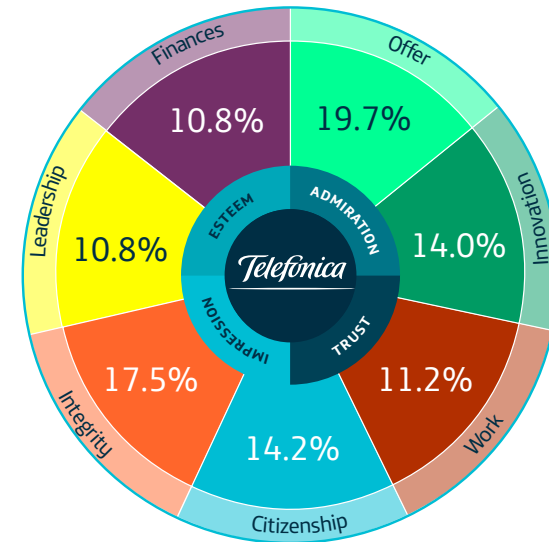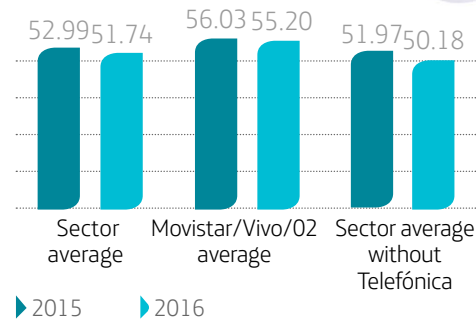
General Public Reputation

The reputation of the sector in the countries where we operate remains stable; with the observation of a statistically insignificant year-on-year fall of about 1 point.
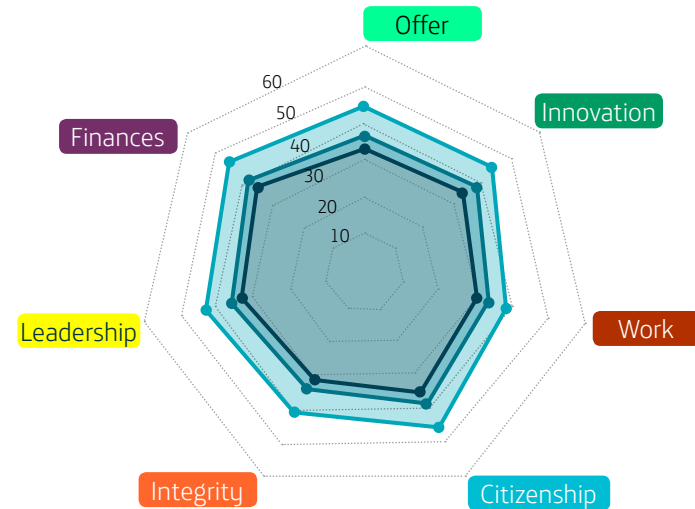
To search for levers to understand and trigger activate these movements, the RepTrak Pulse performs a more rational evaluation of the Company's performance by means of the RepTrak Index indicator. The rational indicator, in the case of General Public, is built upon seven dimensions: Offer, Work, Integrity, Leadership, Innovation, Citizenship and Finance. The weight of each dimension is adjusted annually, and it is worth highlighting that the weight that the Integrity dimension achieved in 2016, according to the model of weights, accounts for 17.5% of the sector's reputation, and is only surpassed by the Offer dimension, which includes commercialisation, provision and after-sales. Evolution of the sector and of our commercials brands is:

GENERAL PUBLIC REPUTATION

Sector average	Movistar/Vivo/O2 average	Sector average without Telefónica
52.99 / 51.74	56.03 / 55.20	51.97 / 50.18

▶ 2015   ▶ 2016

Integrity accounts for *17.5% of the reputation* of our sector

— Sector average   — Movistar/Vivo/O2 average   — Sector average without Telefónica

Reputation among our employees

Our employees place an important role in building our reputation, since they are both active agents for it and because they act as ambassadors with an ever-growing credibility for society in general.

Since 2013, we've measured the reputation Telefónica has among our employees in the 17 countries where we have a presence. Among the aspects evaluated were: ethical behaviour, motivation, professional development and work environment. Ethical behaviour is the dimension that carries the most weight when building a reputation among employees.

REPUTATION OF TELEFÓNICA AMONG ITS EMPLOYEES

2013	2014	2015	2016
79.7	80.4	83.3	84
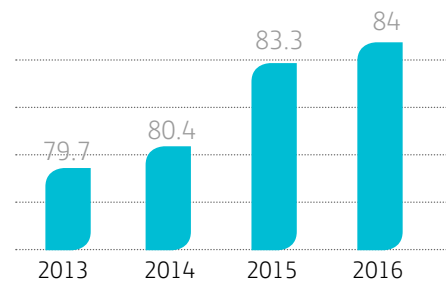
On a global level, our reputation's trend toward improvement continues, reaching levels that approach excellence, having gained more than 4 points in comparison to 2013.

Reputation among our suppliers

As our employees, suppliers are key to building the Company's reputation, particularly in a sector where a high percentage of direct contact with our customers is performed by our partner suppliers.

Sure of this, in 2013 we started measuring our reputation among this group of stakeholders, performing the measurments alongside the twice-yearly satisfaction survey for suppliers.

On a global level, our reputation continues to improve. Since 2014, we have observed a 7-point improvement, reaching a score that approaches excellence.

REPUTATION OF TELEFÓNICA AMONG ITS SUPPLIERS

2013	2014	2016
75.9	77.4	84.4
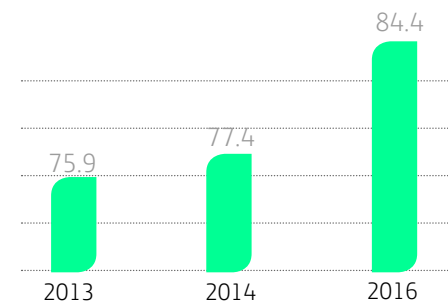
The aspects that most influence construction of our reputation among this group of stakeholders are Leadership and Sustainability.

In Leadership, we find the two attributes that most help with reputation building and are most valued: "Telefónica is solvent and has growth potential" and "Telefónica is a cutting-edge company that leads its sector".

Identified areas for improvement were: complying with acquired commitments and coordinating the departments involved in the purchasing process.

Since 2014, our reputation among suppliers has improved by 7 points, reaching a score that is close to *excellence*

SOME OF THE ASSOCIATIONS WITH WHICH TELEFÓNICA PARTICIPATES

An institution that issues generally accepted accounting principles and standards, and studies of best business practices.

AENOR, a Spanish organisation, conducts normalisation and certification (N+C) activities to improve quality in businesses and the well-being of society.

The Spanish Association for Investor Relations has the purpose of promoting relations with investors in publicly listed companies.

An association comprised of the main telecommunications operators in Latin America.

The Telephone Association for Assistance for the Disabled (ATAM) has as its main purpose the support of preventive actions to disabled people and social integration of people with disabilities.

The purpose of the National Centre of Accessibility Technologies (CENTAC) is to promote accessibility to Information Society Technologies in Spain.

The CEOE is the institution that represents Spanish entrepreneurs.

The Spanish Committee of Representatives of People with Disabilities (CERMI) is a platform that represents people with disabilities in Spain.

The European Commission is the institution which embodies the executive branch of Community power.

CAF is a development bank made up of 19 countries and 14 private banks in the region.

The National Confederation of Deaf People (Spanish acronym: CNSE) defends the interests of people with hearing disabilities and their families.

A significant group of leading Spanish companies, Corporate Excellence aspires to become a technical benchmark.

EcoVadis aims to improve the environmental and social practices of companies.

ERT is an informal forum which brings together up to 50 managing directors and chairmen of major multinational companies with European affiliation.

ETNO is an association which encompasses the major European operators.

ETSI, the European Telecommunications Standards Institute.

The Global Apprenticeship Network (GLN) is a business partnership driven with the overall objective of promoting and linking entrepreneurial initiatives to skills and employment opportunities for young people.

The Global e-Sustainability Initiative (GeSI), a source of information on resources and best practices for achieving integrated social and environmental sustainability through Information Technology companies.

The The United Nations Global Compact is an international initiative which promotes the implementation of ten universally accepted principles in the areas of Human Rights, Labour Standards, the Environment and the Fight against Corruption.

The Global Network Initiative (GNI) is a non-governmental organisation for Internet censorship by authoritarian governments and the protection of privacy on the Internet and the rights of individuals.

Global Reporting Initiative (GRI) is an organisation which aims to promote the development of sustainability reports in all types of organisations.

An association whose purpose is to deal with environmental challenges by means of public-private collaboration.

The GSMA represents the interests of mobile operators worldwide.

The ICT Coalition works to develop services that deal with the challenges of child online safety.

IDB supports efforts in Latin America and the Caribbean to reduce poverty and inequality.

An NGO that locates and reports images of sexual abuse of minors around the world.

The ITU (International Telecommunications Union) is a body of the United Nations specialising in Information and Communications Technology (ICT).

The aim of the OECD is to promote policies which improve the economic and social well-being of people around the world.

An organisation devoted to the social and labour inclusion of people with disabilities.

The United Nations is an international organisation founded by 51 countries committed to maintaining international peace and security and promoting social progress, better living standards and Human Rights.

The Peruvian Network against Child Pornography (Spanish acronym: RCPI) was established to fight the sexual exploitation of children.

An organism that promotes collaboration between public and private entities to promote the short and long-term well-being of people with disabilities.

Spainsif is a not-for-profit association comprised of different types of entities interested in promoting sustainable economic activity.

An organisation that brings together operators to promote freedom of expression and respect for privacy in the telecommunications sector.

The World Bank is a vital source of financial and technical assistance for developing countries around the world.

UN agency that works to defend children's rights.

The World Economic Forum is an international institution dedicated to improving the situation around the world by means of public-private cooperation.

Materiality analysis_

We regard materiality as those issues which could have a present or future impact on our revenue, profitability, the effectiveness of our invested capital, our competitive position, risk profile, or any other aspect which may determine the Company's ability to create long-term value for our stakeholders.

For this reason, each year we perform a materiality analysis process, applying the same methodology in all the countries in which we operate. This process helps us to determine the relationship between the most significant aspects of the Company's strategic management and those which are given greater relevance in the evaluations and decisions of the corporate and local stakeholders.

For the analysis we follow the indications of version G4 of the GRI Guide and, in order to increase the comparability and completeness of the matters under study, we begin with the materiality analysis conducted by the Global e-Sustainability Initiative (GeSI) for the whole value chain of the ICT hypersector in November 2014. This materiality analysis concluded with the pre-selection of 55 potentially material issues, which are grouped around 8 categories: digital inclusion, employees, climate change, supply chain, customers, privacy, governance and impact on communities.

These issues have subsequently been brought to the stakeholder panels - see the section titled "Stakeholder management and reputation" - in order to address these trends and to measure perception of our performance in relation thereto. This is done with a view to updating the Company's materiality matrix, so as to perform a follow-up on our material issues. Interaction with the stakeholders on this extended panel occurs on a half-yearly basis.

The most significant aspects, and those which, therefore, define our Responsible Business Plan are the following:

Customer promise and digital trust (service quality, privacy, cybersecurity).

Integrity, transparency and commitment (ethical business practices, transparency, public affairs).

Environmental strategy (energy consumption, services, emissions, waste).

Talent and diversity (diversity, non-discrimination, talent development and retention).

Sustainable innovation (digital inclusion per user, social innovation, safety solutions and natural disasters).

Management of the supply chain (environmental and social standards in our suppliers).

In the environment section we also present a materiality matrix which is specific to our environmental issues.
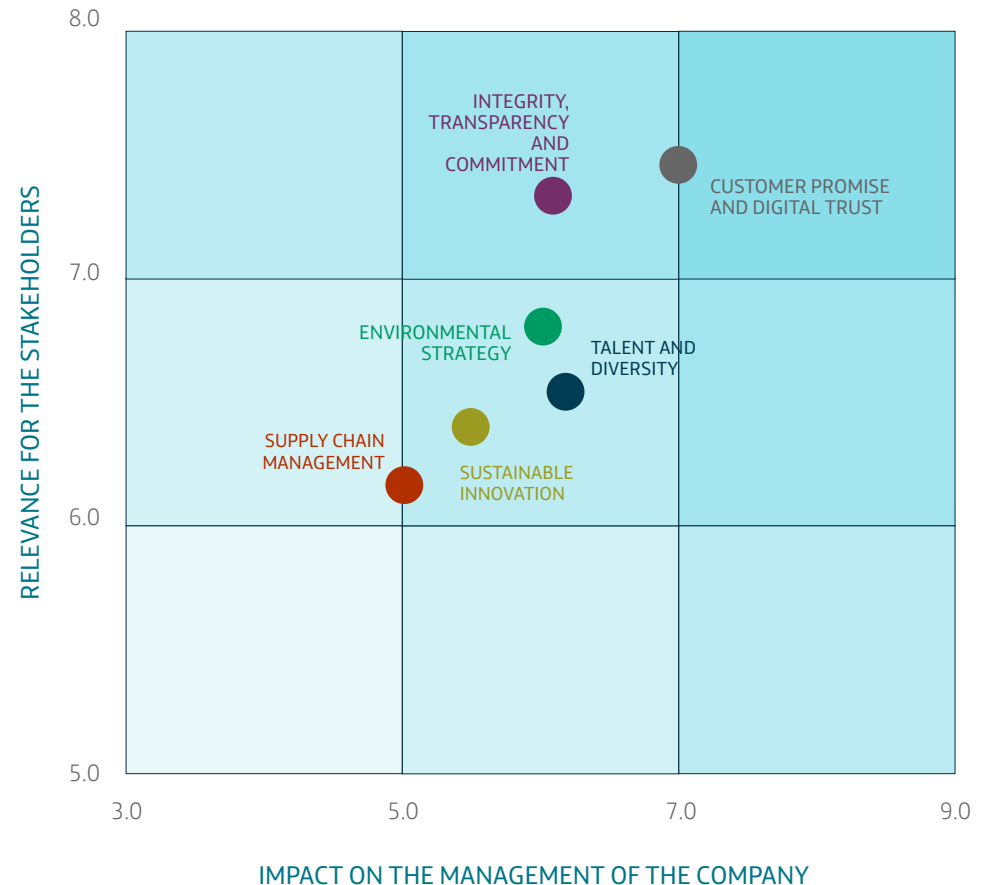
Identifying and managing risks_

Risks are inherent to all businesses and entrepreneurial activities. Their identification, as well as their effective assurance, contribute to achieving our business objectives and strengthening the organisation's commitment to its shareholders, customers, and other stakeholders.

We have a model that has been implemented homogeneously throughout the Group's main operations so that the Company Risk Officers, within their scope of action, can perform a timely identification, assessment, response and monitoring of the main risks.

Through the Integrated Model for risk assurance and management, inspired by best practices, the prioritisation and development

of coordinated initiatives to combat risks, both from the Group's global perspective and from the standpoint of its main operations, is facilitated.

RISK MANAGEMENT MODEL

We perform permanent monitoring of the most significant risks that may affect the main companies that make up the Group. For this the Company has a Risk Management Model which draws from what is established in methodological benchmarks, such as "Enterprise Risk Management - Integrated Framework" issued by the COSO ("Committee of Sponsoring Organizations" of the Treadway Commission), and the ISO 31000 "Risk Management - Principles and Guidelines" standard, among others.

Four categories of risk are considered:

▶ **Business:** potential losses of value or results stemming from changes in the business environment, the situation of the competition and the market, changes in the regulatory or competitive framework, or strategic uncertainty.

▶ **Operational:** potential losses of value or results stemming from events caused by inadequacies or failures originating in customer service, the processes, human resources, the hardware and computer systems, the security, the fulfilment of contracts, laws and standards, or any others stemming from external factors.

▶ **Financial:** potential losses of value or results stemming from adverse movements of the financial variables and the Company's inability to honour its commitments or liquidate its assets.

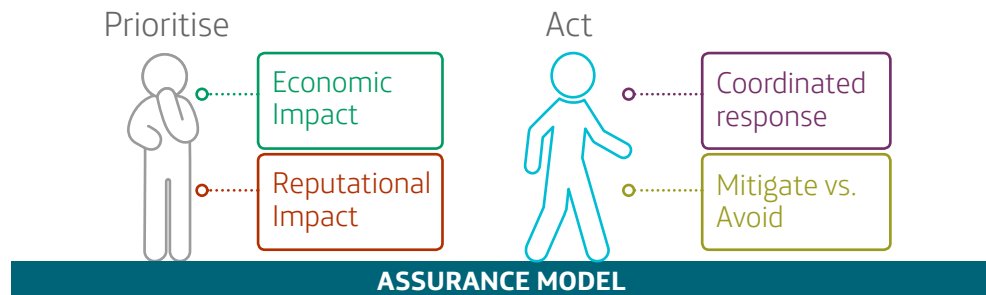Also included in this category are risks of a fiscal nature.

▶ **Global:** potential losses of value or results stemming from events that transversely affect the Telefónica Group, affecting reputation and corporate responsibility, corporate communications, advertising strategy, brand, sponsorships, and innovation.

The Model is adapted to the evolution in the typologies of the main risks, observing an increasing relevance of those related to intangibles, as well as of those with global significance,such as sustainability, public image, or the social impact of organisations.

For implementation of a comprehensive model focused on the needs and configuration of the Group itself, a risk assessment from two complementary perspectives, global (top-down) and local (bottom-up), is considered.

PRIORITISATION AND ACTION IN THE FACE OF RISK

Prioritise — Economic Impact / Reputational Impact

Act — Coordinated response / Mitigate vs. Avoid

ASSURANCE MODEL

EVOLUTION OF THE MAIN RISKS

Financial Operational → Strategic → Global Intangible
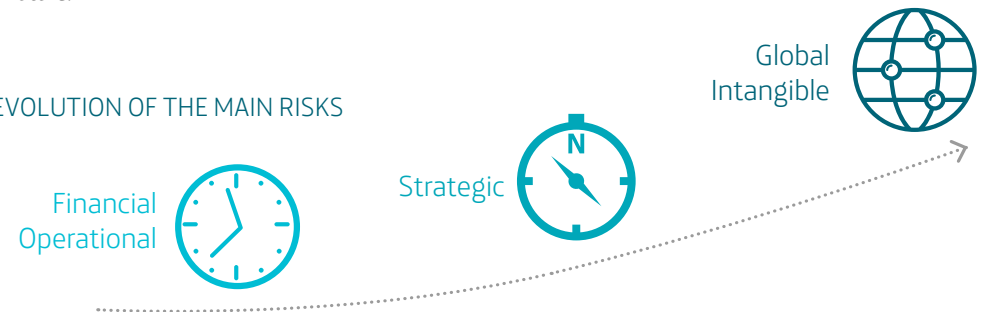
RISK MANAGEMENT GOVERNANCE

Every member of our organisation has the responsibility of contributing to the management of risks. Regarding the coordination of these activities, the Risk Management Policy, which was revised during 2016, establishes the following roles:

Supervision of the risk management system

The Board of Director's Audit and Control Committee oversees the risk management system and proposes the Risk Management and Control Policy to the Board of Directors for analysis and consideration. This policy identifies the risk categories faced by the Company; the definition of the level of acceptable risk; the measures for mitigating the impact of the identified risks; and the control and information systems for controlling and managing the aforementioned risks.

Risk Officers

The Risk Officers actively participate in the risk strategy and in the important decisions regarding its management, preparing a plan for its mitigation, and monitoring its evolution.

Risk management function

This function is independent of management within the Internal Audit area. Its objective is to boost, support, coordinate and verify the application of that established in the Risks Policy, also aiding the Audit and Control Committee with specific issues.
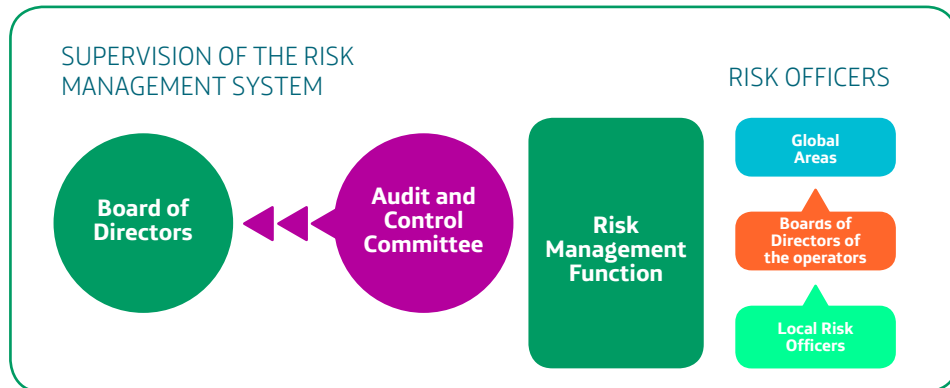
RISK MANAGEMENT PROCESS

The risk management process uses the Company's strategy and objectives as a base reference for the identification of the main risks that may affect said objectives.

The risks are identified and assessed by the Officers for several purposes: to prioritise reporting and monitoring; and, especially, to determine the response to risks, generally through mitigation plans or strategies to avoid or transfer the risks.

Identifying risks

The risks are identified by the Officers, who consider both the factors that cause them and the effects they may have on the achievement of objectives.

We also take into account potential emerging risks that may eventually have a negative impact on future performance; even if their result and temporal horizon is as yet uncertain and difficult to predict, the idea is to anticipate performance in increasingly relevant areas.

Assessing risks

The objective of the risk assessment is to provide an order of magnitude or relevance of said risks, considering both their eventual economic or reputational impact and their likelihood of occurrence.

Qualitative and quantitative factors are considered with regard to the assessment of the risks, through techniques such as: the level of exposure, sensitivity scenarios and analyses regarding specific risks. Furthermore, the reputational impact of the risks are also considered, as well as other additional factors such as the trend or perspectives of the future evolution of said risks.

RISK MANAGEMENT PROCESS

Responding to and monitoring the risk
The Risk Management Model considers identification and assessment of the risks, as well as the establishment of reasonable response and monitoring mechanisms for said risks.

In accordance with the different risk typologies, the response mechanisms to said risks include global initiatives, which are promoted and coordinated homogeneously throughout our main operations, and/ or specific actions aimed at addressing concrete risks in some of the companies.

In matters such as risks of a fiscal nature, a monitoring of the main issues is performed. For specific, operational type risks, Multinational Insurance Programmes, or insurance policies negotiated locally in each country, are available depending on the type of risk and its coverage.

Risk tolerance and acceptable risk
We have a level of risk tolerance or, in other words, acceptable risk, which means that we are willing to assume a certain level of

risk as long as this allows for the creation of value and the development of the business, permitting us to achieve an adequate balance between growth, performance, and risk.

GENERAL OUTLINE OF THE RISK MANAGEMENT MODEL
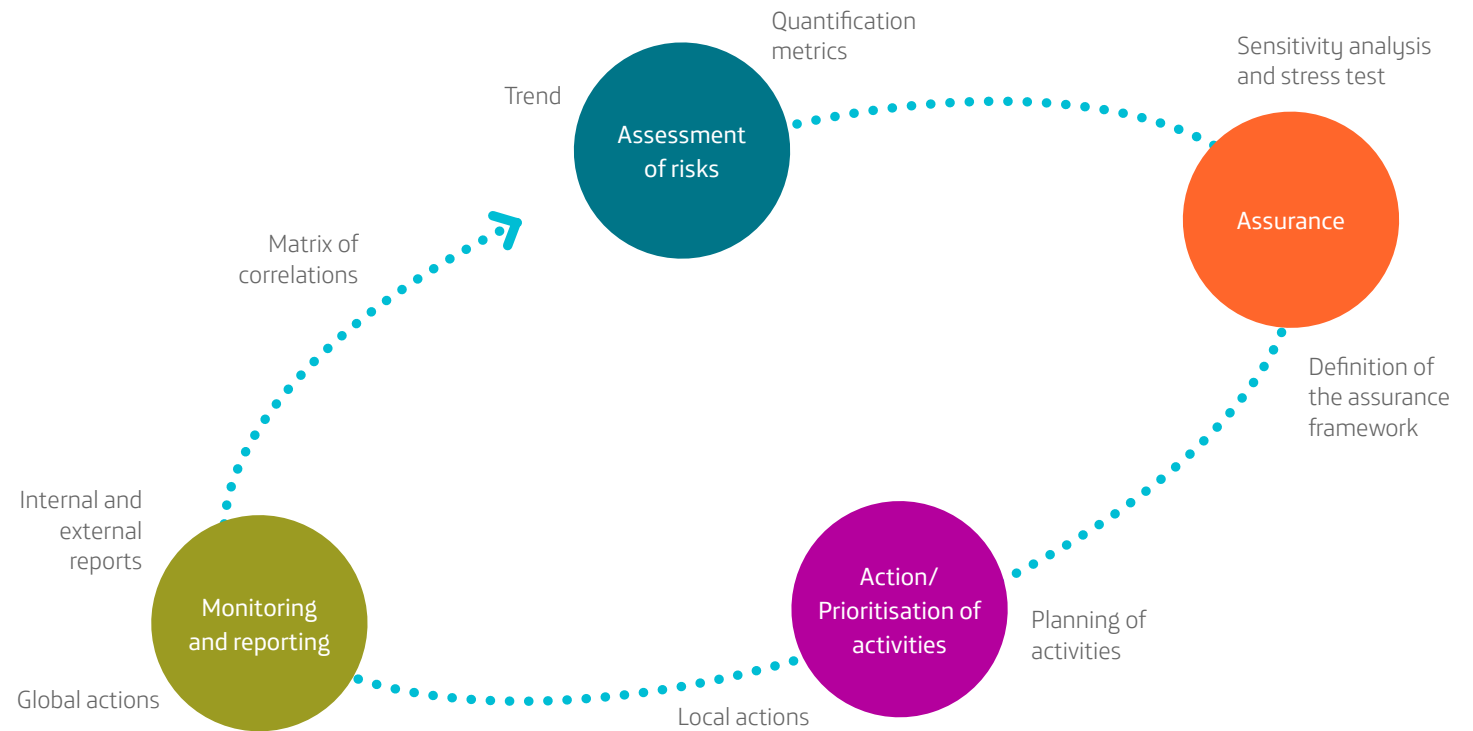
Risks and uncertainties faced by the Company

Our business is conditioned both by factors exclusive to the Group and factors which are common to any company in our sector. The most significant risks and uncertainties that we face (and that may affect the business, financial situation, reputation, corporate image and brand and our results), are presented together with the information contained in the Financial Statements Management Report, the details of which can be found in the Financial Report annex:

▶ Deterioration of the economic or political environment may negatively affect our business.

▶ The results and financial situation of the Group may be affected if we do not effectively manage our exposure to exchange rates of foreign currencies or their interest rates.

▶ Changes in accounting regulations may influence the reported benefits.

▶ We operate in a heavily regulated industry, which requires qualified professionals to authorise the provision of many of its services, as well as the use of the spectrum, which is a scarce and expensive resource.

▶ We are exposed to risks with regard to compliance with legislation against corruption and economic sanction programmes.

▶ The customer perception of the services we offer may be disadvantageous with regard to those offered by competing companies.

▶ We may not adequately anticipate and adapt to the technological changes and trends of the sector.

▶ We rely on a network of suppliers.

▶ Any possible Network failures may lead to a loss of quality or a service interruption.

▶ The telecommunications industry may be affected by the potential effects that the electromagnetic fields emitted by mobile devices and base stations may have on people's health.

▶ Potential changes of a regulatory, business, economic, or political nature may lead to the possible reorganisation of certain assets.

▶ The Telefónica Group's networks transport and store large volumes of confidential, personal and business data, and its Internet access and hosting services may give rise to claims due to the illegal or illicit use of the Internet.

▶ Telefónica and the Group's companies are parties in litigations, claims of a fiscal nature, and other legal proceedings.

Business ethics and compliance_

Ethics management is built from our Responsible Business Principles, which reflect our ethical and responsible performance commitments with our different stakeholders.

HOW DO WE RELATE WITH OUR STAKEHOLDERS?

Both our employees, through an internal complaint channel, and our stakeholders, through an external channel, have the possibility of reporting, anonymously or in person, matters related to compliance with the Responsible Business Principles, as well as matters related to any other internal or external regulation to which Telefónica is subject.

MANAGEMENT FOCUS

WHY IS IT A KEY ISSUE?

Because it reflects the type of Company we want to be. Our business principles help us to build and maintain long-term relationships with our stakeholders, and they directly affect our professionalism and productivity. In addition, they allow us to establish long-lasting business relationships with partners who have similar principles, with the shared goal of contributing to making the world a better place to live.

WHERE IS THE IMPACT?

Ethical and responsible management has an impact on the trust of our clients and employees, on the commitments we have and make as a Company, on the environment, security, privacy, freedom of expression and the societies where we operate, through responsible communications and an internal control.

TELEFÓNICA'S OBJECTIVE

Our objective for 2017 is to approve an updated version of our Responsible Business Principles, adapting them to the Company's current realities and strategy.

Indicators	2015	2016
% of employees who have taken the Responsible Business Principles training course	86%	90.2%
Communications received	822	1,152
Investigations closed	464	1,090

SUSTAINABLE DEVELOPMENT OBJECTIVES

8 DECENT WORK AND ECONOMIC GROWTH

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

17 PARTNERSHIPS FOR THE GOALS

OUR CHALLENGE

2016 was a key year for us in the matter of business ethics. We created a new independent Compliance area with the goal of reinforcing and promoting the ethical culture throughout the Group, and from the highest level.

Dependent on the Board of Directors and reporting directly to the Audit and Control Committee, the Compliance area (governed by its own regulations) seeks to unify, reinforce, and homogenise, at both local and global level, all the internal controls that had been developed in our Corporate Ethics and Sustainability, Internal Audit, and Legal Services areas, among others.

Our commitments with regard to ethics and compliance are manifested in:
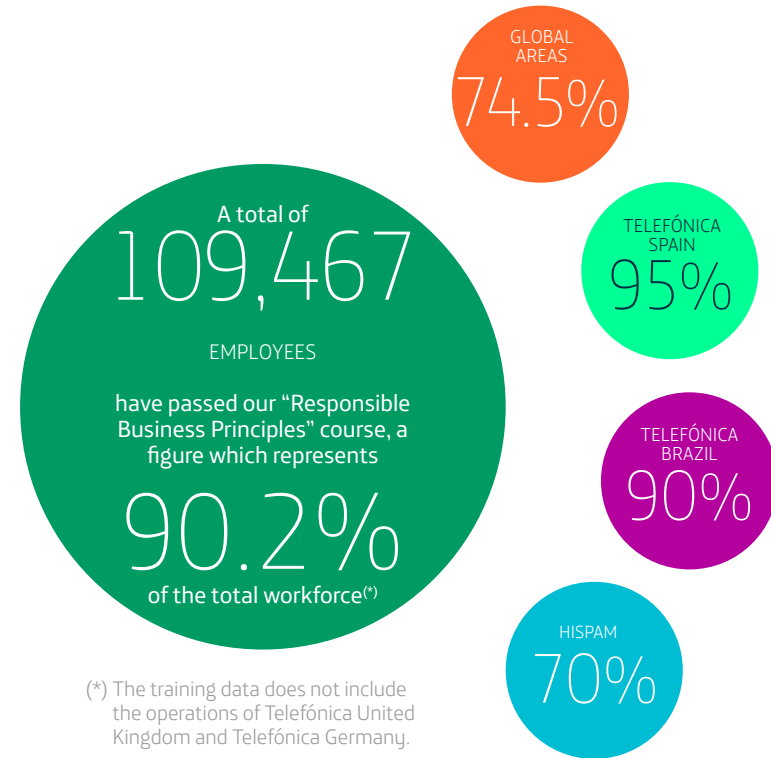
▶ **Responsible Business Principles**
These reflect our ethical and responsible performance commitments to our different stakeholders, and contain the ethics code that must govern the actions of each of our employees. These Principles simultaneously develop relevant Policies and Regulations, such as the Anti-Corruption Policy or the Corporate Regulations on the Conflict of Interests, both approved in 2015.

▶ **Commitment to Human Rights** Our commitment to Human Rights is integrated into all Telefónica operational processes (see the progress made in the identified action lines in the chapter on 'Human Rights').

RESPONSIBLE BUSINESS PRINCIPLES

The Responsible Business Principles were approved by the Board of Directors in 2006 and have suffered minor changes in these past ten years, such as, for example, reinforcement of the Principle of Integrity by including a specific section on matters of corruption in order to adapt them to the latest new regulations and best business practices.

In 2016, we worked on an important update of the Principles, the approval of which is foreseen for the second quarter of 2017 once all the global and local level approval processes have been finalised. The new draft will update the commitments in matters of privacy and security, fiscal compliance and transparency, responsible communications and protection of minority shareholders, among others. The review is being conducted as a result of the evolution of our activity and strategy, and therefore takes into account the opinions of the Company's highest executives both globally and locally. It has also consulted our

A total of
109,467
EMPLOYEES

have passed our "Responsible Business Principles" course, a figure which represents

90.2%
of the total workforce(*)

GLOBAL AREAS
74.5%

TELEFÓNICA SPAIN
95%

TELEFÓNICA BRAZIL
90%

HISPAM
70%

(*) The training data does not include the operations of Telefónica United Kingdom and Telefónica Germany.

employees through focus groups in different countries. Furthermore, international standards and a benchmark of the best international level practices are being considered.

In this way, in addition to including all the commitments that we feel should be assumed with regard to our customers, shareholders, employees, suppliers, and society in general,

the culture of responsibility and ethical behaviour that we want to govern all of our operations is reinforced even more.

In addition to the activity carried out by the Compliance area, the Responsible Business Office is in charge of supervising the communication and implementation of our Responsible Business Principles. The Office

consists of the following areas: Marketing, Purchasing, Operations, Human Resources, Legal Services, Compliance, Internal Audit, and Corporate Ethics and Sustainability. It reports directly to the Board of Directors through the Regulation and Institutional Affairs Committee.

During 2016, we continued with a mandatory on-line training activity for all Group employees with the goal of refreshing all our professionals' knowledge of the Responsible Business Principles. At the time of writing this Report, a total of 109,467 employees had passed it, a figure which represents 90.2% of the total workforce.

RESPONSIBLE BUSINESS CULTURE

The compliance and ethical behaviour of a company greatly depend on the culture that governs said company and how this is perceived by the employees. With this in mind, we dedicate space and effort both in internal communications and in employee training courses to discussing subjects related to the Responsible Business Principles and the Company's Responsible Business Plan.

In this sense, during 2016 different internal communication campaigns were organised on matters such as: the creation of the Compliance area, the importance of complying with regulations, and the criteria for the

acceptance of gifts that may be exchanged on specific dates, among others.

POLITICAL NEUTRALITY

The Company remains politically neutral. Under no circumstances does it take a direct or indirect position in favour of or in opposition to any political party.

We do not make donations to political parties or public or private organisations, the activities of which are clearly linked to politics. This does not prevent us from presenting our points of view through lobbying activities regarding issues that may affect the Company's management or sustainability. We provide transparent information regarding our lobbying activities through various registers for this purpose.

We are registered as a lobbyist in the European Union voluntary register. Registration and activities relating thereto entail costs of 2 million euros, while grants received currently total 4,790,000 million euros.

COMPLAINTS AND COMMUNICATIONS CHANNELS

All our employees have the possibility of reporting, anonymously or in person, issues associated with compliance with the Responsible Business Principles, or any other internal or external regulation that Telefónica is subject to.

This year has also seen the implementation of an external communications channel for all our stakeholders called the Responsible Business Channel. This channel offers the possibility of reporting, anonymously or in person, issues associated with compliance with the Responsible Business Principles and their associated policies.

All communications received through our complaints and communications channels, both internal and external, are treated in accordance

with the principles of respect, confidentiality, and comprehensiveness.

When the reported situation contains the information that allows for its analysis, an appropriate investigation is performed in accordance with our internal procedures.

BEST PRACTICES

PLAY TO MOVE

In 2016, we launched the Play to Move campaign on a global level in order to communicate what we do in matters of Responsible Business to our internal staff. With this objective we played with the Play to Move application (app), talked on Yammer, learned, laughed, and... finally three employees, among all 2,096 players in 15 countries, travelled around the world exploring, on a trip that gave rise to the first Brand film in Telefónica's history: "Play To Move: The Movie".

In 2016, we registered a total of:

1,152
COMMUNICATIONS

641
JUSTIFIED INVESTIGATIONS

135
FIRINGS AS A RESULT OF INVESTIGATIONS

During 2016, a total of 1,152 communications were received through the Responsible Business Principles Channel and via other means. 1,090 investigations were completed this year, 641 of which were found to be justified. Among the measures adopted as a result of valid complaints received, 135 led to termination of the employment contract. Worth noting is that of all the closed investigations, only two were related to cases of corruption.

INTERNAL AUDIT

We have a series of committees and specific units that supervise the appropriate level of control and transparency in ethics and compliance matters. The Company Bylaws and the Regulations of the Company's Board of Directors establish that the Audit and Control Committee has the primary function of supporting the Board in its supervisory functions, and establish among its competences the supervision of the effective internal control of the Company, the internal audit and the risk management systems, including the fiscal ones. During 2016, the Internal Audit issued 710 reports throughout the Group:
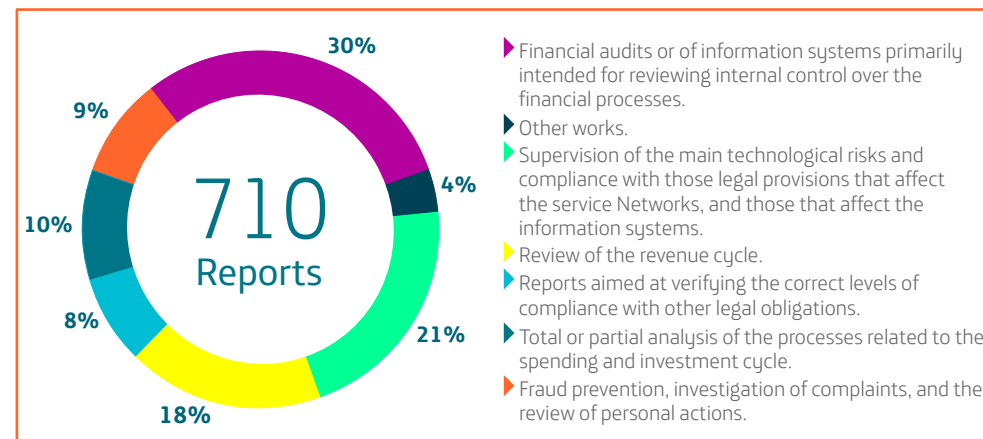
MILESTONES IN 2016

Creation of a communications channel for external stakeholders. — **100% Achieved**

Revision of the internal regulations. Revision of the Responsible Business Principles. — **In progress**

Communications campaign on the Responsible Business Principles. — **100% Achieved**

Delivery of a training course on the Responsible Business Principles (participation of 90% of the workforce). — **100% Achieved**

CHALLENGES FOR 2017

Incorporation in the analysis of stakeholder expectations regarding requests and complaints made.

Final approval and communications campaign to employees about the Responsible Business Principles.

Internal communications campaign linked to the new Responsible Business Principles.

Training course on the Responsible Business Principles (maintain participation of 90% of the workforce).

710 Reports

30% — Financial audits or of information systems primarily intended for reviewing internal control over the financial processes.

4% — Other works.

21% — Supervision of the main technological risks and compliance with those legal provisions that affect the service Networks, and those that affect the information systems.

18% — Review of the revenue cycle.

8% — Reports aimed at verifying the correct levels of compliance with other legal obligations.

10% — Total or partial analysis of the processes related to the spending and investment cycle.

9% — Fraud prevention, investigation of complaints, and the review of personal actions.

Furthermore, the creation of the Compliance area seeks to reinforce said controls. Thus, among its functions, worth noting is its activity in the field of prevention and on other fronts, such as the monitoring of regulatory compliance, management of knowledge, design of specific controls with preventive virtuality of possible non-compliances, and above all else, resolution of queries regarding the interpretation of regulations. In this sense, throughout 2016, 241 different nature requests were made.

Managing the supply chain_

Our strategy and Responsible Business Principles are based on the values of integrity, commitment and transparency, which we apply to the relationship with all our suppliers and in each of the phases of the purchasing process.

HOW DO WE INTERACT WITH OUR PROVIDERS?

We promote a culture of sustainability throughout our value chain, which allows us to multiply the positive effects of our activities. At the same time, we work to improve our processes, seeking greater efficiency and agility in our relationship with suppliers.

MANAGEMENT FOCUS:

WHY IS IT A KEY ISSUE?
The identification and management of risks associated with the supply chain is a responsibility inherent in any business, as a result of which we must promote social and environmental commitment among all our suppliers.

WHERE IS THE IMPACT?
In the improvement of the living and working conditions of the individuals that participate in our supply chain, and that affect the quality of the service offered to our customers.

TELEFÓNICA'S 2017 OBJECTIVE
To tighten the monitoring checks on the higher-risk suppliers, especially as regards customer privacy and data protection. To encourage the exchange of best practices in the area of sustainable management.

Indicators	2015	2016
% of purchases awarded locally	84.7%	81.9%
Number of audits or assessments performed on risky suppliers	n.s.	11,678
Risky suppliers with plans for improvement	608	468

SUSTAINABLE DEVELOPMENT GOALS

8 DECENT WORK AND ECONOMIC GROWTH

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

12 RESPONSIBLE CONSUMPTION AND PRODUCTION
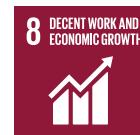
The common management model that we apply to all our purchases allows for coordinated management, which is firmly established in Telefónica Global Services (TGS), a company from which we lead negotiations with our Group's global suppliers, based on Category Management as the principle tool for management and specialisation in our main products and services. In addition, TGS offers purchasing services to the partners with which they collaborate. Furthermore, from its subsidiary Telefónica Compras Electrónicas, it promotes E2E digitisation of processes and automation of certain administrative tasks throughout the supply chain, with the aim of performing our activities with maximum integrity.

TGS is also part of Telefónica Global Resources, an internal unit that seeks technical standardisation, to promote a global focus which ensures we take advantage of our scale, to develop and recognise our talent, and to guarantee the simplification and digitisation of our processes through the resources available. This unit includes the principal global management departments, which represent the highest spending volume within our Company (Network, Information Systems and CRM).

In addition, in 2016 we created a Global Supply Chain unit which has the objective of improving our logistics management. During this first year it focused on the optimisation of stocks and the improvement of availability in mobile handsets.

THE SUPPLY CHAIN IN NUMBERS

The relationship with our suppliers is strengthened by the use of e-commerce tools, which help us to ensure that we manage our supply chain efficiently and transparently, guaranteeing equal opportunities.

30,058 M€(1) negotiated electronically

20,690 M€ in electronic formalisation operations (award letters, orders and contracts)

More than 1 million electronically-issued invoices were received (a 23% increase with respect to 2015)

▸ We continue to make progress in the interconnection between the systems of Telefónica's companies and those of our suppliers, achieving a 171% increase in the number of orders placed between 2015 and 2016.

▸ More than 8,900 suppliers were trained in the management of negotiations, orders and electronic invoices.

IMPACT ON THE COMMUNITY

We are aware of the local and global impact of our activity on society

82% of **purchasing volume** awarded to **local suppliers...**

...and in **global management,** over *20 thousand* **purchasing processes**, with a value of *over 17 billion* **euros.**

AWARDED PURCHASE VOLUME

- 5%
- 9%
- 11%
- 23%
- 26%
- 26%

▸ Network
▸ Mobility
▸ Services and Works
▸ Information Systems
▸ B2B/B2C Solutions
▸ Advertising and Marketing
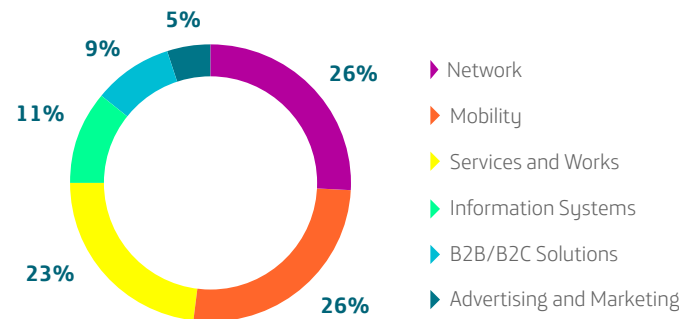
26,063 M€(2) awarded...

... to **12,847** suppliers

(1) Includes negotiations over several years
(2) Agreements with effects in 2016

SUSTAINABLE MANAGEMENT MODEL

We apply our sustainable management model to the supply chain on three levels:

RISK MANAGEMENT

▸ Risk identification

▸ Risk management tools

▸ Training and awareness-raising among employees and suppliers
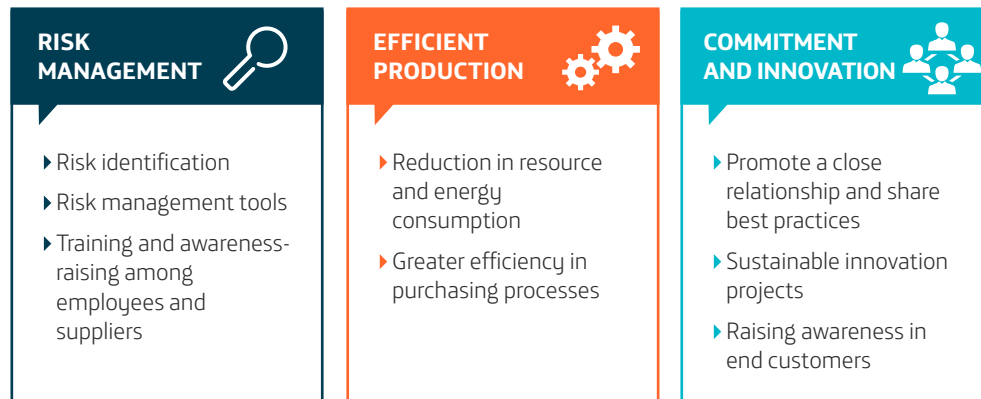
EFFICIENT PRODUCTION

▸ Reduction in resource and energy consumption

▸ Greater efficiency in purchasing processes

COMMITMENT AND INNOVATION

▸ Promote a close relationship and share best practices

▸ Sustainable innovation projects

▸ Raising awareness in end customers

In keeping with our Responsible Business Principles, we ask all our suppliers to guarantee *respect for fundamental human and labour rights,* as well as *respect* for the *environment*
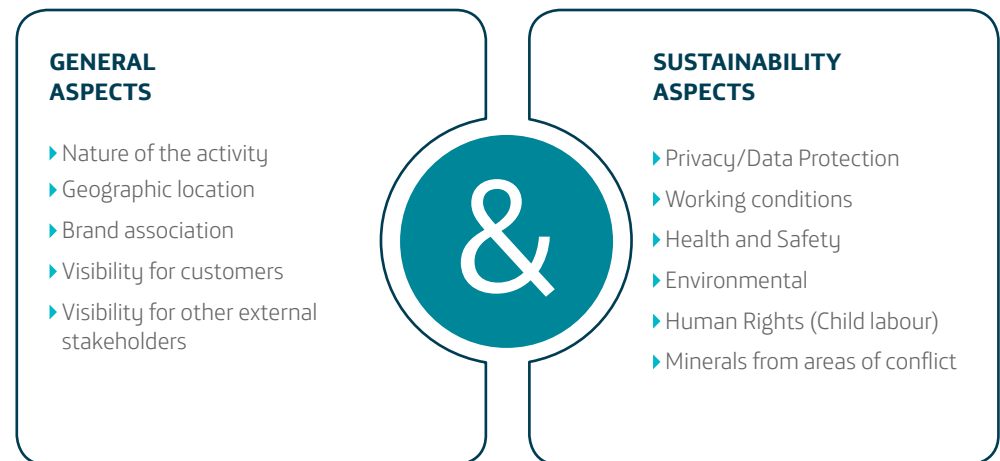
RISK MANAGEMENT

IDENTIFYING RISKS

In order to properly manage our supply chain, we focus on the suppliers that are most significant to our Company, either because of their level of risk or because of their impact on our business given the volume awarded. We do this on the basis of a previous analysis which has been reviewed and updated over the past year.

HOW DO WE DO IT?

Risk assessment is based on five general aspects, as well as the corresponding sustainability aspects outlined in our Minimum Responsible Business Standards.

GENERAL ASPECTS

▸ Nature of the activity

▸ Geographic location

▸ Brand association

▸ Visibility for customers

▸ Visibility for other external stakeholders

&

SUSTAINABILITY ASPECTS

▸ Privacy/Data Protection

▸ Working conditions

▸ Health and Safety

▸ Environmental

▸ Human Rights (Child labour)

▸ Minerals from areas of conflict

REGULATORY FRAMEWORK FOR SUPPLIERS

In keeping with our Responsible Business Principles and our Supply Chain Sustainability Policy, we ask that all our suppliers perform their activity in line with ethical, social and environmental standards similar to those followed by Telefónica.

In 2016, our Board of Directors approved a new Supply Chain Sustainability Policy, which incorporates the Minimum Responsible Business Standards which all our suppliers must respect and apply to their own supply chains. In this version, we incorporated new relevant elements (measures against corruption and conflicts of interest, privacy and confidentiality of information, etc.) and reinforced others, such as social matters (human trafficking) or environmental issues (waste, harmful substances, consumption of resources, etc.).

In addition, as part of the implementation of our Anti-Corruption Policy (approved at the end of 2015) we have added the necessary mechanisms to our purchasing process to allow our suppliers to certify their compliance with the laws on this matter.

As a result, on top of the technical requirements and quality standards that products and services must meet, we add the minimum requirements included in:

▸ The Supply Chain Sustainability Policy.

▸ The Anti-Corruption Policy.

▸ The General Conditions for the Supply of Goods and Services of the Telefónica Group.

In the event that a supplier does not achieve the required level or is not able to provide the requested information, we implement the processes necessary in order to obtain their commitment to implementing the improvement plans which ensure compliance with our standards.

In extreme cases where this is not feasible, upon the basis of the agreement initially signed by both parties, the relationship with the supplier is suspended until they can prove that they have corrected the situation.

SUPPLY CHAIN SUSTAINABILITY POLICY

We are committed to acting with rigorous objectivity, transparency and professionalism in our relationship with our business partners and suppliers

MINIMUM STANDARDS FOR RESPONSIBLE BUSINESS
Any person, company or organisation who wishes to become one of Telefónica's suppliers must promise to fulfil the Minimum Responsible Business Standards and to transmit this obligation to their subcontractors at all times.

ETHICAL

▸ Compliance with the Law
▸ Anti-corruption
▸ Conflicts of interest

PRIVACY AND CONFIDENTIALITY OF INFORMATION

▸ Information
▸ Personal data

SOCIAL

▸ Employment relationship
▸ Working hours
▸ Salaries
▸ Forced labour and human trafficking
▸ Child labour and young people
▸ Freedom of association and the right to collective bargaining
▸ Health and safety conditions
▸ Non-discrimination
▸ Minerals in conflict

ENVIRONMENTAL

▸ Life cycle and preventive action
▸ Environmental policy
▸ Environmental management
▸ Climate change
▸ Waste
▸ Harmful substances and chemical products
▸ Consumption of materials, resources and air emissions

TOOLS FOR COLLABORATION, EVALUATION, VERIFICATION AND IMPROVEMENT

Preventing and reducing possible negative impacts of our activities is another of the objectives of our Global Responsible Business Plan. It also aim to prevent any possible negative impacts of our suppliers' activities.

Therefore, in keeping with our goals for 2016, we have worked on improving our control of possible risks associated with our critical suppliers. In order to do so, we promoted the tools we were already using –such as EcoVadis for evaluations – and we reinforced our annual audit plan, joining the Joint Action Cooperation (JAC) initiative.

—

Suppliers evaluated through EcoVadis make up *43% of all purchases* in 2016

Aliados Programme

We are implementing several tools for continuous improvement in collaboration with our partners and suppliers, which allow us to ensure sustainable management throughout our value chain.

Along these lines, in Latin America we have the Aliados Programme, through which we have worked work hand-in-hand with our suppliers over the past eight years towards a culture of sustainability. This has also allowed us to develop mechanisms for early detection and prevention of risks, while raising awareness among contractors on fulfilment of our regulations.

Last year, the reach of the programme was redefined in certain countries (as a result of the sales and acquisitions that took place) and we improved the standards applied in the supplier selection process. This caused some adjustments in the group of critical suppliers managed through the programme.

The management model that we apply, which is based on global tools (such as our policy of minimums and our third-party committee), has allowed us to once again work on different initiatives according to the needs detected on a local level. In 2016, the following were especially worth mentioning:

▸ Implementation of a contractor monitoring system (in Argentina, Brazil, Chile, Mexico and Peru).

▸ We continued the implementation of OSHAS 18001, which also involves suppliers in different countries (Argentina and Colombia).

▸ In Argentina, through the Portal Aliados application, we incorporated the necessary standards in all the intermediary processes (pay rolls, user management, etc.), simplifying the different processes and minimising our exposure to risk. In addition, we began a digitisation process (using certified signatures) for documents provided by suppliers.

▸ In Brazil, we completed the process of incorporating GVT suppliers into the Aliados programme, which had begun following acquisition.

▸ In Colombia we developed and initiated the Model for integration with Management Systems (Environmental, Quality, Safety and Security at work, and Information Security) for our partners. In addition, we continued implementing the Aliados' management model in the distribution channel, through which we guaranteed the inclusion of the conditions on Human Resources and Occupational Health and Safety in the contracts.
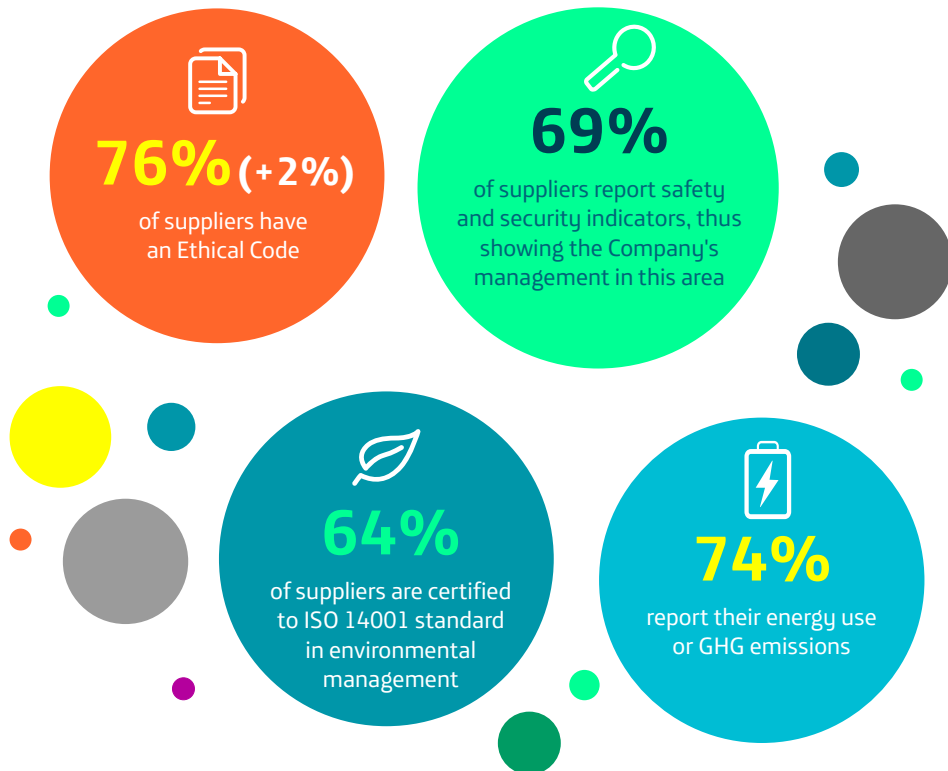
EcoVadis

We analyse and assess the risk level of our suppliers, according to the products and services they provide to us. To do this, we rely on the EcoVadis self-assessment platform, which is run by an external independent body. Using its online tool, we obtained a 360° assessment of the performance of our higher-risk suppliers, based on 21 sustainability criteria.

In keeping with one of the objectives established for 2016, we promoted use of the platform, reaching the 226 critical suppliers evaluated, while an additional 20 are in the process of finishing the corresponding questionnaire. Of these, only 30% have shown some sort of weakness –moderate risk– in their responsible management, as once again they have concentrated on the sustainable management of the supply chain itself.

Of our critical suppliers, 49 have active improvement plans, equalling a total of 644 corrective actions. Of these, 78% were completed by the time of publication of this Report.

RELEVANT INDICATORS REGARDING OUR EVALUATIONS

76% (+2%)
of suppliers have
an Ethical Code

69%
of suppliers report safety
and security indicators, thus
showing the Company's
management in this area

64%
of suppliers are certified
to ISO 14001 standard
in environmental
management

74%
report their energy use
or GHG emissions

Joint Audit Cooperation (JAC)

We reinforced our annual audit plan, joining the Joint Audit Cooperation (JAC) initiative, which is made up of 13 telecommunications operators worldwide.

The aim of the JAC is to verify, evaluate and develop sustainability initiatives in the manufacturing centres of large multinational suppliers to the Information Communication Technology industry.

Members share research and best practices to promote long-term sustainability at different levels of the supply chain. To this end, the alliance works to improve the questionnaire used, encouraging objectivity of the auditor and adapting it to the requirements of the Electronic Industry Citizenship Coalition.

Laborlink Mobile Surveys

Thanks to the collaboration of JAC and through Good World Solutions, in 2016 we put into practice an initiative that established an anonymous communication channel so that our suppliers' factory workers can provide information on real conditions, allowing companies to receive real-time data directly from the workers through mobile telephones. This survey provides real feedback from employees.
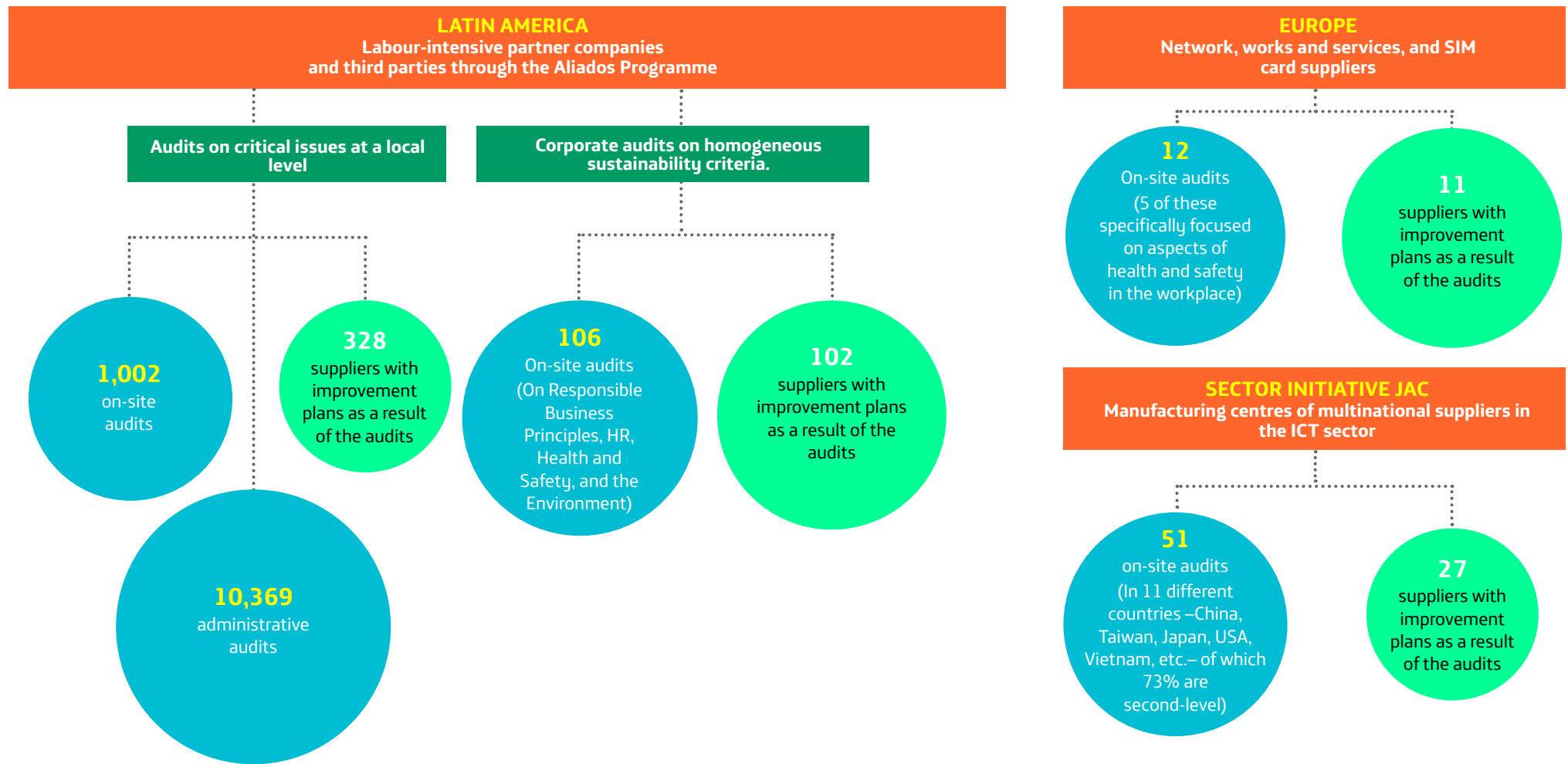
Last year, we coordinated the launch of 3 mobile telephone surveys, involving our suppliers in the continuous improvement of our Supply Chain.

We verify compliance in the factories of the providers of our suppliers, working also to ensure *the second level of our supply chain*
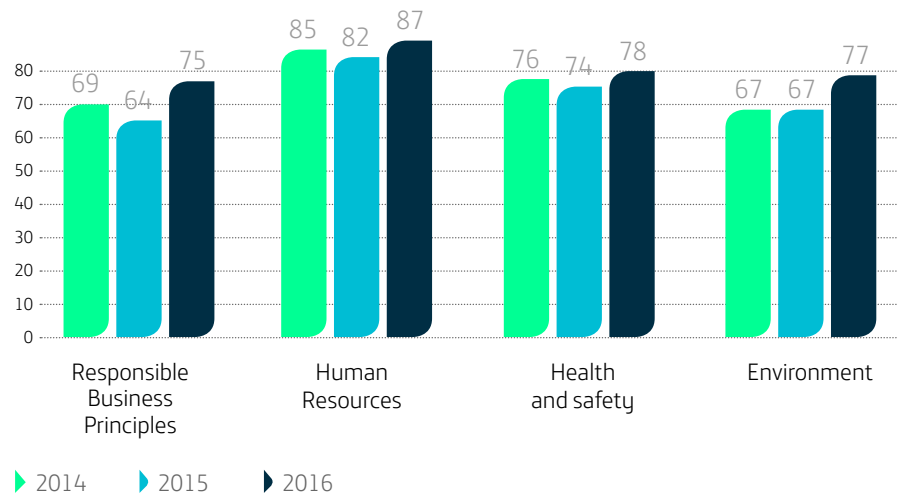
THE ANNUAL AUDIT PLAN IN NUMBERS

Depending on the risks present in each region or country, as well as the types of supplier, we focus on evaluation of performance in the most critical areas

LATIN AMERICA
Labour-intensive partner companies and third parties through the Aliados Programme

Audits on critical issues at a local level

Corporate audits on homogeneous sustainability criteria.

1,002 on-site audits

328 suppliers with improvement plans as a result of the audits

10,369 administrative audits

106 On-site audits (On Responsible Business Principles, HR, Health and Safety, and the Environment)

102 suppliers with improvement plans as a result of the audits

EUROPE
Network, works and services, and SIM card suppliers

12 On-site audits (5 of these specifically focused on aspects of health and safety in the workplace)

11 suppliers with improvement plans as a result of the audits

SECTOR INITIATIVE JAC
Manufacturing centres of multinational suppliers in the ICT sector

51 on-site audits (In 11 different countries —China, Taiwan, Japan, USA, Vietnam, etc.— of which 73% are second-level)

27 suppliers with improvement plans as a result of the audits

% OF COMPLIANCE WITH CORPORATE AUDITS IN LATIN AMERICA

▸ 2014   ▸ 2015   ▸ 2016

Details of corporate audits

We have detected moderate improvements in all disciplines, reaching a general level of 79% compliance. In HR, the 87% registered compliance (+5% with respect to 2015) is a clear example of the work we carry out with our partners in the fulfilment of labour obligations.

Some of the most common risks have been detected in:

▸ The Induction Process, Training and Work Environment, as well as Personnel Relationships and Personnel Management.

▸ In terms of Health and Safety, we have concentrated on the sections of Hygiene and Industrial Safety, Implementation and Operation, and Verification.

▸ And in environmental processes, in the management of waste and the environmental management system.

KEY ASPECTS IN OUR SECTOR

We focus especially on those issues associated with the supply chain that are relevant to our sector and to Company strategy. Among these, we place special emphasis on privacy and data protection, child labour (further information in the chapter on 'Human Rights'), and minerals from areas of conflict.

—

Privacy and Data Protection

Our commitment to privacy is part of our customer promise, and is strategic for the Company. As a result, we need to ensure that it is respected, not only within our own activities, but also by our suppliers, especially when they have access to or manage the data of our customers.

We have identified which suppliers we need to exercise specific control over, and which we need to demand special standards of. We are working tighten monitoring checks on suppliers with the greatest levels of risk in this area, either through evaluations and/or audits.

In addition, in line with the minimum privacy standards stipulated in our Policy and in the General Conditions for the Supply of Goods and Services, we promote a series of security measures among our suppliers that guarantee compliance with our internal regulations in the areas of security and good use of personal data.

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Our suppliers *must have a privacy policy* that reflects their commitment to protect the information we entrust them with

Minerals in conflict

Although we do not have direct commercial relationships with smelters or refineries, we work actively to reinforce the checks that are carried out on the use of minerals from areas of conflict in our value chain. In this regard, we have adopted a Company policy based on the guidelines contained in the report 'Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas', published by the OECD. This policy includes the five stages of the Guide which we apply to our suppliers.

1. Traceability of 3TG minerals. We encourage our suppliers to carry out effective due diligence processes to guarantee, whenever necessary and possible, the traceability of 3TG minerals from conflict zones, as well as mitigation of the associated risks, such as the violation of Human Rights.

In addition, all suppliers that present us with an offer must fulfil the minimum requirements on this aspect included in the Supply Chain Sustainability Policy and the General Conditions for the Supply of Goods and Services of the Telefónica Group.

2. Suppler evaluation and audit. We analyse and evaluate our suppliers' commitment through the EcoVadis platform and audits performed by the Joint Audit Cooperation sector initiative.

We ask that our suppliers have a policy and a procedure that makes reasonably sure that tin, tantalum, tungsten and gold used in the products they manufacture does not directly or indirectly benefit armed groups.

3. Commitment initiatives. We also support and participate in major initiatives, both international and sectoral, aimed at reducing these kinds of risks, such as the Public-Private Alliance for the Responsible Minerals Trade (PPA) or the "Industry Responsibility" working group by GESI (Global e-Sustainability Initiative).

4. Complaints. We have a Responsible Business Channel, through which any stakeholder may ask for information or express complaints in this area.

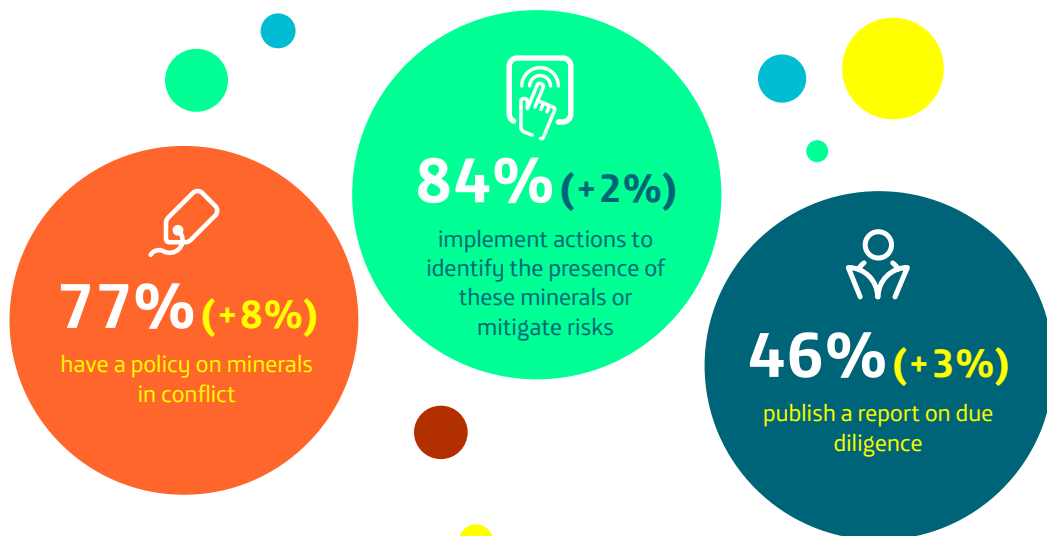**5. Information.** We report on the due diligence of the supply chain.

In addition, as a company listed on the New York Stock Exchange, we duly comply with Section 1.502 of the Dodd-Frank Wall Street Reform and the Consumer Protection Act.

TRAINING AND RAISING AWARENESS

Over the past year, we have reinforced our sustainable management model by training our internal managers and suppliers, taking into account the specific needs of each country. For example, in Colombia we carry out specific training in electrical dangers as a result of the high risk some of our partners face. And in Mexico, in order to improve the quality of customer service, we created an online course on the obligations for quality and customer service that our partners' personnel, who are in contact with customers, must be familiar with. Each training course is offered in person or through online platforms (SuccessFactors, Academia Movistar, Sistema Integral de Capacitación, ICampus,…).

1,889 in-person courses and *1,123 online courses,* benefiting over *61,600 collaborators* in Latin America

AMONG THE SUPPLIERS ASSESSED:

77% (+8%)
have a policy on minerals in conflict

84% (+2%)
implement actions to identify the presence of these minerals or mitigate risks

46% (+3%)
publish a report on due diligence

EFFICIENT PRODUCTION

We constantly aim to improve purchasing processes and to collaborate with our suppliers on projects that reduce costs and help us to be more efficient.

MARCO POLO MODEL

Once again, we maintained our offer for home equipment with its own identity, from which we can manage and optimise the whole end-to-end process. Since implementation of the Marco Polo model in 2013, we have been able to develop an all-around portfolio of our own equipment, which is shared by all our operations, going from 28 units to 7, with operational efficiencies in the 2015-2016 period of more than €100 million.

TECHNOLOGICAL PARTNERS

Within the framework of the Company's Energy Efficiency Project, we work with technological partners that provide us with the best technology and help us to identify opportunities to reduce energy consumption and emissions.

In this vein, in collaboration with our suppliers, we have carried out projects related to:

▸ Efficiency in electronic equipment (rectifiers, UPS and inverters).

▸ Improved efficiency in refrigeration and air conditioning units.

▸ Reduction in energy consumption at radio bases at periods of low load.

▸ Lighting, selective shut-downs, hybrid and renewable generation.

COMMITMENT AND INNOVATION

We promote constant communication with our suppliers in order to maintain a close relationship with them and to promote a culture of sustainability in our supply chain.

SATISFACTION SURVEY

We make an effort to understand the priorities and perception of our suppliers. In 2016, we carried out a survey aimed at our principal suppliers to get to know their level of satisfaction and identify which aspects are positively viewed and which could be improved.
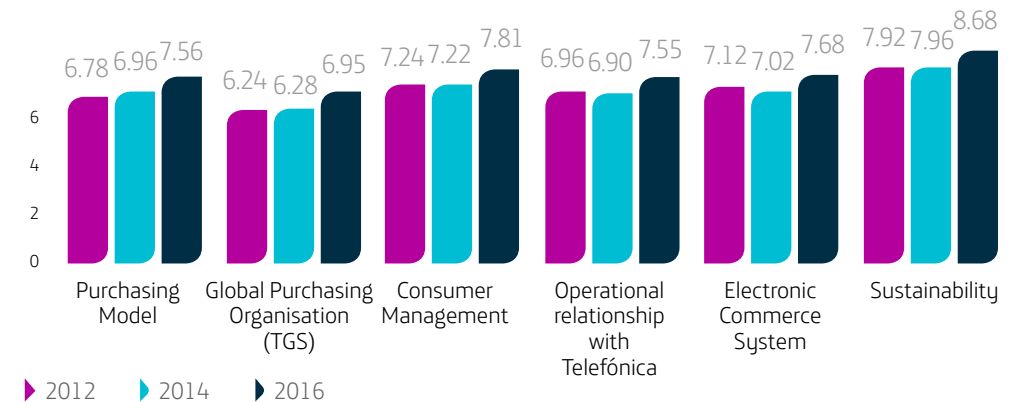
▸ We launched a survey of some 3,800 suppliers, reaching a participation level of 24%.

▸ Evaluations (on a scale of 0 to 10) have improved with regard to surveys carried out in previous years, and once again matters of sustainability were the most highly rated.

Positively evaluated aspects include: honest and transparent action by purchasers; commitment to sustainability in the supply chain; the electronic formalisation of commitments and electronic billing; and fulfilment of the commitments taken on with our suppliers.

Our suppliers identified other aspects that could use improvement, such as the payment conditions established in comparison with those of other companies.

RESULTS OF THE SUPPLIER SATISFACTION SURVEY

	Purchasing Model	Global Purchasing Organisation (TGS)	Consumer Management	Operational relationship with Telefónica	Electronic Commerce System	Sustainability
2012	6.78	6.24	7.24	6.96	7.12	7.92
2014	6.96	6.28	7.22	6.90	7.02	7.96
2016	7.56	6.95	7.81	7.55	7.68	8.68

▸ 2012   ▸ 2014   ▸ 2016

In addition to measuring our suppliers' satisfaction, we also measured our Company's reputation among these stakeholders. In 2016, Telefónica improved its relationship with its suppliers, receiving 84.4 points in the Pulse indicator.

DIALOGUE WITH OUR SUPPLIERS

▸ Suppliers have different communication channels, such as our quarterly partner bulletin (Colombia, Ecuador and Mexico) the Partner Portal or the Supplier Portal. On the latter, suppliers can find all of our Global Policies, as well as specific local policies. For example, in Ecuador we updated our environmental operational control documents,

and made them available to all concerned suppliers through the portal. We also provide a confidential channel for questions and complaints related to compliance with our minimum responsible business standards.

▸ In 2016, we held direct meetings with some of our main global suppliers, at which we shared our strategies on sustainability issues and exchanged good practices.

▸ On a local level, we also organise on-site events with suppliers, including the following:

> The 3rd Meeting of Telefónica Partner Companies in Chile, where we presented the

Company's strategic "Elegimos Todo" (We Choose it All) programme to 43 companies that provide different services (customer service, call centres, distributors, billing, loop and Network deployment).

> A workshop organised in Brazil where we discussed the principle risks for suppliers in the country, local legislation on anti-corruption, our Sustainability strategy and our new Telefónica Chain Sustainability Policy with the 25 suppliers present.

> Themed workshops, such as one on Energy and Climate Change (held in Uruguay) where, together with our principal suppliers, we analysed plans to promote energy efficiency and to reduce CO_2 emissions in the world of telecommunications.

REDUCING CARBON
IN THE SUPPLY CHAIN

Telefónica United Kingdom has obtained "Carbon Trust Supply Chain Standard (Level 3)" certification. This standard, launched by Carbon Trust in 2015, establishes best practices in the management of emissions in the supply chain. The certification is obtained by:

▸ Evaluating emissions in the supply chain.

▸ Identifying the purchases that generate the most emissions, and negotiating a reduction in emissions with the corresponding suppliers, with the goal of reducing Scope 3 emissions.

In this way, we have obtained commitments to an 18% reduction in emissions in Telefónica United Kingdom's supply chain. In addition, we have incorporated the reduction in carbon to our purchasing processes in the country, so that these commitments are part of the negotiations of significant purchases.

RAISING AWARENESS
AMONG OUR CUSTOMERS

We collaborate with our principal suppliers of mobile handsets in order to offer our customers environmental and social information on the devices they are interested in purchasing, through the Eco-Rating project.

BEST PRACTICES

III SUPPLIER SUSTAINABILITY FORUM IN THE UNITED KINGDOM

We presented our new local sustainability strategy, "Think Big 2", to our suppliers.

In doing so, we promoted the new "UK 2015 Modern Slavery Act" and provided orientation on best practices with respect to compliance and due diligence in the supply chain. We also offered information on new carbon requirements for our principal suppliers, which stipulate that they have a

programme for carbon reduction or a plan to create one.

We also presented the Sustainability Prize for Telefónica United Kingdom's Suppliers to Tech Mahindra, for being the best supplier in responding to and complying with the established environmental requirements, and, above all, for their social and environmental commitments.

In order to evaluate handsets, Forum for the Future –an independent organisation with which we collaborate on this initiative, together with other operators– takes into account more than 100 criteria which allow it to establish a rating system that grades each device according to its social and environmental performance.

This way, and in collaboration with our suppliers, we allow our customers to make a "better informed and sustainable" consumer decision.

For further information, see the chapters on 'Environment'.

In addition, in Spain we classify devices according to accessibility criteria, taking into account seven different kinds of interaction (low or no vision, low or no hearing, moderate or severe handling difficulty and comprehension problems). At the end of 2016, this information was included in 50% of our catalogue. This information was included thanks to assistance from the ONCE Foundation (an institution for the blind that assessed the user experience with each device), as well as collaboration from the manufacturers Huawei, LG, Samsung and TCL Communication.

For further information, see the chapter on 'Accessibility'.

We want our customers'
mobile handsets
to be more sustainable
and accessible

MILESTONES IN 2016

100% Achieved
Revision of the minimum responsible business standards that we apply to our suppliers

100% Achieved
Place special emphasis on suppliers involved in provision of services

100% Achieved
Telefónica joining the JAC (Joint Audit Cooperation)

95% Achieved
Expand the scope of the EcoVadis assessment process, including Telefónica's 250 leading risk suppliers.

CHALLENGES FOR 2017

Tighten the monitoring checks on the higher-risk suppliers, especially as regards customer privacy and data protection.

Review internal regulations defining the minimum general criteria for contracting service and works suppliers (contracts and subcontracts).

Integration of platforms for increased automation of the critical supplier evaluation process, allowing for more efficient management of information on our suppliers' actions.

Expand the scope of the EcoVadis assessment process to include Telefónica's 300 leading risk suppliers.

Encourage the exchange of best practices in the area of sustainable management, carrying out several initiatives for dialogue with suppliers.

5

Business model and development

- Trends, opportunities and strategy
- Network deployment
- Digital transformation
- Innovation

Trends, opportunities and strategy_

We are currently experiencing a digital revolution which is conditioning the social and economic development of the world and profoundly transforming our way of life, from how we relate to and inform each other to how we work or access services. Similarly, in the coming decades, coinciding with this revolution, humanity will have to face up to global social and environmental challenges, such as demographic growth and urban development, a scarcity of resources and water, and climate change. Within this scenario, technology and innovation will play a key role in increasing efficiency, improving our quality of life and addressing the growing challenges facing humanity.

As a provider of connectivity and innovative services, we also form part of the above revolution, playing a fundamental role in the changes in the countries in which we operate.

According to the EY consulting firm, in its report titled "The upside of disruption", we can find 8 large megatrends brought about by the increasing impact of technology, globalisation and demographic change. Thus, phenomena such as urban development, population ageing, the rise of the millennial population, Big Data and robotics interact with each other and mark the future of the economy, industry, the planet and its people.
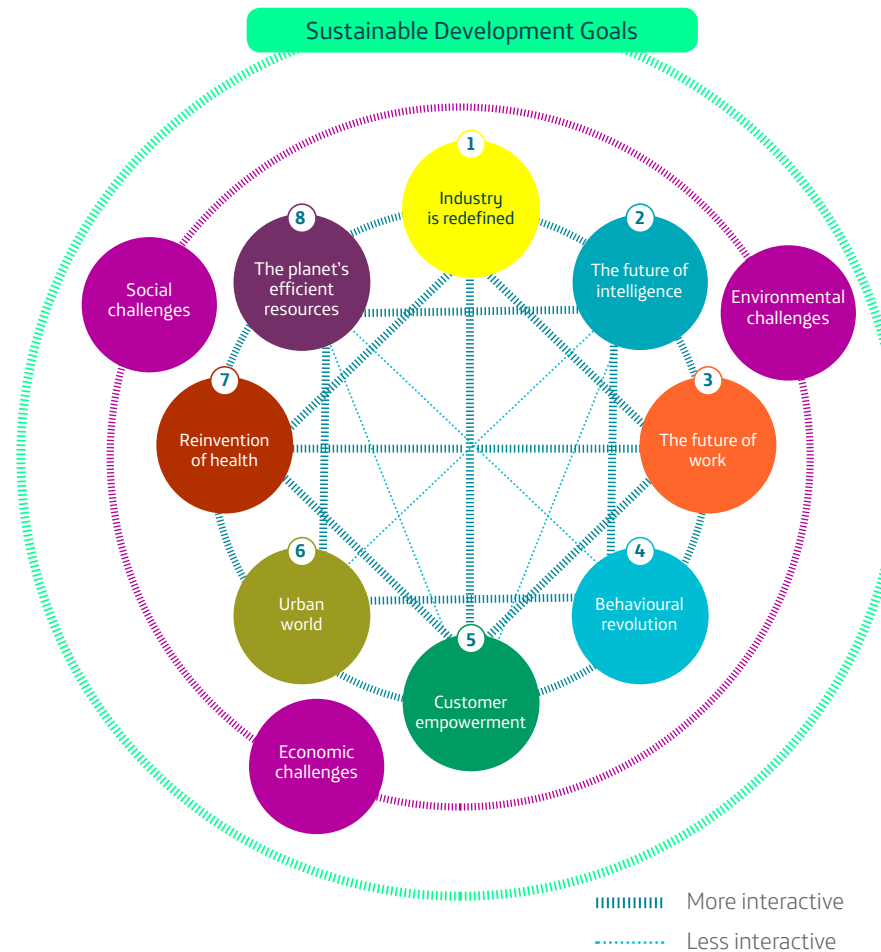
1. Industry is redefined: The traditional diversity of companies is being broken by the appearance of new competitors from other industries, including some unrelated to the sector.

2. The future of intelligence: Connectivity, the intelligent use of Big Data and its application in artificial intelligence is opening up new ways of decision-making and interacting.

3. The future of work: The world of work is being reinvented, due to the impact of technology and globalisation.

4. Behavioural revolution: Behavioural economics will become a growing resource for businesses.

5. Customer empowerment: Customers are becoming increasingly aware of their commercial value and expect to be understood and attracted in all their complexity.

6. Urban world: Innovation is becoming fundamental in the new cities, thanks to new sustainable solutions.

7. Reinvention of health: The demographic, globalising and technological changes are giving rise to Health 2.0, a model in which patients, instead of being passive recipients of care, are becoming an active and personalised element, with more information and control over the decisions regarding their health.

8. The planet's efficient resources: The transformation of resources is already challenging the business models and reducing the use of coal in the global energy mix, generating a fourth industrial revolution in terms of resource use.

As part of this new scenario, the United Nations launched its Sustainable Development Goals - 17 goals which seek to reduce the impact of phenomena such as climate change and economic inequality, and encourage innovation and sustainable consumption.

TELEFÓNICA'S STRATEGY AND BUSINESS MODEL

Our industry is a facilitator of profound changes in the economy, chiefly linked to the irruption of artificial intelligence. The connectivity of all our devices is resulting in an explosion of data which, together with the power of cloud computing, is becoming a driving force for product and service innovation and the customer experience.

The explosion of data, the speed and ubiquity of connectivity and the improvements made to computing efficiency are the main facilitators of this change. The rate of the growth in data, brought about, among other reasons, by the rise in the Internet of Things, is doubling every two years. All the above represents an unprecedented leap in the history of artificial intelligence and, therefore, in innovation.

This new technological paradigm is having a significant impact on the economy, reflected in improved productivity, to the extent that the new applications of technology could trigger a new cycle of growth, as well as improving profitability and capital returns. All this is largely due to innovations in areas such as energy efficiency, smart cities and process automation. New competitive advantages will entail changes in the competitiveness of sectors and lead to the emergence of new competitors in industries such as health, farming, energy,
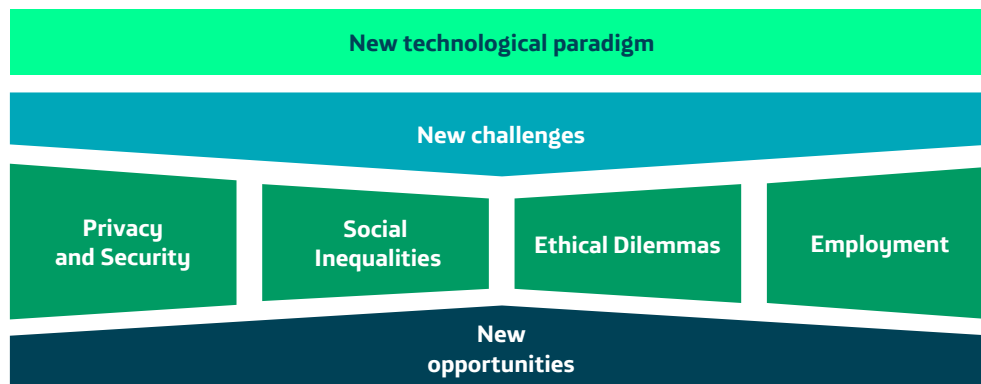
finance and so on. Finally, a new cycle of innovation arising from artificial intelligence will emerge, providing new transversal services to increase innovation and value in all industries.

This new revolution is also creating new social and sustainability challenges, which we must be ready to face. These challenges include the privacy and security of our customers' data, social inequalities arising from new technological skills, among both individuals and countries, ethical dilemmas generated by new technologies such as self-driving cars, data use and the future of employment with robotisation.

Our industry is a **facilitator of profound changes** *in the economy, chiefly linked to the irruption of artificial intelligence.*

We believe that these challenges may also represent an opportunity to make a more sustainable digital society, if we do so in accordance with our values. We want to give our customers the opportunity to choose the products and services which will help them to improve their lives in an integrated, transparent and committed way. Our goal is to put technology at the service of people, giving customers control over their digital lives. In relation to the inequality which may be generated by the new technologies, we want to promote and ensure access to them, giving our customers, and society in general, the opportunity to choose the most advanced technology and the most innovative services in a secure and high-quality fashion.

New technological paradigm

New challenges

Privacy and Security	Social Inequalities	Ethical Dilemmas	Employment

New opportunities

The intelligent use of data can yield important benefits for society. We can apply the data economy to pandemics and crime, improve efficiency in sectors such as transport and emergency services in the event of disasters, face up to major challenges such as the management of large cities and natural resources, and even improve administration of governments by means of statistics and analyses.

Finally, in relation to employment, we seek to transform our way of working and the skills and aptitudes of our employees by means of collaborative work, labour flexibility and career development.

We want to become a real-time, automated and convergent company, thanks to the digitisation of our production processes. To achieve this, the transformation of the above and the policies and systems form a cornerstone and an essential element for our future. Every business element needs to be digital, fully automating the internal operations and improving the customer experience.

Our objective is also to be an increasingly sustainable company, committed to the objectives and goals set by the United Nations, given that our business and strategy have a profound impact on our contribution to them. Thus, although our main activity has a clear impact on Goal 9, which is focused on industry, innovation and infrastructures, we also contribute, in one way or another, to the other 16 goals, mainly education (4), economic growth (8), sustainable cities (11) and action for climate change (13).

**FURTHER
INFORMATION**

To empower people
and companies
with their data

4th platform
Cognitive power
3rd platform
Better experiences
2nd platform
Digitally intelligent
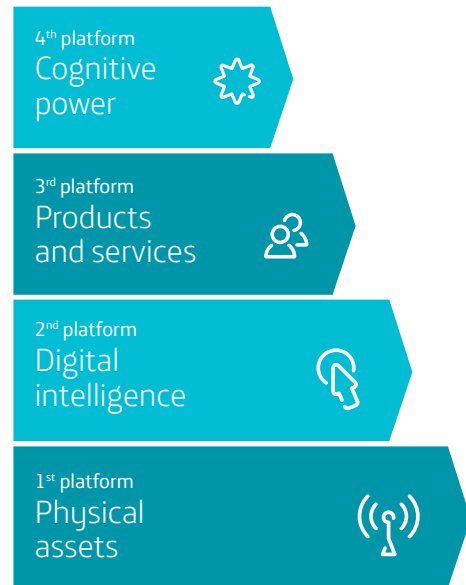1st platform
The best connectivity

—
We offer our customers the chance to choose the products and services which *will help them to improve their lives*
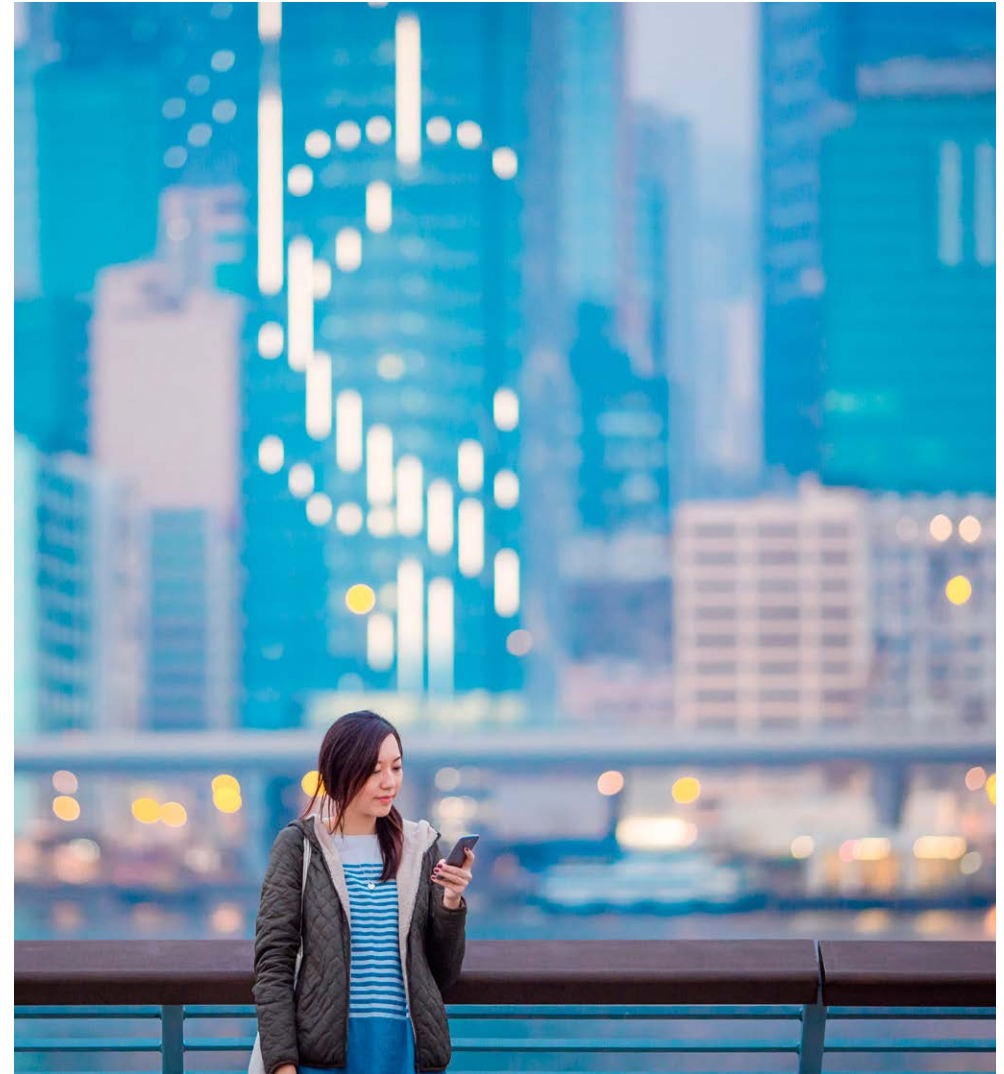
At Telefónica we are building a data-based company so as to be at the forefront of this new revolution. To achieve this, we are improving each of our assets and combining them in a coherent collective at the service of our customers, which is organised into four platforms:

4th platform
Cognitive power

3rd platform
Products and services

2nd platform
Digital intelligence

1st platform
Physical assets

1ST PLATFORM: NETWORK AND PHYSICAL ASSETS

The first platform is made up of all our physical assets, which generate a large amount of data in real time. It includes networks and base stations, stores and customer teams. This platform makes us relevant and accounts for most of our investment.

At Telefónica we believe that connectivity provides us with a differential advantage in the face of the continuous growth of data traffic. For this reason, we are making a significant effort to lead the deployment of high-speed fixed and mobile broadband accesses in the markets in which we operate. In the same way, we are enhancing optimised connectivity in accordance with the needs of companies as a key element in our value proposition. In a complementary manner, we are refocusing our physical stores in order to provide a better customer experience with software-based services.

FURTHER INFORMATION

The 1st platform.
The best connectivity

2ND PLATFORM: IT SYSTEMS

The second platform consists of our support systems and commercial systems, linking the data generated by the first platform with the business component. It encourages end-to-end digitisation and allows connection with the other platforms, enabling us as a real-time, automated and customer-oriented company.

For us, software is playing an increasingly important role in connectivity solutions. It is a key element for meeting the needs of our customers, including features such as virtualisation and cloud services. We are also committed to the simplification and homogenisation of the Company's technological infrastructures, as an enabler of new growth opportunities.

In addition, we are promoting the digitisation of our channels and interaction with our customers, based on new multi-channel capabilities, including self-service tools and non-voice channels such as chatbots.

FURTHER INFORMATION

The 2nd platform.
Digitally intelligent

3RD PLATFORM: END SERVICES FOR OUR CUSTOMERS

The third platform refers to the products and services we make available to our customers, and which make up a distinctive, personalised and simple offer which capitalises on the capillarity of our physical assets and systems.

We have adopted video as a key element in our proposal in order to increase the value of connectivity, combining our own offers and agreements with third parties. In the business segment this role is played by the cloud, combining our own assets with those of other agents. We are committed to innovation, focusing on a specific set of digital services (new video formats, music, cloud, games and security) and investing in startups in order to acquire digital capabilities beyond connectivity.

FURTHER INFORMATION ▷

The 3rd platform.
Better experiences
10 KMS
700 KCaL
110 ♥

4TH PLATFORM: COGNITIVE INTELLIGENCE BASED ON BIG DATA

We believe that data will be the enabler of a new company, incorporating cognitive capacities as the basis for a new relationship model with our customers.

Our fourth platform is the ecosystem which connects data, devices, networks and people. Designed as the pillar upon which our relationship of trust with our customers is based, it gathers internal and external data and allows secure connections between Telefónica and third-party services which are relevant to our users.

We want to return the data to customers to improve their user experience and to allow them, in a simple and personalised manner, to interact with our products and services, thereby managing their digital lives. In addition, we want to help companies in their transformation towards data-driven businesses. We will provide them with an easy way of collecting, understanding and transforming data into better decisions, enabling them to translate the increased knowledge of their customers into new opportunities.

FURTHER INFORMATION ▷

The 4th platform.
Cognitive power

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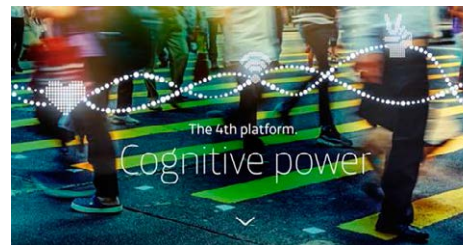
Our goal is to become a real-time, automated and convergent company thanks to the *digitisation of our production processes*

Network deployment_

Connectivity is one of the main driving forces of digital transformation. We want no one to be left out, and for everyone to have access to the benefits of digital life and the economic development resulting from the new technologies.

Our customers want to be permanently connected, anywhere and from any device, with the highest quality and the very best

—

Since 2012 we have invested *38,000 million euros* in the development of our fixed and mobile networks

experience. In order to meet this demand, we use our physical assets to build the networks of the future, enabling us to make a distinctive offer.

Organised under our first platform, the Network assets are becoming a key source of customer knowledge. These data allow us to prioritise the deployment of our networks in accordance with customer needs.
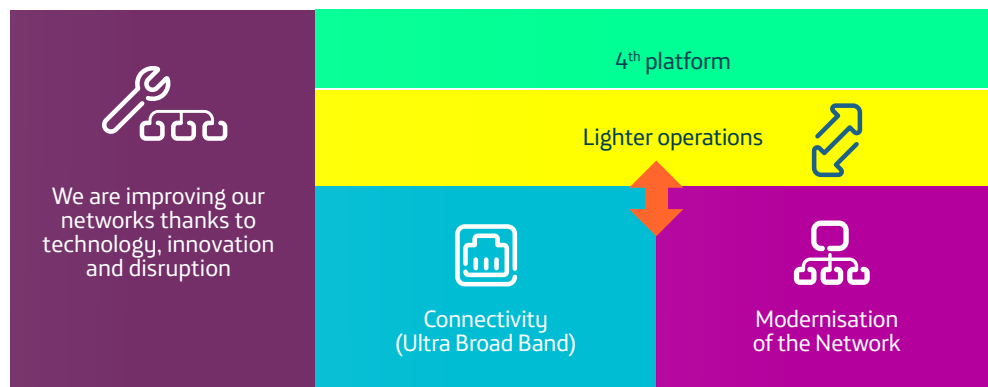
OUR CONNECTIVITY

Connectivity forms the basis of our business, even more so in an age that has seen an exponential increase in applications, services and terminals, and in which investment in infrastructures is key to giving more and more homes the opportunity to access the digital world.

Our systems add smart ways of administering the assets and help us to become a real-time, efficient and convergent company.

Our customers want and expect the maximum access speed, the greatest capacity for information transmission, 24-hour availability and flexibility of access from any device, anywhere. For this reason, since 2012 we have invested 38,000 million euros in the development of our fixed and mobile networks. In addition, we are continuing to work on improving capacity and coverage, enabling us

to record exponential growth in traffic, which has increased by 49% over the past year.

During 2016 we invested almost 9,000 million euros, mainly directed to the deployment of ultra-fast and state-of-the-art networks.

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

We are improving our networks thanks to technology, innovation and disruption

4th platform

Lighter operations

Connectivity (Ultra Broad Band)

Modernisation of the Network

MAP OF 3G/4G MOBILE COVERAGE GREATER THAN 80% OF THE POPULATION IN THE COUNTRIES IN WHICH TELEFÓNICA OPERATES

4G
>60% coverage of the population in Germany, Argentina, Brazil, Chile, Spain, Peru and the United Kingdom

3G
>90% coverage of the population in Germany, Argentina, Brazil, Chile, Colombia, Spain, Guatemala, Nicaragua, Panama, the United Kingdom, Uruguay and Venezuela

MOBILE NETWORKS

In our mobile networks we have achieved historic levels of 4G coverage in the regions in which we operate, recording 96% in Spain, 95% in the United Kingdom, 79% in Germany, 60% in Brazil and 49% in Latin America. In 2016 accesses totalled 350 million, of which 147.2 million corresponded to smartphones, representing an increase of 17% in comparison to 2015, with an overall penetration of 57%. Our LTE customers totalled 66.3 million (1.8 times more than the previous year). In addition, we have begun our journey towards the new 5G networks, working in international forums which are defining the access and architecture of these new ultra high-speed networks.

LABORATORY OF EXCELLENCE 5G - 5TONIC

We have created, together with IMDEA Networks, the first 5G laboratory of excellence in Spain: 5TONIC. Its objective is to create an open ecosystem of innovation and research in which industry and the academic world can work together. The laboratory addresses the research process from an eminently practical standpoint by means of feasibility tests, analysing all the technological aspects and the complexity of the different solutions.
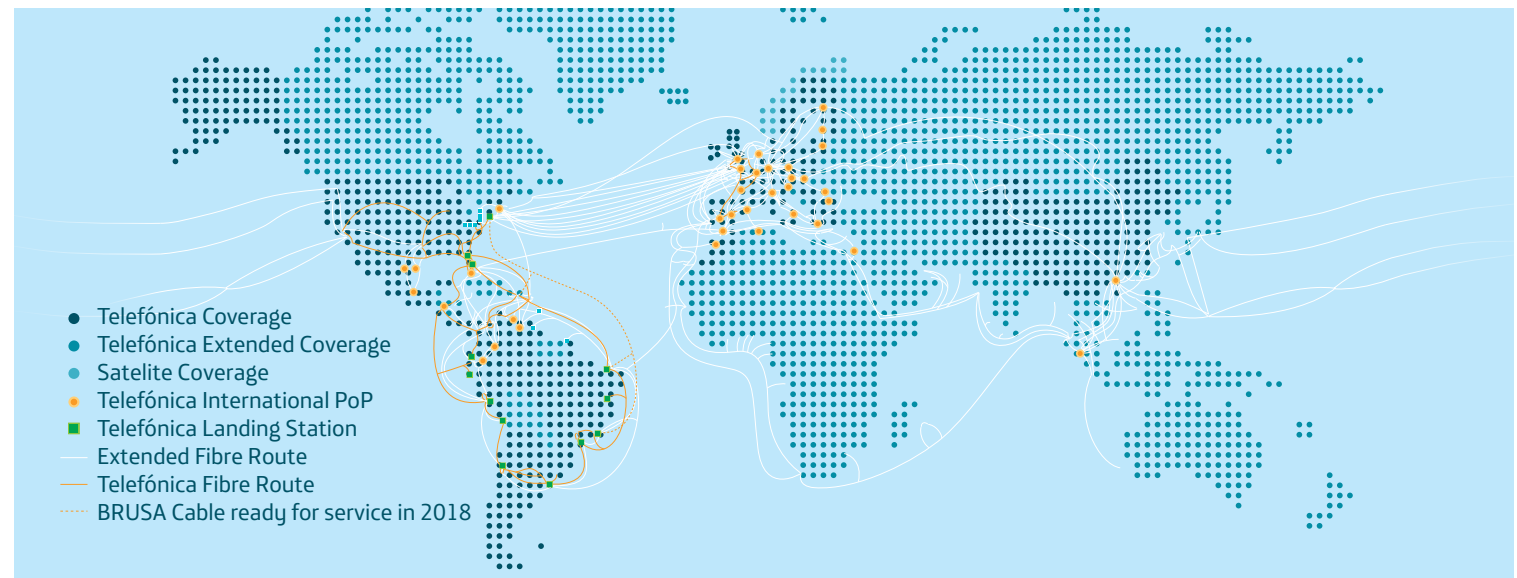
BEST PRACTICES

DEPLOYMENT OF VOLTE TECHNOLOGY IN LATIN AMERICA

During 2016 we began the deployment of VoLTE technology in Colombia, Argentina and Peru. This Network service allows us to make high-definition (HD) voice calls and simultaneously maintain a data connection at the speed of the 4G LTE Network, which improves the user experience. We have become one of the first operators in Latin America to provide this solution to our customers.

The benefits for users include call connections which are four seconds faster, the possibility of using the Internet in 4G while making a voice call, greater voice clarity and being able to make high-definition video calls without the need to open an application.

In 2016, the number of accesses totalled *350 million*

- Telefónica Coverage
- Telefónica Extended Coverage
- Satelite Coverage
- Telefónica International PoP
- Telefónica Landing Station
- Extended Fibre Route
- Telefónica Fibre Route
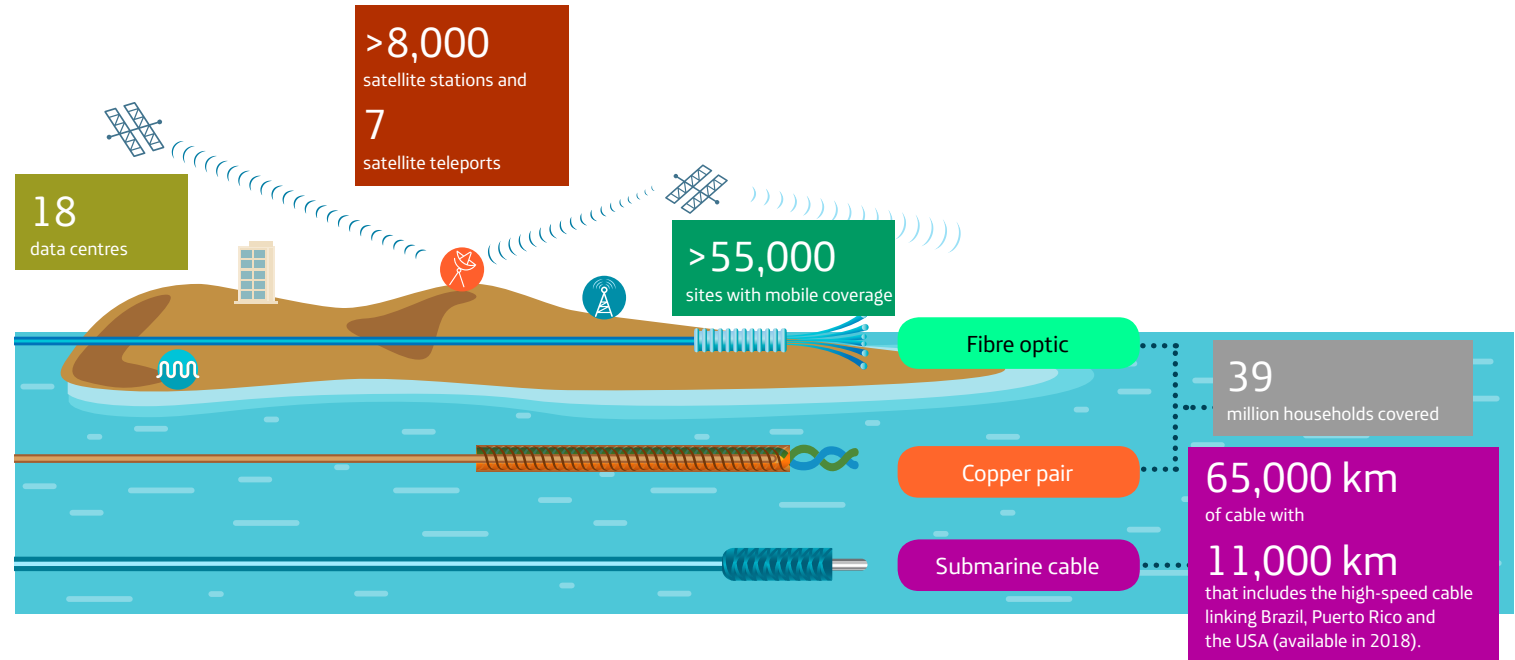- BRUSA Cable ready for service in 2018

FIXED NETWORKS

During the last year we reached 39 million households with fibre and cable networks in Spain, Brazil and Latin America, and 9.2 million fibre + VDSL customers. In addition, our fibre optic and cable customers increased by 24% compared with 2015, accounting for 43% of total fixed broadband accesses. As for pay TV services, we recorded 8.3 million accesses over the past year.

Telxius

We should highlight the creation, in 2016, of Telxius, a Group subsidiary which brings together some of our main physical assets, and has become one of the leading providers of telecommunications infrastructure services in Europe and America. Its main objective is to increase the number of services provided to other operators and to participate more actively in the existing growth opportunities in the sector, including the possibility of incorporating third-party assets.

Business Solutions

Our Business Solutions division provides international telecommunications services in more than 170 countries to fixed and mobile operators, ISPs and content providers. Thus, we have more than 8,000 satellite stations and 18 data centres (including the largest data centre in Europe to have TIER IV Gold certification). For further information, see the chapters on 'Environment'.

>8,000 satellite stations and

7 satellite teleports

18 data centres

>55,000 sites with mobile coverage

Fibre optic

Copper pair

Submarine cable

39 million households covered

65,000 km of cable with **11,000 km** that includes the high-speed cable linking Brazil, Puerto Rico and the USA (available in 2018).

MILESTONES IN 2016

Increase LTE coverage in Spain to over 85% (compared with 75% in December 2015). — *100% Achieved*

Expand LTE coverage in Brazil to 60%(compared with 46.6% in December 2015), reaching 352 cities. — *100% Achieved*

Reinforce our commitment to digital inclusion, focusing our investment on improving access to high-speed Internet services and adapting our offer to the needs of our customers. — *100% Achieved*

CHALLENGES FOR 2017

To strengthen FTTH coverage in Brazil, reaching 18.8 million households, and expanding LTE coverage to 80% of the population.

To increase 4G coverage in Europe to 90%.

Extension of VoLTE technology deployment in Latin America and Europe.

Digital transformation_

Our systems add smart ways of administering our physical infrastructure and help us, by digitising the whole value chain, to become a real-time, automated and convergent company. We are a company driven by data, using them to enrich and simplify the lives of users and improve business efficiency.

We thus build customised products and services for our customers, ranging from connectivity services to video, security systems, cloud storage and the Internet of Things.

DIGITISATION

The digitisation of our systems, which makes up what we call the second platform, is fundamental if we wish to become a competitive company in the current markets, managing the interactions of our products and services with our customers. We thereby promote a comprehensive transformation of the business and capitalise on technology as a key facilitator. We are transforming

our processes and systems in a profound, structural and standardised manner.

During 2016 we managed to make 49% of our processes digital. In this way, we can improve the experience of our customers and the administration of our products, obtaining operational benefits. Our users can enjoy an omni-directional experience, switching seamlessly from one service channel to another. We promote the online channel and self-management in a personalised manner, enabling our customers to purchase and change products and services and solve problems autonomously.

This digitisation allows flexible portfolio management and leads to an offer in which we can integrate third parties in a faster and more straightforward manner.

This transformation simplifies and automates operations, improving processes such as invoicing, provisioning and service guarantees.
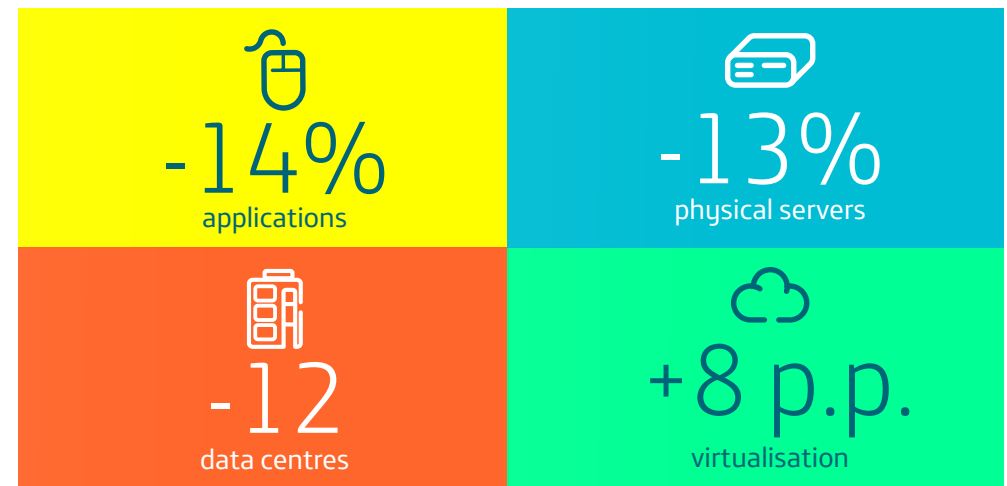
We thus reduce back-office needs and decrease errors. Thanks to more efficient data management, we can make more effective and streamlined decisions. In this sense, 59% of our customers have already migrated to the Online Charging System (OCS), thereby benefiting from accurate account information and consumptions in real time.

Thus, in the 2014-2016 period, our simplification has meant an increase of 8 percentage points

in terms of virtualisation, owing to a 14% reduction in the applications we use, 13% fewer physical servers and 12 fewer data centres.

SYSTEM SIMPLIFICATION
(2014-2016)

-14%
applications

-13%
physical servers

-12
data centres

+8 p.p.
virtualisation

In 2016 we managed to make

49%
of our processes
digital

DIGITAL SOLUTIONS:

Life is a collection of scenarios. Integrating devices and services, providing a simple digital connection, enriches and simplifies our daily lives. These solutions drive digital transformation, creating a more natural hyper-connected world, in which the Internet of Things is a living, natural and evolving fabric.

As a result of the above, our customers demand an integrated offer which goes beyond connectivity and includes communications, devices, video and digital services. Thus, under what we call our third platform, our digital services have grown by 14%, driven, among other factors, by the cloud, the data economy, security and IoT services.

Many of these services help us to address social and environmental challenges such as energy efficiency solutions, fleet management, and sensorisation and measurement systems. For further information, see the chapter on 'EcoSmart services'.

SECURITY

Connecting people with *things that matter to them*, opening up a whole world of possibilities

Personal

Communication is the basis of human interaction. Thanks to technology, our bodies and the things around us can "talk", taking us to a new dimension.

Home

Technology and connectivity are transforming our homes and the way in which we communicate and carry out our daily lives.

Cities

Cities are becoming centres of economic and social influence. The digital revolution is creating a hyper-connected and collaborative society, transforming life and allowing environmental sustainability.

Industry

Thanks to the digital transformation, companies are improving their flexibility, increasing their speed of production and efficiency and developing new processes, business models and products.

We live in a digital society in which everything is hyper-connected, and it is essential to *guarantee the security and privacy* of solutions for our customers

In a technological world based on connectivity, security is essential in our digital lives. Nowadays, the threats are becoming increasingly frequent and sophisticated, affecting organisations and individuals and putting their economy, reputation, privacy and trust in jeopardy. To face this we have Eleven Paths, a specialised business unit which has the objective of endowing our services and products with. For further information, see the chapter on 'Digital Trust'.

Eleven Paths · *Telefónica* CYBER SECURITY UNIT

FURTHER INFORMATION Visit the Eleven Paths website

FURTHER INFORMATION

Eleven Paths

We create a **more secure** digital world

Telefónica CYBER SECURITY UNIT

BIG DATA AND COGNITIVE INTELLIGENCE

Connectivity is a concept which goes far beyond purely technical matters. We want to be a data-driven company. Therefore, by means of the use of cognitive power, the data from the three previous platforms are converted into knowledge by our fourth platform. Cognitive intelligence allows us to understand our customers better and establish a more natural and easier connection, generating a new relationship of trust with them on the basis of transparency and the control of their data.

**LUCA**

Telefónica DATA UNIT

In 2016 we launched LUCA, a new unit specialising in Big Data, the objective of which is to boost the digital transformation of our customers. We would like other organisations - both public and private - to evolve through management of their own data. In this way, LUCA enables organisations to accelerate their journey to Big Data by means of data engineering and business insights, based on data from more than 350 million accesses to our communications Network throughout the world, which enables us to offer highly
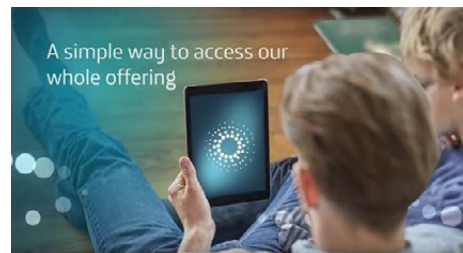
valuable information to both our private and corporate customers in sectors such as tourism, distribution and financial services.

FIND OUT MORE:

BIG DATA STORAGE

x 6.7

2016
27 PB

2014
4 PB

FURTHER INFORMATION ▶

A simple way to access our whole offering
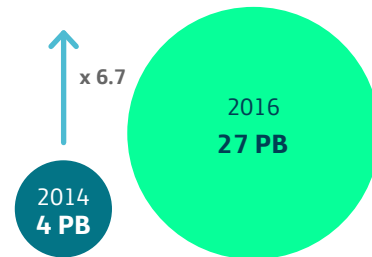
Simplify

Enrich

AURA

Empower

Discover

Our commitment to revolutionising the way our customers relate to us materialises under the name of AURA. Thanks to this initiative, users will enrich, as well as simplify, access to numerous use cases, via different media and using natural interaction (voice, text, etc.) with our products and services. This new form of interaction will allow us to build a path of trust, facilitating the opportunity to complement their digital experience with the discovery of new ways of putting their data to work.

AURA will provide transparency in data management, as it will allow users to know what we store; they will be able to decide which data they wish to eliminate from their digital lives with us and, in addition, we can offer new

services based on those generated on our platforms. With AURA the customer is in charge and is the person who decides what is to be done with his or her data.

To implement this new customer relationship model, AURA relies on cognitive technology which, thanks to its state-of-the-art computing capabilities, is able to implement the power of reasoning of artificial intelligence solutions. Thus, it allows generation of a personalised response that takes into account the context in which the user expresses his or her need and offers very short response times.

Innovation_

Innovation is the fundamental tool that enables us to be a key player in the digital revolution and to encourage solutions which are capable of addressing the big challenges and the sustainable development of our business.

HOW DO WE ENCOURAGE INNOVATION?

Through our internal capabilities and the creation of open ecosystems we encourage all phases of innovation, from its initial stages until the investment and acquisition of companies and solutions.

MANAGEMENT FOCUS

WHY IS IT A KEY ISSUE?

Our ability to develop sustainable solutions allows us to offer products and services that are new, unique and increasingly innovative, to our customers.

WHERE IS THE IMPACT?

Innovation has an impact in all areas of our business, from the research and development departments, to the commercial and business units which seek to become more effective through innovation.

TELEFÓNICA'S OBJECTIVE

We want to promote the generation of new business opportunities to devise solutions that build a more sustainable world, and at the same time create a competitive advantage and unique products.

Indicators	2015	2016
R&D&I investment (Millions of euros)	6,582	6,568
Patent portfolio	545	577

SUSTAINABLE DEVELOPMENT GOALS

8 DECENT WORK AND ECONOMIC GROWTH

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

11 SUSTAINABLE CITIES AND COMMUNITIES

We are committed to technological innovation as a fundamental tool to become one of the main players in the new digital universe, with the capacity to help create a more sustainable world and, in turn, obtain competitive advantages and unique products.

Through the introduction of new technologies and developing business solutions and processes, we aim to become a more effective, efficient and customer-oriented Group.

We base our innovation strategy on the balance between two work streams:

▶ Promotion of our internal research, development and innovation (R&D&I) capabilities, for which we have developed our own innovation model. This allows us to promote the application of technical research in developing commercial products and services using the knowledge gained in research centres, technological institutes and universities, among other sources.

▶ Promotion of the creation of open innovation ecosystems, in which the Open Future initiative stands out as a global programme designed to connect entrepreneurs, start-ups, investors, venture capital funds and public and
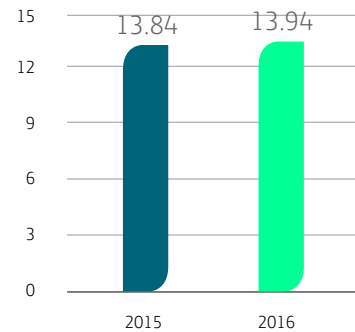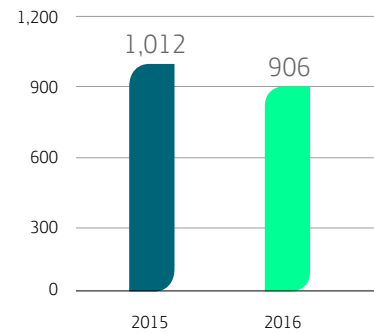
R&D&I INVESTMENT

Millions of euros
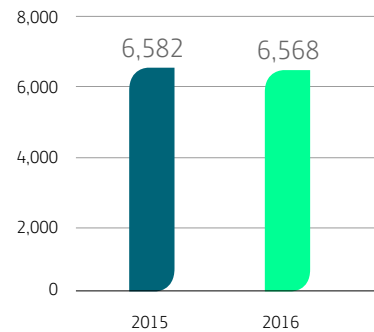
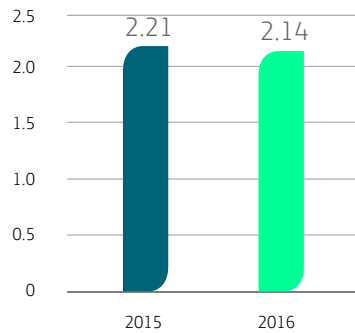### R&D&I INVESTMENT / INCOME

%

R&D INVESTMENT

Millions of euros

R&D INVESTMENT / INCOME

%

Note: The 2015 figures consolidate the GVT and DTS results from 1 May 2015 and consider, from the first quarter 2015, the Telefónica UK operations as discontinued operations.
However, the results of 2014 are not like for like and include the contribution from Telefónica UK but do not include GVT or DTS. Therefore, these figures are not comparable.

private organisations around the world which promote innovation in collaboration with other agents.

In parallel with these two models, Telefónica seeks to promote the development of sustainable solutions that generate a positive impact on the economic, social and technological progress of all the regions in which we operate.

R&D IN FIGURES

This year, a total of 6,568 million euros have been spent on R&D&I. Also worthy of note is that, for another year running, we are the world's fourth largest Telco Company investor in innovation, and the second in Europe, according to the 2016 EU Industrial R&D Investment Scoreboard report by the European Commission.

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We are the World's fourth largest *Telco* investor in innovation and *the second* largest in Europe

PORTFOLIO OF REGISTERED PATENTS

Year	Patents
2012	200
2013	346
2014	454
2015	545
2016	577
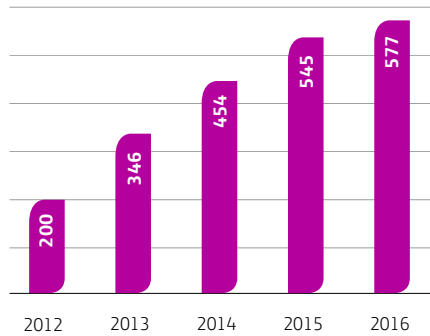
During 2016, Telefónica registered 27 new patent applications: 3 through the American office (USPTO), 2 through the Chilean office (INAPI) and 22 through the Spanish Patent and Trademark Office (Spanish acronym: OEPM), 7 of which were international applications (PCT) and 15 were European. Moreover, 1 utility model was registered in Spain, also through the OEPM.

INTERNAL INNOVATION

We firmly believe that the competitive advantage that innovation offers cannot be based solely on acquired technology. For this reason, we consider it a core strategy to promote internal innovation, research and development activities, with the aim of achieving this differentiation and advancing the fundamental work areas which guarantee the sustainability of our business.

Our internal innovation policy focuses on contributing solutions that guarantee Telefónica's commitment to developing a responsible business under the criteria of economic, social and environmental sustainability.

One of our main tools for managing internal innovation are our centres of technological excellence. We have centres in the United States, Israel, the United Kingdom, Chile and Spain (Barcelona, Granada, Huesca, Madrid and Valladolid).

More than 79 Spanish and foreign universities and research centres have helped us to create one of the most important innovation networks in the field of new technologies. We also cooperate with other European operators and institutions.

We run our internal innovation on the basis of these main core areas:

INNOVATION IN NETWORKS AND COMMUNICATIONS

INNOVATION IN PRODUCTS, SERVICES AND BIG DATA

APPLIED AND EXPERIMENTAL DISRUPTIVE INNOVATION

INNOVATION IN NETWORKS AND COMMUNICATIONS

The main objective of this innovation stream is to achieve more flexible and adaptable networks that are capable of providing support to the changing needs of the digital world while improving efficiency on a global level. To do this, we propose new technological solutions, in addition to coordinating and working with the industry and contributing to international standardisation.

Of particular note in 2016 are the projects we have carried out in the new networks designed for the management devices of IoT (Internet of Things), such as NB-IoT (Narrow Band) or LTE-M, as well as those designed to meet connectivity requirements and battery power consumption of the new sensors, used in a wide range of current solutions, such as water, light or telemetry sensors.

BEST PRACTICES

ONLIFE NETWORK

This is an initiative which explores the benefits of implementing solutions in the cloud, within the limits of our Network infrastructure.

Currently there is a growing demand to obtain a low lag time in communication, increasingly more accurate localisation and personalised experiences for our consumers and businesses. Connectivity of vehicles, autonomous robots or augmented reality are some of the services that require network solutions with a reduced lag time and high computational potential in order to be able to emulate real-life properly and thus facilitate interaction with humans.

To make these services possible, we have launched an innovation line focused on the concept of the "Onlife Network" that is developing, through cutting-edge technological solutions such as Network virtualisation or "Software Defined Networking", mini data centres located in their own Network infrastructure, with the aim of positioning ourselves as close as possible to the end users.

INNOVATION IN PRODUCTS, SERVICES AND BIG DATA

Beyond the new network capabilities and the new communications services, we work in the development of new solutions for the future in areas such as security, video and television distribution and multimedia content, services for the digital home, advanced solutions for agriculture or mining, new tools for the management of communications or content in the cloud. In addition, one of our principal lines of research is giving value to data (Big Data) in all aspects of our work.

These projects, among others, were undertaken based on our objective to quickly identify emerging technologies that may have a significant impact on our business, and to test these technologies in pilot projects related to new services, applications and prototype platforms.

To do this, a central ingredient in this way of working is the use of the Lean Startup methodology. In fact, we have been world pioneers in its application in a big corporation with the creation of the Lean Elephants methodology, which has generated business cases in the prestigious Universities of Berkeley and Harvard. This model divides the design process into 4 phases that are worked on to

WE DIVIDE OUR PROCESSES INTO 4 PHASES

to ensure the implementation of future new businesses with a greater chance of success.

Pre-conception of ideas
PHASE 1

Conception of ideas
PHASE 2

Execution
PHASE 3

Implementation
PHASE 4

create a commercial solution with an internal startup model, which then has to pass through each of the different phases before a new solution can be launched on the market.

In addition, we emphasize the search for innovative ideas among our employees through calls for innovation. These allow us to improve processes and create new solutions. In line with this, we have created a global framework of in-house enterprise called "in_prendedores" (in_trpreneurs), which integrates all the assets the Group has dedicated to innovation in order

to make them available to all those workers who are able to show they have a potential idea. In this way, Company resources will be made available to them and they will be able to devote part of their time to developing their own initiative internally.

BEST PRACTICES

TOKBOX

TokBox is a Telefónica Group company that develops and operates OpenTok, a global cloud platform which integrates live video, voice, messaging, and screen-sharing experiences on websites and mobile applications.

The platform, which is scalable and customisable, allows companies to develop all types of video communications, from a chat between two people to an emission involving a large number of sources. All this allows us to offer services such as virtual medical consultations and live diagnostics, interactive educational tutorials, or to facilitate activities such as remote teams and customer services workers.

APPLIED AND EXPERIMENTAL DISRUPTIVE INNOVATION

With a view to the future, we have innovation teams whose mission is to investigate the future possibilities of technology as well as to meet the challenges of social, environmental and economic issues that are emerging, to convert them into business opportunities that will enable us to ensure our long-term sustainability.

In this sense, we have created Telefónica Alpha, a new subsidiary focused on product innovation and the development of disruptive technologies. This area seeks to take this innovation into the long-term future production of new technologies. Thus, we are concentrating on areas such as voice recognition, tactile and visual communications, with a focus on technological products that are at an embryonic stage and still have a long way to go in their maturation process before they can finally be launched to the market.

Within this type of innovation we are also exploring the possibilities of cognitive intelligence. Thus, AURA, a solution that redefines our interaction with customers has been born. For further information, see the chapter on 'Digital Transformation'.

OPEN FUTURE: OPEN INNOVATION

We group all our activities, initiatives and projects in the field of open innovation together under the Telefónica Open Future unit, a global and open programme that has the aim of connecting entrepreneurs, startups, investors and public and private organisations from all over the world.

Through Open Future we aim to develop talent and digital-technology enterprise in any of its phases. This initiative was created in response to the demands of a new era in which connection between different ecosystems is a key factor. Thus, 7 initiatives converge within the programme, aiming to convert ideas or projects into models of success:

▶ Encourage (Think Big and Talentum Startups)

▶ Accelerate (Crowdworking and Wayra)

▶ Invest (Telefónica Ventures, Amerigo and CIP Telefónica).

OPEN FUTURE VALUE CHAIN
Data accumulated December 2016

CIP TELCO FUND
▶ Consolidated demand

INVEST

amerigo
▶ 8 funds
▶ 87 companies invested in
▶ 9 successes
▶ +345 M€ committed

Telefónica Ventures
▶ Global presence
▶ 22 companies invested in
▶ 5 successes
▶ 67 M€ invested by Telefónica

ACCELERATE

wayra.
▶ 11 academies in 10 countries
▶ 618 startups invested in
▶ 21 successes
▶ 199 M€ third party investment

CROWD WORKING OPEN FUTURE
▶ 33 operating spaces:
Argentina (4), Brazil (3), Chile (1), Costa Rica (1), Ecuador (1), Spain (12), Finland (1), United Kingdom (3), China (6) and Korea (1)
▶ 906 accelerated startups

talentum
▶ 976 grants
▶ 673 companies benefited

ENCOURAGE

think big
▶ 14,700 projects
▶ 122,600 young people
▶ 4,800 volunteer mentors

▶ 49,900 users
▶ 153 calls / challenges
▶ 18,000 projects

By means of tools like Think Big, Talentum, the Crowdworking spaces, Wayra, Telefónica Ventures, the venture capital funds of Amerigo and CIP, we can invest in people, ideas and viable projects based on technology, at any stage of their growth. We do this openly and in connection with public and private organisations.

Our open and transformative nature is one of the main features of Telefónica Open Future, the initiatives of which enjoy the collaboration and participation of public and private organisations, universities, co-investors and other stakeholders in the telecommunications sector and other industries.

With a team of 90 people present in 17 countries in Latin America, Europe and Asia, and a global network of more than 85 partners, from the beginning of the programme and until December 2016, we have received and analysed 50,000 projects and 18,000 entrepreneurs, who are developing their projects, connected through our digital tool. We have also helped to accelerate more than 1,500 startups in our academies and Crowdworking spaces and invested in more than 700 startups.

So, thanks to Open Future, Telefónica ended the year as one of the main investors in Spain in the area of open innovation, and positioned itself as one of the major Venture Capital

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At *Telefónica Open Future* we believe that business talent responds to the demands of a *new era* in the field of *innovation*

investment funds in Europe and Latin America.

In 2016 we promoted the rotation of our portfolio. Some of the successes to be highlighted are Ticketbits and Trip4Real from Amerigo, Busportal, BuzzMove, Clever and CinePapaya from Wayra.

Some of the new startups, invested in through the Amerigo funds, presented promising expectations, such as in the case of Job&Talent (88 M€), Carto (81 M€), LogTrust (Valued at: 40 M€) and Iguama (Valued at: 22.5 M€). In addition, we have ratings that exceed 150 M€ as, for example, in the case of Wallapop (384 M€).

TELEFÓNICA OPEN FUTURE IS A UNIQUE OPEN INNOVATION NETWORK
We encourage global talent by transforming innovative ideas into successful companies

Programme initiatives

▶ Crowdworking
▶ Wayra
▶ Telefónica Ventures
▶ Amerigo
▶ CIP (Open Innovation Factory)
▶ China Open Future
▶ Finland Open Future
▶ Korea Open Future

+700 companies invested in

+1.500 accelerated startups

+85 public and private partners

17 countries

445 M€ total committed investment from our partners
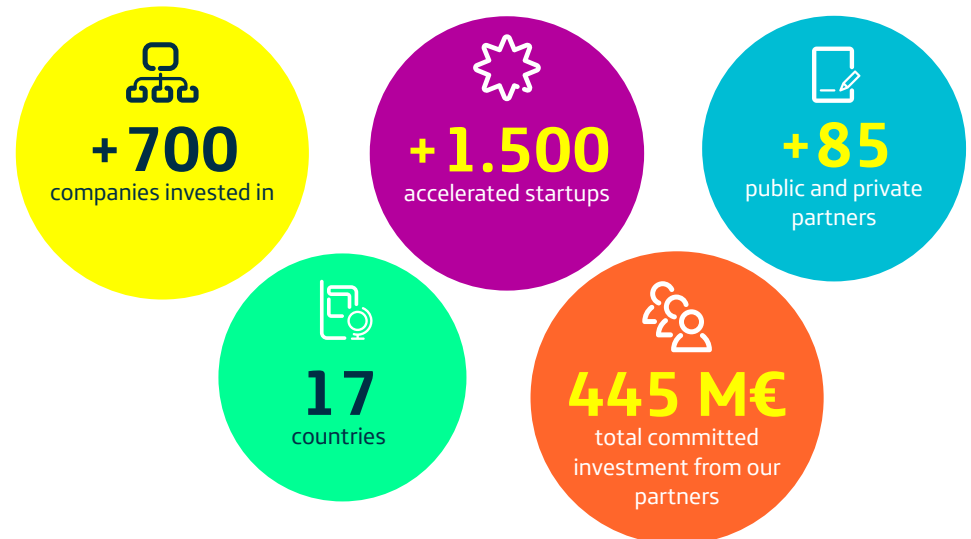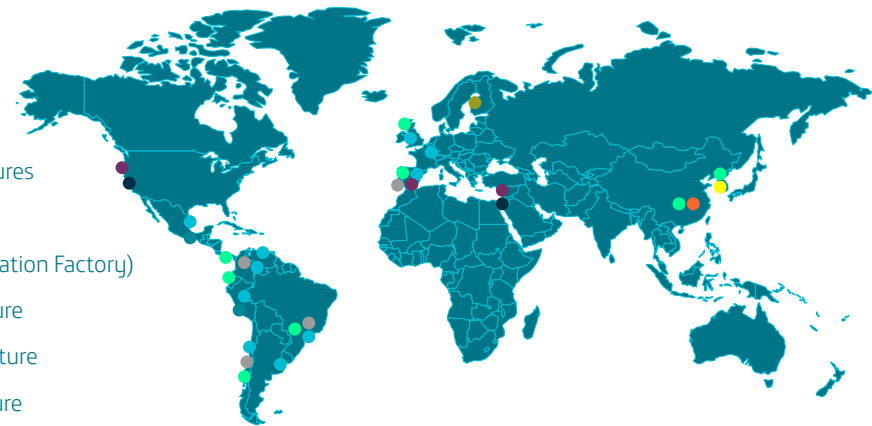
Some of the companies that Telefónica Ventures participates in are considered success cases due to the revenue or savings implied for the Telefónica Group. Among those that stand out are:

ASSIA: Solutions provider for operators of broadband services all over the world. ASSIA solutions allow operators to increase revenues, increase customer satisfaction, improve operational efficiencies and deliver new multimedia content to households with broadband. Since participation started, ASSIA has contributed to more than 53 M€ in savings for the Telefónica Group.

BOKU: The most important mobile payment service platform in the world. Participation in Boku has resulted in 20 M€ of net revenue for the Telefónica Group.

BEST PRACTICES

QUANTENNA

Quantenna, a startup owned by Telefónica Ventures and available for sale after its IPO in October 2016, has a value of more than 600 M€, which implies a latent capital gain of 4X.

Quantenna

MILESTONES IN 2016

Continue leading in R&D investment in Spain, as a driving force for the creation of value and progress in the sector and in society.

100% Achieved

Be a leading investor and accelerator in new technological companies in Spain and Latin America.

100% Achieved

CHALLENGES FOR 2017

To lead in R&D investment in Spain and remain among the top 5 Telcos in global R&D investment.

To continue being a leading investor in technology companies in Spain and Latin America.

The commercial launch of AURA in some of the countries in which we operate.

To strengthen the in-house enterprise and spirit of innovation among employees through the in_prendedores programme.
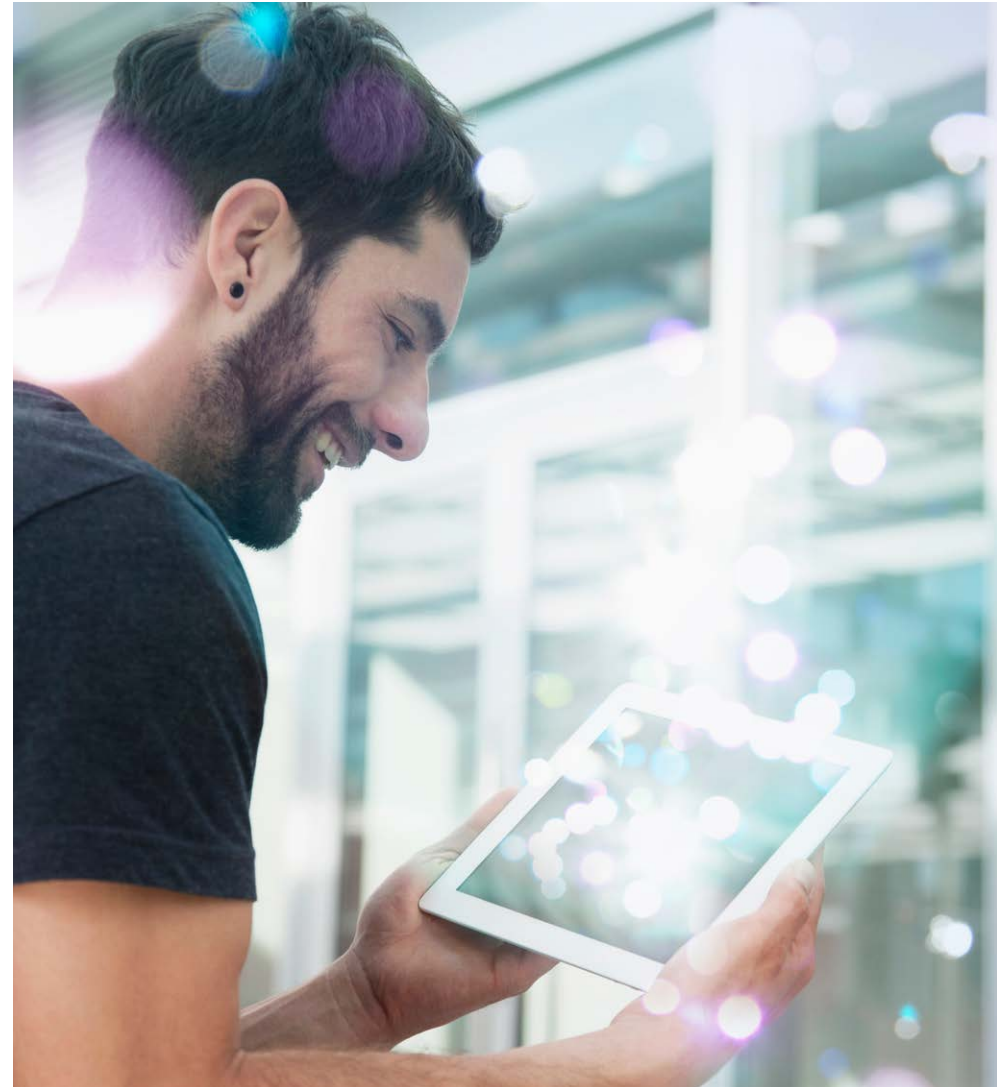
6

Commitment to the customer

- Commitment to our customers
- Digital trust

Commitment to our customers

"We're expanding the relationship with our customers, seeking to increase their satisfaction, and opening up new possibilities to them so that they can enrich their digital lives with us"

José María Álvarez-Pallete
Chairman & CEO

Today any company will state that their strategy is focused on listening and responding to the demands of their customers. When it comes to the connectivity service and other value-added digital services, the focus on the customer is not optional, it is a necessity. The markets in which Telefónica operates are highly competitive, and in the digital field, our customers' expectations have multiplied. We adapt our customer strategy to the markets, but we are aware of the importance of maintaining common standards aligned with the values of integrity, commitment and transparency which characterise our company culture.
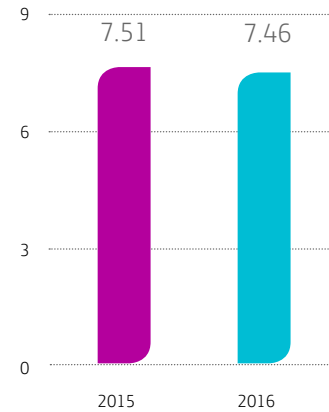
HOW DOES IT WORK?
Customer experience is affected by a combination of factors and activities within the Company, and thus becomes one of the most important objectives across the whole organisation. Taking just the case of the mobile

service for example, customer experience is influenced by elements as diverse as Network coverage, the quality and speed of the connection, the digitisation of the experience, the simplicity and the transparency with which we continuously communicate the terms and conditions of our service, the friendliness and efficiency of our call centres, effective management on the part of our suppliers, etc. All this requires a holistic management of what the customer expects from us and some shared incentives.

At Telefónica, each operator uses multiple indicators to measure the customer experience (Churn, NPS, customer care satisfaction surveys, response times, etc.). However, there is one that influences the remuneration of all of the Company's employees and that reflects therefore the significant and transversal nature of customer experience for the Group.

OUR CSI

In 2015 it was established that *50% of the variable remuneration* of Group employees would be directly linked to customer satisfaction levels

We are currently in the number 1 position for our sector according to the Customer Satisfaction Index (CSI) in 10 of our 17 markets.

Governance
The quality or customer experience plans are strategic for all operators within the Group and they are reported to the highest level in the executive committees of each company.

In addition, at Group level, the Board of Directors has a specific Committee dedicated to Quality which meets quarterly to review the development of the different countries' plans and the CSI globally.

Finally, Telefónica incorporates into its customer strategy a firm commitment to the right to privacy and control of personal data. This strategy is led by the Chief Data Officer, at global level, who forms part of the Group's Executive Committee.

Initiatives

In 2016, multiple initiatives aimed at improving the customer experience were carried out, both at the Group level and locally in each country. Some examples are:
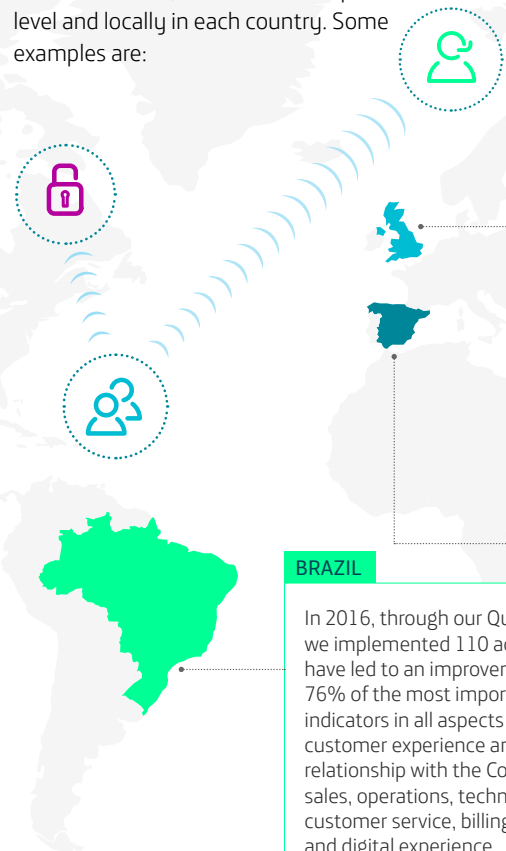
UNITED KINGDOM

At Telefónica UK we are in a continuous process of innovation. Through digitisation and personalisation, we ensure that our customers are more satisfied and loyal; we reduce Churn, which enables us to increase value for our customers. Our omni-channel is the best in the mobile sector in the country. By way of example, in 2016 we implemented a new development that allows us to deliver orders placed before midnight the following day. In addition, we are building a customer experience engine based on data, which will lead to even greater personalisation.

In 2016, Telefónica UK received several acknowledgements thanks to our customer service and operational experience:

- Branded Number 1 in Customer Service by the regulator Ofcom for the seventh consecutive year
- Web page of the year, for the third consecutive year
- Best "Pay As You Go Network" in the Switch Mobile Awards 2017
- UK Business Award for best customer-focused organisation
- Best retail network in the Mobile News 2016 Awards
- Best customer service in the Mobile Choice Consumer Awards 2016
- British Franchise Association Customer Focus Awards 2016

GLOBAL

E2E digitisation

As part of our commitment to our customers, we are implementing a global digitisation strategy through provision of a real time omni-channel experience, while at the same time adjusting our processes to comply with Lean methodology. This means that we are transforming all the processes and core systems that support the customer value chain (how we launch our products, how to sell and bill them, how we resolve requests and problems, how we consolidate them and even how we finalise the service), generating new digital skills.

The Full Stack and Satellite projects are being implemented in 15 markets simultaneously. 2017 is a key year for us as we have set ourselves the goal of migrating a significant number of our customers (from 13 to 42%) to these platforms and increasing our level of E2E digitisation of processes from 50% to 67%, almost doubling it by 2019.

BRAZIL

In 2016, through our Quality Plan, we implemented 110 actions that have led to an improvement in 76% of the most important quality indicators in all aspects of the customer experience and in their relationship with the Company: sales, operations, technical support, customer service, billing, charges and digital experience.

We have also expanded the digital channels available (our application has reached more than 40 million contacts in December 2016 and the virtual assistant, *Vivi*, is now capable of responding to more than 90% of questions thanks to artificial intelligence). We perform internal awareness actions such as awarding the Quality Value Trophy to recognise initiatives that have contributed to the transformation of customer experience. In 2016, the year in which we achieved a score of 7.27 (on a scale of 1 to 10) in the Customer Satisfaction Index (CSI), more than 250 projects were registered.

SPAIN

In Movistar Spain we have greatly improved understanding and accessibility of our privacy and security conditions, through the implementation of a Privacy Centre which explains Telefónica's policy. Here, the terms and conditions of the contracts we offer can be found, along with how data collected by the Company is used.

110

actions implemented in 2016, through our Quality Plan

MAJOR CUSTOMERS

Our Telefónica Business Solutions division is responsible for providing comprehensive communication solutions for the B2B market and for managing commercial operations for businesses (multinationals, large companies and SMEs), wholesalers and Telefónica Group roaming.

CUSTOMER LIFE CYCLE

- **PRE-SALE**
- **SALE**
- **SUPPLY & INSTALLATION**
- **USE**
- **COMMERCIAL SUPPORT**
- **TECHNICAL SUPPORT**
- **RENEWAL AND RETENTION**

We support our customers in an agile, quick and efficient way. To do so, we offer experiences through an integrated operational improvement programme which is designed to encompass all the different types of interaction that a customer has with our Company throughout their life cycle.

With the objective of offering our customers a distinctive operating model where technology and the use of information make a difference, we are working on a complete transformation project aimed at developing the way we interact with our B2B customers, the products and services we offer and our internal departments.

This operating model is based on three pillars:

▶ **1. Optimisation of processes**
We define and implement improvements in processes, systems, personnel, KPIs and the organisation itself. To do this, we have in place our own Quality Model that sustains the continuously improving procedure.

▶ **2. Optimum coordination of functional areas**
We classify and map key interactions with our customers, allowing us to identify the relevant points of contact and, consequently, to work on improving them using the Lean methodology of redesigning processes.

▶ **3. Digitising daily customer interactions**
We incorporate intelligent automation of processes and provide intelligence to facilitate decision-making. In addition, we are working to integrate the customers' and the Company's points of view with the purpose of achieving an unbeatable experience.

B2B Quality Model

- Questionnaires launched
- **Definition of objectives and KPI processes (Illuminati)** — 1
- CSI objectives agreed
- **Measurement of quality perceived and provided** — 0
- **Analysis and selection of processes to be improved** — 2
- Monthly control panel launched
- Processes selected and agreed
- **CSI and KPI monitoring B2B quality control panel** — 8
- **Analysis of selected processes** — 3
- **Measurement and Follow-Up**
- **Analysis**
- Definitive improvement opportunities
- Regular monitoring meetings
- **Implementation and Monitoring**
- **Implementation plan**
- **Monitoring of improvement initiatives** — 7
- **Identification and formalisation of improvement initiatives** — 4
- Improvement initiatives launched
- Defined implementation plan
- **Creation of Improvement initiatives** — 6
- **Definition of the Management System** — 5
- Management System implemented

IN THE B2B SECTOR WE LEAD IN SATISFACTION AND IN NPS

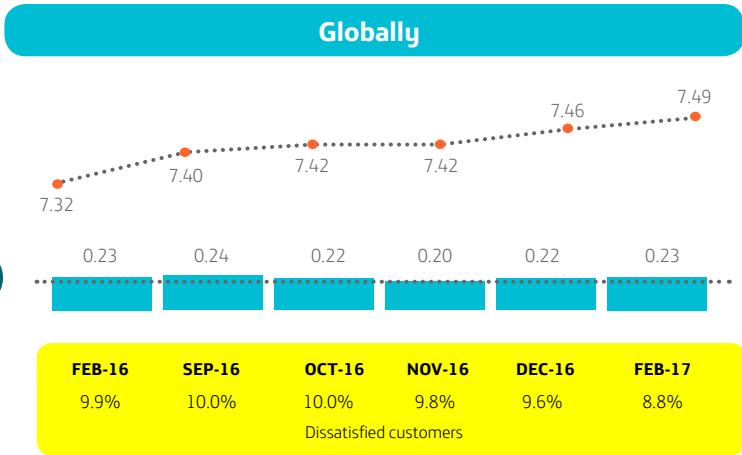In February 2017, we achieved a global B2B CSI of 7.49, the highest value achieved so far during the period measured. In addition, the NPS remains very positive, reaching a value of +18%, with 40.8% of our proponents in this sector.

CSI and the contrast with our competition

Distribution of proponents and critics
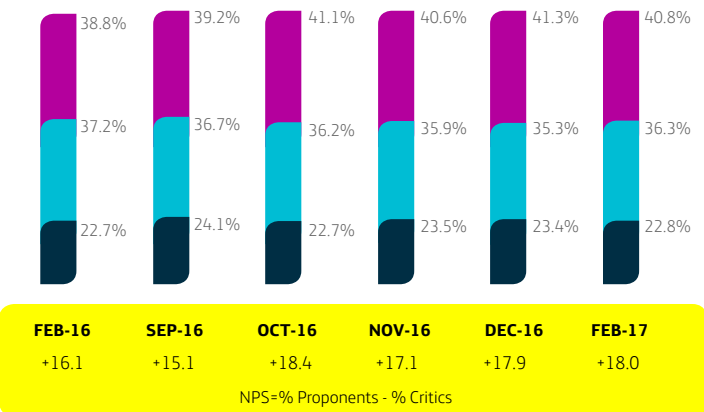
* Based on a question of recommendation

Globally

7.32   7.40   7.42   7.42   7.46   7.49

0.23   0.24   0.22   0.20   0.22   0.23

FEB-16	SEP-16	OCT-16	NOV-16	DEC-16	FEB-17
9.9%	10.0%	10.0%	9.8%	9.6%	8.8%

Dissatisfied customers

● Telefónica CSI   ■ Contrast with our competition

	FEB-16	SEP-16	OCT-16	NOV-16	DEC-16	FEB-17
Proponents	38.8%	39.2%	41.1%	40.6%	41.3%	40.8%
Neutral	37.2%	36.7%	36.2%	35.9%	35.3%	36.3%
Critics	22.7%	24.1%	22.7%	23.5%	23.4%	22.8%

FEB-16	SEP-16	OCT-16	NOV-16	DEC-16	FEB-17
+16.1	+15.1	+18.4	+17.1	+17.9	+18.0

NPS=% Proponents - % Critics

▶ Proponents (9-10)   ▶ Neutral (7-8)   ▶ Critics (1-6)

Objectives

7.46
0.18
9.4%

BEST PRACTICES

IN MULTINATIONAL COMPANIES AND WHOLESALERS THE VOICE OF THE CUSTOMER IS HEARD

With implementation of the Voice of the Customer (VoC) programme, the aim is to continuously improve interaction between multinational and wholesale customers and the services offered by Telefónica Business Solutions. Through the programme, efficient and effective responses can be provided according to customer needs and, thus, improve their experience with our Company.

We systematically document customer feedback at all levels, spreading the Voice of the Customer throughout the organisation so that it provides the main input for the content of improvement plans and it creates "customer records" when cross-referencing the information on quality provided with that on quality perceived.

The main objectives of this project are to optimise the product and services offered to customers, to improve customer satisfaction, reduce Churn and improve the working environment for employees.

BEST PRACTICES

OPERATIONAL CUSTOMER SERVICE MODEL

At the end of 2015, Brazil initiated transformation of its corporate sector Service Model with the aim of improving customer satisfaction and streamlining operations.

The Global Telefónica Business Solutions team has been supporting the Brazilian operator in this transformation ever since. It has created a more personalised Service Model, with greater E2E vision and integration of Corporate and Top VIP operations.

The results of the month of February 2017 reached a value of 7.47 (+0.32 p.p. YoY) and a reduction of customer service costs (-5%). The next challenges for 2017 are to work on fixed-mobile convergence of Post Sales customer service and on operational integration with Vivo2.

GLOBAL OPERATING SME TECHNICAL SUPPORT MODEL

A new Global Technical Support Model was defined in 2016 with the aim of transforming this process to suit SME customers.

The project started with implementation in the Spanish operation, which led to improvements in the front line of service of +0.72 p.p. in satisfaction and reduced the volume of dissatisfied customers by 60%. In addition, the improvements observed in the second line of service were +0.8 p.p in satisfaction and a reduction of 63.75% of dissatisfied customers. This experience was documented and is being replicated across all the convergent operators of the Group (Argentina, Brazil, Chile, Colombia and Peru).

63.75%
reduction in dissatisfied customers

BI_EN (SALESFORCE) PLATFORM

For the last two years, we have been working on the definition and implementation of an architectural system for the B2B sector, in all operators and global areas, in order to cover all the needs of our business. In this context, we have selected Salesforce as a tool for the management of the macro-processes of marketing, pre-sales and sales, integrating them with different transactional tools for the management of orders, provisioning and billing, and with various Fullstack projects and global digital service platforms.

With Salesforce we have developed what we call BI_EN (Business Intelligence for *empresas y negocios* - companies and businesses), constituting the first step of this transformation and including:

- 360° customer vision for all countries, products and channels.
- "Out of the box" processes by applying best practices and standardised processes (adapted to the reality of each operation)
- A unique catalogue with both a local and global vision
- Sharing of global data instantly through a homogeneous information structure

- Scalability and efficiency thanks to the features developed in unique effort for all countries and maintained by an internal global centre of excellence (in Global IT).
- Easy incorporation of new channels and areas: "opex based".
- Facility for establishing shared capabilities.

We have already implemented BI_EN in 12 countries and in the global B2B areas, reaching more than 5,000 users, 476,000 active customers, and reflecting 2,000 billion euros of opportunities gained in 2016.

476,000
active customers
on the BI_EN platform

Digital trust_

INTRODUCTION

We live in a world defined by connection and data. In turn, society is becoming increasingly concerned with how personal data is protected and kept safe. According to an Accenture survey from 2016 of 28,000 consumers in 28 countries on the use of technology, 47% of those surveyed expressed concern for privacy and security (Accenture's 2016 Digital Consumer Survey).

Regulations also reflect these concerns; in May 2018, a European law on privacy will come into effect - the European Regulation on the Protection of Personal Data. We feel that this is a significant step forward in the fundamental right to privacy, offering EU citizens greater control over their personal data. The goals of the GDPR match Telefónica's strategy to provide customers with privacy, transparency and control over their data.

In Latin America, regulators are also increasing measures to protect users. For example, in January 2017, the Peruvian Legislative Decree to create the National Authority on Transparency and Access to Public Information was published, strengthening the Personal Data Protection Regime and the regulation of the Management of Interests.

At Telefónica, we share this concern. We know that digital trust must be a key element of our promise to customers, and that we need to go beyond simply fulfilling current legislation. As a result, we are committed to a series of basic principles:

1. Individuals' data mast be protected and secure:
Security and data privacy are the foundation of our business, and must be our principal concern when designing our services or collaborating with third parties.

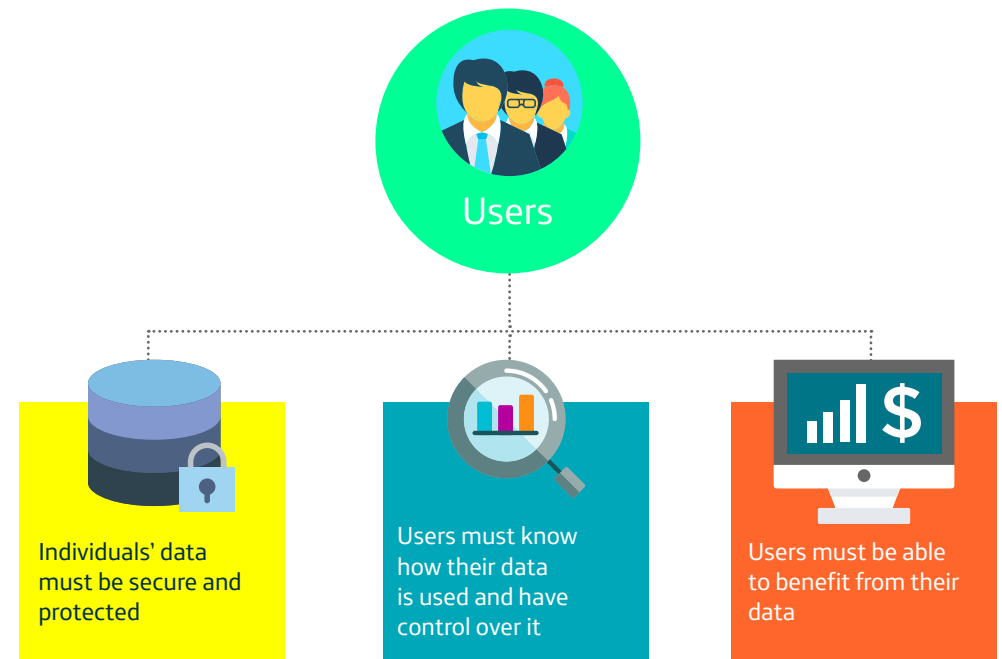**2. Users must know how their data is used and have control over it:**
Customers must be able to easily access their data and understand how it is used. We need to provide simple tools that allow for data decision management. Transparency throughout the service life cycle is a basic principle that defines our relationships with customers and partners.

3. Users must be able to benefit from their data:
With the consent of the customer, we will put their data to work to make our services simpler and more useful, with the goal of personalising their experiences or of offering them new services that fit their profile. We will innovate in our collaboration with other companies to offer services based on this data, and to generate value for them and for society.

In addition, privacy and cybersecurity are two of the aspects included in the Company risk management model. For further information, see the chapter on 'Identifying and managing risks'.

Users

Individuals' data must be secure and protected

Users must know how their data is used and have control over it

Users must be able to benefit from their data

GOVERNANCE OF DIGITAL TRUST

Digital Trust (the protection of the right to privacy, data security and information, the protection of the right to freedom of expression), together with the protection of human rights in general, are issues which fall under the responsibility of the Board of Directors, through the Regulation and Institutional Affairs Committee. This Committee is in charge of driving and supervising the implementation of our Global Responsible Business Plan, which includes specific goals on these matters.

At Telefónica, we also have a Chief Data Officer, who is part of the Executive Committee of the Group. Their principal objective is to define the Company's global strategy on data, or, in other words, on the cognitive intelligence services associated with Big Data. This strategic function ensures that data privacy and security are key elements considered in all our services, no matter where we are.

We also have a Chief Privacy Officer who ensures that the Privacy Policy is adhered to in any operation we are a part of. Furthermore, we have a Data Privacy Officer for each operation, who ensures that our actions on a local level comply with our internal and external regulations. The Privacy Committee is the body in charge of coordinating all the actions to ensure data protection. In 2016, we held regional meetings where, among other issues, we discussed international transfers and adaptatation to the new Regulation 2016/679 on the protection of the treatment of personal data.

The Global Security Director is the head of the area of security for the Telefónica Group, answering directly to the CEO. The Director's area of responsibility includes protection of the Group's assets, both in vertical organisation (including business units) and in its transversal dimension (applicable across all three of its platforms): infrastructure and Network assets, information technologies and products and services.

Within the security organisation there are Security Officers at both global and local levels. Their obligations and responsibilities are defined and coordinated by the Global Security Director. Each company in the Telefónica Group has one of these Security Officers assigned to it, depending on what is the most efficient and effective solution in each case.

For coordination purposes, there is a Global Security Committee which meets every eight weeks and is presided over by the Global Security Director. Other participants include Security Officers from certain functions, companies, or territories, as well as those areas that are considered necessary at any given time. This Committee is responsible for supervising the Global Strategic Security Plan and the series of activities aimed at promoting specific action plans. Relevant security information for the Group, including both exterior and interior factors, is also discussed by the Committee,.

3 Committee meetings were held in 2016, in which a series of different issues were addressed, such as new challenges in data protection, the impact of the NIS directive, global management of physical security or criteria for security in the cloud.

PRIVACY BY DESIGN

We work on including customer privacy in the development of all our products and services, from the initial idea to its final implementation, providing customers with security, transparency and control over how they treat their personal data. This is what we call privacy by design, through which we take into account not only the guarantees provided by the applicable legislation on the subject, but also the customers' expectations with regard to privacy when using our products and services.

So, for example, in our fourth platform, from the very beginning experts in data protection have worked on defining customers' experience with the Company and on proposals for controlling and managing data. They have incorporated new, more intuitive, easy-to-understand mechanisms for transparency and informed consent, promoting the generation of a safe space which is open to new proposals and where, for example, customers can decide if they want to share the knowledge generated using their data with others in order to enrich their digital experiences.

INTERNAL REGULATORY FRAMEWORK

Our commitment to privacy, security and freedom of expression are included in different sections of our Responsible Business Principles, which were re-formulated (among other things) to emphasise the importance that these rights have for us.

The principle of "Respect for the Right to Privacy and Freedom of Expression" included in our Responsible Business Principles is applied through policies and internal regulations that establish common guidelines for all of our companies.

In order to guarantee that our customers' data and services are as safe as they need to be, we are reviewing our regulatory framework, bringing it up to speed with the latest international standards so as to adapt to current challenges and needs in privacy and global security.

Transparency and fluid communication with our customers or users are priorities, enabling us to make sure that our customers feel comfortable using our services. We ensure that they have clear, simple information on how we use their data, and that they have the option of communicating with us directly and easily if they have any doubts.

Privacy

Global Privacy Policy
Approved by the Board of Directors, this Policy establishes the guidelines that all the companies in the Group must follow in order to protect the privacy of our customers and all the stakeholders that entrust us with their data. Soon, an online policy will be approved, which will be updated in accordance with Company strategy and centred on the trust we need to generate among users.

Freedom of Expression

Global Procedure for dealing with requests from the competent authorities
Defines the procedure for attending to requests by the authorities in the countries where we operate, guaranteeing a response that respects the privacy and security of these requests.

Information Technology

Regulations on Basic Controls for Information Technology

Global Security

Global Security Policy
Updated in 2016. This new version, specifies the principles of legality, efficiency, co-responsibility, cooperation and coordination that structure the security activities within the Group. It also establishes the principal security roles within the organisation and establishes the basis of the normative framework.

Global Security Regulations (pending approval)
Currently being developed and/or updated, with specific regulations on:
▸ Classification of Information
▸ Incident Management
▸ Business Continuity
▸ Change Management
▸ Risk Analysis
▸ Supply Chain Security
▸ Access Control
▸ Security of the Platform
▸ Security of People
▸ Physical Security
▸ Security of Communications
▸ Asset Management
▸ Security in the Development Cycle
▸ Cybersecurity
▸ Review and Compliance

Global Privacy Centre:
A public point of reference available on the different telefónica.com sites for all the countries where we operate, which describes our position and our way of showing respect for privacy and security. Stakeholders have expressed great acceptance of this Centre, with our page having received 8,889 visitors from the time of its launch, in August 2016, to February 2017.

Movistar Spain Privacy Centre: A public point of reference in which we offer easy-to-find information on issues related to privacy and security in Movistar, including options regarding how we collect, use and share users' information. The total number of visits received from December 2016 to March 2017 was 6,066. We are working to ensure that all of our markets apply the same measures for transparency and ease of access.

Responsible Business Channel:
This channel, managed on a global level, establishes a stakeholder communication system that is directly associated with our Responsible Business Policy and, more specifically, our commitment to protect and promote human rights in our activities.

HOW WE INFORM OUR CUSTOMERS IN THE UNITED KINGDOM ABOUT PRIVACY

FURTHER INFORMATION ▷

25,265 employees have been trained in data _protection_, information _security_ and _raising awareness_

INTERNAL TRAINING
In 2016, we continued with our global training plan on data protection. More than 25,265 employees were trained in data protection, information security and awareness. The breakdown by region is:

▶ **Telefónica Europe**:
20,231 employees received training in privacy and data protection.

▶ **Telefónica Latin America:**
5,034 received either in-person or online training in privacy, data protection, security and confidentiality.

TABLE OF CERTIFICATIONS
Our Global Security Committee supervises the Group's Security Certifications in order to develop, implement and maintain the Company's system for managing certifications.

As an example, below are some of the certifications involving security processes held within our Group:

▶ ISO27001: Managing Information Security

▶ Systems for managing occupational health and safety

▶ PCI\DSS: Data Security Standard for the Prepaid Card Industry

▶ 22301: Business Continuity Regulation

▶ Data Centre TIER IV certification: GOLD certification for Operational Sustainability, Design and construction.

AUDITS
In order to meet each country's legal provisions on Data Privacy, our Annual Audit Plan encompasses specific projects that ensure compliance with these provisions, and identify best practices in data protection. In 2016 we continued to conduct reviews of personal data protection, performing a total of 21 internal audits on this subject.

The most important aspects to be reviewed were: the application of security measures in the processing of personal data, control of access thereto, the quality of the information, consent for the processing of data and the possibility for the affected parties to exercise their rights of access, rectification, cancellation and opposition.

In addition, within our Annual Audit Plan we focus on issues related to Cybersecurity, a fundamental basis for protecting the perimeter that guards access to and consistency of our customers' information and data. These audits are based on the carrying out of so-called penetration tests, applying "Black Box" and "White Box" techniques based on the OSSTMM, CVSS and OWASP standards.

These audits are performed every 18 months on all the public IP addresses of the Group's operators, as well as on specific products and services to improve their level of resistance to cyberattacks, if appropriate. In 2016 we conducted 84 cybersecurity audits on all our operators' Networks, Systems, Products and Services.

84 _Cybersecurity_ audits

OPEN PROCEEDINGS AND SANCTIONS

In 2016 the Group reported 92 penalties and 105 proceedings initiated on data protection issues throughout the year. The total sum of sanctions was €2,300,445.01. Most of these proceedings were initiated in Spain, where legislation is stricter than in other markets.

FREEDOM OF EXPRESSION

We are a founding member of Telecom Industry Dialogue, a group of telecommunications operators and vendors that come together to address freedom of expression and right to privacy in the telecommunications sector, within the context of the Guiding Principles for Companies and Human Rights.

In this period, we have been particularly active in the area of privacy and freedom of expression, promoting the merger between Telecom Industry Dialogue and the Global Network Initiative (GNI), a multi-party organisation made up of Internet companies, academia, civil society organisations and investors. This step forward will result in more than 1,500 million people in over 120 countries in Africa, North America, Central America, South America, Europe, the Middle East and Asia-Pacific being covered by the standards and principles protecting users' rights to which all GNI members commit. We

have already officially announced our desire to join the new organisation.

Furthermore, we participated in meetings on Network shutdowns, at which all the agents involved shared experiences and identified the negative effects of this practice, both in terms of human rights and from an economic and social point of view. In turn, the members of the GNI prepared a joint statement expressing their views on the matter.

We have also collaborated with the Special Rapporteur on the promotion and protection of the right to freedom of opinion and expression, David Kayne. We provided our position and best practices to the public enquiry on Freedom of Expression in the Telecommunications and Internet Access Sector.

The progress we have made in the implementation of the 10 principles of Privacy and Freedom of Expression adopted by the TID in 2016 is described in the table on the following page.

—
We actively *collaborate* with the United Nations' Special Rapporteur on the *right to freedom* of *opinion* and *expression*

17 PARTNERSHIPS FOR THE GOALS

Transparency Report

In the interest of greater transparency for all of our stakeholders, in 2016 we published our Transparency Report for the first time. By doing so, we informed the public of the requests we can receive from the authorities regarding certain information.

At Telefónica we are subject to the legal environments in which we operate, which means that, in exceptional circumstances and always within the express provisions of national laws, we must respond to the requirements of the competent authorities concerning certain information on communications by our customers or the blocking of content. We must do so according to the legal framework applicable in each country, and with maximum respect for privacy, freedom of expression and the secrecy of users' communications.

In all of these cases, we implement a strict procedure which simultaneously guarantees

compliance with our obligations to collaborate with the administration of justice and the protection of the rights of the affected parties.

We report that, in 18 countries for which we provide information on legal context, each jurisdiction allows the authorities to issue these types of requirements for four key indicators: legal interceptions, metadata associated with communications, blocking and filtering content and geographical or temporary suspension of service.

PRINCIPLES OF FREEDOM OF EXPRESSION

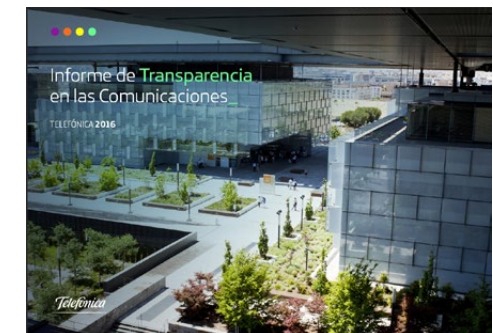| GUIDING PRINCIPLE	PROGRESS BY TELEFÓNICA
1 Create and/or maintain relevant policies, under the supervision of the Board of Directors or equivalent, highlighting the commitment to preventing, assessing and mitigating, to the extent of its capabilities, the risks for freedom of expression and privacy associated with the design, sale and operation of technology and telecommunications services.	Our Responsible Business Principles, revised in 2010, recognise the right to privacy as the basis for a relationship of trust with our stakeholders. Moreover, the Group has a Privacy Policy, approved by the Board in March 2013, which is binding in all the countries in which we operate. The Group includes the figure of the Chief Privacy Officer, the person responsible for the implementation and monitoring of the Policy, who is assisted by local Data Protection Officers. With regard to security management, the Group has in place the Corporate Information Security Policy (in addition to other regulations), which is based on international standards and updated in accordance with the growing international demands in matters of security. In addition to conducting specific training on the said Policies, all our employees have access to this via the Group Intranet.
2 Conduct regular impact assessments on human rights and use due diligence processes appropriate to the company for identifying, mitigating and managing risks for freedom of expression and privacy (in relation to technologies, products and services and specific countries), in accordance with the Guiding Principles for the application of the UN's "Protect, respect and remedy" framework.	As part of our due diligence process, in 2016 we began an update of our 2013 impact evaluation on human rights. We aim to understand the potential impacts of the Telefónica Group's strategies, of the Group's new activities, and the changing digital environment. As a starting point, we used the results from the previous evaluation and followed a methodological framework, the point of reference for which was the UN Guiding Principles on Companies and Human Rights. In this first phase, we have identified 23 human rights issues in which we find: Neutrality and respect for freedom of expression in publishing information online; offering sufficient, transparent information on mechanisms for collecting and treating information, and possible illegitimate or non-authorised uses of data. With this work, we manage to have an updated impact matrix that defines which issues are priorities for Telefónica, and which lines of action must be applied in order to ensure due diligence in the area of human rights.
3 Create and/or maintain operational processes and procedures for assessing and managing any governmental requests which might have an impact on freedom of expression and privacy.	At Telefónica, we are subject to the legal environments in which we operate, which means that, in exceptional circumstances and always within the express provisions of national laws, we must respond to the requirements of the competent authorities concerning certain information on customers' communications or the blocking of content. In doing so, besides adhering to the laws of each country, we always seek maximum respect for privacy, freedom of expression, and the secrecy of communications by users. At Telefónica, in all of these cases, we implement a strict procedure which simultaneously guarantees compliance with our obligations regarding collaboration with justice administrations and the protection of the rights of the affected parties. In 2016, we approved the Global Procedure establishing a single process for addressing these requests, in keeping with the legislation of the countries in which we operate on user information, the interception of communications, blocking access to certain websites and content, and suspending networks or services. We also specify the process for receiving and treating legal petitions, areas involved, responsibilities, treatment of communications, searches and internal control in order to guarantee legal compliance and respect for individuals' fundamental rights.
4 As far as possible, adopt strategies to anticipate, respond to and minimise any potential impact on freedom of expression and privacy in the event that an illegal governmental request or demand is received, or when the governments are deemed to be misusing products or technology for illegitimate purposes.	In addition to the formal processes indicated in the previous principle, the right to privacy, data security and information, protection of the right to freedom of expression are, together with the protection of human rights in general, issues which fall under the control of the Board of Directors, through the Regulation and Institutional Affairs Committee. This Committee is in charge of driving and supervising the implementation of Telefónica's Global Responsible Business Plan, which includes specific objectives in privacy, security and promoting the responsible use of technology. Telefónica also has a Chief Data Officer who is part of the Executive Committee of the Group. Their principal objective is to define the Company's global strategy on data or, in other words, the cognitive intelligence services associated with Big Data. This strategic function ensures that the privacy and security of data is a key element considered in our services, no matter where we are. We also have a Chief Privacy Officer who ensures that the Privacy Policy is followed in any operation we are a part of. Furthermore, we have a Data Privacy Officer for each operation, who ensures that our actions on a local level fulfil our internal and external regulations. The Privacy Committee is the body in charge of coordinating all the actions to ensure data protection. In addition, privacy and cybersecurity are two of the aspects included in our Company's risk management model (See chapter on 'Identifying and managing risks').

PRINCIPLES OF FREEDOM OF EXPRESSION

GUIDING PRINCIPLE	PROGRESS BY TELEFÓNICA
5 Always aim to guarantee the security and freedom of Company employees who may be exposed to situations of risk.	Our Global Management of Physical Security applies the security controls, processes and technologies meant for the personal protection, health and welfare of Company employees and collaborators. The information obtained by physical and logical access control allows for the management of efficient evacuation plans, managing emergency teams and affected personnel in real time, while mobilising the necessary resources to guarantee their integrity.
6 Raise awareness and train the employees involved in the relevant policies and processes.	The Telefónica Group has designed a specific plan to train and raise awareness among employees in the policies and processes that concern them. This continuous training programme is conducted both in person and online. In 2015, more than 25,265 employees were trained in Data Protection and Information Security. For further information, see details in the chapter on 'Digital Trust'.
7 Share knowledge and impressions, whenever relevant and appropriate, with all the interested parties involved in order to have a better understanding of the legal framework and the effectiveness of these principles in practice, and to provide support for their application and development.	In order to contribute to international cooperation between governments and the private sector, and to improve transparency in issues affecting National Security, Human Rights and Privacy, we are members and active participants in international and regional working groups that promote respect and protection of Privacy, Security and Freedom of Expression. Telefónica regularly participates in forums and inquiries on these issues. For further information, see details in the chapter on 'Digital Trust'.
8 Every year, and when circumstances so require, provide external information on the progress made in the application of the principles and, where appropriate, on the main events which occur in this respect.	This report summarises the progress made by the Telefónica Group in matters of privacy and freedom of expression. For further information, see the chapter on 'Digital Trust' in this Report. Seeking greater transparency for all our stakeholders, in 2016 we published our Report on the Transparency of Communication where we informed the public of the requests we may receive from the authorities in 18 countries in which we operate regarding legal interceptions, Metadata associated with communications, blocking and filtering of content and geographic or temporary suspensions of service. You may consult the Report on Transparency.
9 Assist in the development of policies and regulations promoting freedom of expression and privacy, either individually or in collaboration with other entities, seeking to mitigate the potential negative impacts arising from policies and regulations.	In this period, Telefónica has been particularly active in the area of privacy and freedom of expression, promoting the merger between Telecom Industry Dialogue and the Global Network Initiative (GNI). Furthermore, Telefónica participated in meetings on Network shutdowns, at which all the agents involved shared experiences and identified the negative effects of this practice, both in terms of human rights and from an economic and social point of view. Telefónica has also collaborated with the United Nations' Special Rapporteur on the right to freedom of opinion and of expression, David Kayne, providing the Company's opinion and best practices to the public enquiry on freedom of expression, the telecommunications sector and Internet access.
10 Examine the options for the implementation of the appropriate complaint mechanisms, as listed in Principle 31 of the UN's Guiding Principles on Business and Human Rights.	Questions regarding Telefónica's actions can be asked via the Responsible Business Channel, which is published on the Sustainability corporate web page. This channel was created in 2016 with the aim of establishing a system for communication with stakeholders, directly linked with the Responsible Business Policy and Telefónica's Commitment to Human Rights, in keeping with the principles of respect, confidentiality, rapid response and completeness.

SECURITY

Data security

We develop the concept of all-around global security for our Group. This covers the security of information through a number of control objectives that translate into a series of preventive and reactive measure on data and the technological systems processing them, in order to keep and protect information and guarantee its confidentiality, availability and integrity. For our customers, information security has a significant effect on privacy, and this takes on different dimensions depending on the country and culture.

Business continuity

The growing competitiveness among business organisations, the ever-increasing demands of customers and shareholders, or the ever-stricter regulatory requirements are factors that force the organisation to demonstrate the resistance of its business activities when faced with any serious contingency.

A power outage, a flood, a fire or a robbery must be considered real threats that need to be treated preventively to ensure that, should any of these occur, losses are not serious enough to threaten the viability of the business. We need processes, mechanisms and techniques to mitigate the risks to which we are exposed and to guarantee high availability in the Company's operations.

The goal of our Global Continuity Plan is to preventively manage risks, ensuring the maximum possible resistance of fundamental business activities when faced with any sort of interruption to their systems.

Efficient distribution of investments in security according to our previous risk analysis process allows us to focus our efforts and budget for the most essential tasks. For more information, see the section on 'Emergencies'.

The reach of the continuity plan and of plans for recovering from disasters covers:

Continuity management

People · Facilities · Technology · Information · Suppliers
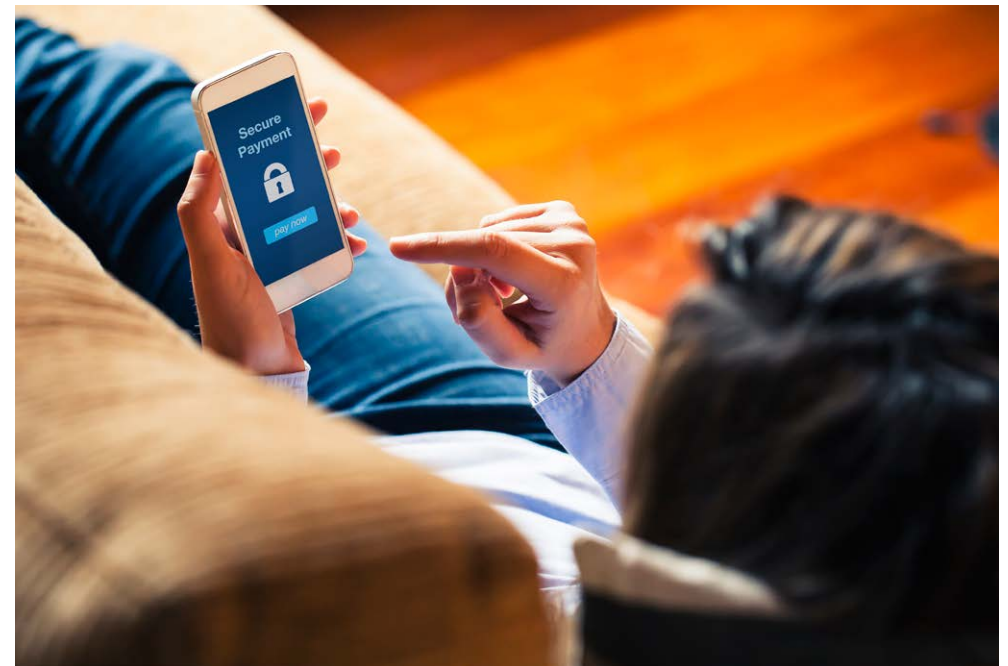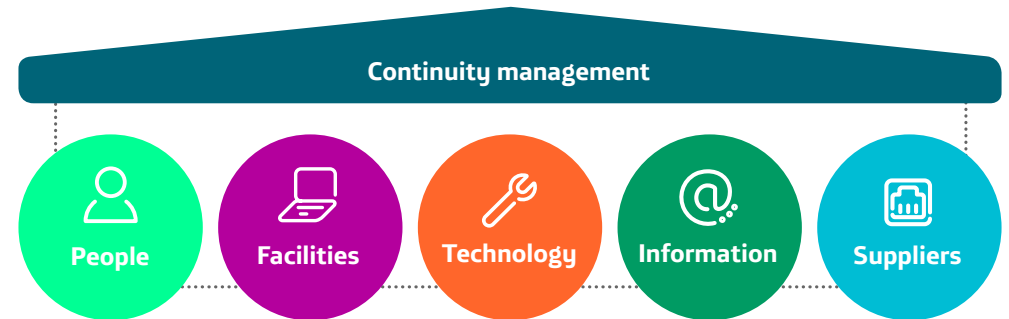
The continuity process is annual, and seeks constant improvement and expanded reach:

Define reach	Define security policy and decisive bodies	Define Risk Analysis methodology	Perform risk analysis and determine acceptable levels of risk	Identify options for addressing risks
Define a risk treatment plan	Institute a risk treatment plan	Implement selected controls	Define metrics	Define a training programme
Review the effectiveness of the PCN	Measure the effectiveness of control measures	Ensure effectiveness of security objectives	Review residual risks	Complete audits of the system
Implement the best proposals in the CHEK phase	Undertake preventive actions	Undertake corrective actions	Communicate	Plan again

BEST PRACTICES

INVESTMENT IN CONTINUITY PLANS

When we speak of continuity, we are not referring to costs. We are speaking of an investment with very tangible returns in terms of reputation and Company image.

▸ Simplicity. The Business Continuity Plan is easy to understand, use and maintain.

▸ Limited reach. It covers the organisation's most critical operations.

▸ Responsibilities. It clearly states who is participating, and indicates their functions, responsibilities and authority.

▸ Activation of the Plan. The Business Continuity Plan is only activated in clearly defined crisis or emergency situations once the preventive security measures have failed.

▸ Real tests. As a result of Telefónica's large footprint, we have been able to test and improve our plans in real situations, gathering lessons learned and improvements that are unique in the sector.

Managing vulnerability and breaches

We have a network of Incident Response Centres (referred to as CSIRT in the world of cybersecurity) that work together to:

▸ Be aware of and analyse the risk of potential cyberthreats, as part of an intelligence process where the most relevant cyberthreats affecting the organisation are identified and understood, with the aim of predicting them and protecting the global organisation of the Group from their potentially damaging effects, and to mitigate any possible damage to a degree that is acceptable for the business.

▸ Monitor the serious vulnerabilities existing in the organisation's most critical technological activities, in order to minimise these assets' exposure time to the associated risks.

▸ Establish relationships with other national and international CSIRTs/CERTs in both the public and private sector for mutual support and the sharing of early warning information on cyberthreats and vulnerabilities.

▸ Detect potential security incidents affecting the organisation's technological assets by monitoring and analysing security events.

▸ Respond to and manage security incidents that affect the organisation by lessening their impact.

Security Services

With ElevenPaths, our cybersecurity unit, we offer disruptive innovation in cybersecurity to provide privacy and confidence to our digital lives.

We create innovative products capable of transforming the concept of cybersecurity, keeping a step ahead of the attackers who are a growing threat in our digital lives.

Eleven Paths
Telefónica CYBER SECURITY UNIT

**FURTHER INFORMATION** See the Eleven Paths website

Over the past three years, we have combined the development of innovative patented technologies with the creation of alliances with the principal actors in the market. We choose to provide intelligent security services as our path towards a safer future.

Our global security services are designed to continuously improve the efficiency of our security infrastructure. Consequently, we are working to develop new services and security capabilities that can help to protect companies and their customers from the threats surrounding them. In 2016, we began a transformation process based on innovation through technology.

We collaborate with the foremost entities and organisations, such as the European Commission, CyberThreat Alliance, ECSO, EuroPol, Incibe and the OEA.

In addition, we have opened nine Security Operations Centres and a new Advanced Global Centre (Telefónica Advanced Global SOC -TAGS-). This broad network allows us to take on threats and security problems from a global point of view, but without having to distance ourselves from our customers.

Furthermore, with ElevenPaths we promote the entrepreneurial spirit by investing in security startups like Countercraft, 4IQ, BlueLive, LogTrust, IMBox and Alise Devices. Thanks to these collaborations, alliances and our experience, we can offer a portfolio of integral cybersecurity solutions for the world of IoT, identity and privacy, anti-fraud, document management, industrial cybersecurity, safe mobility and risk management, with the aim of providing our customers with solutions that are adapted to their specific needs.
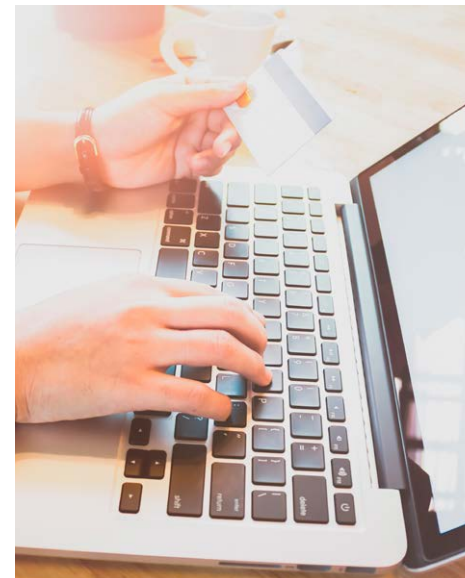
STAKEHOLDERS, INSTITUTIONS AND OPINION LEADERS

In order to contribute to international cooperation between governments and the private sector, and to improve transparency in issues affecting National Security, Human Rights and Privacy, we are members and active participants in international and regional working groups that promote respect and protection of Privacy, Security and Freedom of Expression.

Telefónica regularly participates in forums and inquiries on these issues. In 2016, the principal initiatives were:

▸ **Centre for Information Policy Leadership:** We are members of the Centre for Information Policy Leadership, a discussion group on privacy and safety with offices in Washington DC, Brussels and London, which works with

—

We offer a portfolio of *integral cybersecurity* solutions with the aim of providing our customers with *solutions* that are *adapted* to fit their needs

leaders in the industry, regulatory authorities and policy leaders worldwide in order to contextualise and promote a policy of privacy and cybersecurity on a global scale.

In 2016, we worked together to elaborate a public position on data transparency.

▸ **Rightscon:** We participated in the edition of Rightscon Silicon Valley held from March 30 to April 1, 2016 in San Francisco, California. Rightscon is a debate forum on digital human rights that brings together stakeholders from around the world.

▸ **GSMA**: Working sessions for the elaboration of the Responsibility Principles for the Mobile Ecosystem.

▸ **Data Transparency Lab:** We are members of the Data Transparency Lab, a community of technology specialists, investigators, politicians and industry representatives that work to move forward in transparency of personal online data through scientific research and design.

PROTECTING MINORS AND PROMOTING THE RESPONSIBLE USE OF TECHNOLOGY

As part of our commitment to the responsible use of technology, we have defined a global strategy based on promoting proper Internet use by children and adolescents. Via implementation of this strategy, we seek to provide parents, tutors and everyone involved in educating society's youngest members with the tools and services they need to promote safe Internet surroundings, and to raise awareness in society in general of the importance of addressing these key issues to raise more responsible digital citizens.

Our lines of action and commitments to the protection of minors on the Web and to the responsible use of technology can be grouped into 5 working areas:

Alliances with stakeholders, self-regulation initiatives and content blocking

Looking out for security in the online environment is a challenge we cannot take on alone. Therefore, Telefónica will need to work together with allies in different sectors and in civil society to ensure that young people can take advantage of the potential of technology while minimising any risk they may encounter.

Along these lines, we would like to underline our collaboration with:

▸ State security forces and support for national crime reporting hotlines (Equipo Niños, ASI, Te Protejo, Safernet, Centre for Child Protection on the Internet, Seguros en Internet...).

▸ NGOs and national associations (Pantallas Amigas, Safernet, NSPCC, Childnet, Red Papaz, among others).

▸ Key stakeholders to deliver actions for the protection of minors online (Inhope, Insafe, ANATEL, Red de Aliados por la Niñez, Zentrum für Kinderschutz im Internet, RCPI, Governments, etc.).

As well as our participation in the following alliances:

▸ Alliance with the GSMA to fight against content involving sexual abuse of minors.

▸ We block content on the lists provided by the Internet Watch Foundation in the following countries: Argentina, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Spain, the UK and Venezuela. Telefónica Colombia also does their part through MINTIC.

▸ **ICT Coalition:** Principles of Safe Use of connected devices and online services for minors. At the end of 2016, each of the member companies submitted a report on our performance with regard to the commitments we took on for each of the actions in the ICT Principles. These documents are in the public domain, so that they can be reviewed by whoever would like to see them.

▸ **Alliance to better protect minors online:** We have participated in this initiative since its creation in September 2016. Its goal is to identify the risks children might encounter as they surf the Internet, to promote the exchange of best practices, and for members to commit themselves to realising specific actions, including a code of conduct, to protect minors in the digital world. Nevertheless, the Alliance is not starting from scratch. Rather, it takes advantage of the achievements and the lessons learned by the Coalition of CEOs to make the Internet a safer place.

On a local level, we also participate in several working groups, and we take part in national initiatives to promote responsible use of technology by young people, and the protection of minors in online environments:

GUATEMALA

Telefónica Guatemala signed, together with GSMA, UNICEF, CLARO and TIGO, a commitment letter for the protection of boys, girls and adolescents from online violence and sexual exploitation. In addition a committee was formed to ensure these commitments are fulfilled.

ECUADOR

Telefónica Ecuador is part of a public-private technical council that aims to establish a reporting hotline in Ecuador for the protection of children and adolescents online.

PERU

Seguros en Internet (Safe on the Internet) is an initiative driven by the Red Peruana Contra la Pornografía Infantil (Peruvian Network Against Child Pornography, RCPI) and Telefónica Peru, which seeks to promote safe use of the Internet by children. In order to achieve this, they operate the web portal www.segureseninternet.org, which can be used by the public to report online content that is illegal or inappropriate for children, such as child pornography, grooming, or cyberbullying, among others.

PANAMA

Through the Telefónica Foundation, the Company is part of the Red de Aliados para la Niñez (Network of allies for childhood), which brings together more than 23 organisations and/or foundations that work towards children's welfare.

COLOMBIA

Telefónica Colombia participates in the Mesa TIC (ICT Table), a multi-sector work group (involving the government, universities, civil society and private companies) that promotes initiatives for the protection of minors on the Internet. In addition, we collaborate with the Ministry of Information Technology, the Instituto Colombiano de Bienestar Familiar (Colombian Institute of Family Welfare, or ICBF), and the NGO RedPapaz as partners of the Te Protejo reporting hotline.

URUGUAY

Through the Proyecto Emprender (telecommunications training and responsible use of social networks), the Telefónica Foundation is part of the Grupo de Gobernanza en Internet (Internet Governance Group).

MEXICO

We participate in the "Nos importa México" (We care about Mexico) programme promoted by the Agencia Nacional de Telecommunications (ANATEL), which aims to empower users and give them access to tools that allow them to enjoy mobile services in a safe and trustworthy environment.

GERMANY

O2 Germany is an active member of the Centre for the protection of minors on the Internet, which is currently working on developing a tool to report inappropriate and illegal content on the Internet in cooperation with the German ICT industry.

NICARAGUA

Since 2012, Telefónica Nicaragua has been a part of the Mesa de Trabajo Nacional del Uso Seguro del Internet (National Working Council for Safe Internet Use) led by the Vice President of the Republic through the Nicaraguan Council of Science and Technology, made up of the Ministry of Education, universities, private companies, the Cámara Nicaragüense de Telecomunicaciones e Internet (Nicaraguan Chamber on Telecommunications and the Internet) and NGOs.

Tu PIN de compra y parental

PIN de compra y parental

THE AUDIOVISUAL ENVIRONMENT

Children and adolescents have made the use of ICT and the consumption of content part of their daily lives. This is an important part of their play time, their studies and their interactions with those around them. In addition, television is a fundamental element in their development, and therefore we at Movistar+ are committed to:

▶ Ensuring that our programming protects children from potentially inappropriate content.

▶ Establishing the tools needed to make good use of television, guaranteeing that parents have effective technical means of exercising their responsibility over the programmes their children watch.

▶ Encouraging digital literacy among young people and their families, persuading them to take advantage of the potential of audiovisual media.

—

Our aim is for the audiovisual experience to promote the *development* of *creative, social and civic* abilities in children

▶ Labelling content: Movistar+ includes a permanent label that indicates the recommended age for audiovisual content being shown. In addition, these are visible on all Company promotions related to audiovisual content offered through the platform. This information can also be found through online programming guides.

▶ Technical protection: Parental controls, purchasing PINs and parental PINs, age verification tools... These security measures depend on the technology available to customers for accessing the service: IPTV, satellite TV or Internet, as well as the device used. In general, we offer our customers the ability to block channels by activating the parental PIN. In addition, with the IPTV platform, content can be blocked on demand for children under 7, 12, 16 and 18.

Moreover, the specific content for adults is offered to customers in a section separate from other content. On some devices, this section may not even be available. In order to view this type of content, a PIN code is required.
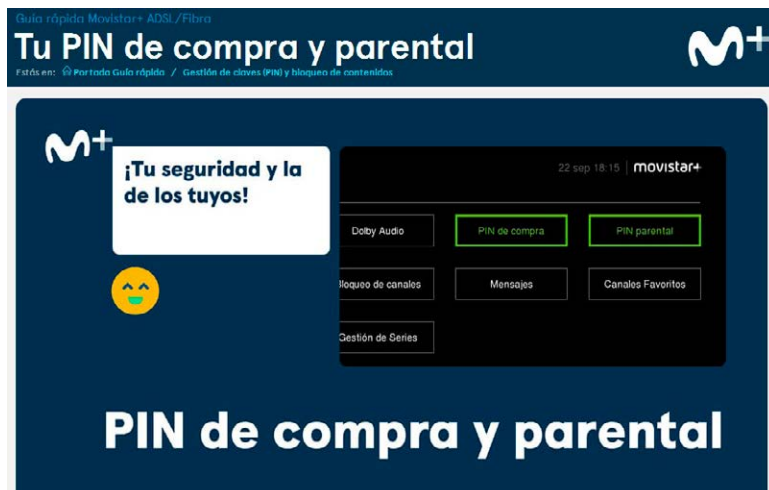
PRODUCTS AND SERVICES

Together with family supervision, technology itself is the best tool to help parents and minors make effective use of technology. For this reason, we feel that promoting and developing products and services that facilitate responsible use of the Web and connected devices is key:

‣ **Parental controls:** Movistar Protege (Spain), Protección Familiar Movistar (Mexico), Escudo Movistar (Argentina, Uruguay, Colombia, Nicaragua), Qustodio (Peru), Vivo Filhos Online (Brazil), Parental Control (UK).

‣ **Safety measures aimed at protecting minors on the Web:** Online Protection Pack.

‣ **Technical security (antivirus, security packs, personalised care…):** Protección Multidispositivo (Mexico), Seguridad Total (Argentina), Gurú, O² protect (Germany), Safe Connection and Security Centre in devices.

SUPPLY CHAIN

Together with our providers, we study the possibility of promoting basic protection parameters for minors to ensure the best possible development in children. Some of the initiatives we are working on are:

‣ **'Safety by design':** The Innovation in Ecosystems area works closely with the principal manufacturers of terminals, as well as with operating systems to include functionalities for protecting minors in the operating system itself.

‣ **Safety through operating systems:** We are fully committed to our customers' security and privacy. As a result, we work with the principal players in the industry to improve the level of security updates in the terminals our customers use, as well as to improve transparency on the type of data that can be shared through mobile terminals.

‣ **Collaboration in the development and implementation of initiatives that promote responsible use of technology and user protection:** We maintain fluid communication with product managers in different digital ecosystems to improve the use of the same by customers, and to promote proper use of technology.

EDUCATING AND RAISING AWARENESS:

We cannot ignore the importance of teaching children and youths to use the Internet and connected technologies creatively, responsibly and safely. The same can be said about the need for parents and educators to have the resources they need to successfully face this new challenge. For this reason, Telefónica supports the development of training and awareness-raising initiatives that promote coexistence in an increasingly digital society:

‣ **The Familia Digital and Dialogando portals are the principal lines of action for achieving all of these objectives:**

In 2016, Familia Digital became the go-to website for advice on the responsible use of technology by minors in Movistar's Hispanic community, with the platform having been launched in 9 countries (Spain, Ecuador, Mexico, Costa Rica, El Salvador, Guatemala, Nicaragua, Panama and Venezuela).

In November 2016, Movistar and Vivo presented Dialogando, a global initiative that has the aim of discussing our relationship with technology in each area of our lives, from our first steps in a digital environment to our personal relationships through ICT and responsible use of digital entertainment, among others.

This project has already been launched in Brazil, Spain, Venezuela, Colombia, Ecuador, Nicaragua, Panama, Guatemala and Uruguay, and in the coming months it will be launched in 6 of the Group's other operations to reach a total of 15 countries.

In addition, we have carried out several initiatives, including the launch of an educational programme for promoting the responsible use of smartphones "Pilar y su celular" (Pilar and her mobile phone): a series of animated videos and educational guides for children that address issues like privacy, managing one's digital identity, caring for the environment through technology, downloading applications and integrated purchases, among other relevant subjects.

BEST PRACTICES

SPAIN

Last year in Madrid, we organised the 1st Encuentro de Familias Digitales (Digital Families Meeting) on the subject "Connected children, disconnected parents?". At this Meeting we brought together experts, bloggers and minors to debate the importance of digital education in children, young people and adults in an increasingly connected environment, and sought solutions to the challenges we face regarding our digital diet and health.

The Ciberexpert@ program, a collaboration between Telefónica Spain and the Spanish National Police to help minors understand how to use connected devices through training in schools.

MEXICO

We launched the project "Caravana de Educación Vial Mapfre" (Mapfre Road Education Caravan), to promote responsible use of mobile phones behind the wheel; as well as the "Netiquétate" programme for training educators, parents and minors in collaboration with Pantallas Amigas (Friendly Screens).

NICARAGUA

Participation in the campaign "Por una comunidad educativa segura en Internet" (For a safe educational community on the Internet), by setting up a free advice reception service on responsible use of technology in mobile phones, which can be used by any interested customers.

BEST PRACTICES

COLOMBIA

We launched a social network communication campaign entitled #AprenderdeTIC, which provides information on safe use of smartphones, best Internet practices, privacy in social networks and how to responsibly choose video games, among other topics.

GERMANY

We created a Guide to raise awareness on safe, positive technology use among parents and children in collaboration with Deutsches Kinderhilfswerk e.V.,and have supported the development of school materials to teach minors and their teachers about developing digital skills.

UNITED KINGDOM

Through O2 United Kingdom, we initiated a broad strategy for protecting minors on the Internet in collaboration with the NSPCC organisation. The project, visible through a section of the commercial website, includes initiatives for raising awareness, offering advice and training as well as the development of programmes and products/services that help families make safe use of the online environment.

In addition, we have a free telephone help line aimed at addressing any doubts on the digital education of minors (how to install parental controls, how to report cases of cyberbullying…), as well as NET AWARE, a website developed together with NSPCC, which provides advice and recommendations on the responsible use of technology from O2 personnel, as well as other children and parents.

BRAZIL

We have published parental and school mediation Guides on the responsible use of technology among children and youths.

ECUADOR AND GUATEMALA

We organise talks in schools on proper Internet use, which are aimed at students, teachers and families.

7

Commitment to our team

- Evolution of the workforce

- Attracting and developing talent

- Managing diversity

- Freedom of association, social dialogue and fair compensation

- Work environment, work-life balance and commitment

- Occupational health, safety and well-being

Evolution of the workforce_

At the end of 2016, we had 127,323 employees throughout the Group with an average age of 39.2, of which fewer than 1% held executive positions. This represents a reduction in absolute terms of 7.7% compared to the 2015 workforce, although much of that is due to the departure of some companies which were sold throughout the year – Telefónica Billing Centre in Peru, Vocem in Venezuela, Telefe in Argentina and the assets of TGSC in Spain, Argentina and Peru. The organic variation of the workforce, without taking into account corporate movements, represented a fall of 4.9% compared to 2015, mainly due to implementation of the voluntary simplification plans, which took place chiefly in Spain and Brazil.

Diversity is very important to us, since it enriches the culture of the Company and brings us closer to our customers and society in general. Our employees currently represent more than 106 nationalities, and are based throughout the 36 countries where we have personnel. With regard to gender diversity, 37.6% of our professionals in 2016 were women. For further information, see the chapter on 'Managing diversity'.

As regards long-term employment, it is important to note that 97.4% of our staff have permanent employment contracts, which demonstrates our commitment to sustainable

127,323	**106**	**37.6%**	**97.4%**
employees	nationalities	of the workforce *are women*	with a *permanent employment contract*

employment policies. In 2016, 82,444 employees had a negotiated work agreement (64.8% of the total), which represents a decrease over the previous year (91,451 employees in 2015). This decrease is strongly influenced by simplification plans and the sale of the aforementioned companies.

EMPLOYEES

	Germany	**Brazil**	**Spain**	**LatAm**	**United Kingdom**	**Rest of the World**
2015	8,738	35,512	38,130	46,771	7,807	739
2016	8,720	34,918	33,440	42,191	7,344	710

TURNOVER RATE

2016	**Germany**	**Brazil**	**Spain**	**LatAm**	**United Kingdom**	**Group**[1]
Total turnover	24.8%	26.1%	20.6%	29.4%	31.3%	25.9%
Voluntary turnover	11.1%	4.7%	3.6%	8.1%	18.6%	6.8%

(1) Data for Atento Venezuela, which was sold in 2016, is not included.

EMPLOYEE AGE PYRAMID

Men		Women
13,502	< 30 years old	10,829
12,090	30-34 years old	9,420
23,225	35-44 years old	16,289
24,270	45-54 years old	9,710
5,876	> 54 years old	1,507
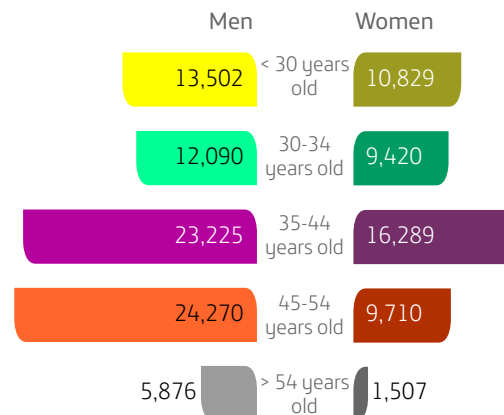
Note: 305 employees in countries where Telefónica does not operate are not included.

5 GENDER EQUALITY

8 DECENT WORK AND ECONOMIC GROWTH

Attracting and developing talent_

TALENT MANAGEMENT

In a sector marked by the digital transformation of communication technologies, attracting and retaining talent is one of the main issues for our sustainability and profitability. For this reason, we offer a professional career, which on the one hand aims to address employees' concerns and aspirations, and, on the other, aligns itself with the mid and long term challenges facing our Company.

It is important for us to be a good place to work, where our employees feel appreciated, motivated and where they can extend their training and development.

A significant element of the project is that we are committed to attracting talent from the new generation of digital natives, who are essential for a sector as dynamic as ours. Thus, in 2016, 19.1% of our employees were under 30 years of age and we recruited a total of 9,917 young people, of which 45.6% were women.

Our Human Resources Policy is that all employees receive regular evaluations of their performance and professional development. Last year we continued to promote global and local talent development programmes that contribute to the professional development of our teams, in order to improve the implementation of Company strategy at various levels and sectors, from youth to managers and the promotion of diversity in the workforce.

DIGITAL TRANSFORMATION: PROFESSIONAL PROFILES

Transformation needs a vision of the future, anticipation, and this is what has led us to implement the talent project: Profile for Digital Transformation. The initiative aims to identify the skills needed to lead change and thus maintain our competitive position in the market in the coming years. To achieve this we have applied Business Intelligence to the management of talent, which has allowed us to cross reference the input of the approximately 2,300 leaders who have participated in the project, with more than 28,000 references obtained.

The Profile for Digital Transformation has allowed us to identify what these differential capacities to succeed are in technological disruption environments:

- **Learning capacity,** crucial in changing environments, essential for continual reinvention. It means being able to learn and being able to do things differently, through experience, and at the pace of business. In turn, we are able to apply this knowledge to new situations.

- **Transformation skills,** which allow us to successfully navigate constant change. The model also identifies those skills with greater impact in transformational leadership.

- **Breadth and depth of digital experiences,** which are key to maintaining a competitive position, maximising impact on the business and improving customer experience.

- **Global Young Leaders Programme:** a two-year development programme that aims to develop digital, transformational and leadership skills among the most able young professionals. 100 young people participated in the first edition in 2015-2016. In 2017 we launched the second edition, in which 86 employees took part following a rigorous selection process. These young leaders come from 11 countries and all have a high level of English, which drives our globality. 53% of them are women, in line with the promotion of diversity in the Company.

- **Talentum:** an initiative that brings together all the proposals related to the development of talent and employability of our Company. This programme contains different types of scholarships and grants, for different ages, from school to a first job. Noteworthy in these programmes are: Talentum Mood, Talentum Startups, Talentum Universities and Talentum Schools.

- **Women in Leadership:** a development programme that aims to strengthen the leadership of the women within the Company.

For further information, see the chapter on 'Managing diversity'.

- **International rotations:** thanks to this global programme our employees can enjoy an international and multi-functional experience in other companies within the Group.

TRAINING

A fundamental aspect for managing talent well in a company like ours is continuous employee training. We articulate this through:

- **In-person training:** in 2016, Universitas Telefónica, our corporate university, trained 2,005 executives on its campus in Barcelona, thanks to the in-person leadership and strategy programmes focused on digital transformation. A further 1,963 have completed our on demand courses.

- **Online training:** delivered via our e-learning programmes, among which we highlight the use of virtual classrooms and learning through MOOCs.

In 2016, we invested a total of 39.3 million euros in various training initiatives, which were given in a total of 4.9 million hours. The average number of training hours per employee has increased by more than 25% in comparison with last year, reaching 38.61 hours. This demonstrates the significance that this aspect has for us.

The training process has been integrated into a global model supported by a single unified tool.

BEST PRACTICES

TALENTUM MOOD

In 2016 we created a new talent incorporation programme for the Company, aimed at bachelor's and master's university students with an interest in the digital world. The programme was founded last October and will have 2 inscription windows per year: in March (when 86 people were incorporated) and another one in May. These academic internships last 6 months (with the possibility of extension) and are encompassed within the Talentum programme.

talentum **Mood**

In addition, it should be noted that, as of January 2016, all employees have individual access to any training process, through the cloud, from any device, and from any location, so that they can receive training and learn without interruption.

Moreover, through the Digital Development Festival, during the last quarter of 2016, we reached more than 2,000 of the Company's leaders with a unified message regarding the latest digital transformation trends, employing and promoting new ways of learning:

▸ We have been able to reach more than 40% of directors and managers, inviting them to do the online training offered, with an average evaluation of 4.3 out of 5.

▸ We have delivered the same 'homogenised' content, both in physical and digital format, which received a positive evaluation.

▸ 60% of the Group has received 100% of the training content in a digital and virtual format.

SPENDING ON TRAINING
Thousands of euros

	Germany	Brazil	Spain	LatAm	United Kingdom	Group
2016	7,045.54	4,726.62	19,233.37	6,079.92	2,108.08	39,311.11

AVERAGE HOURS OF TRAINING PER EMPLOYEE

2014	2015	2016
30.01	30.65	38.56

TRAINING HOURS

4.9 million hours

- 25.3%
- 19%
- 1.4%
- 0.01%
- 0.01%
- 53.6%
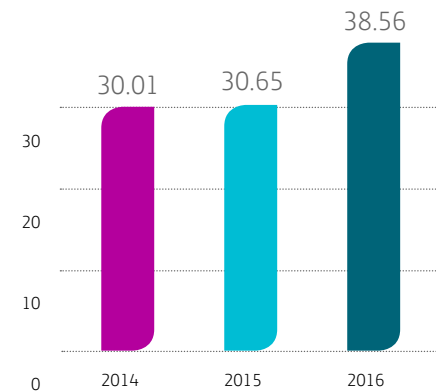
▸ Germany   ▸ Spain   ▸ United Kingdom
▸ Brazil   ▸ LatAm   ▸ Others
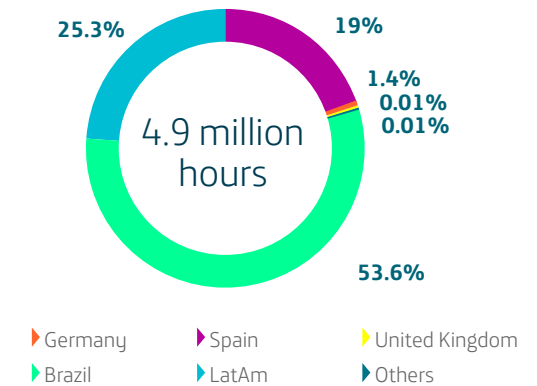
MILESTONES IN 2016

Identification of key and high potential talent in the different levels and sectors.
100% Achieved

Definition, maintenance and development of the global talent and development framework.
100% Achieved

Design individual development plans for key collectives within the organisation.
100% Achieved

Development of Training Schools based on a model of Communities and Working Groups within SuccessFactors, distributed by the key skills of our strategy.
100% Achieved

Implementation of a global training offer consisting of language plans, new MOOCs, the "Being a Trainer at Telefónica" project and a management kit to promote a culture of empowerment.
100% Achieved

CHALLENGES FOR 2017

Ensure the full adoption of the global training tool: 100,000 people to be trained through the courses offered globally.

25,000 people to be registered as users in the JAM communities.

Managing diversity_

We are convinced that a company is the reflection of the people who work inside it.
Therefore, management of diversity is a key lever in the digitisation of the Company.

WHAT DO WE UNDERSTAND BY DIVERSITY?

We believe that diversity is a source of talent, and because of this we embrace it as a competitive element that allows us to get closer to a diverse and changing society. Diversity promotes empathy and innovation, and as such, generates value for the Company.

MANAGEMENT FOCUS

WHY IS IT A KEY ISSUE?
Diversity is an important source of talent, allowing us to promote inclusion and innovation, which are two strategic lines within our Company. We seek to attract and develop the potential of the best professionals.

WHERE IS THE IMPACT?
Giving better and more personalised customer care has an impact both on the Company's culture, as well as on our suppliers and partners.

OUR OBJECTIVES
To ensure equal opportunities and the attraction of diverse talent. Reduce the difference in the number of women occupying positions of responsibility, attract young talent and advance the development of best practices in order to attain these objectives.

Indicators	2015	2016
% women	37.7%	37.6%
% employees under 30	19.9%	19.1%

SUSTAINABLE DEVELOPMENT GOALS

5 GENDER EQUALITY

8 DECENT WORK AND ECONOMIC GROWTH

10 REDUCED INEQUALITIES
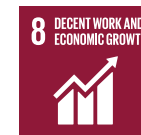
POLICY FOR DIVERSITY

We understand diversity to be a source of talent within our Company and a competitive element that draws us closer to a diverse and changing society. Through diversity we promote empathy and innovation, which in turn generates value for the Company and has a positive impact on our results.

In this sense, our commitment to diversity is transversal to the whole organisation and is part of the strategic cores of our Business Plan.

In order to establish and regulate the principles within the Telefónica Group that guarantee equal opportunities and diversity, in 2016 our Board of Directors approved a Global Policy for Diversity and Inclusion, with the objective of ensuring non-discriminatory, fair, and impartial treatment in very field of our organisation. We thus ensure prejudice-free management in terms of nationality, ethnic origin, religion, gender, sexual orientation, marital status, age, physical abilities and family responsibilities.

Diversity and Inclusion Policy

7 PRODUCTS AND SERVICES FOR EVERYONE

1 DIVERSITY ON THE BOARD OF DIRECTORS

6 NON-DISCRIMINATORY COMMUNICATION

2 EQUALITY IN SELECTION, RENUMERATION AND CAREER DEVELOPMENT

5 REMOVAL OF PHYSICAL BARRIERS

3 A RESPECTFUL WORK ENVIRONMENT

4 A BALANCE BETWEEN PERSONAL AND PROFESSIONAL LIFE

All our actions are based on our:

Responsible Business Principles

OUR GLOBAL DIVERSITY COUNCIL PROMOTES INITIATIVES TO ENCOURAGE EQUALITY THROUGHOUT THE GROUP

Integrity

Commitment

Transparency

GLOBAL DIVERSITY COUNCIL

To ensure that our Company advances with the concept of diversity management as a source of value, at the beginning of 2016 a Diversity Council was created. Composed of top level managers (women and men of different nationalities, disciplines and origins), its purpose is to promote initiatives aimed at consolidating diversity as a key lever towards digital transformation.

The Diversity Council establishes the main lines of corporate action along which each country defines and implements its specific management plans at a local level. It also seeks to be a space for sharing best practices and for being able to replicate and extend the most successful initiatives to all operations.

"Each person's *greatness* is *different*"

José María Álvarez-Pallete,
Chairman & CEO of Telefónica

BEST PRACTICES

PLAN TO PROMOTE DIVERSITY IN SPAIN

In 2016, the Spanish Telefónica Management Committee approved an ambitious Plan to Promote Diversity. This plan is primarily based on 4 areas of action:

1. Selection: encouraging the presence of female talent in the processes for structural posts and new incorporations.

2. Talent: identifying our youngest talent and updating the chart of executive and pre-executive talent, as well as reinforcing the diversity criterion as part of the process.

3. Training and development: promoting diversity awareness programmes for all professionals and designing specific modules on inclusive leadership for all personnel managers and key groups within the Company.

4. Communication: defining a framework which extends the main achievements and milestones of the initiative throughout the Company.

DIVERSITY IN FIGURES

DISTRIBUTION OF MEN AND WOMEN ACROSS THE TOTAL WORKFORCE

127,323

47,934
37.6%
of the total workforce

79,389
62.4%
of the total workforce

—

Of all our employees under the age of 30, *44.5% are women*

MAIN INDICATORS

	2015	2016
Women in the workforce	37.7%	37.6%
Women in management positions	19.1%	20.5%
Women on the Executive Committee	3	2
Percentage of women on the Board of Directors	11.1%	17.6%
Number of nationalities in the workforce	98	106
People with disabilities in the workforce[1]	886	855
Percentage of young people under 30 years of age	19.9%	19.1%
Percentage of young women under 30 years of age[2]	48.3%	44.5%

(1) The reported percentage of integration of people with disabilities in Spain (previously LISMI) is 2.11%.
(2) Percentage of the total number of young people under the age of 30 years in the workforce.

20.5% of women in an executive position

FEMALE PROMOTION RATIOS (2016)

30%
40%
67%
38%
27%

Our employees currently represent more than 106 nationalities across the 36 countries in which we operate. With regard to gender diversity, the total number of professional women amounts to 47,934 employees, a 37.6% increase of the total, with 20.5% in managerial posts. This diversity strengthens our culture and allows us to position ourselves as a global and competitive company.

BEST PRACTICES

WORK-LIFE BALANCE:

In Telefónica Germany we have promoted the work-life balance among our employees regardless of gender, offering services to all professionals with children in order to make their personal lives easier. In this vein, we have made teachers, carers and tutors available for the children of our employees.

In addition, we have created the WMAD Community, which brings together all employees who are parents, to provide them with a support network.

GENDER EQUALITY

We want to promote diversity as a key component in the management of talent in all markets in which we operate. To support this goal, the Diversity Council proposed gender equality as a priority area of action in the Telefónica diversity plan. Consequently, Telefónica has designed a medium and long term work plan focused on reducing the gap between women and men who occupy positions of responsibility, guaranteeing equal opportunities and attracting female talent in selection processes. In this regard, a specific goal has been established: that 30% of all management positions shall be occupied by women by 2020.

Moreover, we highlight a new edition of the "Women in Leadership" programme, which seeks to provide career acceleration and increased visibility for women with the greatest potential for leadership. The initiative, which in 2016 included 151 female Group employees, compared to 60 in 2015, includes elements of leadership, digital skills, mentoring and networking training. Last year, 44% of the women promoted to executive positions within our Company had participated in this programme.

"Women in Leadership" workson the development of the following key levers:

▸ To improve the support given to women with high potential in executive and pre-executive positions in the Company.

▸ To establish a framework for career acceleration.

▸ To develop the skills, confidence and self-assurance needed to become influential leaders in a global environment.

▸ To build a network of mutual support between women with high potential in the Company.

DIVERSE TALENT

Despite the fact that the Diversity Council has chosen gender equality as its main area of focus, we are conscious that diversity is a much broader concept. For this reason, we have chosen talent as the core theme of our management, with the emphasis on being able to promote the best, diverse talent, regardless of gender, nationality, race, religion or physical abilities.

BEST PRACTICES

LGTB DIVERSITY

We have been recognised as one of the best companies in the management of LGTB diversity (lesbian, gay, transsexual, bisexual, and intersexual) in the workplace. We are ranked among those companies that have the best practices and strategy in Spain in the management of sexual and gender diversity, according to a report prepared by the State Federation of Lesbians, Gays, Transsexuals and Bisexuals (**FEL GTB**).

As regards people with disabilities, we are committed to removing barriers in the working environment in order to be able to fully incorporate people with disabilities and make our facilities easy to access for everyone. In addition, we carry out specific measures such as encouraging recruitment in special employment centres. In this regard, we also promote participation in our Telefónica Spain Talentum scholarships among young people with disabilities and high-level athletes. For further information on our progress in the area of disability, see the chapter on 'Digital Inclusion'.

EQUALITY POLICIES IN CORPORATE GOVERNANCE

In 2015 the Board of Directors approved our Policy for the Selection of Board Members, which encourages diversity in knowledge, experience and gender on a global level.

In connection with the promotion of women on the Board of Directors, it is important to note that our Director Selection Policy expressly obliges the selection procedures to encourage gender diversity, prohibiting any type of implicit bias that could result in a form of discrimination. As has been pointed out, the Appointments, Remuneration and Good Governance Committees, as well as the Board of Directors, have followed this maxim in all proposals for the appointment, re-election and ratification of Directors presented, analysed and approved.

During the first few months of 2017 the percentage of women on the Board of Directors rose to 17.64%. For more information, see the chapter on 'Corporate Governance'.

AWARENESS

We have designed an online training programme "We Chose Diversity", and made it available to all of our employees in Spain. The programme fosters a sense of responsibility and commitment to diversity in its broadest sense. This training includes a specific section on diversity in the Group. In addition, the online course on "Diversity Management" has been launched globally.

Furthermore, all Company managers have access to a specific module on "inclusive leadership", which sets out the main guidelines for encouraging, developing and promoting diversity in their teams.

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The management of talent and diversity is *a key lever in the digitisation* of the Company

MILESTONES IN 2016

Creation of a Global Diversity Council.

100% Achieved

Approval of the Global Diversity and Inclusion Policy.

100% Achieved

To encourage measures to incorporate greater diversity into our workforce, especially of women and people with disabilities.

In progress

CHALLENGES FOR 2017

To continue making progress in the priority areas by raising sensitivity and awareness, through specific workshops on unconscious biases.

To increase the percentage of female executives in management positions to 30% of the total by 2020.

Freedom of association, social dialogue and fair remuneration_

By virtue of the agreement reached with Union Network International (UNI), we are committed to the basic ILO standards on labour, which chiefly refer to the freedom of association and the right to collective bargaining.

The agreement, renewed in late 2014, remains in force and takes into account developments in matters of corporate responsibility, as set out in the Guiding Principles on Business and Human Rights of the United Nations, which clarify that companies must respect human rights in all their operations. Within the framework of the above, the Group's Human Resources department held its annual meeting with UNI in January 2016 in Chile.

During the past year, we successfully concluded the collective bargaining processes in Brazil and Argentina and, in Spain, we signed the extension of the First Collective Agreement of Related Companies which will apply until 2018. It should be emphasized that were not involved in any significant collective dispute in 2016.

In general terms, we are involved in a simplification process, which is why some voluntary departure programmes have been implemented and, in the main, well-received by the Group's employees. In this regard, Telefónica España has extended the 2016 Individual Suspension Plan until 2018 in the same terms of universality, voluntariness and non-discrimination. This plan applies to employees who will be 53 years old before the end of 2018 and have been working for our Company for fifteen years. Those who voluntarily join the plan will receive 68% of their salary until they are 65, in addition to the payment of social security and health insurance.

FAIR REMUNERATION

Within our Responsible Business Principles we include our commitment to our employees, guaranteeing fair pay that is in keeping with the labour market in which we perform our operations. We ensure that our remuneration policies and practices guarantee equality of salaries and opportunities for men and women.

The aim of our remuneration policy is to attract, retain and motivate professionals so that, together, we can take on the challenges posed by the transformation of the sector which is taking place. The employees' remuneration comes in the form of payments (basic salary, variable remuneration dependent on objectives, sales incentives, long-term benefits and share programmes) and by means of specific benefits (pension plans, holidays, life and health insurance, company cars, etc.), as well as other forms of compensation, such as career development and opportunities.

Our employees also have access to a personalised remuneration system enabling them to voluntarily allocate part of their fixed financial payments to the purchasing of a series of products and/or services and, therefore, to adapt their remuneration to their personal and family needs at all times.

Within the concept of total remuneration, the Action Plans for Employees play an important role, because they align the interests of the employees with those of the shareholders and, at the same time, they generate a sense of belonging and more direct involvement in the

Company's results. 25% of employees were Telefónica shareholders in 2016.

Moreover, we have a Global Remuneration Policy whose aim is to achieve homogeneity and alignment in the remuneration practices throughout the Group. In turn, the local remuneration teams ensure alignment with the usual practices in each area of activity. All our variable remuneration systems include at least one Responsible Business target for the employees: customer satisfaction.

We have designed and implemented different measures to improve the social benefits that our employees enjoy in different countries, such as the following:

▶ Health, life and accident insurance.

▶ Pension plans with contributions by the employee and the Company.

▶ Child and school aid, which vary according to the age of the children.

▶ Financial compensation for cases of redundancy within the Company due to declaration of the worker's permanent total disability for his or her usual occupation.

▶ A teleworking option once a week, with prior authorisation.

▶ Advance payments of up to three monthly salaries.

▶ Holiday and study plans for children of employees.

▶ Aid for children who study in a different location from that of their family home.

▶ Supplements during situations of maternity leave.

▶ Social care.

▶ Possibility of continuous working hours in summer and each year for one part of the collective, voluntary split working days and unpaid leave.

▶ Flexibility in the use of different permits.

—

Within our Responsible Business Principles we are committed to *guaranteeing fair remuneration suited to* the labour market

AVERAGE SALARY DIFFERENCE BETWEEN MEN AND WOMEN

Percentage of the average salary of women in comparison with the average for men in our geographical areas

Basic salaries	Germany	Brazil	Spain	LatAm	United Kingdom
Managers	97.7%	96.2%	97.4%	94.0%	96.8%
Middle management	77.1%	97.5%	96.0%	91.5%	89.9%

Total salaries	Germany	Brazil	Spain	LatAm	United Kingdom
Managers	97.0%	96.2%	96.6%	91.5%	95.6%
Middle management	75.9%	97.5%	96.8%	91.8%	88.1%

Note 1: LatAm reflects the weighted average of the countries which reported data by 31 December 2016: Argentina, Chile, Colombia, Ecuador and Mexico.
Note 2: The data shown by countries correspond to the whole collective of Managers and Middle Managers, as a result of which they do not constitute homogeneous samples in terms of age, seniority or the functional typology of the role performed.

MINIMUM SALARY AT TELEFÓNICA IN COMPARISON WITH THE MINIMUM SALARY IN EACH COUNTRY

🇩🇪 1.62	🇨🇷 1.37	1.46	🇺🇾 2.01
🇦🇷 1.60	1.86	🇮🇹 2.74	🇻🇪 1.17
🇧🇷 1.42	1.28	🇵🇪 1.41	
🇨🇴 1.60	🇪🇸 2.25	🇬🇧 1.04	

Work environment, work-life balance and commitment_

A very important aspect of the attraction and retention of talent is to foster a pleasant working environment. Aligning expectations and being aware of the problems are key to maintaining our professionals motivated, which in turn is essential to obtaining high commitment and providing an excellent service to our customers.

To achieve all this, we develop a constant and continuous dialogue with our employees through different channels and we carry out an annual survey regarding the work environment, the results of which provide a basis for the objectives we set. In this survey we apply quantitative, qualitative, measurable and manageable criteria to identify trends and objectives within the different categories of preparation, motivation and resources of our employees.

In 2016, a total of 87,682 of our professionals took part in our work environment and commitment study, in which we received a score of 79 out of 100. Colombia (91 points), Panama (91 points) and Venezuela (92 points) got the best results.

With regard to the analysis of diversity, the results show that commitment and motivation are higher among younger employees than in the groups of those aged 30 and over: 83 points for those under 20 years of age; and 80 points for those in the 20-30 age range. The score according to gender turned out to be very similar among women (79 points) and men (78 points).

In the global analysis, the issues that obtained better results from the workers were:
▶ "I know what is expected of me in my work" (89 points)
▶ "I feel energised to try to always give the best of myself at work" (87 points)
▶ "I am proud to work in my company" (87 points)

It is important to highlight that the statement "My company acts in an ethical and responsible way" obtained a score of 80 points, one above the global average.

WORK ENVIRONMENT INDEX
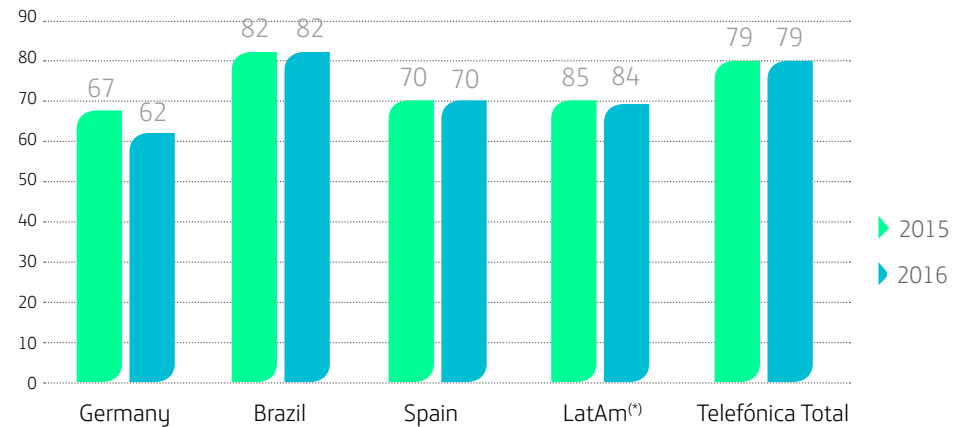
(*): The LatAm figures only include operator data.

BEST PRACTICES

PEOPLE OF VALUE

For another year running we launched the global annual recognition "People of Value" programme. It is an initiative that aims to foster a culture of meritocracy through personal recognition of leaders among employees and peers. This programme gives high visibility to those who stand out, both for their unique contribution and for alignment of their behaviour to the values of the Company. It also recognises the Volunteer or social contributor of the year.

Among employees the campaign reported a total of 74,000 awards through our internal Success Factors platform. At the end of the programme, high global visibility was given to 32 people from the selected operations and 7 of them were acknowledged by the Chairman as being People of Value 2016.

WORK-LIFE BALANCE

We encourage the search for new ways of working that allow our employees a better balance between their professional and personal lives; we look for greater flexibility in timetables and to facilitate adoption of new ways of working.

Besides this, we have already implemented a set of measures and provisions aimed at work flexibility, with services and benefits tailored to employee needs.

▶ At a corporate level, in matters of the working day and timetables, a large percentage of the workforce has opted for a continuous working day in the summer months, thereby fostering new forms of flexible working permitted by new technologies.

▶ To enhance the work-life balance, our employees enjoy flexibility when taking their holidays and also benefit from daycare vouchers. In some cases, like at the Company headquarters, we even have a daycare service available for employees' children.

At Telefónica Spain there is also an Equal Opportunities Committee made up of representatives of the Company and the workers in order to promote measures that encourage them to find a balance between their work, family and personal lives.

For further information, see the chapter on 'Managing diversity'.

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We value *diversity* in our employees and see the *balance between personal and family life* as key to the development of our business

BEST PRACTICES

SMART WORKING

In 2016, we implemented "Smart Work" in Telefónica Germany. Through this formula, our employees have flexible working hours, which they choose according to their objectives. In this way, we encourage initiatives such as teleworking and we run a job-sharing arrangement for management positions.

In addition, we make collaborative work spaces available, which facilitates access to facilities during a greater availability of timetables, so that employees can better reconcile their work and personal life.

Occupational health, safety and well-being_

Health, safety and well-being for us constitute one of our main lines of action. We implement it through an occupational risk prevention management system that ensures the integration of health and safety criteria with preventive measures in our processes and services.

The management body for this area is the Joint Service for Occupational Risk Prevention Management (belonging to Telefónica Spain's Transformation and Human Resources Division), which is the unit designated as the Telefónica Group Competence Centre, and which coordinates actions with regard to prevention and occupational health.

In 2016, we performed the OHSAS Certification Follow-up Audit of the Health and Safety and Healthy Company Management System, for all the 33 companies of the Group in Spain. Obtaining certification such as the OHSAS 18001, which goes beyond formal compliance with legislation, is a sign of our commitment

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In 2016, we conducted the *OHSAS 18001 certification* Follow-up Audit for all the companies in Spain
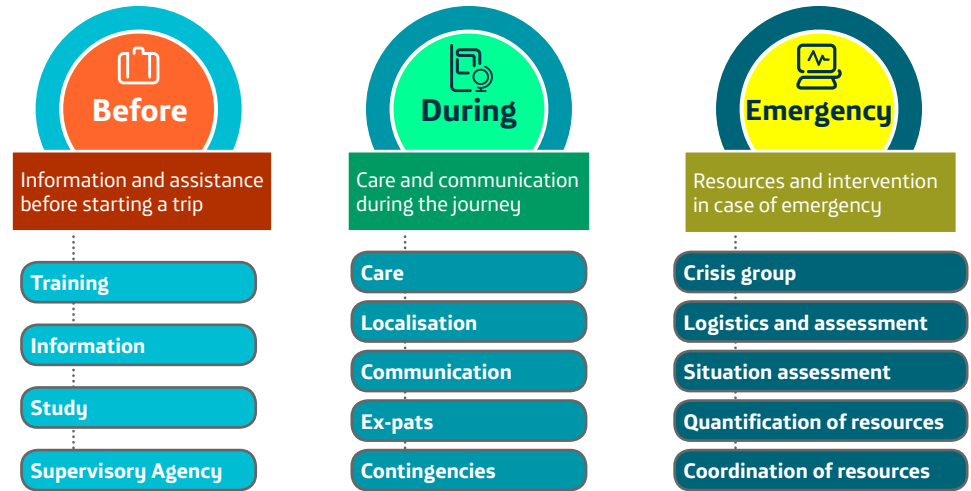
to continuous improvement in matters of occupational health and safety.

The OHSAS standard requires an annual follow-up of the certification, which involves both a prior internal audit, carried out by the prevention technicians of the Joint Prevention Service, and, subsequently, an external audit to verify the consistency of implementation of the system over time through the review and monitoring of the improvement actions proposed and the consolidation of the system implemented.

In addition, in 2016, we obtained renewal of the Healthy Business model certificate, for which we reviewed the Comprehensive Healthy Management model (Spanish acronym: SGSI) based on the physical and social work environment, personal health resources and participation in the community.

With the objective of making progress in effective management, as well as disseminating our established safe work procedures, during the past year, changes have been made to the web environment through which our Company's Coordination of Corporate Activities (Spanish acronym: CAE) are managed, both for contractors and customers.

The goal of the new website is to streamline the sending and receiving of documentation on occupational health and safety, with the aim of

Before	**During**	**Emergency**
Information and assistance before starting a trip	Care and communication during the journey	Resources and intervention in case of emergency
Training	Care	Crisis group
Information	Localisation	Logistics and assessment
Study	Communication	Situation assessment
Supervisory Agency	Ex-pats	Quantification of resources
	Contingencies	Coordination of resources

creating an environment that ensures that our employees are informed and can effectively manage any incident in this regard.

PHYSICAL SAFETY OF EMPLOYEES

The information we collect regarding physical access controls enables us to manage efficient evacuation plans, in real time, in collaboration with emergency teams and the personnel concerned, by mobilising the resources needed to ensure their safety. Furthermore, the planning of absences (due to public holidays, holidays or illness) enables us to redistribute spaces, such as the assignment of parking spaces for employees, and the allocation of spaces for people with temporary

limited mobility and pregnant women.

Since we are a global company, our employees often make international business trips. Protection during business travel is essential in order to minimise exposure to any risk, to provide an appropriate response in any given situation and to provide backup at all times.

A training course on the prevention of risks when travelling is available from our e-learning platform. The information provided beforehand to employees on the region, country, city, local safety and insurance is essential for ensuring good use of all resources.

'FEEL GOOD' PROGRAMME

In 2016 we carried out various health promotion campaigns. For instance, as part of the 'Feel Good' programme (which focuses on four key areas: physical activity, nutrition, health and individuals) we launched initiatives to promote healthy habits among our employees. Key initiatives include the "Healthy Diet" nutrition campaign, prevention of osteoporosis and road safety when riding motorcycles. In addition, wellness rooms have been set up, with spaces for physical activity and talks on health for employees.

Through the "We Choose to Protect Ourselves" campaign, we promoted awareness regarding vaccination as a responsible act of self-care for individuals within their environment and society, and held informative talks for employees in parallel with the campaign.

IMPROVEMENTS IN PSYCHOSOCIAL PERFORMANCE

The Joint Service also implemented evaluations of psychosocial factors through external entities. In the light of the results, we have decided to reinforce the necessary preventive measures and actions.

In this way, the assessment will be enhanced by personal surveys of workers and leaders of the groups which are being studied: sales, managers and support staff. This will enable identification of the best actions to follow.

JOINT COMMITTEES (SPAIN)

The health and safety model established in the various regions where we operate shows high worker representation and participation in health and safety matters through the corresponding Health and Safety Committees, in all regions.

These Committees enable established health and safety objectives to be implemented and consolidated by means of continuous analysis and monitoring of programmed preventive measures.

In 2016, we had 214 joint committees representing more than 90% of the employees of the telecommunications businesses.

INDICATORS

Among the professional activities that are carried out within our Company, no particular incidence or high risk of certain diseases is apparent. In 2016, 41 cases of occupational disease were detected among the 127,323 employees of the Group and there were no fatalities within the Telefónica Group.

Country	Incidence rate			Ratio of seriousness			Average duration rate		
	2014	2015	2016	2014	2015	2016	2014	2015	2016
Germany	1.2	1.8	1.9	9.1	20.0	18.3	7.8	11.1	9.6
Brazil	0.9	6.4	4.8	12.6	98.3	44.6	14.4	15.5	9.3
Spain	7.3	6.2	6.7	274.6	238.9	212,3	37.7	38.6	31.6
LatAm	19.0	18.8	19.0	476.8	488.4	532.5	25.2	26.0	28.0
United Kingdom	3.0	-	15.6	71.7	-	263.1	23.5	-	16.9

Incidence rate: total number of incidents / average number of workers during the period.
Ratio of seriousness: total number of days lost due to accidents at work / average number of workers during the period.
Average duration rate: total number of days lost due to accidents at work / total number of accidents.

2016	Incident rate (IR)			Occupational disease rate (ODR)			Lost days rate (LDR)			Absenteeism rate (AR)		
	Total	Men	Women	Total	Men	Women	Total	Men	Women	Total	Men	Women
Germany	**0.19**	0.24	0.12	**0.00**	0.00	0.00	**1.83**	2.60	0.71	**0.058**	0.050	0.069
Spain	**0.67**	0.63	0.67	**0.00**	0.00	0.00	**21.23**	21.62	20.33	**0.031**	0.026	0.038
Brazil	**0.48**	0.69	0.17	**0.00**	0.00	0.00	**4.46**	6.15	2.02	**0.011**	0.009	0.015
LatAm	**1.90**	2.45	0.86	**0.02**	0.01	0.02	**53.25**	71.62	17.87	**0.024**	0.007	0.015
United Kingdom	**1.56**	1.09	2.39	**0.46**	0.31	0.73	**26.31**	19.98	37.70	**0.006**	0.004	0.009

Incident rate (IR): total number of incidents at work leading to absenteeism / hours worked per year x 200,000.
Occupational disease rate (ODR): total number of occupational diseases / hours worked per year x 200,000.
Lost days rate (LDR): total number of days lost due to work-related accidents at work leading to absenteeism / hours worked per year x 200,000.
Absenteeism rate (AR): total number of days lost due to any type of incapacity / working days per year.

Note:
In order to facilitate transparency and comparison with other companies in our industry, only Telefónica's core businesses have been included in the ratios: the fixed and mobile telecommunications in the countries in which we operate, which amount to more than 95% of our total number of employees..

8

Commitment
to society

- Human Rights
- Digital inclusion
- Social and cultural action

Human Rights

OUR COMMITMENT

The respect for Human Rights is one of the pillars of our Responsible Business Principles and is reflected in the explicit commitment that we published in 2013 in accordance with the United Nations Guiding Principles on Human Rights.

Our approach is based on five basic components that cover the sphere of influence of the Company: our people, our technology, our suppliers, our role in communities and our role to bring change through participation and partnership with stakeholders.

OUR DUE DILIGENCE IN THE FIELD OF HUMAN RIGHTS

In 2012 we carried out an assessment regarding the potential impacts of our Company on Human Rights, following the directives of the United Nations Guiding Principles on Human Rights. The evaluation was carried out in 16 countries and identified 15 topics.

16 PEACE, JUSTICE AND STRONG INSTITUTIONS

Our due diligence model has been built according to the following management model:

1. Integration of our commitment to Human Rights into our policies and processes both corporately and locally.

2. Evaluation of the impacts on Human Rights in each of our markets.

3. Adaptation of the current complaints system to include all evaluated aspects of Human Rights.

4. Continued commitment, together with all stakeholders, to unite efforts in addressing the risks of the industry and create innovative solutions that allow us to take advantage of the opportunities.

5. Monitoring and reporting on the progress and challenges both globally and locally.

6. Update our 'impact on Human Rights' matrix to adapt it to the reality of the sector, our strategy and the context in which we operate.

We have been progressing with implementation of this model in all the countries in which we operate. As part of the monitoring exercise we have realised that current changes in the digital industry and the definition of Telefónica Group's new strategy mean a review of the first impact assessment should take place.

We are on the brink of a new era: robotics, artificial intelligence and automation... All of these are going to shape the future. Digital Services, hyper-connectivity, the correct use of Big Data and artificial intelligence will change the market in which we are competing and will have an impact on everyone's lives. It is important to be aware of the potential impacts that these developments may have on Human Rights, and to have established work plans in place to mitigate these impacts.

As part of our due diligence, in 2016 we began an update of our 2013 impact evaluation on Human Rights.

We seek to understand the potential impacts of our strategy, of the new activities of the Group, and of a digital environment in constant change, taking as a starting point the results of the previous evaluation and following a methodological framework, the point of reference for which are the United Nations Guiding Principles on Business and Human Rights.

In order to determine and differentiate between the different levels of connection and influence of the potential impacts to Human Rights, five areas of analysis (employees, supply chain, business activities, corporate expansion activities and transversal issues) were defined, along with the possible impacts associated with each one.

In this first phase, 23 Human Rights issues have been identified:

INTERNAL AFFAIRS

▸ Inequality of working conditions between different countries, work positions and the Company's internal workers vs. outsourcing.

▸ Discrimination and diversity.

▸ Guarantee of freedom of association with Trade Unions.

▸ Restructuring of organisational functions.

SUPPLIERS

▸ Impacts related to mining in conflict.

▸ Fair, equitable, satisfactory and respectful conditions of the labour rights of outsourced workers.

▸ Environmental impacts related to recycling of electronic scrap materials.

CUSTOMERS

▸ Digital divide: full access to telecommunication services.

▸ Imposition of excessive contractual charges and additional charges as a consequence of abusive working conditions.

▸ Subliminal, misleading, aggressive and discriminatory advertising.

▸ Safety of products and services supported on the Network.

▸ Neutrality and respect for the right of freedom of expression in the dissemination of information on the Network.

▸ Disclosure of sufficient and transparent information on mechanisms for the collection and processing of data.

▸ Possible unlawful or unauthorised uses of data.

▸ Generation of cognitive models using customer and operational data.

▸ Appropriate, proportionate and legitimate use of technology.

▸ Impacts on communities of the maintenance, construction and development of infrastructure.

▸ Quality and stability of telecommunications networks.

CORPORATE BUSINESSES

▸ Quality assurance of due diligence in Human Rights in M&A operations, Joint ventures, partnerships and technology transfer agreements.

TRANSVERAL ISSUES

▸ Bribery and Corruption.

▸ Financial Responsibility.

▸ Impacts on the rights of children as subjects of special protection and care.

▸ Impacts associated with emerging technologies.

In this update we take into account the following sources of information:

▸ Opinions of experts, NGOs and regulators in relation to the impacts of new technology.

▸ The Company's commercial strategy.

▸ Opinions of internal teams on our capacity to manage any possible impacts.

On the basis of dialogue and following the criteria of the Guiding Principles, issues that require further attention are prioritised. This prioritisation will cross the relevance variables of the issue with our management level:

▸ For the Company's strategy, the sector, the regulator and the market, as well as the frequency of occurrence and Telefónica's connection with our impact.

▸ The management level variable assesses the policies, procedures, responsible, measure indicators and management capacity of Telefónica's complaint mechanisms.

When this task is finalised we will have an up-to-date impact matrix which defines which issues are priorities for Telefónica and which new areas of action must be applied with the aim of continuing to ensure due diligence in the field of Human Rights.

COMPLAINTS AND CLAIMS MECHANISMS

Even with the best policies and practices, in some cases we cannot avoid causing or contributing to an adverse impact on Human Rights. At present, consultations and queries regarding Human Rights may be raised through the Responsible Business Channel, published on the Sustainability corporate web page.

The channel was created at the end of 2016, with the aim of establishing a communication system with our stakeholders and is directly linked to the Responsible Business Policy and our commitment to Human Rights, in accordance with the principles of respect, confidentiality, diligent response and thoroughness.

We have a procedure in place that guarantees that the Channel works as it should.

Once we receive any communication, we analyse it, we reply to the sender and, where necessary, forward it to the appropriate department. Once this department resolves the issue, we communicate the solution to the person concerned, thus closing the query.

Since the opening of the channel in October of 2016, we received 263 queries through to December 2016 that were processed through the relevant departments according to the issue raised.

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Our focus on Human Rights *is based on* what we consider *basic components: our employees, technology, service providers, and our role in society*

ERADICATION OF CHILD LABOUR

Preventing and eradicating child labour is an international objective, present on the development agendas of various countries.

In this regard, we are committed to goal 8.7 of the Sustainable Development Goals, which aims to "take immediate and effective measures to eradicate forced labour, end modern slavery and human trafficking, and secure the prohibition and elimination of the worst forms of child labour, including recruitment and use of child soldiers, and by 2025 end child labour in all its forms". Proof of this is the fact that we are the only company in the telecommunications sector which is part of the Colombian Network against Child Labour. Here we work to comply with the six commitments signed in 2014, which strive to ensure the eradication of child labour within the Company, in the supply chain and in its areas of influence.

BEST PRACTICES

WORLD DAY AGAINST CHILD LABOUR

On Sunday, 12 June 2016 we celebrated the World Day against Child Labour with the companies and partners of the Colombian Network Against Child Labour, mobilising the Campaign *#SacaleLaLengua al Trabajo Infantil* (Stick your tongue out to Child Labour), which managed to trend on Twitter. At this meeting, new companies and partners signed to join the Network. Currently, this Network consists of 15 partners and 35 companies.

Likewise, in 2016 within the framework of the Colombian Network against Child Labour, an Educational Session for Suppliers was organised, during which the Company participated in two days of awareness sessions with partners in Bogotá and Barranquilla.

In addition, the Company continued to promote the use of *"Aquí Estoy y Actúo"* (I Am Here and I Will Take Action), a platform that allows organisations access to a diagnosis on the issue of child labour. At the end of 2016, of the 199 organisations which have registered, 60% had already been able to perform a self-diagnosis.

In Chile this platform was released among 50 collaborating companies, with the aim for them to be able to perform a self-diagnosis procedure on the risk of child labour in their supply chains. All suppliers of the Telefónica Foundation in Chile are obliged to use the platform, as well as any new supplier that may participate in one of our nation-wide procurement processes.

Digital Inclusion_

We develop innovative and sustainable solutions that add value to the communities in which we operate and enable us to bring connectivity and Internet services to everyone, regardless of their location, economic status or disability.

HOW DO WE ENSURE DIGITAL INCLUSION?

Beyond efforts to investment in Network deployment, we develop affordable and accessible connectivity solutions through technological innovation and new business models, so as to ensure that everyone has access to the benefits of digital transformation.

MANAGEMENT FOCUS

WHY IS IT A KEY ISSUE?

Access to high-speed broadband networks is the basis for development of the digital economy. In this regard, as a connectivity provider, Telefónica has the goal of reaching increasing numbers of people and, therefore, plays a fundamental role as a catalyst of digital transformation.

WHERE IS THE IMPACT?

The impact is felt directly by people who are excluded from the potential benefits offered by the digital revolution through connectivity services. It is also felt through a more efficient response to emergency situations and natural disasters.

TELEFÓNICA'S OBJECTIVE

We want to increase investment in new projects and sustainable innovation initiatives, with a special focus on connecting the unconnected and bringing Internet to rural areas. We also aim to continue incorporating accessibility as a natural element, while spreading the best practices acquired in our various operations.

Indicators	2015	2016
Investment in a Universal Service (millions of euros)	324	343
Smartphone penetration	48.5%	49.5%

SUSTAINABLE DEVELOPMENT GOALS

1 NO POVERTY	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE	10 REDUCED INEQUALITIES	11 SUSTAINABLE CITIES AND COMMUNITIES	13 CLIMATE ACTION

With the digital revolution we are experiencing a period of great social and economic development in which technology opens the door to a world of information and knowledge. Connectivity is, therefore, a great ally that enables us to guarantee access to digital life, with the best technology and without leaving anyone behind.

It has been shown that digital inclusion, which can be defined as the expansion of global connectivity and the adoption of Internet services, can bring economic and social benefits in addition to having a great potential to help reduce poverty, improve infrastructure or increase access to services such as health, education or financial services, among others.

In the last decade, thanks to investment in Network deployment and new business models, we have been able to extend the coverage of our services and reduce the digital divide rapidly (for further information, see the chapter on 'Network deployment').

However, despite all this progress, barriers to digital inclusion still exist, leaving the

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Connectivity is the great ally that enables us to *guarantee access to digital life*

communities that are either not connected or neglected, to run the risk of falling further behind, in addition to losing the opportunity for growth and development.

For this reason, we believe that the solution for reducing this divide should be comprehensive and involve both private companies and public authorities and administrations. This is one of the major challenges that we will face in the coming years. To overcome it, we have already begun work on the following fronts that will help us to make progress in the communities in which we operate:

▸ **Network deployment in remote areas:** Ensuring access to technology through the deployment of our network in regions or geographical areas with difficult access.

▸ **Emergency response:** Developing policies and solutions which will enable us to act in an effective way in response to natural disasters, bringing our communications services to both the population and emergency teams, and working on our infrastructure to ensure the continuity of the service.

▸ **Digital Education** and **Development of Local Content:** Through educational programmes that increase the adoption and use of the Internet and the removal of knowledge barriers regarding digital services. In addition, we promote the development of content which is relevant for our customers.

DIGITAL INCLUSION
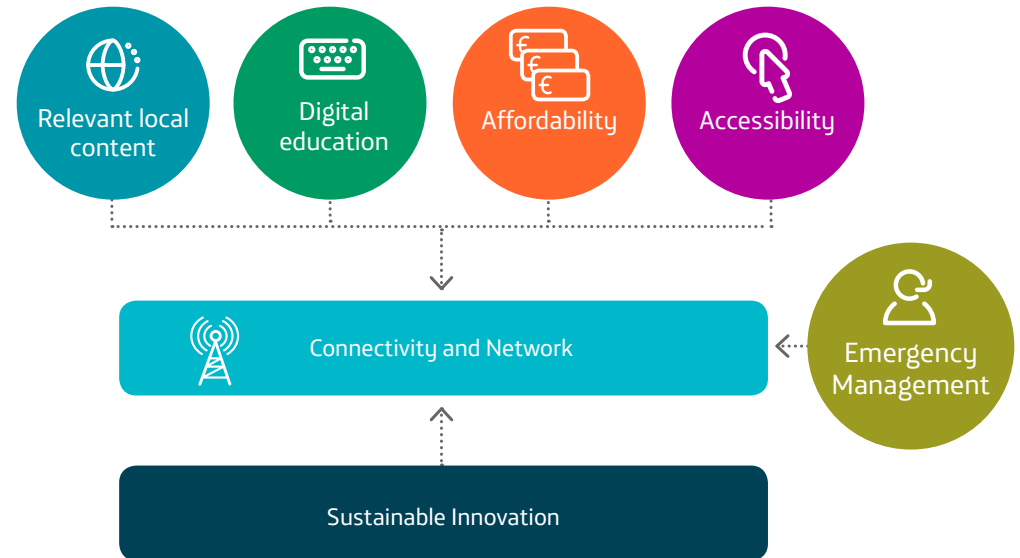
▸ **Accessibility:** Ensuring the accessibility of our solutions for all groups and people with any kind of disability.

▸ **Affordability:** Developing new business models that enable all segments of the population to access our products and services, regardless of their financial resources.

▸ **Sustainable Innovation:** Developing new innovative solutions which seek to have a positive social and/or environmental impact and generate long-term value for our Company.

CONNECTIVITY AND NETWORK IN REMOTE AREAS

In addition to Network deployment and investment in infrastructure, we carry out specific projects that seek to bring connectivity to remote and rural areas through innovative business models which guarantee a return on investment.

With about 64 million people who still do not have access to mobile broadband networks in Latin America of (GSMA data), these solutions are intended to ensure that everybody has access to communication and the digital world. We believe that the Internet and mobile communications have the potential to make a positive impact on the transformation of people's lives, offering benefits in a number of areas such as health, education, financial services, transport and agriculture, among others.

Models such as the sharing of Network infrastructure, use of new frequency spectra or network virtualisation solutions are helping reduce the investment required for deployment, which enables new areas to be reached so that more people can access communication services. For further information, see the chapter on 'Network deployment'.

Universal Service

The Universal Service is a public investment fund, financed by special taxes on telecommunications operators, which has the objective of ensuring connectivity for the entire population, with a minimum level of quality guaranteed and affordable prices.

We currently provide Universal Service funds in 7 countries: Argentina, Brazil, Colombia, Ecuador, Spain, Peru and Venezuela, where they are subject to the control and monitoring of the public bodies appointed by each country for such purpose.

CONTRIBUTIONS TO THE UNIVERSAL SERVICE

(Millions of euros)	**2016**
Argentina	111.8
Brazil[1]	138.1
Colombia[2]	50.8
Ecuador	4.6
Spain	16.5
Peru[3]	20.5
Venezuela[4]	1.7
TOTAL	**343.1**

(1) Includes figures for 2016: FUST 316,161,466 and FUNTTEL 158,057,748; and 2015: FUST 275,875,221 and FUNTTEL 137,937,611.
(2) The figures from Q1-3 are real, the Q4 figure is an estimate.
(3) Includes services provided by Telefónica del Perú S.A.A., Telefónica Multimedia S.A.C., TIWS and Media Network S.A.C. Does not take into account the pending annual adjustment.
(4) Timetrac: 2,117,100.04/Telefónica: 1,198,326,275.14.

BEST PRACTICES

INTERNET FOR EVERYONE

The Telefónica I+D teams, together with the team for rural connectivity in Peru, are working on new, more efficient solutions, which will enable mobile communications networks to be deployed in remote areas of the Peruvian rainforest, where it is estimated that there are still more than 1 million people without Network coverage.

This project provides 4G connectivity to rural populations using innovative software technology, such as the integration of satellites, flight networks, virtualised radio, small cells, software-defined networks and network virtualisation features, among others.

This initiative is an essential part of achieving a sustainable model that provides Internet access in the most remote areas. The project offers Network flexibility, elasticity and profitability, as well as the capability to move this model to other unconnected regions.

EMERGENCIES

Having cutting-edge, secure and efficient technology makes the difference in emergency situations, as it optimises the coordination of rescue and logistical operations, enables real-time action and helps to deal more efficiently with the security challenges faced after a catastrophe. For these reasons, technology and telecommunications are increasingly important in emergency situations, improving the management and increasing the speed of operations.

We are aware of the importance of our networks and the potential of the innovative services we offer to address the growing social and environmental challenges more effectively.

The new services born of the digital transformation have great potential to improve efficiency in emergency situations. Digital services based on the analysis of Big Data or the Internet of Things enable progress to be made in the adaptation to climate change, and also enable prediction of behaviour patterns in migrant crises or pandemic outbreaks.

In the event of disasters, the response is primarily the responsibility of governments. We therefore encourage collaboration with these and with humanitarian organisations in order to strengthen response strategies. Our response policy in these cases focuses on the organisation and execution of a timely deployment of telecommunications

technology to assist and support the efforts that are made to prepare for and respond to natural disasters and emergencies.

We also provide an early warning channel; we facilitate coordination of the response of emergency teams, logistical coordination, and support to vital communications between, and with, those who are affected.

Among the noteworthy initiatives we have undertaken are:

▸ **Spain:** Agreement with the Military Emergency Unit (Spanish acronym: UME).

▸ **Brazil:** Agreement with the Ministry of Science, Technology and Innovation and the National Centre for Natural Disaster Monitoring and Alerts (Spanish acronym: Cemaden).

Moreover, in early 2016, we signed the Humanitarian Connectivity Charter, promoted by the GSMA. This document seeks to improve coordination between mobile network operators before, during and after a disaster.

Response Policy

The key to a quick and efficient response by emergency teams in disaster situations is the good management of telecommunications networks and services. In addition to establishing the Continuity Plans needed for ensuring the normal provision of services to

our customers, we include specific actions that complement humanitarian aid in all the countries in which we operate:

▸ We carry out safety drills in order to build, improve and maintain up-to-date the processes, action plans, capabilities and priorities in a joint response.

▸ We have established a basic code of humanitarian aid in conjunction with the national regulators in order to ensure orderly participation of public and private companies.

▸ We support access to our mobile services during emergencies, providing simplified and free access to vital communications, until suspended or cancelled services have been re-established.

▸ We solve the communication infrastructure deficit by means of our satellite services. We thereby complement the other solutions, either as the only possible form of communication or as 100% diversified backup solutions. In addition, we can offer it globally, regardless of the geography and the distances to nodes and centres, and deploy it rapidly.

▸ We actively participate in the GSMA Association (an organisation of mobile operators and related companies, dedicated to supporting the standardisation, implementation and promotion of the GSM mobile telephone system) so as to organise a specific working group for "Responses to Disasters and Emergencies".

▸ We promote innovative projects that seek out new tools and processes in order to improve the response to emergency situations.

CHALLENGE FOR 2017

To promote the development of policies and solutions that respond to emergency situations and natural disasters.

BEST PRACTICES

AID DURING NATURAL DISASTERS

Chile
After the large earthquakes that struck Chile, we have continued with the development and improvement of the business continuity contingency plan, which includes carrying out simulations and safety drills on a regular basis.

In the event of an emergency, local, long distance and mobile calls can be enabled through 188 short codes which are free of charge. In the same way, free telephone boxes can be set up for those who do not have a telephone of their own. Customer billing may be deferred, and in some cases suspended for services such as SMS, paging and phone calls, depending on the context and the duration of the emergency.

Mexico
Together with the other mobile operators in Mexico, we have announced our commitment to the We Care initiative, by supporting the Humanitarian Connectivity Chapter principles of the GSMA with the aim of collaborating with the authorities in the implementation of preventive measures to mitigate the impact that natural disasters can cause and reinforce coordination during prevention, response and recovery stages.

Ecuador
In April 2016, Ecuador was shaken by an earthquake reading 7.8 on the Richter scale, which required a global and coordinated response from the entire Telefónica Group in order to assist and support those affected. To that end, satellite phones were sent for rescue work, coordination with security forces and emergency care. Also, equipment was installed at mobile emerging service points (Spanish acronym: PSEM) and vans were deployed that travelled in a coordinated way through the affected areas offering free calls upon request. In addition, mobile recharging points were used to alleviate the lack of power supply.

Furthermore, an aeroplane was sent to the country with supplies and experts who assisted in the rescue of victims. Also, the Group operators in Venezuela, Spain and Guatemala temporarily offered free calls to those who had family and friends in the area.

In parallel, the Ecuadorian teams worked intensely from the start, to re-establish the service of the base stations that were hit by the earthquake, as well as to support the Ecuadorian Government in the texting of safety instructions to the general public.

DIGITAL EDUCATION AND DEVELOPMENT OF LOCAL CONTENT

Despite the fact that basic literacy rates are increasing, in some sectors of the population the digital skills and literacy divide persists, hindering access to and use of many products and services that the Internet offers.

Digital literacy is defined not only as the set of skills that enable users to access the Internet, but also as those skills that enable them to browse websites and assess and create information via digital devices.

For this reason, aware of the importance of digital education, we have implemented programmes in every country in which we operate through our Foundation, which have the aim of promoting the knowledge of digital tools, or making use of them to ensure a quality education. For further information, see the chapter on 'Social and cultural action'.

Furthermore, the lack of relevant content for users in their own language or that covers local interests, including services or content that are not adapted to people with special needs, is a challenge which hinders the adoption of digital services. Therefore, since the perceived value of the Internet and literacy are essential for promoting the development of and access to digital services, it is important for us not only stimulate the creation of relevant content locally, but also to improve the digital skill set.

Projects such as Think Big support and encourage local entrepreneurial talent by helping to convert innovative ideas into businesses, and thereby facilitating the creation of local solutions that favour the use of the Internet. For further information, see the chapter on 'Innovation'.

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20% of the population does not access the Internet because they do not know how or *do not see the need*

CHALLENGES FOR 2017

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To ensure the value of online services and content offered to populations with fewer resources.

AFFORDABLE SERVICE

As regards our goal of being able to connect people, we know that it is very important that the services we offer are affordable for the population, regardless of their social status.

The adoption of fixed broadband, and especially mobile broadband, has improved significantly during the last decade. However, despite this progress, there are still sections of the population that cannot access it, mostly for economic reasons, especially in Latin America. Even taking into account the significant reduction in telecommunications rates recorded in recent years (between 2010-2015 they reduced annually by an average of 8.17%) the average income of the population at the bottom of the region's demographic pyramid is so small that this progress does not allow them to overcome the economic barrier.

In this regard, the Sustainable Development Goals (SDG) also highlight the potential of the Internet with regard to social and economic welfare.

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The cost of a mobile phone for the poorest 40% of the population can amount to *17% of their income*

Similarly, in the case of small businesses and entrepreneurs, being able to access affordable telecommunications services helps them to promote and develop their businesses.

The pay-as-you-go mobile service, a differentiated broadband provision and service packages for small businesses and entrepreneurs are key tools for increasing penetration among sectors of the population with lower incomes.

A unique and tailored offer

In the mobile market, as well as with regard to Internet access, competition, technological and commercial innovation and private investment have enabled millions of people to access telecommunications services. Offering a flexible range of plans is key to ensuring we reach all segments of the population, since, in this way, our customers can decide what to access based on their own demand and on what they can afford.

Access to the Internet, both via fixed broadband and through smartphones, is the main factor that has a determining influence on the affordability of our services. For this reason, in the markets in which we are present, our customers can now access the Internet (1GB per month) for less than 4% of the gross national income. In Latin America, we have been pioneers in the development of pay-as-you-go rates as a tool for promoting mobile services, which has

DIGITAL INCLUSION INDICATORS

(%)	Dec. 2015	Dec. 2016
Smartphone penetration	49.5	57.1
Pay-as-you-go	49.5	43.1
Contract	37.7	81.8
LTE smartphones (millions)	126.2	147.2
LTE penetration	15.7	25.3

BEST PRACTICES

ACCESS FOR THOSE WITH THE LOWEST INCOMES

Mainly in Latin America, we are developing new initiatives to facilitate access to mobile broadband and to new services that favour the inclusion of lower-income sectors of the population. Some key examples are:

▸ **Charges per day:** In Argentina, we offer the "Internet per Day Plus" tariff, which provides 50MB per day at AR$6.5 (US$0.41).

▸ **Charges per application (app):** Movistar Peru offers unlimited access to social media (WhatsApp, Facebook and Twitter) for 1

Peruvian nuevo sol per day (US$0.30) in 15-day or 30-day packages.

▸ **Co-payments:** These programmes, established in collaboration with governments, enable any customer, regardless of their economic level, to access the services they wish, thereby selecting and controlling their expenses. Thus, for instance, in Colombia, the Colombia Internet Móvil social initiative was launched, with the aim of extending adoption and use of the Internet.

allowed us to attain an average penetration of 112%.

As regards smartphones, these devices are essential for accessing the Internet, since their price is significantly lower than that of other terminals and they are increasingly widespread

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In *Latin America,* between 2010-2015, mobile broadband rates *reduced* annually by an average of *8.17%*(*)

(*) Source: "Initiatives for bridging the digital divide in Latin America". Author: Raul Katz, CET.LA, August 2016.

in the region. Hence, smartphones are a key tool for reducing the digital divide in the most economically vulnerable sectors.

Moreover, these handsets do not require significant skills for their use, which in turn can bring down certain barriers arising from a lack of digital literacy. 57.1% of our mobile customers currently have a smartphone, 43.1% of whom are pay-as-you-go customers.

CHALLENGES FOR 2017

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To seek and reinforce initiatives to facilitate and enhance Internet access for lower-income households.

57.1%
of our mobile customers
have a smartphone

43.1%
of them are
pay-as-you-go

ACCESSIBILITY

We want to be a fully accessible company which actively contributes to equal opportunities, both for people with disabilities and the elder generations. In order to achieve this, our global lines of action are based on an important awareness-raising initiative, which we believe is a key aspect in progressing towards our "Design for All" goal.

Our goal is for all the products and services that we offer to be accessible to every customer. In order to achieve this, we take these attributes into account in our work from the earliest stage of development: the design phase.

We are convinced that the commitment to accessible products and services represents a business opportunity that enables us to develop this market and position ourselves as a leading company with regard to disability.

"Design for All" is a concept integrated into our value chain. As a result, and by means of training, testing and development activities involving accessibility experts, we are able to consider it in everything we do.

Collaboration with leading associations in the field of disability helps us to understand the needs of this group and to transmit them internally, so that every department within our Company can incorporate accessibility criteria into their daily activities.

ACCESSIBLE TELEFÓNICA

With the aim of giving greater visibility to our accessibility initiatives and promoting the social integration of people with different needs, we have launched a labelling system under the slogan "Accessible Telefónica", which identifies all projects that help us to become a company within everybody's reach, where our products and services, can be enjoyed by all, regardless of the capabilities of each person, and no one feels discriminated against.

Consequently, our strategy and efforts focus mainly on two fronts:

▸ Our customers and the societies in which we operate, because we believe that access to the digital world is essential for improving people's lives. In addition, in some cases, such as for people with disabilities, technology constitutes a key tool for their day to day lives. We are committed to accessibility, hence we want to offer innovative and accessible products and services which enable people to enjoy all the benefits

BEST PRACTICES

ATAM: EPSILON PROJECT

Through use of the latest technology, ATAM is building a combined system of services to promote the autonomy of the most vulnerable people. To do this it leads the EPSILON international innovation initiative. The project consists of the development of a technological infrastructure of support services for groups such as people with disabilities and those who have a high degree of dependence.

The ultimate goal is for clinicians and users, through the different solutions and tools of this platform, to be able to access predictive models, which allow great developments in processes of diagnosis, prevention and determination in clinical intervention plans.

ATAM is a private social protection system for our employees. Its work focuses on ensuring comprehensive support for families who have to cope with a disability. Its vision focuses on providing tools and strategies for coping with disability, for managing lives, and for integrating into normal daily life. Currently, ATAM provides a network of clinical and social care for more than 50,000 families throughout Spain.

offered by information and communication technologies.

▸ The Company itself, where we have implemented policies on labour inclusion as part of our commitment to diversity as a source of talent. We believe that people with different abilities enrich us all. For this reason, through awareness-raising initiatives aimed at our employees, such as the exhibition which we put on at the central Distrito Telefónica facilities with the Fundación ONCE Perro Guía (Guide Dogs for the Blind Foundation), we seek to bring the reality of that community to our workers. In addition, we strive to improve access to all our facilities.

During the coming year, we would like to continue to move forward with the consolidation of our global accessibility strategy by ensuring compliance with the regulatory framework and even going a step further. In order to do this, we prioritise the most sensitive and differential fronts, which will enable us to continue incorporating accessibility as a natural element, while disseminating the best practices acquired in our various operations.

In 2016, we made progress in different lines of work, among which we can highlight:

▸ **Accessible Websites:** We have worked to evaluate and improve the accessibility of our websites in accordance with WCAG (Web Content Accessibility Guidelines). Consequently, in Spain, we have provided training for our developers, to ensure that accessibility criteria are incorporated into their daily work and are integrated into the creation of our web portals. In the same way, in Brazil, an audit was conducted and the content of our websites was adapted, both for people with visual impairments, and for people with hearing disabilities, through videos in sign language.

▸ **Accessible Handsets:** It is not only specific services that we want to offer these groups. Rather, we intend to make each of the products and services we offer to our customers more accessible, so that they will be practical for all users. Thus, we are working to sort our global catalogue of mobile devices by accessibility criteria, using icons to identify the best handsets for overcoming visual, auditory, cognitive or dexterity difficulties.

▸ **Accessible Facilities:** One of our main objectives is to guarantee an accessible working environment and offer equal opportunities to the representatives of all the different communities that make up our team. In order to do this, we must have facilities which anybody visiting us can move around with autonomy and without difficulty.

—
We incorporate *accessibility* as a natural element of *our processes*

Accessible Shops: In line with the improvements which we seek to implement in all our departments, we have launched various accessibility projects in Premium shops. In Chile, we are working on improving the experience. In order to achieve this we sought to identify, through a focus group, which were the attributes that our customers were looking for. The result has been the creation of preferential service areas in some shops, as well as the installation of a video-interpreting service. In Mexico, 100% of our own brand shops have been adapted to make them accessible, and in Spain, we have trained our sales personnel in serving people with different abilities.

Innovative Projects: We are seeking out initiatives that will enable us to continue to make progress in the field of accessibility thanks to new technology. We have both internal initiatives, such as Vivo Libras (Brazil), which is a commercial video-interpreting service for companies and individuals; and external initiatives, such as helping startups, for instance Showleaps, via Open Future. We also work in partnership with other institutions such as the Universidad Carlos III in Madrid, with which we worked on the launch of GoAll, an application that enables deaf-blind people to enjoy TV subtitles on their Braille tablets.

TELEFÓNICA'S ACCESSIBLE MOBILE DEVICES

PARTIAL Vision
69% of the catalogue

ZERO Vision
67% of the catalogue

PARTIAL hearing
33% of the catalogue

ZERO hearing
92% of the catalogue

MODERATE difficulty with handling
76% of the catalogue

SEVERE difficulty with handling
40% of the catalogue

Difficulty UNDERSTANDING
34% of the catalogue

Percentages of the total number of devices analysed by Fundación ONCE.

BEST PRACTICES

MOVISTAR + 5S

In Spain in 2016, we launched Movistar + 5S, a new free service that enables people with sensory disabilities to access the series and films on our Movistar + television platform through the three accessibility systems: audio description, subtitling and sign language.

This initiative, created in collaboration with WhatsCine, Universidad Carlos III and the main disability associations and agencies in Spain, was recognised by the ONCE 2016 Solidarity Awards.

MOVISTAR + 5S
El entretenimiento por fin accesible para todos
5S Audiodescripción Subtitulado Lengua de Signos
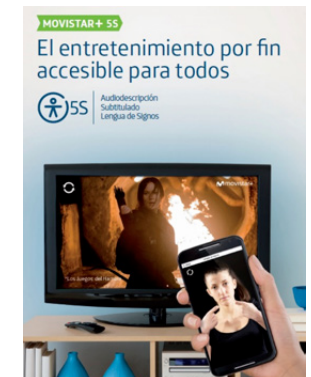
MILESTONES IN 2016

Improve the accessibility of our in-person and virtual customer care channels. — **IN progress**

Expand the scope of Movistar's accessible services. — **100% Achieved**

Further the implementation of "Design for All" throughout all Company departments. — **IN progress**

CHALLENGES FOR 2017

Improve the accessibility of the platform Movistar +.

Implementation of Premium Access Shops in Spain.

Create a global catalog of terminals that includes the accessibility features for all our operations.

SUSTAINABLE INNOVATION

We believe that some of the major challenges the world faces today can be seen as an opportunity which enables us, through innovation, to have a positive impact on society and the environment, in addition to ensuring the sustainable development of our business.

For this reason, in 2016, we promoted the concept of "Sustainable Innovation" as innovation which seeks to address a social or environmental challenge, while at the same time producing a financial return for our business. Our goal is for this innovation to be fully integrated into the processes and life cycle of the solutions we offer, as an intrinsic part of our innovation model (see the chapter on 'Innovation').

We understand that the new digital technologies are a fundamental tool for social and economic transformation; therefore, we are convinced that through sustainable innovation we can create a future where societies and the protection of the environment are one of the priorities of our business. To that end, we have given impetus to two major areas of work.

The impetus of Sustainable Innovation

In addition to promoting the incorporation of sustainability principles in each of the new solutions that are developed by our innovation departments, in order to promote Sustainable Innovation, last year we developed investment programmes aimed at funding new initiatives and ideas that, in addition to generating a positive impact on society or the environment, represent a clear business opportunity for us.

Different projects have been carried out, both locally and globally, in order to come up with ideas for this type of initiative. The most appropriate ideas are then selected and provided with funding. Among these, the following stand out:

▸ Inclusion of sustainable goals in Telefónica's In_Prendedores (Intrapreneurship) programmes in Spain (for further information, see the chapter on 'Innovation') and in the "Calls" for innovation of the Group's product innovation teams. The ideas selected through these programmes (in which numerous employee proposals have been assessed, dealing with topics such as the use of Big Data, solutions for responses in emergency situations or collaborative economy development platforms) have had internal resources allocated to them so as to enable employees to develop their ideas and try to turn them into new commercial products.

▸ Investment in Internet of Things solutions for Mining in the R&D centres in Chile.

BEST PRACTICES

MEASURING SOCIAL / ENVIRONMENTAL IMPACT

Last year, a series of studies was carried out with the aim of measuring the social, environmental and economic impact of some of the commercial solutions that we currently offer.

To that end, we have developed tools that facilitate these calculations and which can also be used by the business units, which have been formed for this purpose, so as to determine, both quantitatively and qualitatively, the positive impact that a service can have.

▸ Promotion of and investment in 'Big Data for Social Good' projects aimed at using Big Data capabilities to address social and environmental issues.

▸ Investment Initiative in Sustainable Innovation 2016. For the first time in history this initiative was launched simultaneously throughout the whole Group, with the aim of detecting projects for business areas related to connected societies, environment and sustainable societies, which require an initial capital boost to start development.

These projects must demonstrate a clear social/environmental impact in addition to a sustainable business model. In this initiative, proposals were received from most of our operations. Three projects were selected which are currently in the development phase:

▸ Project Yanapaqi, aimed at bringing mobile connectivity to rural areas of Peru.

▸ Project Phoenix, the aim of which is to develop portable technologies enabling

antennas and coverage to be deployed in a very short timeframe in areas that have experienced a natural disaster.

▶ Project for the protection of areas classified as World Heritage sites in Chile, in order to monitor and control the state of these areas of high natural and historical value.

Assess and promote "sustainable" business solutions

In this regard, and within our portfolio of business solutions, a group of products and services have been selected that have a clear positive impact either in society or on the environment in some of the following areas (and measurements and studies have been carried out to assess that impact so as to quantify its value).

—

Our aim is to *innovate* in order to address *social and environmental* challenges, and in so doing, generate *financial return*

Connected Societies

We are leading projects that seek to bring connectivity to all areas in an efficient and sustainable way, and we are seeking out new technologies or business models that are capable of providing communications services in remote areas which are difficult to access and operate in.

Protecting the planet

One of the main benefits that technology can offer is help in the fight against climate change and the protection of ecosystems and biodiversity. To this end, we have a wide range of solutions that improve energy efficiency, enable the monitoring and control of natural environments and reinforce internal Circular Economy processes (for further information, see the chapter on 'EcoSmart services').

Sustainable societies

Health solutions, Smart Cities, the collaborative economy, open governance, smart mobility and the use of Big Data are just some of the projects that we promote and foster in order to achieve a more human and sustainable development of the societies in which we operate and where we offer our services, so as to improve people's quality of life and meet every one of their needs.

Connected societies

so that people can have **access to communication and the digital world**

▶ Conectivity
▶ Universal design
▶ Affordability of services

Protecting the planet

and rising to **environmental and climate change challenges**

▶ Climate action
▶ Biodiversity and natural resources

Sustainable societies

so as to **improve people's quality of life**, and meet **every one of their needs**

▶ Sustainable cities
▶ Emergencies
▶ New economy
▶ Institutions and governments

MILESTONES IN 2016

—

To further enhance the values of sustainable innovation, throughout the life cycle of the processes and solutions we offer.

100% Achieved

—

We include metrics for measuring our social and environmental impact in key services.

100% Achieved

CHALLENGES FOR 2017

—

Increase investment in new projects and acceleration of innovation initiatives with social or environmental impact.

—

Promote innovation in connecting the unconnected and bring Internet to rural areas.

Social and cultural action_

We are fully aware of the impact that new technology has on social transformation. That is why we use the latest developments at our disposal as a vehicle for promoting knowledge, culture and solidarity.

Every year we endeavour to go a step further in our commitment to the societies of the countries in which we are present, forming an active part of the social and cultural life of those who live in them. In 2016, we allocated 137 million euros to social and cultural initiatives, in accordance with LBG (London Benchmarking Group) methodology. This amount represents 0.26% of the Group's revenue, which is an increase on last year's amount, and a greater proportion of it is dedicated to activities related to education and young people.

**FURTHER
INFORMATION**

CONTRIBUTION TO SOCIAL AND CULTURAL INITIATIVES
2016

7.0%   1.9%   0.2%
5.2%   22.5%

**137
MILLION**

63.2%

- Socio-economic development
- Art and culture
- Education and young people
- Social welfare
- Environment
- Others

FORM OF CONTRIBUTION
2016

2.5%   0.3%

**137
MILLION**

97.1%

- Money
- Employee time
- In kind **0.0%**
- Management costs

CONTRIBUTION BY GEOGRAPHICAL AREA
2016

24.86%

**137
MILLION**

10.93%

0.2%   64.2%

- Spain
- Germany
- Brazil
- LatAm
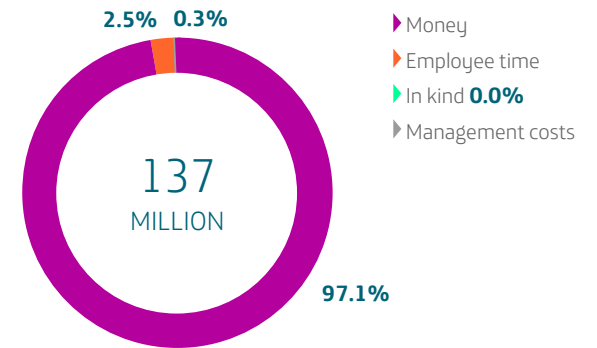
CONTRIBUTION BY TYPE OF ACTIVITY
2016

2.4%
20.9%

**137
MILLION**

76.7%

- For the community
- For commercial issues
- Charity

| 1 NO POVERTY | 4 QUALITY EDUCATION | 10 REDUCED INEQUALITIES |
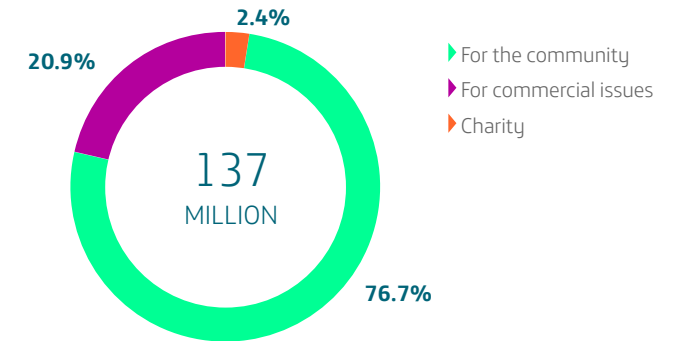
EDUCATION

We are committed to education as the main driver of digital transformation. We see the challenge of bridging the digital divide as a personal goal, which will lay the foundations for economic growth in all countries, without leaving anyone behind. For this reason, in 2016, we invested 86 million euros in various projects and initiatives related to education.

BEST PRACTICES

SIELE

At Telefonica Digital Education, we have developed and marketed the International Spanish Language Assessment Service (Spanish initials: SIELE). This is a certificate which accredits candidates' levels of Spanish through a single online exam. The assessment incorporates all variants of the language, recognised by all Spanish-speaking countries.

Promoted by the Cervantes Institute, the University of Salamanca and the National Autonomous University of Mexico (Spanish initials: UNAM), it became operational in January 2016. The aim is for it to become the

benchmark electronic examination, which can be taken quickly and easily. In this way, it satisfies the growing need for assessment and certification of Spanish, and it is aimed both at students from all over the world and native speakers.

BIENVENIDOS A UN MUNDO QUE HABLA — ESPAÑOL

At Telefónica Digital Education, we develop products and services that promote the use of new technologies at all levels of education, through online learning solutions that facilitate access to the labour market.

Specifically, in 2016, the Miríada X, online learning platform, which collaborates with more than 75 universities and 1,780 teachers, managed a sustained monthly growth of 7.5% and recorded enrolment levels of over two million students. In addition, ScolarTIC, the social learning space for teachers, educators and parents registered more than 290,000 users as of March 2017.

We also encourage education through cultural activities. In 2016, we invested more than 30 million euros in art and culture. In addition, we continue to use the Fundación Telefónica Spaces to hold workshops, talks and exhibitions.

At Fundación Telefónica, we carry out activities with the aim of improving the skills, competencies and abilities of young people and increasing their opportunities for access to the labour market. In particular, in 2016, 132 job launchers were set up (and will remain open during 2017), involving 3,326 unemployed people.

Also worthy of note is the Think Big training programme, which drives social entrepreneurship and supports companies that are seeking to achieve a better society. In 2016, 1,430 projects were supported, which have benefited 362,250 people.

With the aim of reducing inequality in the world, in 2016, the ProFuturo Foundation was created, in collaboration with the "La Caixa" banking Foundation, whose mission is to reduce the educational divide in the world by providing a digital education in vulnerable regions of sub-Saharan Africa, Latin America and South-east Asia. In this new educational initiative we incorporate technology, educational content and teaching methodologies for teachers and students with the aim of transforming the education of 10 million boys and girls by 2020. In addition, the project aims to welcome and encourage the participation of other companies and institutions and aims to create a large international network of centres for promoting better education worldwide.

VOLUNTEERING

None of these initiatives would get very far if we did not involve our employees. For this reason, we empower our workers to get involved in social activities. Telefónica Volunteers constitute the seeds of the Group's social commitment. For instance, in 2016, they contributed through 4,076 initiatives, which go beyond mere philanthropy, with the aim of improving society.

In 2016, a total of 27,134 employees participated in volunteer activities and gave up 252,600 hours of their time, experience and enthusiasm to help those who need it most, managing to benefit 262,802 people from various vulnerable groups, among which are some 32,813 people with disabilities.

FURTHER INFORMATION

More than 50 million children cannot go to school

FURTHER INFORMATION

El Voluntariado Online es una forma innovadora de utilizar la tecnología para el beneficio de muchos.

In addition, this year we have given ourselves the challenge of setting the benchmark with our digital volunteer programme, in which we promote activities that include digital tools as part of their purpose or process, which contribute to the achievement of social objectives.

BEST PRACTICES

EARTHQUAKE IN ECUADOR

After the earthquake that devastated Ecuador on 16 April 2016, more than 250 volunteers carried out aid work for those affected. Similarly, the SMS solidarity campaign that we organised along with six NGOs in Spain – Action Against Hunger, UNHCR, the Red Cross, Oxfam Intermón, Plan International and the Spanish UNICEF Committee – raised more than 69,000 euros (each SMS lets you donate 1.20 euros in full), and as a result, we have been able to help 60,000 victims.

In addition, more than 80 volunteers from 14 countries participated in the International Solidarity Holiday project, which contributed to the reconstruction of schools, community centres and children's groups in the affected areas, thus directly helping more than 4,590 people.

FURTHER INFORMATION

#ContigoEcuador

Telefónica FUNDACIÓN | M movistar

More than 27,000 employees participated in *volunteer activities* during the past year

CHALLENGES FOR 2017

— To promote greater inclusion, and bridge the educational and digital divide.

— To set the benchmark with our digital volunteer programme.

9

Commitment to the environment

- Growth in a green economy
- Circular economy and recycling
- Energy and climate change
- Managing electromagnetic fields
- EcoSmart services

Growth in a green economy_

We want to promote an economy that contributes to the environmental sustainability of our operations, customers and cities.

HOW DO WE MANAGE THE ENVIRONMENT?

We have a global environmental strategy through which we want to contribute to growth in a green economy, by separating business development from our impact on the environment. In addition, we create digital services to help our customers reduce their environmental footprint and increase resilience to environmental challenges

MANAGEMENT FOCUS:

WHY IS IT A KEY ISSUE?

Like other companies and society as a whole, we are facing major environmental challenges. Among these is climate change, which has been identified as one of the biggest risk factors worldwide. This is therefore a major issue for both our main stakeholders and the economic sustainability of the Company, but one for which we believe we can offer solutions through digitisation, Big Data services and the Internet of Things.

WHERE IS THE IMPACT?

Our work on environmental influence within and outside the Company affects not only our operation, costs and revenue, but also our customers and the societies and environments in which we operate.

TELEFÓNICA'S OBJECTIVE

We want our Company to be among the leading champions of green growth, with a vision of sustainability in the medium and long term, and supported by our objectives in Energy and Climate Change, environmental management, as well as the expansion of our EcoSmart services, in order to help reduce the negative impacts caused by climate change and other environmental challenges.

Indicators	2015	2016	% Variation
% of Revenue with ISO 14.001 Certification	65%	90%	+38%
Energy consumption of traffic (MWh/PB)	400	262	-34%
GHG emissions (Scopes 1+2) (tCO$_2$)	1,866,070	1,372,145	-26%
% of Renewable Energy Consumption	20	44	+113%

SUSTAINABLE DEVELOPMENT GOALS

6 CLEAN WATER AND SANITATION

7 AFFORDABLE AND CLEAN ENERGY

11 SUSTAINABLE CITIES AND COMMUNITIES

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

13 CLIMATE ACTION

14 LIFE BELOW WATER

15 LIFE ON LAND

The services that we offer are subject to a continuously growing demand, not only in connectivity, but also in data traffic which is increasing exponentially. This poses the challenge of further developing our networks and equipment, while reducing our environmental footprint and separating the business growth from greenhouse gas emissions (GHG) by decarbonisng our activity.

Energy

Renewable energy

Water

Emissions

Waste

Eco-efficiency

Decarbonisation

Circular economy

Paper

EcoSmart Services and Products

Cloud

Connectivity

Big Data

IoT

Environmental responsibility

Compliance

Environmental management systems ISO 14001

Responsible Network

+ Efficiency

- Risks

+ Income

+ Resilience

Besides this, we offer products and services that help our customers reduce their impact on the environment, thus adding value to connectivity, the Internet of Things, the Cloud or Big Data. In a digital world there are more opportunities for eco-efficiency and a descarbonised and circular economy.

To achieve this, we work at different levels:

▶ Risk management: focused on compliance and environmental management;

▶ Efficiency and Productivity: by taking advantage of the use of internal eco-efficient methods, the promotion of the circular economy and the decarbonisation of our activity;

▶ Development of products and services that reduce the consumption of resources, greenhouse gas emissions (GHG), or which help our customers in the area of adaptation to climate change.

We have a global environmental strategy which is implemented through the Global Environment and Energy Policies. These policies are common to all companies that make up the Group.

ENVIRONMENTAL GOVERNANCE

The environmental strategy falls under the responsibility of the Board of Directors, within the framework of the Company's Global Responsible Business Plan. The most relevant environmental objectives are defined globally by the top managers for operations and sustainability. We have a multidisciplinary team, both overall and within the different countries, which supervises implementation of the strategy at the different levels of responsibility.

Climate change office

Global Financial Unit

Environment managers

Global Operations Unit

External Partners

Global Environmental Unit

Energy managers

Aligned objectives enable a company to reduce its environmental footprint

Global Procurement Unit

Responsible Business Office

Innovation units

Country environment committee

Chief Commercial Digital Officer

ENVIRONMENTAL MATERIALITY

We analyse and define our most significant environmental issues annually, on the basis of the business strategy, the regulatory requirements and the demands of our stakeholders.

RELEVANCE FOR STAKEHOLDERS

IMPACT ON COMPANY MANAGEMENT

GREENHOUSE GASES

REUSE AND RECYCLING OF DEVICES

RENEWABLE ENERGY AND CONSUMPTION

ENVIRONMENTAL MANAGEMENT SYSTEMS

ECOSMART SERVICES

ADAPTATION TO CLIMATE CHANGE

RESPONSIBLE NETWORK IMPLEMENTATION

WATER

ENVIRONMENTAL ISSUES IN THE SUPPLY CHAIN

ELECTROMAGNETIC FIELDS

FLUORINATED GASES
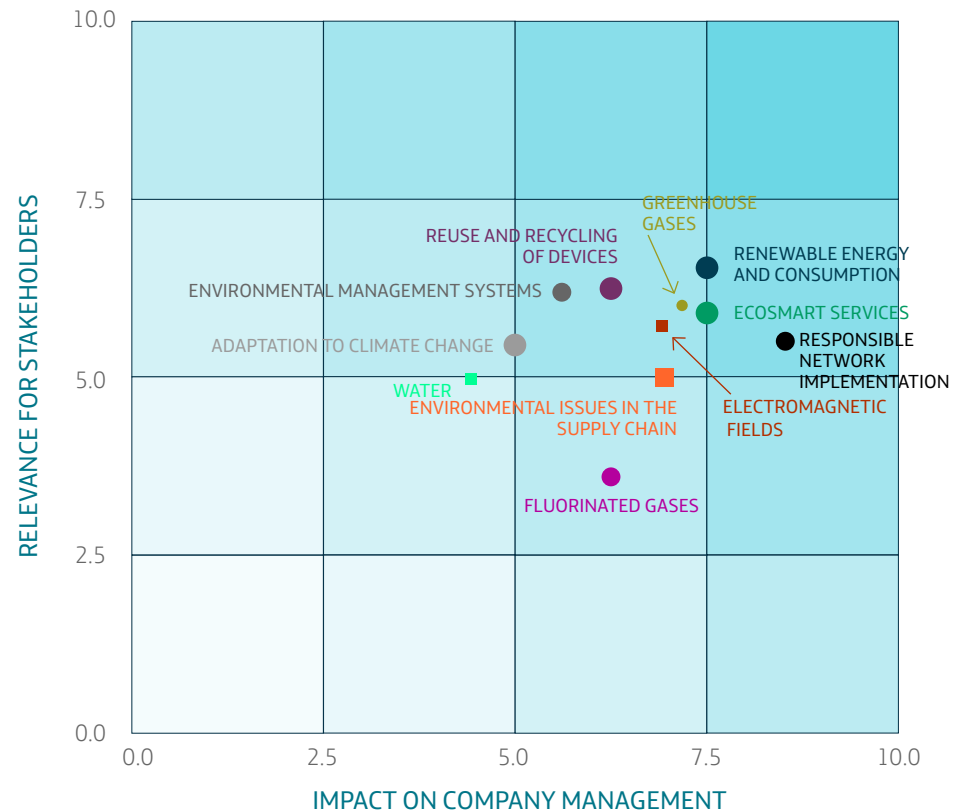
MILESTONES IN 2016

New targets for reducing energy and GHG emissions, in which we committed ourselves to using 100% renewable sources for our electricity consumption by 2030 and to reducing GHG emissions, in accordance with a science-based methodology, in line with the Paris Agreement.

100% Achieved

We reached a renewable energy consumption equivalent to 44% of our electricity consumption.

100% Achieved

We reduced our energy consumption by 2.17% despite an increase in traffic of more than 50%.

100% Achieved

We reduced our total carbon footprint by 22%.

100% Achieved

90% of Telefónica's Environmental Management Systems are certified to ISO 14001 standard.

100% Achieved

New Smart Energy and Smart Transport services accounted for 51.5 million euros of revenue.

100% Achieved

We launched the Environmental Eco-Rating for our customers in Brazil, Spain and Chile.

100% Achieved

We adopted a Global Energy Management Policy and certified our operations in Spain and Germany under the ISO 50001 standard.

100% Achieved

Our work was externally acknowledged with the Green Mobile Award 2016 in the GSMA Mobile World Congress.

100% Achieved

For the third year in a row, we were included on the "A-List" for the Carbon Disclosure Project (CDP).

100% Achieved

CHALLENGES FOR 2017

100% of our operators to be certified to ISO 14001 standard.

To comply with the energy and greenhouse gas emissions (GHG) objectives.

To move forward with our Renewable Energies Plan.

To maintain external recognition of our strategy in the area of climate change and energy by the CDP.

To digitise waste management processes, GReTel, and reduce the amount of waste generated by reusing equipment.

To extend the Eco-Rating initiative to more countries in which we operate, and launch the OpenEcoRating website.
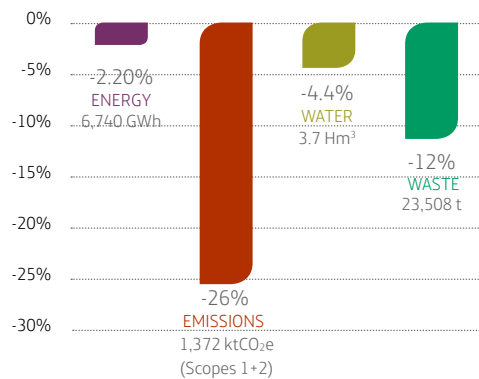
To increase the environmental value of our IoT and Big Data services, and thereby have a greater positive impact on the environment.
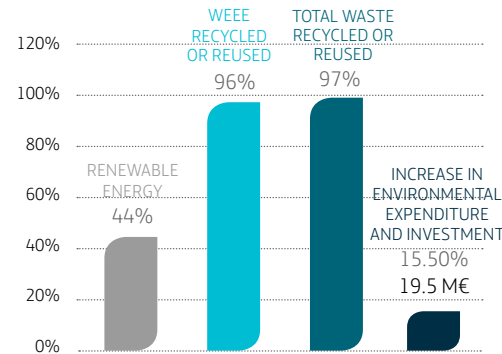
MANAGEMENT SYSTEMS

Within the framework of a clear commitment to continuous improvement and prevention of pollution, we now have an Environmental Management System certified to ISO 14001 standard, which covers around 90% of Company operations, with the goal of reaching 100% in 2017. In addition, in Spain and Germany, which account for 40% of our revenue, we have an Energy Management System certified to ISO 50001 standard.

Thanks to both systems, we can ensure the adequate control of risks and environmental impacts along the entire value chain, from deployment of the Network to dismantling of obsolete facilities, through efficient operation of networks and the reuse of equipment (both ours and that of the customer). This allows us to provide the highest quality service without compromising care for the environment and, for example, continuing to reduce energy consumption.

Besides this, and based on the principle of precaution, under the global risks model we analyse the environmental and climate change risks across all our operations, with the aim of reducing these risks and further identifying opportunities to manage them. The possible risks are associated with the regulatory aspects of environmental legislation, the vulnerability of our Network to climatic disasters and energy costs. The Management Systems and specific plans such as the Global Energy Efficiency Plan contribute to controlling these risks and taking advantage of the opportunities that they provide. In 2016 we were not subjected to any significant sanction in environmental matters.

We reduced our negative impact (2015 vs. 2016)

-2.20% ENERGY 6,740 GWh
-26% EMISSIONS 1,372 ktCO$_2$e (Scopes 1+2)
-4.4% WATER 3.7 Hm^3
-12% WASTE 23,508 t

We increased our positive impact (in 2016)

RENEWABLE ENERGY 44%
WEEE RECYCLED OR REUSED 96%
TOTAL WASTE RECYCLED OR REUSED 97%
INCREASE IN ENVIRONMENTAL EXPENDITURE AND INVESTMENT 15.50% 19.5 M€

ENVIRONMENTAL MANAGEMENT SYSTEMS

ISO**14001** CERTIFIED

2016

90% — Revenue
304M — Customers
108,000 — Employees
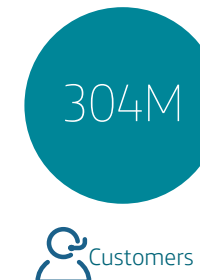
OBJECTIVE % CERTIFIED REVENUES

| 2016 | OBJECTIVE ACHIEVED | 88% |
| 2017 | | 100% |

A RESPONSIBLE NETWORK

The greatest environmental impact we generate comes from our Network, which is mainly due to the energy consumption required for its operation, the visual impact that it generates and the waste resulting from maintenance work.

For the responsible management of our Network infrastructure we apply the best practices available and manage all the resulting environmental aspects and impacts, from design to dismantling, through operation and maintenance in compliance with the environmental legislation in areas such as waste management, efficient use of resources, management of the landscape (visual impact) and biodiversity.

When deploying the Network, one of the criteria that we take into account is the sharing of infrastructure. Whenever possible, we place our facilities with other operators or communication tower managers. This results in lower visual impact and energy consu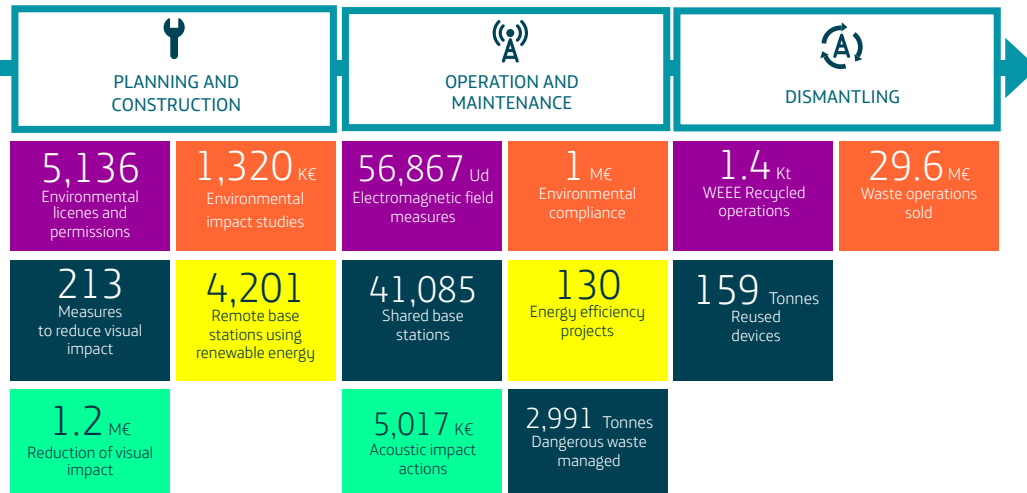mption, and a reduction in generation of waste. This practice is increasingly widespread throughout the Group, as was seen during 2016, when 41,085 of our base stations were shared.

For further information, see the chapters on 'Network deployment' and 'Environmental Impact'.

RESPONSIBLE MANAGEMENT OF NETWORK INFRASTRUCTURE

PLANNING AND CONSTRUCTION	OPERATION AND MAINTENANCE	DISMANTLING

5,136 Environmental licenes and permissions	**1,320** K€ Environmental impact studies	**56,867** Ud Electromagnetic field measures	**1** M€ Environmental compliance	**1.4** Kt WEEE Recycled operations **29.6** M€ Waste operations sold
213 Measures to reduce visual impact	**4,201** Remote base stations using renewable energy	**41,085** Shared base stations	**130** Energy efficiency projects	**159** Tonnes Reused devices
1.2 M€ Reduction of visual impact		**5,017** K€ Acoustic impact actions	**2,991** Tonnes Dangerous waste managed	

1ST DEPLOYMENT OF A SUBMARINE CABLE

Telxius, one of the business units, is responsible for deploying and operating the submarine cable and mooring stations in the various countries.

As the aquatic environment is an ecosystem which is highly sensitive to any interventions, we perform environmental impact studies and establish appropriate preventive measures to ensure minimal impact.

In 2016 we acheived ISO 14001 standard certification for our submarine cable.

2ND PREVENTION OF THE IMPACT ON BIODIVERSITY

Within the scope of the Environmental Management System the potential impact of our infrastructure on biodiversity is evaluated. To do this, sustainability criteria (preventive measures during construction; location of the base stations in protected areas; waste management operation/dismantling, etc.) are taken into account, with the aim of preventing the impact on biodiversity.

One example is the case of Galeras, in southern Colombia: In 2016 we presented the National Parks Unit with a Geomorphological Recovery and Ecosystem Repair Programme, as the final stage in the dismantling of the disused infrastructure. When developing the Programme, the conditions of the area before intervention were taken into account: soil samples were taken, patterns for the flora were designed and monitoring activities were included in the reforestation process.

Circular economy_

RETHINKING THE MODEL

The Circular Economy proposes creating flows of materials and energy in which there is no waste, and the balance and sustainability of the system are based on the relationships of the different 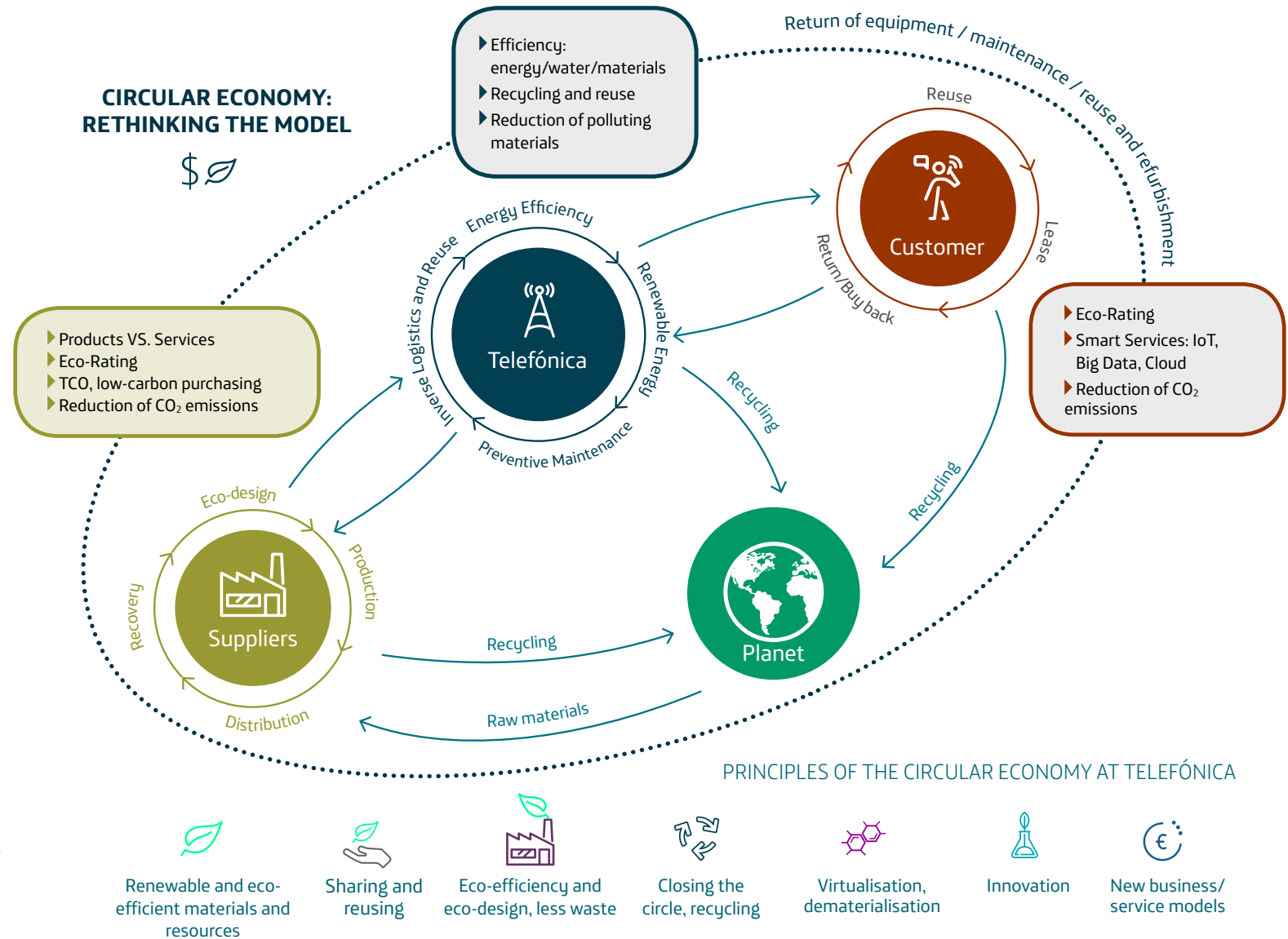players, simulating natural biological cycles. This model offers numerous opportunities to companies, which is why we have been integrating this philosophy into our activities for several years. We promote reuse and recycling, low-carbon purchasing, the buying of increasingly efficient equipment, the leasing of terminals, Eco-Rating and new business models such as ESaaS (Energy Savings as a Service).

One of the main pillars of this Circular Economy consists of the extension of the useful life of products, in order to integrate their environmental aspects from the design stage onwards. The approach to the product life cycle takes into account, among other factors, the resources used for their manufacture (e.g. energy), the selection of materials, the emissions generated and the management of the end of their useful life.

We are working on different strategies to optimise the consumption of our resources throughout the whole value chain and to promote the return of used goods to the production cycle. These initiatives are chiefly based on Network and customer processes, which are the greatest consumers of materials and resources. Furthermore, we focus on the development of digital services in which there are possibilities for the Circular Economy, such as Smart Waste.

CIRCULAR ECONOMY: RETHINKING THE MODEL

Efficiency: energy/water/materials
Recycling and reuse
Reduction of polluting materials

Products VS. Services
Eco-Rating
TCO, low-carbon purchasing
Reduction of CO_2 emissions

Eco-Rating
Smart Services: IoT, Big Data, Cloud
Reduction of CO_2 emissions

Return of equipment / maintenance / reuse and refurbishment

Reuse
Lease
Return/Buy back
Customer
Energy Efficiency
Inverse Logistics and Reuse
Renewable Energy
Telefónica
Preventive Maintenance
Recycling
Eco-design
Production
Recovery
Suppliers
Distribution
Recycling
Recycling
Planet
Raw materials
Recycling

PRINCIPLES OF THE CIRCULAR ECONOMY AT TELEFÓNICA

Renewable and eco-efficient materials and resources

Sharing and reusing

Eco-efficiency and eco-design, less waste

Closing the circle, recycling

Virtualisation, dematerialisation

Innovation

New business/ service models

RESPONSIBLE PURCHASING

Aware of the importance that the acquisition of goods and services can have for the environment, we are gradually incorporating environmental selection criteria into our purchasing processes, choosing those goods and services with fewer polluting materials, a lower impact on the climate, or that incorporate eco-design criteria.

One example of the above is the use of the Total Cost of Ownership (TCO) concept when purchasing products that have a significant impact on our energy consumption; we integrate the impact of the consumption during the useful life of the product into the calculation of its cost, which allows us to choose those with the greatest efficiency and, therefore, the lowest carbon emissions.

In addition, we establish sustainability criteria associated with the replacement of refrigerant gases, limiting the recharging of CFC and HCFC gases which deplete the ozone layer, anticipating the deadlines stipulated by International Agreements and prioritising other gases in accordance with their global warming potential.

In terms of energy management, we have begun to implement long-term renewable energy purchasing strategies (Power Purchase Agreements - PPAs), with the aim of progressively increasing the amount of renewable energy used in our operations by

### ECO-RATING: A SMART WAY OF THINKING WITH YOUR MOBILE PHONE

Eco-Rating is a seal which evaluates the environmental impact of the entire production, use and disposal process of mobile phones. In order to provide more sustainable options, classification is given on the basis of 100 criteria which analyse social and environmental aspects, resulting in a final score on a scale of 1 to 5 (1 being the lowest score and 5 being the highest).

The methodology applied by this seal, which we developed internationally in collaboration with the British NGO Forum for the Future, considers established criteria, such as analysis of the device's useful life and indicators such as global warming and the depletion of raw materials. The evaluation also includes scores for the corporate policies and the environmental care criteria followed by the manufacturer.

Since its launch, other operators have joined up, and our goal is to turn the Eco-Rating into a global standard. To date we have reported on the Eco-Rating of our terminals fabricated in Spain, Brazil, Germany, United Kingdom and Chile, and we intend to cover the rest of our operations between 2017 and 2018.

FURTHER INFORMATION

Do you know what your mobile phone is made of?

Extraction of raw materials

Manufacture

Transport

Distribution and sales

End of useful life
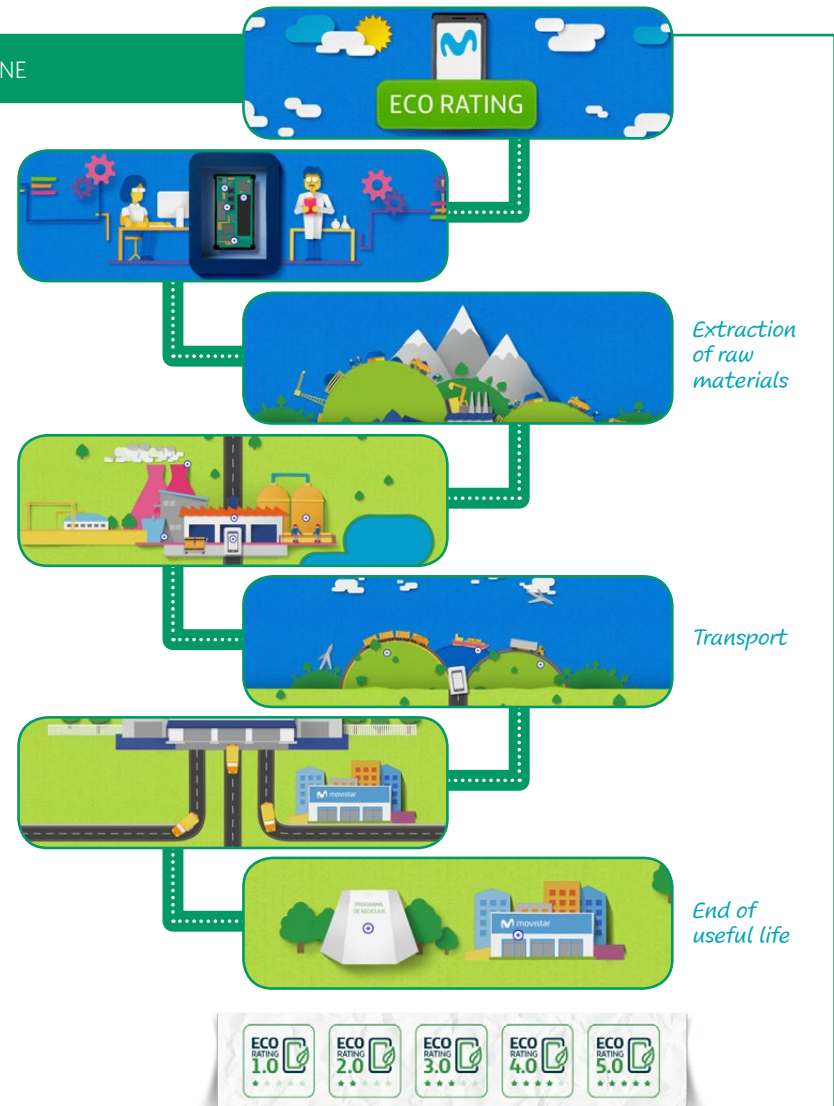
decoupling our growth from carbon emissions, in keeping with the energy and emission targets established by the Group. In addition, we work with technological partners to conduct projects on energy efficiency and the self-generation of renewable energy, which substitute products with services and thereby achieve greater efficiencies.

Other examples are the purchasing of FSC-certified paper, Eco-Rating and the initiative dedicated to reducing the greenhouse gas emissions of our supply chain. For further information, see the chapter on 'Managing the supply chain'.

INTERNAL ECO-EFFICIENCY

Eco-efficiency entails the efficient use of the materials and resources we consume for the provision of our services. In this regard, eco-efficient practices allow us to provide more services to a greater number of customers while reducing our environmental footprint. Resource consumption is reduced thanks to practices such as appropriate infrastructure maintenance and the reuse of equipment on an internal basis.

Given its relevance, energy consumption is the subject of a separate chapter titled 'Energy and climate change'.

Our water consumption is chiefly the result of sanitation use and, to a lesser extent, its use in air conditioning. Every year, each of our operations takes specific measures to achieve

more efficient consumption, especially in places where hydric stress is greater, such as Mexico City and São Paulo, and in countries like Spain. In these cases, we carry out specific plans for sustainable water management.
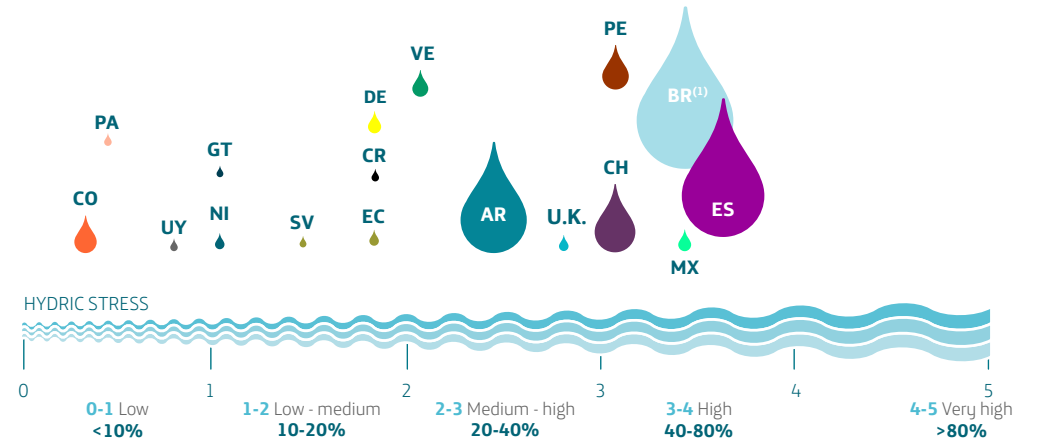
As a result of the different efforts made during 2016, we reduced our global water consumption by 4.4% in comparison with 2015.

—

We *reduced water consumption* by *4.4%* in comparison with 2015

Water

TELEFÓNICA'S WATER CONSUMPTION VS. HYDRIC STRESS

WATER CONSUMPTION

0	1	2	3	4	5
0-1 Low **<10%**	**1-2** Low - medium **10-20%**	**2-3** Medium - high **20-40%**	**3-4** High **40-80%**		**4-5** Very high **>80%**

Source: World Resources Institute.
(1) Brazilian Cities

OUR HEAD OFFICES, SUSTAINABLE BUILDINGS: COLOMBIA ECO-OFFICES

With the purpose of converting Telefónica Colombia's main building, which houses more than 3,000 employees, into environment-friendly offices, different initiatives were launched for the efficient management of resources such as water and energy. 100% of the building now has LED lights, leading to savings of 166,000 kWh. Solar panels also generate energy for several meeting rooms.

With regard to the water resources, measures were taken to use rain water for the irrigation of the large grassed areas. In addition, eco-sustainable bathrooms were built over a space covering 50 m^2, with systems to save water and recycle soapy and rain water, and decorated with vertical gardening with a drip irrigation system that takes the water once it has been treated.

Finally, a daily inspection of water consumption was introduced, based on meters, in order to identify imperceptible leaks. The above has led to a reduction in water consumption of 8.7 m^3/month.

Paper

As for paper consumption, we have common guidelines to reduce the impact of this material, promoting efficient use through the digitisation of processes, and as a result we reduced our consumption by 27% in 2016. In addition, we promote the use of recycled paper over virgin fibre paper, resulting in a 12.3% use of recycled paper, and we attempt to ensure that virgin fibre paper always comes from sustainable sources and, therefore, has FSC or PEFC seals. 84% of the white paper used in our offices is currently certified with this guarantee.

Another example of eco-efficiency applied to the consumption of this material is the digitisation of our customer invoices, thanks to new technologies. In 2016, 61.8 million customers chose to receive paperless invoices. Therefore we generated more than 700 million electronic invoices, representing 3,500 fewer tonnes of paper used, which is equivalent to about 60,000 trees.

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84% of the virgin fibre paper we use *is FSC certified*

WASTE AND DISUSED EQUIPMENT

Waste generation is present in all our activities. The maintenance of Network infrastructure is a chief generator of waste, but so a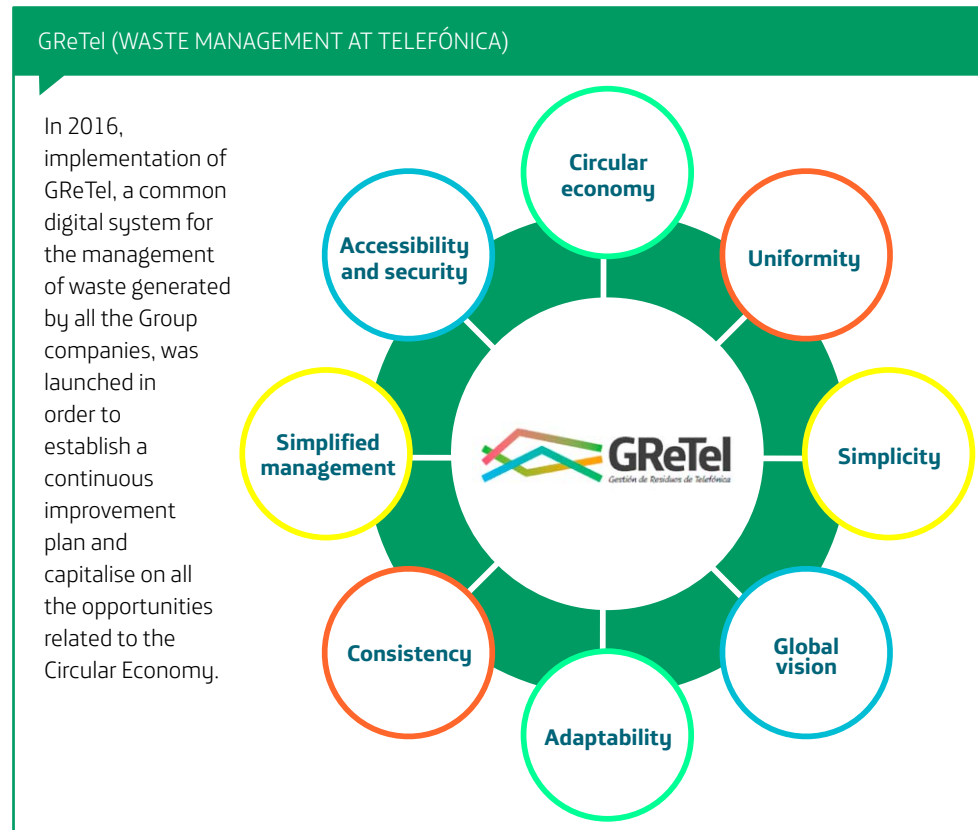re the administrative activities we carry out in our offices and buildings and, to a lesser extent, the commercial activities linked to our customers. Within the framework of our Circular Economy, it is important to address all the sources of waste and the activities that generate them,

GReTel (WASTE MANAGEMENT AT TELEFÓNICA)

In 2016, implementation of GReTel, a common digital system for the management of waste generated by all the Group companies, was launched in order to establish a continuous improvement plan and capitalise on all the opportunities related to the Circular Economy.

which in our case are largely conducted by suppliers. This is the reason why we carry out inspections of the management of both hazardous and non-hazardous waste, with the aim of guaranteeing their satisfactory handling and increasing the potential for their recycling or reuse.

Our main objective is to reduce waste generation and to promote a Circular Economy which supports reuse and recycling. To achieve this, we encourage practices which promote the reuse of equipment, both internally and among our customers, whenever possible. In 2016 we facilitated the reuse of 1,235 tonnes of our customers' equipment (mobiles, routers, etc.).
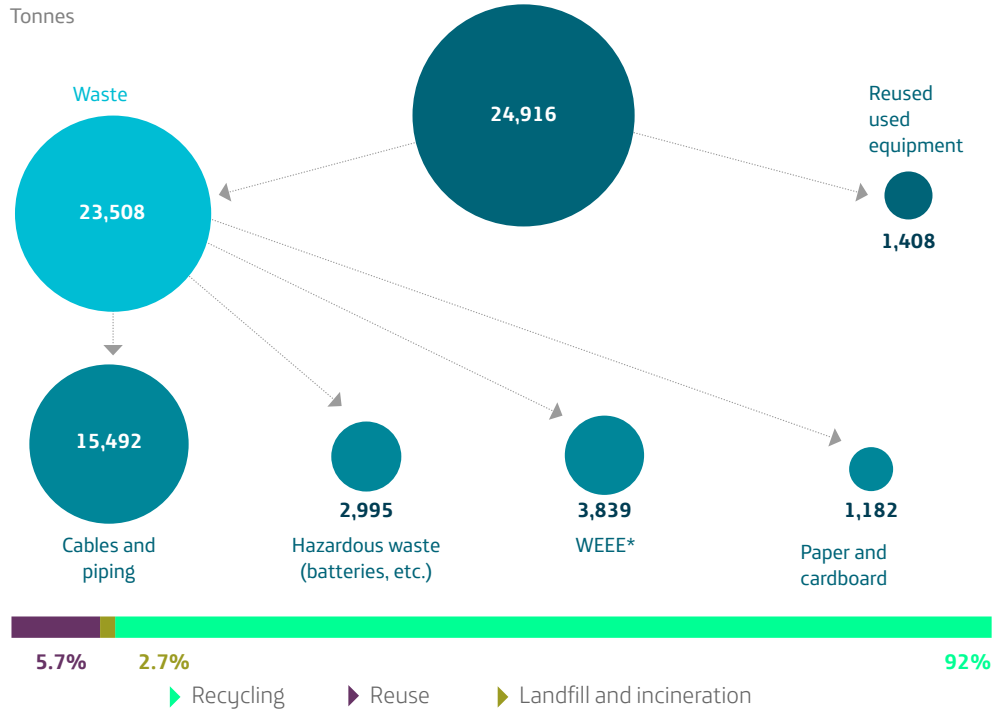
When reuse is not an option, recycling is the best alternative for dealing with waste. Thus, in 2016, we generated 23,507 tonnes of waste (12% less than in 2015), of which 97% was recycled.

About 66% of our waste consists of cables which come from our Network transformation process. Reuse of these cables is not possible but we can recycle them. 98% are recycled by specialist companies.

WASTE AND USED EQUIPMENT AT TELEFÓNICA

Tonnes

Waste and used equipment

24,916

Waste

23,508

Reused used equipment

1,408

15,492

Cables and piping

2,995

Hazardous waste (batteries, etc.)

3,839

WEEE*

1,182

Paper and cardboard

5.7%   2.7%   92%

▶ Recycling   ▶ Reuse   ▶ Landfill and incineration

* WEEE: Waste Electrical and Electronic Equipment.

ELECTRONIC WASTE AND USED EQUIPMENT

Tonnes

Electronic waste and used equipment

5,247

Operations

1,792

Other customer equipment

2,892

1,422

211

159

Customer mobile phones

132

90

42

Offices

431

416

14

1

1,747

1,145

4%   27%   69%

▶ Recycling   ▶ Reuse   ▶ Landfill and incineration   ▶ Donation

Electronic waste

According to the United Nations, only 12% of the 42 million tonnes of electronic waste or e-waste generated each year is recycled, and this is the fastest growing type of waste in recent years. Consequently, we consider that the solution to this problem has to share the responsibility among all the actors involved. Our contribution to the change is based on the following principles:

▶ Carrying out reuse and recycling.

▶ Encouraging the development of a regulatory framework for reuse and recycling.

▶ Guaranteeing adequate treatment by monitoring our supply chain.
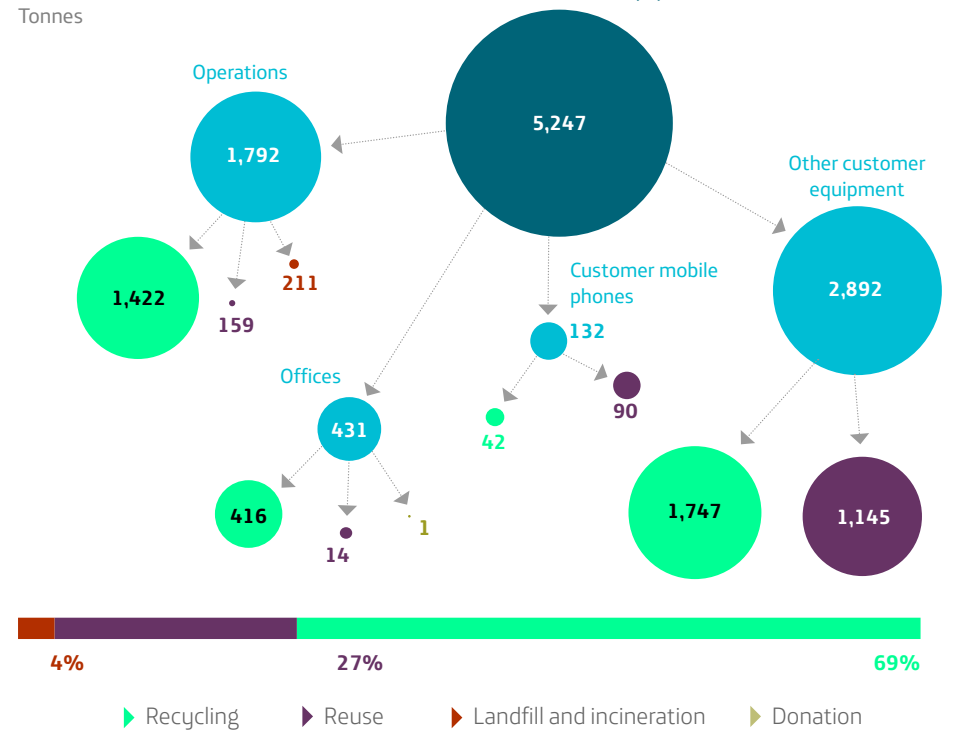
▶ Providing our customers with environmental information at the time of purchase (Eco-Rating) and alternatives for disposing of their used phones.

▶ Promoting the best eco-design with the manufacturers, in line with international standards.

As a result of these principles, 69% of the devices used in our operations and by our customers in 2016 were recycled and almost 27% reused. Promotion of the Circular Economy will bring an increase in reuse over the coming years.

CUSTOMERS AND THE CIRCULAR ECONOMY

Our customers are at the centre of all our processes, and therefore we would like to help them to join the Circular Economy and thus reduce their environmental impact.

In the countries in which we operate, we offer our customers the option of bringing their disused mobile phones for later reuse. By means of buy-back programmes we facilitate the recycling of the components. Fixed operations equipment, such as routers, modems and decoders recovered from customers' homes, are reconditioned and reused again in our operations.

For this purpose, we collaborate with specialised companies which guarantee proper compliance with environmental legislation. During 2016 we collected about 3,000 tonnes of disused equipment, of which 41% were assigned to reuse (thereby generating an extension of their useful life), and 59% to recycling.

With the purpose of helping our customers to join the Circular Economy and reduce their environmental impact, we facilitate the reuse of terminals through the leasing or sale of second-hand terminals in some of our markets, such as the United Kingdom, via the O2 Refresh programme.

In addition, as mentioned above, we offer environmental information on the terminals through Eco-Rating, which allows customers to choose the most eco-efficient terminal.

We also encourage the Circular Economy through our services. For example, virtualisation reduces the consumption of raw materials and resources. Furthermore, we offer IoT services like Smart Waste, with which we help to improve the management of municipal waste (85% recycled, 60% incidents, 18% maintenance costs).

The Circular Economy brings many opportunities. We are in a position to make the most of them and provide solutions by means of sustainable innovation.

—

The extension of the *useful life of products* is one of the main pillars of the Circular Economy

The case of Panama - Electronic recycling programme

At every Movistar store we have an electronic recycling box for disused devices and, through our strategic partners, we guarantee that each device has a suitable end. In addition, for each recycled mobile phone, we plant a tree in the country's priority basins and equip community-based organisations with the skills and knowledge needed to recover the basins. With this programme we have planted about 60,000 seedlings in Panama.

Energy and climate change_

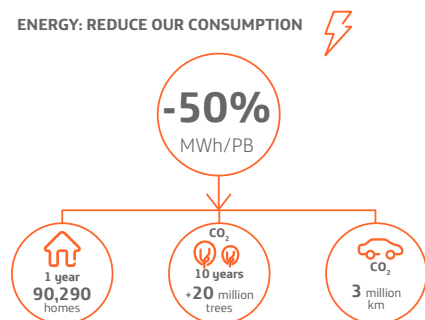We are working towards a more energy and carbon efficient Network.

Currently, climate change is one of the most important challenges that we face, since it not only effects quality of life, but the planet as a whole. So much so, that in 2016 it was identified by the World Economic Forum as one of the greatest risk factors worldwide. Additionally, the United Nations has marked it as one of its main Sustainable Development Goals. Therefore, progressing with decarbonisation has become an urgent issue, breaking the link between economic growth and greenhouse gas emissions.

We are aware of the role that our services can play in the search for solutions, but we are also aware that we must accept the responsibility of reducing our carbon footprint.
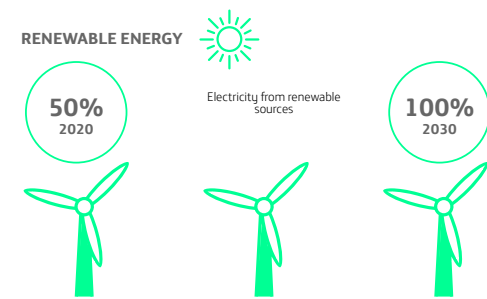
With this aim, 9 years ago we created a Global Climate Change Office, and defined our first energy and emissions reduction goals. In 2016, coinciding with the signing of the new Paris Agreement, we announced our new Energy and Climate Change goals for 2020 and 2030. The objective is to align efforts with the level of decarbonisation required to keep global warming below 2°C.
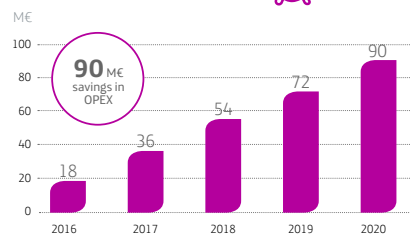
ENERGY AND CLIMATE CHANGE GOALS 2015 – 2020/2030

ENERGY: REDUCE OUR CONSUMPTION

-50%
MWh/PB

- 1 year **90,290** homes
- CO_2 10 years **+20** million trees
- CO_2 **3** million km

RENEWABLE ENERGY

Electricity from renewable sources

- **50%** 2020
- **100%** 2030

OBTAIN SAVINGS FROM ENERGY EFFICIENCY

M€

90 M€ savings in OPEX

18	36	54	72	90
2016	2017	2018	2019	2020

DECARBONISE TELEFÓNICA
(Reduce our GHG emissions)

- ⊕ **2020** **30%**
- ⊕ **2030** **50%**
- **2°C scenario** Paris Agreement
- **Certified objectives** SBTI

tCO_2e

| 2010 | 2016 | 2020 | 2025 | 2030 | 2050 |
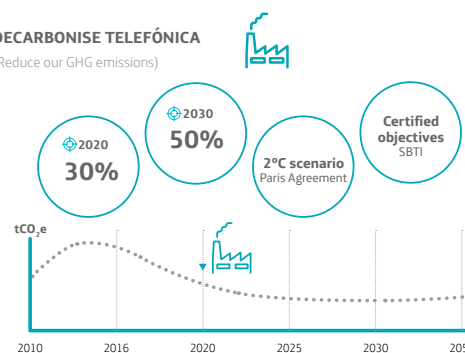
PROJECTS

Energy Efficiency Programme
- **Power equipment**
- **Lighting, shutdowns, Legacy, and others**
- **Cooling and air conditioning**
- **Energy saving functions**

- **Renewable energy**
- **Fuel reduction**
- **Network transformation**

Our goals for 2015-2020 are not only compatible with the expansion of the Network and quality of service, but will also help us to be more competitive. They are all inter-related and both complement and strengthen each other:

▶ Reduce energy consumption by 50% per unit of traffic in 2020.

▶ Separate our business growth from GHG emissions. Reducing our Scope 1 and 2 emissions by 30% in absolute terms by 2020, and achieving a 50% reduction by 2030.

▶ Save 90 million euros through energy efficiency projects over the next 5 years.

▶ Commit to renewable energies as a sustainable source for our business, achieving 50% of electricity consumption from renewable sources by 2020 and 100% by 2030.

—

We are committed to being *100% renewable* by 2030

Likewise, during 2016 we approved our Energy Management corporate policy with the goal of providing a common reference framework for establishing objectives and actions based on our commitment to consume energy in an efficient manner and to reduce greenhouse gas emissions.

The leverage to making progress towards achieving our energy and climate change goals are the following plans: the Renewable Energy Plan, the Energy Efficiency Plan and Network transformation.

HOW DO WE MANAGE OUR ENERGY AND GHG EMISSIONS?

Measure

Calculate

Analyse

Reduce

Check

We measure our energy consumption and **calculate** our carbon footprint. **We analyse** and identify new opportunities for energy and green house gas emissions (GHG) reduction and we implement energy efficiency and renewable energy projects in each of our operations. As a result of this, **we are reducing** the operational energy consumption and the environmental impact of our activities.

Winner of the Green Mobile Award

We were recognised and awarded the GSMA Glomo 2016 at the MWC for our global energy efficiency programme. The panel of judges recognised it as a noteworthy example of everything that an operator should strive for: improved energy efficiency, reduced carbon footprint and environmental conservation.

GSMA
GLOMO
AWARDS
THE GLOBAL MOBILE AWARDS
WINNER

CDP A List Award

For the third consecutive year Telefónica was awarded with the maximum classification of "A" in the CDP Climate Change 2016, thus renewing its presence on the "Climate A List". This list is made up of companies that meet the maximum criteria as defined by the Carbon Disclosure Project, which measures companies' performance levels in strategy, goals and actions related to mitigating climate change risks.

RE100 INITIATIVE

Telefónica is part of the RE100 initiative, **RE 100** which brings together companies that have committed to using 100% renewable energy, providing a leading example in the fight against climate change and the development of a low carbon economy.

FURTHER INFORMATION ▶

Telefónica **contra**
el **cambio climático**
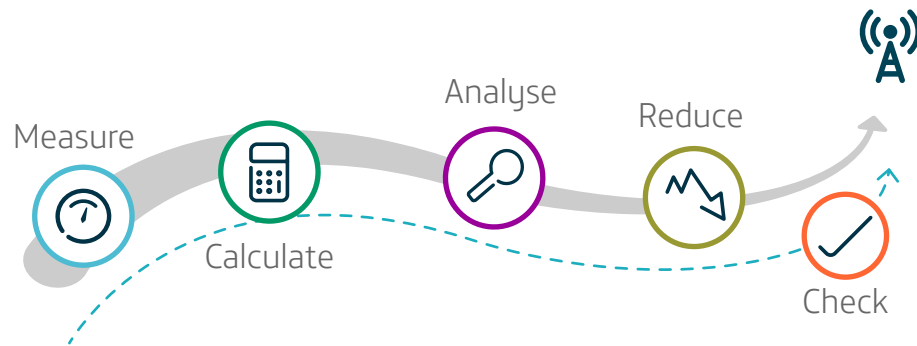
ADAPTATION TO CLIMATE CHANGE

We have analysed our vulnerability to climate change risks, which are mainly concentrated at a geographic level in Latin America (particularly in Brazil and Peru, followed by Colombia, Chile and Central America), and also at a business level in our Network.

The most significant risks are related to extreme weather events and, in the mid-term, temperature increase. This will affect the energy consumption of our infrastructures, or a potential increase in the cost of energy dependent on the hydroelectric sector in some countries.

Our Climate Change adaptation strategy is made up of different plans, from business continuity in the face of weather disasters, as recently occurred in Peru, to energy efficiency projects and our Renewable Energy Plan.

We also recognise the key role we can play in the face of natural disasters. Connectivity can be a life-saver, either by means of an early alert or by contacting emergency services. For further information, see the chapter on 'Digital Inclusion'.

MEASURING

We measure our energy consumption and monitor the Network by installing smart meters in our facilities. Thanks to these, we can record our consumption more precisely, identify faults in the Network and optimise operational energy costs.

SUSI PLATFORM

The SUSI platform (Spanish acronym for 'Unified System of Infrastructure Supervision') is a BAS (Building Automation System) that enables automatic and centralised control of different sub-systems of critical infrastructure, providing effective, real-time management of equipment, such as generators, rectifiers, UPS (Uninterrupted Power Supply), and air conditioning units, which are essential to providing services to our customers. It also allows us to achieve significant power savings, owing to the automation of air conditioning units, for example.
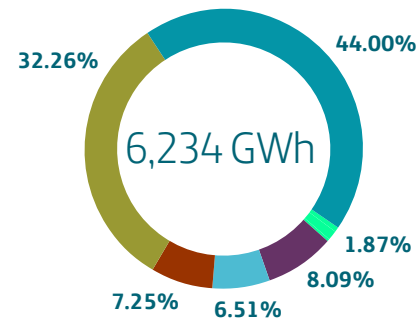
In 2016 our *energy use* decreased by 2.2%

DISTRIBUTION OF OUR ELECTRICITY CONSUMPTION

Thanks to our Energy Efficiency Plan, energy consumption in 2016 was 6,740 Gwh, 2.2% less than the previous year. The consumption of our operations corresponds to 93% electricity consumption and 7% fuel consumption.

The graphics below show the distribution of energy consumption between electricity and fuel. The distribution of electricity consumption by infrastructure shows that the largest usage is concentrated at base stations and central fixed line telephony offices.

Regarding fuel consumption, 49% comes from our operations and 51% is associated with the fuel consumption of our vehicle fleet.

The countries with the greatest energy consumption are Spain and Brazil, given that this is where our largest revenues are concentrated.

In 2016 we implemented *130 Energy Efficiency projects,* achieving savings of *€22M*

ELECTRICITY CONSUMPTION BY FACILITY

6,234 GWh

- 44.00%
- 1.87%
- 8.09%
- 6.51%
- 7.25%
- 32.26%

▶ Base Stations
▶ Central Fixed Line Telephony Offices
▶ Central Mobile Telephony Offices
▶ Data Centers
▶ Offices
▶ Other

ELECTRICITY CONSUMPTION BY COUNTRY

- 25%
- 1%
- 2%
- 3%
- 4%
- 4%
- 5%
- 5%
- 6%
- 8%
- 13%
- 25%
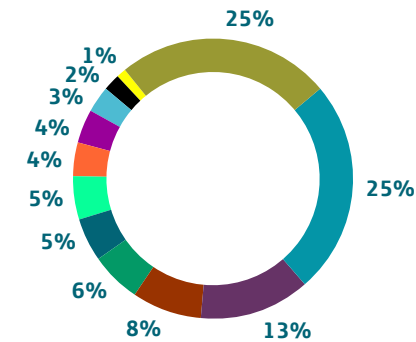
▶ Brazil
▶ Spain
▶ Germany
▶ United Kingdom
▶ Argentina
▶ Colombia
▶ Mexico
▶ Chile
▶ Peru
▶ Venezuela
▶ CAM
▶ Ecuador

FUEL CONSUMPTION

501 GWh

- 51%
- 49%
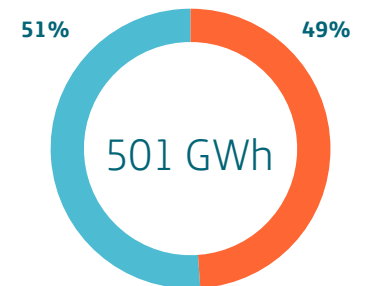
▶ Vehicle consumption
▶ Operational consumption

CALCULATE

We calculate our carbon footprint based on our energy consumption. This inventory encompasses both direct emissions (Scope 1), mainly derived from fuel consumption and refrigerant gas leaks in our operations, and indirect emissions from electricity consumption (Scope 2), as well as other indirect emissions related to our value chain that, though not controlled by us, are a consequence of the activity we perform (Scope 3). Our method of calculation is based on the GHG protocol, the ISO 14064 standard and the ITU-T L.1420 recommendation.

As can be seen in the graphic, our largest emissions correspond to Scope 2, and mainly come from the Network's electricity consumption. The actions we undertake to reduce this consumption are based on implementing numerous energy efficiency projects and transitioning to increased consumption of renewable energy.
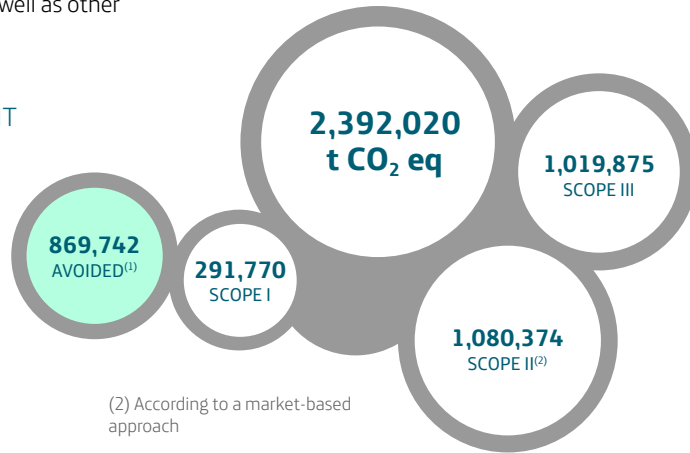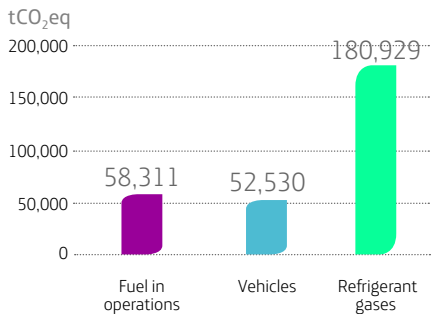
We also take action with regard to Scope 1 emissions by trying to reduce fuel consumption through renewable self-generation projects and by purchasing refrigeration units that contain refrigerant gases with a lower potential to affect global warming.

We have calculated seven categories of Scope 3 indirect emissions that are most relevant to our business. The largest amount of emissions comes from the use of products by our customers and the purchase of goods and services. We take on various initiatives that aim to reduce these emissions, as described throughout this Report, such as Eco-Rating, which enables our customers to choose more efficient devices, and which promotes eco-innovation among our device providers.

For further details on Scope 1 and 2 emissions, see the chapters on 'Managing the supply chain' and 'Circular Economy'.

OUR CARBON FOOTPRINT

(1) Emissions avoided due to the purchasing and self-generation of renewable energy.

2,392,020 t CO$_2$ eq

1,019,875 SCOPE III

869,742 AVOIDED[1]

291,770 SCOPE I

1,080,374 SCOPE II[2]

(2) According to a market-based approach

SCOPE 1 EMISSIONS DETAILS

tCO$_2$eq

58,311	52,530	180,929
Fuel in operations	Vehicles	Refrigerant gases

SCOPE 2 EMISSIONS DETAILS

tCO$_2$eq

1,078,654	1,721
Electricity consumption	District heating

OTHER INDIRECT EMISSIONS IN SCOPE 3

tCO$_2$eq

Purchasing of goods and services	Capital goods	Activities related to energy and fuel consumption (not included in Scopes I and II)	Operational waste	Work travel	Use of sold products	Investments
269,458	117,753	144,901	619	33,127	390,085	63,932
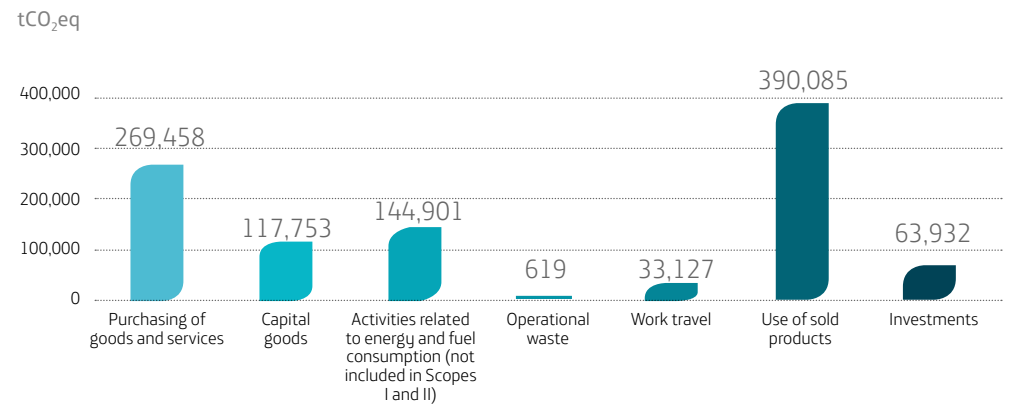
ANALYSIS

As a result of the analysis of our energy consumption and the inventory of greenhouse gases, we were able to identify the most energy and emission intensive processes, thus allowing us to prioritise our actions. Thanks to the integrated analysis of energy consumption and GHG emissions, we can add the carbon component into the decision-making process.

In 2016, we cross-referenced this information with our corporate strategy and we defined new Energy and Climate Change goals for 2020 and 2030, including emissions goals in absolute terms that, based on science, contribute to the global goal of limiting the Earth's temperature rise to 2°C. These goals affect the entire energy and climate change paradigm: energy consumption, OPEX, GHG emissions and renewable energy.

—

We have reduced our *energy intensity*, energy consumption by traffic, by 34%

7TH GLOBAL ENERGY AND CLIMATE CHANGE WORKSHOP

The Global Energy and Climate Change workshop is a yearly meeting between Telefónica's leaders in energy transformation and other principal companies collaborating in this field.

In 2016 we celebrated the 7th edition in Montevideo, uniting more than 190 representatives from teams in the operations, sustainability and environment, purchasing, finance, and technology and IoT departments, with more than 23 key technology partners.

The objectives of the workshop were to share our energy efficiency strategy at a global level, evaluate the degree of compliance with the energy consumption
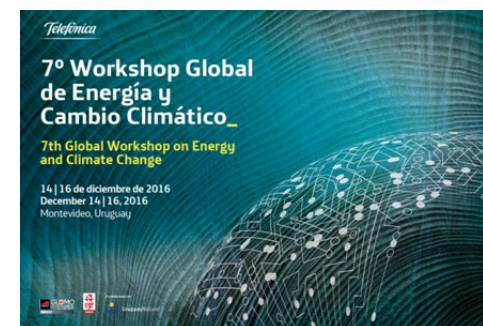
and greenhouse gas emissions (GHG) reduction goals, and to review and define future strategic actions within the 2020 efficiency plan.

GLOBAL ENERGY AND EMISSIONS GOALS

KPI	Unit	Base year	Target year	Base year value	Value 2016	Target reduction	Current
Energy consumption by traffic	MWh/PB	2015	2020	400	262	50%	34%
Reduction of GHG emissions (Scopes 1+2)	tCO$_2$	2015	2020	1,866,070	1,372,145	30%	26%
Savings in energy OPEX	M€	2016	2020	-	22	90 M€	25%
% consumption of renewable energy	%	2015	2020	20	44	50%	44%

DEGREE OF ACHIEVEMENT OF OUR GOALS:

2016   2020 target

Energy consumption by traffic: **-34%**   **-50%**

Reduction of GHG emissions (Scopes 1+2): **-26%**   **-30%**

Savings in energy OPEX: **22 M€**   **90 M€**

% consumption of renewable energy: **44%**   **50%**
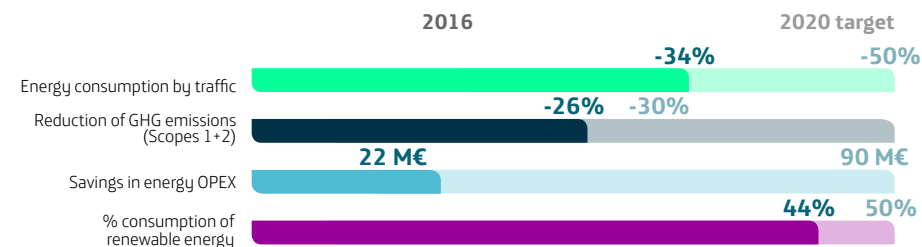
REDUCE

Under the Energy Efficiency Plan, during 2016 we undertook 130 initiatives in our offices and networks. As a result of these, we reduced energy consumption by 211 GWh and avoided more than 68,229 tonnes of CO_2eq emissions.

Additionally, as a result of the various strategies set out in our Renewable Energy Plan, 43.6% of our electricity consumption is now renewably sourced. This has allowed us

to reduce our Scope 2 emissions by 480,302 tonnes of CO_2 equivalent. This in turn shows that renewable energies are key to achieving the decarbonisation of our activities and to reducing our carbon footprint in absolute terms.

These efforts are reflected in the 34% improvement of our energy intensive ratios (Mwh/PB), which shows improved efficiency of our operations.

TELEFÓNICA RENEWABLE ENERGY PLAN

Reducing the energy costs of our operations through energy efficiency is a necessary step, but it is not sufficient. It is estimated that potential savings from energy efficiency could be neutralised by the expected increase in electricity prices in coming years.
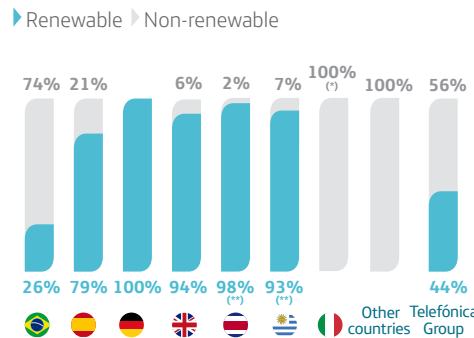
For this reason, the shift towards clean energy will reduce our operational costs and make us less dependent on the energy supply. Therefore, in 2016 we established the goal of consuming 50% of electric energy from renewable sources by 2020 and 100% by 2030.

To achieve this, we have considered all kinds of solutions: self-generation, purchasing renewable energy with guarantees of origin, and long-term purchasing agreements (Power Purchase Agreement – PPA).

Our Renewable Energy plan projects potential OPEX savings of 6% for 2020, with the possibility to reach 26% by 2030.

DEGREE OF PLAN IMPLEMENTATION

▶ Renewable ▶ Non-renewable

74%	21%		6%	2%	7%	100% (*)	100%	56%
26%	79%	100%	94% (**)	98% (**)	93% (**)			44%
Brazil	Spain	Germany	UK	Costa Rica	Uruguay	Italy	Other countries	Telefónica Group

(*) Photovoltaic solar plant pending start-up, which will provide 50% of energy for Mexico.

(**) Based on the country's mixed generation.

In 2016 our percentage of *renewable consumption was 44%* and our total emissions *decreased by 22%* in comparison to 2015

ENERGY EFFICIENCY PROJECTS

Savings of 211 GWh

69.91%
0.88%
2.69%
1.60%
3.23%
13.16%
8.52%
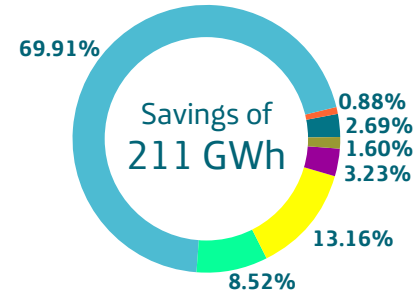
▶ **Lighting:** Replacement of fluorescent lights with LED technologies and installation of presence sensors.

▶ **PSF (Power Saving Features):** Activation of energy saving functions during periods of low traffic.

▶ **Cooling:** Technology update for cooling units and installation of free cooling.

▶ **Power:** Technology update for power units and substitution of poor efficiency rectifiers.

▶ **Network transformation:** Legacy unit shutdowns, Network upgrades and location optimisation.

▶ **Renewable self-generation:** Implementation of renewable systems for auto-consumption and reduction of fuel consumption.

▶ **Other:** Setpoint settings for cooling units, power factor correction, etc.

SELF-GENERATION PROJECTS

TELEFÓNICA HAS 4,201 OPERATIONAL SITES POWERED BY RENEWABLE ENERGY

We are gradually increasing the number of locations that operate on self-generated renewable energy, with the aim of reducing dependency on fossil fuels in isolated areas where there is no access to electrical systems.

In this respect, in 2016 we took on a project to substitute seven diesel generation groups with photovoltaic panels in five nodes of the mobile Network located in the rural area of Meta in Colombia.

This project represents an estimated annual reduction of 200,567 litres of diesel and, therefore, a reduction of 537 tonnes of CO_2.

CHECKS

Additionally, at Telefónica we carry out an annual independent energy and emissions data checking process that allows us to identify areas for improvement in our processes and manage energy and carbon in a transparent manner.

—
We have managed to reduce our *Scope 1 and 2 emissions by 26%* compared to 2015

In the table to the left, it is possible to see that our total energy consumption has diminished by 2.2% as a result of the energy efficiency projects we are implementing in our networks. Additionally, our renewable energy consumption has increased by 47% compared to the previous year, and now accounts for 44% of our electric energy usage.

This has enabled our total Scope 1 and 2 emissions (according to a market-based approach) in 2016 to become 26.47% lower compared with 2015.

The most significant emissions are those in Scope 2, due to the energy consumption produced by our networks, which has been reduced by 30.78% as a result of energy efficiency projects and increased consumption of renewable energy.

Scope 1 emissions come from two main sources: the fuel consumption in our lines of business and fugitive emissions from refrigerant gases used in air-conditioning units. These emissions decreased by 4.46% in 2016, mainly due to the 11% reduction in HFC emissions.

ENERGY AND GHG EMISSIONS INVENTORY

Energy	Units	2015	2016	% variation
Total energy consumption	MWh	6,891,114	6,740,541	-2.2%
Electricity	MWh	6,459,172	6,239,880	-3.4%
Fuel and District heating	MWh	431,942	500,662	16%
Energy from renewable sources	%	20.49	43.64	113%
GHG emissions	**Units**	**2015**	**2016**	**% variation**
Scope 1 emissions	tCO$_2$eq	305,393	291,770	-4.46%
Scope 2 emissions (location-based approach)	tCO$_2$eq	2,011,870	1,855,167	-7.79%
Scope 2 emissions (market-based approach)	tCO$_2$eq	1,560,677	1,080,374	-30.78%
Scope 3 emissions	tCO$_2$eq	1,198,701	1,019,875	-14.92%
Emissions avoided(*)	tCO$_2$eq	514,429	869,742	69.07%
Intensity of emissions (Scopes 1 and 2/Revenue)	tCO$_2$eq/M€	40	26	-33.28%

(*) Emissions avoided due to the purchasing and self-generation of renewable energy.

Managing electromagnetic fields_

We have been the protagonists of an astounding development in mobile telephony in recent years. The science in this field, guided by this technological progress, has been researching the possible effects of emissions over peoples' health for the past four decades. For this reason, we actively collaborate with institutions, citizens, companies, public administrations and with society in general to promote the maximum guarantee of safety and the most scientific and objective perception possible of knowledge regarding electromagnetic fields.

WE COMPLY WITH INTERNATIONALLY RECOGNISED LIMITS

During 2016, all the measurements we recorded at our base stations were always below those levels recognised by the world's leading standardisation normalisation organisations such as the ITU (International Telecommunication Union) and the ICNIRP (International Commission on Non-Ionizing Radiation Protection), among others. In the majority of countries in which we operate, these measurements are audited and are available to the public.

Additionally, all the devices and computers that offer our service meet the international standards established by in the SAR measure (*Specific Absorption Rate*); a parameter established by regulatory bodies and various

health agencies duly empowered for this purpose.

In this sense, we highlight the conclusions of the compliance report of the voluntary agreement that Telefónica Germany and the remaining mobile network operators have upheld since 2001 with the Federal Government. This document covers several commitments, including more transparency in the development of mobile communication infrastructure, local government participation in Network expansion and the strengthening of information provided to consumers. Expert opinion concludes that the participation of local governments in Network expansion works well, and that the high quality in the information measures and coordination processes has been maintained.

—

The measurements from our *base stations* have always been *below* the recognised levels

WE COOPERATE WITH RESEARCH: INCREASING OUR KNOWLEDGE

For the World Health Organisation, scientific research in this field is a priority in its research schedule. Similarly, the European Union research programme covers various projects in this field with the goal of responding to the potential effects of electromagnetic fields on people's health. We closely follow these projects and we work directly with some of them:

COLLABORATING WITH INSTITUTIONS

We cooperate with different institutions with the aim of creating synergies to respond to all concerns, not only those of our customers, but also the general population.

We promote a responsible deployment of our infrastructure. For example, in Colombia we form part of an initiative of the Colombian Mobile Industry Association (Asomóvil) and the

BEST PRACTICES

PRO-ANTENAS PROGRAMME
Standing out in 2016 is the *Pro-Antenas* program with Ciudadanos por Respeto (Citizens for Respect), carried out in Peru. It is a collaboration project with villages that require coverage and improved institutional relations, with both members of civil society (Contributors for Respect), and in the arena of international cooperation (Atlas Foundation) and operator companies (AFIN). It seeks to promote the development of an institutional vehicle with greater legitimacy and communicational, institutional and coordinated legal actions. Training is also developed for aerial installation service providers, civil servants and local governments.

GSMA called "Nos Importa Colombia" (Colombia Is Important To Us). Its purpose is to work in an articulated manner with the government and its bodies to empower users with more tools that allow them to enjoy mobile services within a secure environment.

Along this line, in collaboration with institutions and with the commitment we always assume, we place an emphasis on the work done in Venezuela, which in 2016 rose to the role of Vice-Chairman of the Sub-Committee for Electromagnetic Compatibility and Human Health, an interdisciplinary group that includes academia, public and private institutions, and various governmental bodies. All topics related to electromagnetic fields are discussed regularly, and an awareness programme is in the works for those communities that live near the base stations.

COMMUNITY DIALOGUE

One of our greatest concerns is establishing adequate communication with the communities in all the countries where we operate. We've been able to verify that the manner of approaching this dialogue, though it should be adapted to the characteristics of each country, is a procedure that can be reproduced with multiple communities. Therefore, we've decided to create a Best Practices Manual that covers all these successful actions. The cornerstone of the manual is the procedure we implemented in Ecuador, which is fundamentally based on providing society with information, with the goal of strengthening citizen participation processes.

Thanks to this methodology, we can manage the social component in the roll-out of the Network and improve our relationships with communities. We have consequently seen a reduction in community

EFFECTIVENESS IN THE SOLUTION OF COMMUNITY CONFLICTS
Rolling out the Network - Ecuador

2011	2012	2013	2014	2015	2016
31%	58%	68%	95%	96%	96%
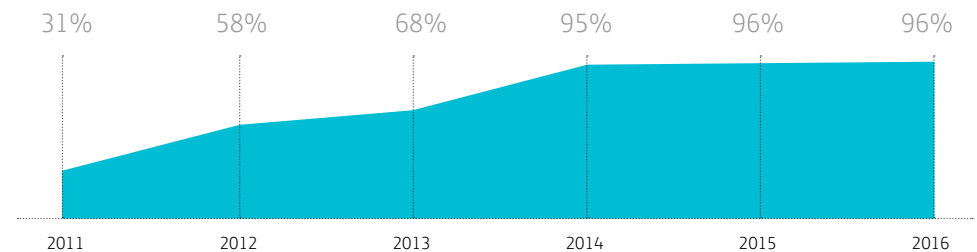
conflicts associated with the subject of health, achieving a successful Network roll-out, as shown in the graphic (previous page). This project has served as a guide to other operations in Telefónica Mexico. This operator has developed and implemented an internal procedure that establishes the various steps to be followed for the ideal coordination of community responses.

Also in Ecuador, we continue to work in association with the Telefónica Foundation on the 'Alfabetización Digital' project. This project has allowed us to reduce the digital gap in rural and marginal areas, and to bring communities the benefits of technology in their daily activities. This has been definitive for the roll-out of the Network in these areas, where before there was absolute rejection of the construction of base stations due to the lack of knowledge of their operations and importance to local development.

Furthermore, together with local institutions in Colombia, we are very committed to the initiative 'Antenas para el Progreso', with the aim of improving the public perception of telecommunications infrastructure, generating confidence and promoting a favourable environment for the roll-out, quality and stability of the Network.

RAISING EMPLOYEE AWARENESS

We are committed to training and raising awareness among employees, and have held two workshops at a global level:

"Understanding science to resolve doubt: Electromagnetic Fields and Health": All the operators from the various countries participated in this event and were given the opportunity to have their questions answered by experts from the ICNIRP (International Commission on Non-Ionizing Radiation Protection) and the SCENHIR (Scientific Committee on Emerging and Newly Identified Health Risks).

"Telefónica shares best practices": A workshop in which, with the help of scientists, we were able to understand the key processes of communicating with the communities and come to know the various research projects that are under way. This activity is in response to the work plan designed to define and share the practical improvements in the group as set out in the Manual of Best Practices.

Also during 2016, the "Mobile Telecommunications and Society" course was launched and made available to all the Spanish-speaking Group employees. The training course is made up of four modules that explain the technical basics of mobile telephony, how exposure limits are established, and how we meet the various regulations. We explain the scientific studies and advances regarding electromagnetic fields, while emphasising the benefits of the information society. Our goal is to reach our German and Portuguese-speaking employees throughout 2017.

COMMITTED TO OTHER COLLECTIVES

In 2016 we continued with the campaign "En la Onda con las Antenas" (On the Waves with the Antennas), developed in Colombia. The aim of the campaign is to communicate and define scenarios which share and circulate solid arguments that will help us disprove the myths that have been created about telecommunications infrastructure and health.

WE COMMUNICATE

We believe that information is fundamental for society to overcome myths related to electromagnetic fields and to understand telecommunications operations. Therefore, we provide relevant links, expert information on the subject and frequently asked questions, which are updated regularly.

MILESTONES 2016

Internal Training Course: "Mobile Telecommunications and Society" for Spanish-speaking countries.

100% Achieved

Holding of 2 workshops "Sharing Best Practices at Telefónica" and "Understanding science to resolve doubt: electromagnetic fields and health".

100% Achieved

Improved internal procedure "Community Dialogue" in Ecuador.

100% Achieved

CHALLENGES 2017

Publication of the Telefónica Best Practices Manual "Community Dialogue".

Holding the workshop: "Understanding science to resolve doubt".

Implementing the "Community Dialogue" procedure in other operations.

Launching the "Mobile Telecommunications and Society" course for our German and Portuguese-speaking employees.

EcoSmart Services_

Digitisation will be essential to addressing the environmental challenges affecting society as a whole. For this reason, we are developing services based on the Internet of Things (IoT), the Cloud and Big Data, which have a very positive environmental impact.

These services enable our clients to more efficiently use resources such as energy and water to improve traffic planning, air quality and

urban planning in cities, to reduce greenhouse gas emissions and to improve their response to a climate catastrophe.

We are aligning our business and environmental strategies so as to seize opportunities related to the search for solutions to environmental issues. We want to position ourselves as a key actor

in the green economy, for which sustainable innovation is essential. For further information, see the chapter on 'Innovation'.

188 KtCO$_2$

Emissions avoided in 2016 thanks to our *fleet management service*

We are creating a more digital world in all areas: personal life, the home, transport, work, industry, the city...

2020

2016

2010

Big Data

IoT

2016: +14 M connections IoT +50 M€

Added value services

Connectivity

Note: The IoT connections support more services than the green services.

Smart Metering

Fleet Management

Smart Traffic

Fire Prevention

Smart Water Cycle Management

Smart Agri

Hydro Smart

Smart Parking

Smart Waste Management

Smart Energy

Smart Urban Lighting

Energy   CO$_2$ emissions   Water   Waste recycling   Atmospheric emissions   Time   Biodiversity

INTERNET OF THINGS

The IoT is leading us to a world of total connectivity in which, thanks to Big Data, information is acquiring a new dimension. There are still barriers to be overcome but we are on the right path. As a platformed company, we are committed to integrating connectivity, equipment and services so as to facilitate digitisation. 2016 ended with 14 million IoT lines, which undoubtedly offers enormous potential for a circular and decarbonised economy. Innovation in this field is constant; to support this, we work alongside the leading companies in the sector and we have innovation centres in Chile, Rio, Madrid, Munich and London. We currently have highly specialised services for certain sectors, such as retail, logistics and cities.

Our Energy Efficiency in Buildings service *saved 103 GWh* for our customers

INCOME FROM ECOSMART SERVICES

%

- 6%
- 19%
- 2%
- 73%

▶ IoT connectivity ▶ Smart energy

▶ Smart cities ▶ Smart mobility

GOOD IoT PRACTICES

TELEFÓNICA IS LAUNCHING AN IoT PROJECT FOR EFFICIENT WATER MANAGEMENT IN CHILE

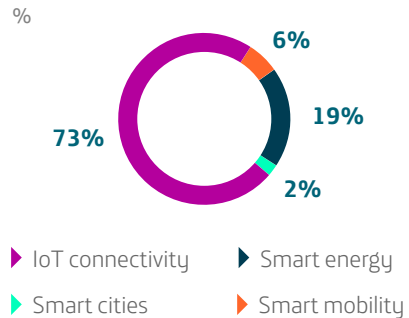Telefónica, in partnership with Huawei and Kamstrup, has deployed the first NB-IoT technology project in Latin America using real user data. One of the leading water companies in Chile has successfully tried out this telemetry solution for residential water meters.

According to the World Resource Institute, in the coming decades Chile will be the country with the greatest water shortages in America, therefore this IoT solution will facilitate the efficient management of the resource, thereby reducing losses and leaks from the system.

The telemetry will enable customers to monitor their daily use, facilitate real invoicing by avoiding estimated use and detect leaks and abnormal situations in the home, as well as non-invoiced water flows. The sensors will also supply information to the water network management company with regard to water supply to end customers.

BIG DATA

Analysis of data with patterns of social behaviour and movement flows can have important applications in environmental matters, such as adaptation to climate change, transport management, efficient use of resources and so on.

These data come from internal sources, such as our Network and IoT sensors, and from Open Data sources - information which is made available to society, public administrations and other bodies, including censuses, climatology and pollution levels, in order to provide our services in a more comprehensive manner.

In 2016 we introduced LUCA, a new Big Data unit with specialised services for corporate customers. Our aim is to help our customers in their decision-making and in more efficient management of their resources, as well as, ultimately, investing the benefits of this wealth of information in society as a whole.

The new unit offer includes four main lines of products and services:

▶ The first line is based on the value of the anonymised and aggregated data of our networks. This category includes the Smart Steps service, focused on mobility management solutions, with current success cases in the enhancement of traffic planning and caring for the population in the face of a climate catastrophe.

IoT SERVICES

15% reduction of fuel consumption with our *fleet management services*

15% *reduction* of water irrigation with Smart Water

10% of *fuel savings* and an 85% improvement in black spots where there exists poor waste separation, thanks to Smart Waste

A reduction of **30%** in the consumption of *public street lighting* with Smart Lighting

Smart Parking allows *a reduction* of **43%** of the average time *looking for regulated parking* in large cities

23% *reduction in energy consumption* with our Energy Efficiency in Buildings service

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▸ The second line focuses on the analytical and external consultancy services for national and international customers already offered by Synergic Partners, the company specialising in Big Data and Data Science which we incorporated in late 2015.

▸ Chiefly through BDaaS (Big Data as a Service), helping our customers to manage and get the most out of their data, using our infrastructure in the cloud.

▸ Finally, Big Data for Social Good, designed to use data to help with the development of society, providing value and thereby contributing to the Sustainable Development Objectives (7 of the 17 objectives are linked

to the environment). In this area, for example, initiatives have been launched to reduce pollution levels caused by traffic in the cities of Nuremberg and Stuttgart.

HOSTING AND THE CLOUD

Thanks to our hosting services in Data Centers, we are achieving the dematerialisation of contents and services, thereby reducing energy consumption and maximising space usage. All of this significantly reduces our customers' carbon footprint. We regard virtualisation as the first step towards cloud computing.

We currently have 11 strategic Data Centers or satellites enabling us to cover our needs in the most effective manner possible. The main ones are located in Spain, Brazil, Miami, Chile, Peru and Mexico. They all comply with the international Green IT principles of eco-efficiency and sustainability and have electrical and conditioning equipment that allows us to reduce our energy consumption to about 75% of that typical of this kind of infrastructure. The average EUP of our main Data Centers is 1.85.

For further information, see the chapter on 'Environmental Impact'.

BIG DATA BEST PRACTICES

ADAPTATION TO CLIMATE CHANGE AND IMPROVING MOBILITY BY MEANS OF BIG DATA

▸ **Analysis of transport demand in Zaragoza**
As innovative leaders of urban planning and public transport analysis in Spain, the Zaragoza transport consortium decided to use data from Smart Steps to create matrices to help them to determine the demand for transport in the city, as well as demographic trends.

FURTHER INFORMATION ▷

▸ **Information System on journeys for Highways England**
Highways England manages, maintains and upgrades roads in England. We worked with them to transform their data strategy, switching from traditional (and often lengthy and costly) data collection to using mobile data from our Smart Steps platform, converting the Network with 4 billion events created each day by O2 customers into valuable insights into infrastructure planning.

FURTHER INFORMATION ▷

▸ **Adaptation to climate change, Colombia**
We collaborated with UNICEF by means of the Magic Box initiative, a Big Data social platform, to optimise its response to natural disasters.

A pilot scheme was carried out using data from Telefónica Colombia with a view to responding to three potential emergencies: an earthquake, an avalanche and floods.

By means of this UNICEF-Telefónica partnership, the technology, data and cross-sectoral articulation are proactively and innovatively integrated to enhance or emergency response capacity, demonstrating that the telecommunications sector is crucial for risk management, given that the availability and accuracy of information can save lives.

FURTHER INFORMATION ☞

10

Annexes

Summary of Milestones in 2016 and Challenges for 2017

	MILESTONES		SHORT-TERM CHALLENGES
Business ethics and compliance	Creation of a communication channel with external stakeholders.	100% Achieved	Internal communication campaign on the new Responsible Business Principles.
	Revision of internal regulations. Revision of the Responsible Business Principles.	In progress	Training course in Responsible Business Principles (90% workforce participation).
Supply chain management	Incorporation of Telefónica into the industry initiative JAC (Joint Audit Cooperation).	100% Achieved	Tighten the monitoring checks on the higher-risk suppliers as regards customer privacy and data protection.
Network deployment	Increase LTE coverage in Spain to over 85% (as compared to 75% in December 2015).	100% Achieved	Extension of VoLTE technology deployment in Latin America and Europe.
Diversity	Creation of a Global Diversity Council.	100% Achieved	Reach a goal of 30% of women in managerial positions by 2020.
Accessibility	Further the implementation of "Design for All" throughout all Company departments.	In progress	Create a global catalogue of handsets that include accessibility features for all our operations.
Sustainable Innovation	Include metrics for measuring our social and environmental impact in key services.	100% Achieved	Increase investment in new projects and acceleration of innovation initiatives with a social or environmental impact.
Environment	Reduction of energy consumption by 2.17% despite an increase in traffic of more than 50%.	100% Achieved	100% of our Group operators to be certified to ISO 14001 standard.
	Reduction of our carbon footprint by 22%.	100% Achieved	Comply with the energy and greenhouse gas emissions objectives.
	90% of Telefónica's Environmental Management Systems certified to ISO 14001 standard.	100% Achieved	Extend the Eco-Rating initiative to more of the countries in which we operate, and launch the OpenEcoRating website.

Principles for preparing the Report_

The Telefónica Annual Integrated Report 2016 reflects the progress made during the year by the Company and its value chain in economic, social and environmental matters, as well as its strategic and market positioning, enabling the reader to get a better understanding of our business model, its ability to generate value from the capitals which comprise it, and our interaction with stakeholders.

Telefónica makes all of its information available to all its stakeholders, providing reliable, tangible, concise and comparable details of the Company's performance, its business model, its value drivers and its strategic lines for the coming years. All this information is published annually and can be accessed from here in all its various books:

Integrated Report: drawn up according to the IIRC (International Integrated Reporting Council) recommendations.

Sustainability Report: comprises part of the Integrated Report and has been drawn up under the general G4 guidelines issued by the Global Reporting Initiative (GRI). For its Annual Sustainability Report Telefónica has chosen GRI's "Exhaustive Compliance Option" in accordance with the G4 guidelines. This option has been subsequently subjected to external verification by EY.

Financial Report: drawn up according to international financial information standards and externally audited by EY.

Corporate Governance Report: drawn up according to the model of the Spanish National Securities Market Commission.

Director Remuneration Report: drawn up according to the model of the Spanish National Securities Market Commission.

Telefónica Atlas: downloadable graphics and data, both past and current, for countries and regions, of all the Sustainability KPIs that comprise the integrated report.

Additional and complementary information is available to all our stakeholders online via the Telefónica web pages. We highlight the following:

In this document Telefónica reports on its commitment with regard to the following International Standards:
- Universal Declaration of Human Rights of the United Nations
- Sustainable Development Goals of the United Nations (SDG)
- Covenant on Civil and Political Rights
- Covenant on Economic, Social and Cultural Rights
- Convention on the Rights of the Child
- Convention on the Rights of People with Disabilities
- Agreements of the International Labour Organization
- Union Network International (UNI)
- OHSAS
- Basel Convention (hazardous wastes)
- Sarbarnes-Oxley Act (USA)
- ISO Standards (14.001, 50.001, 14.064, 31.000, 27.001, 22.301)
- International Guidelines (ICNIRP)

Information is also submitted in reference to different voluntary standards to which Telefónica subscribes:
- United Nations Global Compact
- GRI G4
- OECD Guidelines for Multinational Enterprises
- Conthe Code
- UN Principles for Responsible Investment (UNPRI)
- Global Network Initiative (GNI)
- Due Diligence Guidance for Responsible Supply Chains from Conflict-Affected and High Risk Areas
- Global e-Sustainability Initiative (GeSI)
- Electronic Industry Citizenship Coalition
- Public-Private Alliance for the Responsible Minerals Trade (PPA)
- London Benchmarking Group (LBG)
- Collaboration with ETNO (European Telecommunications Network Operators Association), ITU (International Telecommunication Union) and GSMA (World Association of Mobile Phone Operators)
- ICNIRP (International Commission on Non-Ionizing Radiation Protection)
- Carbon Disclosure Project
- GHG Protocol
- Code of Good Advertising Practices, Self-Monitoring

FIND OUT MORE: 👉

- **About Telefónica**
- **Press Room**
- **Shareholders and investors**
- **Quarterly results**

- **20F (SEC)**
- **Corporate governance**
- **Responsible Business**
- **Jobs**

- **Public policies**
- **Business solutions**

Below we explain how the standards have been applied, listing those which determine the content and the quality, and which ensure a balanced and reasonable presentation of the performance of the organisation. This whole process has been performed taking into account both the experience and the purpose of Telefónica, as well as its usefulness for its stakeholders. Moreover, the review carried out by EY was conducted under the principles defined by the Standard AA1000AS (2008), the values of which seek to "ensure the quality of the organisation's Sustainability Report and the processes, systems and competences which serve as a basis for its execution by the entire organisation".

Both the principles issued by the Global Reporting Initiative (GRI) and those defined by Standard AA1000AS (2008) are the most recognised and commonly used standards in the preparation of sustainability and corporate social responsibility reports.

The point of contact for any questions regarding this report is the Global Department of Corporate Ethics and Responsible Business.

PRINCIPLES FOR DETERMINING THE CONTENT OF THIS REPORT

▶ **Participation by stakeholders**
The chapter on 'Managing our stakeholders and reputation' identifies these groups and explains how Telefónica has responded to their reasonable expectations and interests.

▶ **Sustainability context**
Telefónica contributes to the progress of the communities in which it operates and their sustainability, both social and environmental, throughout its value chain: from working with our suppliers, to the marketing of sustainable products and services, and respect for consumer rights.

▶ **Materiality**
Aspects are addressed which reflect the significant economic, environmental and social effects of the Company and which substantially influence the assessments and decisions of our stakeholders. For this purpose we have conducted a materiality analysis at a local, regional and corporate levels.

▶ **Thoroughness**
We indicate the material aspects and their cover, scope and time, in such a way that their significant economic, environmental and social effects are reflected. In this way, stakeholders can analyse Telefónica's performance in the period under study.

PRINCIPLES FOR DETERMINING THE QUALITY OF THE INFORMATION IN THIS REPORT

According to the reporting standards of the GRI (Global Reporting Initiative):

▶ **Balance**
This testimony reflects both the positive and negative aspects of the Company's performance in order to propitiate a well-founded assessment.

▶ **Comparability**
The information contained herein is submitted in a systematic manner in order to enable stakeholders to analyse the evolution of the Company's performance, so that it can be compared with that of other organisations.

▶ **Precision**
This Report is accurate in qualitative and quantitative terms, enabling stakeholders to assess the performance of the organisation.

▶ **Punctuality**
This Report is submitted on the occasion of the convening of Telefónica's Ordinary Meeting of Shareholders, in order to maintain a regular schedule so that stakeholders have all the information at that time and can make well-grounded decisions.

▶ **Clarity**
The information is set out in a comprehensible manner for stakeholders who have reasonable knowledge of the Company and its activities. In addition, the information given by indicators is maintained in series of three years.

▶ **Reliability**
This Report is externally reviewed by EY, as is reflected in the attached independent review report.

In accordance with the AA1000 sustainability assurance standards:

▶ **Inclusiveness**
This refers to the participation of stakeholders in the development and achievement of a responsible and strategic response to sustainability.

▶ **Relevance**
By means of this principle, Telefónica has determined the importance of each issue for its stakeholders.

▶ **Response capacity**
This is Telefónica's reaction to the demands of its stakeholders, reflected in the Company's milestones and challenges in terms of sustainability.

Structure and scope of consolidation of the Report_

During 2016 the following variations took place in the scope of consolidation:

▶ Since the second quarter of 2016, Telefónica United Kingdom's operations have ceased to be reported as discontinued operations, and its assets and liabilities are no longer classified as "held for sale". They are now reported line by line using the Global Integration Method in accordance with the IFRS for all financial information and is once again included in its totality in non-financial information.

▶ On 15 November, Telefónica S.A. sold 100% of the share capital of Televisión Federal, S.A. ("Telefe") to Viacom International Inc, which it indirectly owned.

▶ The equity value was 345 million U.S. Dollars (approximately 322 million euros).

▶ In February, Telxius was created, a new global company that groups together certain infrastructure assets of the Group, including mobile telecommunications towers and the Group's fibre optic international submarine cable.

▶ Following closure, on 20 February 2017, Telefónica signed an agreement to sell up to 40% of the social capital of Telxius, the company created in February of the same

year, to Taurus Bidco S.à.r.l. for 1,275 million euros (12.75 euros per share). Finalisation is subject to the relevant regulatory approvals. In any case, following the transaction, Telefónica will maintain control of Telxius and therefore its results remain wholly incorporated in the financial and non-financial information of this Report.

The complete list of all the companies which comprise the Telefónica Group is published in Annex VI: "Main companies of the Telefónica Group" of the Consolidated Financial Statements accompanying this report, and which can be found on the corporate website.
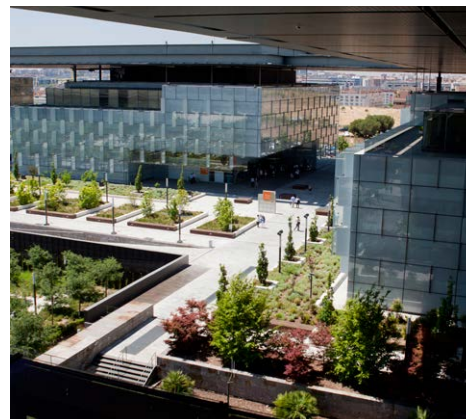
THE ORIGIN OF THE INFORMATION IN THIS REPORT

Corporate governance and shareholders
Taken from the same sources as those which draw up the information contained in the Annual Report on Corporate Governance 2016, included in full in the annexes.

Economic and financial information
Taken from the same sources as those which draw up the information contained in the Financial Report 2016, audited by EY and included in full in the annexes.

Innovation
Consolidated through the corporate Innovation department, for information on both R&D and open innovation. The sources of the data in these chapters come from the purchasing systems and are consolidated without applying any proportionality criterion.

Customers
Taken from the management control systems of Telefónica S.A. and the operations in the countries. The Company's total number of accesses does not necessarily coincide with their partial total, country by country, given that, with homogenisation criteria, the Corporate Management Control area standardises some accounting criteria for the accesses.

Employees
The figure comes from the management systems of Corporate Human Resources and local management departments. This Report uses the concept of people rather than employees. In cases in which the information is submitted in a consolidated form, the number of people is used as a proportionality factor. The chapter devoted to employees includes the entire economic scope of the Telefónica Group, except for the section on Employee Health and Safety, in which the rates reported are only those of the Group's telecommunications businesses, so that they may be more easily compared with other companies in the sector, as specific circumstances and legislation in the sector are taken into account in their preparation (e.g. listing of occupational diseases), and account for a proportion greater than 86% of the total number of employees.

	Telecommunications businesses	Other companies
Revenue (Millions of euros)	97.5%	2.5%
People	91.4%	8.6%

Environment and climate change

The information comes from the Environment and Operations areas in each country by means of online questionnaires and other computer applications. The data are consolidated by simple addition and, in the case of climate change, take into account the emission factors of the GHG Protocol.

Suppliers

Taken from the contract procurement system through the Purchasing areas. Consolidation of the information is performed without applying any criterion as a proportionality factor and is submitted by country. The chapter devoted to suppliers includes the entire economic scope of the Telefónica Group. It is important to underline the difference between the data on procurements in the consolidated accounts of the financial statements (in accordance with the accrual criterion and the accounting scope of consolidation of the Telefónica Group) and the allocated purchases criterion used in different sections of this Report, which refer to the purchases which are approved within the period, regardless of the accounting criterion and periodification as an expense.

Digital inclusion

The information reaches the systems of the local operators of the countries and the Telefónica Foundation.

Social action

The data come from the management control systems and sponsorship committees of the Telefónica Foundation, ATAM and the Telefónica Group, and are integrated under the LBG criterion.

Exchange rates

All the information in this Report is submitted in current euros, unless otherwise indicated. The exchange rates applied correspond to those used in all the financial statements published by the Company (balance sheet, consolidated and individual income statements) in order to facilitate the overall relationship between financial and non-financial variables.

Telefónica United Kingdom

In 2016, Telefónica United Kingdom's operations ceased to be reported as discontinued operations, and its assets and liabilities no longer classified as "held for sale", and consequently have been reported line by line using the global integration method in accordance with the IFRS, for both 2016 and 2015, and therefore the financial and market information are shown in such a way in this Report. By contrast, the non-financial information has not been reconsolidated in its historical data for the purpose of preserving the sustainability context principle and to be able to reflect the real impact and contribution that Telefónica as a whole had on its social and environmental surroundings in said previous years. Nevertheless, organic growth in some internal variables is also shown, where expressly indicated.

SCOPE OF CONSOLIDATION OF EACH SECTION OF THIS REPORT

	"Core"	Other subsidiaries	Corporate centres	Outside the organisation
Market indicators	▲			
Financial indicators	▲	▲	▲	
Non-financial indicators	▲	▲	▲	▲
Corporate governance			▲	
Impacts on the community	▲	▲	▲	▲
Social and cultural action	▲	▲	▲	▲
Business model	▲	▲	▲	
Stakeholders and Materiality	▲	▲	▲	▲
Reputation management	▲		▲	
Sustainability governance and management	▲	▲	▲	▲
Ethics and compliance	▲	▲	▲	
Supply chain	▲	▲	▲	▲
Customer promise	▲	▲		▲
Digital trust	▲	▲	▲	▲
Human team	▲	▲	▲	
Social innovation (digital inclusion)	▲	▲	▲	▲
Digital education	▲	▲	▲	▲
Innovation	▲	▲	▲	
Environment	▲	▲	▲	▲

Relevant awards and recognitions in 2016_

EXTERNAL RATINGS FROM SUSTAINABILITY ANALYSTS AND INDICES

MSCI — Rating A

Dow Jones Sustainability Indexes — Member of the World and Europe Index

FTSE4Good — Member

CDP — The top worldwide A list

Carbon Ranking — Rank 8

Ethibel Sustainability Index Excellence Global — Excellence Register

STOXX ESG Leaders Indices — Member

ecovadis — 71 points

oekom — Prime C+

Sustainalytics — 6th Telco out of 112 companies

Euronext vigeo Indices — Euronext 120

MOBILE WORLD CONGRESS — Glomo Award 2016

ROBECOSAM Sustainability Award Industry Leader 2014 — Bronze 83 points

MEXICO

▸ "Ethics and Values in the Industry" award for Telefónica from the Confederation of Industrial Chambers of the United States of Mexico (CONCAMIN).

▸ Company Quality of Life Award for the Feel Good programme granted by the Mexican Center for Philanthropy (Cemefi), the Social Responsibility Alliance in Mexico (AliaRSE) and the Business Forum.

▸ 'Best Consumer Experience' award in IZO Telecommunications, given to companies with the best practices and highest degree of innovation in customer experience in Ibero-America.

VENEZUELA

▸ "Banco Exterior por un Mundo Sin Igual" (Banco Exterior for an Unparalleled World) award for the 'Movistar goes to University" programme, for its socially responsible nature.

COLOMBIA

▸ LTE Network Quality Innovation award for Movistar.

▸ Honoured as one of the 10 companies that most promotes gender equality in the country, by the District Secretariat for Women in Bogotá, the Secretariat for Economic Development, the consultancy firm Aequales and the College of Higher Management Studies (Spanish acronym: CESA).

BRAZIL

▸ Telefónica Brazil recognised as one of the best companies in 2015 according to the magazine Consumidor Moderno (Modern Consumer) in a ranking carried out by the Padrão Center for Intelligence (CIP).

▸ Vivo named Outstanding Company in 2016 in the ranking of Biggest and Best Companies published in *Exame* magazine, and developed by the Institute of Economic Analyses at the University of São Paulo.

▸ First position in five out of six TMT sector awards in the 2016 Latin America Executive Team Ranking from Institutional Investor: CEO of the year, best director of Investor Relations, Best Investor Relations Programme, Best Web Page for Investor Relations and Best Analysts Event.

▸ Award for the best deployment of Self-organising Network technology at SON World 2016, for excellence of the Vivo service during the 2016 Summer Olympic Games held in Rio de Janeiro.

GERMANY

▸ TÜV Saarland certification for the elevated data protection on the Telefónica platform.

▸ Second place in the GERMAN GENDER INDEX.

PERU

▸ Best employer in the telecommunications sector, by Marca Empleadora 2016.

CHILE

▸ Telefónica Chile chosen as the second best company for young people by Best FirstJob Employers.

CENTRAL AMERICA

▸ TopBrands Nicaragua recognised Movistar as one of the country's leading brands for reliability, innovation and closeness.

▸ Best marks in mobile internet and telephony in Costa Rica according to the Superintendency of Telecommunications (Sutel).

SPAIN

▸ Movistar, leader in customer service and technical assistance in the Telco sector, according to the Adeces Consumer Association.

▸ Best company in the field of Digital Transformation in the Telecommunications and Network Transformation categories of the "Computing Awards in the Digital Era Awards".

▸ ONCE 2016 Solidarity Award for implementing the Movistar+ 5S integrated accessibility platform.

▸ Expansion Award for the Telefónica Talentum LAB program in the IoT category.

▸ Gold Medal for the Movistar + Eurofighters production at the New York Television and Film Festival.

▸ Best EnerTIC 2016 Project for the Valencia Smart City Platform (VLCi) implemented by Telefónica, with three additional recognitions in the Smart Cities, Smart eGovernment and Smart Sustainability categories.

▸ Iris Critics Award from the Television Academy for the Movistar + programme #0.

GLOBAL

▸ GSMA award at the Global Mobile Awards for our Energy Efficiency programme in the Green Mobile category.

▸ OpenStack, "Business Transformation" award from "Red Hat Open Innovation Club" for the paradigm change in telecommunications networks by means of NFV technology development.

▸ "Architectural Collaboration of the Year" award from Cisco's Partner Summit Awards, as best technological partner.

▸ Telefónica Open Future, granted fourth position in the Berlin Startup Europe Partnership organised by the Nesta Foundation.

▸ Second highest score (9 points) in Ibex-35 Fiscal Transparency awarded by the Transparency and Commitment Foundation.

Tables of GRI compliance_

GRI G4 Content Index

For "in accordance" - Comprehensive

GENERAL STANDARD DISCLOSURES

General standard disclosures	Page	Omissions	External Assurance	
Strategy and Analysis				
G4-1	3			Statement from the most senior decision-maker of the organisation.
G4-2	58 and 76			Description of key impacts, risks, and opportunities.
Organisational Profile				
G4-3	7			Name of the organisation.
G4-4	7			Primary brands, products, and services.
G4-5	7			Location of the organisation's headquarters.
G4-6	9			Countries where the organisation operates.
G4-7	7			Nature of ownership and legal form.
G4-8	9			Markets served.
G4-9	7			Scale of the organisation.
G4-10	117			Total number of employees by employment contract, region and gender.

GENERAL STANDARD DISCLOSURES

General standard disclosures	Page	Omissions	External Assurance	
G4-11	117			Percentage of total employees covered by collective bargaining agreements.
G4-12	63, 64, 65, 66, 67, 68, 69, 70, 71, 72 and 73			Organisation's supply chain.
G4-13	182			Significant changes during the reporting period.
Commitments to External Initiatives				
G4-14	157			Precautionary approach or principle addressed by the organisation.
G4-15	180, 181			Externally developed economic, environmental and social charters, principles, or other initiatives to which the organisation subscribes or which it endorses.
G4-16	52 and 53			Memberships of associations.
Identified Material Aspects and Boundaries				
G4-17	ICA: 286, 287, 288 and 289			Entities included in the organisation's consolidated financial statements or equivalent documents.
G4-18	183			Process for defining the report content and the Aspect Boundaries.
G4-19	54			Material Aspects identified in the process for defining report content.
G4-20	183			Aspect Boundary within the organisation.
G4-21	183			Aspect Boundary outside the organisation.
G4-22	182 and 183			Restatements of information provided in previous reports.
G4-23	182 and 183			Significant changes from previous reporting periods in the Scope and Aspect Boundaries.
Stakeholder Engagement				
G4-24	47 and 48			List of stakeholder groups engaged by the organisation.
G4-25	43, 44, 45, 46, 47 and 48			Basis for identification and selection of stakeholders with whom to engage.
G4-26	43, 44, 45, 46, 47 and 48			Organisation's approach to stakeholder engagement, including frequency of engagement by type and by stakeholder group.
G4-27	44 and 45			Key topics and concerns that have been raised through stakeholder engagement, and how the organisation has responded.

GENERAL STANDARD DISCLOSURES

General standard disclosures	Page	Omissions	External Assurance	
Report Profile				
G4-28	7			Reporting period.
G4-29	7			Date of most recent previous report.
G4-30	7			Reporting cycle.
G4-31	181			Contact point for questions regarding the report or its contents.
G4-32	180			'In accordance' option, GRI Content Index, reference to the External Assurance Report.
G4-33	180 and 181			Organisation's policy and current practice with regard to seeking external assurance for the report.
Governance				
G4-34	IAGC: 13, 29, 30, 31 and 32			Governance structure of the organisation.
G4-35	42			Process for delegating authority for economic, environmental and social topics from the highest governance body to senior executives and other employees.
G4-36	42			Whether the organisation has appointed an executive-level position or positions with responsibility for economic, environmental and social topics, and whether post holders report directly to the highest governance body.
G4-37	42			Processes for consultation between stakeholders and the highest governance body on economic, environmental and social topics.
G4-38	28			Composition of the highest governance body and its committees.
G4-39	27			Whether the Chair of the highest governance body is also an executive officer.
G4-40	IAGC: 17			The nomination and selection processes for the highest governance body and its committees.
G4-41	IAGC: 36			Processes for the highest governance body to ensure conflicts of interest are avoided and managed.
G4-42	42			The highest governance body's and senior executives' roles in the development, approval, and updating of the organisation's purpose, value or mission statements, strategies, policies, and goals related to economic, environmental and social impacts.
G4-43	IAGC: 26			Measures taken to develop and enhance the highest governance body's collective knowledge of economic, environmental and social topics.
G4-44	IAGC: 22 and 23			Processes for evaluation of the highest governance body's performance with respect to governance of economic, environmental and social topics.
G4-45	IAGC: 31 and 32			Highest governance body's role in the identification and management of economic, environmental and social impacts, risks and opportunities.

GENERAL STANDARD DISCLOSURES

General standard disclosures	Page	Omissions	External Assurance	
G4-46	IAGC: 31 and 32			Highest governance body's role in reviewing the effectiveness of the organisation's risk management processes for economic, environmental and social topics.
G4-47	42			Frequency of the highest governance body's review of economic, environmental and social impacts, risks, and opportunities.
G4-48	3			Highest committee or position that formally reviews and approves the organisation's sustainability report.
G4-49	42			Process for communicating critical concerns to the highest governance body.
G4-50	44			Nature and total number of critical concerns that were communicated to the highest governance body and the mechanism(s) used to address and resolve them.
G4-51	IAGC: 90, 91, 92, 93, 94, 95, 96, 97, 98, 99 and 100			Remuneration policies for the highest governance body and senior executives.
G4-52	IAGC: 91			Process for determining remuneration.
G4-53	IAGC: 91			How stakeholders' views are sought and taken into account regarding remuneration.
G4-54	IAGC: 111 ICA: 172	On the referenced pages you can find the information which allows calculation of this ratio.		Ratio of the annual total compensation for the organisation's highest-paid individual in each country of significant operations to the median annual total compensation for all employees.
G4-55	IAGC: 111 ICA: 172	On the referenced pages you can find the information which allows calculation of this ratio.		Ratio of percentage increase in annual total compensation for the organisation's highest-paid individual in each country of significant operations to the median percentage increase in annual total compensation for all employees.
Ethics and Integrity				
G4-56	60			Organisation's values, principles, standards and norms of behaviour such as codes of conduct and codes of ethics.
G4-57	62			Internal and external mechanisms for seeking advice on ethical and lawful behaviour, and matters related to organisational integrity.
G4-58	61			Internal and external mechanisms for reporting concerns about unethical or unlawful behaviour, and matters related to organisational integrity.

SPECIFIC STANDARD DISCLOSURES

Management focus and indicator	Page	Omissions	External Assurance	
CATEGORY: ECONOMIC				
Indirect Economic Impacts				
G4-DMA	19 and 20			Disclosures on management focus.
G4-EC7	22			Development and impact of infrastructure investments and services supported.
G4-EC8	19 and 20			Significant indirect economic impacts, including the extent of impacts.
Procurement Practices				
G4-DMA	63 and 64			Disclosures on management focus.
G4-EC9	9			Proportion of spending on local suppliers at significant locations of operation.
CATEGORY: ENVIRONMENTAL				
Energy				
G4-DMA	153, 157 and 165			Disclosures on management focus.
G4-EN3	167, 169 and 171			Energy consumption within the organisation.
G4-EN4	159 and 168			Energy consumption outside of the organisation.
G4-EN5	167, 169 and 171			Energy intensity.
G4-EN6	170 and 171			Reduction of energy consumption.
G4-EN7	175, 176 and 177			Reductions in energy requirements of products and services.
Emissions				
G4-DMA	154, 165 and 166			Disclosures on management focus.
G4-EN15	168 and 171			Direct greenhouse gas (GHG) emissions (Scope 1).
G4-EN16	168 and 171			Energy indirect greenhouse gas (GHG) emissions (Scope 2).
G4-EN17	168 and 171			Other indirect greenhouse gas (GHG) emissions (Scope 3).
G4-EN18	168 and 169			Greenhouse gas (GHG) emissions intensity.
G4-EN19	169 and 170			Reduction of greenhouse gas (GHG) emissions.

SPECIFIC STANDARD DISCLOSURES

Management focus and indicator	Page	Omissions	External Assurance	
G4-EN20		Still in the process of acquring the data.		Emissions of ozone-depleting substances (ODS).
G4-EN21		Not relevant. Emissions of these pollutants are not significant to our business.		NO_x, SO_x, and other significant air emissions.
Effluents and waste				
G4-DMA	153 and 159			Disclosures on management focus.
G4-EN22		Pouring water in Telefónica is just a sanitary issue and is poured into municipal sanitation systems.		Total water discharge by quality and destination.
G4-EN23	163			Total weight of waste by type and disposal method.
G4-EN24		There have been no significant spills.		Total number and volume of significant spills.
G4-EN25	163			Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I, II, III, and VIII, and percentage of transported waste shipped internationally.
G4-EN26		Pouring water in Telefónica is just a sanitary issue and is poured into municipal sanitation systems.		Identity, size, protected status and biodiversity value of water bodies and related habitats significantly affected by the organisation's discharges of water and runoff.
Products and Services				
G4-DMA	175			Disclosures on management focus.
G4-EN27	159 and 176			Extent of impact mitigation of environmental impacts of products and services.
G4-EN28	163 and 164			Percentage of products sold and their packaging materials that are reclaimed by category.

CATEGORY: SOCIAL
SUBCATEGORY: LABOUR PRACTICES AND DECENT WORK

Occupational Health and Safety				
G4-DMA	130			Disclosures on management focus.
G4-LA5	131			Percentage of total workforce represented in formal joint management—worker health and safety committees that help monitor and advise on occupational health and safety programmes.
G4-LA6	131			Type of injury and rates of injury, occupational diseases, lost days, and absenteeism and total number of work-related fatalities, by region and by gender.
G4-LA7	131			Workers with high incidence or high risk of diseases related to their occupation.
G4-LA8	131			Health and safety topics covered in formal agreements with trade unions.

SPECIFIC STANDARD DISCLOSURES

Management focus and indicator	Page	Omissions	External Assurance	
Training and Education				
G4-DMA	118			Disclosures on management focus.
G4-LA9	119	Breakdown by gender is not available. We are adapting our information systems to be able provide these figures shortly.		Average hours of training per year per employee by gender, and by employee category.
G4-LA10	118 and 119			Programmes for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings.
G4-LA11		Breakdown is available by hour, but not by employee, due to possible duplication of information. We are adapting our information systems to be able provide these figures shortly.		Percentage of employees receiving regular performance and career development reviews, by gender and by employee category.
Diversity and Equal Opportunity				
G4-DMA	121			Disclosures on management focus.
G4-LA12	117 and 123			Composition of governance bodies and breakdown of employees per employee category according to gender, age group, minority group membership and other indicators of diversity.
Equal Remuneration for Women and Men				
G4-DMA	126			Disclosures on management focus.
G4-LA13	127			Ratio of basic salary and remuneration of women to men by employee category, by significant locations of operation.
Supplier Assessment for Labour Practices				
G4-DMA	63 and 64			Disclosures on management focus.
G4-LA14	63			Percentage of new suppliers that were screened using labour practices criteria.
G4-LA15	70			Significant actual and potential negative impacts for labour practices in the supply chain and actions taken.
SUBCATEGORY: HUMAN RIGHTS				
Investment				
G4-DMA	133			Disclosures on management approach.
G4-HR1	68			Total number and percentage of significant investment agreements and contracts that include human rights clauses or that underwent human rights screening.
G4-HR2	60			Total hours of employee training on human rights policies or procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained.

SPECIFIC STANDARD DISCLOSURES

Management focus and indicator	Page	Omissions	External Assurance	
Non-Discrimination				
G4-DMA	133			Disclosures on management focus.
G4-HR3	16			Total number of incidents of discrimination and corrective actions taken.
Freedom of Association and Collective Bargaining				
G4-DMA	126			Disclosures on management focus.
G4-HR4	66			Operations and suppliers identified in which the right to exercise freedom of association and collective bargaining may be violated or at significant risk, and measures taken to support these rights.
Forced or Compulsory Labour				
G4-DMA	133 and 134			Disclosures on management focus.
G4-HR6	66			Operations and suppliers identified as having significant risk for incidents of forced or compulsory labour, and measures to contribute to the elimination of all forms of forced or compulsory labour.
Supplier Human Rights Assessment				
G4-DMA	133 and 134			Disclosures on management focus.
G4-HR10	69			Percentage of new suppliers that were screened using human rights criteria.
G4-HR11	134			Significant actual and potential negative human rights impacts in the supply chain and actions taken.
SUBCATEGORY: SOCIETY				
Anti-Corruption				
G4-DMA	60			Disclosures on management focus.
G4-SO3	62			Total number and percentage of operations assessed for risks related to corruption and the significant risks identified.
G4-SO4	60			Communication and training on anti-corruption policies and procedures.
G4-SO5	62			Confirmed incidents of corruption and actions taken.

SPECIFIC STANDARD DISCLOSURES

Management focus and indicator	Page	Omissions	External Assurance	
Supplier Assessment for Impacts on Society				
G4-DMA	63 and 64			Disclosures on management focus.
G4-SO9	69	Percentages are not available; only total amounts are given.		Percentage of new suppliers that were screened using criteria for impacts on society.
G4-S10	70			Significant actual and potential negative impacts on society in the supply chain and actions taken.
SUBCATEGORY: PRODUCT RESPONSIBILITY				
Customer Health and Safety				
G4-DMA	172			Disclosures on management focus.
G4-PR1	173			Percentage of significant product and service categories for which health and safety impacts are assessed for improvement.
G4-PR2	173			Total number of incidents of non-compliance with regulations and voluntary codes concerning the health and safety impacts of products and services during their life cycle, by type of outcome.
Customer Privacy				
G4-DMA	100			Disclosures on management focus.
G4-PR8	104			Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.

OTHER NON MATERIAL SPECIFIC STANDARD DISCLOSURES REPORTED

Management focus and indicator	Page	Omissions	External Assurance	
CATEGORY: ECONOMIC				
Market presence				
G4-EC5	127			Ratios of standard entry level wage by gender compared to local minimum wage at significant locations of operation.
CATEGORY: ENVIRONMENTAL				
Materials				
G4-EN1	163			Materials used by weight or volume.
G4-EN2	163			Percentage of materials used that are recycled input materials.
Water				
G4-EN8	161			Total water withdrawal by source.
Supplier Environmental Assessment				
G4-EN32	70			Percentage of new suppliers that were screened using environmental criteria.
G4-EN33	70			Significant actual and potential negative environmental impacts in the supply chain and actions taken.
CATEGORY: SOCIAL **SUBCATEGORY: LABOR PRACTICES AND DECENT WORK**				
Labor Practices Grievance Mechanisms				
G4-LA16	62			Number of grievances about labor practices filed, addressed, and resolved through formal grievance mechanisms.
Child Labor				
G4-HR5	66			Operations and suppliers identified as having significant risk for incidents of child labor, and measures taken to contribute to the effective abolition of child labor.
Product responsibility				
G4-PR5	95			Results of surveys measuring customer satisfaction.

ICA	Financial Report.
IAGC	Annual Report on Corporate Governance.
20F	Form 20-F de la SEC.
IAR	Annual Compensation Report.
PDA	Business Principles.

Commitment to the United Nations Global Compact_

			CHAPTERS
Human Rights	Principle 1	Businesses should support and respect the protection of internationally proclaimed Human Rights.	Human Rights
	Principle 2	Businesses should make sure that they are not complicit in Human Rights abuses.	Human Rights
Labour	Principle 3	Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining.	Freedom of association, social dialogue and fair compensation
	Principle 4	Businesses should support the elimination of all forms of forced and compulsory labour.	Managing the supply chain
	Principle 5	Businesses should support the eradication of child labour.	Managing the supply chain
	Principle 6	Businesses should support the elimination of discrimination in respect of employment and occupation.	Managing diversity

			CHAPTERS
Environment	Principle 7	Businesses should support a precautionary approach to environmental challenges.	Commitment to the environment
	Principle 8	Businesses should undertake initiatives to promote greater environmental responsibility.	Commitment to the environment
	Principle 9	Businesses should encourage the development and diffusion of environment friendly technologies.	EcoSmart services
Anti-Corruption	Principle 10	Businesses should work against corruption in all its forms, including extortion and bribery.	Business ethics and compliance

FURTHER INFORMATION Visit the United Nations Global Compact website.

Commitment to the United Nations Global Compact_

- **Economic impacts**
  - 8 DECENT WORK AND ECONOMIC GROWTH

- **Environmental impact**
  - 12 RESPONSIBLE CONSUMPTION AND PRODUCTION
  - 13 CLIMATE ACTION

- **Impacts of the Network**
  - 8 DECENT WORK AND ECONOMIC GROWTH

- **Ethics and compliance**
  - 8 DECENT WORK AND ECONOMIC GROWTH
  - 12 RESPONSIBLE CONSUMPTION AND PRODUCTION
  - 17 PARTNERSHIPS FOR THE GOALS

- **Managing our interest groups and reputation**
  - 17 PARTNERSHIPS FOR THE GOALS

- **Supply chain management**
  - 8 DECENT WORK AND ECONOMIC GROWTH
  - 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
  - 12 RESPONSIBLE CONSUMPTION AND PRODUCTION

- **Network Deployment**
  - 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

- **Digital transformation**
  - 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
  - 11 SUSTAINABLE CITIES AND COMMUNITIES
  - 12 RESPONSIBLE CONSUMPTION AND PRODUCTION

- **Innovation**
  - 8 DECENT WORK AND ECONOMIC GROWTH
  - 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
  - 11 SUSTAINABLE CITIES AND COMMUNITIES

- **Digital trust**
  - 17 PARTNERSHIPS FOR THE GOALS
  - 4 QUALITY EDUCATION

- **Staff evolution**
  - 5 GENDER EQUALITY
  - 8 DECENT WORK AND ECONOMIC GROWTH

- **Talent and diversity management**
  - 5 GENDER EQUALITY
  - 8 DECENT WORK AND ECONOMIC GROWTH
  - 10 REDUCED INEQUALITIES

- **Freedom of association, social dialogue and fair compensation**
  - 8 DECENT WORK AND ECONOMIC GROWTH
  - 10 REDUCED INEQUALITIES

- **Derechos Humanos**
  - 16 PEACE, JUSTICE AND STRONG INSTITUTIONS

- **Digital inclusion**
  - 1 NO POVERTY
  - 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE
  - 10 REDUCED INEQUALITIES
  - 11 SUSTAINABLE CITIES AND COMMUNITIES
  - 13 CLIMATE ACTION

- **Social and cultural action**
  - 1 NO POVERTY
  - 4 QUALITY EDUCATION
  - 10 REDUCED INEQUALITIES

- **Growth in a green economy**
  - 6 CLEAN WATER AND SANITATION
  - 7 AFFORDABLE AND CLEAN ENERGY
  - 11 SUSTAINABLE CITIES AND COMMUNITIES
  - 12 RESPONSIBLE CONSUMPTION AND PRODUCTION
  - 13 CLIMATE ACTION
  - 14 LIFE BELOW WATER
  - 15 LIFE ON LAND

External validation_

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INDEPENDENT REVIEW REPORT ON TELEFÓNICA S.A.'S 2016 INTEGRATED REPORT

To the Regulation and Institutional Affairs of Telefónica, S.A.

Scope of work

We have reviewed the contents of Telefonica, S.A.'s 2016 Integrated Report (the Report) which was prepared in accordance with

- The Global Reporting Initiative (GRI) Preparation Guide 4 (G4).
- The principles stated in the AA1000 Assurance Standard Guide issued by AccountAbility (Institute of Social and Ethical Accountability).

The scope determined by Telefónica for the preparation of this report is defined in the section "Structure and scope of consolidation of the Report" of the accompanying Report

The preparation of the accompanying Report, as well as the information contained therein, is the responsibility of the Institutional Affairs Committee of Telefónica, S.A. They are also responsible for defining, adapting, and maintaining the management and internal control systems from which the information is obtained. Our responsibility is to issue an independent report based on the procedures applied in our review.

Criteria

Our review was carried out based on:

- Standard ISAE 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information, issued by the International Auditing and Assurance Standard Board (IAASB) of the International Federation of Accountants (IFAC), with a limited scope of assurance.
- AA1000 AccountAbility Assurance Standard 2008, with a moderate level of type 2 assurance.
- The Guidelines for reviewing Corporate Responsibility Reports, issued by the Official Register of Auditors of Accounts (ICJCE).

Applied procedures

Our review consisted in requesting information from Telefonica S.A.'s Corporate Ethics and Sustainability Global Direction and the management of business areas participating in the preparation of the Report, and applying certain analytical procedures and sampling review tests as described in general terms below:

1. Interviews with the persons in charge of Telefonica S.A.'s Corporate Ethics and Sustainability Global Direction and a selection of managers and key management personnel involved in the Report's preparation. The purpose of these was to obtain awareness of the opinion of Corporate Sustainability objectives and policies, as well as how they are put into practice and integrated into Telefónica's strategy.
2. Review of the principal processes and systems through which Telefónica establishes its commitments with stakeholders, along with the relevance and integrity of the information included in the Report.
3. Analysis of the adaptation of the structure and content of the Report as indicated in G4 Global Reporting Initiative (GRI).
4. Checks, on a sample basis, of the quantitative information included the Report, as well as its adequate compilation from data supplied by information sources. The review tests have been defined to provide assurance levels in line with the criteria described in this report. The review was carried out based on Telefónica's operations in Spain, Brazil, Argentina, Germany, Chile and Colombia.

This review is considerably less in scope than a reasonable assurance report. Therefore, the degree of assurance is also less extensive. This report should in no case be considered an audit report.

These procedures were performed on the information contained in the accompanying Report and GRI tables with the perimeter and scope indicated above

Independence and quality control

We have complied with the requirements of independence and other requirements of ethics the code of ethics for professionals of accounting issued by the International Ethics Standards Board for Accountants (IESBA).

Our firm applies the standard International Quality Control Standard 1 (NICC 1) and therefore maintains a global system of quality control that includes policies and procedures documented compliance with requirements of ethics, professional standards and legal and regulatory provisions applicable.

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Conclusions

As a result of our review of the Telefonica S.A´s 2016 integrated report, and the scope indicated in "Applied procedures" above, we conclude that:

- No matter came to our attention that would indicate that the Report had not been prepared according to the Guidelines included in the Global Reporting Initiative (GRI) Preparation Guide for Sustainability Reports.
- No se ha puesto de manifiesto ningún aspecto que nos haga creer que el Informe no haya sido preparado de acuerdo con los principios recogidos en la Norma AA1000 APS (2008) emitida por AccountAbility, entendidos como:
- No matter came to our attention that would lead us to believe that the Report has not been prepared in accordance with the principles established in standard AA1000 APS (2008), such as:

✓ **Inclusiveness**: The mechanisms are in place to identify stakeholders, as well as to gain an awareness and understanding of their expectations, as explained in the "Managing our stakeholders and reputation" section of the accompanying Report.

✓ **Relevance**: Relevance is analyzed and a survey conducted to select the most significant matters to be included in the Report, as described in its "Managing our stakeholders and reputation" section.

✓ **Responsiveness**: Telefonica has the mechanisms to design, develop, evaluate and communicate the responses necessary to meet the principal expectations of stakeholders, which are reflected in the "Managing our stakeholders and reputation " section and included in the various sections of the accompanying Report.

Recommendations

We also presented to the Regulation and Institutional Affairs of Telefonica, S.A our recommendations regarding areas of improvement related to the application of standard AA1000 APS (2008), as well as to actions taken with main stakeholders. The most significant recommendations are summarized below:

a) *Inclusiveness*

Telefónica takes into account the opinion of its stakeholders to select the most relevant issues that guide its sustainability strategy. Interaction with stakeholders is carried out periodically through the Sustainability Advisory Panel. Our recommendation is to reinforce the consideration and contribution of value of the "Clients" stakeholder on Telefónica's sustainability strategy.

b) *Relevance:*

Telefónica conducts a materiality assessment at the corporate and local levels and includes the results of the study in the Report. In 2016, this process has been reinforced by regular consultations with stakeholders. We recommend that stakeholders be regularly consulted to reinforce the inclusion of relevant factors in their sustainability strategy.

c) *Responsiveness:*

Telefónica has different communication channels for each stakeholder. Our recommendation is to take advantage of periodic stakeholder consultations to assess the effectiveness of communication channels and their influence on the company's responsiveness in order to improve corporate communication.

In addition, we present below a series of recommendations on the actions related to the different dimensions included in the Report:

1) Economic dimension:

Telefónica has reviewed the minimum criteria on responsible business demanded from its suppliers. Our recommendation is to continue to strengthen the different control mechanisms to ensure the compliance of Human Rights by its suppliers, especially on aspects related to the privacy and protection of clients´ data.

2) Environmental dimension:

In 2016, Telefónica has published a more detailed report on its environmental performance. It is recommended to continue working on improving the definitions of environmental indicators and increasing the reporting frequency of certain indicators to improve their management.

3) Social dimension:

Telefónica, through the constitution of the Global Diversity Council, manages diversity as a source of added value, promoting initiatives aimed at consolidating diversity as a key factor for digital transformation. Our recommendation is to improve the quality and homogeneity of the information to be reported in the different countries in which it operates.

This report has been prepared solely for the attention of the Regulation and Institutional Affairs of Telefónica, S.A., in accordance with the terms set out in our engagement letter.

ERNST & YOUNG, S.L.

AA1000
Licensed Assurance Provider
000-59

(signed in the original
issued in Spanish language)

(Free translation from the Original Report on Independent Review in Spanish dated May 12th 2017. In case of any discrepancy, the Spanish version always prevails)

AENOR

Verification Statement of AENOR for Telefónica on the Inventory of greenhouse gas emissions corresponding to the year 2016

DOSSIER: 2009/1133/HCO/01

Introduction

Telefónica (hereinafter the company) commissioned AENOR to make a limited revision of the inventory of greenhouse gases (GHG) of its activities included in the GHG report of 2016, which is part of this Declaration.

AENOR is accredited by Entidad Mexicana de Acreditación (OVVGEI 004/14) (issue date: 31/10/2014; expiry date: 31/10/2018), according to ISO 14065:2007, to conduct GHG verifications according to ISO 14064-3:2006 in the Energy Sector.

Inventory of GHG emissions issued by the Organisation: Telefónica, C/ Ronda de la Comunicación, Distrito Telefónica, Madrid (Spain).

Representatives of the Organisation: Maya Ormazábal Herrera/Ana Belén Pociña Hijosa, Climate Change and Energy Efficiency Office

Telefónica was responsible for reporting its GHG emissions considered in accordance with the reference standard ISO 14064-1:2006.

Objective

The objective of the verification is to provide the interested parties with an independent and professional opinion on the information and data contained in the above mentioned GHG Report issued by Telefónica.

Scope of the Verification

The GHGs, considered emissions sources as well as the organizational boundaries from the activities of Telefónica included in the GHG inventry are described below.

The GHG inventory of the organization includes the following GHGs: CO_2, CH_4, N_2O and HFCs.

Direct, indirect activities and exclusions from the verification.

- Scope 1- Direct GHG emissions
- Scope 2 – Energy indirect GHG emissions
- Scope 3- Other indirect emissions:

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- o Purchased goods and services
- o Capital godos
- o Fuel- and energy-related activities (not included in scope 1 or scope 2)
- o Waste generated in operations
- o Business travel
- o Use of sold products
- o Investments

General Exclusions

The following ghg emissions sources have been excluded:

- Emissions from purchases of works and services and Marketing within the category of "Purchased goods and services".
- Emissions from the use of mobile phones within the category of "use of sold products".

The exclusions are justified based upon the criteria of emissions which are not technically feasible or profitable due to robust data are not available or the organization has not the ability to manage those emissions.

During the verification the information was analysed according to operational control approach. Under this approach the geographic scope is established in the following countries where Telefónica Group operates:

Organizational and geographic boundaries		
Europe	**Latin America**	**Telxius**
Spain	Argentina (Fixed and Mobile network)	
Fixed and Mobile Network	Brazil (Fixed and Mobile network)	
Distrito Telefónica	Chile (Fixed and Mobile network)	
Telefónica Soluciones	Colombia (Fixed and Mobile network)	
Telxius	Ecuador (Mobile Network)	
Germany (Fixed and Mobile network)	El Salvador (Mobile Network)	
United Kingdom (Fixed and Mobile network)	Guatemala (Mobile Network)	
	Mexico (Mobile Network)	
	Nicaragua (Mobile Network)	
	Panama (Mobile Network)	

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	Peru (Fixed and Mobile network)	
	Costa Rica (Mobile network)	
	Uruguay (Mobile Network)	
	Venezuela (Mobile Network)	

Base year

Telefónica has selected 2015 as the base year.

Materiality

For the verification it was agreed to consider as material discrepancies those omissions, distortions or errors that could be quantified and result in a difference of more than 5% with respect to the total of emissions declared.

Criteria

The criteria and information that have been taken into consideration to carry out the verification were the following:

1) Standard ISO 14064-1:2006: Specification with guidance at the organization level for quantification and reporting of greenhouse gas emissions and removals.

2) Standard ISO 14064-3:2006: Specification with guidance for the validation and verification of greenhouse gas assertions.

3) Referencial ITU-T L.1420 (02/2012) *Methodology for energy consumption and greenhouse gas emissions impact assessment of information and comunication technologies in organizations*

4) GHG Protocol A Corporate Accounting and Reporting Standard. Rev 01.

AENOR waives any responsibility for decisions, regarding investment or of any other type, based on this declaration.

Conclusion

As a conclusion and according to the limited level of assurance agreed, AENOR states:

Based on the above, in our opinion *there is no evidence to suggest that the information on emissions reported in the Greenhouse Gases Report of Telefónica for period 2016, dated March 31st, 2017 is not a true reflection of the emisssions from its activities.*

In consequence with this Declaration below is a list of the emissions data that were finally verified.

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Year: 2016	t CO₂e
Scope 1: Direct GHG emissions	**291.770**
Scope 2: Energy indirect GHG emissions (Location-Based Method)	**1.855.167**
Scope 2: Energy indirect GHG emissions (Market-Based Method)	**1.080.374**
Scope 3: Other indirect emissions	**1.019.875**
o Purchased goods and services	269.458
o Capital godos	117.754
o Fuel- and energy-related activities (not included in scope 1 or scope 2)	144.901
o Waste generated in operations	619
o Business travel	33.127
o Use of sold products	63.932
o Investments	390.085
Emissions from biofuels	**11.648**

Lead Verifier: Raúl BLANCO BAZACO

Madrid, April 26th, 2017

Environment Manager: José MAGRO GONZÁLEZ